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November 7, 1990

## **RECENT DEVELOPMENTS**

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Prepared for the Federal Open Market Committee

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

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# **DOMESTIC NONFINANCIAL DEVELOPMENTS**

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## DOMESTIC NONFINANCIAL DEVELOPMENTS

Incoming data since the last FOMC meeting have shown a noticeable weakening in the economy. The downturn in activity is most evident in the October labor market news and in the preliminary information on industrial production, the principal data available on fourth-quarter output. A substantial decline in real disposable income and plunging consumer sentiment point to a likely deterioration in consumer demand; motor vehicle sales dropped back in October to a pace somewhat below the average for the year to date. Contracts and orders suggest weakness in business investment, and housing activity has been soft.

Indicators of inflationary pressures have been mixed of late. The consumer and producer price indexes have skyrocketed in the past couple of months because of surges in energy prices. Prices of industrial materials have declined noticeably overall, however, and recent wage data suggest stability, if not some easing, in labor cost trends.

### Employment and Unemployment

Data for October indicate increasing softness in the labor market. Private nonfarm employment dropped 98,000 after falling 58,000 in September.<sup>1</sup> Moreover, with extraordinarily sharp cutbacks in average workweeks in October, aggregate hours of production or nonsupervisory workers fell 1.6 percent. The civilian unemployment rate was unchanged at 5.7 percent as of the October 13 survey reference week, but initial claims

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1. Census layoffs, which totaled an estimated 40,000 in September and 7,000 in October, are nearly complete, and we expect future labor market reports to be largely free from this effect.

CHANGES IN EMPLOYMENT<sup>1</sup>  
(Thousands of employees; based on seasonally adjusted data)

	1988	1989	1990			1990		
			Q1	Q2	Q3	Aug.	Sep.	Oct.
-----Average Monthly Changes-----								
Nonfarm payroll employment <sup>2</sup>	272	193	246	236	-89	-127	-52	-68
Excluding census workers			207	153	24	1	-12	-61
Private	242	162	169	106	-7	20	-58	-98
Manufacturing	20	-16	-22	-23	-44	-47	-67	-61
Durable	16	-16	-12	-20	-45	-50	-62	-40
Nondurable	4	-0	-11	-3	1	3	-5	-21
Construction	8	5	32	-14	-29	-35	-11	-80
Trade	66	47	24	27	-2	-3	-23	-59
Finance, insurance, real estate	5	9	12	8	3	10	0	1
Services	134	100	109	92	61	100	20	93
Total government	30	30	77	129	-83	-147	6	30
Private nonfarm production workers	197	134	143	28	-32	-20	-49	-76
Manufacturing production workers	14	-17	-21	-18	-35	-42	-65	-40
Total nonagricultural employment <sup>3</sup>	193	145	147	-31	-108	-346	196	-172

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

UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES  
(Percent; seasonally adjusted)

	1988	1989	1990			1990		
			Q1	Q2	Q3	Aug.	Sep.	Oct.
Civilian unemployment rate	5.5	5.3	5.2	5.3	5.6	5.6	5.7	5.7
Teenagers	15.3	15.0	14.5	14.8	16.2	16.7	15.5	16.2
20-24 years old	8.7	8.6	8.4	8.9	8.9	8.8	9.6	9.6
Men, 25 years and older	4.2	3.9	4.1	4.1	4.5	4.6	4.6	4.5
Women, 25 years and older	4.3	4.2	4.2	4.1	4.3	4.3	4.4	4.3
Labor force participation rate	65.9	66.5	66.5	66.5	66.3	66.2	66.3	66.2
Teenagers	55.3	55.9	55.6	54.3	52.1	50.9	53.1	53.0
20-24 years old	78.7	78.7	77.8	78.0	77.5	77.3	77.7	77.7
Men, 25 years and older	77.0	77.2	77.1	77.0	77.1	77.1	77.2	77.1
Women, 25 years and older	54.9	56.0	56.3	56.6	56.6	56.7	56.4	56.1
Memo:								
Total national unemployment rate <sup>1</sup>	5.4	5.2	5.2	5.2	5.5	5.5	5.6	5.6

1. Includes resident armed forces as employed.

for unemployment insurance moved up quite sharply to more than 440,000 in the week ended October 20 from a September average of about 390,000.

The recent employment losses have been widespread across industries; indeed, the diffusion index of employment change over a three-month span in 356 private industries was below the 50 percent mark in the past two months. The manufacturing and construction industries, in particular, suffered further sizable declines in jobs in October: Factories shed another 60,000 workers, and employment in contract construction plunged 80,000. The weakness in the goods-producing sector continued to filter through to wholesalers, where employment declined for a fourth consecutive month. In addition, retailers cut nearly 50,000 jobs last month, and employment in business services declined, after several months of little change. The only two areas in which jobs expanded noticeably in recent months were health services and education.

In the household survey, total nonagricultural employment was down 173,000 in October, more than the average monthly decline over the preceding three months. As a result of these declines, the employment-population ratio has dropped 0.6 percentage point since June, after hovering around the 63.0 percent mark for more than a year. Over the same period, the number of job losers as a percentage of total employment has risen sharply.

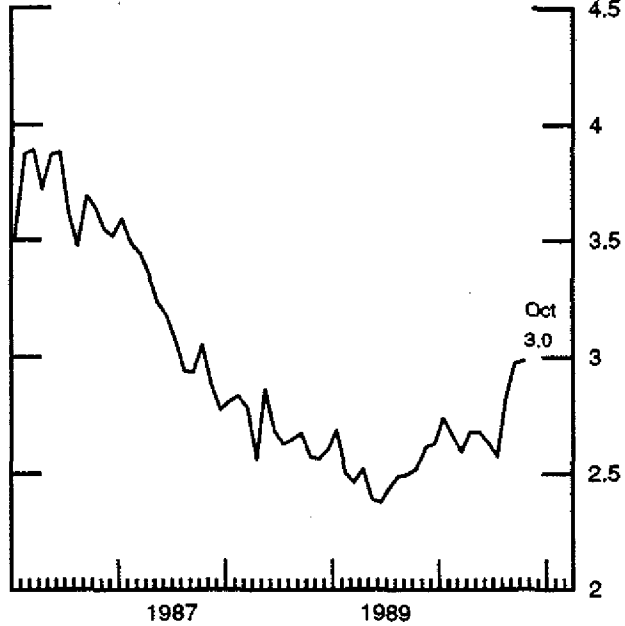
The drop in employment last month translated into an equivalent decline in the labor force, as unemployment was little changed in October. After trending upward for most of this expansion, the labor force participation rate leveled off over the past year and has fallen markedly since early this summer. In October, the participation rate stood at 66.2 percent, 0.3 percentage point below its second-quarter level. Declines in



## OTHER LABOR MARKET INDICATORS

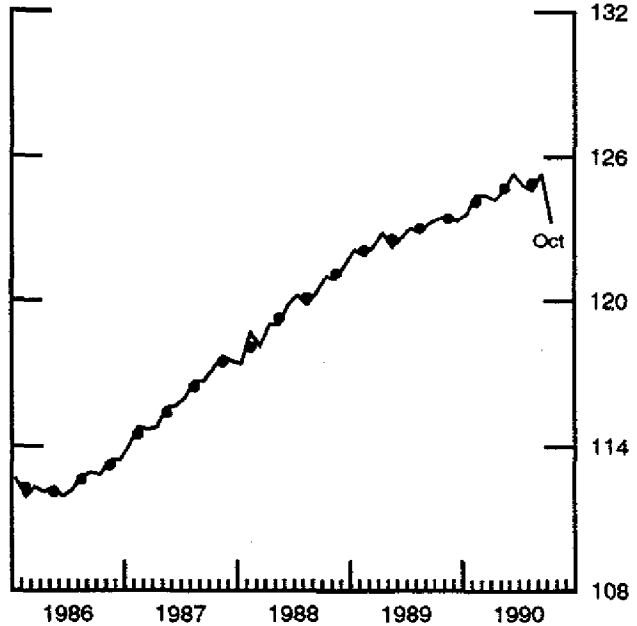
Monthly Data

Job Losers <sup>1</sup>



1. Job losers as a percentage of household employment.

Aggregate Hours

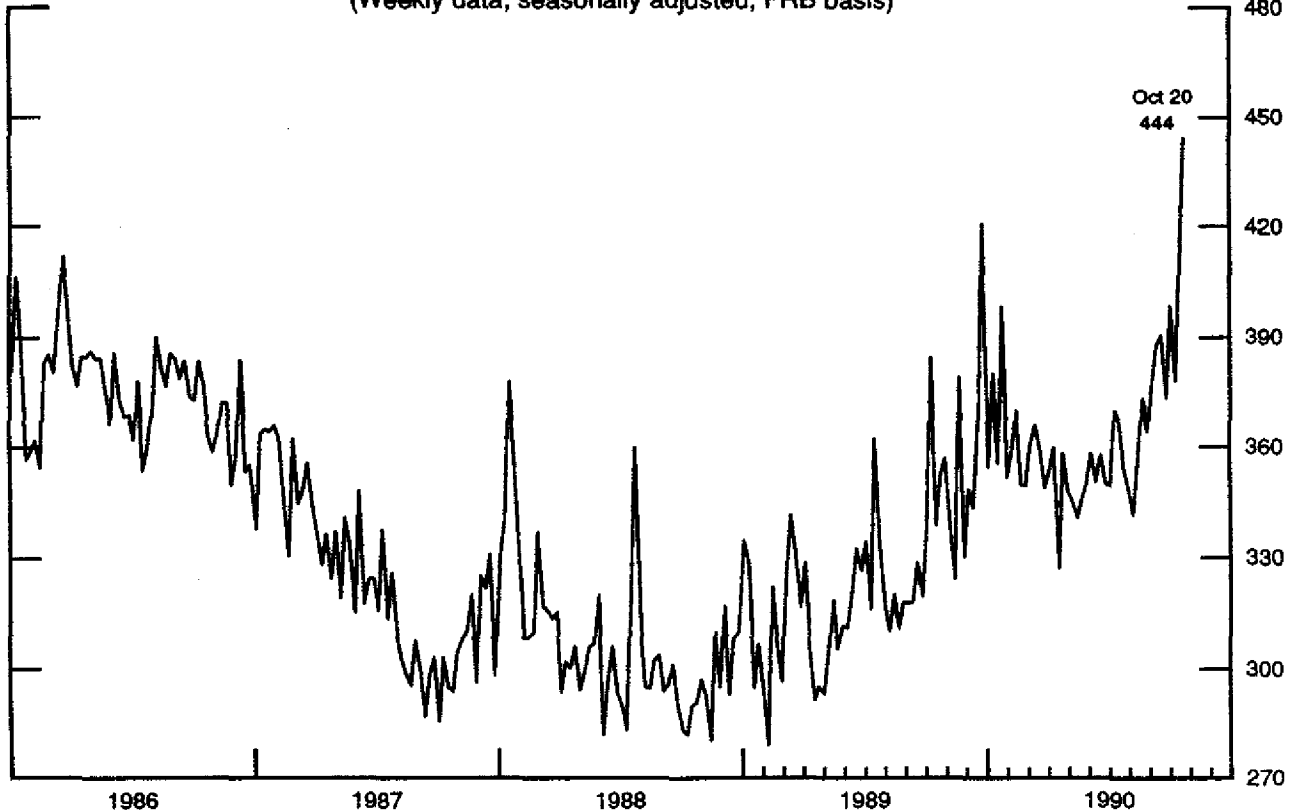


1. Dots denote quarterly averages.

## UNEMPLOYMENT INSURANCE

(Weekly data; seasonally adjusted, FRB basis) <sup>1</sup>

Initial Claims



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

participation have been exceptionally large over this period for teenagers and women 25 and older.

With growth in hours worked curtailed in the third quarter, productivity in the nonfarm business sector rebounded at an annual rate of 1.6 percent.<sup>2</sup> Output per hour had declined about 1 percent over the preceding four quarters when the adjustment to labor input lagged the deceleration in output. Productivity growth in manufacturing is estimated to have strengthened last quarter and stood 4 percent above a year earlier.

#### Labor Costs

Recent data on labor costs have been relatively favorable. Most notably, the Employment Cost Index (ECI) for compensation in private industry decelerated to a 4.2 percent annual rate in the third quarter (based on confidential BLS seasonal adjustment). In the twelve months ended in September, the increase was 4.9 percent, about the same as in the year ended September 1989 but a bit below the 12-month changes recorded earlier this year, when payroll tax and minimum wage hikes first raised the figures. In addition to those legislated changes, benefits inflation continued to reflect large increases in health care costs. At the same time, wage and salary inflation remained steady at 4-1/4 percent over the past 12 months. Compensation gains were held down last quarter by particularly small wage adjustments for sales workers, however. Excluding this group, the 12-month

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2. The productivity release also contained further small revisions to the productivity data for 1987 through 1989, incorporating the benchmark to the establishment data released in early September. At the time of the annual GNP revisions in August, productivity in the nonfarm business sector was estimated to have declined 1.3 percent in 1989, a sharp downward revision of 2 percentage points from the change reported last spring. Incorporating the revised data on hours worked, productivity is now estimated to have declined 1.6 percent in 1989.

**EMPLOYMENT COST INDEX**  
(Percent change from preceding period at compound annual rates;  
based on seasonally adjusted data)<sup>1</sup>

	1989			1990		
	June	Sep.	Dec.	March	June	Sep.
<b>Total compensation costs:</b>						
Private industry workers	4.9	4.9	4.8	5.6	5.5	4.2
By industry:						
Goods-producing	4.1	5.3	4.4	6.0	5.1	4.6
Service-producing	5.4	4.9	4.4	5.2	5.9	3.9
By occupation:						
White-collar	4.9	5.3	5.2	5.6	5.9	4.2
Blue-collar	4.9	4.5	3.2	6.4	4.7	3.5
Service workers	4.1	4.1	5.2	4.8	5.1	3.5
By bargaining status:						
Union	4.1	3.6	3.6	6.0	3.1	3.9
Nonunion	4.9	5.7	4.0	6.8	5.5	4.2
<b>Memo:</b>						
Wages and salaries	4.1	4.1	4.4	4.0	5.1	3.1
Benefits	7.1	6.6	5.2	10.1	5.4	6.1

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

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

	1988	1989		1990		
	Sep.	Sep.	Dec.	March	June	Sep.
<b>Total compensation costs:</b>						
Private industry workers	4.4	4.8	4.8	5.2	5.2	4.9
Excluding sales workers	4.5	4.4	4.5	4.9	5.1	5.0
By industry:						
Goods-producing	4.5	4.1	4.3	5.1	5.2	5.0
Service-producing	4.5	5.3	5.1	5.1	5.2	4.8
By occupation:						
White-collar	4.5	5.4	5.2	5.3	5.5	5.2
Blue-collar	4.5	4.1	4.1	4.8	4.7	4.5
Service workers	4.6	4.1	4.4	4.7	4.9	4.5
By bargaining status:						
Union	4.4	3.3	3.7	4.3	4.1	4.2
Nonunion	4.6	5.3	5.1	5.4	5.5	5.1
<b>Memo:</b>						
Wages and salaries	3.7	4.3	4.1	4.2	4.5	4.2
Benefits	6.8	6.0	6.1	7.2	6.9	6.8

change in compensation remained at 5 percent, 1/2 percentage point above the 12-month change recorded in September 1989.

By occupation, compensation for white-collar, blue-collar, and service workers all showed hints of deceleration in the latest ECI report--although quite tentative ones, given the variability of the figures. The same is true of the broad industry groupings--that is, goods-producing and service-producing. In the case of service-producing industries, the 12-month change in September was a bit below that recorded in September 1989, reflecting the weakness in sales workers' pay. In contrast, in goods-producing industries, the 12-month change in compensation remained considerably higher than a year earlier, despite heavy layoffs.

Average hourly earnings of production or nonsupervisory workers were unchanged in October. As a result, the year-over-year change in this indicator of wage trends dropped to 3.7 percent, after having been fairly stable at around 4 percent over the first nine months of the year. Manufacturing wages, which appeared to accelerate over the first half of the year, have slowed, on average, since midyear, but remain 4 percent above a year earlier.

AVERAGE HOURLY EARNINGS  
(Percentage change; based on seasonally adjusted data)<sup>1</sup>

	1989	1990			1990		Oct. 1989 to Oct. 1990
		Q1	Q2	Q3	Sept.	Oct.	
		--Annual rate--			-Monthly rate-		
Total private nonfarm	4.0	3.3	4.7	4.3	.4	.0	3.7
Manufacturing	2.6	2.5	5.8	3.8	.3	.5	4.0

1. Changes over periods longer than one month are based on quarterly averages.

NEGOTIATED WAGE RATE CHANGES  
 UNDER MAJOR COLLECTIVE BARGAINING SETTLEMENTS<sup>1</sup>  
 (Percent change)

	1987	1988	1989	Same parties under prior settlements	1990 First nine months
All industries					
First-year adjustments	2.2	2.5	4.0	2.3	3.9
Average over life of contract	2.1	2.4	3.3	2.1	3.3
Workers affected (in thousands)	2037	1799	1847	--	1569

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

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

	1986	1987	1988	1989	1990 <sup>1</sup>
Decreases	9	4	2	1	0
No wage change	21	23	20	8	5
0 to 4 percent	51	50	51	45	58
4 to 6 percent	14	17	24	28	30
6 percent and over	4	5	4	18	8
Mean adjustment	1.2	2.2	2.5	4.0	3.9
Number of workers (in thousands)	2486	2037	1799	1847	1569

1. Over the first nine months.

During the first nine months of 1990, wage adjustments in major union settlements were larger than in agreements they replaced, but were no bigger than new settlements during 1989. Negotiated wage settlements averaged 3.9 percent in the first contract year and 3.3 percent annually over the life of the contract (exclusive of lump-sum payments and COLAs). While these first-year wage settlements were on average similar to those in 1989, the dispersion of adjustments narrowed in 1990, with fewer workers receiving either very large gains or having their wages held constant or cut. About 88 percent received wage gains between 0 and 6 percent, up from 73 percent in 1989.

#### Industrial Production and Capacity Utilization

After rising 0.2 percent per month, on average, from June to September, the index of industrial production evidently declined substantially in October. Motor vehicle assemblies dropped from 11.5 million units in September (annual rate; FRB seasonals) to 10.8 million units, directly reducing October IP growth 0.2 percentage point. Based on other weekly physical product data, steel production and electricity generation are expected to reverse their recent strength. Moreover, declines in production worker hours were widespread in October, and especially deep in industries that tend to be related to construction and home goods: lumber; stone, clay, and glass; furniture; and fabricated metals. Significant reductions in factory labor input also occurred in textiles, apparel, and petroleum products.

Prospects for the remainder of the fourth quarter also look weak. As the staff had expected, motor vehicle manufacturers have cut their assembly schedules for November and December; planned output for these months is now

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

	Proportion in total IP 1989:Q4	1989	1990			1990		
		H2 <sup>1</sup>	H1 <sup>1</sup>	Q2	Q3	Jul.	Aug.	Sep.
		-----Annual rate-----			---Monthly rate---			
Total index	100.0	-0.5	2.4	4.2	3.8	0.2	0.1	0.2
Excluding motor vehicles and parts	95.7	0.1	2.2	2.3	3.7	0.4	0.2	-0.1
Major market groups:								
Products, total	61.2	-0.1	2.8	4.2	2.3	-0.1	0.1	0.5
Final products	46.6	-0.4	3.2	5.6	2.9	-0.2	0.2	0.8
Consumer goods	25.9	1.7	-0.3	2.5	2.3	-0.4	0.5	1.2
Autos and trucks	1.4	-16.1	11.1	93.0	9.5	-7.2	-3.1	13.4
Other consumer goods	24.5	2.8	-1.0	-0.9	1.9	-0.0	0.7	0.5
Business equipment	15.2	-3.6	8.7	10.7	5.9	0.1	0.2	0.6
Motor vehicles	1.1	-13.9	14.1	92.7	5.8	-8.2	-2.0	12.7
Other business equipment	14.1	-2.8	8.2	6.1	5.9	0.8	0.4	-0.3
Computers	2.5	2.8	16.1	14.1	11.5	1.4	1.2	-0.2
Aircraft	1.1	-18.5	49.7	16.5	10.6	1.5	-0.4	0.5
Other	NA	-2.1	2.5	3.0	4.0	0.6	0.3	-0.4
Construction supplies	6.0	1.4	-1.7	-6.8	-0.9	0.3	-0.5	-0.9
Materials	38.8	-1.2	1.8	4.2	6.2	0.7	0.1	-0.2
Durable	19.8	-2.3	3.2	7.7	7.9	0.3	0.9	-0.6
Metals	2.8	-4.5	2.5	9.0	18.4	1.5	1.5	-1.6
Nondurable	8.8	-0.9	1.4	1.4	3.8	1.5	-1.0	-0.4
Major industry groups:								
Manufacturing	84.9	-1.1	2.9	3.8	3.5	0.1	0.2	0.2
Excluding motor vehicles and aircraft	77.8	0.4	1.8	1.4	3.5	0.4	0.3	-0.2
Motor vehicles and parts	4.3	-14.4	7.1	58.3	5.6	-4.9	-1.7	7.5
Mining	7.4	-0.8	3.6	4.8	0.1	1.3	-1.7	0.4
Utilities	7.8	8.2	-5.0	8.5	10.9	-0.4	1.3	0.9

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

PERCENT CHANGE IN ORDERS FOR MANUFACTURED GOODS<sup>1</sup>  
(For industries that report unfilled orders; seasonally adjusted)

	1990			1990		
	Q1	Q2	Q3	Jul.	Aug.	Sep.
Durable goods excluding civilian aircraft, defense, and motor vehicles and parts	-0.2	1.2	0.5	2.4	-1.3	-0.2
Nonelectrical machinery	2.1	-2.5	1.5	3.5	-5.4	6.3
Nondurable goods	2.8	2.2	0.1	-0.8	4.1	-0.9

1. Percent change from prior comparable period.

at a 9.9 million unit annual rate (FRB seasonals). The reductions are largely attributable to the decision by General Motors to idle 14 assembly plants for up to four weeks. The reduction in planned assemblies through year-end, including its likely effect on the manufacture of parts and upstream supplies, will reduce total industrial output 1/2 percentage point between October and December.

The timing of the downshift in motor vehicle production is an important factor in the apparent break in the trend of industrial production in October. Elsewhere, declines had appeared in September, with marked turnarounds in those sectors that had registered strong growth through the summer, including the production of a variety of capital goods and materials. At the same time, output of construction supplies continued on its downward trend, as did defense and space equipment production.

Reflecting the steady pace of total industrial output through the summer, capacity utilization remained about flat at 83.6 percent in the third quarter. Nonetheless, utilization in manufacturing was about 2 percentage points below the peak reached in January 1989. The lumber, pulp and paper, chemicals (both primary and advanced producers), instruments, and motor vehicles industries were the farthest below their past peaks, while petroleum products was above its 1988-89 high.

In addition to the temporary shutdowns announced by General Motors, the company also announced the permanent closing of four facilities that had previously been idle, some for as long as three years. These plants represent approximately 5 percent of domestic auto and light truck capacity, as measured in terms of unit production, and are currently counted in the FR capacity index for autos and light trucks. These reductions will be



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

	1967-89	1978-79	1988-89	1989	1990		
	Avg.	High	High	Q4	Q1	Q2	Q3
Total industry	82.2	87.3	85.0	83.5	83.1	83.4	83.6
Manufacturing	81.5	87.3	85.1	82.9	82.6	82.8	82.8
Primary processing	82.3	89.7	89.0	85.9	85.7	85.1	85.8
Textile mill products	86.0	90.5	91.2	86.9	87.2	87.9	87.1
Lumber and products	82.7	87.6	91.2	85.7	85.3	82.5	80.8
Pulp and paper	92.2	98.2	97.7	93.5	91.9	92.0	92.8
Primary processing chemicals <sup>1</sup>	82.9	89.8	91.7	88.4	88.0	86.9	86.3
Petroleum products	85.1	89.5	90.3	88.3	90.8	87.5	91.0
Stone, clay and glass	78.3	87.0	86.4	84.1	84.1	81.7	81.6
Primary metals	79.8	102.4	91.6	83.0	83.4	84.3	88.2
Iron and steel	79.4	110.4	92.0	79.5	81.2	81.4	86.7
Nonferrous metals	80.8	90.5	95.0	88.5	86.9	88.8	90.4
Fabricated metal products	77.7	83.9	85.1	82.0	80.9	81.2	82.0
Advanced processing	81.1	86.3	83.6	81.6	81.4	81.8	81.6
Furniture and fixtures	82.7	86.6	88.3	84.8	84.5	86.3	86.0
Advanced processing chemicals <sup>2</sup>	77.2	82.4	83.2	78.7	78.9	78.4	78.6
Nonelectrical machinery	81.3	92.1	83.5	81.2	82.1	82.7	83.1
Electrical machinery	80.4	89.4	83.1	81.0	80.9	80.8	80.1
Motor vehicles and parts	76.7	93.0	85.5	75.1	69.0	76.9	77.3
Autos and light trucks	na	92.2	83.6	71.1	63.1	73.5	75.0
Aerospace and miscellaneous transport equipment	75.3	80.5	86.2	80.6	83.6	84.6	84.0
Instruments	83.1	92.5	83.9	80.1	79.5	78.4	78.3
Mining	87.3	95.2	87.2	86.7	87.6	88.9	89.2
Coal mining	87.3	95.6	94.4	88.3	92.7	92.0	92.9
Utilities	86.8	88.3	92.3	88.0	83.9	85.3	87.3
Electric utilities	89.0	88.3	96.2	92.6	89.5	91.3	93.0

1. Primary processing chemicals includes industrial organic and inorganic chemicals, synthetic materials, plastics resins and fertilizers.

2. Advanced processing chemicals includes drugs and toiletries, soaps and detergents, paints and allied products, pesticides, and other miscellaneous chemical products.

incorporated in the published figures when revisions to 1990 capacity estimates are released next February.

#### Personal Income and Consumption

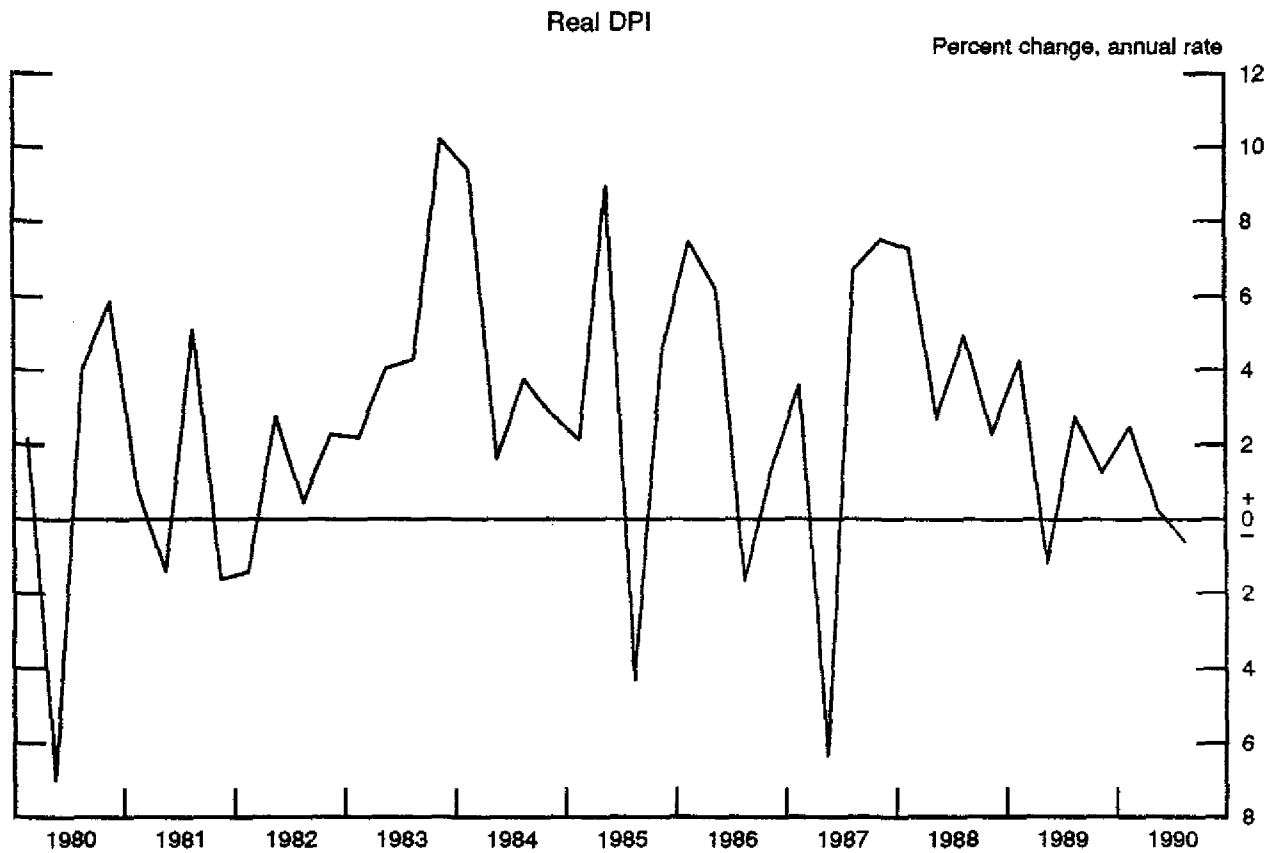
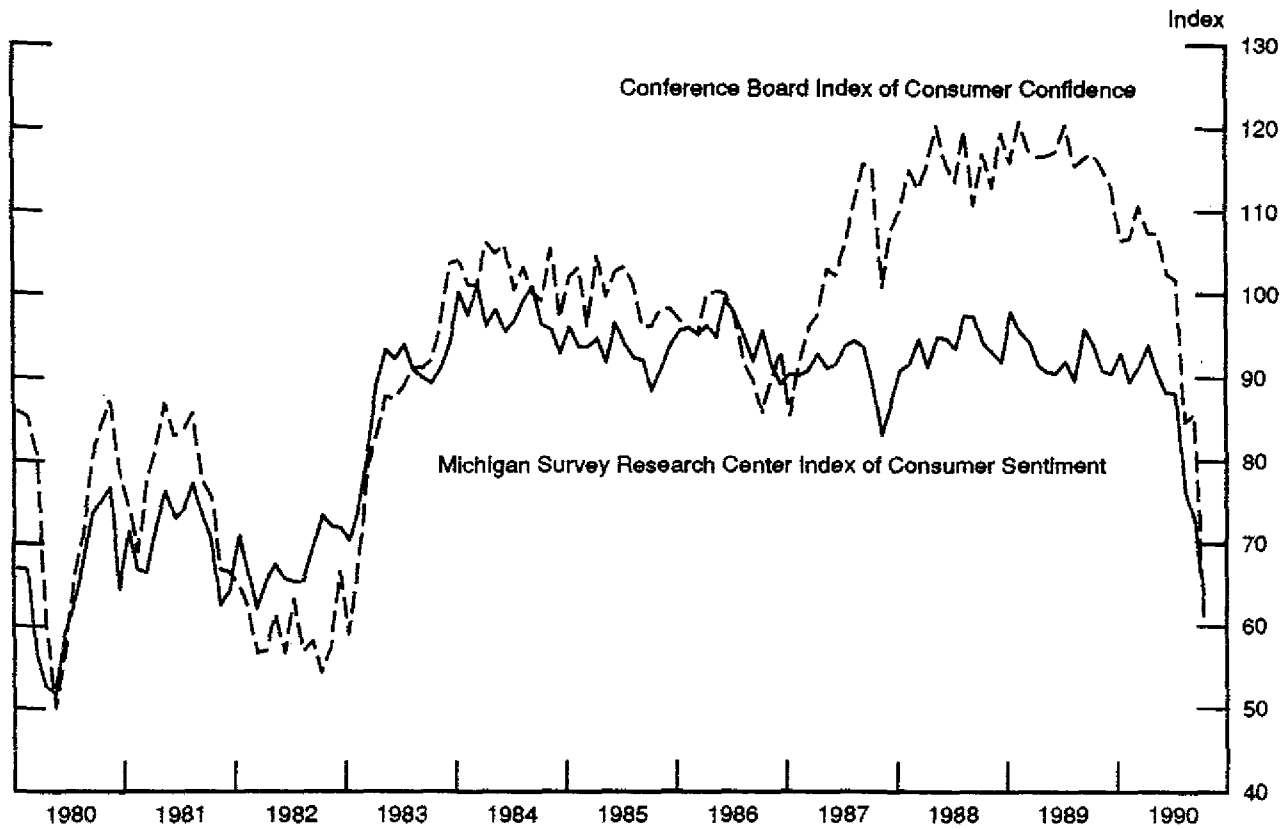
The two leading surveys of consumer sentiment fell sharply again in October (chart): The Conference Board's Consumer Confidence Index registered its steepest one-month drop on record, putting the index at its lowest level since early 1983. Similarly, the Michigan Survey Research Center Index of Consumer Sentiment dropped another 9 index points to 63.9; the decline in this index since July is its steepest three-month drop ever and has taken the index to its lowest reading since 1982.

With the labor market soft and higher oil prices pushing up consumer inflation, real disposable personal income fell 0.5 percent in August and 0.3 percent in September. The drop is likely to continue in October.

The declines in consumer sentiment and household income apparently had only modest effects on spending through September. Real PCE rose 0.3 percent in September and was up at an annual rate of 3-1/2 percent for the third quarter as a whole. Spending on household durables fell in August and September, while outlays for apparel declined 2-1/2 percent in September after posting noticeable increases over the preceding several months. In contrast, consumption in September was supported by strong end-of-model year purchases of cars and trucks, continued growth in consumption of non-energy services, and a rise in spending on electricity.

One anomalous factor in the September increase in consumer spending is that real PCE for gasoline is estimated to have edged up from pre-invasion levels. Although data from earlier episodes suggest that demand for gasoline responds to changes in price with an elasticity of -0.2 to -0.4, a

### Consumer Attitudes and Real DPI



The base of the Michigan index is February 1986; the base of the Conference Board index is the annual average for 1985. Both indexes are an average of five equally-weighted questions that relate to current and expected economic conditions. However, the

PERSONAL INCOME  
(Percent change from the preceding period)

	1989	1990			1990		
		Q1	Q2	Q3	July	Aug.	Sept.
Total personal income	6.8	2.1	1.3	1.2	.5	.2	.5
Wages and salaries	4.5	1.5	1.7	1.4	.6	.0	.6
Private	4.1	1.3	1.7	1.4	.7	.0	.7
Memo:							
Disposable personal income	6.2	2.3	1.0	1.1	.4	.2	.4
Real disposable income	1.7	.6	.1	-.2	.2	-.5	-.3

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

	1989	1990			1990		
		Q1	Q2	Q3	July	Aug.	Sept.
		----Annual rate----			---Monthly rate---		
Personal consumption expenditures	1.2	1.1	.2	3.6	.3	-.1	.3
Durable goods	-1.4	14.4	-9.5	3.0	.6	-1.9	1.9
Excluding motor vehicles	2.3	7.8	-7.2	-.3	.5	-.7	-.4
Nondurable goods	.6	-3.2	-1.9	1.7	.3	.0	-.6
Gasoline and oil	-.9	-5.2	-9.2	7.9	2.2	-.5	1.5
Excluding gasoline	.8	-2.9	-1.0	1.0	.0	.0	-.8
Services	2.4	.1	5.1	5.1	.3	.4	.4
Excluding energy	2.2	3.4	3.8	4.3	.4	.2	.2
Memo:							
Personal saving rate (percent)	4.6	4.9	5.0	4.0	4.4	4.1	3.5

SALES OF AUTOMOBILES AND LIGHT TRUCKS<sup>1</sup>  
(Millions of units at an annual rate; BEA seasonals)

	1988	1989	1990			1990		
			Q1	Q2	Q3	Aug.	Sep.	Oct.
Autos and light trucks	15.44	14.51	14.40	13.97	14.18	13.76	14.47	13.53
Autos	10.64	9.90	9.81	9.54	9.72	9.42	10.06	9.31
Light trucks	4.80	4.61	4.59	4.43	4.47	4.34	4.41	4.23
Domestic total <sup>2</sup>	11.74	11.19	11.17	10.77	11.30	10.83	11.67	10.69
Autos	7.54	7.08	7.02	6.80	7.21	6.91	7.60	6.91
Light trucks	4.20	4.11	4.14	3.98	4.09	3.92	4.07	3.78
Import total	3.70	3.33	3.23	3.19	2.88	2.92	2.80	2.84
Autos	3.10	2.82	2.78	2.74	2.51	2.51	2.46	2.39
Light trucks	0.60	0.50	0.45	0.45	0.38	0.42	0.34	0.45

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.

short-term boost to the volume of gasoline purchases may have been provided by gasoline stations or motorists seeking to increase their holdings of gasoline in anticipation of further price increases or possible product shortages.<sup>3</sup> This explanation suggests that the recent strength in gasoline demand may be temporary; if so, data for future months should show some declines as the traditional response to higher prices emerges.

With consumption growth outpacing income growth, the personal saving rate fell to 3.5 percent in September, the lowest monthly reading since January 1988. Given the weak performance of stock and house prices as well as the deterioration in consumer sentiment, the saving rate might have been expected to move in the other direction. But households apparently have resisted, at least initially, making major changes in their real spending patterns in response to the sudden runup in their energy bills.

#### Autos and Light Trucks

Total sales of autos and light trucks averaged 13-1/2 million units (annual rate) in October compared with an average sales pace of just over 14 million units during the first nine months of the year. Sales of light trucks, particularly domestic models, weakened noticeably in October; apparently, sales of vans and other less energy-efficient trucks have been hurt by the rise in gasoline prices. Sales of imported cars also were down again last month. In contrast, sales of domestic autos were surprisingly well maintained at a 6.9 million unit rate in October. Although this sales

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3. The BEA estimates the gasoline component of real PCE from data on the volume of gasoline deliveries to retail outlets, which will include any building or liquidation of gasoline inventories held at gasoline stations. The BEA does not adjust the Department of Energy data for gasoline consumed by business.

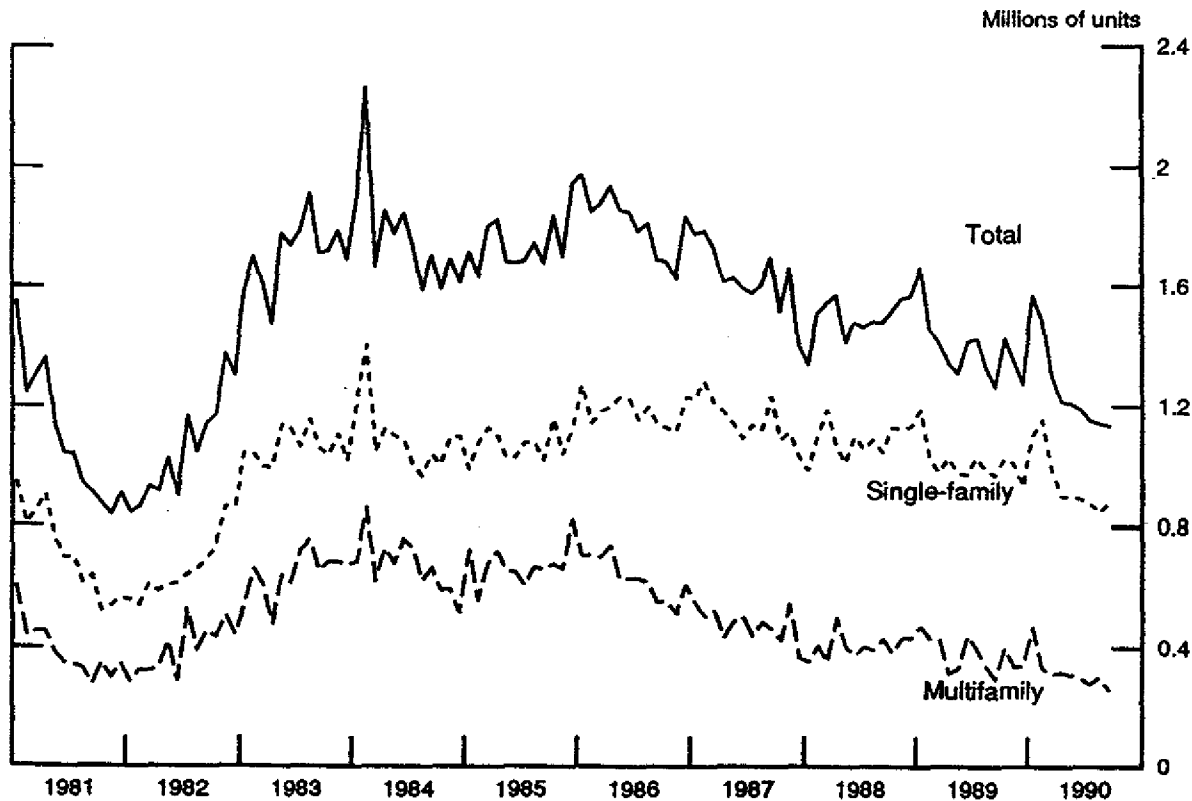
**PRIVATE HOUSING ACTIVITY**  
(Seasonally adjusted annual rates; millions of units)

	1989	1990			1990		
	Annual	Q1	Q2	Q3 <sup>p</sup>	July <sup>r</sup>	Aug. <sup>r</sup>	Sep. <sup>p</sup>
<b>All units</b>							
Permits	1.34	1.42	1.09	1.05	1.08	1.05	1.01
Starts	1.38	1.45	1.20	1.14	1.15	1.14	1.14
<b>Single-family units</b>							
Permits	.93	.96	.80	.76	.78	.76	.73
Starts	1.00	1.08	.90	.86	.88	.84	.88
<b>Sales</b>							
New homes	.65	.59	.54	.53	.55	.54	.50
Existing homes	3.44	3.44	3.32	3.35	3.33	3.50	3.22
<b>Multifamily units</b>							
Permits	.41	.47	.29	.29	.30	.29	.27
Starts	.37	.37	.31	.28	.28	.30	.26
<b>Vacancy rate<sup>1</sup></b>							
Rental units	9.3	9.4	8.5	9.5	n.a.	n.a.	n.a.
Owned units	7.1	7.6	7.9	6.6	n.a.	n.a.	n.a.

1. Percent. Owned units consist mainly of condominiums. All vacancy rate data are revised.

p Preliminary. r Revised estimates. n.a. Not available.

**PRIVATE HOUSING STARTS**  
(Seasonally adjusted annual rate)



rate is markedly lower than the elevated pace a month earlier, it is little different than the rate that prevailed earlier in the year.<sup>4</sup>

Incentive programs, which have been in place since the late spring, still seem to be playing an important role in supporting sales of motor vehicles. For instance, when Ford attempted in September to reduce sales incentives, its sales dropped off sharply, and the company subsequently reinstated its discounts. At the same time, the incentive programs sponsored by General Motors and Chrysler have remained in place.<sup>5</sup>

As of the end of October, auto dealers were not holding excessive inventories, overall, relative to the recent sales rate. Nonetheless, dealers reportedly have been quite cautious in placing orders, and that caution was a factor in the recent decision by GM to pare assembly schedules over the next few months. The company apparently is hoping to prevent the type of large inventory run-up that historically has plagued the company during periods of general economic weakening.

### Housing Markets

Residential construction activity remained weak in September. Total private housing starts were about unchanged at a 1.14 million unit annual rate, the lowest monthly reading since August 1982. Starts of multifamily units fell in September, but a rise in single-family starts interrupted the decline of the preceding six months. Issuance of building permits, which is

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4. The most important of the transitory factors that contributed to the September surge was the over-compensation by BEA in its adjustment of its seasonal factor for the lack of new clearance sales. A second factor was that manufacturers apparently were successful in shifting forward fleet sales, which typically occur in the fourth quarter.

5. Ford has reinstated a \$1,500 customer cash rebate on 1990 Lincoln Town Car, Continental, and Mark VII. It also has increased its customer rebate from \$500 to \$750 on 1991 Taurus, Thunderbird, Sable, Cougar, and Grand Marquis, and to \$1,000 on Ford Ranger trucks.



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

	1988	1989	1989	1990		
			Q4	Q1	Q2	Q3
<b>South</b>						
Atlanta	n.a.	n.a.	5.6	6.2	3.3	2.5
Dallas	.0	1.8	6.0	.0	-.4	-4.2
Houston	-6.2	7.9	10.2	12.4	3.9	1.8
Jacksonville	4.0	2.4	4.3	7.0	7.7	4.2
Memphis	1.7	2.4	6.2	1.2	.1	0.8
New Orleans	n.a.	-3.4	1.8	-1.0	-3.2	-5.5
Oklahoma City	-9.8	-4.8	.7	-3.3	3.4	-0.9
Washington, D.C.	16.0	9.0	12.7	.7	7.4	3.4
<b>Northeast</b>						
Boston	2.3	.4	.4	.6	-5.4	-4.0
Buffalo	15.7	10.5	12.2	12.5	8.1	3.5
Hartford	6.5	-1.0	-.5	-5.1	-3.5	-5.4
New York City	.2	-.3	-.3	-4.4	-6.2	-3.8
Philadelphia	5.6	1.5	6.2	-1.0	10.9	10.7
Providence	7.6	-.3	-3.5	-1.4	-.3	-1.7
<b>West</b>						
Denver	-8.0	4.5	9.1	8.9	4.6	-.8
Los Angeles	21.5	19.3	13.6	8.0	-.5	-4.7
Phoenix	-1.1	-1.5	-2.6	4.8	2.2	11.7
Portland	.3	8.9	12.5	12.2	15.8	14.6
Salt Lake City	-2.5	2.5	1.8	2.2	-1.0	1.0
San Francisco	24.1	22.4	12.1	7.5	-1.1	-3.1
Seattle	7.4	29.7	37.2	36.5	35.3	24.9
<b>Midwest</b>						
Chicago	8.9	8.2	11.1	12.8	11.0	9.5
Cincinnati	5.5	8.8	6.6	6.7	6.3	5.3
Cleveland	1.6	8.7	7.1	11.1	7.0	7.7
Detroit	11.4	.8	.3	6.5	6.6	3.1
Indianapolis	5.8	7.7	8.4	7.7	16.1	4.1
Kansas City	1.0	1.6	2.3	.1	.8	9.4
Minneapolis	5.8	2.4	1.3	2.2	3.8	.5
St. Louis	5.1	-1.5	1.6	.8	8.9	5.6

n.a.--not available

Source: National Association of Realtors

measured more reliably than starts, continued to trend down through September and suggests a somewhat lower level of production than does the estimate of starts.

In the multifamily sector, starts fell in September to an annual rate of about 260,000 units. Although the pace of multifamily starts in the third quarter was down 60 percent from its peak in early 1984, the vacancy rate for rental apartments returned to 9.5 percent, a reading at the upper end of the range in recent quarters. Persistently high vacancies have depressed the profitability of multifamily construction by holding down real rents.

Single-family starts in September remained close to their eight-year low in August. Sales of new homes have slowed, and prices provide additional evidence of weak demand. After adjustment for changes in location and quality, the sales price of new homes rose only 2.3 percent in the third quarter from a year earlier. Actual transactions prices were down 3 percent on average; about half of the difference between these two measures arises from a reduction during the past year in the share of sales occurring in the high-priced Northeast and Western markets.

Prices for existing homes have continued to be soft as well. For the nation as a whole, the median price of existing homes sold in the third quarter was only 2 percent above the level of a year earlier, while the average sales price was down 0.5 percent. The market was particularly weak in the Northeast, as prices declined (relative to last year) in about half of the metropolitan areas in the Northeast for which data are collected. Slowing prices also were prevalent in California, which had seen rapid appreciation. In the South, continuing weakness in some areas was balanced

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

	1990			1990		
	Q1	Q2	Q3	July	Aug.	Sept.
<u>Producers' durable equipment</u>						
Shipments of nondefense capital goods	4.8	- .9	1.1	-4.2	4.6	- .3
Excluding aircraft and parts	2.8	-1.5	- .7	-4.4	4.0	.1
Office and computing	4.0	-1.0	-1.6	-8.0	3.7	3.9
All other categories	2.5	-1.6	- .5	-3.5	4.1	- .7
Weighted PDE shipments <sup>1</sup>	2.4	-1.4	.0	-2.4	2.9	- .1
Shipments of complete aircraft <sup>2</sup>	124.8	-14.3	n.a.	-10.1	23.0	n.a.
Sales of heavy-weight trucks	- .1	-5.9	6.4	10.5	-8.1	-1.9
Orders of nondefense capital goods	-3.3	-5.8	5.0	10.1	-10.0	7.0
Excluding aircraft and parts	.5	-1.4	.7	2.7	-3.4	3.1
Office and computing	1.8	-1.2	5.0	10.7	-15.4	26.1
All other categories	.3	-1.5	- .4	.9	- .3	-2.0
Weighted PDE orders <sup>1</sup>	.1	- .7	.4	1.6	-2.1	2.2
<u>Nonresidential structures</u>						
Construction put-in-place	1.0	- .5	1.2	3.3	-3.6	-1.6
Office	-4.0	-3.8	1.6	.3	-3.6	.1
Other commercial	-1.5	-3.5	-2.9	1.5	-2.5	-7.6
Public utilities	2.2	- .5	.0	- .2	.1	1.1
Industrial	8.2	.7	3.1	16.0	-14.1	- .6
All other	2.5	4.9	4.6	2.6	- .4	- .5
Rotary drilling rigs in use	2.3	21.6	-6.0	-4.3	-8.5	.9
Footage drilled <sup>3</sup>	-1.1	-1.2	n.a.	.1	3.1	n.a.

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.

3. From Department of Energy. Not seasonally adjusted.

n.a. Not available.

by robust increases in others, while fairly brisk increases continued throughout most of the Midwest.

#### Business Fixed Investment

Real business fixed investment rebounded strongly in the third quarter, but the pickup likely reflected special factors rather than a fundamental strengthening of demand. Most of the gain was the result of a bulge in shipments of aircraft to domestic carriers and in business purchases of motor vehicles, which brought the overall rise in real equipment spending to 8-1/4 percent (annual rate). At the same time, however, real spending for computers grew just 1/2 percent, the smallest increase since the end of 1988. Real outlays for nonresidential structures were estimated by the BEA to have advanced at 5 percent last quarter, after a 9 percent drop in the second quarter. The September data for construction put-in-place, released after BEA's advance estimate of GNP, imply about a \$1 billion downward revision to real nonresidential structures in the third quarter, lowering the increase to less than 2 percent (annual rate). Given the overall signs of weakness in construction, this rise seems rather anomalous and is likely to be reversed.

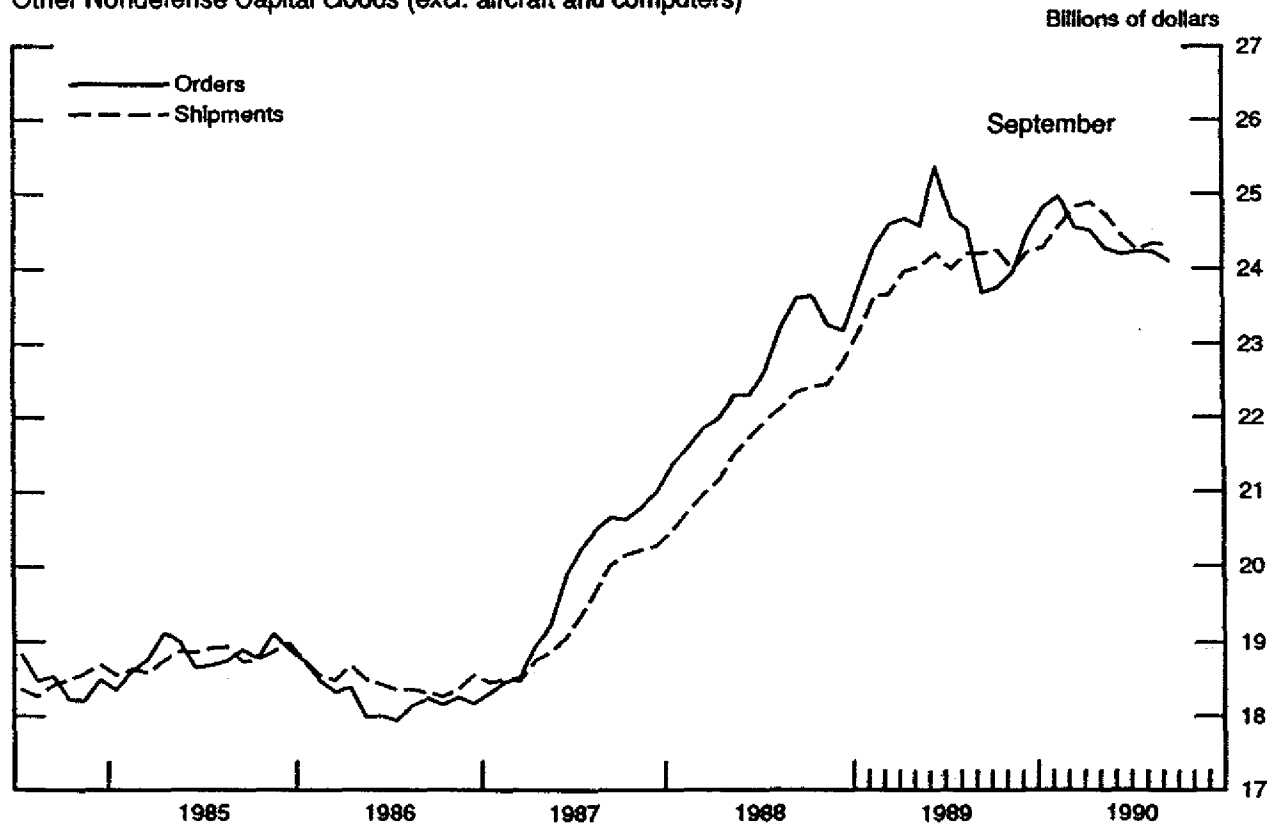
Looking ahead, recent orders for nondefense capital goods are consistent with near-term declines in equipment spending. Although orders outside the aircraft group rose 3.1 percent in September (not at an annual rate) and 0.7 percent for the third quarter as a whole, a pickup in computer orders more than accounts for these increases. Excluding both aircraft and computers, orders have trended down since the beginning of the year (chart), and point to a decline in current-quarter shipments of equipment.

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

Office and Computing Equipment



Other Nondefense Capital Goods (excl. aircraft and computers)



The wide swing in computer orders from August to September, as confirmed by contacts in the computer industry, owes partially to the early September announcement by IBM of a new generation of more powerful mainframe computers. Because this announcement was widely anticipated, some August bookings were shifted to September, when IBM first accepted orders for the new equipment. The announcement effect is smaller than occurred when IBM last announced a new generation of mainframes--Sierra--in February 1985. (chart). Since then, mainframes have become a smaller share of the total computer market, and IBM's share of the mainframe market has slipped. Just as in 1985, the backlog of orders for the new equipment probably will be worked off gradually; industry analysts expect shipments of the new equipment to begin in the middle of next year.

Despite the third-quarter growth in spending for nonresidential construction, indicators for this sector, overall, remain weak. Total private construction contracts continue on the downward trend that began early last year (chart), with weakness indicated for most sectors. Permits for office construction have plunged in the past eighteen months, as persistently high vacancy rates have damped enthusiasm for new office construction. Despite declines in office construction of more than 11 percent over the past four quarters, vacancy rates have remained around 20 percent.<sup>6</sup> In the non-office commercial sector, contracts have declined substantially since the beginning of 1989. Anecdotal reports continue to suggest that tightening lending standards are depressing activity in the office and other commercial sectors. In particular, these reports suggest

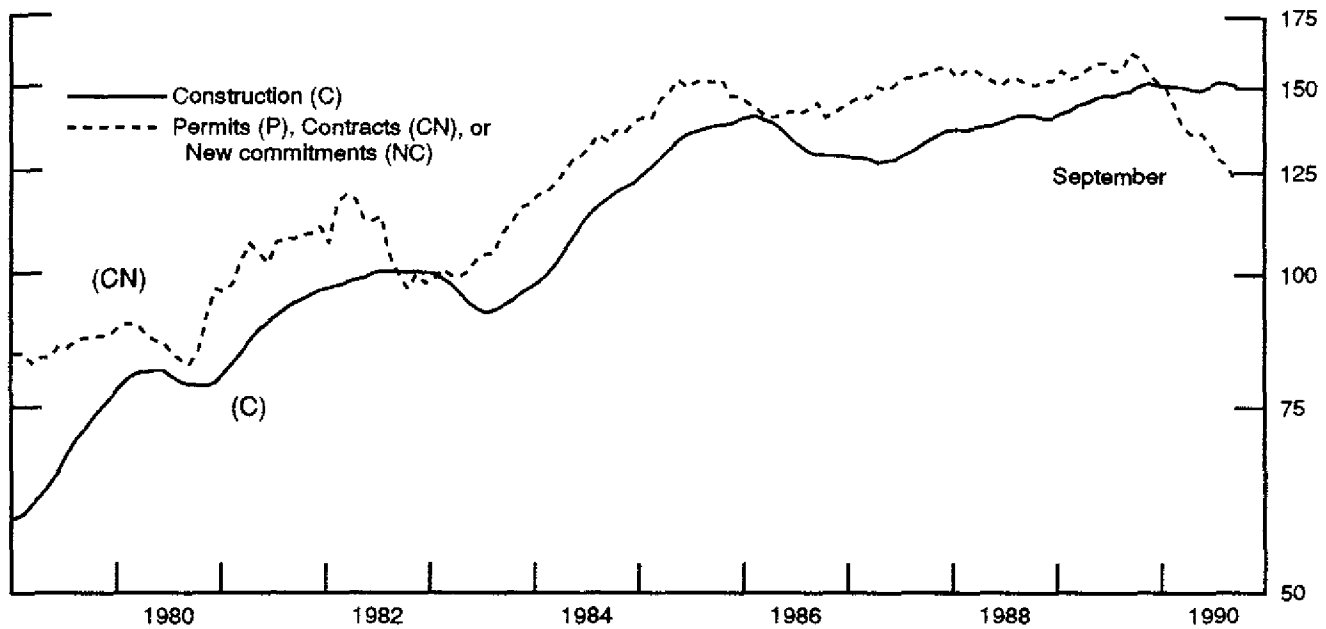
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6. The metropolitan office vacancy rate--as reported by Coldwell-Banker--stood at 19.5 percent at the end of September 1990, down slightly from a year ago.

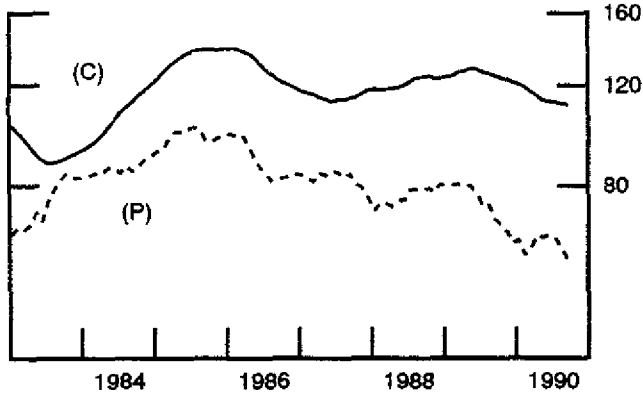
### NONRESIDENTIAL CONSTRUCTION AND SELECTED INDICATORS\*

(Index, Dec. 1982 = 100, ratio scale)

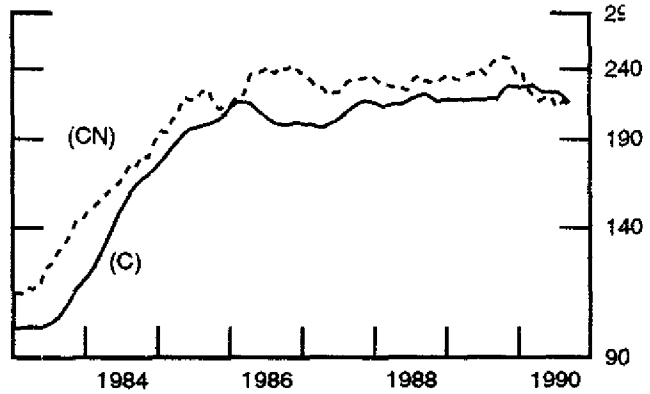
#### Total Building



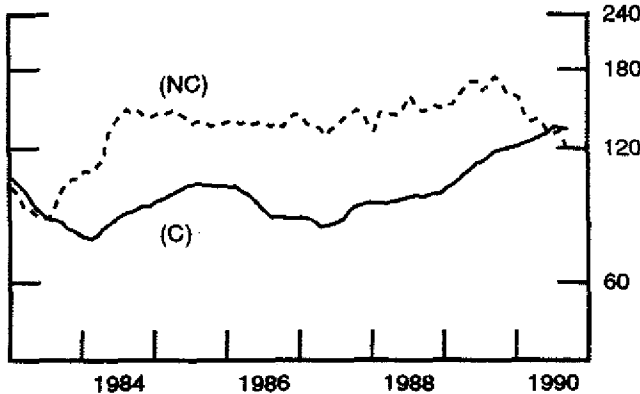
#### Office



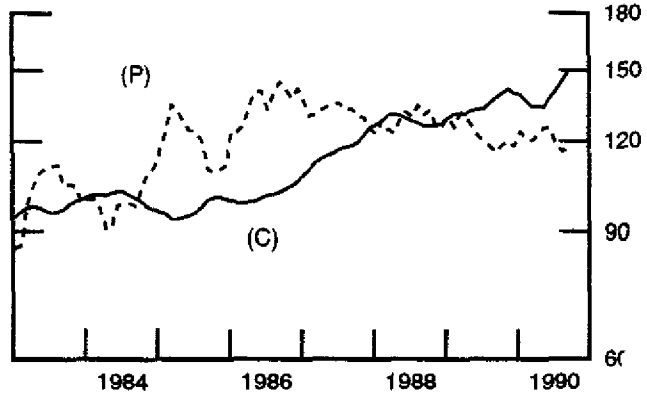
#### Other Commercial



#### Industrial



#### Institutional



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

that insurance companies--following thrifts and banks--now are beginning to cut back on real estate lending. Although industrial construction has been an area of strength in the last two years, new commitments for industrial construction also have trended down since early last year. Given the lags involved, this decline has not yet generated corresponding decreases in industrial construction.

Oil and gas drilling activity has been about flat despite the increase in oil prices since the summer. Although rigs in use increased 1 percent in September, they declined more than 4 percent in the first four weeks of October. Apparently, uncertainty among drillers about the long-run price of oil--as well as shortages of skilled labor--have deterred any rapid expansion of drilling activity.

#### Business Inventories

Businesses have continued to keep a tight rein on their inventories in the current environment of slowing demand. Outside of petroleum-related businesses, available third-quarter data show that inventory-sales ratios in major sectors have either remained flat or continued their moderate downtrends (chart).

In manufacturing, inventory investment remained modest through late summer. Excluding the petroleum refining industry, factory stocks rose only \$8 billion (current cost) at an annual rate in August and September, compared with a \$29.5 billion buildup in July. In current-cost terms, inventories held by petroleum refineries rose at an annual rate of \$11.7 billion in August and September. Much of this current-cost increase, however, reflects higher petroleum prices since the Iraqi invasion of Kuwait. Inventories of transportation equipment, which had contributed



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

	1990			1990		
	Q1	Q2	Q3	July	Aug.	Sept.
Current-cost basis:						
Total	-7.0	11.2	n.a.	68.2	56.4	n.a.
Total excluding retail auto	9.1	9.8	n.a.	50.6	14.7	n.a.
Manufacturing	2.7	-4.2	23.3	31.1	12.2	26.8
Wholesale	2.2	7.6	10.1	14.5	6.4	9.3
Retail	-11.8	7.8	n.a.	22.6	37.8	n.a.
Automotive	-16.1	1.4	n.a.	17.6	41.7	n.a.
Excluding auto	4.3	6.5	n.a.	5.0	-3.9	n.a.
Constant-dollar basis:						
Total	-25.0	6.2	n.a.	42.7	-9.8	n.a.
Total excluding retail auto	-2.4	3.3	n.a.	35.8	-13.8	n.a.
Manufacturing	1.7	-2.6	n.a.	22.1	-6.8	n.a.
Wholesale	-1.1	1.2	n.a.	11.4	2.5	n.a.
Retail	-25.6	7.6	n.a.	9.2	-5.5	n.a.
Automotive	-22.6	2.8	n.a.	6.9	4.1	n.a.
Excluding auto	-3.0	4.8	n.a.	2.3	-9.6	n.a.

INVENTORIES RELATIVE TO SALES<sup>1</sup>  
(Months supply; based on seasonally adjusted data)

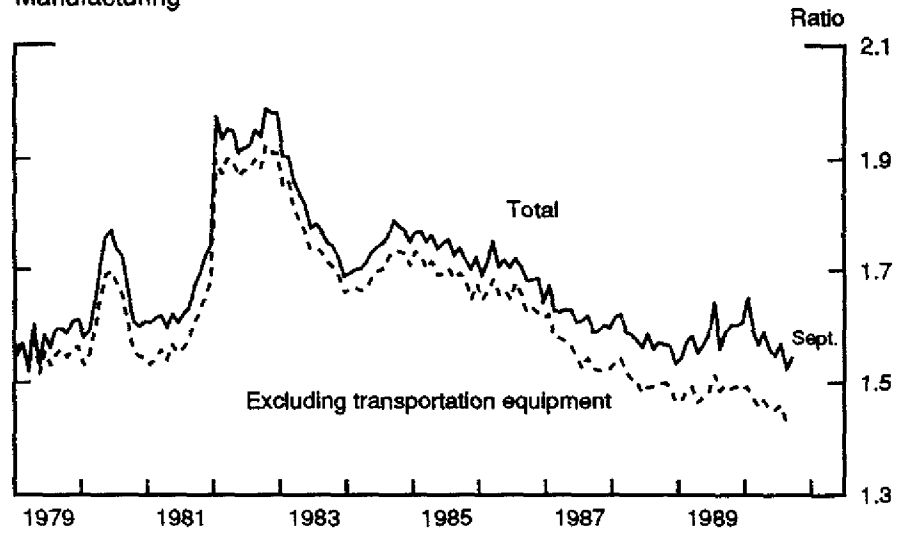
	1990			1990				
	Q1	Q2	Q3	July	Aug.	Sept.		
Range in preceding 12 months: <sup>2</sup>								
Low      High								
-----								
Current-cost basis:								
Total	1.46	1.51	1.48	1.48	n.a.	1.48	1.46	n.a.
Total excluding retail auto	1.43	1.49	1.46	1.45	n.a.	1.46	1.43	n.a.
Manufacturing	1.52	1.65	1.60	1.56	1.55	1.57	1.52	1.54
Wholesale	1.24	1.27	1.25	1.25	1.26	1.26	1.24	1.27
Retail	1.55	1.62	1.55	1.58	n.a.	1.57	1.60	n.a.
Automotive	1.81	2.12	1.84	1.92	n.a.	1.93	2.12	n.a.
Excluding auto	1.46	1.50	1.48	1.49	n.a.	1.48	1.47	n.a.
Constant-dollar basis:								
Total	1.42	1.46	1.44	1.43	n.a.	1.44	1.42	n.a.
Total excluding retail auto	1.39	1.45	1.42	1.41	n.a.	1.42	1.39	n.a.
Manufacturing	1.44	1.54	1.50	1.47	n.a.	1.48	1.44	n.a.
Wholesale	1.26	1.29	1.28	1.27	n.a.	1.28	1.26	n.a.
Retail	1.51	1.58	1.51	1.55	n.a.	1.54	1.56	n.a.
Automotive	1.72	2.04	1.73	1.82	n.a.	1.81	1.90	n.a.
Excluding auto	1.44	1.49	1.46	1.48	n.a.	1.47	1.47	n.a.

1. Ratio of end of period inventories to average monthly sales for the period.
2. Highs and lows are specific to each series and are not necessarily coincidental. Range is for the 12-month period preceding the latest month for

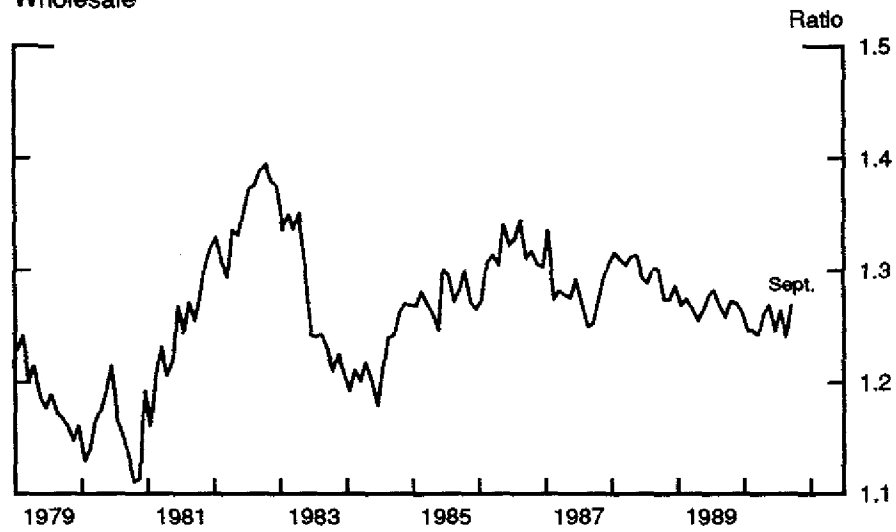
### RATIO OF INVENTORIES TO SALES

(Current-cost data)

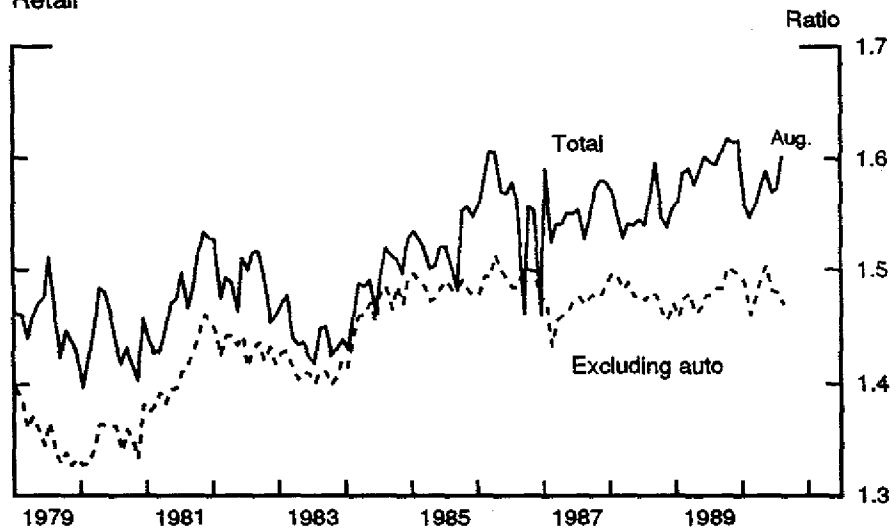
#### Manufacturing



#### Wholesale



#### Retail



significantly to the volatility in manufacturing inventories in earlier months, showed small net declines in August and September.

In the trade sector, inventory changes at businesses other than retail auto dealers and wholesale petroleum distributors also have been moderate. The nonpetroleum wholesale inventory accumulation in the third quarter, a net change of \$8 billion at an annual rate, was concentrated in machinery, but was about the same as the pace in the second quarter. Nonauto retail stocks as a whole showed little net accumulation in July and August, after buildups that averaged \$6.5 billion at an annual rate from April to June. At retail establishments that carry largely discretionary consumption goods (general merchandise, apparel, and furniture and appliances), no excessive inventory buildups were reported through August. The stock-sales ratios for stores in the G.A.F. grouping remained well within the range observed over the past three years. Anecdotal evidence suggests that in recent months, although most retailers considered their current inventory levels satisfactory, some had begun to trim their stocks because of deteriorating consumer confidence and the uncertain sales outlook.

#### Federal Government Sector

The FY1991 reconciliation bill was signed on November 5 and implements major elements of the FY1991 budget that were negotiated by Congress and the administration. The bill calls for changes to tax laws and to mandatory spending rules, substantial revisions to the Gramm-Rudman-Hollings law, and increases in the debt limit to \$4.073 trillion, a level that the Treasury estimates will be sufficient until May 1993. FY1991 appropriations bills that are consistent with the discretionary spending caps of the Budget Resolution also have been passed and signed by the President. This

legislation contains about the same amount of savings as the September 30 Budget Summit agreement. However, it relies less on cuts in Medicare outlays and gasoline tax increases; instead it raised the wage ceiling for Medicare contributions further and contained larger increases in personal income taxes. Other elements of the bill closely parallel the Budget Summit agreement.<sup>7</sup>

Cuts in budget outlays, mainly in the 1993 to 1995 period, account for more than two-thirds of the deficit-reducing actions included in the October 27 package; these cuts total \$22 billion in FY1991 and cumulate to \$345 billion over five years, measured relative to the OMB baseline. Discretionary spending programs will be reduced \$10 billion in FY1991 and a total of \$182 billion over five years. Between FY1991 and FY1993, the cuts in discretionary spending all are slated to come from national defense; in FY1994 and FY1995, the reductions can be made in any type of discretionary spending. If those cuts also were made exclusively in defense, real defense spending would fall about 4 percent per year while nondefense discretionary spending would grow at the rate of inflation.<sup>8</sup> Cuts in entitlements and other mandatory spending programs along with user fee increases amount to \$10 billion in FY1991 and \$98 billion over the five years covered by the accord. By restraining the growth of federal debt, the deficit-reduction

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7. As before, the budget does not include the cost of Operation Desert Shield, which will be funded separately through a supplemental spending bill. In September, OMB estimated that Operation Desert Shield would add about \$6 billion to FY1991 outlays, assuming no hostilities. (It is unclear whether the estimate includes increases in force levels that have recently been discussed in the press.)

8. After FY1993, even larger cuts in defense could fund some discretionary nondefense spending increases in FY1994 and FY1995.

FY1991 BUDGET PACKAGE--CHANGES FROM OMB BASELINE<sup>1</sup>  
 (Billions of dollars, fiscal years)

Category	1991	1992	1993	1994	1995	Total 1991-95
Outlays	22	46	68	96	115	345
Defense	10	23	35	} 53	62	182
Nondefense discretionary	0	0	0			
International	0	0	0			
Mandatory and fees	10	17	20	24	27	98
Interest	2	7	12	18	26	64
Receipts <sup>2</sup>	18	30	28	32	31	139
Personal	3	7	2	5	4	22
Corporate	2	1	1	1	0	4
Social insurance	3	9	9	10	10	41
Excise	10	13	15	15	16	69
Other	0	0	1	1	1	2
Deficit reduction	40	76	96	128	146	484
OMB September baseline deficit	295	309	228	116	84	
Post-policy deficits						
--consolidated	255	233	132	-12	-62	
--excluding deposit insurance	158	153	113	42	-17	

1. Based on preliminary estimates by OMB. Excludes IRS enforcement initiative (\$3 billion in FY1991 and \$9 billion over five years).

2. Stabilization payroll deposit rules increases personal income taxes \$1 billion in FY1991 and \$2 billion in FY1992 and reduces them \$3 billion in FY1993.

package reduces expected net interest outlays \$64 billion over the five years.

Net receipts are expected to increase \$18 billion in FY1991 and \$139 billion over five years. Excise taxes account for about half of the increase. Personal income taxes are increased \$22 billion over five years; \$40 billion of tax increases on upper income groups is partially offset by an expansion of low income tax credits estimated to be worth \$18 billion. The boost to payroll taxes is estimated at \$3 billion in FY1991; it grows to \$9 billion in FY1992 as the full-year effects are felt.

The Gramm-Rudman-Hollings revisions establish three distinct sequester mechanisms. First, the revised law establishes caps for discretionary spending. For FY1992 and FY1993 there are separate caps for domestic, international, and defense discretionary spending; in FY1994 and 1995 there is a single cap for total discretionary spending. If new legislation drives spending above the discretionary caps, all programs within the category will be cut equally to meet the target. The caps are to be adjusted for changes in economic and technical assumptions. Second, mandatory spending and taxes are put on a pay-as-you-go basis, under which any increase in entitlements or decrease in revenues must be balanced by other spending reductions or revenue increases. Third, in FY1994 and FY1995 violation of the deficit target may trigger a sequester. This sequester would be across the board as specified in the earlier Gramm-Rudman-Hollings rules. The deficit targets for all years will be adjusted for economic and technical assumptions in FY1992 and FY1993 and may be adjusted similarly in FY1994 and FY1995 at the Administration's option.

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

	FY1989	FY1990	Net change	Percent change
Outlays	1144.0	1251.9	107.9	9.4
Deposit insurance	22.1	58.3	36.2	163.8
Outlays, excluding				
deposit insurance	1121.9	1193.6	71.7	6.4
National defense	303.6	299.3	-4.3	-1.4
Net interest	169.1	183.8	14.7	8.7
Social Security	232.5	248.6	16.1	6.9
Medicare and health	133.4	155.8	22.4	16.8
Income security	136.0	148.3	12.3	9.0
Agriculture	16.9	12.0	-4.9	-29.0
Other	130.4	145.8	15.4	11.8
Receipts	990.7	1031.5	40.8	4.1
Personal income taxes	445.7	466.9	21.2	4.8
Social insurance				
contributions	359.4	380.0	20.6	5.7
Corporate income taxes	103.3	93.5	-9.8	-9.5
Other	82.3	91.1	8.8	10.7
Deficit(+)	153.3	220.4	67.1	43.8

Details made not add due to rounding.

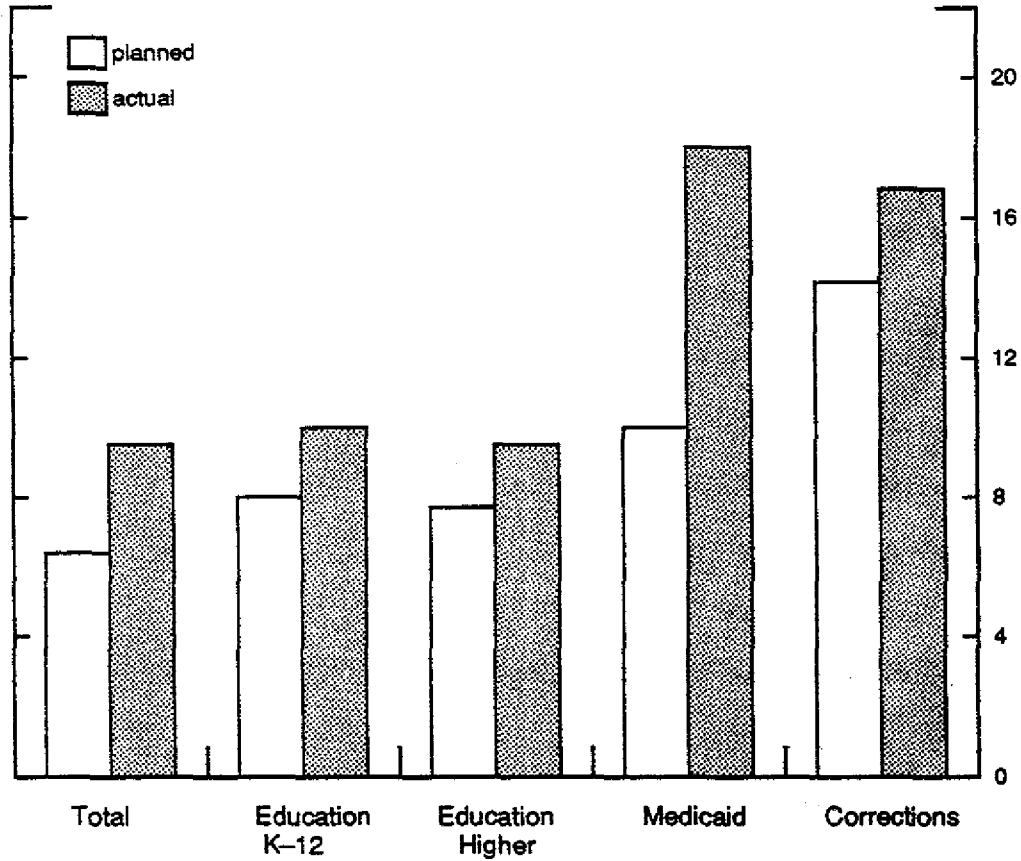
In September, the federal government recorded a \$21 billion budget surplus, bringing the deficit for FY1990 to \$220 billion, essentially matching the record deficit in FY1986 and \$67 billion higher than the FY1989 deficit. About half of the increase in the deficit can be attributed to higher deposit insurance outlays, which, on net, totaled \$58 billion in FY1990 compared with \$22 billion a year earlier. Outside of deposit insurance, the principal areas of outlay growth were net interest payments and the major entitlement programs--social security, Medicare, income security (federal employee retirement programs and low income programs), and health (largely Medicaid)--that are driven by larger caseloads, cost-of-living adjustments, and rising health care costs.

Defense and agriculture were the two primary areas in which spending declined. National defense spending edged down \$4 billion in FY1990 from its peak in FY1989, and in real terms declined significantly. According to a statement issued by the Administration, Operation Desert Shield added \$1.2 billion to defense spending; however, this was more than offset by a moratorium on military construction and delays in other spending. Agriculture spending came in at \$12 billion, the lowest total since 1981.

Receipts were \$1,031 billion, only 4 percent above a year earlier. A major factor of the slow growth in receipts was the decline in corporate profits tax collections from \$103 billion in FY1989 to \$93 billion in FY1990. Also, personal income tax receipts grew only 4-3/4 percent, in part because the unusually strong final payments on 1988 liabilities did not recur. Social insurance taxes grew 5-3/4 percent, reflecting in part the final increase (scheduled in the 1983 Social Security Amendments) in the social security tax rate to 15.3 percent.



### STATE GENERAL FUND SPENDING (Percent Change, Fiscal Year 1990)



Source: National Conference of State Legislatures. The individual categories shown here represent about 50 percent of all general fund spending.

On an NIA basis, real federal government purchases of goods and services, excluding CCC, were about unchanged in the third quarter. Operation Desert Shield has had mixed effects on purchases because the increased spending for this operation has been accompanied by reduced spending in less critical areas. Defense purchases in the third quarter were reduced by sales of defense inventories to Saudi Arabia, which boosted net exports by an equal amount. The slight drop in nondefense purchases reflects, among other things, the layoff of temporary census workers.

#### State and Local Government Sector

Real purchases by state and local governments rose at a 2.5 percent annual rate in the third quarter, after a 0.6 percent drop during the spring. The rise in the third quarter reflected a 7.0 percent jump (monthly rate) in real construction spending in August, the largest monthly increase in more than a year and a half. More recent data, available after the NIA publication date, confirm the rise in August but show a slightly larger decline in September than that assumed by BEA. State and local employment continued to expand during the third quarter, but at a slower rate than during the first half of the year. The rise in purchases was nearly matched by an increase in indirect business tax collections, owing largely to a hike in the general sales tax in New Jersey in July; the deficit of operating and capital accounts is estimated to have edged down to about \$28 billion.

Budgetary shortfalls are likely to continue to be widespread in fiscal 1991. Reports from many states indicate that revenues are coming in below projections. In Massachusetts, receipts so far are not only below projection but also below actual collections last year. A few states are responding by cutting back outlays, but most appear to be deferring action

RECENT CHANGES IN CONSUMER PRICES  
(Percentage change; based on seasonally adjusted data)<sup>1</sup>

	Relative importance Dec. 1989	1988	1989	1990			1990	
				Q1	Q2	Q3	Aug.	Sept.
				-----Annual rate-----			-Monthly rate-	
All items <sup>2</sup>	100.0	4.4	4.6	8.5	3.5	7.9	.8	.8
Food	16.3	5.2	5.6	11.4	2.1	3.7	.3	.2
Energy	7.4	.5	5.1	14.8	-2.0	42.7	4.3	5.6
All items less food and energy	76.3	4.7	4.4	7.5	3.9	5.7	.5	.3
Commodities	25.2	4.0	2.7	7.8	.7	2.9	.0	.4
Services	51.1	5.0	5.3	7.2	5.5	7.2	.8	.3
Memorandum:								
CPI-W <sup>3</sup>	100.0	4.4	4.5	8.3	3.2	8.0	.8	.8

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)<sup>1</sup>

	Relative importance Dec. 1989	1988	1989	1990			1990	
				Q1	Q2	Q3	Aug.	Sept.
				-----Annual rate-----			-Monthly rate-	
Finished goods	100.0	4.0	4.9	7.1	.3	11.7	1.3	1.6
Consumer foods	25.9	5.7	5.2	10.6	-2.9	-.3	.8	-.9
Consumer energy	9.2	-3.6	9.5	24.7	-14.3	137.4	9.5	13.8
Other finished goods	64.9	4.3	4.2	3.6	3.9	3.5	.3	.6
Consumer goods	39.5	4.8	4.4	3.5	5.1	2.5	.2	.6
Capital equipment	25.4	3.6	3.8	4.0	1.7	6.0	.3	.8
Intermediate materials <sup>2</sup>	94.9	5.3	2.5	2.5	-1.1	14.2	1.5	1.9
Excluding food and energy	82.5	7.2	.9	1.0	.7	4.0	.3	.6
Crude food materials	41.9	14.2	2.8	9.1	-11.5	-6.6	-.9	-1.8
Crude energy	40.5	-9.5	17.9	.5	-38.9	293.7	25.5	12.4
Other crude materials	17.5	7.5	-3.6	4.0	10.9	10.9	1.8	-.1

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

until after the elections. On the expenditure side, general fund outlays are projected to rise 6.4 percent during fiscal 1991, according to the National Conference of State Legislatures. The same advance was forecast last year when actual spending increased about 9.5 percent (chart). Continuing pressure for expansion of education, corrections, and health services could result in unplanned spending again this year.

### Prices

Climbing petroleum costs continued to boost producer and retail prices in September. The CPI rose 0.8 percent in September, the same as in August, while the PPI for finished goods was up 1.6 percent, even more than in the preceding month.

Outside the food and energy areas, the CPI rose 0.3 percent in September. The increase in nonenergy service prices moved back down to 0.3 percent, after three months of large increases. This easing mainly reflected a slowdown in two components that had posted sizable jumps in earlier months: owners' equivalent rent and lodging while out of town. At the same time, some spillover effects of the climb in crude oil prices began to show up, as airfares and other public intercity transport costs increased about 2 percent. The CPI for nonfood, nonenergy commodities rose 0.4 percent in September, as the index for apparel jumped 0.8 percent. The pickup for apparel reflected the sampling of higher priced fall and winter clothing and followed four months in which marked discounting of spring and summer lines had led to declines in this component. The CPI for apparel commodities was 5-1/2 percent above its level of a year earlier. Over the first nine months of this year, the CPI excluding food and energy items has

risen at an annual rate of 5-3/4 percent, more than a percentage point above the pace during 1989.

At the producer level, about half of the 0.6 percent increase in September in the PPI for finished goods less food and energy occurred because discounts for motor vehicles were not increased in September at the end of the model year; manufacturers already had introduced price incentives earlier in the model year. Excluding motor vehicles, this PPI series was up 0.3 percent, about the average monthly pace earlier in the year. As expected, the spillover effects of higher crude oil prices began to boost prices at the intermediate stage of processing. The PPI for intermediate materials (less food and energy) jumped 0.6 percent in September, the largest increase since early 1989, mainly because of sharply higher prices for petrochemicals and plastics.

Food. Increases in food prices at the consumer level slowed further in September, to a monthly rise of only 0.2 percent. Nonetheless, the level of food prices remained about 5-1/2 percent above that of a year earlier, in the range that has persisted for more than two years. In part, this elevated year-over-year pace reflects upward pressures from nonfarm costs, which account for the major part of the consumer food bill and cause the prices of many foods to follow trends similar to that of inflation in general. Additional pressures have come from cutbacks in the supplies of some livestock products this year; pork production, in particular, has turned down, and the output of beef also has been sluggish. Upward pressures on the prices of cattle and hogs still were much in evidence in October and are likely to show up in the near-term PPI and CPI reports;

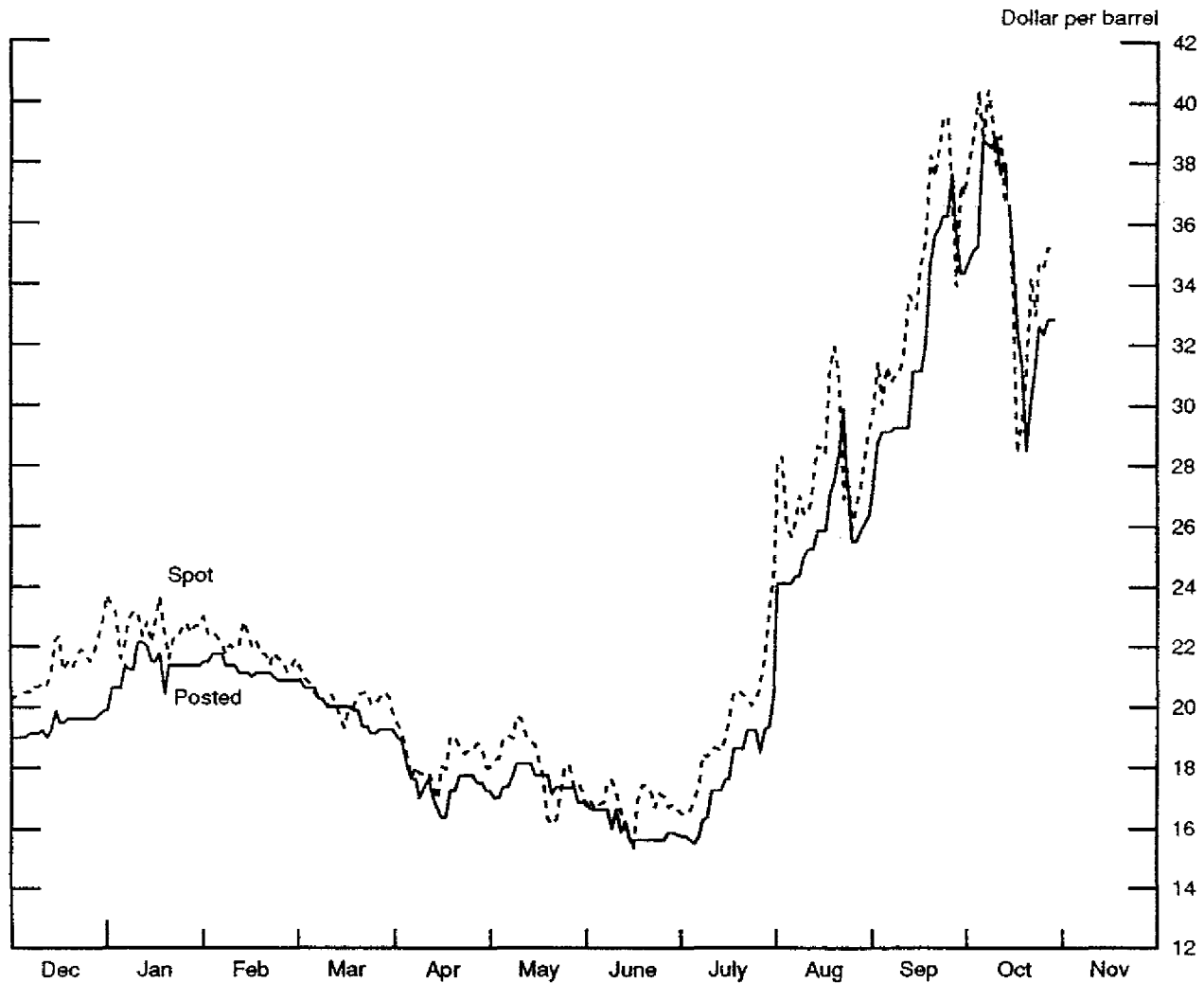
dairy prices seem to be easing, however, after large increases over the past two years.

Energy. Both consumer and producer prices for energy posted record monthly increases in September, 5.6 percent and 13.8 percent respectively. At the producer level, the gasoline component jumped 20.6 percent, even faster than the preceding month's record-breaking pace. However, the PPI for natural gas increased only 1.3 percent, restrained by plentiful supplies. The margin between crude oil prices and retail gasoline prices narrowed in August and September, as refiners boosted gasoline production and inventories returned to normal levels.

In October, spot crude oil prices gyrated wildly, ranging from a high of \$40 per barrel on October 11 to a low of \$28 on October 22, with prices at roughly \$35 by the end of the month. On average, however, crude prices were \$3 to \$4 per barrel higher than in September. Survey data suggest that retail gasoline prices rose about 10 cents per gallon (seasonally adjusted) in October, matching the crude price increase. Early November survey estimates indicate a much smaller increase in retail gasoline prices, and a slight decline in wholesale gasoline prices.

As noted above, U.S. gasoline demand, possibly because of anticipatory stockpiling, has remained surprisingly resilient since the invasion. This continued strength may have caught refiners by surprise, as gasoline inventories fell to the bottom of their normal operating range in October. Recent survey evidence suggests that world oil demand in the fourth quarter is weakening. The market apparently anticipates some increase in gasoline supplies over the remainder of the year; gasoline futures prices for December delivery are well below prices for November delivery. However,

Daily Spot and Posted Prices of West Texas Intermediate



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

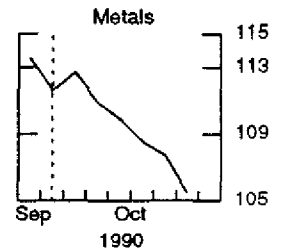
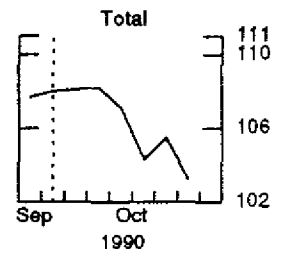
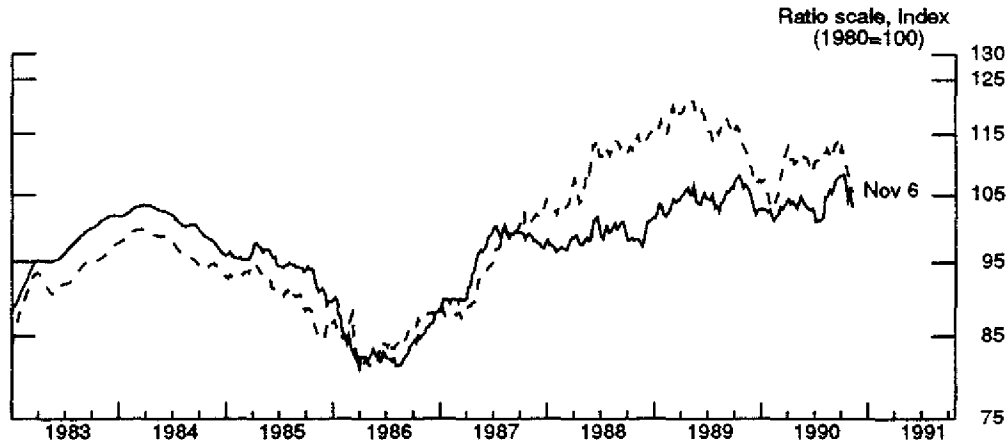
MONTHLY AVERAGE PRICES--WEST TEXAS INTERMEDIATE

Month	Posted	Spot
December	19.32	21.09
January	21.21	22.64
February	21.27	22.12
March	20.08	20.42
April	17.77	18.58
May	17.55	18.24
June	16.15	16.87
July	17.23	18.64
August	24.99	27.17
September	31.10	33.69
October	34.82	35.92
November *	32.88	35.15

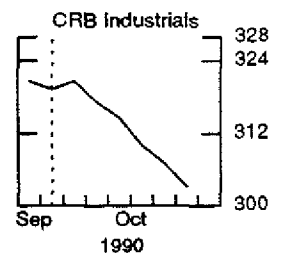
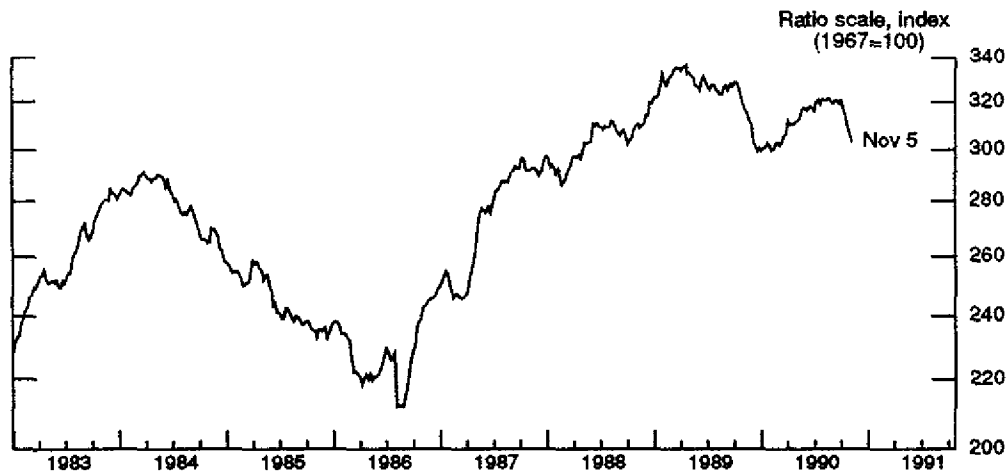
\* Price through November 1, 1990.

# COMMODITY PRICE MEASURES \*

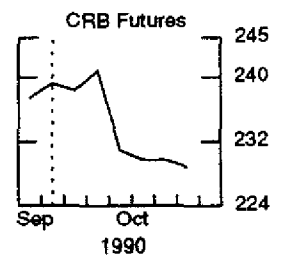
— Journal of Commerce Index, total  
 - - - Journal of Commerce Index, metals



CRB Spot Industrials



CRB Futures



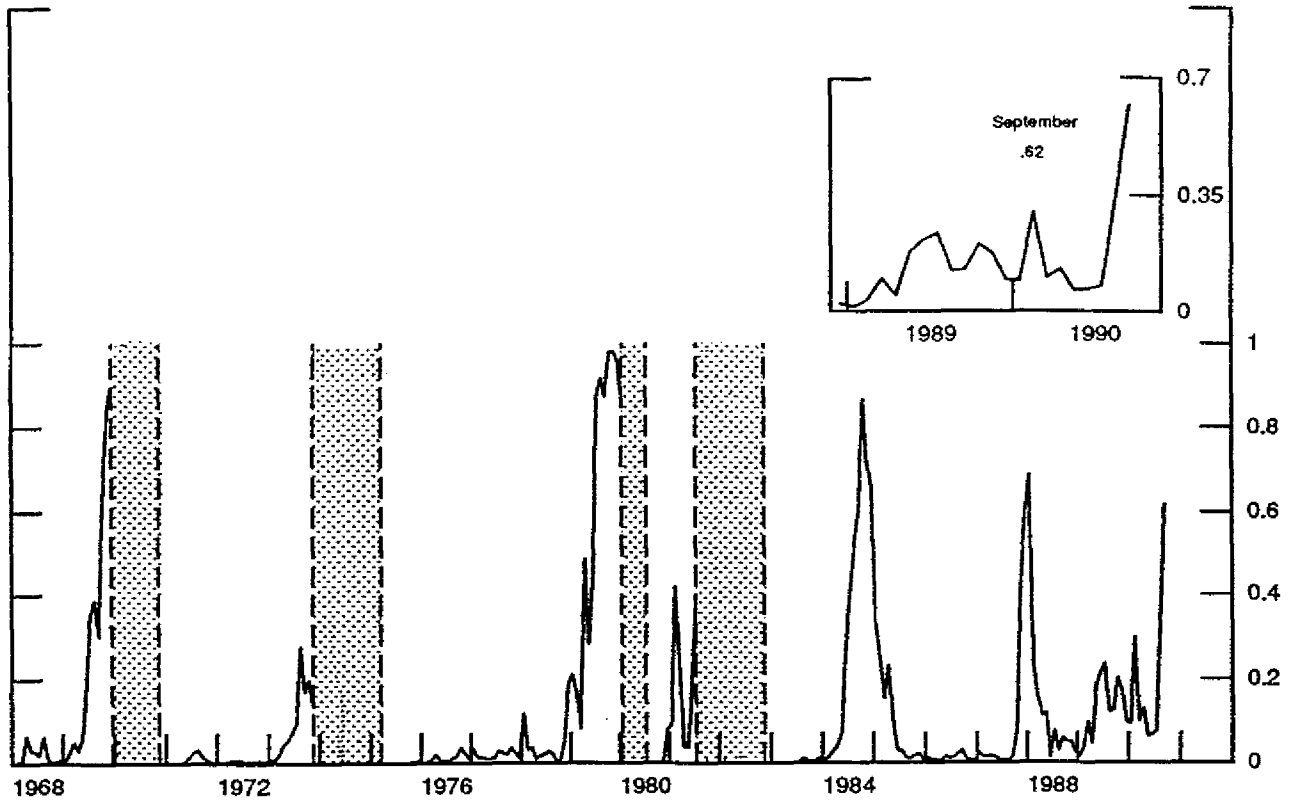
\* Weekly data, Tuesdays; Journal of Commerce data monthly before 1985

Dotted lines indicate week of last Greenbook.

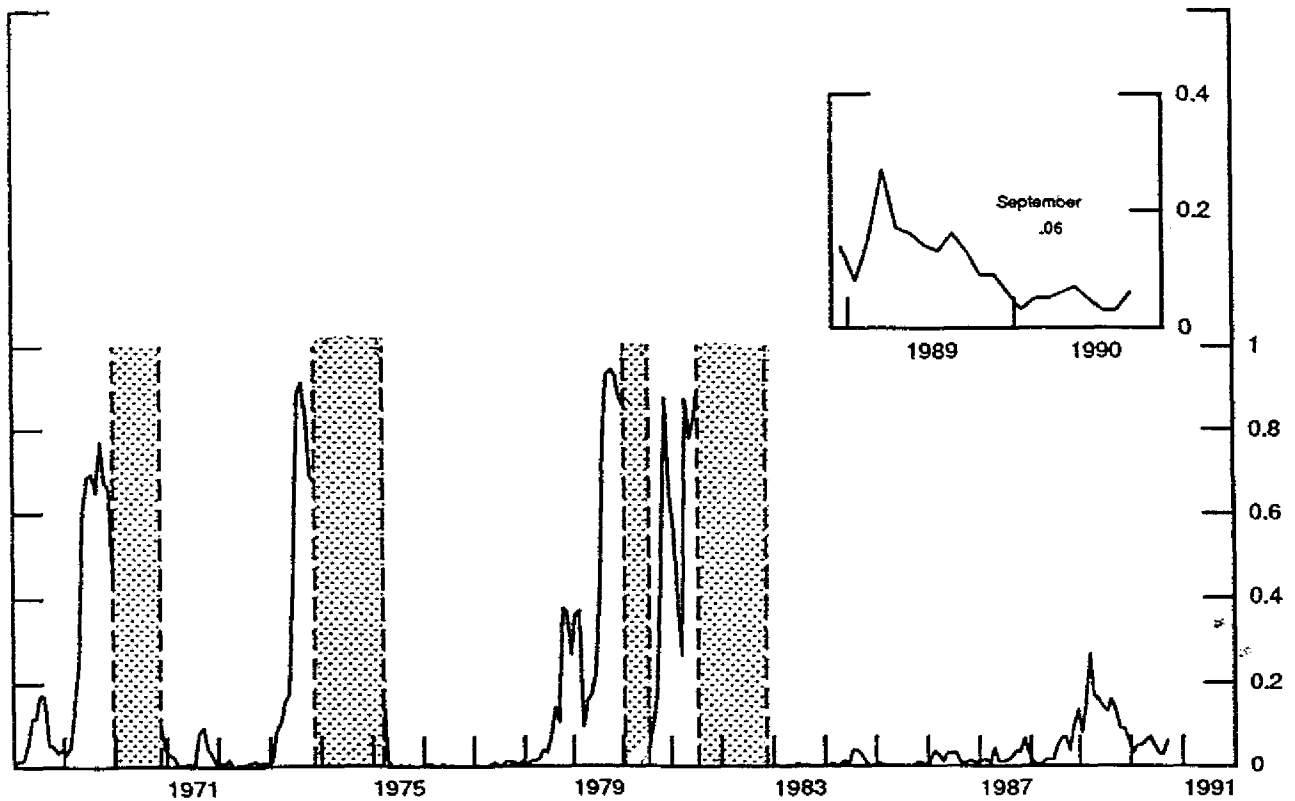


### Probability of a Recession\*

GENERATED FROM COMMERCE LEADING INDEX



GENERATED FROM NBER LEADING INDEX



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

consumers may not see a corresponding decline at the retail level because the new federal deficit-reduction package mandates a 5-cent increase in gasoline taxes, effective December 1.

Commodity prices. Prices in spot markets have retreated significantly in recent weeks for most industrial metals. Both the CRB spot price index for industrials and the metals component of the Journal of Commerce industrial price index have dropped back markedly since the week of the last Greenbook (chart), consistent, it would seem, with the signs of accumulating weakness that have been apparent in other recent indicators.<sup>9</sup>

#### Recession Probabilities

The latest readings on recession-probability measures based on indexes of leading economic indicators are mixed. The measure based on the Commerce Department's September index of leading economic indicators puts the probability of a recession starting in the next six months at 62 percent (chart). The sudden jump in the August and September reading on the recession probability is largely attributable to declines in the stock market and in the Michigan survey index of consumer expectations; however, manufacturers' unfilled orders, unemployment initial claims, and building permits have made substantial negative contributions to the underlying index.<sup>10</sup>

The most recent reading on the National Bureau of Economic Research (NBER) measure, which includes September nonfinancial data as well as October readings on exchange rates and interest rates, shows only a

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9. The Journal of Commerce index total also has been affected by the sharp swings in the price of crude oil.

10. The relevant data for October on most of these indicators have shown further weakness.

6 percent recession probability. Researchers at the NBER also have constructed an alternative version of their experimental leading index that excludes financial variables. Based on this alternative index, the probability of a recession beginning in the next six months is 29 percent.

# **DOMESTIC FINANCIAL DEVELOPMENTS**

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III-T-1 1  
**SELECTED FINANCIAL MARKET QUOTATIONS**  
 (percent)

	1989		1990			Change from:		
	March	Dec	Aug	FOMC		Dec 89	Aug 90	FOMC
	highs	lows	highs	Oct 2	Nov 6	lows	highs	Oct 2
<b>Short-term rates</b>								
Federal funds <sup>2</sup>	9.85	8.45	8.21	8.21	8.00	-.45	-.21	-.21
Treasury bills <sup>3</sup>								
3-month	9.09	7.53	7.59	7.18	7.08	-.45	-.51	-.10
6-month	9.11	7.29	7.51	7.18	7.06	-.23	-.45	-.12
1-year	9.05	7.11	7.45	7.10	6.89	-.22	-.56	-.21
Commercial paper								
1-month	10.05	8.51	8.10	8.05	7.88	-.63	-.22	-.17
3-month	10.15	8.22	8.05	7.95	7.86	-.36	-.19	-.09
Large negotiable CDs <sup>3</sup>								
1-month	10.07	8.52	8.14	8.00	7.92	-.60	-.22	-.08
3-month	10.32	8.22	8.18	8.00	7.96	-.26	-.22	-.04
6-month	10.08	8.01	8.25	8.01	7.95	-.06	-.30	-.06
Eurodollar deposits <sup>4</sup>								
1-month	10.19	8.38	8.13	8.00	7.94	-.44	-.19	-.06
3-month	10.50	8.25	8.19	8.00	7.94	-.31	-.25	-.06
Bank prime rate	11.50	10.50	10.00	10.00	10.00	-.50	.00	.00
<b>Intermediate- and long-term rates</b>								
U.S. Treasury (constant maturity)								
3-year	9.88	7.69	8.50	8.10	7.80	.11	-.70	-.30
10-year	9.53	7.77	9.05	8.69	8.52	.75	-.53	-.17
30-year	9.31	7.83	9.17	8.84	8.64	.81	-.53	-.20
Municipal revenue <sup>5</sup> (Bond Buyer)	7.95	7.28	7.80	7.81	7.55	.27	-.25	-.26
Corporate--A utility recently offered	10.47	9.29	10.50	10.16	10.08	.79	-.42	-.08
Home mortgage rates <sup>6</sup>								
S&L fixed-rate	11.22	9.69	10.29	10.22	10.13	.44	-.16	-.09
S&L ARM, 1-yr.	9.31	8.34	8.39	8.28	8.15	-.19	-.24	-.13
<b>Stock prices</b>								
			1989	1990		Percent change from:		
	Record		Lows	FOMC		Record	1989	FOMC
	highs	Date	Jan 3	Oct 2	Nov 6	highs	lows	Oct 2
Dow-Jones Industrial	2999.75	7/16/90	2144.64	2505.20	2485.15	-17.15	15.88	-.80
NYSE Composite	201.13	7/16/90	154.98	172.59	170.21	-15.37	9.83	-1.38
AMEX Composite	397.03	10/10/89	305.24	309.63	292.15	-26.42	-4.29	-5.65
NASDAQ (OTC)	485.73	10/9/89	378.56	356.39	340.53	-29.89	-10.05	-4.45
Wilshire	3523.47	10/9/89	2718.59	2963.70	2907.21	-17.49	6.94	-1.91

1/ One-day quotes except as noted.

2/ Average for two-week reserve maintenance period closest to date shown. Last observation is average to date for the maintenance period ending November 14, 1990.

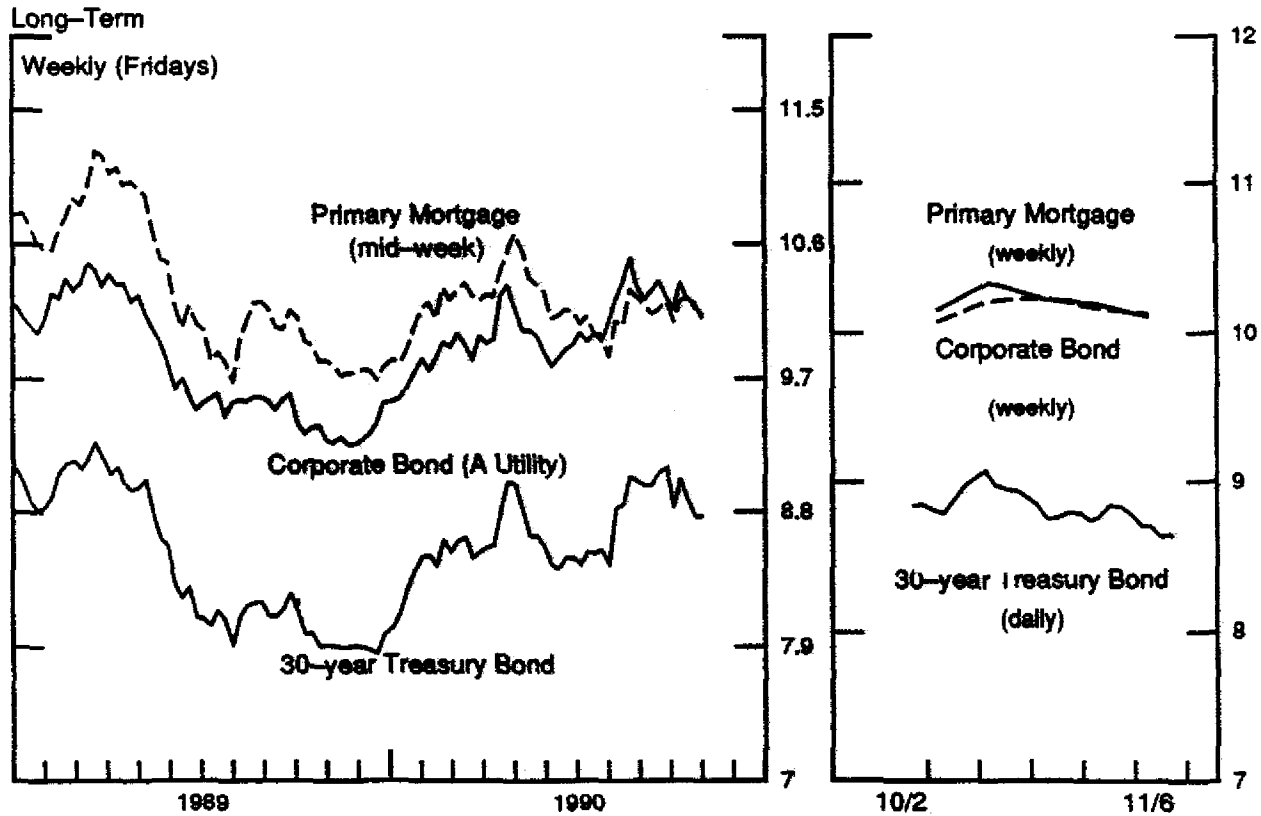
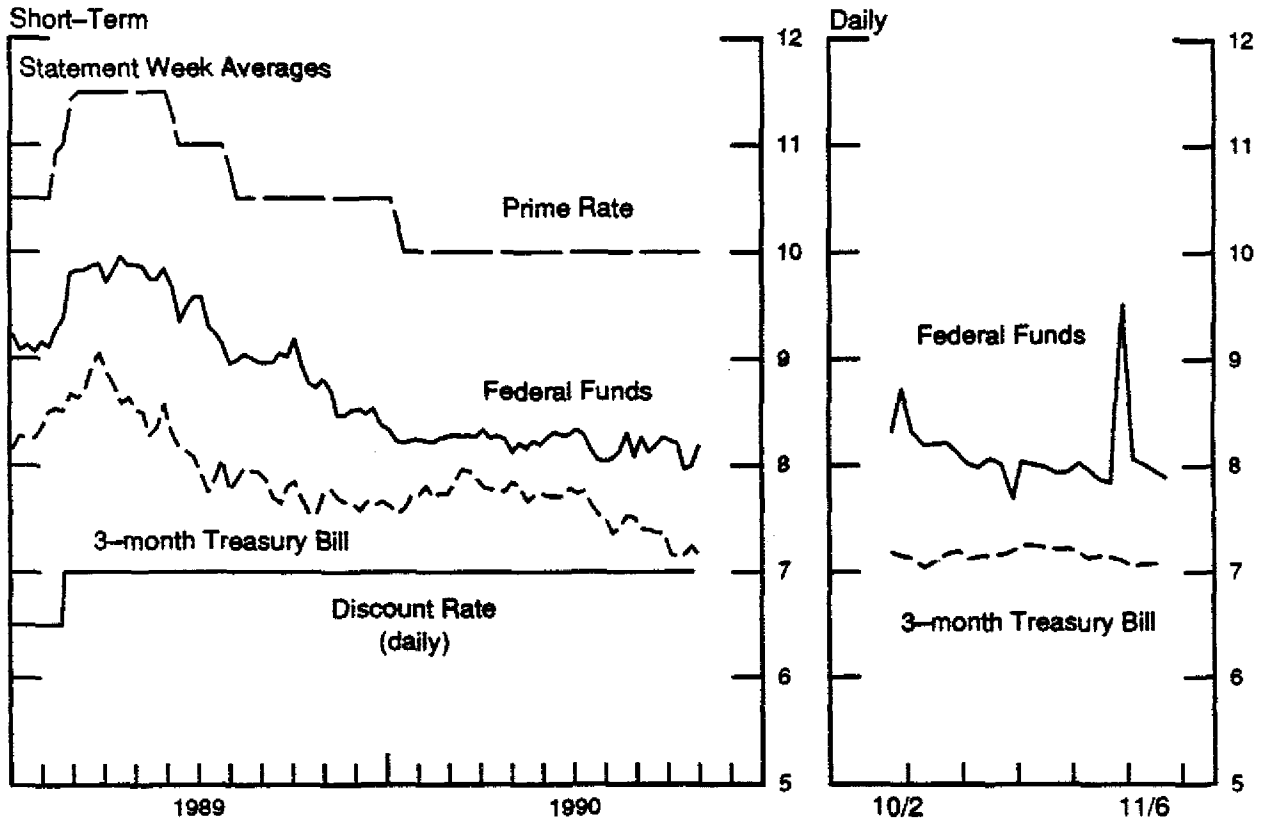
3/ Secondary market.

4/ Bid rates for Eurodollar deposits at 11 a.m. London time.

5/ Based on one-day Thursday quotes and futures market index changes.

6/ Quotes for week ending Friday closest to date shown.

**Selected Interest Rates\***  
(percent)



\*— Friday weeks through November 2, Wednesday weeks through October 31.

## DOMESTIC FINANCIAL DEVELOPMENTS

Yields on Treasury and investment-grade securities have declined moderately since the October 2 FOMC meeting. Passage of the deficit-reduction program, and a subsequent quarter-point easing in the federal funds rate, and weak economic indicators have helped push these rates down. Outside the highest-quality sectors, however, evidence of financial stress has become increasingly visible in the rate structure. Yield spreads over Treasuries have increased noticeably across a broad front, not only encompassing nonfinancial corporate bonds and bank-related securities, but also spreading to finance companies, insurance companies, asset-backed securities, and financially strapped municipalities.

Several medium-grade companies have encountered investor resistance to offerings of commercial paper with maturities carrying over the approaching year-end statement date and have been forced to draw on backup lines of credit at banks. In the third quarter, the number of firms reducing or omitting dividends rose, the volume of defaults on corporate bonds so far in 1990 topped previous full-year records, and downgradings of corporate and municipal debt increased further. Disappointing reports of third-quarter earnings have depressed stock prices in general; large declines have been posted for banks, thrift institutions, and insurance companies.

Growth in M2 slowed in October to a 1 percent annual rate, which moved M2 further below the midpoint of its target range. Demand deposits dropped sharply, and growth of most of the retail components of M2 slowed. Bank credit showed little change, which, along with shrinkage in the thrift

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

	1989 <sup>1</sup>	1990 Q2	1990 Q3	1990 Aug	1990 Sep	1990 Oct pe	Growth Q4 89- Oct 90pe
-----Percent change at annual rates-----							
1. M1	0.6	3.5	4.3	10.4	9.6	-3	4
2. M2	4.6	2.8	3.1	6.5	5.8	1	4
3. M3	3.3	0.8	1.5	4.5	1.0	0	1½
-----Percent change at annual rates-----							Levels bil. \$ Sep 90
Selected components							
4. M1-A	0.4	1.6	7.0	14.8	12.4	-1	529.7
5. Currency	4.8	9.2	11.6	14.8	16.1	12	241.5
6. Demand deposits	-2.8	-4.7	2.9	14.0	8.2	-13	279.9
7. Other checkable deposits	1.0	7.1	-0.4	2.5	4.9	-7	293.1
8. M2 minus M1 <sup>2</sup>	5.9	2.6	2.7	5.3	4.5	3	2495.1
9. Overnight RPs and Eurodollars, NSA	-8.6	-2.0	7.4	-17.1	-11.6	44	82.2
10. General purpose and broker/dealer money market mutual fund shares	29.7	-0.7	12.8	32.1	22.6	11	340.1
11. Commercial banks	7.5	10.3	11.4	7.5	6.9	14	1148.3
12. Savings deposits plus MMDAs <sup>3</sup>	-1.7	8.6	7.5	8.3	4.6	3	572.6
13. Small time deposits	19.0	12.1	15.4	6.8	9.5	24	575.8
14. Thrift institutions	-0.2	-4.6	-10.3	-3.6	-6.1	-15	924.9
15. Savings deposits plus MMDAs <sup>3</sup>	-9.3	1.4	-5.5	-2.7	-3.8	-12	350.3
16. Small time deposits	5.8	-8.0	-13.3	-3.9	-7.5	-18	574.6
17. M3 minus M2 <sup>4</sup>	-1.3	-7.3	-5.1	-4.0	-19.1	-7	774.0
18. Large time deposits	4.2	-10.3	-8.7	-14.5	-16.5	-13	516.9
19. At commercial banks, net <sup>5</sup>	9.9	-2.8	-0.7	-9.9	-13.3	-6	392.0
20. At thrift institutions	-7.8	-30.1	-31.7	-28.4	-26.3	-36	124.9
21. Institution-only money market mutual fund shares	17.1	11.5	22.0	56.2	22.1	38	116.1
22. Term RPs, NSA	-14.7	5.0	3.3	23.5	-41.2	-41	95.6
23. Term Eurodollars, NSA	-21.9	-22.4	-0.6	29.8	0.0	-5	66.1
-----Average monthly change in billions of dollars-----							
MEMORANDA: <sup>6</sup>							
24. Managed liabilities at commercial banks (25+26)	6.0	-1.8	1.2	-2.3	-6.9	6	727.0
25. Large time deposits, gross	2.6	-1.5	-2.3	-3.1	-5.2	-3	445.7
26. Nondeposit funds	3.5	-0.2	3.5	0.8	-1.7	10	281.3
27. Net due to related foreign institutions	0.2	-0.9	1.5	-0.1	2.5	8	19.2
28. Other <sup>7</sup>	3.3	0.6	2.0	0.9	-4.3	2	262.0
29. U.S. government deposits at commercial banks <sup>8</sup>	-0.3	0.4	2.6	18.4	-5.0	-6	28.2

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 September and October at rates of 4.9 percent and 7 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during September and October at rates of -6.5 percent and -12 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



industry, kept M3 unchanged in October and in the lower portion of its annual range. Some of the weakness in bank credit reflects heavy securitization of consumer receivables, motivated by desires to boost capital-asset ratios. Business loans also remained weak, and survey data indicate that banks have continued to tighten their lending terms for business borrowers in recent months.

Borrowing by nonfinancial businesses has been moderate of late, in both short- and long-term categories. Equity offerings have been light, but with takeovers and share repurchases less prevalent, net equity retirements have remained below the pace of recent years.

Residential mortgage growth evidently remained slow through the third quarter, reflecting continued weakness in the housing market, and spreads on conventional mortgages have stayed narrow. Lenders apparently remain willing to extend credit to the household sector, as evidenced by a pickup in consumer installment credit in the third quarter, although recent survey information suggests that banks have become somewhat less enthusiastic about making consumer loans.

#### Monetary Aggregates and Bank Credit

The monetary aggregates were weak in October: M1 fell and the broader aggregates posted little or no growth. The weakness occurred despite a narrowing of the spread between market rates and deposit rates. Money fund inflows, which had lifted M2 and M3 in August and September when investors reacted to turmoil in the financial markets, continued at double-digit rates. Nonetheless, the contraction of the thrift industry--with a number of large RTC resolutions taking place around quarter-end--and efforts by

COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT  
 (Percentage changes at annual rates, based on seasonally adjusted data)<sup>1</sup>

	1988:Q4	1990					Levels
	to 1989:Q4	Q2	Q3	Aug.	Sept	Oct. p	bil.\$ Sept
----- Commercial Bank Credit -----							
1. Total loans and securities at banks	7.5	5.2	5.8	10.3	.1	1	2708.5
2. Securities	4.1	9.4	6.6	4.3	11.6	3	626.5
3. U.S. government securities	10.0	15.4	7.8	1.9	15.8	12	447.1
4. Other securities	-6.7	-4.4	3.4	10.1	1.3	-21	179.4
5. Total loans	8.5	3.9	5.6	12.1	-3.3	1	2082.0
6. Business loans	6.9	4.9	.9	3.9	-2.4	-3	651.6
7. Real estate loans	13.3	9.3	6.5	4.9	3.5	7	814.7
8. Consumer loans	6.3	-.8	3.1	5.7	3.2	1	381.1
9. Security loans	3.8	-20.4	88.4	222.7	-75.7	-59	43.1
10. Other loans	1.5	-6.5	8.3	41.8	-28.7	-4	191.5
----- Short- and Intermediate-Term Business Credit -----							
11. Business loans net of bankers acceptances	7.0	4.7	1.0	4.3	-3.2	-2	644.0
12. Loans at foreign branches <sup>2</sup>	-5.0	9.2	28.8	-15.9	80.7	20	23.8
13. Sum of lines 11 & 12	6.5	4.8	2.0	3.6	-.2	-2	667.9
14. Commercial paper issued by nonfinancial firms	31.2	9.3	16.8	13.3	50.3	25	151.6
15. Sum of lines 13 & 14	10.0	5.6	4.6	5.3	8.7	4	819.5
16. Bankers acceptances: U.S. trade related <sup>3,4</sup>	6.1	-9.8	-27.6	-38.5	-19.9	n.a.	29.7
17. Line 15 plus bankers acceptances: U.S. trade related	9.8	5.0	3.4	3.7	7.7	n.a.	849.2
18. Finance company loans to business <sup>3</sup>	10.6	15.4	20.7	20.0	17.1	n.a.	284.3
19. Total short- and intermediate- term business credit (sum of lines 17 & 18)	10.0	7.5	7.7	7.7	10.1	n.a.	1133.6

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.  
p--preliminary.

n.a.--not available

commercial banks to retrench has restrained the growth of depository credit and the monetary aggregates last month.

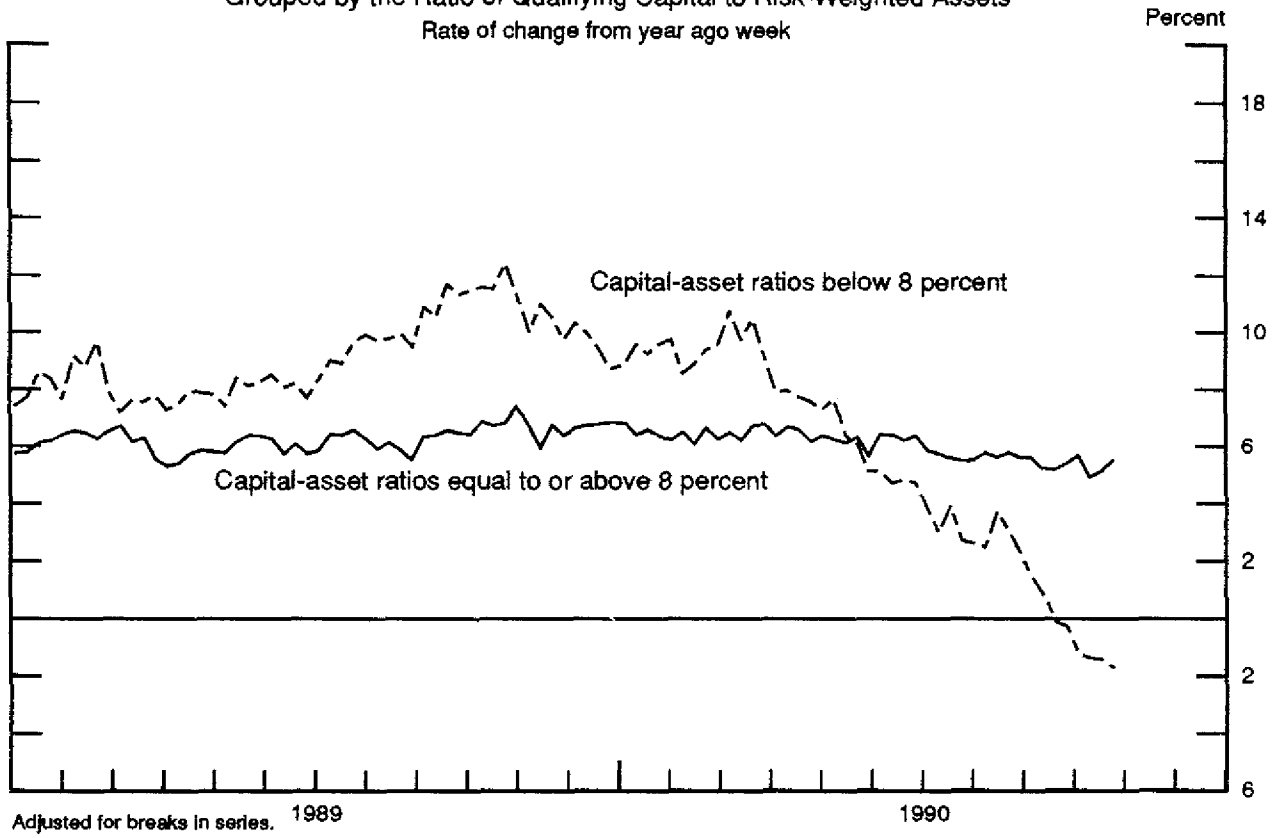
M1 declined at a 3 percent annual rate in October, as a reduction in transaction balances more than offset continued robust currency expansion. Demand deposits, whose growth had been boosted in recent months by special factors, dropped sharply, and OCDs also fell.

The decline in M1, along with continued weakness in nontransaction retail deposits and a slowing of inflows into money funds, held M2 growth to a 1 percent rate in October. The disparity between deposit growth at banks and thrifts widened, as the RTC concluded several large resolutions around quarter-end. These transfers of core deposits from thrift institutions to banks may have depressed overall deposit growth in light of banks' current reluctance to expand their balance sheets and consequently to bid aggressively for funds.

With the thrift industry shrinking and banks expanding at a very subdued pace, M3 was about unchanged in October. The sluggishness of M3 was partly a result of late-quarter activities of the RTC. The decline of M3 at the end of the third quarter was amplified by the reduced availability of funds from investors concerned about bank creditworthiness. In addition, many commercial banks sought to shrink their balance sheets in anticipation both of the phase-in of risk-based capital standards and of the higher FDIC assessments next year, which will be based on average deposits outstanding at the ends of the third and fourth quarters of this year.

Overall bank credit was little changed again last month. Growth in recent months has been damped by the behavior of the less well capitalized segment of the banking industry. Large commercial banks with capital of

Growth of Total Loans at Large Banks  
Grouped by the Ratio of Qualifying Capital to Risk-Weighted Assets  
Rate of change from year ago week



less than 8 percent of risk-weighted assets have sharply reduced loan growth this year; indeed, recent readings show total loans at this group of banks below year-ago levels. By contrast, total loan growth has slowed only slightly at larger banks with a risk-based capital ratio of 8 percent or more on June 30, 1990 (chart).

Each of the major categories of loans remained weak last month. Security loans, which had boosted bank credit during the summer, ran off in September and October, reflecting both quarter-end downsizing and the drop in Treasury tax and loan accounts after the recent spate of RTC resolutions. Consumer loans were little changed last month; adjusted for securitization, however, these loans grew at about a 6 percent rate. Real estate lending grew moderately, with much of the 7 percent increase reflecting home equity loan growth and transfers of thrift mortgage assets to commercial banks as a result of RTC resolutions.

Business loans contracted again last month; declines at large banks offset increases at foreign-related institutions. A survey, taken in late October, of senior loan officers at large commercial banks indicated that banks have continued to tighten terms for business customers, including shortening credit lines, raising fees and spreads, and imposing more restrictive loan covenants. Close to half of the domestic banks and more than two-thirds of agencies and branches of foreign banks reported some degree of firming since the August survey. In recent years, expansion of business loans at foreign-related institutions has outpaced that of overall business loans, but this trend was broken in the third quarter when growth at foreign-related institutions abruptly halted. In part, this year's slowdown reflects a change in the behavior of U.S. offices of Japanese

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

	1987	1988	1989	1990				
	Year	Year	Year	Q1	Q2	Q3 <sup>P</sup>	Sept. <sup>P</sup>	Oct. <sup>P</sup>
Corporate securities - total <sup>1</sup>	24.09	22.39	19.83	16.99	23.55	16.01	13.74	18.25
Public offerings in U.S.	21.90	20.37	17.77	15.10	20.70	13.73	11.83	16.50
Stocks--total <sup>2</sup>	4.45	3.53	2.69	3.00	2.32	1.16	.43	1.00
Nonfinancial	2.32	1.14	1.09	1.55	1.29	.73	.21	.60
Utility	.57	.24	.29	.41	.38	.26	.04	.30
Industrial	1.75	.90	.80	1.14	.91	.47	.17	.30
Financial	2.12	2.39	1.60	1.45	1.03	.43	.22	.40
Bonds--total <sup>1</sup>	17.45	16.84	15.08	12.10	18.38	12.57	11.40	15.50
Nonfinancial	6.56	6.17	6.26	3.83	6.81	3.29	3.40	4.30
Utility	2.02	1.80	1.78	1.22	2.37	1.43	1.80	1.30
Industrial	4.54	4.37	4.48	2.61	4.44	1.86	1.60	3.00
Financial <sup>3</sup>	10.89	10.67	8.81	8.27	11.57	9.28	8.00	11.20
By quality <sup>3</sup>								
Aaa and Aa	3.28	2.73	3.30	2.68	3.78	2.58	1.77	2.80
A and Baa	5.20	5.50	5.66	4.33	8.36	4.73	4.31	4.95
Less than Baa	2.77	2.59	2.39	.17	.24	.08	.00	.15
No rating (or unknown)	.07	.04	.04	.00	.08	.00	.00	.0
Memo items:								
Equity-based bonds <sup>4</sup>	.87	.28	.52	.05	.88	.34	.26	.15
Mortgage-backed bonds	5.19	4.72	1.67	1.64	2.95	2.65	2.70	2.60
Other asset-backed	.94	1.26	2.02	3.28	2.97	2.53	2.62	5.00
Variable-rate notes	1.90	1.19	1.03	1.45	.29	.45	.55	.60
Bonds sold abroad - total	2.03	1.93	1.90	1.62	2.43	2.13	1.90	1.70
Nonfinancial	.94	.73	.48	.38	.58	.50	.90	.25
Financial	1.09	1.20	1.42	1.24	1.85	1.63	1.00	1.45
Stocks sold abroad - total	.16	.09	.16	.27	.42	.15	.01	.05
Nonfinancial	.12	.08	.12	.10	.15	.10	.01	.03
Financial	.04	.01	.04	.17	.27	.05	.00	.02

1. Securities issued in the private placement market are not included.

Total reflects gross proceeds rather than par value of original discount bonds.

2. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings. Such swaps totaled \$20.4 billion in 1989.

3. Bonds categorized according to Moody's bond ratings, or to Standard and 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.

banks, which, until recently, had been aggressively increasing their share of credit extended by foreign-related institutions.<sup>1</sup> U.S. offices of Japanese banks now account for approximately three-quarters of the total credit extended by weekly reporting foreign-related institutions and for a somewhat larger share of the business loans.

#### Nonfinancial Business Finance

Total borrowing by nonfinancial corporations remained subdued in October. Business loans at commercial banks contracted again, falling at about the same rate as in September. Gross public bond issuance was up from the third quarter's depressed level; however, most issues had short- to intermediate-term maturities, and only one firm has sold junk bonds in the public market since August. After growing rapidly in August and September when firms avoided longer-term financing, outstandings of commercial paper have been about unchanged since the end of the third quarter.<sup>2</sup>

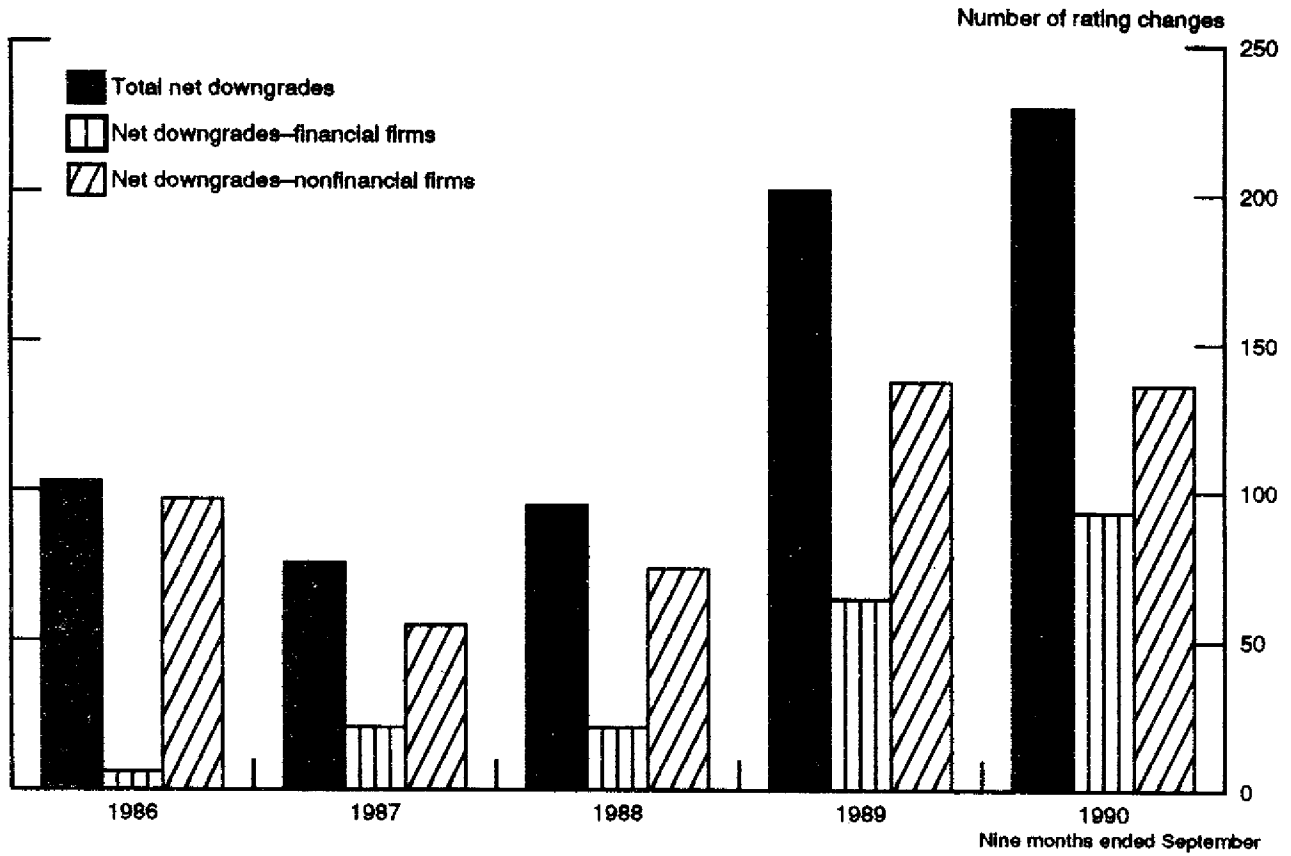
While highly rated corporations have had little difficulty in placing commercial paper, medium-grade companies encountered significant investor resistance at quarter-end, which caused rates on medium-grade paper to rise roughly 8 basis points above those on high-grade paper. Despite the passing of quarter-end window-dressing pressure, spreads have widened since the statement date, as investors continue to be wary of paper carrying less than the top rating. Within the medium-grade (A2/P2) sector, tiering has become

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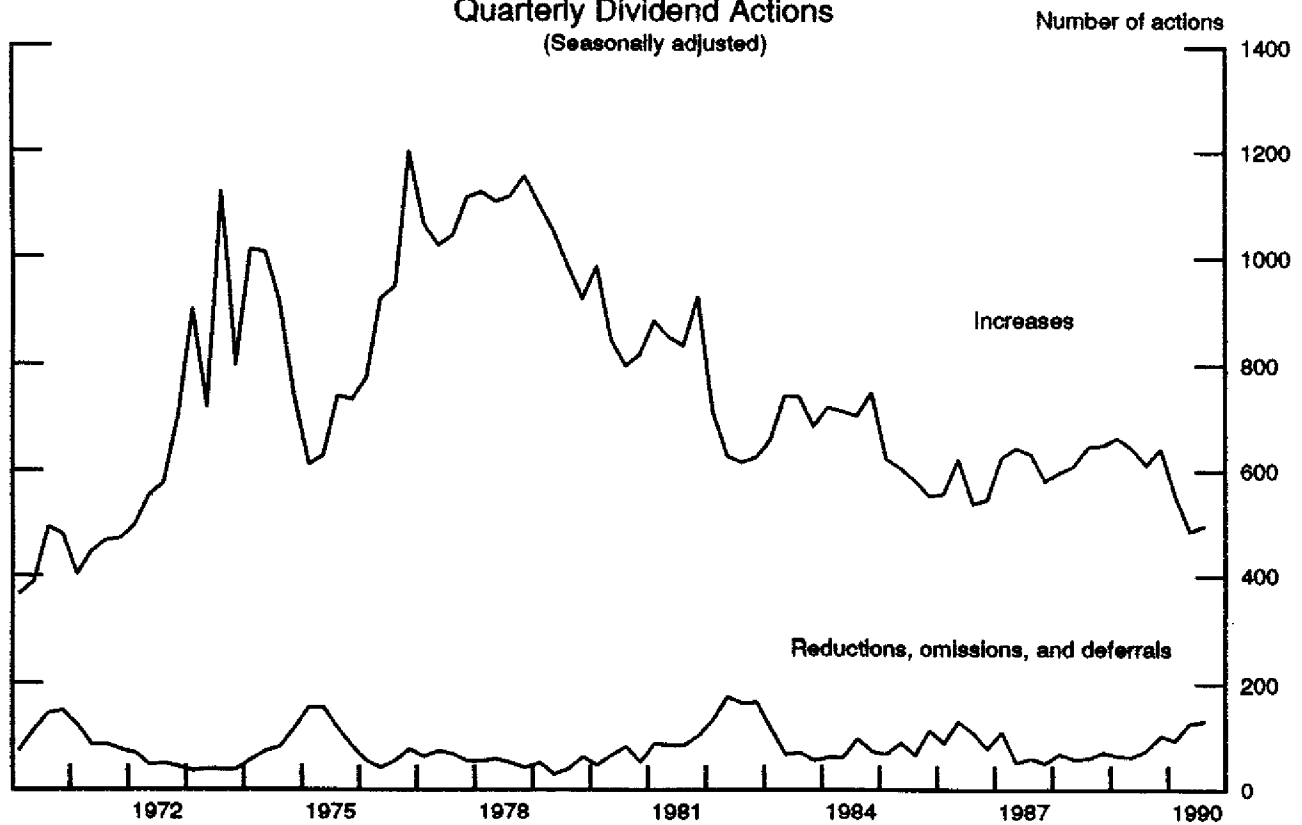
1. Under the Basle agreement, Japanese banks are allowed to count 45 percent of the unrealized capital gains on their equity holdings toward their tier 2 capital requirements. The decline in the Japanese stock market has eroded these gains considerably in recent months.

2. As shown in the table, commercial paper posted a 25 percent annualized growth rate in October, but this growth reflects the use of monthly averages of weekly data.

Moody's Rating Changes for Corporate Bonds



Quarterly Dividend Actions  
(Seasonally adjusted)



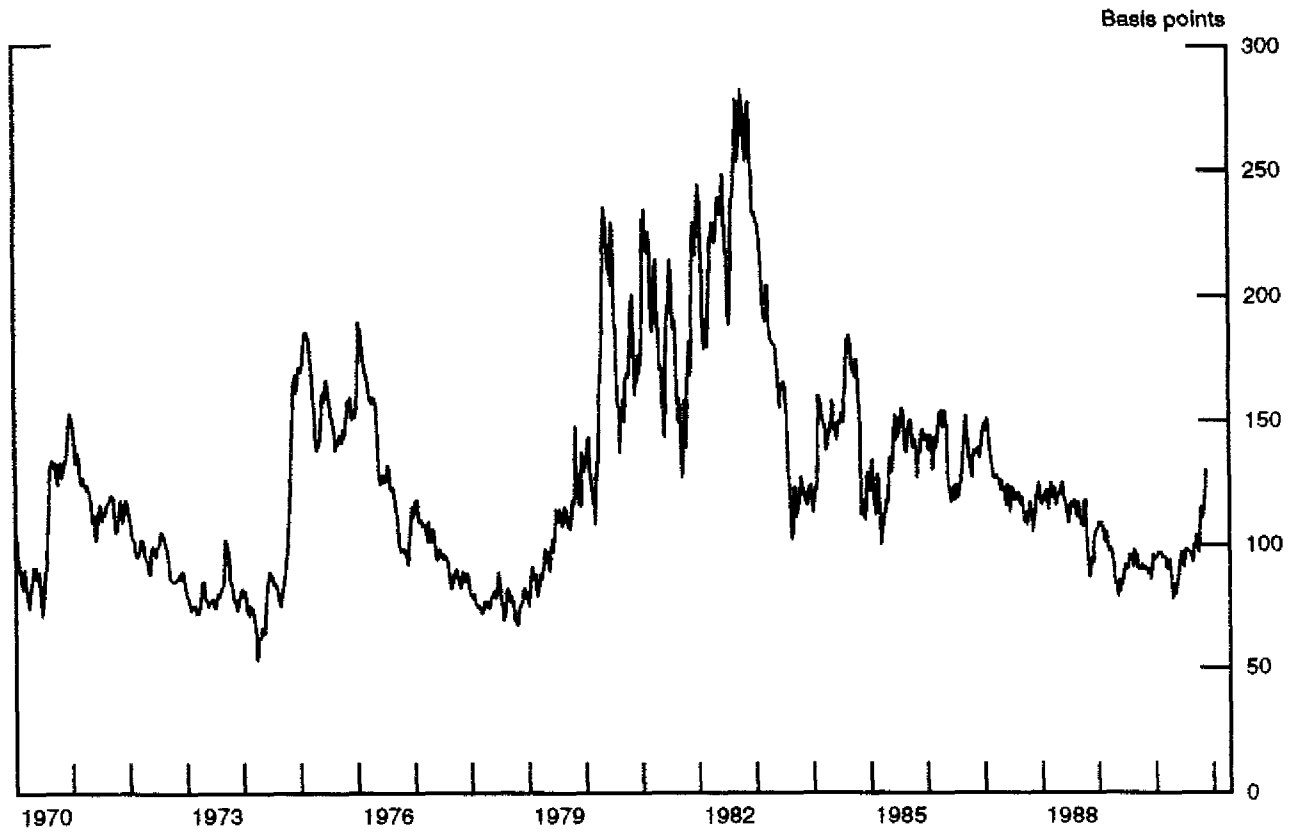


slightly more pronounced, the rate spreads between the lowest- and highest-regarded issuers having widened to 20 basis points, about 5 basis points more than in midsummer. Some medium-grade issuers have found it difficult to place paper, especially with maturities that extend beyond year-end, and have turned to bank back-up lines. Moreover, investors reportedly have become more selective in their purchases of paper backed by letters of credit issued by Japanese banks, amid concern about the strength of those institutions.

Several other indicators point to financial stress in the corporate sector. In the third quarter, the number of debt downgrades far exceeded the number of upgrades, although the difference between the two was a bit narrower than the average for the first half of the year. The difference for the first nine months of this year already had surpassed 1989's record (top panel of chart). Gross downgrades in the third quarter, as in the first half of the year, were concentrated in financial institutions and in industrial firms with ratings below investment grade. In addition, the number of corporations reducing, omitting, or deferring dividends remained high during the third quarter, while the number raising dividends continued downward (lower panel of chart). Further, Moody's Investors Service reported that corporations have defaulted on \$12.3 billion of public long-term debt through September, compared with \$11.8 billion for all of 1989.

Amid signs of corporate stress, bond yield spreads widened further in October. The yield spread between A-rated utilities and the 30-year Treasury bond moved up 12 basis points, and the spread between Baa and Aaa bonds increased about 20 basis points to 130 basis points; this was the widest spread in nearly four years (chart), though it was narrower than that

Spread Between Baa and Aaa Corporate Bonds



in the early 1980s. Furthermore, prices of junk bonds continued their long slide, and liquidity in the market deteriorated further.

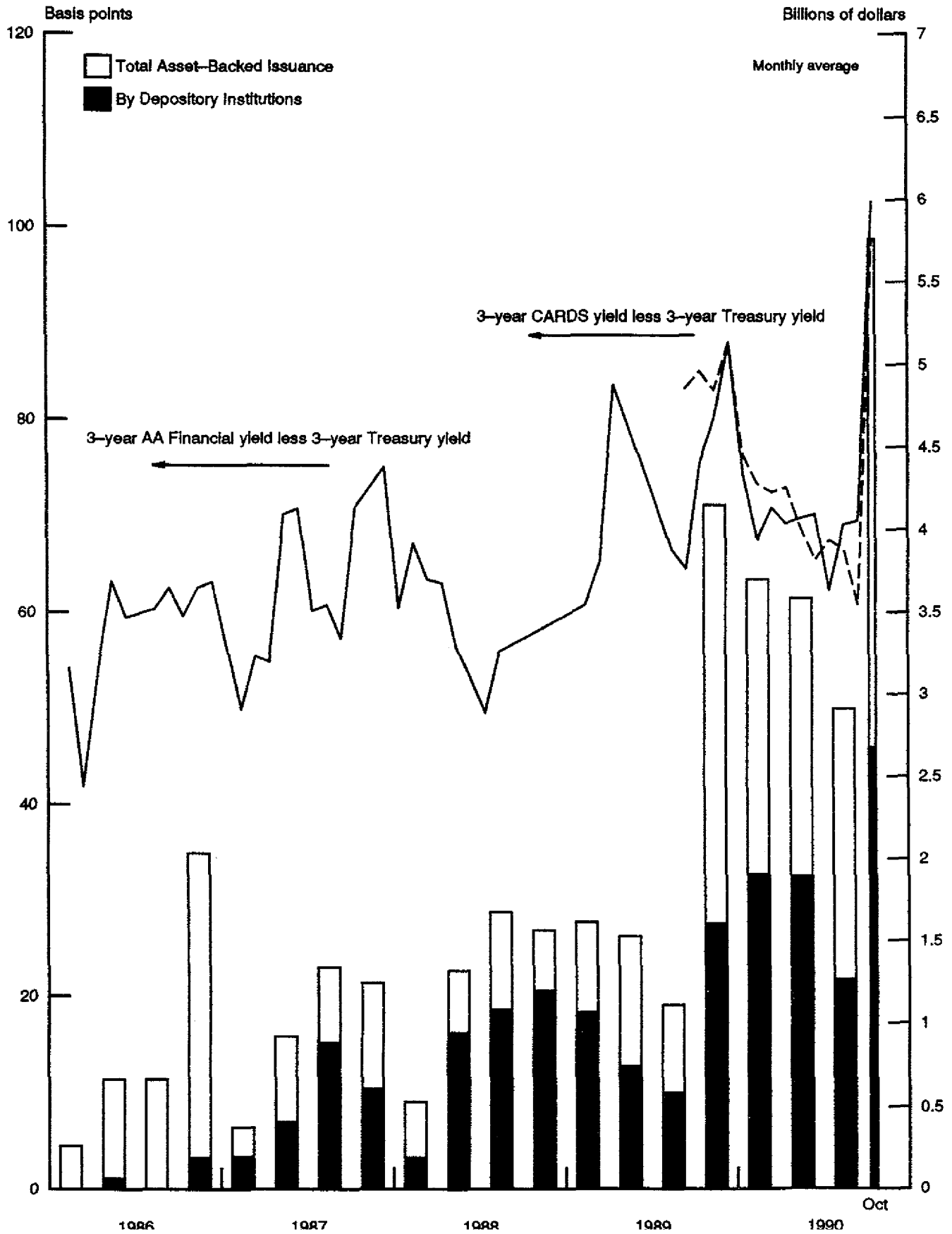
In equity markets, major price indexes declined between 1 and 6 percent over the intermeeting period, with the largest drops registered by smaller companies. Mutual fund investors appeared to become less bearish in September: transfers from equity and bond funds to money funds were sharply reduced from the heavy flows in August. Reports from fund officials indicate that transfers from mutual funds probably moderated further in October, but withdrawals from junk bond funds likely continued.

Responding to the decline in the stock market since the onset of the Persian Gulf crisis, offerings of new domestic shares have been rare recently. Offerings in October, although somewhat stronger than the \$426 million in September, fell far below the pace of earlier in the year. With a paucity of new merger announcements thus far in the fourth quarter, net equity retirements are expected to drop from the third-quarter pace. However, share repurchases may continue to produce some offset to the reduction in merger activity.

#### Financial Firms

Further signs of stress in financial institutions emerged during the intermeeting period, as investor concern about potential losses on real estate loans and HLT portfolios spread from depository institutions to other sectors of the financial system. In the banking system, third-quarter earnings for most money center and regional banks reflected large provisions for loan losses in commercial real estate portfolios and some evidence of deterioration in loans to highly leveraged corporations. In these circumstances, Chemical followed Chase Manhattan's lead in cutting its

### ASSET-BACKED VOLUME AND YIELD SPREADS



dividend, and dividend cuts by other bank holding companies are widely anticipated.

Share prices of money center and regional banks have declined about 3 percent since the October FOMC meeting, so that their cumulative slides for the year are now about 40 percent. Banks perceived to be experiencing financial difficulties have encountered investor resistance in raising funds. These difficulties are highlighted by the 650 basis point premium Citicorp was required to pay on its auction-rate preferred stock relative to two higher-rated bank holding companies, and by the continued run off of commercial paper at lower-rated companies. Further, institutional investors probably were unwilling to hold obligations of certain banking companies over the quarterly statement date, and some foreign banks and official institutions reportedly are reluctant to enter into swaps with a number of U.S. bank swap dealers.

Longer-term financing by banks remained dormant: no banks issued equity and only one sold longer-term bonds in the public market during the intermeeting period. To meet capital requirements, banks have instead turned aggressively to securitization to downsize their balance sheets (chart). As a result of the record volume of asset-backed securities issued through the first ten months of 1990 and in anticipation of heavy volume before year-end, spreads on securities backed by credit card receivables have widened about 35 basis points relative to Treasury securities and have reached unprecedented levels.

Finance companies also have come under close market scrutiny. Yield spreads on notes of finance companies increased in October, partly because these securities are close substitutes for asset-backed securities, whose

duration is also typically less than five years. The widening of spreads, particularly for A-rated issues with intermediate maturities, also reflects investor concern that a number of finance companies could be subject to the same asset-quality problems as commercial banks. For example, press reports suggesting that General Electric Capital Corporation's large commercial real estate and HLT portfolios could be vulnerable to recession was associated with a further widening of spreads. Nevertheless, available data indicate that business lending by finance companies remained strong through September. Paced by rapid growth in wholesale automobile and equipment leasing, business receivables grew at a 17 percent annual rate in September, so that the average growth rate for the year is 14 percent. With this year's rapid growth, the share of short- and intermediate-term business credit (bank and finance company loans, plus nonfinancial commercial paper and bankers acceptances) accounted for by finance companies has risen to 25 percent, up from 23-3/4 percent at year-end 1989.

Announcements by two insurance firms of sizable loan loss provisions and writedowns on mortgage lending and real estate portfolios heightened concern for the insurance industry. Over the past decade, life insurance companies, facing greater resistance to the traditional whole-life policies and stiffer competition from deregulated deposits, have bid more aggressively for funds through Guaranteed Investment Contracts and annuities. To generate revenues to cover promised returns, some companies have turned to riskier assets, particularly commercial real estate lending and junk bonds. With the spreading decline in commercial real estate values and the deterioration of the junk bond market, stock prices for full-line insurers have fallen 12 percent on average since the October meeting; the

cumulative losses for the year are now about 38 percent. Further, yield spreads on long-term bonds of insurance companies have increased by at least 60 basis points in the past two months. In addition, the proportion of securities in the portfolios of U.S. insurance companies considered below investment grade, and thus subject to higher capital reserves, could increase substantially under new rating categories outlined by the National Association of Insurance Commissioners. Some analysts have expressed concern that the reclassification will force insurers to reduce holdings of lower-rated bonds; such reductions could worsen downward pressure on junk bond prices and limit credit availability to medium-sized firms in the private placement market.

Securities firms have continued to suffer from excess capacity, the slowdown in merger activity, an overhang of bridge loans, and intense competition in investment banking. Stock prices of publicly traded firms have declined 5 percent since the October FOMC meeting and about 17 percent since the beginning of the year. Earnings at the five largest publicly traded firms declined substantially from the second quarter; trading profits partially offset a decline in revenues from domestic investment banking at one of these firms and a restructuring charge at another. In the wake of the Drexel bankruptcy and the tightening of bank credit, securities firms are seeking to extend the maturities of their funding lines and to broaden their investor bases.

Finally, losses at "nonintervened" thrift institutions widened in the second quarter, as a softening in real estate markets led to higher loan-loss provisions. According to earnings reports of publicly traded institutions, the performance of the thrift industry appears to have

TREASURY AND AGENCY FINANCING<sup>1</sup>  
(Total for period; billions of dollars)

	1990					
	Q2	Q3	Q4 <sup>P</sup>	Oct. <sup>e</sup>	Nov. <sup>P</sup>	Dec. <sup>P</sup>
<u>Treasury financing</u>						
Total surplus/deficit (-)	-12.0	-57.8	-103.0	-39.9	-44.2	-18.9
Means of financing deficit:						
Net cash borrowing from the public	41.0	69.0	85.1	33.7	40.6	10.8
Marketable borrowings/ repayments (-)	32.7	64.5	79.7	28.7	40.2	10.7
Bills	.5	29.0	41.4	18.0	25.3	-1.9
Coupons	32.2	35.6	38.3	10.7	14.9	12.6
Nonmarketable <sup>2</sup>	8.3	4.5	5.4	4.9	.4	.1
Decrease in the cash balance	-16.2	-5.5	15.2	4.8	12.9	-2.4
Memo: Cash balance at end of period	34.6	40.2	24.9	35.4	22.5	24.9
Other <sup>3</sup>	-12.8	-5.6	2.6	1.4	-9.3	10.5
<u>Federally sponsored credit agencies, net cash borrowing<sup>4</sup></u>						
	2.5	-1.9	--	--	--	--
FHLBs	-8.5	-6.7	--	--	--	--
FHLMC	4.9	-3.1	--	--	--	--
FNMA	1.1	.9	--	--	--	--
Farm Credit Banks	-.3	.9	--	--	--	--
FAC	.3	.1	--	--	--	--
SILMA	1.4	1.0	--	--	--	--
FICO	.0	.0	--	--	--	--
REFCORP	3.5	5.0	--	5.0	--	--

1. Data reported on a not seasonally adjusted, payment basis.

2. Includes proceeds from securities issued by federal agencies under special financing authorities and the face value of zero-coupon bonds issued to REFCORP (the discount from face value is offset in other means of finance).

3. Includes checks issued less checks paid, accrued items and other transactions.

4. Excludes mortgage pass-through securities issued by FNMA and FHLMC.

e--staff estimate.

p--projected.

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



deteriorated further in the third quarter, in part reflecting an increase in problem loans of California institutions. Thrift stock prices, which declined 18 percent over intermeeting period, have fallen 40 percent since the beginning of the year.

#### Treasury and Sponsored-Agency Financing

The federal deficit is projected to swell to \$103 billion in the fourth quarter, from \$58 billion in the third, despite the absence of change in projected RTC-related outlays. This increase, largely a seasonal phenomenon, is expected to be financed by a sizable decline in the cash balance and by \$80 billion of marketable borrowing, to be split about evenly between coupons and bills. The auctions of three-month, six-month, and one-year bills are expected to raise almost \$30 billion, with another \$12 billion coming from cash management bills. Thus far in the quarter, the gross sizes of the weekly bill auctions have been increased from \$18.4 billion to \$20.0 billion, while coupon issues have been increased by as much as \$1 billion.

The \$3.195 trillion temporary debt ceiling was extended four times in October before being raised to more than \$4 trillion in the deficit-reduction bill. During this period, the Treasury postponed several auctions because of uncertainty over whether room existed under the debt ceiling to settle them. Although the Treasury subsequently was able to hold the auctions, it had to scale back the gross sizes so that no new cash was raised. The uncertainty over the auction schedule does not appear to have affected Treasury borrowing costs.

Subject to congressional approval, the RTC estimates that it will utilize \$62 billion to fund resolutions during the fourth quarter of this

year and the first quarter of next year, including \$23 billion of loss funds and \$39 billion of working capital borrowed from the Federal Financing Bank. Of the loss funds, \$11 billion would come from Treasury appropriations and \$12 billion from the sale of REFCORP bonds. Although the Congress adjourned without providing additional funding, the RTC has announced that it will exploit a drafting error in FIRREA that will allow it to raise as much as \$18.8 billion of additional funds and thus continue operations into early 1991.<sup>3</sup>

In the market for GSE debt, spreads have remained narrow as overall issuance has continued light, in large part because of the Federal Home Loan Bank System's ongoing paydown. REFCORP issued \$5 billion of thirty-year bonds in October, priced at a spread of 29-1/2 basis points above the Treasury yield curve, down from the 38 basis points for the previous issue in July. This latest sale brings REFCORP's outstanding debt to \$23 billion, and leaves it with \$7 billion in remaining borrowing authority.

#### Municipal Securities

Gross issuance of long-term municipal securities slowed substantially from September's \$15 billion pace to an estimated \$9 billion in October. The bulge in September largely reflected a surge in mortgage revenue bonds that was prompted by the expected expiration of their tax-exempt status. The September 30, 1990, expiration date subsequently was extended in the final budget bill to December 31, 1991. Yields have fallen recently from the 1990 highs reached in early October, though apparently not enough to

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3. FIRREA places limits on the negative net worth of the RTC. In the past, the RTC included the original \$18.8 billion Treasury contribution from 1989 when computing its net worth--reflecting the spirit but not the letter of the law. Omitting the Treasury contribution from the net worth calculation eases the net worth constraint.

prevent refunding volume from slowing further in October. The budget agreement, with its limit on deductions and its higher marginal tax rates for the top bracket, may enhance the attractiveness of municipal bonds to individuals and lower tax-exempt yields relative to those on long-term Treasuries.

Deterioration of municipal credit ratings continued in the third quarter, although at a slower rate than earlier in the year. Based upon Standard & Poor's ratings, 56 large issuers of municipal bonds were downgraded, while 39 were upgraded in the third quarter; for Northeastern states and municipalities, downgrades outnumbered upgrades 8 to 1 (table). In dollar terms, \$3.6 billion of municipal debt was downgraded in the third quarter, while only \$1.2 billion was upgraded.

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

	1988	1989	1990				
	Year	Year	Q1	Q2	Q3	Sept.	Oct. <sup>P</sup>
Total offerings <sup>1</sup>	11.73	11.90	8.85	15.53	14.88	14.96	9.10
Total tax-exempt	11.41	11.65	8.73	15.30	14.61	14.76	8.80
Long-term	9.54	9.47	7.63	11.41	10.85	13.80	8.00
Refundings <sup>2</sup>	2.90	2.47	1.45	1.58	.93	.86	.30
New capital	6.64	7.01	6.19	9.73	9.92	12.94	7.70
Short-term	1.87	2.17	1.10	3.88	3.76	.97	.80
Total taxable	.32	.25	.12	.23	.26	.20	.30

p--preliminary.

1. Includes issues for public and private purposes; also includes taxable issues.

2. Includes all refunding bonds, not just advance refundings.

Despite Mayor Goode's directive to escrow all funds necessary to service debt in fiscal year 1991, Philadelphia has announced that it can guarantee payment of its obligations only through February. The city, which

Long-Term Municipal Debt Rating Actions: 1984-1990:Q3  
 Number of Rating Revisions by Region

	1984	1985	1986	1987	1988	1989	1990-H1	1990-Q3
<b>West</b>								
Up	20	12	86	31	13	28	29	13
Down	8	14	74	41	22	30	26	9
<b>Southwest</b>								
Up	4	22	19	19	10	16	5	1
Down	8	8	55	76	41	8	24	8
<b>Northwest</b>								
Up	0	0	8	11	1	1	1	11
Down	4	6	9	11	2	6	9	9
<b>Midwest</b>								
Up	8	20	189	20	26	50	8	1
Down	45	19	62	30	43	22	20	3
<b>Southeast</b>								
Up	15	22	30	27	27	45	17	10
Down	8	39	67	73	46	13	48	3
<b>Northeast</b>								
Up	16	27	31	47	37	25	14	3
Down	15	19	27	37	31	64	92	24
<b>Total</b>								
Up	63	103	363	155	114	165	74	39
Down	88	105	294	268	185	143	219	56

Source: Standard and Poor's Credit Week.

has a junk-bond credit rating, is \$65 million short of the Mayor's goal and, without outside assistance, may face insolvency on December 1.

The A- rating of New York City's \$13 billion of general-obligation debt has been placed on credit watch by Standard & Poor's. Faced with escalating city expenses and net private sector job losses well beyond earlier forecasts, the city may see its deficit approach \$500 million for the current fiscal year and \$2 billion for the following year. Recognizing the decline of its economic base, the city recently released a report suggesting that between 20,000 and 50,000 city employees may have to be cut through attrition and layoffs. Detroit also is encountering greater investor scrutiny, in part because of its BBB credit rating, but also because of the potential loss of state revenues resulting from population declines. This concern was manifested in late October when the city issued twenty-year bonds at a yield of 8-7/8 percent.

Deteriorating credit quality in the municipal sector has raised concerns about the capital adequacy of companies that insure the principal and interest payments of municipal debt. Approximately 30 percent of the total available capital supporting the \$400 billion gross exposure of these insurers is estimated to be in the form of reinsurance and letters of credit, which collectively are called soft capital. Questions recently have been raised about the extent to which soft capital can actually absorb losses. In particular, extensive common ownership ties exist among the various insurers and their reinsurers. Furthermore, bank letters of credit often contain provisions that allow the banks to terminate the support agreement. These factors may cause problems if insurers need to obtain additional capital from their parents or need to draw on their letters of

credit. In 1990, more than 70 percent of municipal debt has received credit support from a municipal guarantor or a letter of credit.<sup>4</sup>

#### Mortgage Markets

Net mortgage lending appears to have picked up little in the third quarter from the sharply lower second-quarter pace; this weakness reflects continued weak demand for financing in housing and commercial real estate markets as well as more stringent credit standards and regulatory constraints at lenders. As SAIF-insured thrift institutions apparently continued to divest mortgage assets, growth in real estate loans at commercial banks slowed to a 6-1/2 percent annual rate in the third quarter, but picked up a bit in October.

Issuance of federally related pass-through securities remained strong through the third quarter with a seasonally adjusted monthly average volume of \$17.2 billion (table). Over the same period, the steepening yield curve prompted record CMO issuance, providing a strong bid for pass-through collateral. Since the October FOMC meeting, CMO demand has dropped relative to pass-through supply, contributing to some widening in spreads of pass-throughs relative to Treasuries. Spreads between primary mortgage rates and comparable Treasury security yields have widened about 10 basis points over the intermeeting period, but they remain fairly narrow by historical standards.

In the ARM sector, commitment rates on loans indexed to the one-year Treasury bill have fallen about 10 basis points on average, compared with a

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4. Moody's has placed Sumitomo Bank, Ltd. under review for possible downgrade from its present Aaa rating. If the downgrade were to go through, it would affect \$5.3 billion of long-term municipal debt currently backed by the bank's letters of credit.

decline of 13 basis points in the index itself. As a result of this decline, the initial rate spread now favors ARMs by about 2 percentage points, close to the spread at which the ARM share of new mortgage originations historically has begun to rise. In recent months, ARMs have accounted for less than one-third of new conventional mortgage loans, well below the peak share of 70 percent reached in December 1987.

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

	Federally related pass-through securities			Multiclass securities				
	Total (SA)	Total (NSA)	ARM- backed	Total	Private issues	FNMA REMICs	FHLMC REMICs	Agency strips
1988	12.4	12.5	2.4	6.9	4.2	.9	1.2	.6
1989	16.8	16.7	2.6	8.1	1.4	3.1	3.2	.3
1989-Q1	15.9	13.6	3.1	6.6	2.5	1.2	2.5	.4
Q2	13.5	14.1	2.8	5.2	.6	2.4	2.1	.1
Q3	15.9	17.6	2.5	9.8	1.2	3.6	4.4	.5
Q4	21.6	21.6	2.2	10.7	1.2	5.2	4.0	.4
1990-Q1	23.3	19.9	1.4	11.3	1.6	5.0	3.8	.9
Q2	17.9	18.6	2.2	11.1	2.9	4.7	3.0	.4
Q3 p	17.2	19.0	1.6	11.7	2.3	6.6	2.3	.6
1990-Apr.	18.3	18.1	1.9	9.1	2.4	4.5	2.2	.0
May	18.4	18.1	2.5	12.6	4.6	5.0	3.0	.0
June r	17.0	19.6	2.2	11.5	1.8	4.7	3.8	1.3
July r	14.7	16.7	0.5	10.9	1.4	6.7	2.8	.0
Aug. r	19.2	20.6	1.6	11.9	3.7	4.4	2.4	1.4
Sep. p	17.6	19.6	2.8	12.4	1.9	8.6	1.6	.3
Oct. p	n.a.	n.a.	n.a.	n.a.	2.3	5.6	n.a.	n.a.

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

Federally supported multifamily mortgage programs continue to experience difficulties. FHLMC, which had tightened requirements for its multifamily mortgage programs in January, recently announced that it was

CONSUMER CREDIT  
(Seasonally adjusted)

	Percent change (at annual rate)						Net change (billions of dollars)		Memo: Outstandings (billions of dollars)
	1988	1989 <sup>1</sup>	1990		1990		1990		1990 Sept. <sup>P</sup>
			Q2	Q3 <sup>P</sup>	Aug. <sup>r</sup>	Sept. <sup>P</sup>	Aug. <sup>r</sup>	Sept. <sup>P</sup>	
Total installment	8.9	5.5	2.3	6.0	5.0	4.9	3.06	3.00	735.4
Installment, excluding auto	10.3	8.6	7.4	11.4	12.4	7.6	4.57	2.84	449.9
Selected types									
Auto	7.0	1.3	-5.2	-2.4	-6.1	.7	-1.51	.16	285.4
Revolving	13.7	14.2	12.1	15.4	13.3	10.7	2.36	1.90	216.4
All other	7.6	4.2	3.2	7.8	11.5	4.8	2.21	.93	233.5
Memorandum:									
Total <sup>2</sup>	7.3	5.0	1.5	3.3	3.8	2.0	2.49	1.33	792.0

1. Growth rates are adjusted for discontinuity in data between December 1988 and January 1989.

2. Installment plus noninstallment.

r--revised. p--preliminary.

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

CONSUMER INTEREST RATES  
(Annual percentage rate)

	1987	1988	1989	1990				
				May	June	July	Aug.	Sept.
At commercial banks <sup>1</sup>								
New cars (48 mo.)	10.46	10.86	12.07	11.82	...	...	11.80	...
Personal (24 mo.)	14.23	14.68	15.44	15.41	...	...	15.46	...
Credit cards	17.92	17.79	18.02	18.14	...	...	18.18	...
At auto finance cos. <sup>2</sup>								
New cars	10.73	12.60	12.62	12.23	12.58	12.68	12.62	12.34
Used cars	14.61	15.11	16.18	16.03	16.00	15.96	15.98	16.03

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.



suspending indefinitely its new program for buying mortgages on apartment buildings; it cited its dissatisfaction with the level of delinquencies and losses on the existing multifamily portfolio. FHLMC reports that approximately \$400 million of its \$11 billion multifamily portfolio was at least 60 days delinquent or in foreclosure as of August 31, 1990. The largest concentration of multifamily exposure was reported to be in New York City and Atlanta. FHLMC officials report that multifamily mortgages accounted for 3.4 percent of the corporation's \$322 billion holdings of residential mortgage loans as of September 30, 1990. Losses to be charged to reserves for the third quarter for all residential loans totaled \$124 million, \$81 million of which were from the multifamily portfolio.

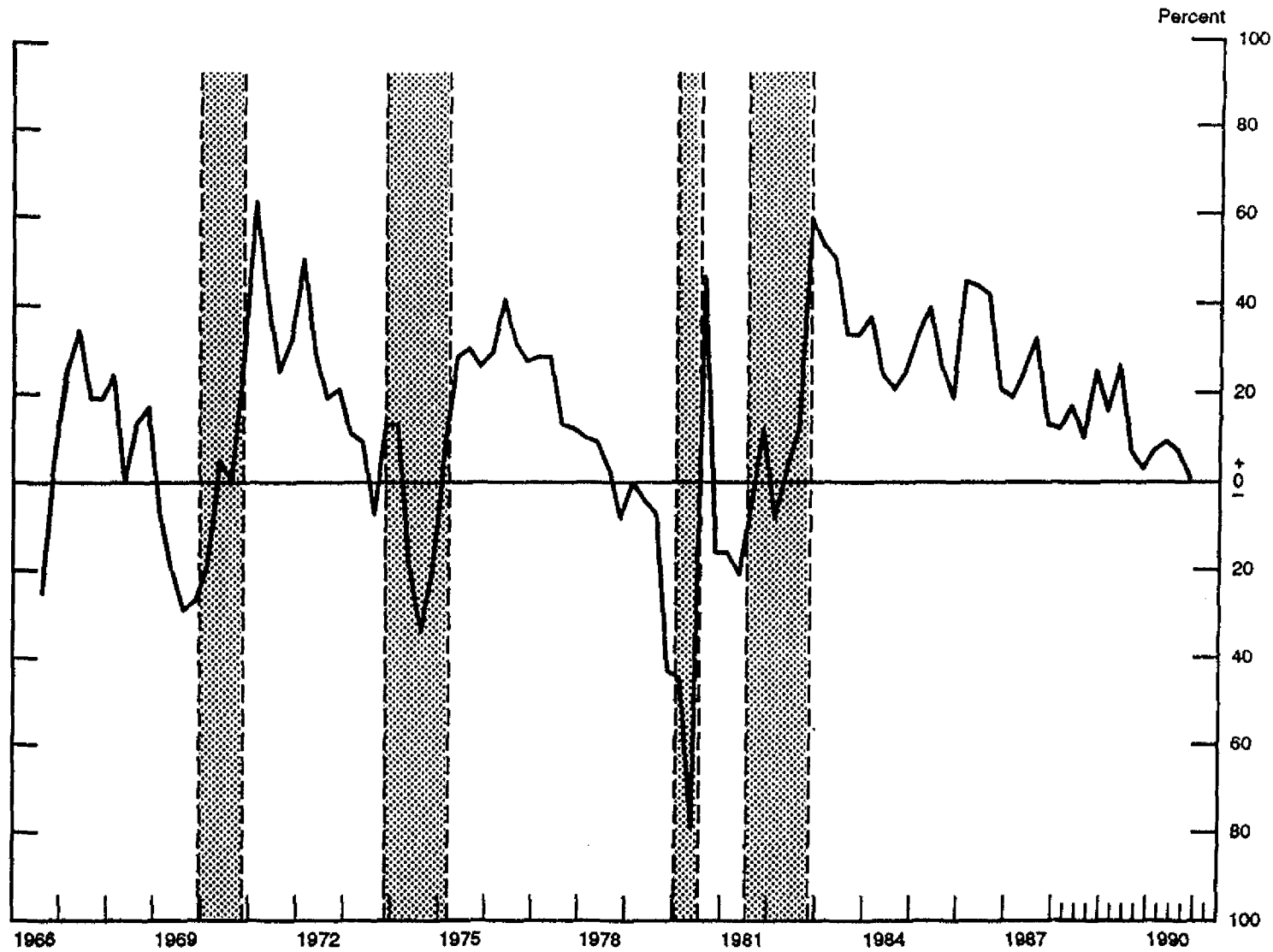
Separately, FNMA also announced that it was tightening requirements for its multifamily mortgage program. The new standards raise the reserves that apartment projects must carry and lower the maximum acceptable loan-to-value ratio.

#### Consumer Installment Credit

Growth in consumer installment credit picked up in the third quarter to a seasonally adjusted annual rate of 6 percent from just over 2 percent in the first half of the year. The auto credit component contracted for the quarter and is down slightly for the year as a whole. Revolving credit, on the other hand, continued a long-standing pattern of double-digit increases, accelerating to a 15 percent annual rate in the third quarter. Growth in the large "all other" component also quickened, continuing a rebound from the contraction in the first quarter.

The robust expansion of revolving debt has persisted despite sluggishness in nonauto consumer spending. Conceivably, rather than

RELATIVE WILLINGNESS OF BANKS TO MAKE CONSUMER LOANS 1/



III-28

Source: Senior Loan Officer Opinion Survey.

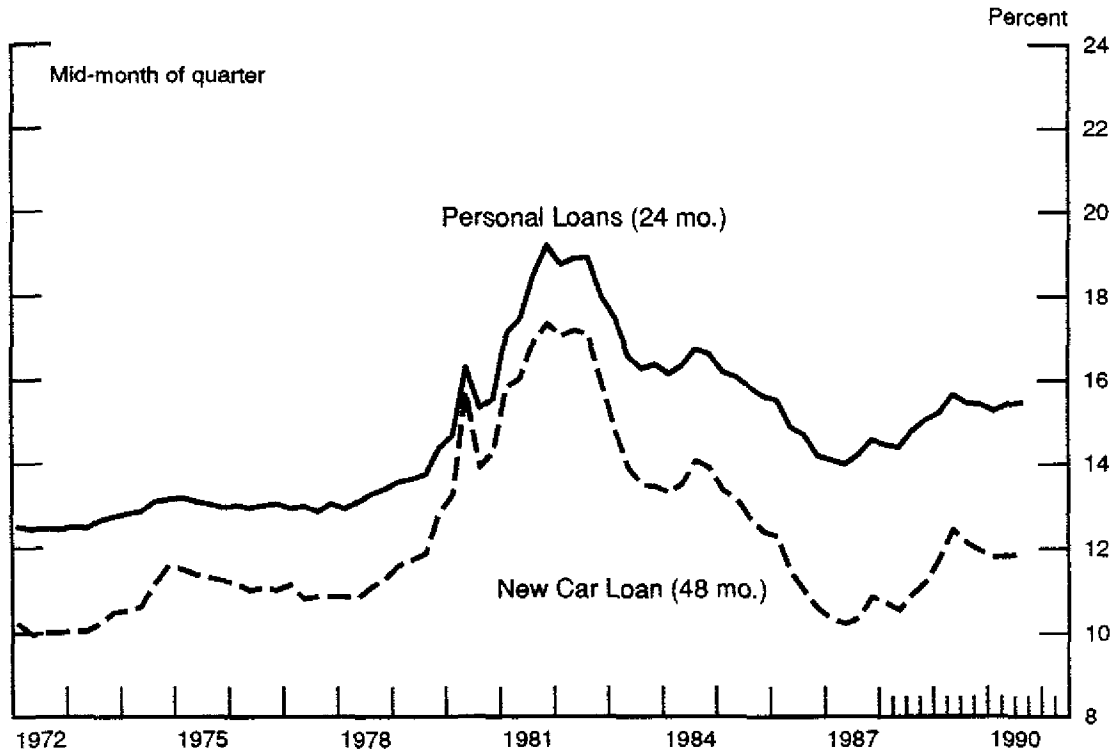
1. Weighted responses of banks more willing to make consumer loans minus responses of banks that are less willing.

indicating vigor in new borrowing, such a pattern could reflect a slowdown in repayments on credit-card and other flexible-payment accounts. However, recent discussions with contacts at banks and retailers provide only limited support for this notion. Some of the bankers have seen a decline in repayment rates but emphasized that changes have been quite small. One retailer has also observed lower repayments this year, but most contacts had not detected any material change in account activity until very recently, when consumers began making significantly larger repayments. The retailers attribute this debt-reduction effort to greater caution on the part of consumers, and they say it is fairly typical behavior for a period of economic uncertainty. If such an acceleration in repayments is widespread, revolving credit may have begun to slow substantially in October.

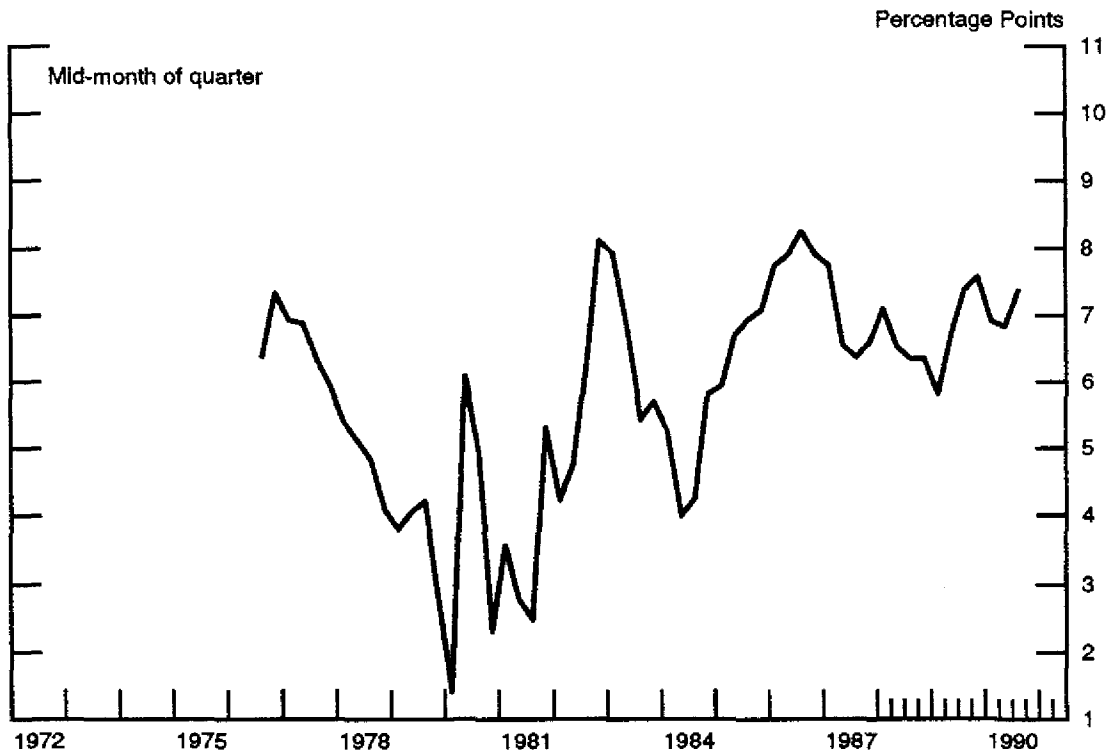
Press reports of tightening loan standards for consumer credit have been cropping up more frequently in recent weeks. Although it is probably true that many lenders have become more cautious as economic activity has slackened, the effective degree of tightening has apparently been quite limited. Revolving credit, as noted, continues to expand fairly sharply. In the short run, the existence of sizable unused portions of credit lines, along with flexible repayment terms, renders revolving credit more responsive to the initiative of borrowers than of creditors. Moreover, developments such as the introduction of the AT&T-sponsored credit card and continued aggressiveness of bank issuers probably are offsetting any pullback by other issuers.

Reports of tightening have focused on auto credit, but, in this submarket as well, any reduction in supply by some lenders is likely to be neutralized by others, in particular the finance subsidiaries of the major

**CONSUMER LOAN INTEREST RATES AT BANKS**



**SPREAD BETWEEN CONSUMER RATES AND TREASURY YIELD \***



Spread is calculated at the rate on 24-month personal loans at banks less the yield on 2-year Treasury securities.

auto manufacturers. A primary function of these "captives" is to support the sales efforts of their parent companies by serving as a "lender of last resort" when banks or other institutions retreat from the market.<sup>5</sup>

Personal cash loans, frequently unsecured, would seem to be vulnerable to tightening, but the "all other" category, of which personal loans are a major component, has shown some resurgence lately.

Overall, there is little significant evidence in the flow data of tightening, and survey data do not convey a notable firming of lending standards although the most recent surveys suggest a slight reduction in banks' enthusiasm for making consumer loans. In the October Senior Loan Officer Opinion Survey, the large majority described their banks' willingness to make consumer loans as virtually unchanged from three months earlier, whereas in previous surveys a number of respondents had indicated a greater willingness to make such loans (chart). In addition, consumer interest rates have shown little tendency to rise this year, either absolutely or relative to Treasury securities of comparable maturity, as they might be expected to do if lending practices had tightened significantly (chart).<sup>6</sup>

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5. During the 1980-81 period, for instance, when market interest rates were exceptionally high but most auto loan rates were capped under tight state usury ceilings, banks shifted resources sharply away from auto loans. Auto loans outstanding at banks declined \$9.3 billion during the period, while car loans at finance companies (dominated by the captives) rose \$16.5 billion. The finance company share of total auto lending rose from just under 20 percent at the end of 1979 to 33 percent at the end of 1981.

6. Consumer interest rates are collected from banks at 3-month intervals. The next observations will be for the week beginning November 4.

# **INTERNATIONAL DEVELOPMENTS**

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INTERNATIONAL DEVELOPMENTS

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U.S. Merchandise Trade

Preliminary data for August indicate that the deficit in U.S. merchandise trade was little changed at \$9.3 billion (seasonally adjusted, Census basis) from a revised deficit in July of \$9.1 billion. The small widening of the deficit in August reflected a sharp increase in the value of oil imports that was largely offset by gains in exports.

The value of oil imports in August was 21 percent higher than in July. The quantity imported declined 10 percent from the strong levels of the preceding three months, but the price of imported oil rose \$5 per barrel or more than 30 percent between July and August.

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

	Exports			Imports			Balance
	Total	Ag.	Nonag.	Total	Oil	Non-oil	
1990-Jan	31.4	3.6	27.8	41.6	5.9	35.7	-10.2
Feb	31.6	3.4	28.2	38.7	4.7	34.0	-7.1
Mar	33.3	3.7	29.6	41.6	4.7	36.9	-8.4
Apr	32.1	3.3	28.8	39.4	3.8	35.6	-7.3
May	32.8	3.3	29.5	40.5	4.3	36.2	-7.8
Jun	34.2	3.6	30.6	39.6	3.7	35.9	-5.3
Jul <sup>r</sup>	32.1	3.1	29.0	41.2	4.0	37.2	-9.1
Aug <sup>p</sup>	32.6	3.4	29.2	42.0	4.8	37.2	-9.3

r--revised

p--preliminary

Source: U.S. Department of Commerce, Bureau of the Census.

For July and August combined, on an estimated balance of payments basis, the merchandise trade deficit widened from its second-quarter rate, as sluggish exports were coupled with growing imports (see table on the next page). Rapid growth in the value of exports in the first quarter of the year has not been sustained. Declines in exports of capital goods and

automotive products in July-August were partly offset by increases in industrial supplies and consumer goods. The decline in capital goods was largely the result of a drop in the volatile category of aircraft exports.

U.S. Merchandise Trade  
Billions of dollars, SAAR, BOP-basis

	Exports			Imports			Trade
	Total	Agric	Nonagric	Total	Oil	Non-oil	Balance
1987	250	30	221	410	42	367	-160
1988	320	38	282	447	40	407	-127
1989	360	41	319	475	51	424	-115
1989-1	353	43	310	465	44	422	-112
2	364	43	322	477	54	423	-113
3	357	40	318	477	53	424	-119
4	367	41	326	482	53	429	-115
1990-1	385	44	341	490	62	428	-105
2	387	41	346	477	48	429	-90
Jul-Aug <sup>e</sup>	386	40	346	503	54	449	-117
Percent Change (not AR)							
Jul-Aug/Q2	-0.3	-2.4	0.0	5.5	12.5	4.7	
Jul-Aug/Q3-89	8.1	0.0	8.8	5.5	1.9	5.9	

e--estimated

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

The increase in the value of imports in July-August was not limited to oil, as the value of non-oil imports in July-August was higher than the average of recent quarters. Part of the increase in value, especially in August, was from an increase in prices that was associated, in part, with the recent decline in the foreign exchange value of the dollar. The increase in the quantity of non-oil imports in July-August was in line with the increase in domestic demand in the third quarter; the rise was especially noticeable for imports of automotive products, consumer goods, and capital goods. The quantity of automotive imports rose in August from



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

	Year	1989		1990		Jul-Aug <sup>e</sup>
	1989	Q3	Q4	Q1	Q2	
Agricultural Exports	41.5	39.7	40.9	43.8	41.4	40
Nonagricultural Exports	319.0	317.7	326.1	341.2	345.6	346
Industrial Supplies	90.6	90.5	89.0	94.2	93.0	95
Gold	2.5	2.6	2.1	2.6	3.7	4
Fuels	12.1	11.0	12.2	12.8	11.2	13
Other Ind. Supp.	76.0	76.9	74.7	78.8	78.1	78
Capital Goods	138.0	141.1	140.8	152.9	154.2	152
Aircraft & Parts	26.5	29.7	25.6	32.3	34.4	32
Computers & Parts	24.2	24.6	24.7	26.4	24.9	26
Other Machinery	87.3	86.8	90.5	94.2	94.9	94
Automotive Products	34.7	33.0	35.6	34.7	38.5	38
Canada	22.5	21.5	22.8	20.8	23.5	23
Other	12.2	11.5	12.9	13.9	15.1	15
Consumer Goods	35.4	35.0	38.0	40.7	42.0	44
Other Nonagric.	20.3	18.1	22.7	18.7	17.9	17
Oil Imports	50.9	52.7	53.3	62.4	48.4	54
Non-Oil Imports	424.4	423.9	428.6	427.8	428.9	448
Industrial Supplies	84.1	82.5	83.2	80.4	82.2	86
Gold	3.6	3.4	4.3	1.7	2.1	3
Other Fuels	3.2	3.1	3.7	3.1	3.1	3
Other Ind. Supp.	77.3	76.0	75.2	75.6	77.0	80
Capital Goods	113.1	113.1	116.5	115.7	115.6	119
Aircraft & Parts	9.5	9.2	9.0	9.2	10.6	10
Computers & Parts	21.5	22.5	23.4	23.1	22.8	23
Other Machinery	82.1	81.4	84.1	83.4	82.2	86
Automotive Products	86.0	85.4	83.0	83.9	84.9	92
Canada	22.5	29.1	29.6	27.6	30.7	35
Other	56.5	56.3	53.4	56.3	54.1	57
Consumer Goods	102.8	104.9	106.4	103.4	102.9	109
Foods	25.1	24.7	25.0	27.8	26.7	25
Other Non-oil	13.4	13.3	14.5	16.6	16.6	16

e--estimated

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

already strong July levels (largely from Japan) and may reflect anticipation of a new model year; such seasonal movements in Japanese shipments in the past were muted by binding export quotas. Japanese shipments of passenger cars to the United States were 14 percent less in the April-August period (the first five months of the voluntary export agreement year) than last year.

The price of imported oil increased by almost \$5 per barrel in August, responding to the sharp increase in posted and spot prices as in previous oil market disruptions. Allowing for shipping lags, posted and spot prices suggest that the price of imported oil should approach \$27 in September and \$32 in October.

The quantity of oil imported fell in August despite an increase in oil consumption that was explained by "end-use" or secondary and tertiary stockbuilding that is recorded as consumption. All else equal, a decline in imports and an increase in consumption would imply a relatively large drawdown in primary stocks. In contrast, weekly Department of Energy (DOE) data for August indicates an increase in the quantity of oil imported and a small decline in primary stocks. It is often the case that the weekly DOE data on imports are revised in the direction of the trade data, suggesting, again all else equal, that the small DOE decline in primary stocks may become a larger decline upon revision.

OIL IMPORTS  
(BOP basis, value at annual rates)

	1989		1990		Months			
	Q3	Q4	Q1	Q2	May	Jun	Jul	Aug
Value (Bil. \$)	52.69	53.29	62.37	48.39	52.32	45.90	49.31	59.10
Price (\$/BBL)	16.75	17.67	19.47	15.81	15.76	14.92	14.76	19.69
Quantity (mb/d)	8.55	8.20	8.90	8.41	8.93	8.54	8.98	8.07

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

	Year		Quarters			Months	
	1990-Q3	1989-Q3	1990			1990	
			Q1	Q2	Q3	Aug	Sep
	(annual rates)					(monthly rates)	
----- BLS Prices -----							
<u>Imports, Total</u>	7.0	3.7	-6.8	28.9		3.0	3.6
Foods, Feeds, Bev.	6.7	11.5	2.2	6.2		0.8	0.9
Industrial Supplies	16.7	-0.4	-20.1	114.6		9.4	11.2
Ind Supp Ex Oil*	-0.4	-2.2	-3.5	6.6		0.0	1.9
Capital Goods	4.5	9.1	-0.9	7.4		0.7	1.0
Automotive Products	1.0	-0.3	-5.1	4.1		0.8	0.1
Consumer Goods	3.7	6.9	0.9	3.0		0.3	0.6
Memo:							
Oil	54.3	3.3	-47.2	664.9		31.0	28.1
Non-oil	2.5	3.8	-1.8	5.4		0.5	0.9
<u>Exports, Total</u>	1.7	1.8	1.4	3.6		0.1	0.6
Foods, Feeds, Bev.	-5.3	-3.3	5.7	-14.9		-4.3	-0.2
Industrial Supplies	2.3	0.0	-2.0	14.6		1.5	2.1
Capital Goods	2.8	4.1	2.6	2.2		0.3	-0.1
Automotive Products	2.7	1.8	1.8	2.2		0.0	0.4
Consumer Goods	3.1	6.3	2.0	2.0		0.0	0.3
Memo:							
Agricultural	-3.8	-1.1	7.1	-14.9		-4.1	-0.1
Nonagricultural	2.6	2.1	0.4	7.6		0.8	0.9
----- Prices in the GNP Accounts -----							
<u>Fixed-Weight</u>							
Imports, Total	4.0	10.1	-12.3	17.6	--	--	--
Oil	19.8	48.2	-56.7	165.8	--	--	--
Non-oil	1.7	4.9	-2.3	3.6	--	--	--
Exports, Total	1.2	3.8	1.5	1.9	--	--	--
Ag.	-4.0	2.7	10.7	-12.0	--	--	--
Nonag.	2.3	4.1	-0.2	4.9	--	--	--
<u>Deflators</u>							
Imports, Total	2.3	5.4	-8.7	13.5	--	--	--
Oil	19.8	48.2	-56.6	164.7	--	--	--
Non-oil	-0.2	2.8	-1.1	1.2	--	--	--
Exports, Total	-0.2	-0.6	4.7	-2.2	--	--	--
Ag.	-4.0	2.7	10.7	-12.0	--	--	--
Nonag.	0.2	-1.2	4.4	-1.1	--	--	--

\*Not for publication.

Prices of Imports and Exports

Prices of U.S. imports rose very sharply during the third quarter following a decline in the second quarter, according to data released by BLS. This was the largest quarterly increase in the BLS index since its inception in 1982. The jump in total import prices was attributable primarily to the rise in oil prices. However, prices of non-oil imports rose 5.4 percent (annual rate) over the third quarter, the largest quarterly increase in two years. While the rise was spread among all major trade categories, the strongest increases in prices of non-oil imports were for capital goods and industrial supplies; the depreciation of the dollar contributed to the upward movement of import prices.

Prices of exports increased 3.6 percent (annual rate) in the third quarter. Declines in prices of agricultural exports were offset by increases in prices of other exports (especially petroleum-based chemicals and fuels).

U.S. International Financial Transactions

In August, as in July, recorded net capital inflows were significantly larger than estimates of the current account deficit for these months. (See the Summary of U.S. International Transactions table.) If this trend is not reversed by September data, a significant negative statistical discrepancy will be recorded for the third quarter, partially offsetting the positive discrepancy of \$48 billion recorded for the first half of 1990. The negative statistical discrepancy in July and August occurred while the exchange value of the dollar was declining by about 5 percent on a weighted-average basis.

Large net capital inflows were registered by banks and foreign official holders in August (lines 1 and 4 of the Summary of U.S. International Transactions Table); these flows more than offset the moderate

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

	1988	1989	1989		1990		1990		
	Year	Year	Q3	Q4	Q1	Q2	June	July	Aug.
<b>Private Capital</b>									
Banks									
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	22.2	27.5	15.1	10.6	17.0	-1.3	-10.3	9.5	10.4
Securities									
2. Private securities transactions, net <sup>1</sup>	17.8	16.1	0.7	6.2	-7.5	-8.6	-1.0	3.3	-1.8
a) foreign net purchases (+) of U.S. corporate bonds <sup>2</sup>	26.8	32.8	5.6	12.5	5.1	6.6	4.1	3.4	-0.5
b) foreign net purchases (+) of U.S. corporate stocks	0.4	7.6	5.3	-1.3	-3.2	-3.5	-0.4	1.4	-1.4
c) U.S. net purchases (-) of foreign securities	-9.4	-24.3	-10.2	-5.0	-9.5	-11.8	-4.8	-1.4	*
3. Foreign net purchases (+) of U.S. Treasury obligations	20.6	30.4	12.7	5.2	-0.9	3.7	3.5	5.8	-0.6
<b>Official Capital</b>									
4. Changes in foreign official reserves assets in U.S. (+ = increase)	40.2	8.3	13.4	-7.6	-7.4	4.5	1.1	2.8	7.9
a) By area									
G-10 countries	15.5	-5.2	6.1	-2.2	-6.2	-1.1	1.0	-0.1	5.3
OPEC	-3.4	10.1	4.6	-1.5	3.1	*	0.1	-3.0	1.1
All other countries	28.1	3.4	2.8	-3.9	-4.3	5.6	-0.1	5.9	1.6
b) By type									
U.S. Treasury securities <sup>3</sup>	41.7	0.1	12.8	-7.5	-5.8	2.4	0.4	1.6	6.9
Other	-1.6	8.2	0.6	-0.1	-1.6	2.0	0.7	1.1	1.0
5. Changes in U.S. official reserve assets (+ = decrease)	-3.9	-25.3	-6.0	-3.2	-3.2	0.4	0.6	2.1	-0.2
<b>Other transactions (Quarterly data)<sup>4</sup></b>									
6. U.S. direct investment (-) abroad	-16.2	-31.7	-9.6	-8.8	-9.3	-3.1	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	58.4	72.2	12.4	21.5	5.5	5.0	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow) <sup>5</sup>	-1.8	-9.9	-8.6	-3.3	3.8	-5.1	n.a.	n.a.	n.a.
9. U.S. current account balance	-128.9	-110.0	-27.6	-26.7	-19.8	-21.8	n.a.	n.a.	n.a.
10. Statistical discrepancy	-8.4	22.4	-2.5	6.1	21.8	26.3	n.a.	n.a.	n.a.

## MEMO:

U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-127.2	-114.9	-29.8	-28.7	-26.3	-22.6	n.a.	n.a.	n.a.
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- 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.
- Includes all U.S. bonds other than Treasury obligations.
- Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
- Seasonally adjusted.
- 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.

net outflows associated with transactions in private securities and U.S. Treasury obligations (lines 2 and 3).

For the second straight month banks reported very large net capital inflows on a month-end basis (line 1), totaling almost \$20 billion for July and August. Most of this total was the result of transactions with own offices outside the United States. However, daily data reported to the Federal Reserve on banks' net claims on their own foreign offices and IBFs indicate that the month-end data are distorted by special factors. Monthly averages of the daily data show only small net inflows between June and August, with more substantial inflows on average in September (line 1 of the International Banking Data table).

Foreign official holdings in the United States increased by \$8 billion in August (line 4 of the Summary table). The increases were broadly based, with the holdings of the G-10 countries rising by over \$5 billion.

. Partial

information from FRBNY indicates continued increases in September for G-10 reserves held in the United States.

In August, net capital outflows occurred in all categories of transactions with respect to private securities and Treasury obligations (lines 2 and 3). However, the outflow in each category was small to moderate, and only partly reversed the sizeable net inflows in July. The small net foreign sales of corporate and U.S. government agency bonds (line 2a) reflected the sharp decline in the volume of new bond issues in August; data on new issues of U.S. corporate bonds for September and October show no revival in the market as a whole, and only a small increase in the value of new offerings sold in the Euromarkets. There was a resumption of net sales

INTERNATIONAL BANKING DATA  
(Billions of dollars)

	1988	1989				1990				
	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	July	Aug.	Sept.
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	-4.9	-2.9	-3.9	-6.4	-5.5	-11.7	-11.0	-10.3	-12.6	-15.3
(a) U.S.-chartered banks	21.6	20.4	19.2	14.9	19.2	12.2	7.2	7.4	4.9	5.7
(b) Foreign-chartered banks	-26.5	-23.3	-23.1	-21.3	-24.7	-23.9	-18.2	-17.7	-17.5	-21.1
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	21.2	24.0	26.0	21.6	20.7	21.8	22.2	22.3	23.0	24.0
3. Eurodollar Holdings of U.S. Nonbank Residents <u>1/</u>	145.3	144.8	131.5	130.3	123.5	110.6	106.5	104.5	106.1	108.5

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.

by foreigners of U.S. corporate stocks after July's net inflow (\$1.4 billion, line 2b). Net transactions in foreign stocks and bonds by U.S. residents were virtually zero in August (line 2c).

Private foreigners sold net \$0.6 billion of U.S. Treasury securities in August (line 3). Substantial net sales were recorded by the United Kingdom, but the World Bank and Japanese residents made large net purchases, \$1.6 billion and \$2.1 billion, respectively.

#### Foreign Exchange Markets

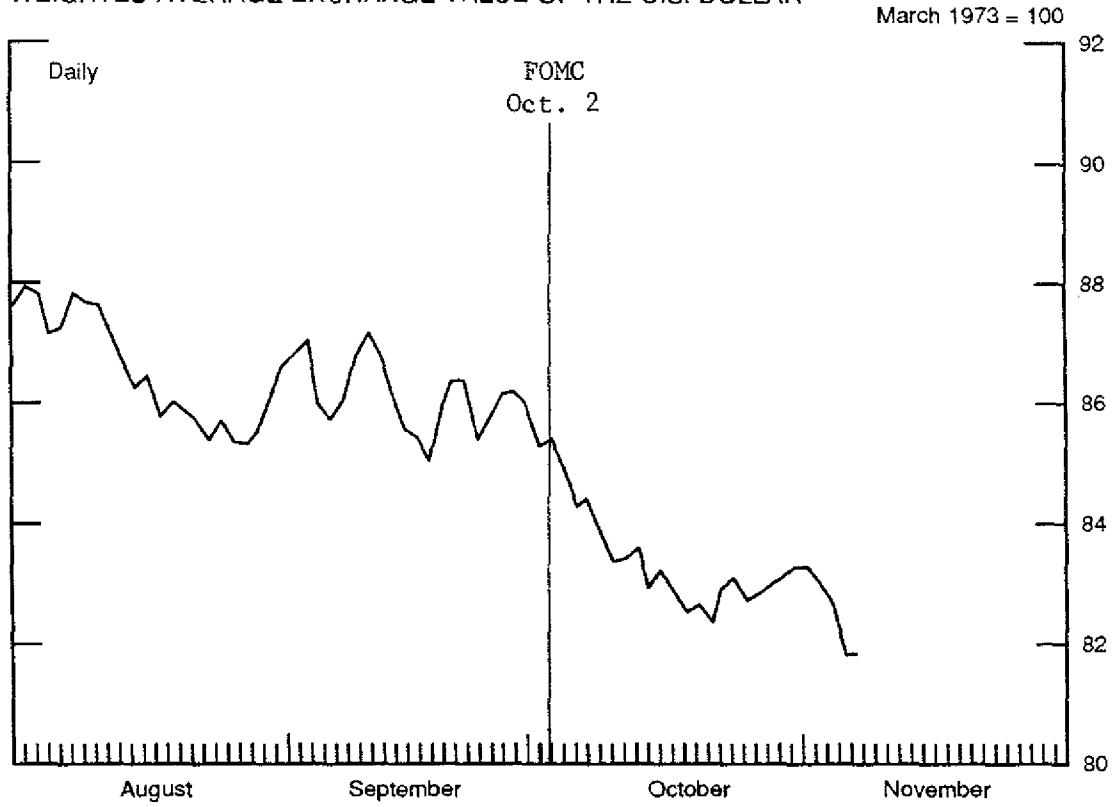
The weighted-average foreign-exchange value of the dollar, in terms of the other G-10 currencies, has declined more than 4 percent since the October 2 FOMC meeting, as shown in the accompanying chart. The dollar was weakened by the long budget stalemate, a slight easing in U.S. monetary policy, and further signs of weakness in the U.S. economy and in the U.S. financial system. Nevertheless, the dollar continued to derive some safe-haven support from developments in the Middle East. The dollar declined more against the yen (nearly 7 percent) than against the mark (more than 4 percent).

Over the intermeeting period, the yield on the Japanese bellwether government bond declined 35 basis points, while Tokyo stock prices rose 2-1/2 percent, on balance, probably reflecting the easing of oil prices and a pause in Japanese monetary tightening. However, by the end of the period, the Bank of Japan had nudged the call money rate up 25 basis points.

German stock prices declined about 3 percent, on balance, while the bellwether bond yield edged off slightly. The German call money rate remained near or just above the 8 percent Lombard rate, until the Bundesbank raised the Lombard rate to 8-1/2 percent on November 1. The Bundesbank claimed that the move was largely technical, to restore the gap between the Lombard rate and market rates and to reduce the extremely large Lombard



WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



borrowing that has occurred since German monetary union in July. The Bundesbank also switched to a fixed-rate RP tender at 8 percent, the same as the minimum accepted rate on the previous flexible-rate tender. Although the Bundesbank noted that the Lombard rate increase was not intended to lead to a general rise in German interest rates at this time, German three-month interest rates responded by rising 20 basis points, and the call money rate temporarily rose to the new Lombard rate before the Bundesbank injected short-term liquidity.

The Bundesbank's move was followed by a 1/4 point increase in Dutch and Belgian official interest rates, but other European central banks did not follow. In fact, just the day before the Bundesbank's action, the Bank of France had taken the second of two small steps to ease monetary policy. First, it had cut reserve requirements on time and savings accounts on October 16, prompting major French banks to lower their lending rates by 10 to 20 basis points. Later, on October 31, the Bank of France cut its key money market intervention rate 1/4 point to 9-1/4 percent, citing the franc's recent strength in the EMS and slow growth in French monetary aggregates. Following the changes in official rates by Germany and others, the franc eased about 1/4 percent against the mark to just below its EMS central rate with the mark.

On October 8, sterling joined the Exchange Rate Mechanism of the EMS, with allowable deviations of 6 percent from its central rate with other EMS currencies. At the same time, the Bank of England lowered its official lending rate by 1 percent. Sterling initially strengthened somewhat and traded above its EMS central rate, but subsequently weakened amid rumors of a further cut in U.K. interest rates, and amid political difficulties for the Thatcher government, including the resignation of Deputy Prime Minister Howe over Mrs. Thatcher's opposition to European monetary union.

Developments in Foreign Industrial Countries

Economic performance in major foreign industrial countries continues to diverge. Canada and the United Kingdom appear to have entered recessions. Economic activity in continental Europe has been more robust, particularly in Western Germany where recent monthly indicators suggest an acceleration of activity. It appears that the demand stimulus generated by German economic and monetary union is spilling-over to other European countries. In Japan, recent monthly indicators suggest some slowing at the end of the third quarter, but the pace of activity for the quarter as a whole appears strong.

Inflation has accelerated in most foreign industrial countries, largely reflecting the recent increases in oil prices. There is little evidence to date that recent changes in oil prices are causing prices for other products or wages to accelerate.

On November 1 the Bundesbank raised its Lombard rate by 1/2 percentage point to 8.5 percent. The Dutch and Belgian Central banks followed with small increases in their official rates. The Bank of France had lowered its intervention rate just prior to the Bundesbank's action. The only other

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

	Q4/Q4 1988	Q4/Q4 1989	1989				1990					Latest 3 months from year ago 2
			Q4	Q1	Q2	Q3	May	June	July	Aug.	Sept.	
<b>Canada</b>												
GDP	3.1	2.9	.6	.5	-.4	n.a.	*	*	*	*	*	1.4
IP	1.5	-.4	-.8	-1.8	.2	n.a.	.5	.3	.6	-1.0	n.a.	-2.0
<b>France</b>												
GDP	3.5	3.4	.7	.6	.2	n.a.	*	*	*	*	*	2.1
IP	4.6	2.8	-.6	-.2	1.6	n.a.	.3	.4	2.1	.0	n.a.	1.9
<b>Germany</b>												
GNP	3.4	3.2	1.0	3.6	-.9	n.a.	*	*	*	*	*	3.4
IP	4.0	4.8	.7	2.4	-.7	3.1	2.8	.0	1.5	.7	.5	5.6
<b>Italy</b>												
GDP	3.7	3.0	.7	.6	-.2	n.a.	*	*	*	*	*	1.9
IP	7.5	3.3	2.1	-2.3	-1.2	n.a.	-2.0	1.0	n.a.	n.a.	n.a.	1.2
<b>Japan</b>												
GNP	5.1	4.8	.8	2.7	.9	n.a.	*	*	*	*	*	7.5
IP	7.6	4.2	.7	.9	1.9	2.4	2.5	-.2	1.8	.3	-.9	6.0
<b>United Kingdom</b>												
GDP	3.8	1.5	.4	.9	.3	n.a.	*	*	*	*	*	2.3
IP	2.5	.3	-.0	-.2	1.9	n.a.	-.9	1.9	-3.4	-.5	n.a.	.9
<b>United States</b>												
GNP	3.5	1.8	.1	.4	.1	.4	*	*	*	*	*	1.1
IP	4.5	1.1	.0	.2	1.0	.9	.5	.6	.2	.1	.2	2.2

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	1989			1990			1990				Latest 3 months from year ago
			Q2	Q3	Q4	Q1	Q2	Q3	July	Aug.	Sept.	Oct.	
<b>Canada</b>													
CPI	4.1	5.2	1.7	1.4	.7	1.4	.9	1.1	.5	.1	.3	n.a.	4.2
WPI	3.7	.7	.3	-.2	-.4	.6	.3	n.a.	n.a.	n.a.	n.a.	n.a.	.2
<b>France</b>													
CPI	3.0	3.6	1.2	.7	.8	.7	.9	1.0	.3	.6	.5	n.a.	3.4
WPI	7.2	.9	.4	-.7	-1.0	-.3	-.2	n.a.	*	*	*	*	-2.2
<b>Germany</b>													
CPI	1.6	3.1	.9	.0	.6	1.1	.5	.4	.0	.3	.4	.7	3.0
WPI	2.2	4.3	1.5	-.6	.3	-.3	.6	.2	-.3	.8	.3	n.a.	.9
<b>Italy</b>													
CPI	5.2	6.6	1.7	1.0	1.8	1.6	1.2	1.4	.4	.7	.6	.8	6.3
WPI	n.a.	n.a.	1.7	.0	2.5	2.1	-.1	n.a.	.0	4.0	n.a.	n.a.	6.8
<b>Japan</b>													
CPI	1.5	2.9	2.2	.1	.9	.4	1.2	.2	.1	.2	.8	1.1	3.0
WPI	-1.4	3.7	2.7	.8	-.3	.4	.8	.0	-.1	.3	.2	n.a.	.9
<b>United Kingdom</b>													
CPI	6.5	7.6	2.9	.9	2.0	1.8	4.7	1.6	.1	1.0	.9	n.a.	10.4
WPI	4.9	5.2	1.2	1.2	1.2	1.6	2.1	.9	.2	.3	.4	n.a.	6.0
<b>United States</b>													
CPI (SA)	4.3	4.6	1.5	.7	1.0	2.0	.9	1.6	.4	.8	.8	n.a.	5.5
WPI (SA)	3.4	4.9	1.6	.0	1.2	2.3	-.2	1.4	-.1	1.3	1.6	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	1989			1990			1990			
			Q2	Q3	Q4	Q1	Q2	Q3	June	July	Aug.	Sept.
<b>Canada</b>												
Trade	8.3	6.4	1.2	1.6	1.1	1.5	2.6	n.a.	1.5	1.1	.8	n.a.
Current account	-8.4	-14.1	-4.0	-3.5	-4.0	-4.2	-3.8	n.a.	*	*	*	*
<b>France</b>												
Trade	-5.4	-6.6	-2.1	-1.6	-2.1	-.4	-1.9	-4.0	-.2	-.9	-1.1	-1.9
Current account	-3.4	-4.0	-1.2	-1.2	-3.0	.9	-2.7	n.a.	*	*	*	*
<b>Germany</b>												
Trade (NSA)	72.9	71.6	17.7	17.8	16.6	22.4	16.7	12.0	4.9	4.9	3.6	3.4
Current account (NSA)	50.5	55.5	14.0	11.1	13.5	17.0	10.8	8.2	2.2	3.0	2.4	2.9
<b>Italy</b>												
Trade	-10.5	-12.4	-3.4	-2.6	-1.8	-4.3	-1.9	n.a.	.6	-.8	-.8	n.a.
Current account (NSA)	-6.3	-10.6	-1.1	.1	-1.5	-6.0	-6.1	n.a.	*	*	*	*
<b>Japan</b>												
Trade	77.3	64.5	16.2	15.5	12.2	15.6	13.5	16.3	6.9	5.4	5.7	5.2
Current account 2	79.6	57.2	14.0	14.2	9.2	15.3	8.3	7.1	3.8	1.8	3.0	2.3
<b>United Kingdom</b>												
Trade	-37.0	-38.2	-10.3	-10.5	-6.9	-9.0	-8.2	-6.9	-2.7	-3.0	-2.3	-1.6
Current account	-26.6	-31.2	-7.6	-9.6	-6.6	-7.8	-7.2	-6.3	-2.3	-2.5	-2.3	-1.6
<b>United States</b>												
Trade 2	-127.0	-114.9	-28.2	-29.8	-28.7	-26.3	-22.6	n.a.	*	*	*	*
Current account	-128.9	-110.0	-28.6	-27.6	-26.7	-21.7	-21.8	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.

major policy change in recent weeks was the United Kingdom's entry into the Exchange Rate Mechanism (ERM) of the EMS on October 8.

The process of economic reform and restructuring in Eastern Europe is progressing unevenly. Poland and Hungary are struggling to meet IMF performance criteria, and aggregate economic activity in the region continues to decline. Hard-currency trade for these countries appears to be developing well, but the full impact on external balance of changes in oil markets and in trade within CMEA has not yet been felt.

Individual Country Notes. The pace of activity in Japan appears to have remained generally strong in the third quarter, although some indicators showed weakness near the end of the quarter. Industrial production (s.a.) in the third quarter was 2.4 percent above its average level in the second quarter, and 6 percent above a year earlier. New machinery orders (s.a.) declined in August, but remained a strong 20.8 percent above their level of a year earlier. Retail sales (s.a.) declined for the second consecutive month in August, but recorded a strong 12-month increase of 7.9 percent. New passenger car registrations (s.a.) declined in September, falling below their level of a year earlier for the first time in a year and a half. Housing starts (s.a.) declined for the third consecutive month in August and were slightly below their level 12 months earlier.

Labor-market conditions remained extremely tight. The unemployment rate (s.a.) edged up to 2.2 percent in September, but remained only slightly above the 2 percent level of March, which was the lowest since June 1980. The ratio of job offers to applicants (s.a.) also remained unchanged in August (at 1.45), just below its June 1990 peak of 1.47, the highest level reached since February 1974.

Appreciation of the yen appears to have largely offset the inflationary impact of higher oil prices. Although consumer prices in the

Tokyo area (n.s.a.) increased by 1.1 percent in October, most of this increase appears to have been due to seasonal factors. The 12-month increase in consumer prices increased only slightly to 3.1 percent. Wholesale prices (n.s.a.) increased overall by only 0.2 percent in September and their 12-month rate of increase declined to 0.9 percent from 1.1 percent the previous month. Wholesale prices of domestically produced goods increased by 0.5 percent in September, and import prices rose 3.8 percent, while export prices fell by 3.3 percent.

The current account surplus (s.a.) fell slightly in September to \$2.3 billion. However, the cumulative current account surplus through the first three quarters of the year, at \$40.9 billion (a.r.), was \$24 billion below the surplus rate in the corresponding period last year.

Economic performance in Eastern and Western Germany continues to diverge. In Western Germany, industrial production (s.a.) increased 13 (a.r.) percent in the third quarter to 5.6 percent above the same period in 1989. Although the volume of new orders for West German manufactured goods (s.a.) fell 1.1 percent in September they were still 7.7 percent above year-earlier levels after sharp increases in July and August. Most of the increase in the volume new orders came in domestic orders, which were 11.7 percent above year-earlier levels in September, while foreign orders were up only 1.3 percent from a year ago. The volume of West German retail sales (s.a.) in August was up 10.3 percent on a year/year basis. West German unemployment (s.a.) fell 0.1 percent in October to to 6.9 percent, after falling 0.2 percent in September. Shipments to Eastern Germany have been an important source of demand for Western Germany. In July and August, shipments to Eastern Germany were up 187 percent over the same period in 1989, and the surplus of shipments to Eastern Germany over shipments from



Eastern Germany is expected to increase West German GNP by about 3/4 of a percent in the third quarter.

After collapsing in July, economic activity in Eastern Germany fell further in August. Industrial production (n.s.a.) fell to 51 percent of its year-earlier level in August, down from 42 percent in July. Retail sales (n.s.a.) in August were 45 percent below their level in the same month of 1989, down 1 percent from July. Official East German unemployment (n.s.a.) was 6.1 percent in October, up from 5 percent in September. The number of workers engaged in government subsidized "short-time" work (n.s.a.) was unchanged in October at 20 percent of the labor force. Recent surveys of managers in Eastern Germany indicate that manufacturing output is expected to stabilize at current levels over the next 3 months to 6 months.

West German consumer prices (n.s.a.) increased 0.4 percent and 0.7 percent in September and October, respectively, due almost entirely to increases in energy prices. On a year/year basis consumer price inflation has increased from 2.4 percent in July to 3.3 percent in October. Import prices (n.s.a.) increased 2.4 percent in September due almost exclusively to increases in oil prices, but they remain below year-earlier levels.

The combined German trade balance (n.s.a.) was \$48 billion (a.r.) in the third quarter. This compares with a West German trade balance of \$71 billion (a.r.) for the third quarter of 1989.

West German M3 increased rapidly in August and September, but for the year to date monetary growth remains moderate. Compared with the fourth quarter of 1989, West German M3 (s.a.) grew at an annual rate of 5 percent through September, up from 3.8 percent through July, but within the Bundesbank's 4 to 6 percent target range.

The Bundesbank raised its Lombard rate by 1/2 a percentage point to 8.5 percent on November 1. The Bundesbank said that it did not want to

increase market interest rates at this time. Rather, the change in the Lombard rate was intended to reduce excessive Lombard borrowing that had emerged since the establishment of a Germany monetary union on July 1. The Bundesbank's first securities repurchase auction following the change in the Lombard rate, held on November 7, was a so-called "volume tender" with a fixed rate of 8 percent.

The third supplemental budget for 1990, passed in late October, envisions a Federal deficit in 1990 of DM 67 billion, or 2.8 percent of projected GNP. This compares with a West German deficit of DM 15 billion in 1989, that is, 0.7 percent of GNP. Additional expenditures related to unification account for almost the entire increase of the expected deficit.

The ruling Christian Democratic coalition fared well in recent elections in the five new states of Eastern Germany and in Bavaria. It now appears likely that Chancellor Kohl's coalition government will win the all-German Federal election scheduled for December 2.

Recent data indicate a firming of economic activity in France, following slow second-quarter growth. GDP (s.a.) growth was only 0.7 percent (a.r.) in the second quarter, after a rise of 2.5 percent in the first quarter. The slowing of GDP in the second quarter was primarily due to reduced investment spending and poor export performance. More recently, industrial production (s.a.) for July and August (reported as a single observation) rose 2.3 percent compared with the average for May and June. Inflation picked up in August and September.

Consumer prices (n.s.a.) rose 0.5 percent in September and 0.6 percent in August, after an average monthly increase of 0.2 percent during the previous year. In both August and September, energy prices accounted for the bulk of increases in inflation.

The French trade deficit has deteriorated recently. The September deficit (s.a.) was \$1.9 billion, compared with \$1.1 billion in August and a total of \$6.3 billion for the first nine months of the year. Both an increase in the energy import bill and a decrease in exports contributed to the larger deficit. In spite of the deterioration in France's total trade balance, and a significant deterioration against the European community as a whole, France's trade deficit with Western Germany (s.a.) narrowed in September relative to both the previous month and the same month in 1989.

Second-quarter GDP (s.a.) in Italy declined 0.8 percent (a.r.) from the previous quarter, to a level 1.9 percent above that of a year earlier, due to a sharp fall in inventories and a small decline in investment. Strength in other components of aggregate demand suggest that this slowdown may prove temporary. Consumption growth was relatively stable at 2 percent (a.r.), while exports grew 16 percent (a.r.). Industrial production (n.s.a) rose in July and August to 2.3 and 1.5 percent, respectively, from levels a year earlier, also suggesting continued strength.

In October, consumer prices (n.s.a.) were 6.2 percent above year-earlier levels, roughly the same as in September and August. The trade balance (n.s.a.) registered its third consecutive surplus in August. The cumulative 8-month trade deficit for 1990 is 30 percent below that of a year earlier, due, in part, to a 14 percent increase in exports to Germany.

The cabinet approved budget changes that will reduce the projected 1991 fiscal deficit by 3 percent of GDP. The package includes equal amounts of spending cuts and tax increases with a small contribution from the sale of state properties. If these changes are adopted, the deficit will fall to roughly 9-1/2 percent of projected GDP, compared with 11.2 percent in 1989.

Recent data indicate that the United Kingdom entered a recession in the third quarter; industrial production (s.a.) declined 0.5 percent in

August after falling 3.4 percent in July. In the latest three months, total industrial output was 0.9 percent below the previous 3-month period while manufacturing output was 1.2 percent below the previous period. The volume of retail sales (s.a.) rose 0.6 percent in September to a level 0.3 percent above a year ago. Retail sales volume in the third quarter was 0.9 percent below that of the previous quarter.

Inflation has continued to worsen. Year-over-year consumer price inflation (n.s.a.) rose to 10.9 percent in September. Excluding mortgage interest rates and the poll tax, consumer prices rose 1 percent in September bringing the underlying rate of inflation to 8.3 percent. Wages have continued to accelerate; in August, the 12-month increase of average earnings was 10.9 percent.

The current account improved significantly in September, as imports continued to decline and exports rose. For the year through September, however, the cumulative current account deficit (s.a.) was \$28.2 billion (a.r.), down only slightly from 1989's record deficit.

On October 8, Britain joined the exchange rate mechanism (ERM) of the EMS, with a central rate of 2.95 DM/£ and deviation margins of 6 percent. The government also lowered its money market dealing rates by 100 basis points at the same time.

Canadian real GDP (s.a.) dropped 1.6 percent (a.r.) in the second quarter, as consumption and investment expenditures fell broadly. Finance Minister Wilson has indicated that GDP also fell in the third quarter. Almost all indicators of activity and demand have been negative. Retail trade (s.a.) declined 0.2 percent and manufacturers' new orders (s.a.) fell 1.1 percent in August. Industrial production (s.a.) fell 1 percent, and new motor vehicle sales (s.a.) dropped 3 percent in August. The unemployment rate (s.a.) increased 0.5 percent in August and 0.1 percent in September

to 8.4 percent. Bankruptcies were also up sharply in September from a year ago.

The deceleration in year-over-year inflation recorded during the past 12 months has stalled. The consumer price index (n.s.a.) rose 0.3 percent in September, as fuel prices rose 1.7 percent. Year-over-year inflation remained for the third consecutive month at 4.2 percent (4.1 percent excluding food and energy).

#### Developments in East European Economies

Poland failed to meet IMF performance criteria on growth of the wage bill and of domestic credit in the third-quarter review of its \$725 million stand-by arrangement. Credit to the agricultural and housing sectors, particularly through loans at subsidized interest rates, were key problem areas.

In September, the 12-month decline in industrial sales by state-owned firms was 24 percent. However, private sector sales were up 25 percent in the first half-year compared with the same period last year. The general price index (n.s.a.) increased 4.6 percent in September after rising only 1.8 percent in August. The National Bank of Poland raised interest rates in October to 3 percent per month (about 43 percent on an annual basis). Poland's 1990 hard-currency trade surplus was \$3.4 billion through September, compared with \$0.7 billion for all of 1989. As of the end of September, Poland's international reserves had more than doubled to \$5.4 billion since the beginning of the year. Presidential elections are scheduled for November 25. The two major candidates are Solidarity leader Lech Walesa and Prime Minister Tadeusz Mazowiecki.

Industrial production in Hungary contracted about 10 percent in the first eight months of 1990. In a continuing effort to keep the budget

deficit within IMF guidelines, newly enacted fiscal measures are designed to reduce outlays by more than 2 percent of GDP.

Twelve-month consumer price inflation was 26 percent in August. Continued reductions in subsidies and price increases for oil products will likely push the rate for 1990 as a whole to over 30 percent. After demonstrators blocked roads to protest the 65 percent increase in gasoline prices in October the price increase was cut to 35 percent.

Hungary achieved a hard currency trade surplus of \$628 million in the first eight months of 1990, compared with \$537 million for all of 1989. This performance occurred despite a drought-induced drop in agricultural exports.

Gross industrial output (n.s.a.) in the Czech and Slovak Federal Republic fell 3.7 percent in the first eight months of 1990 compared with a year earlier. September figures for unemployment suggest about 30,000 unemployed, less than 1 percent of the work force.

Inflation may reach 10 percent this year although comprehensive price controls are still the norm in the CSFR. Gasoline prices were increased by more than 30 percent in October. The State Bank increased the discount rate from 5 to 7 percent in September after increasing it from 4 to 5 percent in August.

Total trade (n.s.a.) fell 5.9 percent in the first half of 1990, despite a near 15 percent increase in exports to non-CMEA countries. CSFR authorities estimate the potential loss in export revenues on contracts canceled after German unification at about \$375-\$500 million. The koruna exchange rate was devalued by about 35 percent against the dollar in October to 24 Koruna/\$.

Economic Situation in Major Developing Countries

Argentina's inflation rate declined in October, mainly due to reduced monetary growth and an increase in the demand for money. After some delay, the country was also successful in arranging the sale of its telephone system, with the transfer to the buyers to take place on November 8. Brazil's debt restructuring proposal offered to commercial bank creditors in early October was rejected by the banks. IMF Executive Board consideration of the \$2 billion stand-by arrangement for Brazil has been delayed until Brazil makes adequate progress in negotiations with commercial bank creditors. Mexican financial markets became less volatile in October, with a decline in the Treasury bill rate and an increase in stock prices. On October 10, the rights to convert \$2.5 billion in external debt into approved investments were auctioned at a 52 percent discount to 29 successful bidders. Venezuela continued to move forward with its debt reduction package, and on October 18 implemented an arrangement to buy back \$1.4 billion (face value) of public sector debt at a 55 percent discount.

Individual country notes. In Argentina, consumer price inflation fell to 7.7 percent in October, after rising slightly to 15.7 percent (monthly basis) in September from 15.3 percent in August. There were marked public sector price hikes at the beginning of September, as well as increases in monetary growth during the month due to purchases of foreign exchange by the central bank. Moreover, the operational (i.e., cash) fiscal balance is believed to have turned negative in September after having been in surplus during the previous months of 1990.

Notwithstanding these adverse developments, inflation declined in October because of a reduction in monetary growth, an improvement in the fiscal situation, and a rebound in the demand for money. An increase in the

value-added tax from 13 percent to 15.6 percent, which was announced in mid-October, should enhance progress toward fiscal adjustment in the coming months. However, the deepening financial problems of the provincial governments may pose a threat to this progress.

On October 4, the consortium of Bell Atlantic and Manufacturers Hanover withdrew its bid to purchase the northern half of the country's telephone system, ENTEL. The offer to purchase these operations was then made to, and accepted by, a consortium consisting of STET (an Italian telephone company), France Cable et Radio, Perez Companc (an Argentine industrial conglomerate), and J.P. Morgan. The transfer of the company, which was scheduled for October 8, has been moved back to November 8. The consortium that won the original bid for the southern half of Argentina's telephone system, Telefonica de Espana and Citibank, will also complete its purchase on November 8.

Brazil's IMF stand-by arrangement of SDR 1,449 million (about \$2 billion) has not yet been scheduled for Executive Board consideration, pending the results of Brazil's negotiations with commercial bank creditors. Progress has been extremely slow. On October 10-12, the Brazilian government presented its debt restructuring proposal to the Bank Advisory Committee (BAC) and indicated that Brazil's domestic fiscal situation limits the payments that it can make to external creditors. The government also considers bank debt to be subordinate to the debt owed to international financial institutions and bilateral official creditors.

Brazil's proposal consisted of three options for the restructuring of term bank debt owed by the public sector: 1) a 45-year zero coupon bearer bond with annual redemptions limited to Brazil's "capacity to pay," and with an option for larger redemptions if real GDP growth and international reserves exceed certain levels; 2) a low-interest, 25-year bullet maturity



bond with interest rates rising to 7 percent per annum by the year 2000; and 3) a 15-year very low-interest bullet maturity "exit" bond. The BAC immediately rejected the proposal. Representatives from the creditor banks were in Brazil during the last full week of October to obtain more information on the data underlying Brazil's proposal.

The government has postponed the sale of Petroquisa, the first enterprise scheduled to be privatized. The company holds interests in the petrochemical, steel and shipping industries. The delay appears to be due to a disagreement concerning the budgetary impact from selling the Petroquisa shares as a block, as opposed to selling the shares of a particular group of firms. There is also some concern that sales of a block of shares would create a private sector monopoly since anti-trust enforcement in Brazil is weak.

Consumer prices rose 14.2 percent in October. Monthly consumer price inflation had remained about 12 to 13 percent since July. Economic activity through August remained weak compared with last year's levels, and since September appears to have deteriorated significantly. Industrial output in August was 8 percent lower than a year earlier. Real interest rates were 10 percent per month in September, reflecting tight monetary policies plus investors' reluctance to hold assets with the banking system. The high real interest rates, a decline in sales, and adverse conditions in certain commodity markets have contributed to a rise in the number of corporations seeking protection from creditors since early September.

Brazil's trade surplus for the first nine months of this year was \$9.2 billion, down 30 percent from the \$13.1 billion surplus in the same period a year earlier.

In Mexico, the financial markets were less volatile after late September, as fears of rising inflation due to the Gulf crisis abated. The

28-day Treasury bill rate, which had increased by 100 basis points from mid-August to late September, fell throughout October. At the October 29 auction, it was 26.5 percent, 350 basis points below the September 25 level. The Mexico City stock market index, which had fallen by 23 percent from late July to late September, recovered in October and was 16 percent higher on November 5 than on September 28--the previous low. In September, the CPI was 1.4 percent higher than in August and 28.7 percent higher than in September 1989.

On October 31, international reserves including gold, were \$8.4 billion, up \$1.3 billion since July 31, when they were last reported. The increase reflects the rise in oil prices, as well as continuing inflows of private capital. The latter included the downpayments of 5 percent required to be made in foreign exchange by the successful bidders, whether Mexican or foreign, in the debt-equity swap auction held October 10 pursuant to the bank financing agreement completed last March. The auction covered debt with a face value of \$2.5 billion. Seventy-two bids totalling \$3.6 billion were submitted, and 29 were accepted at a 52 percent discount. As the swap rights are exercised over the next 18 months and the debt is reduced, the corresponding collateral provided by Mexico under the bank agreement will be released and an equivalent amount will be added to Mexican reserves.

Recently published data show that Mexico had a \$300 million merchandise trade deficit in July, the third straight monthly deficit, and that the cumulative trade surplus for January-July was only \$121 million. In these seven months, imports were about 19 percent higher than in the same period of 1989, while exports were only about 4 percent higher. If Mexico's oil export prices average \$26.75 per barrel over the last five months of the year, after averaging \$13.75 over the first seven months, and if other trade

trends continue with little change, Mexico may end the year with a trade surplus of about \$750 million, compared with one of \$2.4 billion in 1989.

The debt reduction package for Venezuela continues to move forward as scheduled. Banks holding \$19,540 million, or about 99 percent of the medium-term public sector external debt to commercial banks, have selected one of the five options offered. Only 36 banks, including several Kuwaiti institutions holding about \$200 million of debt, have not selected an option. The breakdown by option stands at \$1,411 million for the buyback, \$1,792 million for principal reduction, \$7,420 million for permanent interest reduction, \$2,917 million for temporary interest reduction, and \$6,000 million for the new money option.

The buyback operation, structured as a bond swap, was implemented on October 18. The holders of \$1,411 million (face value) of medium- and long-term Venezuelan public sector debt exchanged their claims for \$635 million worth of 90-day U.S. Treasury bills, the holders thus receiving about 44 cents on the dollar at the time. Operations to implement the remaining options are to be carried out by the end of the year.

Inflows of financial capital due to optimism generated by increased oil export revenues and some slackening of inflation led to upward pressure on the bolivar in August and September. As the Venezuelan central bank resisted the appreciation, the monetary base rose substantially. The increased liquidity led to a reduction in the yield on three-month central bank bills from 42 percent per annum in August to 17 percent in early October. As interest rates fell, capital reflows abated, allowing the central bank to boost the yield on its bills to 20 percent by the end of October. The exchange rate, which has fluctuated in a range of 46 to 50 bolivars per dollar since early this year, presently stands at about 49 bolivars per dollar.