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October 30, 1991

# RECENT DEVELOPMENTS

Prepared for the Federal Open Market Committee
By the staff of the Board of Governors of the Federal Reserve System

# DOMESTIC NONFINANCIAL DEVELOPMENTS

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BEA's advance figures suggest that real GNP increased about 2-1/2 percent at an annual rate in the third quarter, and industrial production posted a 6 percent (annual rate) rise on a quarterly average basis. However, these increases largely reflected strong gains around midyear; the more recent indicators of production and spending generally have been no better than lackluster, suggesting a slackening of activity over the course of the third quarter and into the early part of the fourth quarter. Moreover, consumers and businesses evidently have become even more pessimistic about the economic outlook. Price and wage inflation remains on a gradual downward trend.

Employment and Unemployment

Labor market conditions improved a bit in September but continued to show no real strength. Private payroll employment rose 51,000, and the figures for July and August were revised up slightly. With a further rise in the average workweek, aggregate hours of production or nonsupervisory workers increased 0.5 percent (monthly rate) in September, and, for the third quarter as a whole, rose at a 1.1 percent annual rate. Since the September survey week, initial claims for unemployment insurance have remained in a range that suggests no appreciable gain in employment. Moreover, the proportion of respondents to the October Conference Board Consumer Survey noting that jobs were "hard to get" rose to its highest level since the summer of 1983.

The increase in employment in September was concentrated in the private service-producing sector; there, employment in health services posted another strong gain, business services continued to grow, and retail jobs turned up. In manufacturing, employment fell 22,000, after two months of increases; by industry, the declines in

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

| | 1991 Q1 | 1991 Q2 | 1991 Q3 | 1991 July | 1991 Aug. | 1991 Sep. |
|---|---|---|---|---|---|---|
| | -----------Average Monthly Changes------- | | | | | |
| Nonfarm payroll employment[2] | -240 | -6 | 25 | -26 | 77 | 24 |
| Private | -258 | -22 | 50 | 10 | 88 | 51 |
| Manufacturing | -102 | -22 | 12 | 24 | 34 | -22 |
| Durable | -81 | -17 | 1 | 12 | 6 | -15 |
| Nondurable | -21 | -5 | 11 | 12 | 28 | -7 |
| Construction | -64 | -3 | -8 | -15 | -4 | -6 |
| Transportation, public utilities | -14 | -5 | 3 | 0 | 9 | 1 |
| Wholesale trade | -20 | -12 | -7 | -4 | -15 | -2 |
| Retail trade | -67 | -11 | 4 | 2 | -4 | 14 |
| Finance, insurance, real estate | 1 | -11 | -6 | -15 | -3 | -1 |
| Services | 9 | 45 | 59 | 21 | 79 | 76 |
| Total government | 18 | 16 | 25 | -36 | -11 | -27 |
| State and local | 17 | 10 | -28 | -28 | -21 | -35 |
| Private nonfarm production workers | -223 | -8 | 36 | 49 | 29 | 29 |
| Manufacturing production workers | -83 | -5 | 15 | 38 | 31 | -25 |
| Total employment[3] | -273 | 43 | 94 | -172 | -296 | 749 |
| Nonagricultural | -222 | -27 | 94 | -102 | -324 | 709 |
| Memo: | | | | | | |
| Average weekly hours of production or nonsupervisory workers | 34.5 | 34.2 | 34.3 | 34.1 | 34.4 | 34.5 |
| Manufacturing | 40.3 | 40.5 | 40.9 | 40.7 | 41.0 | 40.9 |

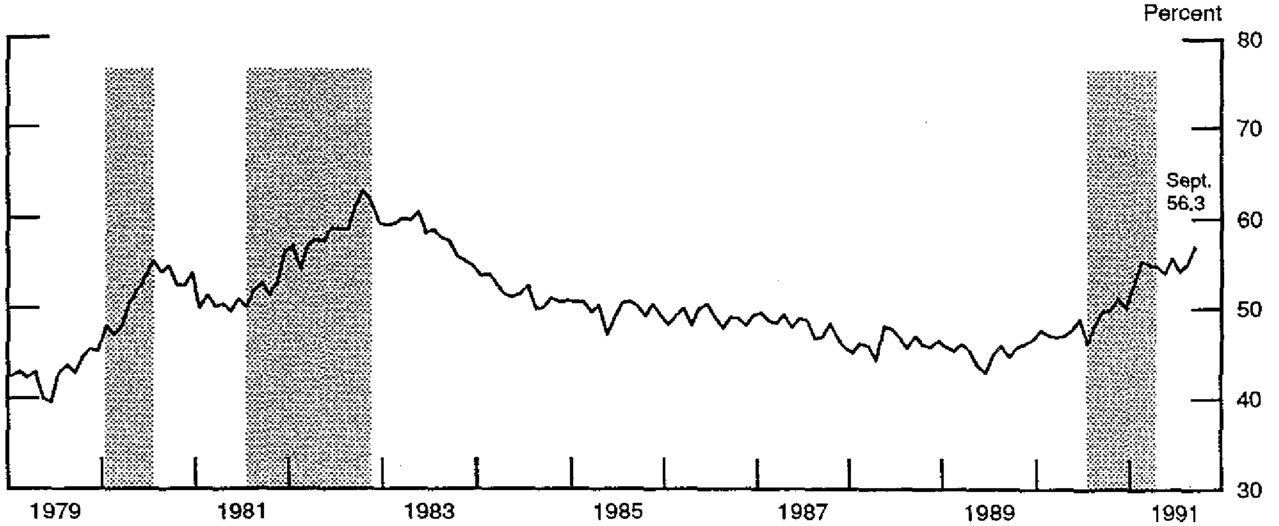
1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments.
3. Survey of households.

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

| | 1990 | 1991 Q1 | 1991 Q2 | 1991 Q3 | 1991 July | 1991 Aug. | 1991 Sep. |
|---|---|---|---|---|---|---|---|
| Civilian unemployment rate (16 years and older) | 5.5 | 6.5 | 6.8 | 6.8 | 6.5 | 6.8 | 6.7 |
| Teenagers | 15.5 | 18.0 | 18.8 | 19.2 | 20.6 | 19.0 | 18.0 |
| 20-24 years old | 8.8 | 10.1 | 10.8 | 10.9 | 11.2 | 10.7 | 10.8 |
| Men, 25 years and older | 4.4 | 5.5 | 5.8 | 5.8 | 5.7 | 5.8 | 5.8 |
| Women, 25 years and older | 4.3 | 5.0 | 5.2 | 5.0 | 4.8 | 5.1 | 5.0 |
| Labor force participation rate | 66.4 | 66.2 | 66.1 | 65.9 | 66.2 | 66.0 | 66.1 |
| Iemo: | | | | | | | |
| Discouraged workers (thousands) | 859 | 997 | 981 | 1075 | n.a. | n.a. | n.a. |

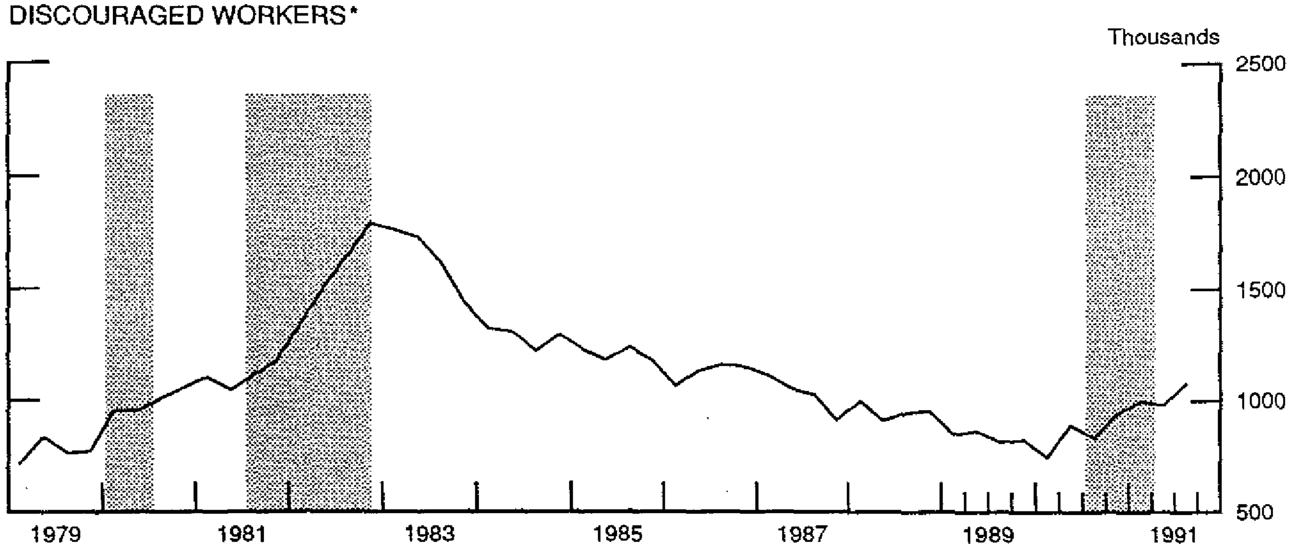
# SELECTED LABOR MARKET INDICATORS

## JOB LOSERS *



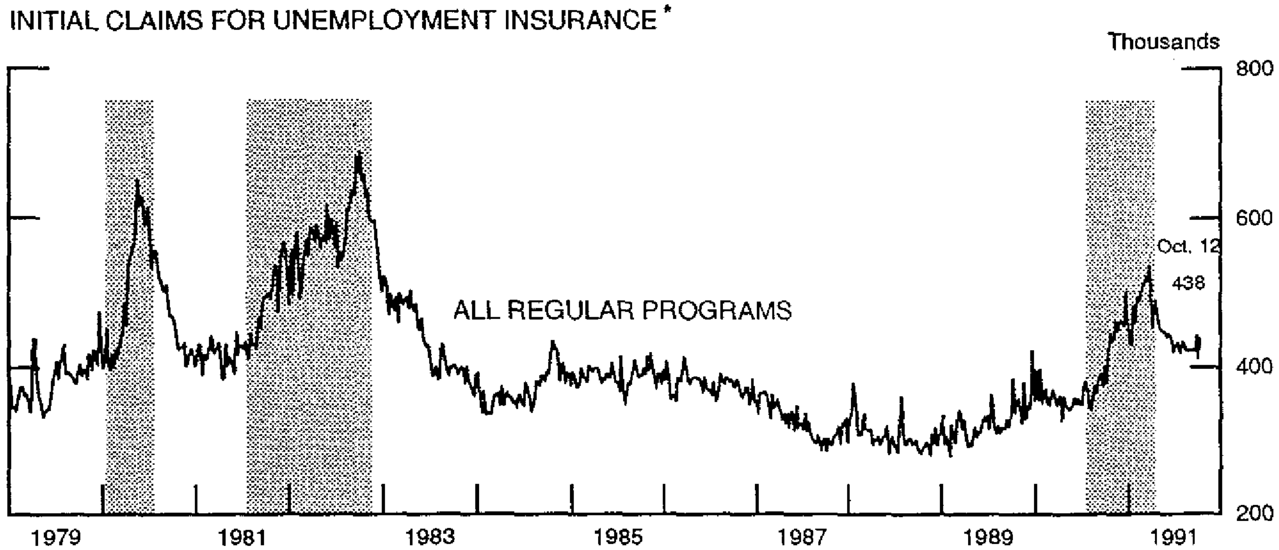

* Job losers as a percent of unemployed.

## DISCOURAGED WORKERS*




* Quarterly data

## INITIAL CLAIMS FOR UNEMPLOYMENT INSURANCE *




* Weekly data; seasonally adjusted, FRB basis.

September were small but widespread. Both the factory workweek and overtime hours fell a bit in September, but, given the surge in August, they remained well above the level recorded last spring.

In the government sector, state and local employment fell another 35,000. Although revised data show that the declines over the summer were smaller than reported earlier, the cumulative drop between May and September is estimated to have exceeded 85,000, the largest since 1982.

In the household survey, both employment and the civilian labor force jumped more than 700,000 in September, reversing declines posted earlier in the summer. On net, growth in the labor force has been quite weak since last spring, attributable in part to declines in the participation of young people. This continues the pattern seen over the preceding year and likely reflects both cyclical and longer-term influences on labor force participation.

The unemployment rate has changed little over the past several months, consistent with the flat picture suggested by the payroll data. However, other data from the September household survey point to continued weakness in labor demand. Job losers, as a percent of the unemployed, climbed to 56.3 percent--a new cyclical high.[1] In addition, the number of individuals looking for full-time jobs but able to find only part-time positions continued to grow. In the third quarter, the average level of involuntary part-time employment was almost 100,000 above the second-quarter level. Finally, the number of discouraged workers (those who have stopped looking for work because they believe that none is available) increased in the third quarter to its highest level since 1987.

1. Generally, this series begins to move lower at roughly the time of the cyclical trough.

Labor Costs

Data on labor costs suggest that continued labor market slack has held down wage increases recently, but that persistently large increases in benefit costs have retarded the overall slowing in hourly compensation. The employment cost index for hourly compensation in private industry rose 4.4 percent at a seasonally adjusted annual rate in the third quarter--the same as the average pace over the preceding year, but 3/4 percentage point below the peak twelve-month change in early 1990. Wages have exhibited a clear deceleration: The 3 percent (annual rate) increase in the third quarter probably overstates the trend, but the change in the twelve-month period ended in September is well below that of the year-earlier period. In contrast, benefits posted their second consecutive rise of 7 percent (annual rate) or more last quarter, fueled by continued sharp increases in payments for employer-provided health insurance and workers' compensation; on a twelve-month change basis, the deceleration is 1/2 percentage point from the peak rate in 1990.

By industry, the recent slowing in the wage and salary component of the ECI was widespread. Most notable were an especially small increase in construction last quarter, where declining activity had already pushed the twelve-month change in wages below 3 percent, and a small decline in finance, insurance, and real estate. Among occupations, wages of white-collar employees have shown the most deceleration in recent quarters, especially in the managerial and administrative support categories, which anecdotal reports indicate are the focus of efforts to cut labor costs. Wage growth has slowed somewhat for blue-collar workers as well, particularly among lower-skilled occupations.

The large benefit cost increases have hit nearly every industrial and occupational sector. Although explicit data on

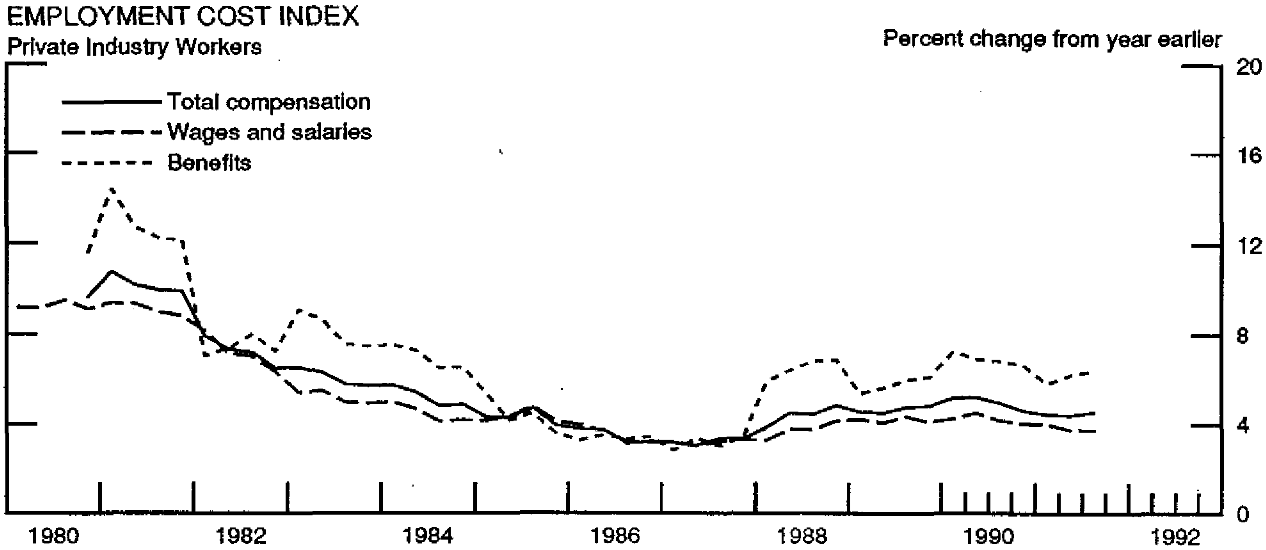
EMPLOYMENT COST INDEXES
(Three month percent changes at compound annual rates; seasonally adjusted)

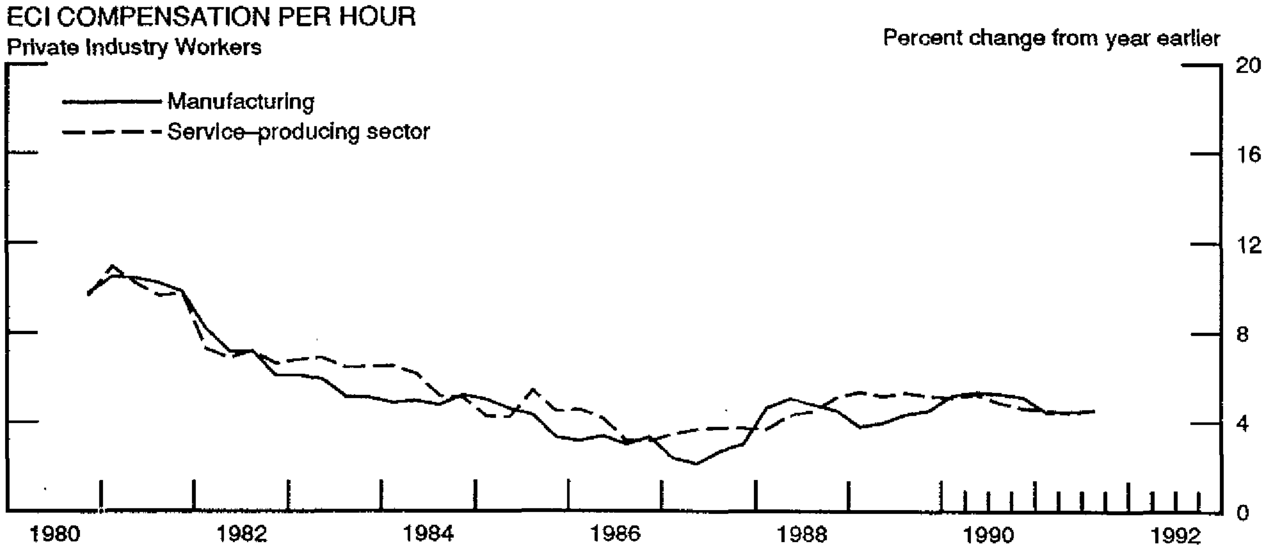
| | 1990 | | | 1991 | | |
|---|---|---|---|---|---|---|
| | June | Sep. | Dec. | Mar. | June | Sep. |
| Total compensation costs: | | | | | | |
| Private industry workers | 5.1 | 4.3 | 3.8 | 4.6 | 4.9 | 4.4 |
| By industry: | | | | | | |
| Goods-producing | 5.1 | 4.3 | 3.8 | 4.6 | 4.9 | 4.4 |
| Service-producing | 5.1 | 4.3 | 3.8 | 4.9 | 4.5 | 4.4 |
| By occupation: | | | | | | |
| White-collar | 5.5 | 4.6 | 2.7 | 6.1 | 4.9 | 4.0 |
| Blue-collar | 4.7 | 3.9 | 3.8 | 4.6 | 4.1 | 4.9 |
| Service workers | 5.1 | 3.5 | 5.0 | 4.2 | 6.4 | 6.7 |
| By bargaining status: | | | | | | |
| Union | 3.1 | 3.9 | 4.3 | 5.0 | 4.9 | 4.9 |
| Nonunion | 5.5 | 4.2 | 2.7 | 5.7 | 4.9 | 4.1 |
| Memo: | | | | | | |
| Wages and salaries | 4.3 | 3.9 | 3.1 | 4.2 | 4.2 | 3.0 |
| Benefits | 6.2 | 6.5 | 5.7 | 5.2 | 7.0 | 7.6 |

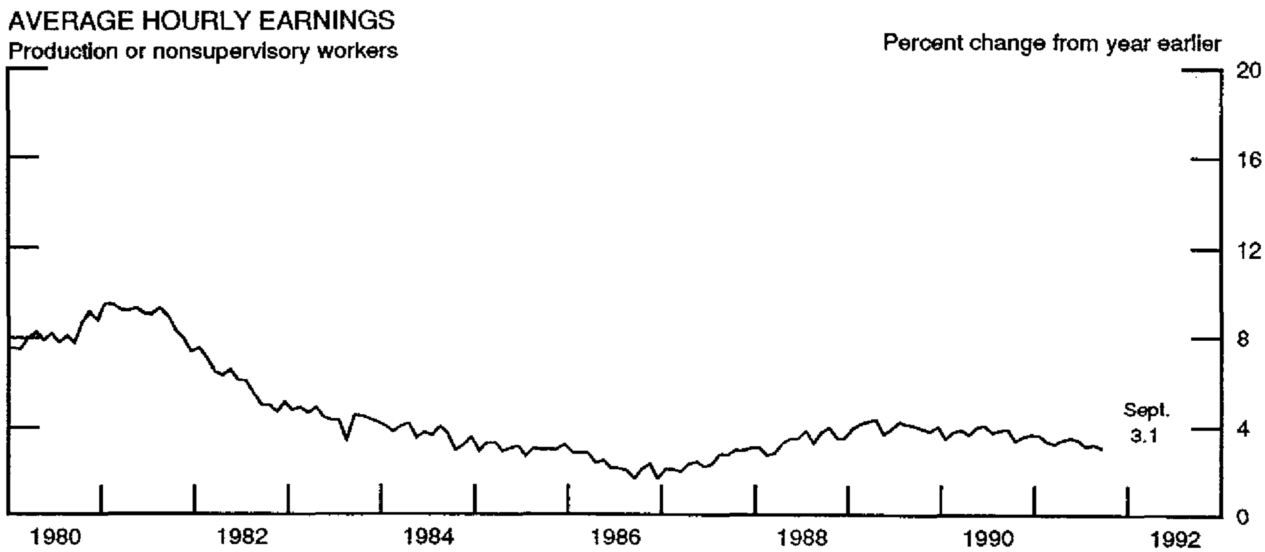
EMPLOYMENT COST INDEXES
(Percent change from year earlier; not seasonally adjusted)

| | | 1990 | | | 1991 | | |
|---|---|---|---|---|---|---|---|
| | 1989 | June | Sep. | Dec. | Mar. | June | Sep. |
| Total compensation costs: | | | | | | | |
| Private industry workers | 4.8 | 5.2 | 4.9 | 4.6 | 4.4 | 4.4 | 4.5 |
| By industry: | | | | | | | |
| Goods-producing | 4.3 | 5.2 | 5.0 | 4.8 | 4.4 | 4.4 | 4.5 |
| Service-producing | 5.1 | 5.2 | 4.8 | 4.6 | 4.5 | 4.4 | 4.5 |
| By occupation: | | | | | | | |
| White-collar | 5.2 | 5.5 | 5.2 | 4.9 | 4.7 | 4.5 | 4.4 |
| Blue-collar | 4.1 | 4.7 | 4.5 | 4.4 | 4.3 | 4.1 | 4.4 |
| Service workers | 4.4 | 4.9 | 4.5 | 4.7 | 4.2 | 4.8 | 5.5 |
| By bargaining status: | | | | | | | |
| Union | 3.7 | 4.1 | 4.2 | 4.3 | 4.1 | 4.5 | 4.8 |
| Nonunion | 5.1 | 5.5 | 5.1 | 4.8 | 4.5 | 4.4 | 4.3 |
| Memo: | | | | | | | |
| Wages and salaries | 4.1 | 4.5 | 4.2 | 4.0 | 4.0 | 3.7 | 3.7 |
| Benefits | 6.1 | 6.9 | 6.8 | 6.6 | 5.8 | 6.2 | 6.[illegible] |

# LABOR COST MEASURES



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

| | | 1991 | | | |
|---|---|---|---|---|---|
| | 1990 | Q1 | Q2 | Q3 | Q3 parties under prior settlements |
| All industries | | | | | |
| First-year adjustments | 4.0 | 4.3 | 3.5 | 3.4 | 2.9 |
| Average over life of contract | 3.2 | 3.3 | 3.4 | 3.0 | 2.9 |
| Workers affected (in thousands) | 2004 | 227 | 649 | 437 | --- |

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)

| | 1987 | 1988 | 1989 | 1990 | 1991[1] |
|---|---|---|---|---|---|
| Decreases | 4 | 2 | 1 | 0 | 0 |
| No wage change | 23 | 20 | 8 | 4 | 9 |
| 0 to 4 percent | 50 | 51 | 45 | 61 | 57 |
| 4 to 6 percent | 17 | 24 | 28 | 27 | 25 |
| 6 percent and over | 5 | 4 | 18 | 8 | 9 |
| Mean adjustment | 2.2 | 2.5 | 4.0 | 4.0 | 3.8 |

1. Based on settlements concluded over the four quarters ended 1991:Q3.

AVERAGE HOURLY EARNINGS
(Percent change; based on seasonally adjusted data)[1]

| | | | 1991 | | | 1991 | |
|---|---|---|---|---|---|---|---|
| | 1989 | 1990 | Q1 | Q2 | Q3 | Aug. | Sep. |
| | | | --Annual rate-- | | | --Monthly rate-- | |
| Total private nonfarm | 4.0 | 3.7 | 2.8 | 5.2 | 1.9 | .4 | .2 |
| Manufacturing | 2.7 | 3.6 | 2.2 | 5.2 | 1.8 | .4 | -.2 |
| Excluding overtime | 3.0 | 3.7 | 2.7 | 3.8 | 1.5 | .2 | -.1 |

1. Changes over periods longer than one month are measured from final month of preceding period to final month of period indicated.

benefits for union and nonunion firms are not available in the ECI, benefit increases apparently were especially sizable in the union sector, where contracts limit the ability of employers to adjust benefit provisions. By contrast, in the nonunion sector, where employers have greater flexibility, benefit costs appear to have decelerated somewhat this year.

Data on major collective bargaining settlements provide additional evidence of a slowing in wage increases this year in the unionized segment of the labor market. In settlements covering 1,000 or more workers, average first-year adjustments have declined from 4 percent in 1990 to roughly 3-1/2 percent in the second and third quarters. Total compensation costs negotiated in new major contracts (this series is limited to contracts covering 5,000 or more workers) also have decelerated, from about 4-1/2 percent last year to around 4 percent through the third quarter of this year. Bureau of National Affairs' data that include smaller contracts point to a slowing in union wages as well. Factoring in lump sum provisions, this series estimates median first-year settlements in contracts reached between January and mid-October of this year at 4 percent, down from the 4.3 percent average increase negotiated in 1990.

In the state and local government sector, the severe fiscal pressures facing many jurisdictions have led to a sharp reduction in compensation inflation. The employment cost index for this sector rose just 1.7 percent at an annual rate in the third quarter, after more than three years of increases in the 5 to 6 percent range. The sharp deceleration in state and local labor costs has been quite widespread--including previously stubborn areas such as health services and educational services--and is consistent with information available on recent collective bargaining settlements in the state and local sector.

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

| | Proportion in total IP 1990:Q4 | 1990[1] | Sep. 90- Mar. 91 | Mar. 91- July 91 | 1991 July | 1991 Aug. | 1991 Sep. |
|---|---|---|---|---|---|---|---|
| | | | Average --Monthly Change-- | | ---Monthly Change--- | | |
| Total index | 100.0 | .3 | -.9 | .7 | .6 | .0 | .1 |
| Motor vehicles and parts | 3.8 | -9.9 | -4.6 | 4.9 | 4.5 | -5.3 | 8.1 |
| Utilities | 7.6 | -2.1 | -.6 | 1.1 | -.5 | .4 | -2.5 |
| EXCLUDING UTILITIES & MOTOR VEHICLES AND PARTS: | | | | | | | |
| Total index | 88.6 | 1.0 | -.7 | .5 | .6 | .2 | .0 |
| Products, total | 58.2 | 0.9 | -.6 | .4 | .1 | .0 | .2 |
| Final products | 43.7 | 1.6 | -.5 | .3 | .1 | -.1 | .3 |
| Consumer goods | 21.8 | 0.2 | -.3 | .5 | .1 | .6 | .3 |
| Durables | 4.0 | -3.5 | -1.0 | 1.5 | .4 | .3 | .7 |
| Nondurables | 18.5 | 1.0 | -.1 | .3 | .0 | .6 | .2 |
| Business equipment | 14.8 | 5.3 | -.5 | .1 | .2 | .1 | .0 |
| Office and computing | 2.7 | 9.0 | .2 | .2 | 1.3 | -1.3 | .6 |
| Industrial | 4.3 | 1.3 | -1.1 | .0 | .3 | -.2 | -.1 |
| Other | 7.8 | 6.3 | -.3 | .2 | -.3 | .8 | -.3 |
| Defense and space equip. | 4.8 | -.2 | -.6 | -1.0 | -.8 | -.3 | -.8 |
| Intermediate products | 13.0 | -1.2 | -1.0 | .6 | .4 | .3 | .1 |
| Construction supplies | 5.7 | -4.6 | -1.6 | .8 | -.3 | .6 | .5 |
| Materials | 27.3 | .5 | -1.2 | 1.0 | 1.6 | .4 | .2 |
| Durables | 18.5 | .4 | -1.5 | .9 | 1.2 | .8 | .3 |
| Nondurables | 8.8 | .5 | -.6 | 1.1 | 2.4 | -.6 | .0 |

1. From 1989:Q4 to 1990:Q4.

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

| | 1967-90 Avg. | 1988-89 High | 1990 Sep. | 1991 Apr. | 1991 July | 1991 Aug. | 1991 Sep. |
|---|---|---|---|---|---|---|---|
| Total industry | 82.2 | 85.0 | 83.6 | 79.1 | 80.0 | 79.8 | 79.7 |
| Manufacturing | 81.5 | 85.1 | 82.8 | 77.8 | 78.7 | 78.5 | 78.7 |
| Primary processing | 82.4 | 89.0 | 85.1 | 79.0 | 81.0 | 81.1 | 81.2 |
| Advanced processing | 81.1 | 83.6 | 81.8 | 77.3 | 77.8 | 77.5 | 77.7 |

Industrial Production and Capacity Utilization

The index of industrial production was unchanged in August and edged up 0.1 percent in September. Available information for October indicates that IP was again about flat. Domestic auto and light truck assemblies look to have run at about the scheduled pace of 10.1 million units (annual rate),[2] only a small increase from the September rate. Other indicators--electricity generation, output of big-ticket home appliances, and selected materials, such as paper, paperboard, lumber, and steel--also are about flat.

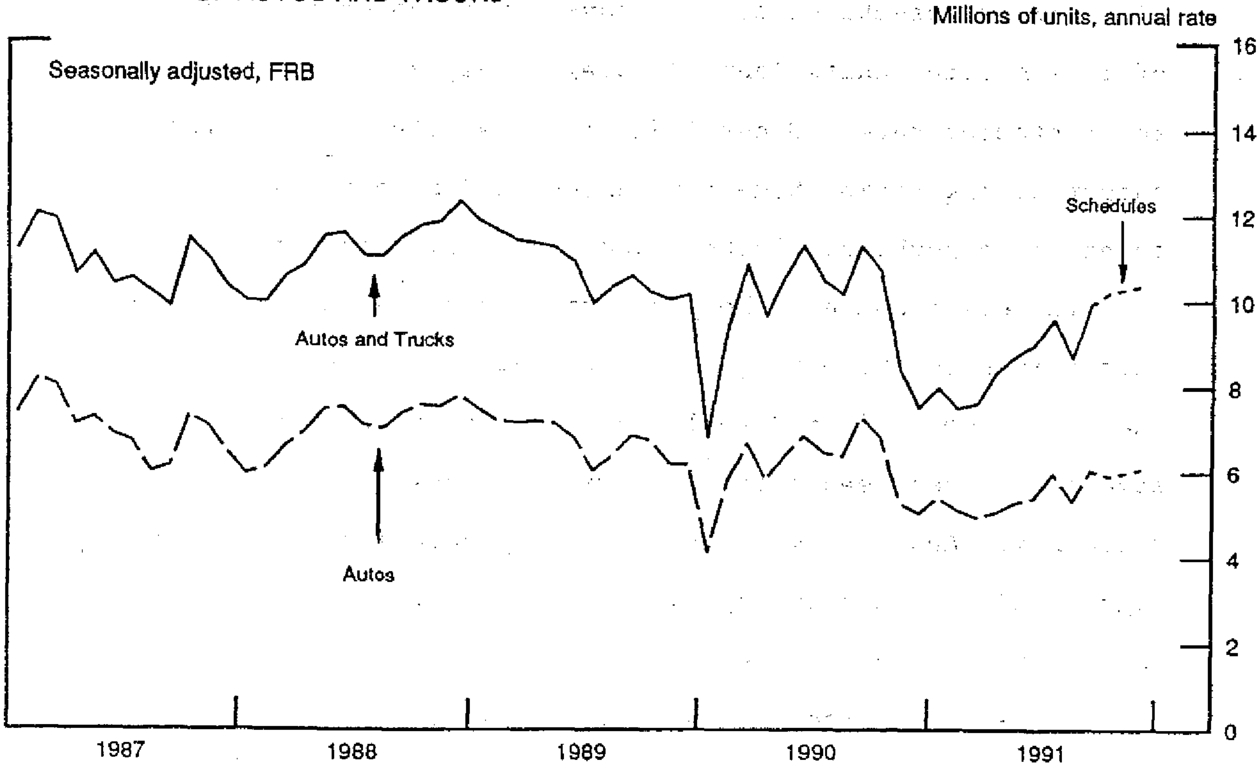
In recent months, the production index has been buffeted by wide swings in the output of motor vehicles and parts. In addition, the output of utilities fell back sharply in September from the high levels that had been associated with the unseasonably hot weather since May. Apart from these sectors, production rose 0.2 percent in August and was flat in September, after posting gains of 0.5 percent per month, on average, between March and July.

In part, the recent flattening of industrial production has reflected a slackening of stimulus from the motor vehicles industry. In addition, output of construction supplies and of non-auto consumer durables has been rising much less rapidly than it did last spring. Moreover, the steep decline in the output of defense and space equipment has persisted.

The production of business equipment other than motor vehicles was unchanged again in September, as a moderate increase in the output of office and computing equipment offset declines elsewhere; this series has not shown much improvement since reaching its low last March. However, the staff's adjusted durable orders series, which is a useful indicator of near-term movements in production,

2. Manufacturers' current schedules call for assemblies to be at an annual rate of 10.1 million units in November and 10.4 million units in December. These schedules are only a tad lower than the previously announced plans, despite rumors of larger cutbacks.

PRODUCTION OF AUTOS AND TRUCKS




DOMESTIC PRODUCTION OF AUTOS AND TRUCKS
(Millions of units at an annual rate; FRB seasonal basis)

| | 1991 Q1 | 1991 Q2 | 1991 Q3 | 1991 Q4[1] | 1991 Aug. | 1991 Sep. | 1991 Oct.[1] |
|---|---|---|---|---|---|---|---|
| Total | 7.7 | 8.6 | 9.4 | 10.2 | 8.7 | 9.9 | 10.1 |
| Autos | 5.1 | 5.2 | 5.8 | 6.0 | 5.3 | 6.0 | 5.9 |
| Trucks | 2.6 | 3.4 | 3.6 | 4.2 | 3.4 | 3.9 | 4.2 |

1. Figures for October through the remainder of the year are based on current manufacturers' schedules.

points in a more positive direction: Its nondefense capital goods component rose sharply in the third quarter and is consistent with some pickup in output of business equipment by year-end.

NEW ORDERS FOR DURABLE GOODS
(Percent change from preceding period; seasonally adjusted)

| | 1991 | | 1991 | | |
|---|---|---|---|---|---|
| | Q2 | Q3 | July | Aug. | Sep. |
| Total durable goods | 1.2 | 7.4 | 11.7 | -4.1 | -3.2 |
| Adjusted durable goods[1] | 1.7 | 4.3 | 6.3 | -1.9 | 3.0 |
| Nondefense capital goods | -1.8 | 3.9 | 4.8 | -2.1 | 8.2 |
| Other | 3.3 | 4.5 | 7.0 | -1.9 | .7 |

1. Adjusted durable goods orders equal bookings for durable goods industries that report unfilled orders, excluding orders for defense, nondefense aircraft, and motor vehicle parts.

Personal Income and Consumption

Real personal consumption expenditures rose 3-3/4 percent at an annual rate in the third quarter. Part of the advance was attributable to a sharp rise in purchases of motor vehicles: Unit sales of new cars and light trucks increased from an average pace of 12.4 million units in the second quarter to 13 million units in the third quarter. Outlays for non-auto goods also rose strongly around midyear, boosting the third-quarter average; these outlays have since trailed off, falling slightly in both August and September. Real expenditures on services rose 2-3/4 percent in the third quarter--about the rate that has prevailed, on average, since 1989.

Data for spending in the fourth quarter are limited to sales of domestically produced cars and trucks, which fell to about 9-1/2 million units at an annual rate in the first twenty days of October, roughly 1 million units below the September monthly average. The sales figures have been erratic in recent months, in part because of the large and volatile fleet purchases and the timing of sales promotions. Notably, sales of light trucks were raised appreciably

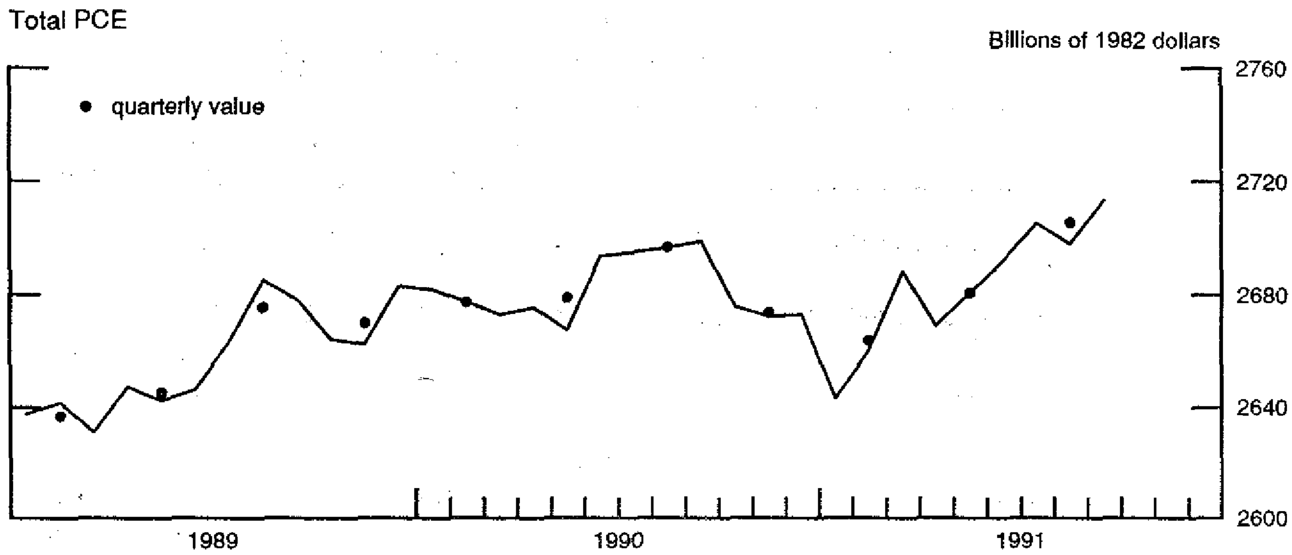
PERSONAL INCOME
(Average monthly change at an annual rate; billions of dollars)

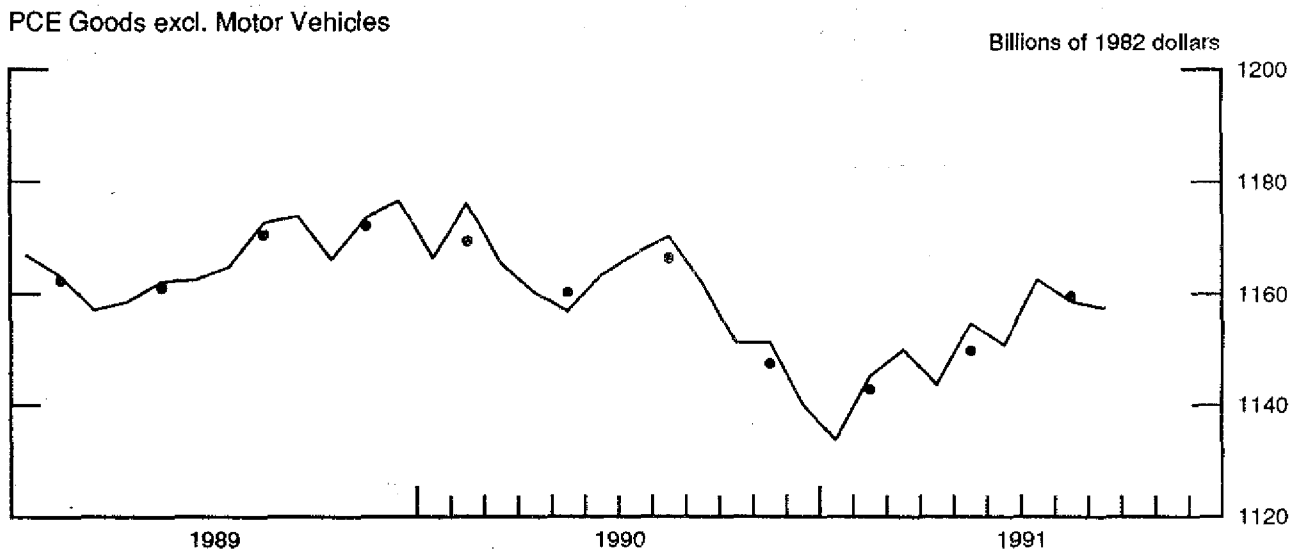
| | | 1991 | | 1991 | | |
|---|---|---|---|---|---|---|
| | 1990 | Q2 | Q3 | July | Aug. | Sep. |
| Total personal income | 20.5 | 20.2 | 11.9 | -8.4 | 21.2 | 22.9 |
| Wages and salaries | 10.9 | 17.9 | 5.4 | -8.7 | 12.9 | 12.1 |
| Private | 8.2 | 16.6 | 4.2 | -11.6 | 12.9 | 11.3 |
| Other labor income | 1.3 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| Proprietors' income | 2.1 | .2 | 2.2 | -2.1 | 2.5 | 6.3 |
| Farm | .5 | -3.7 | -1.3 | -4.2 | -1.1 | 1.3 |
| Rent | .7 | .2 | 1.3 | .6 | 1.0 | 2.3 |
| Dividend | .7 | .1 | .5 | .6 | .4 | .5 |
| Interest | 1.6 | -2.0 | -1.5 | -1.7 | -1.4 | -1.3 |
| Transfer payments | 5.2 | 4.0 | 3.6 | 2.2 | 5.7 | 2.8 |
| Less: Personal contributions for social insurance | 1.1 | 1.2 | .6 | .3 | .9 | .7 |
| Less: Personal tax and nontax payments | 4.0 | .9 | .6 | -3.3 | 1.6 | 3.6 |
| Equals: Disposable personal income | 16.5 | 19.3 | 11.3 | -5.1 | 19.6 | 19.3 |
| Memo: Real disposable income | -.8 | 7.2 | 2.0 | -2.9 | 4.5 | 4.5 |

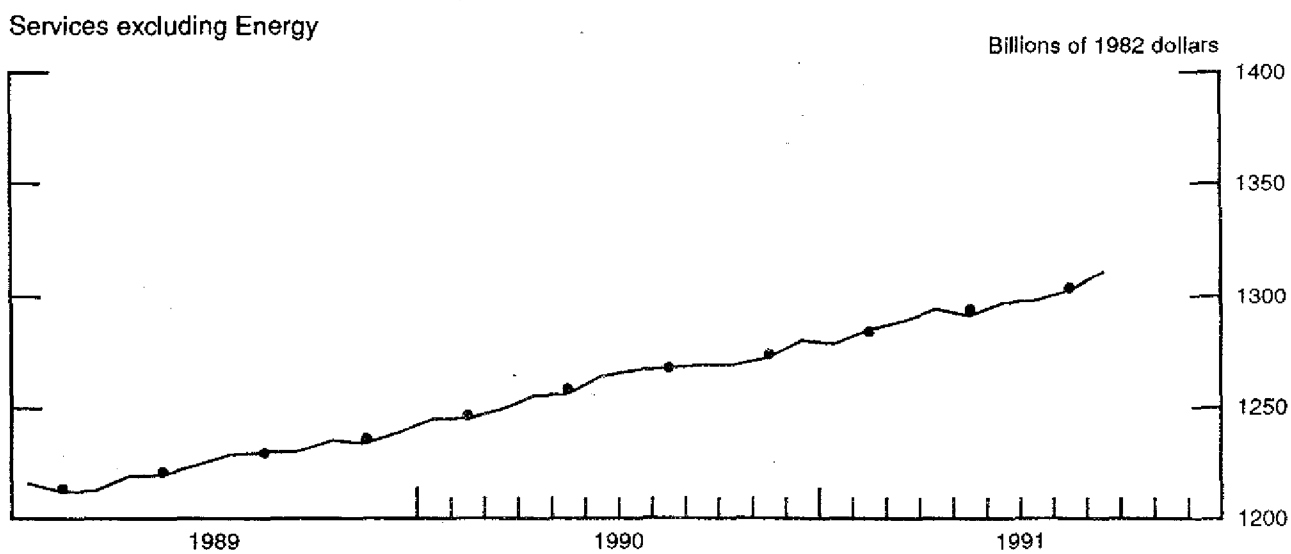
REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from the preceding period)

| | | 1991 | | 1991 | | |
|---|---|---|---|---|---|---|
| | 1990 | Q2 | Q3 | July | Aug. | Sep. |
| | | -Annual rate- | | ----Monthly rate---- | | |
| Personal consumption expenditures | .1 | 2.5 | 3.8 | .5 | -.3 | .6 |
| Total goods | -2.2 | 1.1 | 4.8 | 1.1 | -.9 | .3 |
| Excluding motor vehicles | -2.1 | 2.4 | 3.5 | 1.0 | -.3 | -.1 |
| Durable goods | -1.8 | -1.5 | 9.3 | 1.5 | -2.1 | 1.4 |
| Excluding motor vehicles | -1.1 | 3.0 | 5.4 | 1.2 | -.5 | .1 |
| Nondurable goods | -2.4 | 2.3 | 2.9 | 1.0 | -.3 | -.2 |
| Excluding gasoline | -2.3 | 1.9 | 3.5 | 1.0 | -.1 | -.4 |
| Services | 2.5 | 3.9 | 2.7 | -.1 | .3 | .8 |
| Excluding energy | 3.1 | 3.2 | | .1 | .4 | .6 |
| Memo: Personal saving rate (percent) | 4.6 | 4.2 | 3.8 | 3.7 | 4.1 | 3.7 |

# Personal Consumption Expenditures



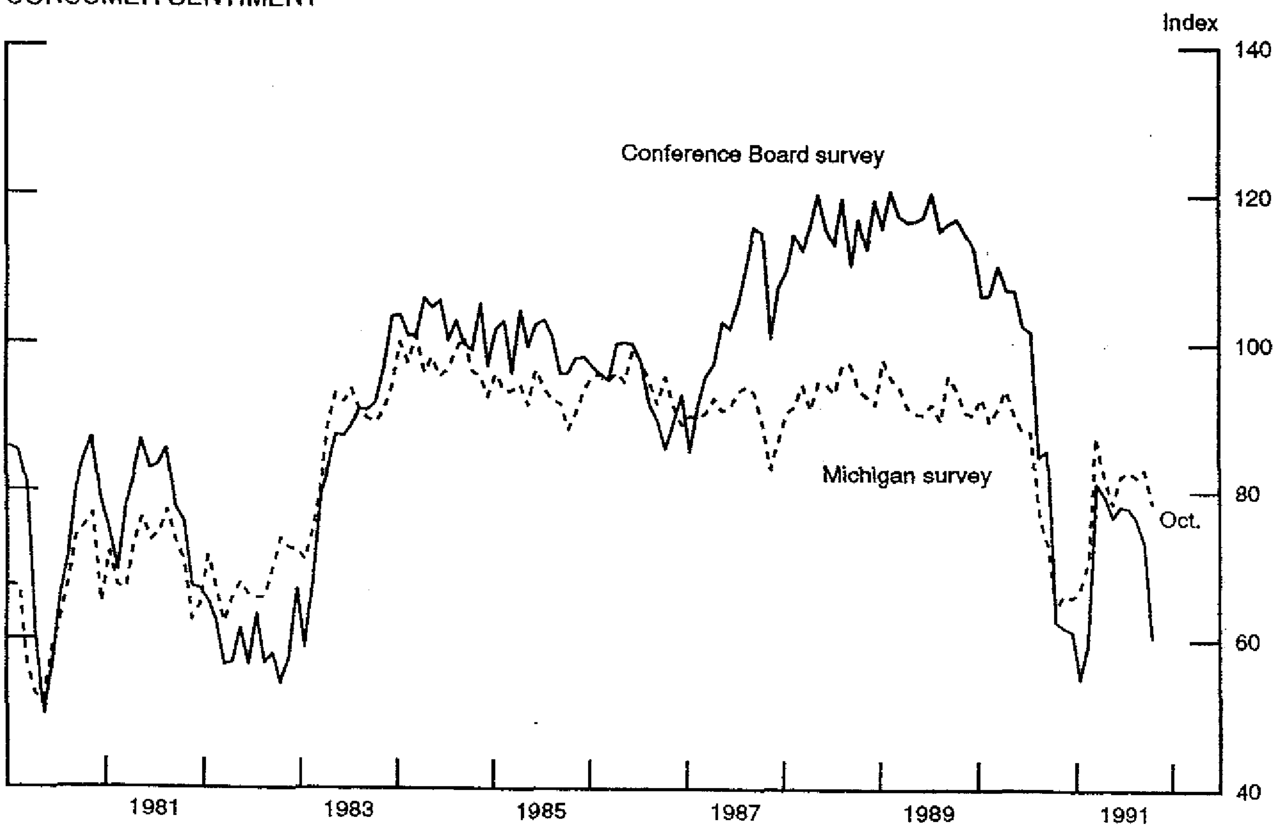
## SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, BEA seasonal basis)

| | 1991 | | | 1991 | | |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Aug. | Sep. | Oct.[1] |
| 1. Total autos and light trucks | 11.8 | 12.4 | 13.0 | 12.4 | 13.2 | n.a. |
| 2. Domestically produced[2] | 9.3 | 9.7 | 10.3 | 9.8 | 10.6 | 9.4 |
| 3. Autos | 6.0 | 6.1 | 6.4 | 6.1 | 6.3 | 6.1 |
| 4. Light trucks | 3.3 | 3.6 | 3.9 | 3.7 | 4.3 | 3.3 |
| 5. Imports | 2.5 | 2.7 | 2.6 | 2.6 | 2.6 | n.a. |
| 6. Auto | 2.2 | 2.4 | 2.3 | 2.2 | 2.3 | n.a. |
| 7. Light trucks | .3 | .3 | .3 | .3 | .3 | n.a. |

1. First twenty days; uses FRB seasonal factors prorated to BEA monthly factors.
2. Includes vehicles produced in Canada and Mexico for General Motors, Ford, and Chrysler as well as foreign makes produced in the United States.

n.a. = not available.
Note: Components may not add to totals due to rounding.

CONSUMER SENTIMENT[1]




1. For Michigan and Conference Board surveys, index equals 100 in 1966 and 1985, respectively.

in September by incentives at Ford and General Motors on 1991-model-year pickup trucks, and there has been some retrenchment in October. The average sales pace since early September for domestically made light vehicles--about 10 million units at an annual rate--is somewhat higher than in the early part of 1991, but nearly a million units below the average for 1990 as a whole.

Most of the basic determinants of consumer spending have shown little strength of late. In particular, real disposable income grew only 2 percent at an annual rate in the third quarter, and it remains a shade below its level of a year ago.

Consumer sentiment, as measured in the Michigan survey, deteriorated in October after three months of essentially no change; since the end of the war in the Persian Gulf, this series has fluctuated around a sub-par level, and the October reading ties the lowest reading for the period (chart). This month's survey indicates softness both in consumers' assessments of the current situation and in their expectations of future economic conditions. Appraisals of buying conditions for autos and other durables were little changed, but consumers reportedly have become much less willing to use credit or to dip into savings to finance purchases. In the Conference Board's October Survey, consumer confidence plunged to recessionary levels. In addition to the deterioration in assessments of labor market conditions noted earlier, consumers' views about current and prospective business conditions worsened.

<u>Business Fixed Investment</u>

Real business fixed investment rose 6-1/2 percent at an annual rate in the third quarter, as a jump in spending on equipment more than offset another steep drop in outlays for nonresidential construction. Spending on computing equipment--much of it apparently imported--was particularly strong. Real business

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

| | 1991 | | | 1991 | | |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | July | Aug. | Sep. |
| **Producers' durable equipment** | | | | | | |
| Shipments of nondefense capital goods | -2.2 | 1.4 | -.1 | -3.4 | 1.7 | 1.1 |
| Aircraft and parts | 2.9 | 5.4 | 1.1 | -7.0 | 5.5 | -1.0 |
| Excluding aircraft and parts | -3.3 | .5 | -.4 | -2.5 | .8 | 1.7 |
| Office and computing | -3.9 | -.8 | -1.6 | .3 | -1.3 | -3.8 |
| All other categories | -3.1 | .9 | .0 | -3.3 | 1.4 | 3.2 |
| Weighted PDE shipments (excl. aircraft)[1] | -4.8 | .5 | -.9 | -2.1 | -.1 | 2.5 |
| Shipments of CIR complete aircraft[2] | 71.7 | .0 | n.a. | -14.4 | 18.9 | n.a. |
| Sales of heavy-weight trucks | -9.1 | -7.4 | 3.9 | 5.2 | -5.6 | 3.3 |
| Orders of nondefense capital goods | -6.6 | -13.6 | 14.5 | 25.3 | -15.6 | -.4 |
| Excluding aircraft and parts | -4.0 | -1.8 | 3.9 | 4.8 | -2.1 | 8.2 |
| Office and computing | 3.6 | -1.6 | -4.0 | -2.5 | -.1 | -7.5 |
| All other categories | -6.1 | -1.9 | 6.3 | 7.2 | -2.7 | 12.9 |
| **Nonresidential structures** | | | | | | |
| Construction put-in-place | -4.4 | -2.7 | n.a. | -.7 | -2.4 | n.a. |
| Office | -6.6 | -5.4 | n.a. | -2.2 | -5.0 | n.a. |
| Other commercial | -10.6 | -3.5 | n.a. | -1.1 | -4.2 | n.a. |
| Public utilities | -.7 | 1.4 | n.a. | -1.1 | 1.4 | n.a. |
| Industrial | .6 | -4.2 | n.a. | .6 | -2.4 | n.a. |
| All other | -4.0 | -3.1 | n.a. | .4 | -3.2 | n.a. |
| Rotary drilling rigs in use | .9 | -8.4 | -11.3 | -4.6 | -9.3 | -7.2 |
| Footage drilled[3] | -8.3 | -9.5 | n.a. | -2.8 | -1.9 | n.a. |

1. Computed as the weighted sum of 25 individual equipment series from the Census M-3 report, with weight for each type of equipment equal to the ratio of final business spending to shipments.
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.

spending on aircraft[3] and motor vehicles also recorded another sizable gain, while outlays for industrial machinery fell further. Real spending on nonresidential structures fell again at a double-digit rate; outlays for every major type of building weakened, but the decline in the commercial sector was especially steep.

Looking ahead, recent indicators suggest that equipment spending is likely to grow moderately in the near future, and that the mix of spending will shift away from computing and transportation equipment toward other items. Orders for nondefense capital goods excluding aircraft advanced 4 percent (not at an annual rate) in the third quarter on the strength of big increases for communication equipment and for several categories of industrial machinery. New orders for office and computing equipment fell about 4 percent in nominal terms, but at least some of the drop undoubtedly was attributable to the reported sizable declines in prices of high-technology items. Moreover, fourth-quarter purchases of computers are expected to be bolstered by deliveries of a new generation of IBM mainframes--many of which were ordered some time ago.[4] Some of these shipments will displace sales of other mainframes, but industry sources indicate that pent-up demand for the new machines is fairly strong and likely will result in increased spending overall.

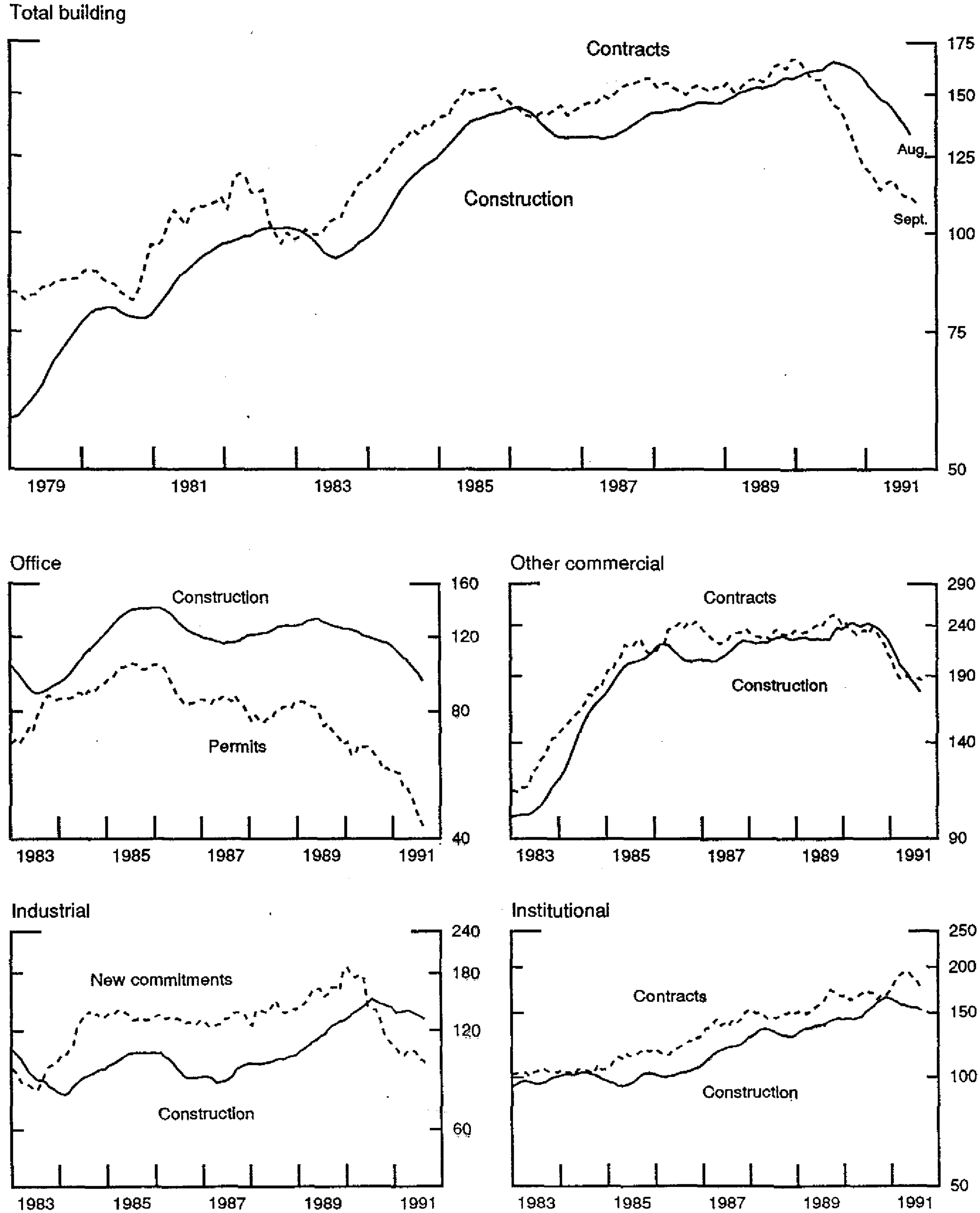
On the structures side, the plunge in new commitments for the industrial and "other commercial" sectors appears to have eased in the last few months (chart). The outlook for office construction

3. BEA once again is using the CIR on shipments of complete aircraft to estimate investment in this category. (Public release of data from the CIR survey had been prohibited since September 1990 because of confidentiality restrictions, but the Census has now received waivers from the manufacturers that allow publication.) Based on CIR data through August, shipments of aircraft appear to have been stronger in the third quarter than in the M3 survey.

4. IBM started to ship the new machines at the end of September. They cost about $15 million apiece (in current dollars) and take about five or six weeks to assemble.

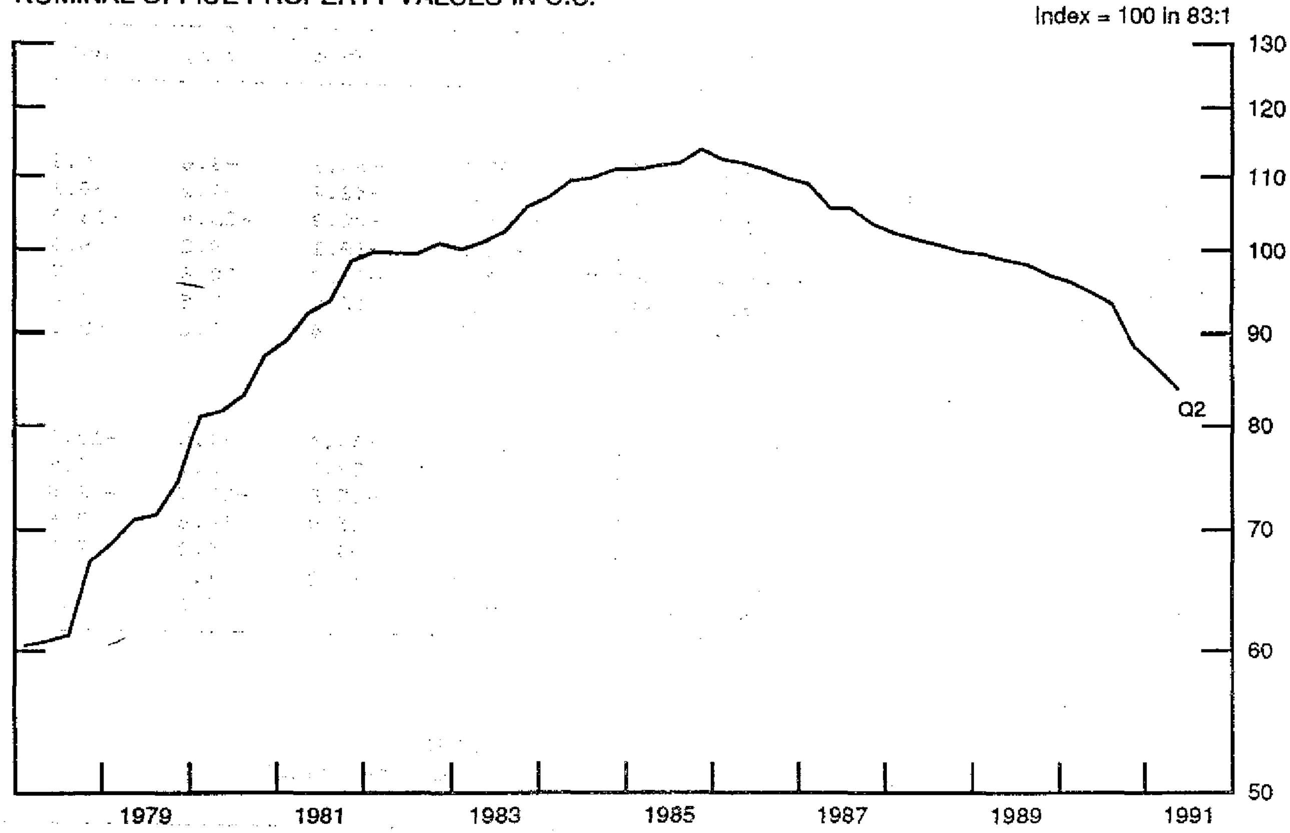
## Nonresidential Construction and Selected Indicators[1]

(Dec. 1982 = 100, ratio scale)



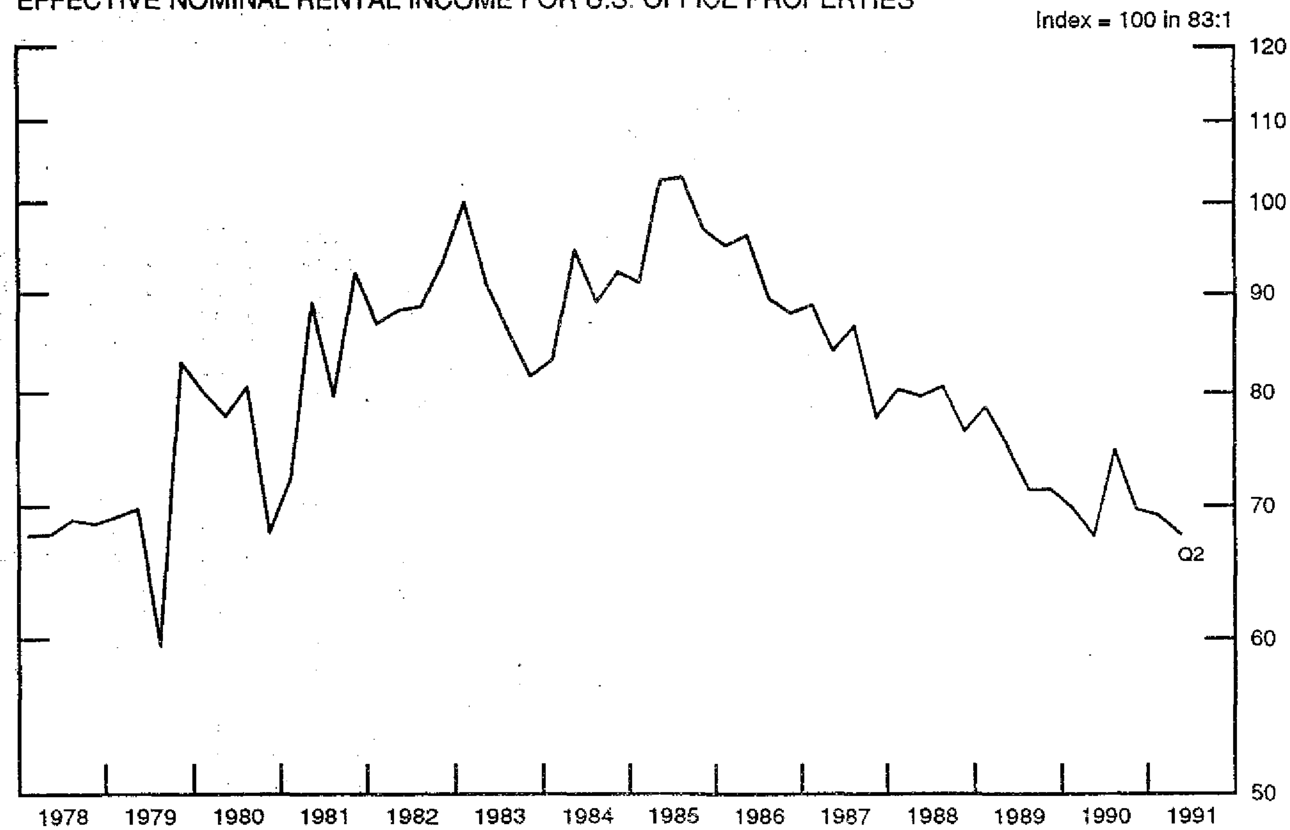

1. Six-month moving average for all series shown. For contracts, total only includes private, while individual sectors include private and public. New commitments are the sum of permits and contracts. Contracts and permits extend through September.

NOMINAL OFFICE PROPERTY VALUES IN U.S.[1]




1. Russell–NCREIF capital index.

EFFECTIVE NOMINAL RENTAL INCOME FOR U.S. OFFICE PROPERTIES[1]




1. Calculated from Russell–NCREIF data.

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

| | 1990 | 1991 | | 1991 | | |
|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | June | July | Aug. |
| Current-cost basis: | | | | | | |
| Total | -.8 | -29.3 | -50.0 | -55.3 | -3.6 | -6.3 |
| Total excluding retail auto | 9.1 | -14.4 | -42.2 | -42.4 | -7.2 | -9.1 |
| Manufacturing | -8.7 | -11.3 | -24.1 | -22.9 | -23.6 | -13.2 |
| Wholesale | 10.5 | 4.7 | -18.8 | -19.1 | 9.2 | 6.3 |
| Retail | -2.6 | -22.7 | -7.2 | -13.3 | 10.8 | .7 |
| Automotive | -9.9 | -14.9 | -7.9 | -12.9 | 3.6 | 2.8 |
| Excluding auto | 7.3 | -7.8 | .7 | -.4 | 7.2 | -2.1 |
| Constant-dollar basis: | | | | | | |
| Total | -21.8 | -20.0 | -27.8 | -34.4 | -1.0 | -12.3 |
| Total excluding retail auto | -11.4 | -2.3 | -28.6 | -33.2 | -2.1 | -12.8 |
| Manufacturing | -18.3 | -1.3 | -12.7 | -15.5 | -17.7 | -12.6 |
| Wholesale | 5.8 | 6.0 | -14.0 | -16.0 | 10.6 | 2.6 |
| Retail | -9.3 | -24.7 | -1.0 | -3.0 | 6.0 | -2.3 |
| Automotive | -10.4 | -17.6 | .8 | -1.2 | 1.1 | .5 |
| Excluding auto | 1.1 | -7.1 | -1.8 | -1.8 | 4.9 | -2.7 |

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

| | Range in preceding 12 months:[2] | | 1990 | 1991 | | 1991 | | |
|---|---|---|---|---|---|---|---|---|
| | Low | High | Q4 | Q1 | Q2 | June | July | Aug. |
| Current-cost basis: | | | | | | | | |
| Total | 1.49 | 1.58 | 1.52 | 1.56 | 1.51 | 1.50 | 1.49 | 1.49 |
| Total excluding retail auto | 1.46 | 1.55 | 1.49 | 1.53 | 1.49 | 1.48 | 1.47 | 1.47 |
| Manufacturing | 1.55 | 1.69 | 1.59 | 1.66 | 1.60 | 1.59 | 1.57 | 1.56 |
| Wholesale | 1.28 | 1.38 | 1.31 | 1.37 | 1.32 | 1.32 | 1.31 | 1.32 |
| Retail | 1.54 | 1.65 | 1.60 | 1.58 | 1.55 | 1.54 | 1.54 | 1.55 |
| Automotive | 1.82 | 2.18 | 2.01 | 1.96 | 1.84 | 1.82 | 1.85 | 1.90 |
| Excluding auto | 1.46 | 1.52 | 1.49 | 1.48 | 1.47 | 1.47 | 1.46 | 1.46 |
| Constant-dollar basis: | | | | | | | | |
| Total | 1.42 | 1.51 | 1.46 | 1.49 | 1.44 | 1.44 | 1.42 | 1.43 |
| Total excluding retail auto | 1.41 | 1.49 | 1.44 | 1.48 | 1.43 | 1.43 | 1.41 | 1.41 |
| Manufacturing | 1.45 | 1.55 | 1.48 | 1.53 | 1.47 | 1.46 | 1.45 | 1.44 |
| Wholesale | 1.30 | 1.40 | 1.34 | 1.39 | 1.33 | 1.32 | 1.30 | 1.32 |
| Retail | 1.50 | 1.60 | 1.55 | 1.52 | 1.50 | 1.50 | 1.50 | 1.51 |
| Automotive | 1.63 | 1.89 | 1.77 | 1.68 | 1.65 | 1.63 | 1.66 | 1.70 |
| Excluding auto | 1.46 | 1.53 | 1.50 | 1.48 | 1.47 | 1.47 | 1.46 | 1.46 |

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

has not improved, however, as the persistent oversupply of existing office space continues to depress rents and property values in this market. Rental income for existing office buildings has declined nearly 30 percent since 1985, and it trended down further in the second quarter (chart).[5] The appraised values of office properties have shown a similar drop.

Business Inventories

The pace of business inventory liquidation slowed significantly this past summer. In constant-dollar terms, manufacturing and trade firms (excluding retail auto dealers) reduced stocks at only a $7-1/2 billion annual rate in July and August, compared with a liquidation averaging nearly $30 billion in the second quarter.[6]

The sharp slowing in the pace of overall inventory liquidation can be traced primarily to a moderate rise in stocks in the wholesale trade sector, where inventories had been liquidated substantially in the second quarter. Although the shift toward accumulation was accompanied by a net increase in sales, the inventory-sales ratio for wholesale trade at the end of August was still above its prerecession low.

Manufacturers continued to run off stocks in the summer at about the same pace as in the second quarter. These reductions in stocks, along with a rise in shipments, have reversed the runup in stock-sales ratios that occurred during the recession. While the

5. These data are compiled by the Frank Russell Company in conjunction with the National Council of Real Estate Investment Fiduciaries (Russell-NCREIF) and are based on rents and appraised values of about 350 office properties owned by major institutional investors.

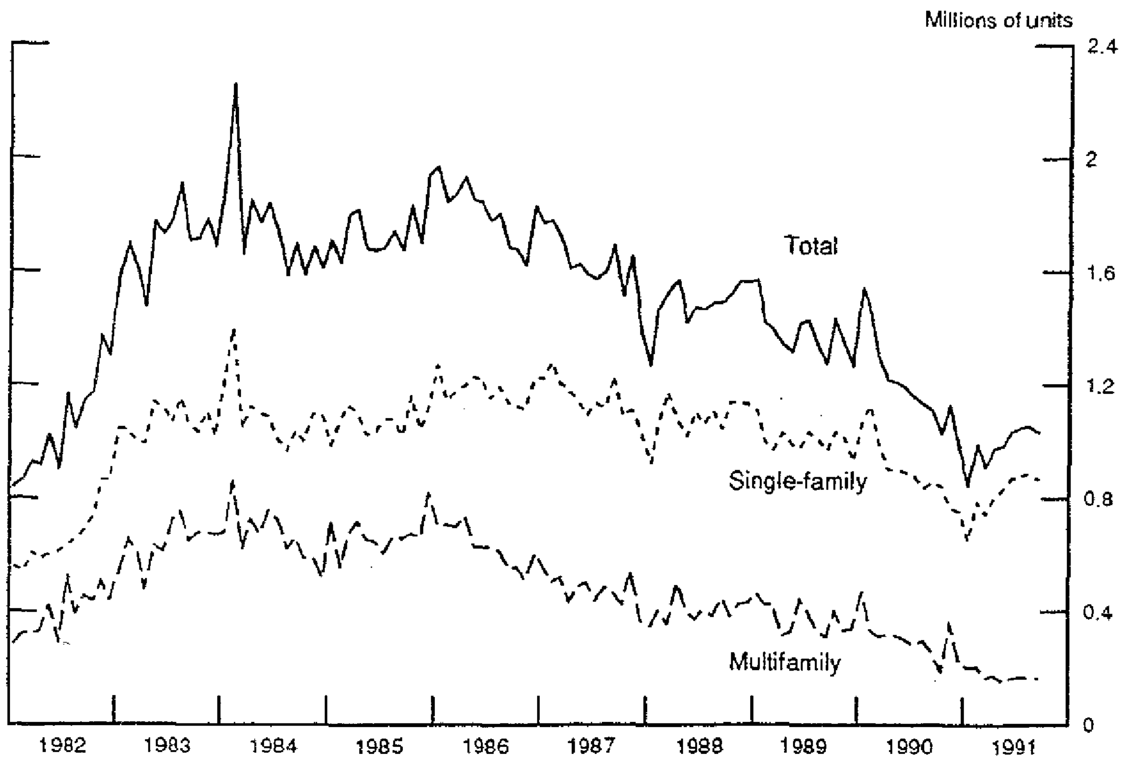
6. In putting together the GNP estimates for the third quarter, BEA assumed that inventories in manufacturing and trade would fall at an annual rate of $17-1/2 billion (current cost) in September, and that the reduction in nonfarm business inventories for the quarter as a whole would amount to $13 billion (annual rate) in real terms, $14 billion less liquidation than in the second quarter. The inventory swing added about 1-1/2 percentage points (annual rate) to growth of real GNP last quarter.

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

| | 1990 | 1991 | | | 1991 | | |
|---|---|---|---|---|---|---|---|
| | Annual | Q1 | Q2 | Q3p | July r | Aug. r | Sep. p |
| All units | | | | | | | |
| Permits | 1.11 | .86 | .96 | .98 | 1.01 | .95 | .98 |
| Starts | 1.19 | .92 | 1.00 | 1.05 | 1.05 | 1.06 | 1.03 |
| Single-family units | | | | | | | |
| Permits | .79 | .67 | .76 | .78 | .79 | .77 | .78 |
| Starts | .90 | .73 | .83 | .88 | .88 | .89 | .87 |
| Sales | | | | | | | |
| New homes | .53 | .47 | .51 | .49 | .50 | .51 | .45 |
| Existing homes | 3.30 | 3.09 | 3.48 | 3.23 | 3.32 | 3.25 | 3.11 |
| Multifamily units | | | | | | | |
| Permits | .32 | .19 | .20 | .20 | .21 | .18 | .20 |
| Starts | .30 | .19 | .16 | .17 | .17 | .17 | .17 |

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

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



improvement in inventory positions has been broadly based, it has been particularly notable in materials industries. Although the inventory-to-shipments ratios of these industries in August still were above their pre-recession lows, they nonetheless have fallen considerably from their recent peaks.

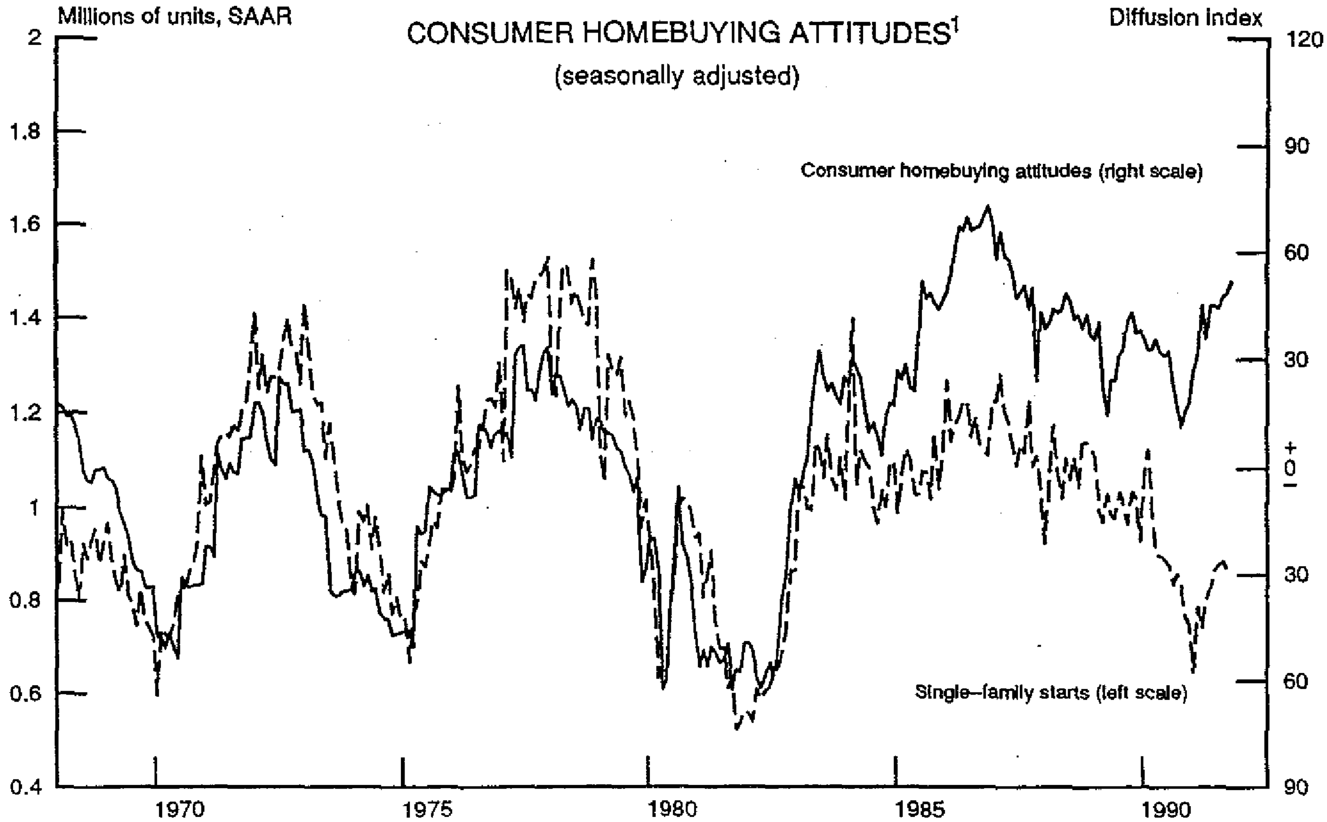
Inventories in the non-auto retail trade sector have posted little net change since April; sales have risen, on balance, over this period, and the inventory-to-sales ratio has edged down. According to current-cost figures, the inventory-sales ratio in August at general merchandise, apparel, and furniture stores, where spending is considered largely discretionary, was at the low end of the range registered over the past year.

Housing Markets

Total private housing starts declined in September to an annual rate of 1.03 million units after edging up to 1.06 million units in August. Nonetheless, the level of starts for the third quarter as a whole--1.05 million units--was about 5 percent above the second-quarter pace and was reflected in the 20 percent (annual rate) rise in real expenditures on residential construction estimated by BEA for the third quarter.

In the single-family sector, starts decreased 2 percent in September to 868,000 units, while permits, which are measured with less statistical error than are starts, edged up--bringing the two series back into more normal alignment. Sales of new and existing homes dropped sharply last month to the slowest pace since January.

Nonetheless, many of the underpinnings for an expansion in the single-family market still seem to be in place. Nominal rates on both fixed-rate and adjustable-rate mortgages are down about 130 basis points over the past year. The cuts in mortgage rates, in combination with quiescent house prices, have helped to reduce the




1 The homebuying attitudes index is calculated by the Survey Research Center (University of Michigan) as the proportion of respondents rating current conditions as good minus the proportion rating such conditions as bad.

HOUSING VACANCY RATES
(Percent; not seasonally adjusted)

| | Rental properties | | Homeowner properties | |
|---|---|---|---|---|
| Period | Total | Multifamily[1] | Total[2] | Multifamily[3] |
| 1989-Q1 | 7.5 | 9.4 | 1.7 | 6.3 |
| Q2 | 7.4 | 9.4 | 1.7 | 7.1 |
| Q3 | 7.6 | 9.4 | 1.9 | 8.1 |
| Q4 | 7.1 | 8.8 | 1.8 | 6.8 |
| 1990-Q1 | 7.5 | 9.4 | 1.7 | 7.6 |
| Q2 | 7.0 | 8.5 | 1.7 | 7.9 |
| Q3 | 7.2 | 9.5 | 1.7 | 6.6 |
| Q4 | 7.2 | 9.0 | 1.7 | 6.6 |
| 1991-Q1 | 7.5 | 9.4 | 1.7 | 7.6 |
| Q2 r | 7.3 | 9.4 | 1.8 | 7.1 |
| Q3 p | 7.6 | 9.6 | 1.8 | 6.6 |

1. Two or more units in structure.
2. Percentage of homeowner properties that are vacant and for sale.
3. Percentage of condominium properties that are vacant and for sale.
r Revised. p Preliminary.

cash-flow cost of homeownership to its lowest level in several years. Partly reflecting these developments, consumer attitudes toward home buying, as measured by the Survey Research Center, continued to improve through October (chart), and, among the age groups that typically exhibit a preference for homeownership, household formations remain on a par with the robust rates of increase in the 1980s. At the moment, however, these favorable influences perhaps are being diluted by concerns among potential homebuyers about the economy.

Construction in the multifamily sector remains dead in the water. Multifamily starts declined in September to 165,000 units at an annual rate, a level only slightly above the thirty-year low recorded in May. Construction continues to be impeded by a persistent oversupply of rental apartments: The multifamily rental vacancy rate, at 9.6 percent last quarter (table), has changed little over the past two years.

Federal Sector

Real federal purchases of goods and services (excluding CCC) fell at a 5-1/2 percent annual rate in the third quarter, owing to a sizable decline in defense purchases. The drop in defense spending followed an even larger decline in the second quarter and reflected both the continued winding down of Operation Desert Storm and the downward trend in real defense expenditures legislated in the budget agreements of the past few years. For the fiscal year as a whole, real defense expenditures were about 2 percent above their 1990 level, as spending for Operation Desert Storm more than offset the scheduled decline in baseline defense outlays. Real nondefense purchases excluding CCC payments were essentially unchanged in the third quarter.

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS
(Unified basis, billions of current dollars, not seasonally adjusted, except where otherwise noted)

| | Third Quarter 1990 | Third Quarter 1991 | Third Quarter Percent change | FY90 | FY91 | Percent change |
|---|---|---|---|---|---|---|
| Outlays | 311.6 | 355.6 | 14.1 | 1251.8 | 1323.0 | 5.7 |
| Deposit insurance (DI) | 16.5 | 36.0 | 118.2 | 58.3 | 66.6 | 14.3 |
| Defense cooperation account contributions (DCA) (-) | 0.0 | -4.7 | -- | 0.0 | -43.6 | -- |
| Outlays ex DI and DCA | 295.1 | 324.3 | 9.9 | 1193.6 | 1300.0 | 8.9 |
| National defense ex DCA | 72.9 | 78.5 | 7.7 | 299.3 | 316.1 | 5.6 |
| Net interest | 48.4 | 49.4 | 2.1 | 184.2 | 195.0 | 5.9 |
| Social Security | 62.7 | 67.9 | 8.3 | 248.6 | 269.0 | 8.2 |
| Medicare and health | 41.6 | 47.4 | 13.9 | 155.8 | 175.7 | 12.8 |
| Income security | 35.5 | 42.4 | 19.4 | 147.3 | 171.6 | 16.5 |
| Agriculture | 0.6 | 1.0 | 66.7 | 12.0 | 14.9 | 24.6 |
| Other | 33.5 | 37.7 | 12.5 | 146.2 | 157.8 | 7.9 |
| Receipts | 253.7 | 264.4 | 4.2 | 1031.3 | 1054.3 | 2.2 |
| Personal income taxes | 116.4 | 120.9 | 3.9 | 466.9 | 467.8 | 0.2 |
| Social insurance taxes | 92.7 | 95.9 | 3.5 | 380.0 | 396.0 | 4.2 |
| Corporate income taxes | 21.0 | 21.7 | 3.1 | 93.5 | 98.1 | 4.9 |
| Other | 23.6 | 25.9 | 9.6 | 90.9 | 92.3 | 1.6 |
| Deficit | 57.9 | 91.3 | 57.7 | 220.6 | 268.7 | 21.9 |
| Deficit ex DI and DCA | 41.4 | 60.0 | 44.9 | 162.3 | 245.7 | 51.5 |

FEDERAL PURCHASES OF GOODS AND SERVICES
(NIPA basis, seasonally adjusted, at annual rates)

| | FY90 | FY91 | Percent change | 1990 Q4 | 1991 Q1 | 1991 Q2 | 1991 Q3 |
|---|---|---|---|---|---|---|---|
| | ---------Billions of 1982 dollars--------- | | | | | | |
| Real purchases ex CCC | 342 | 348 | 1.9 | 352 | 351 | 347 | 342 |
| Real defense purchases | 256 | 262 | 2.1 | 266 | 268 | 259 | 254 |
| Real nondefense purchases ex CCC | 86 | 87 | 1.1 | 87 | 84 | 88 | 88 |

The unified budget deficit increased to $269 billion in FY1991, $48 billion higher than in FY1990.[7] In large part, the rise in the deficit was attributable to the effects of the recession and to a pickup in net outlays for deposit insurance to almost $70 billion. However, allied contributions to defray the cost of Operation Desert Storm provided a sizable one-time offset. Excluding deposit insurance and allied contributions, the deficit totaled about $246 billion.

Excluding deposit insurance and allied contributions (which are scored as negative outlays in the unified budget), outlays rose about 9 percent in FY1991.[8] Spending for health programs continued to rise rapidly, pushed by large increases in health care costs as well as expansion of the Medicaid program and the well-publicized attempts by state governments to maximize the federal reimbursement for Medicaid hospital charges. Among other entitlement programs, outlays for social security were boosted by a

7. The FY1991 deficit was smaller than had been anticipated in OMB's Mid-Session Review of the Budget (released in July) and in CBO's The Economic and Budget Outlook: An Update (released in August).

8. As allied contributions appear in the budget, they give a misleading impression of the stance of fiscal policy--they reduce the deficit as would a tax increase, but they instead represent a transfer of wealth to the United States. In contrast, expenditures on Operation Desert Storm increase the deficit in a way that directly increases U.S. aggregate demand.

5-1/2 percent COLA[9] and by growth in the number of beneficiaries; spending for unemployment benefits also rose sharply. Defense outlays--excluding foreign contributions for Operation Desert Storm--were up moderately because the spending cuts enacted as part of last fall's budget legislation were more than offset by the additional outlays for Operation Desert Storm.

Receipts rose only about 2 percent in FY1991--the smallest gain in many years--despite last year's changes to the tax laws that were projected to raise about $16 billion in new revenues (and another $2 billion from extensions of expiring provisions). Personal income receipts were especially weak, held down by the relatively slow growth in nominal taxable income as well as the unusually low level of final payments on 1990 liabilities last spring. The plunge in final payments follows an unusually high level of withheld taxes relative to NIPA wages and salaries in calendar year 1990; because taxes are withheld at rates based on the anticipation of a full year's pay, and because the withholding schedule is progressive, many workers who had jobs in the first part of 1990, but were laid off during the recession, probably were significantly overwithheld for the year as a whole.

Legislation providing funding for FY1992 is nearing completion. Four of the thirteen regular appropriations bills have not yet been enacted, and the affected programs are currently being funded in accordance with a continuing resolution that was extended on October 28 and expires on November 14. Two of these appropriations bills are out of conference but are not yet approved by both houses of Congress, and two are still in conference. The nine appropriations bills so far enacted abide by the spending caps

9. The social security COLA was based on the change in the CPI-W over the four quarters ending in September 1990. Given the data through September 1991, the COLA for 1992 will be 3-3/4 percent.

contained in last year's budget agreement, and it appears that the remaining four bills will also pass in a form that satisfies the budget agreement.

State and Local Government Sector

Real purchases of goods and services by state and local governments edged down in the third quarter, after a small decline over the first half of the year. Outlays for "other" goods and services--that is, those outside of construction and labor compensation--fell 3 percent at an annual rate--the first reduction since mid-1987. In addition, the cutbacks in employment last summer contributed to a marked slowing in real outlays for compensation. In contrast, construction spending is estimated to have risen about 4 percent at an annual rate in the third quarter after a sizable decline over the first half of the year.[10]

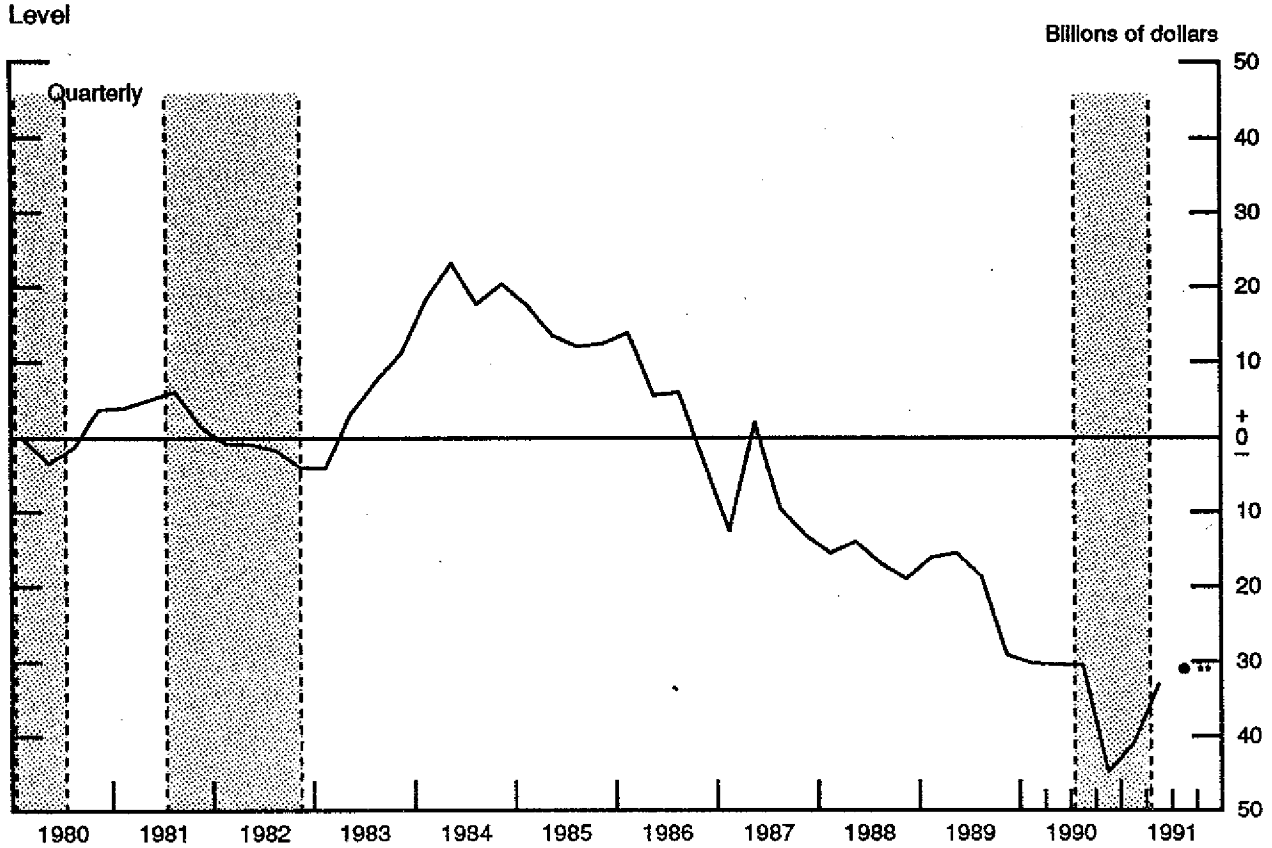
So far this year, real purchases have declined at about a 1 percent annual rate, while receipts have risen moderately--in part reflecting the spate of tax increases that went into effect during the third quarter; as a result, the deficit of operating and capital accounts, which excludes social insurance funds, is estimated to have narrowed from $45 billion at an annual rate in the fourth quarter of last year to about $30 billion last quarter.

Despite widespread spending cuts and tax hikes, many state and local governments are confronting new budget gaps, and some are taking corrective actions. For example, California has trimmed payrolls in view of a shortfall in tax receipts of nearly 4 percent, and layoffs have been reported by several states in the mid-Atlantic and Northeast regions, as well as Ohio. In addition, Michigan and Maryland recently announced the termination of general assistance

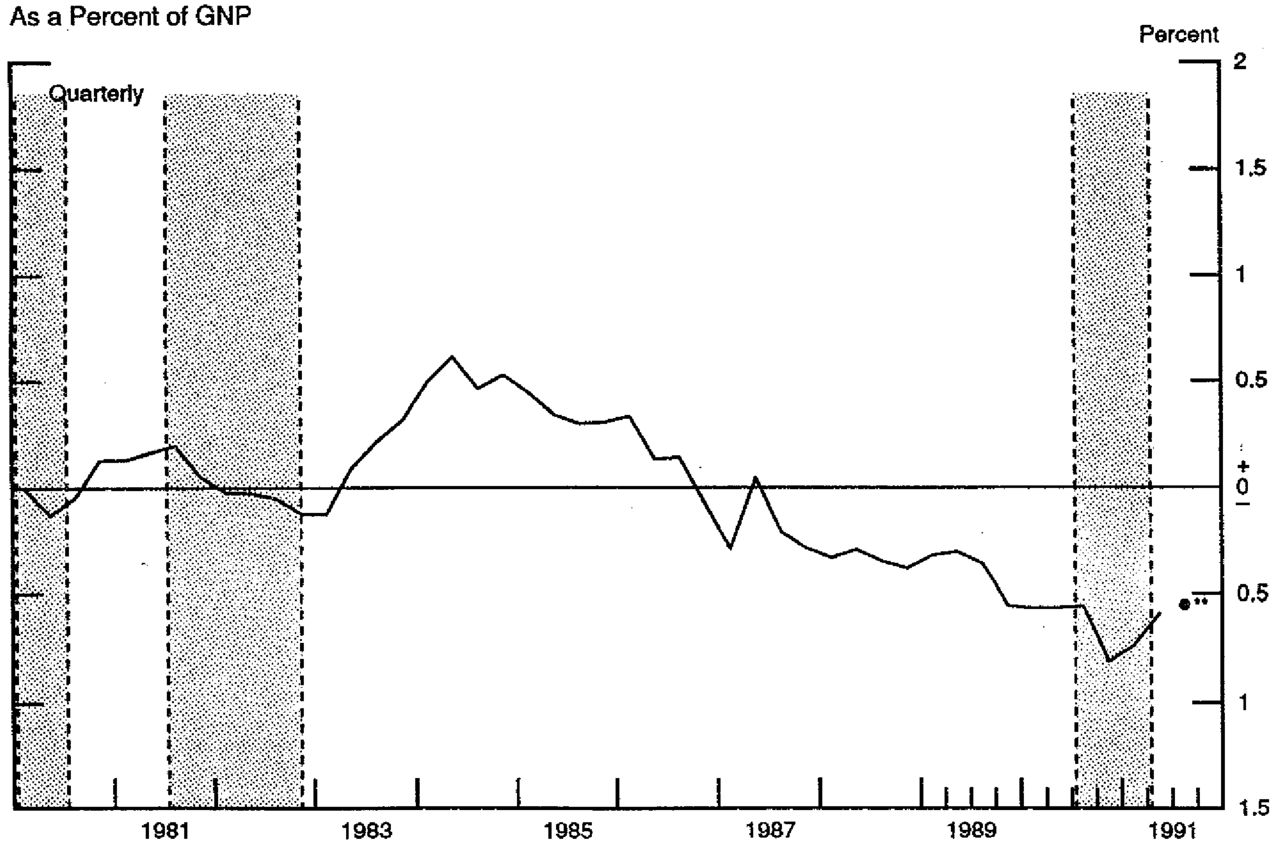
10. The third-quarter estimate incorporates the large increases in outlays for construction put in place in July and August, but BEA assumes a steep decline in this series in September.

## STATE AND LOCAL SECTOR SURPLUS (DEFICIT)*
(NIPA basis)

Level




As a Percent of GNP




*For operating and capital accounts, excludes social insurance funds.
** Staff estimate.

welfare programs for able-bodied adults without children; Illinois, Massachusetts, and Ohio restricted their welfare programs earlier this year.

Prices

The September increase in consumer prices was larger than those of the previous few months because the food and energy sectors failed to provide the offset seen before. Excluding food and energy items, the CPI rose 0.4 percent in September--the same as in July and August; price increases slowed for goods but picked up for services.

Energy prices rose 1 percent in the September CPI, with sizable increases for petroleum products, natural gas, and electricity. Private survey data point to a decline in retail gasoline prices in October, but both spot and posted prices of crude oil have moved up markedly since mid-September, in part owing to concerns about supplies from Iraq and the Soviet Union.[11] These increases likely will show up at retail later in the fourth quarter.

The CPI for food edged up 0.1 percent in September after declines in July and August. Prices of meat, poultry, and vegetables fell further, but prices turned up notably for fresh fruits. Vegetable prices appear to have dropped still further in October, but prices of some other farm products have moved up. Recent increases in cattle prices could lead to some firming in the retail price of beef this quarter. Prices of dairy products also have increased in recent months as milk production has been cut back somewhat. In general, however, inflation remained subdued in the food sector because average price increases in those food categories that mainly reflect nonfarm input costs have continued to be modest.

11. The Soviet Union is an important source of fuel oil for European countries as well as of crude oil in world markets.

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

| | Relative importance Dec. 1990 | 1989 | 1990 | 1991 Q1 | 1991 Q2 | 1991 Q3 | 1991 Aug. | 1991 Sept. |
|---|---|---|---|---|---|---|---|---|
| | | | | -----Annual rate------ | | | -Monthly rate- | |
| All items[2] | 100.0 | 4.6 | 6.1 | 2.4 | 3.0 | 3.3 | .2 | .4 |
| Food | 16.2 | 5.6 | 5.3 | 2.4 | 5.1 | -3.2 | -.3 | .1 |
| Energy | 8.2 | 5.1 | 18.1 | -30.7 | -1.2 | 1.6 | -.2 | 1.0 |
| All items less food and energy | 75.6 | 4.4 | 5.2 | 6.8 | 3.2 | 4.6 | .4 | .4 |
| Commodities | 24.5 | 2.7 | 3.4 | 7.9 | 3.2 | 4.1 | .5 | .2 |
| Services | 51.1 | 5.3 | 6.0 | 6.4 | 3.0 | 4.6 | .3 | .5 |
| Memorandum: | | | | | | | | |
| CPI-W[3] | 100.0 | 4.5 | 6.1 | 1.5 | 3.3 | 2.7 | .1 | .4 |

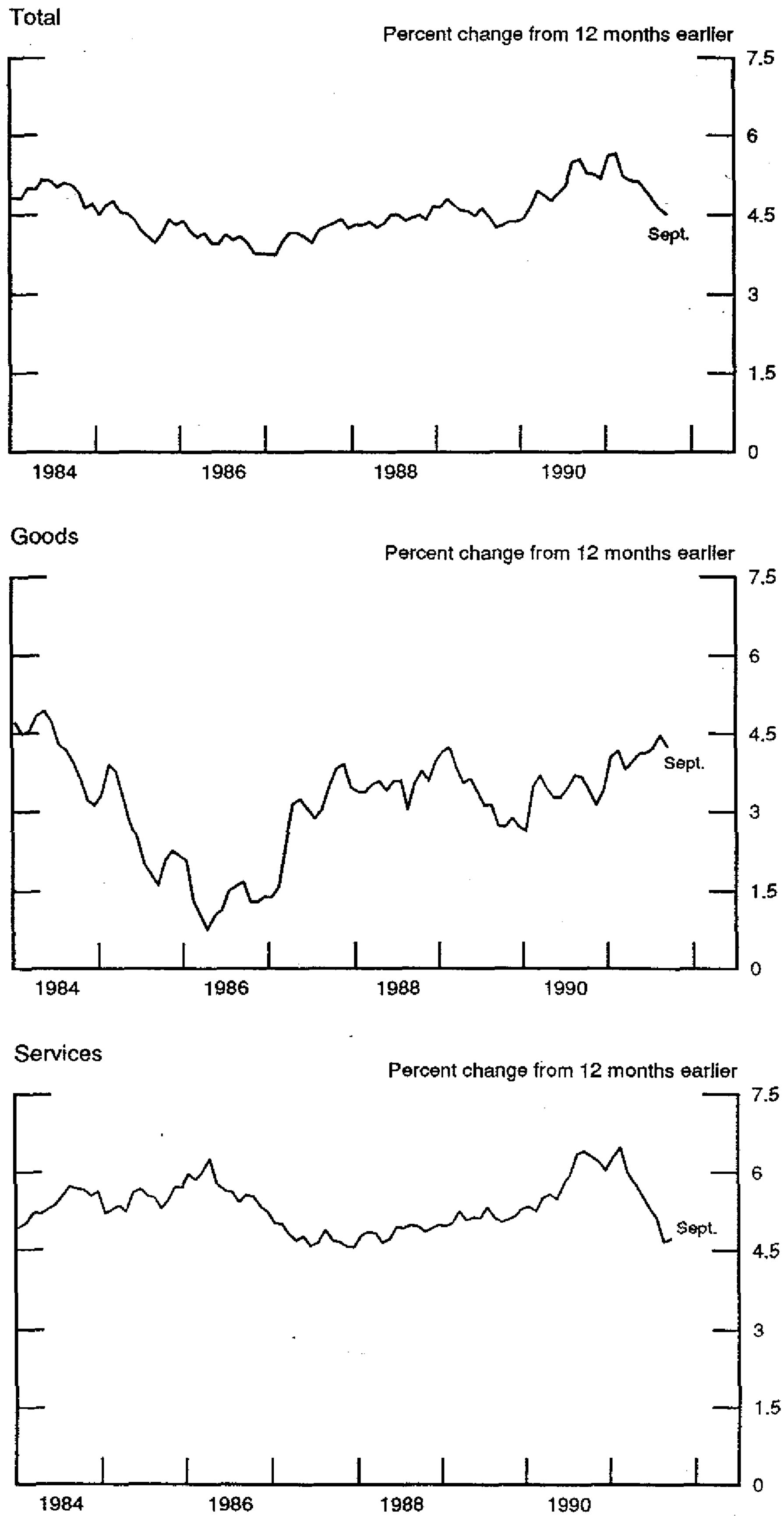
1. Changes are from final month of preceding period to final month of period indicated.
2. Official index for all urban consumers.
3. Index for urban wage earners and clerical workers.

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

| | Relative importance Dec. 1990 | 1989 | 1990 | 1991 Q1 | 1991 Q2 | 1991 Q3 | 1991 Aug. | 1991 Sept. |
|---|---|---|---|---|---|---|---|---|
| | | | | -----Annual rate------ | | | -Monthly rate- | |
| Finished goods | 100.0 | 4.9 | 5.7 | -3.5 | .7 | .3 | .2 | .1 |
| Consumer foods | 23.7 | 5.2 | 2.6 | 1.0 | -.3 | -6.6 | -.4 | -.5 |
| Consumer energy | 16.8 | 9.5 | 30.7 | -35.5 | .0 | 5.3 | 1.8 | .8 |
| Other finished goods | 59.5 | 4.2 | 3.5 | 5.4 | 1.2 | 1.8 | .2 | .0 |
| Consumer goods | 36.4 | 4.4 | 3.7 | 5.9 | .9 | 2.7 | .3 | .0 |
| Capital equipment | 23.1 | 3.8 | 3.4 | 4.6 | 1.3 | 1.3 | .1 | .2 |
| Intermediate materials[2] | 95.2 | 2.5 | 4.6 | -9.8 | -1.0 | .7 | .4 | .1 |
| Excluding food and energy | 78.5 | .9 | 1.9 | -2.3 | -1.0 | -.3 | .0 | .0 |
| Crude food materials | 34.4 | 2.8 | -4.2 | .0 | -12.5 | -8.1 | -1.8 | 1.5 |
| Crude energy | 50.7 | 17.9 | 19.1 | -54.0 | -1.5 | 2.1 | 1.3 | -2.7 |
| Other crude materials | 14.9 | -3.6 | .6 | -4.7 | -13.0 | -4.3 | .5 | -.9 |

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

# CPI EXCLUDING FOOD AND ENERGY



The CPI for nonfood, nonenergy goods advanced only 0.2 percent in September, after two months of large increases. Apparel prices retreated, as expected, on a seasonally adjusted basis; a further seasonally adjusted decline is likely in October. The early pricing of fall and winter clothing had boosted the index in July and August. Prices of new vehicles rose 0.2 percent in September for the fifth consecutive month, as discounting was less than what the BLS seasonal factors anticipate for this time of the model year.[12]

On a twelve-month basis, the rise in the CPI for nonfood, nonenergy goods receded a bit in September (chart). Nonetheless, the year-over-year change in September--4-1/4 percent--was well above the pace over the preceding year, which is unusual at the current stage of the cycle; in part, the acceleration reflected some special factors including hikes in federal excise taxes early this year, increases in state and local sales and excise taxes around midyear, and an acceleration in prices of new motor vehicles (year-over-year).[13] Those increases more than offset declines in a number of other categories, notably apparel.

In contrast to goods, the CPI for nonenergy services rose 0.5 percent in September--more than in recent months--because of a sizable jump in rents after four months of small increases. Nevertheless, the indexes for owners' equivalent rent and residential rent remained only 3.1 percent and 3.3 percent respectively above their levels of twelve months earlier. This represents a deceleration from the rate over the preceding year of about 3 percentage

12. Over the next few months, the prices of 1992 models will be phased into the CPI for new vehicles as they replace the 1991 models at the dealers in the sample. In the PPI, by contrast, new-model vehicles enter the sample each October and are maintained through September of the following year. Both indexes are adjusted by BLS estimates (based on manufacturers' cost data) of the value of the quality changes.

13. Relatively low auto dealers' inventories may have contributed to the latter by limiting discounting.

points for the former and 1-1/4 percentage points for the latter. That slowing accounts for most of the deceleration in the twelve-month change in the CPI for nonenergy services, although deceleration also was evident, on balance, for other services, notably for out-of-town lodging, airfares, and to a lesser extent, medical care. In September, some further large increases were registered for tuition and medical care, while airfares and auto finance costs retreated.

At the producer level, the PPI for capital equipment posted another modest increase of 0.2 percent in September. On a twelve-month change basis, the rise in this component has slowed to about 2-1/2 percent, 3/4 percentage point less than over the preceding year. Prices of intermediate materials less food and energy have been flat, on balance, over the past four months. The PPI for crude nonfood materials less energy was down further in September, after a small increase in August; it remained about 10 percent below its level of a year earlier.

Since the week of the September Greenbook, movements in commodity price measures for industrial materials have given little indication of a break from the relatively flat to declining trend of the past few months.[14] Aluminum prices firmed notably in mid-October--reportedly in response to news of production cutbacks. But with demand soft and stocks ample, prices have since turned back down.

In most, but not all, post-World War II cycles (chart), industrial commodity price measures have turned up around or soon

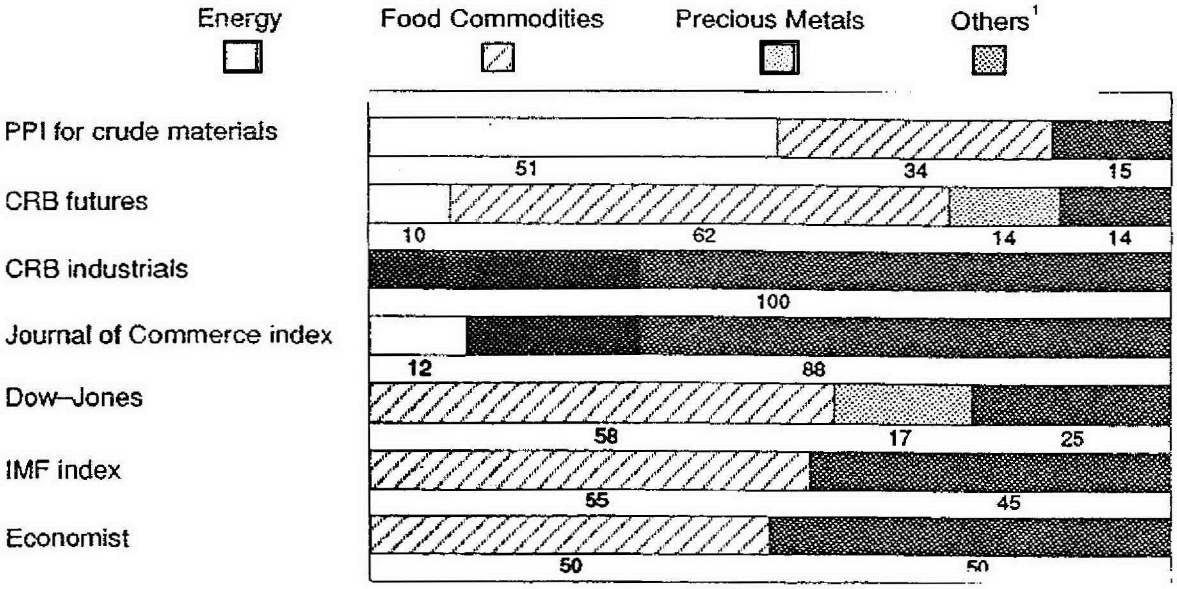
14. The Journal of Commerce subindex for metals fell sharply in the third week of October, but this decline (and a smaller decline in the index total) actually reflected a change in the zinc series used for the index. Another quotation for zinc posted a similar decline between the end of 1990 and May of this year and has since been relatively flat. Recent increases in the CRB futures index are due largely to higher prices of crude oil and fuel oil.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

| | Last observation | 1989 | 1990 | 1991 Percent change[2] To Sept. 24[3] | 1991 Sept. 24[3] to date | Memo: Year earlier to date |
|---|---|---|---|---|---|---|
| 1. PPI for crude materials[4] | Sept. | 7.1 | 6.0 | -11.3 | n.a. | -15.0 |
| 1a. Foods and feeds | Sept. | 2.8 | -4.2 | -4.6 | n.a. | -7.1 |
| 1b. Energy | Sept. | 17.9 | 19.1 | -17.5 | n.a. | -21.7 |
| 1c. Excluding food and energy | Sept. | -3.6 | .6 | -5.3 | n.a. | -10.2 |
| 1d. Excluding food and energy, seasonally adjusted | Sept. | -3.6 | .5 | -5.6 | n.a. | -10.2 |
| 2. Commodity Research Bureau | | | | | | |
| 2a. Futures prices | Oct. 29 | -9.0 | -2.7 | -2.3 | .4 | -4.9 |
| 2b. Industrial spot prices | Oct. 28 | -5.9 | .6 | -10.1 | -.4 | -11.8 |
| 3. *Journal of Commerce* industrials | Oct. 29 | 1.3 | -2.4 | -3.4 | -1.4 | -9.4 |
| 3a. Metals | Oct. 29 | -7.2 | -3.9 | -5.0 | -2.6 | -11.5 |
| 4. Dow-Jones Spot | Oct. 29 | -10.1 | -1.7 | -5.6 | -3.4 | -9.1 |
| 5. IMF commodity index[4] | Sept. | -12.9 | -5.6 | -.1 | n.a. | -6.4 |
| 5a. Metals | Sept. | -23.4 | -3.0 | -8.3 | n.a. | -22.[illegible] |
| 5b. Nonfood agric. | Sept. | -4.6 | -3.5 | 2.2 | n.a. | -3 |
| 6. *Economist* (U.S. dollar index) | Oct. 22 | -22.8 | -4.4 | -8.0 | .3 | -14.7 |
| 6a. Industrials | Oct. 22 | -23.8 | -3.2 | -13.5 | .7 | -20.5 |

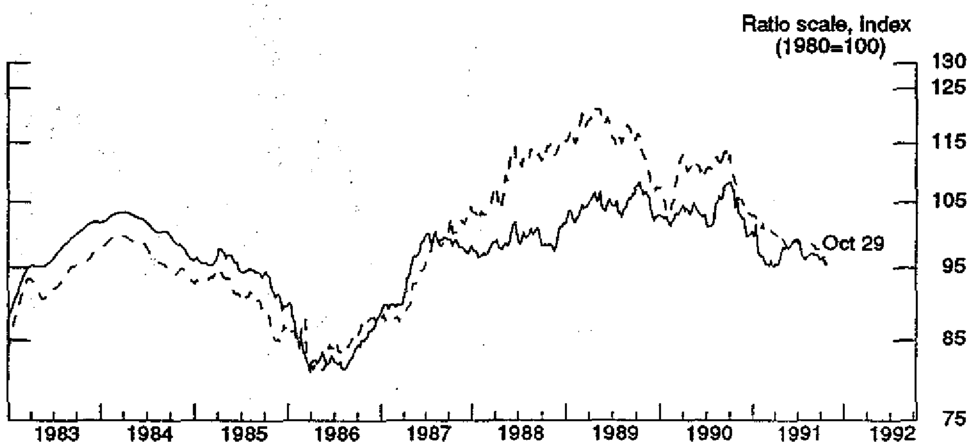
1. Not seasonally adjusted.
2. Change is measured to end of period, from last observation of previous period.
3. Week of the September Greenbook.
4. Monthly observations. IMF index includes items not shown separately.
n.a. Not available.

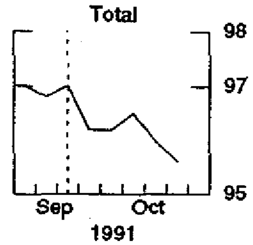
## Index Weights

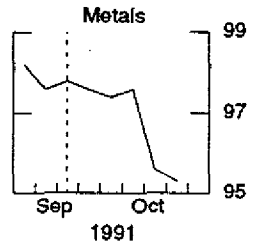



1. Forest products, industrial metals, and other industrial materials.

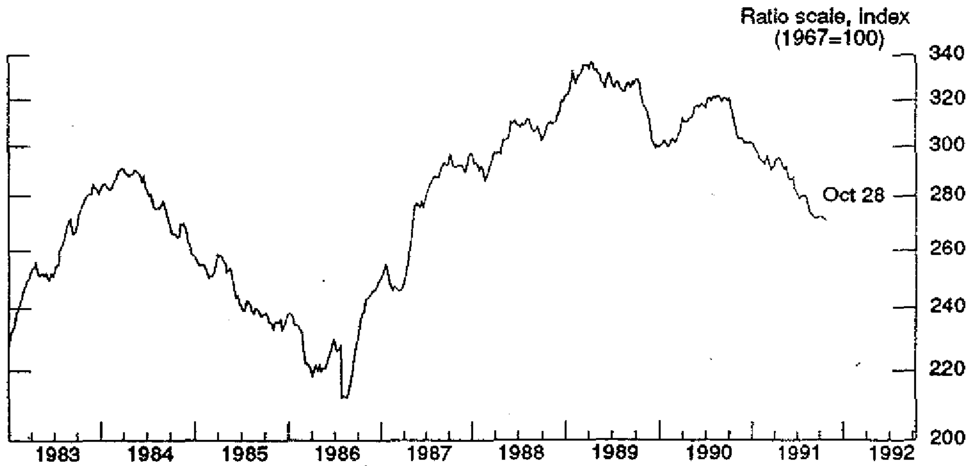
# COMMODITY PRICE MEASURES *

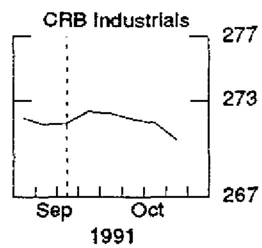


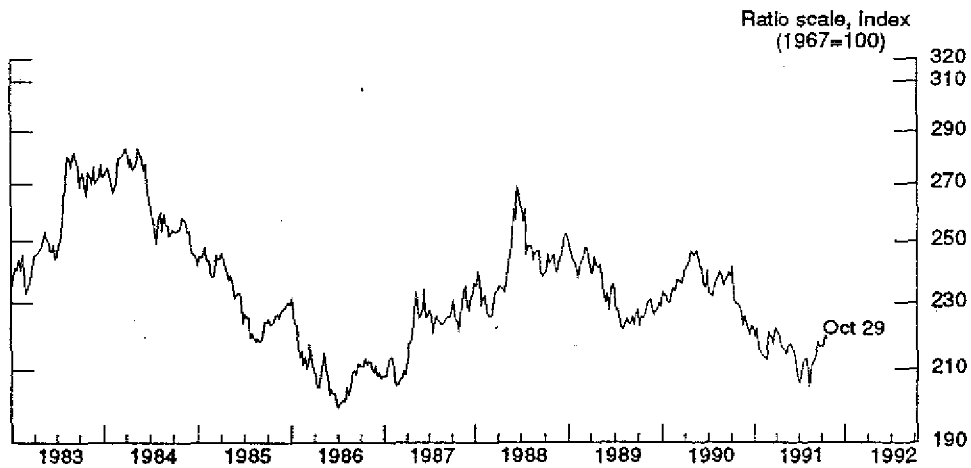



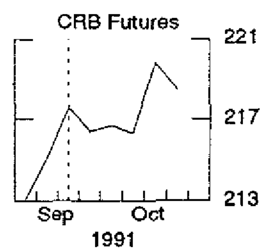

CRB Spot Industrials




CRB Futures

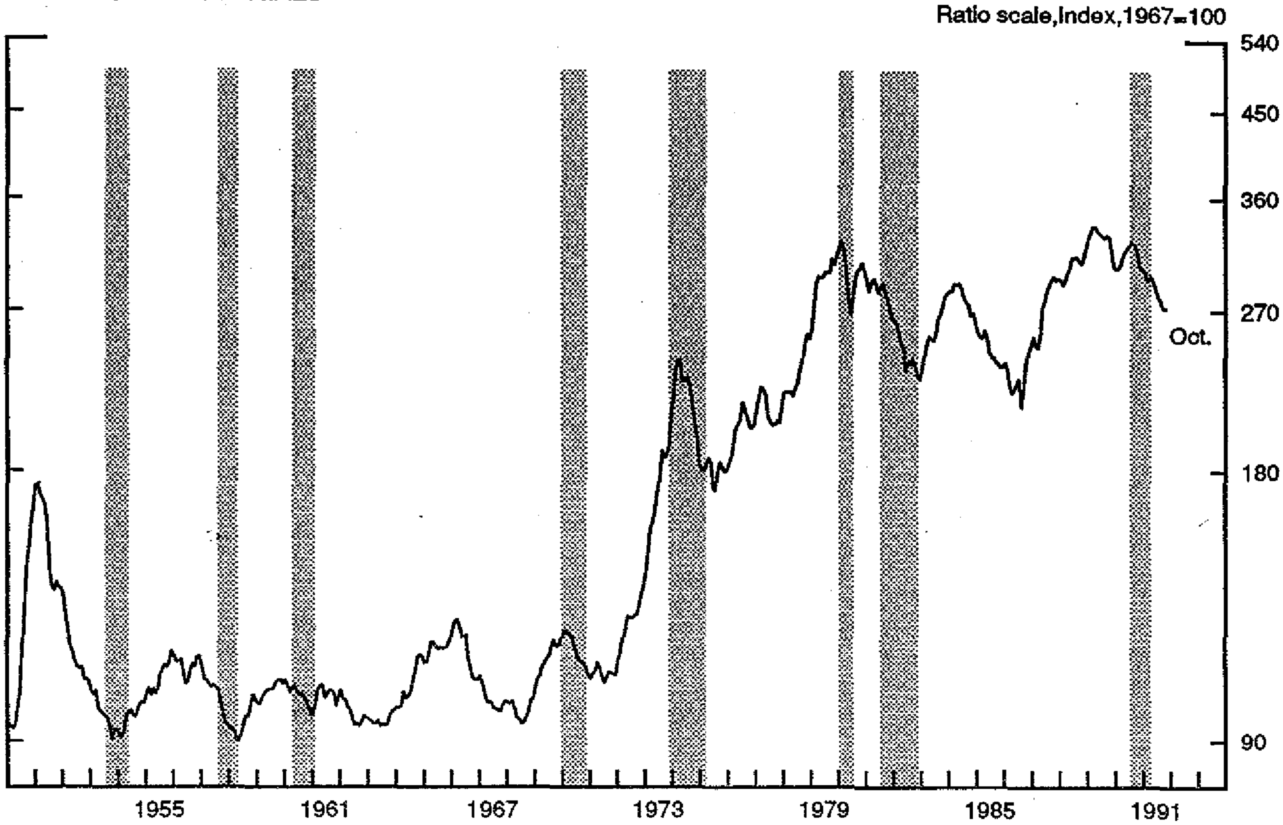


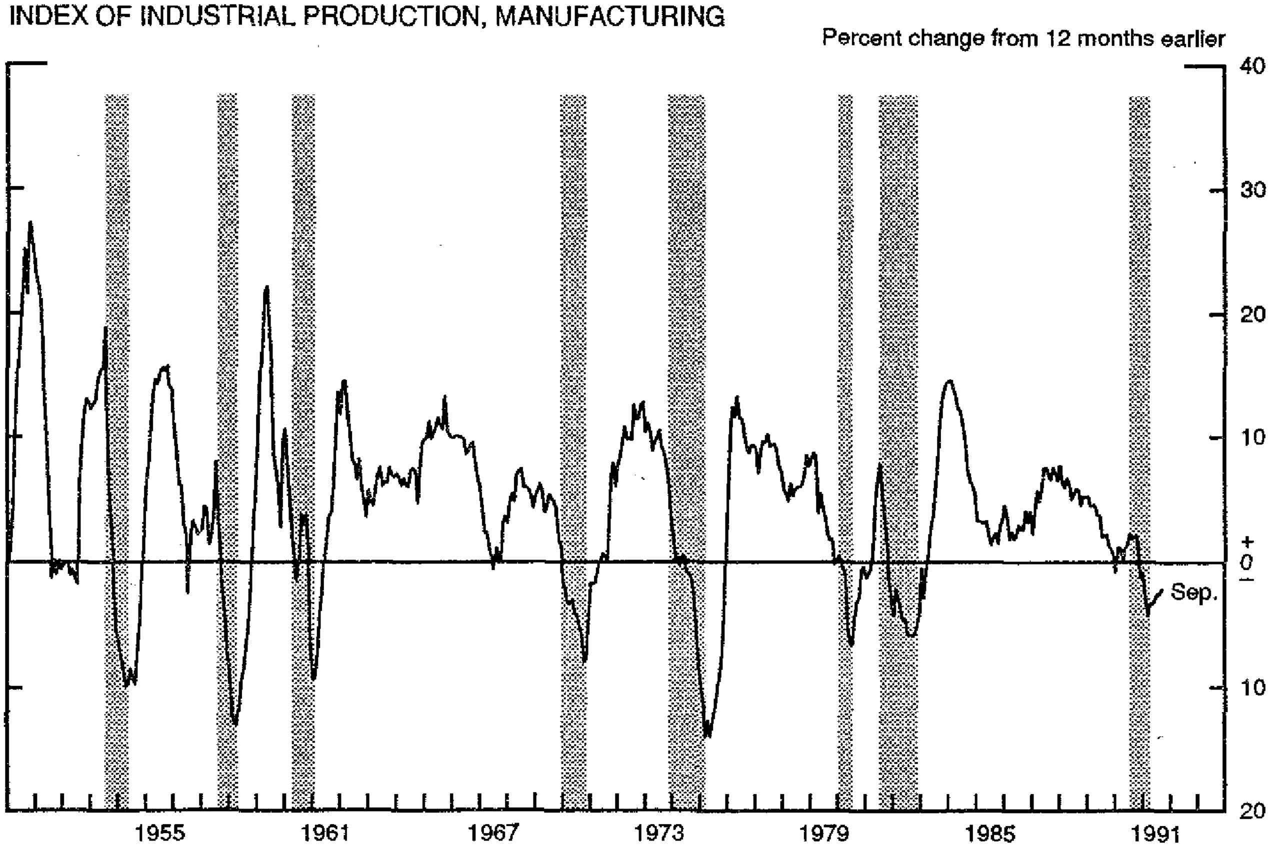

* Weekly data, Tuesdays; Journal of Commerce data monthly before 1985

Dotted lines indicate week of

CRB SPOT INDUSTRIALS




INDEX OF INDUSTRIAL PRODUCTION, MANUFACTURING



after the trough. The slow recovery after the November 1970 cyclical trough is the most notable outlier; in this instance, there was no clear uptrend in spot prices for industrial materials (CRB index) until 1972. The upturn after the March 1975 trough also lagged substantially. Then, an exceptionally large overhang of world stocks--the aftermath of the 1973-74 commodities boom--likely contributed to the relatively long period of price weakness in that recovery.

# DOMESTIC FINANCIAL DEVELOPMENTS

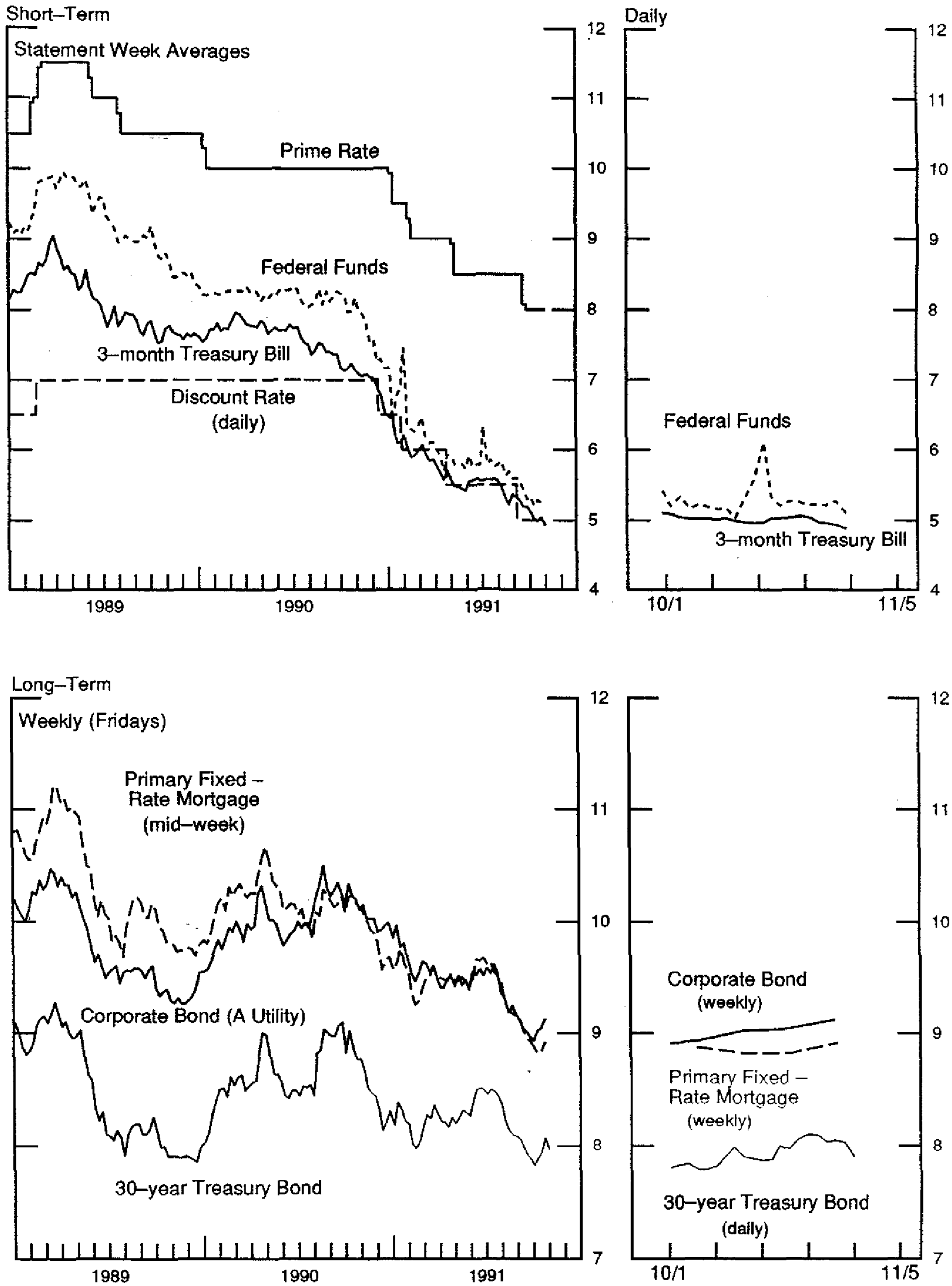
## SELECTED FINANCIAL MARKET QUOTATIONS[1]
(percent)

| | 1989 | 1991 | | Change from: | |
|---|---|---|---|---|---|
| | March highs | FOMC Oct 1 | Oct 29 | March highs | FOMC Oct 1 |
| **Short-term rates** | | | | | |
| Federal funds[2] | 9.85 | 5.32 | 5.22 | -4.63 | -.10 |
| Treasury bills[3] | | | | | |
| 3-month | 9.09 | 5.10 | 4.89 | -4.20 | -.21 |
| 6-month | 9.11 | 5.13 | 4.92 | -4.19 | -.21 |
| 1-year | 9.05 | 5.12 | 4.91 | -4.14 | -.21 |
| Commercial paper | | | | | |
| 1-month | 10.05 | 5.45 | 5.25 | -4.80 | -.20 |
| 3-month | 10.15 | 5.46 | 5.31 | -4.84 | -.15 |
| Large negotiable CDs[3] | | | | | |
| 1-month | 10.07 | 5.34 | 5.19 | -4.88 | -.15 |
| 3-month | 10.32 | 5.47 | 5.28 | -5.04 | -.19 |
| 6-month | 10.08 | 5.47 | 5.25 | -4.83 | -.22 |
| Eurodollar deposits[4] | | | | | |
| 1-month | 10.19 | 5.31 | 5.19 | -5.00 | -.12 |
| 3-month | 10.50 | 5.50 | 5.38 | -5.12 | -.12 |
| Bank prime rate | 11.50 | 8.00 | 8.00 | -3.50 | .00 |
| **Intermediate- and long-term rates** | | | | | |
| U.S. Treasury (constant maturity) | | | | | |
| 3-year | 9.88 | 6.26 | 6.14 | -3.74 | -.12 |
| 10-year | 9.53 | 7.45 | 7.51 | -2.02 | .06 |
| 30-year | 9.31 | 7.81 | 7.91 | -1.40 | .10 |
| Municipal revenue[5] (Bond Buyer) | 7.95 | 6.91 | 6.93 | -1.02 | .02 |
| Corporate--A utility recently offered | 10.47 | 8.93 | 8.99 | -1.48 | .06 |
| Home mortgage rates[6] | | | | | |
| S&L fixed-rate | 11.22 | 8.92 | 8.91 | -2.31 | -.01 |
| S&L ARM, 1-yr. | 9.31 | 6.83 | 6.66 | -2.65 | -.17 |

| | Record highs | Date | 1989 Lows Jan 3 | 1991 FOMC Oct 1 | 1991 Oct 29 | Percent change from: Record highs | 1989 lows | FOMC Oct 1 |
|---|---|---|---|---|---|---|---|---|
| **Stock prices** | | | | | | | | |
| Dow-Jones Industrial | 3077.15 | 10/18/91 | 2144.64 | 3018.34 | 3061.94 | -.49 | 42.77 | 1.44 |
| NYSE Composite | 217.17 | 8/28/91 | 154.00 | 214.01 | 215.58 | -.73 | 39.99 | .73 |
| AMEX Composite | 397.03 | 10/10/89 | 305.24 | 374.95 | 381.61 | -3.88 | 25.02 | 1.78 |
| NASDAQ (OTC) | 540.94 | 10/16/91 | 378.56 | 528.51 | 534.51 | -1.19 | 41.20 | 1.14 |
| Wilshire | 3803.35 | 8/28/91 | 2718.59 | 3755.69 | 3782.37 | -.55 | 39.13 | .71 |

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 October 30, 1991.
3/ Secondary market.
4/ Bid rates for Eurodollar deposits at 11 a.m. London time.
5/ Based on one-day Thursday quotes and futures market index changes.
6/ Quotes for week ending Friday closest to date shown.

## Selected Interest Rates*
(percent)




* Friday weeks through October 25, Wednesday weeks through October 23.

The Treasury yield curve has steepened since the October FOMC meeting. The release of generally weaker-than-anticipated data on the economy and the continued sluggishness of the monetary aggregates have fostered market expectations of a near-term easing of monetary policy and pushed short-term rates down about 20 basis points on balance over the intermeeting period. Meanwhile, long-term rates are up a touch: The yield on thirty-year Treasury bonds increased over much of October owing to disappointing news on consumer prices and rising oil prices along with tax-cut proposals, but these increases have largely unwound in recent days on news pointing to a weak economy. Major stock market indexes, some of which touched new highs over the intermeeting period, are up slightly on net.

M2 and M3 increased in October, but not very much. Depositors evidently have continued to shift into higher yielding assets outside of M2. In addition, the third-quarter surge in RTC resolution activity may have had a lingering depressing influence on M2 in October. The upturn in M3 in October accompanied some strengthening of bank credit growth.

Borrowing by the private sectors may have firmed a bit recently, but it remains rather sluggish. In the business sector, borrowing likely increased in October; commercial paper ran off at a reduced pace, while public bond issuance remained robust and bank loans posted a second monthly increase. The continued heavy pace of equity issuance by many nonfinancial firms has led to a strengthening of balance sheets, slowing the deterioration of credit quality. Data on household borrowing is sketchy, but they suggest that consumer credit probably has remained about flat or edged down a little, while net mortgage borrowing evidently has remained

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

| | 1990[1] | 1991 Q2 | 1991 Q3 | 1991 Aug | 1991 Sep | 1991 Oct pe | Growth Q4 90- Oct 91pe |
|---|---|---|---|---|---|---|---|
| | Percent change at annual rates | | | | | | |
| 1. M1 | 4.2 | 7.3 | 6.9 | 9.4 | 5.5 | 12 | 7½ |
| 2. M2 | 3.8 | 4.8 | -0.3 | 0.3 | -0.1 | 3 | 2½ |
| 3. M3 | 1.7 | 1.9 | -2.4 | -0.8 | -2.2 | 1 | 1 |
| | Percent change at annual rates | | | | | | Levels bil. $ Sep 91 |
| **Selected components** | | | | | | | |
| 4. M1-A | 4.6 | 3.9 | 3.2 | 6.2 | 2.6 | 12 | 549.5 |
| 5. Currency | 11.0 | 3.9 | 5.8 | 8.8 | 7.4 | 9 | 262.4 |
| 6. Demand deposits | -0.6 | 4.5 | 1.3 | 4.3 | -2.1 | 13 | 279.4 |
| 7. Other checkable deposits | 3.5 | 13.5 | 13.4 | 14.9 | 10.6 | 14 | 320.8 |
| 8. M2 minus M1[2] | 3.7 | 4.0 | -2.7 | -2.8 | -2.0 | 0 | 2522.1 |
| 9. Overnight RPs and Eurodollars, NSA | 3.8 | -6.2 | -9.2 | 54.1 | -17.2 | 51 | 68.6 |
| 10. General purpose and broker/dealer money market mutual fund shares | 11.0 | 6.6 | -11.7 | -22.0 | -12.2 | -3 | 349.2 |
| 11. Commercial banks | 9.9 | 7.3 | 6.9 | 9.2 | 4.6 | 5 | 1240.6 |
| 12. Savings deposits plus MMDAs | 7.5 | 16.7 | 12.8 | 10.4 | 9.3 | 15 | 635.9 |
| 13. Small time deposits | 12.4 | -1.8 | 0.8 | 7.8 | 0.0 | -7 | 604.8 |
| 14. Thrift institutions | -5.5 | -1.5 | -9.8 | -15.5 | -8.8 | -8 | 864.3 |
| 15. Savings deposits plus MMDAs | -2.2 | 18.4 | 9.8 | 2.6 | 5.3 | 9 | 366.8 |
| 16. Small time deposits | -7.3 | -13.7 | -22.8 | -28.3 | -19.0 | -21 | 497.5 |
| 7. M3 minus M2[3] | -6.4 | -10.5 | -12.0 | -5.2 | -11.6 | -8 | 746.9 |
| 18. Large time deposits | -9.5 | -7.6 | -15.5 | -16.1 | -21.5 | -26 | 475.8 |
| 19. At commercial banks, net[4] | -3.5 | 0.3 | -8.8 | -8.5 | -16.0 | -21 | 385.4 |
| 20. At thrift institutions | -23.9 | -34.8 | -41.6 | -47.9 | -44.8 | -44 | 90.3 |
| 21. Institution-only money market mutual fund shares | 20.2 | 23.0 | 0.8 | 25.4 | 37.3 | 50 | 149.3 |
| 22. Term RPs, NSA | -12.5 | -27.7 | -6.0 | 1.5 | -16.8 | -31 | 77.5 |
| 23. Term Eurodollars, NSA | -12.1 | -32.3 | -9.1 | 7.4 | -38.5 | -49 | 63.3 |
| | Average monthly change in billions of dollars | | | | | | |
| **MEMORANDA:[5]** | | | | | | | |
| 24. Managed liabilities at commercial banks (25+26) | 0.0 | -3.4 | -2.4 | -5.5 | 2.3 | -2 | 699.8 |
| 25. Large time deposits, gross | -2.6 | 0.3 | -2.8 | -0.5 | -3.4 | -10 | 443.6 |
| 26. Nondeposit funds | 2.6 | -3.7 | 0.4 | -5.0 | 5.7 | 8 | 256.2 |
| 27. Net due to related foreign institutions | 2.2 | -3.7 | 0.2 | -2.6 | 3.2 | 1 | 19.8 |
| 28. Other[6] | 0.3 | 0.0 | 0.2 | -2.4 | 2.5 | 7 | 236.4 |
| 29. U.S. government deposits at commercial banks[7] | 0.3 | -3.5 | -0.4 | 3.3 | -1.9 | 10 | 21.9 |

1. Amounts shown are from fourth quarter to fourth quarter.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. The non-M2 component of M3 is seasonally adjusted as a whole.
4. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
5. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
6. 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.
7. Consists of Treasury demand deposits and note balances at commercial banks.

e - preliminary estimate

subdued, despite a flurry of refinancings recently. In contrast, in the government sector, Treasury borrowing remains outsized, and state and local governments continue to issue substantial amounts of bonds.

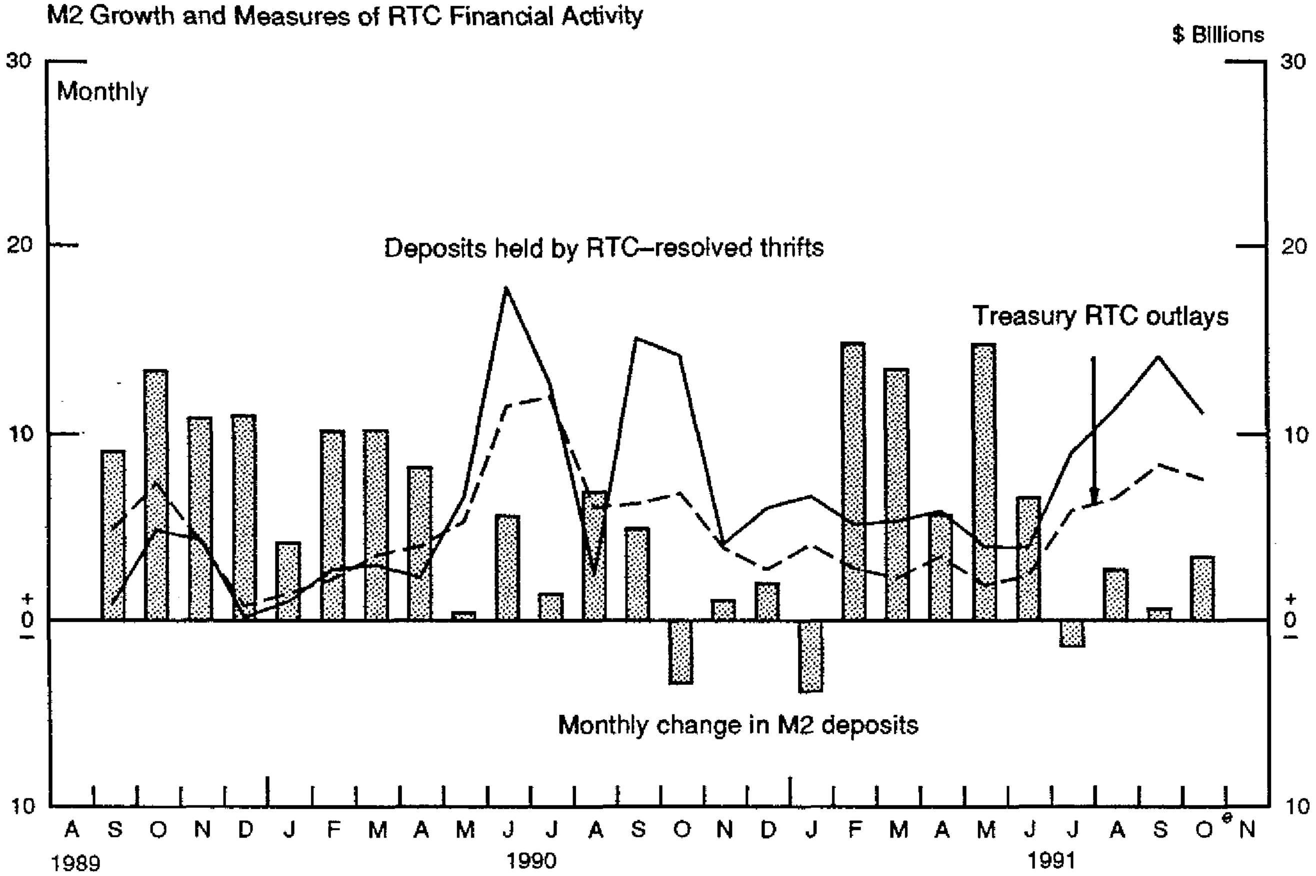
Monetary Aggregates and Bank Credit

After showing essentially no change over the preceding two months, M2 is estimated to have grown at a 3 percent pace in October, leaving it around the lower bound of its target cone. The continued weakness in this aggregate likely stems in part from an ongoing portfolio adjustment, as depositors are reaching for higher returns and shifting to assets outside of M2. Available data suggests that the heavy inflows to stock and bond mutual funds experienced since the spring have continued into the fall.

The more rapid pace of resolution activity by the RTC in recent months also may have contributed to the weakness in M2. Since the RTC's inception in August 1989, periods of slow M2 growth have tended to follow periods of heavy RTC activity (chart). In part, the slower growth may be a result of acquiring institutions seeking to reduce their funding costs by substituting purchased thrift core deposits for higher-cost retail and brokered CDs. Also, some customers may reevaluate their portfolio positions, including holdings of deposits and other assets, when long-standing banking relationships are disrupted. In both cases, RTC actions might be expected to affect M2 growth with a lag.

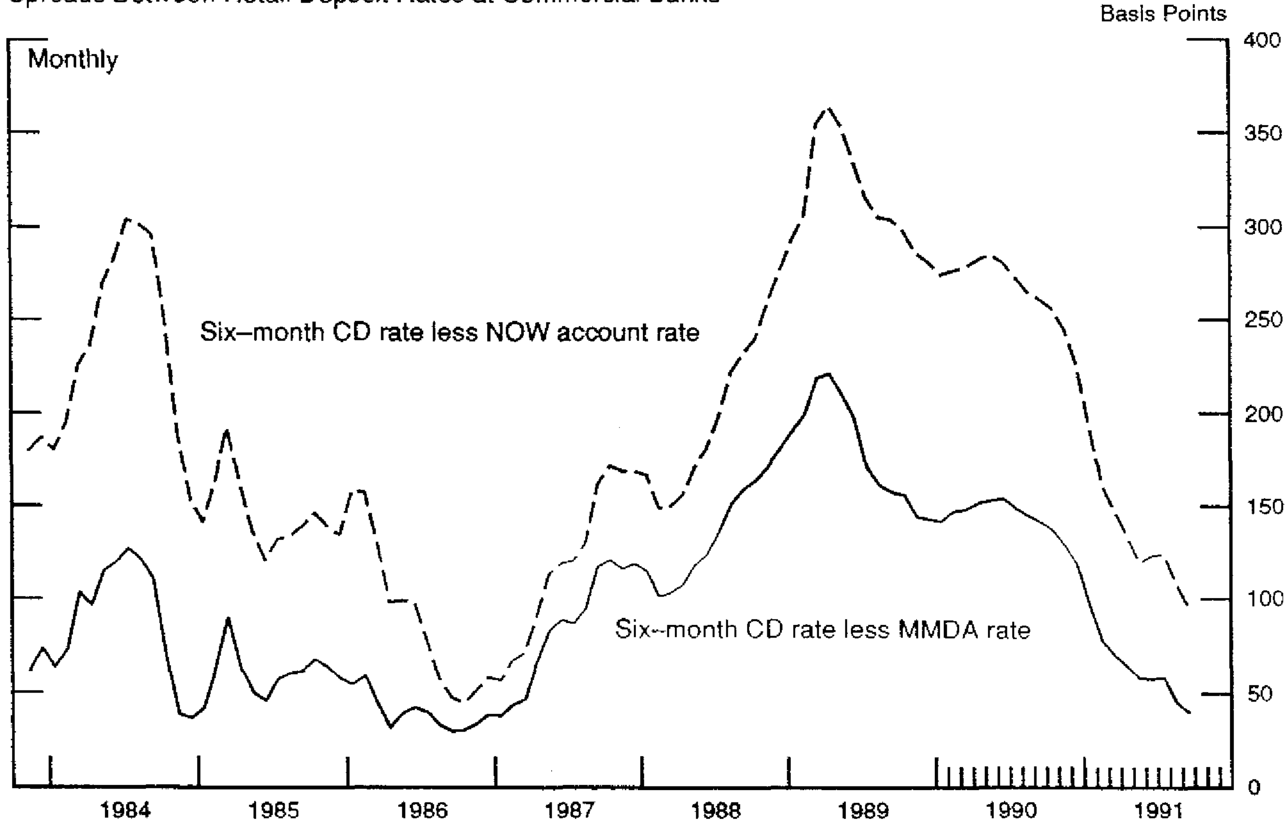
With interest rates generally on a downward trend in recent quarters, the compositional shift within M2 toward liquid retail deposits and away from small time deposits has continued. The rate spread between retail CDs and liquid retail deposits narrowed further (chart)--banks have been especially reluctant to risk alienating customers by cutting rates on savings deposits--further

M2 Growth and Measures of RTC Financial Activity




NOTE: Measures of deposits held by RTC–resolved thrifts and Treasury RTC outlays are two–month moving averages.

Spreads Between Retail Deposit Rates at Commercial Banks



encouraging this compositional shift. Savings deposit growth quickened in October, and the runoff of retail CDs accelerated. Various reports have suggested that an unusually large chunk of retail CDs was scheduled to mature in October; however, an informal survey of regional banks across the country found only modest evidence corroborating these reports.

The pickup in M2 showed through in a turnaround in M3, which posted its first monthly increase since May. The gain was only marginal, however, and this aggregate remains slightly below the lower bound of its 1991 target cone. The upturn in M3 partly reflected a larger increase in claims on commercial banks, likely associated with the strengthening of bank credit growth. It also owed to a continued rapid rise in institution-only money funds, which have experienced strong inflows in recent months as investors have sought to exploit the funds' transitory yield advantage over declining short-term market rates.

Preliminary data suggest that bank credit grew at an annual rate of 7 percent in October, marking two straight months of appreciable growth. Most of the increase occurred in bank holdings of government securities, including federal agency CMOs, which expanded at an annual rate of 34 percent. In contrast, total loans were little changed from September. Business loans increased at a 7 percent pace; as in September, all of the increase occurred at foreign-related institutions. In September, about one-half of the increase in this series was the result of one foreign-related institution rebooking its offshore loans; in October, however, the increase was widespread among foreign institutions, with only about 1 percentage point reflecting rebookings. C&I loans at domestic banks have not shown similar strength, but the runoff of these loans has slowed in recent months. Consumer loans fell at about a

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

| | Dec89 to Dec90 | 1991 Q2 | 1991 Q3 | 1991 Aug | 1991 Sep | 1991 Oct p | Levels bil.$ 1991 Sep |
|---|---|---|---|---|---|---|---|
| | Commercial Bank Credit | | | | | | |
| 1. Total loans and securities at banks | 5.3 | 1.7 | 0.8 | -0.7 | 3.2 | 7 | 2768.9 |
| 2. Securities | 8.6 | 11.9 | 14.7 | 9.0 | 18.5 | 27 | 692.9 |
| 3. U.S. government securities | 13.9 | 19.8 | 21.7 | 17.3 | 22.2 | 34 | 522.1 |
| 4. Other securities | -3.1 | -9.3 | -5.3 | -14.7 | 6.4 | 7 | 170.8 |
| 5. Total loans | 4.3 | -1.5 | -3.6 | -4.0 | -1.8 | 1 | 2076.0 |
| 6. Business loans | 1.9 | -6.7 | -4.2 | -11.9 | 6.4 | 7 | 623.8 |
| 7. Real estate loans | 9.5 | 5.3 | -2.8 | -4.3 | -0.7 | 1 | 853.4 |
| 8. Consumer loans | 1.2 | -3.2 | -7.2 | -2.3 | -11.7 | -9 | 365.3 |
| 9. Security loans | 4.4 | -5.2 | 58.5 | 28.8 | 36.6 | -30 | 43.9 |
| 10. Other loans | -1.8 | -1.2 | -10.5 | 13.2 | -22.4 | 8 | 189.6 |
| | Short and Intermediate-Term Business Credit | | | | | | |
| 11. Business loans net of bankers acceptances | 1.9 | -6.7 | -4.4 | -12.8 | 6.6 | 7 | 617.5 |
| Loans at foreign branches[2] | 19.3 | -35.7 | -3.4 | -35.6 | 21.0 | 31 | 23.3 |
| 13. Sum of lines 11 & 12 | 2.5 | -7.9 | -4.4 | -13.6 | 7.2 | 8 | 640.8 |
| 14. Commercial paper issued by nonfinancial firms | 12.2 | -10.2 | -26.2 | -32.1 | -55.8 | -14 | 135.3 |
| 15. Sum of lines 13 & 14 | 4.2 | -8.4 | -8.3 | -17.0 | -4.3 | 4 | 776.1 |
| 16. Bankers acceptances: U.S.trade related[3] [4] | -9.6 | -22.0 | -20.5 | -29.4 | -8.6 | n.a. | 27.7 |
| 17. Finance company loans to business[3] | 13.1 | 4.6 | n.a. | 13.6 | n.a. | n.a. | 302.6[5] |
| 18. Total short- and intermediate-term business credit (sum of lines 15, 16, & 17) | 5.8 | -5.3 | n.a. | -9.1 | n.a. | n.a. | 1109.4[5] |

1. Average of Wednesdays.
2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
3. Based on average of data for current and preceding ends of month.
4. Consists of acceptances that finance U.S. imports, U.S. exports, and domestic shipment and storage of goods.
5. August 1991 data.

p--preliminary
n.a.--not available

9 percent pace during the month; excluding the effects of securitizations, they were down about 3 percent. The recent Senior Loan Officer Opinion Survey suggests that the demand for bank credit by businesses and consumers has continued to weaken in recent months. The survey also indicated that while banks have not recently changed standards for approving such loans, some banks have continued to increase the cost of credit lines and to tighten other terms of lending for businesses.

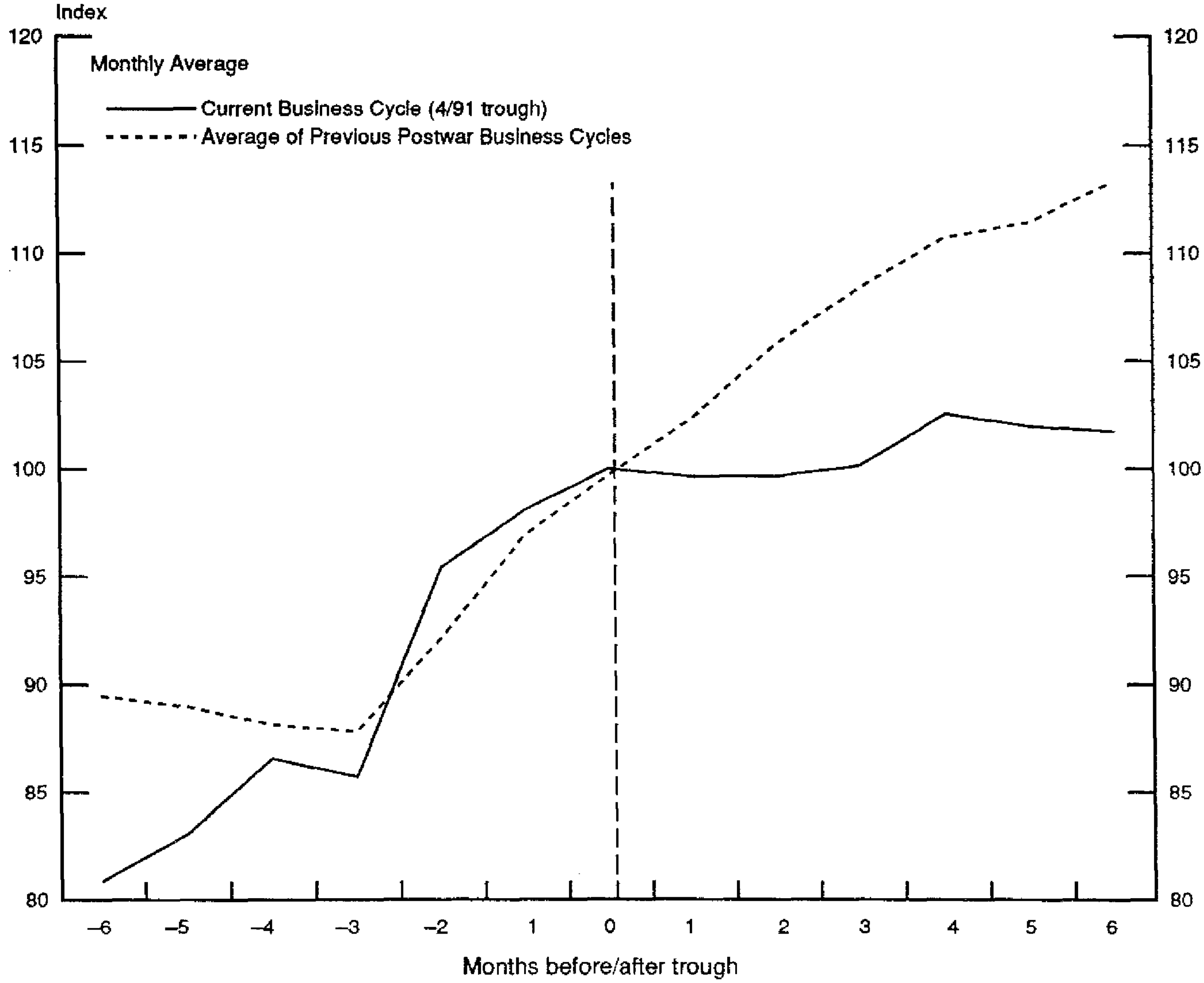
Business Finance

Borrowing by nonfinancial firms probably strengthened somewhat in October, as the runoff in commercial paper abated while public bond issuance remained healthy and bank loans rose. Weakness in commercial paper issuance primarily reflects substitution into bonds and medium-term notes, although more favorable pricing of bank loans reportedly has lured several A-2/P-2 issuers back to banks. In an attempt to avoid year-end pressures, many commercial paper issuers are structuring maturities to secure funding past December 31.

Public bond issuance in October by nonfinancial corporations was strongest in the longer maturities, where, despite heavy issuance, yield spreads on investment grade bonds have remained narrow. The favorable conditions for bond issuance currently appear to extend down at least into the upper ranges of the junk bond market, where spreads on junk bond indexes have narrowed almost 60 basis points over the last four weeks and are now close to 600 basis points. Junk bond issuance in October was the largest since June, although still light compared with that of a few years ago.

On balance, stock prices are slightly above their levels at the last FOMC meeting, with the DJIA and the NASDAQ index setting new highs during the intermeeting period. Some sectors, such as the transportation industry, benefited from stronger-than-expected

Movement of S&P 500 around Business Cycle Troughs



third-quarter earnings reports. Earnings of brokerage firms were boosted by the heavy volume of bond and equity activity in the third quarter, lifting stock prices for the investment banking sector about 7 percent over the intermeeting period. However, commercial bank earnings in the third quarter were decidedly mixed, and money center bank stock prices were little changed while their subordinated debt spreads rose about 30 basis points over the last several weeks.

With the general strength in the stock market, the ratio of prices to four-quarter trailing earnings for the S&P 500 has been quite high--at around 20 since mid-August. No doubt this high level in part reflects an anticipation of robust earnings growth over the near term. Some market analysts anticipate roughly a 20 percent rise in earnings per share for S&P 500 companies from 1991 to 1992. To date, the rise in the stock market has been less robust than those following other postwar business-cycle troughs (chart). The stock market has risen less than 2 percent (on a month-average basis) over the first six months of the current expansion dated from April, compared with an average of about 13 percent for the comparable period during the previous eight expansions; however, prices had rallied by more than is typical in the months just ahead of the trough.

Firms have taken advantage of attractive stock prices to raise equity funds, and in many cases have used the funds to retire debt and clean up their balance sheets to enhance their flexibility and access to credit markets. New stock offerings continue to include a sizable number of reverse LBOs. Prospects are that, absent a sharp drop in share prices, issuance will remain heavy: A number of large offerings recently have been filed with the SEC. RJR Nabisco plans to offer $1.9 billion of preferred equity redemption cumulative

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

| | | | 1991 | | | | |
|---|---|---|---|---|---|---|---|
| | 1989 | 1990 | Q2 | Q3[p] | Aug[p] | Sept[p] | Oct[e] |
| Corporate securities - total[1] | 19.87 | 19.86 | 35.16 | 30.09 | 34.75 | 31.94 | 30.30 |
| Public offerings in U.S. | 17.80 | 17.73 | 31.32 | 27.88 | 32.73 | 29.42 | 28.00 |
| Stocks--total[2] | 2.69 | 1.95 | 6.12 | 4.94 | 6.73 | 5.42 | 7.00 |
| Nonfinancial | 1.08 | 1.03 | 4.01 | 3.50 | 5.43 | 2.76 | 4.00 |
| Utility | 0.29 | 0.35 | 0.70 | 0.16 | 0.21 | 0.06 | 0.50 |
| Industrial | 0.79 | 0.68 | 3.31 | 3.34 | 5.22 | 2.70 | 3.50 |
| Financial | 1.60 | 0.92 | 2.11 | 1.44 | 1.30 | 2.67 | 3.00 |
| Bonds | 15.12 | 15.77 | 25.20 | 22.93 | 26.00 | 24.00 | 21.00 |
| Nonfinancial | 6.30 | 5.65 | 10.26 | 9.08 | 11.55 | 8.50 | 8.50 |
| Utility | 1.78 | 1.97 | 3.71 | 2.77 | 3.30 | 2.20 | 2.50 |
| Industrial | 4.52 | 3.69 | 6.52 | 6.32 | 8.25 | 6.30 | 6.00 |
| Financial | 8.81 | 10.12 | 14.94 | 13.85 | 14.45 | 15.50 | 12.50 |
| By quality[3] | | | | | | | |
| Aaa and Aa | 3.17 | 3.43 | 3.78 | 2.76 | 4.15 | 2.82 | 2.30 |
| A and Baa | 5.83 | 6.41 | 12.93 | 10.66 | 12.80 | 8.80 | 10.00 |
| Less than Baa | 2.39 | 0.15 | 1.33 | 0.47 | 0.48 | 0.45 | 0.70 |
| No rating (or unknown) | 0.05 | 0.04 | 0.01 | 0.01 | 0.02 | 0.00 | 0.00 |
| Memo items: | | | | | | | |
| Equity-based bonds[4] | 0.52 | 0.38 | 0.78 | 0.41 | 0.38 | 0.31 | 1.00 |
| Mortgage-backed bonds | 1.68 | 2.43 | 3.31 | 3.59 | 4.91 | 3.15 | 3.50 |
| Other asset-backed | 2.02 | 3.35 | 3.86 | 5.44 | 3.65 | 8.78 | 3.50 |
| Variable-rate notes | 1.03 | 0.82 | 0.82 | 0.85 | 1.60 | 0.62 | 0.61 |
| Bonds sold abroad - total | 1.90 | 1.92 | 3.04 | 1.85 | 1.50 | 2.50 | 1.80 |
| Nonfinancial | 0.48 | 0.46 | 1.60 | 0.99 | 0.65 | 1.50 | 0.80 |
| Financial | 1.43 | 1.46 | 1.44 | 0.86 | 0.85 | 1.00 | 1.00 |
| Stocks sold abroad - total | 0.16 | 0.22 | 0.80 | 0.36 | 0.52 | 0.02 | 0.50 |
| Nonfinancial | 0.12 | 0.10 | 0.75 | 0.29 | 0.47 | 0.02 | 0.50 |
| Financial | 0.04 | 0.12 | 0.05 | 0.07 | 0.04 | 0.00 | 0.00 |

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings. Such swaps totaled $9.4 billion in 1990.
3. Bonds categorized according to Moody's bond ratings, or to Standard and Poor's if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.
4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.
p--preliminary. e--staff estimate.

stock (PERCS), the proceeds of which will be used to retire outstanding debt. RJR also has proposed an exchange offer of common stock for $1.8 billion of 11.5 percent preferred; it hopes this restructuring will remove its bank loans from the classification of "highly leveraged transaction" under regulatory guidelines, allowing it to renegotiate its loans at more favorable rates. Owens-Illinois, which was taken private in a leveraged buyout in 1987, has filed to offer almost $1 billion of common stock to retire some of its outstanding high-yield bonds.

The restructuring of balance sheets by nonfinancial firms has been reflected in some measures of their financial condition. According to Moody's, the pace of credit quality deterioration subsided somewhat in the third quarter. The number of downgrades of nonfinancial firms dropped significantly, while the number of upgrades stayed roughly the same as earlier in the year. Many of the upgrades stemmed from equity issuance or the retirement of outstanding debt while downgrades continued to be affected by weak operating earnings.

Among financial firms, downgrades have been driven by the continued deterioration of commercial real estate holdings. Half of the downgrades of financial firms in the third quarter were among insurance companies.

Behind the announcement by Westinghouse Electric Corp. of a $1.5 billion third-quarter loss were commercial real estate problems in the portfolio of its finance subsidiary. With a few exceptions, most other large finance companies appear considerably more diversified than Westinghouse Credit which at year-end 1990 had 23 percent of its portfolio in commercial real estate and another 42 percent in loans designated as highly leveraged transactions. Most rating agencies report that they expect other finance companies

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

| | 1991 | | | | | |
|---|---|---|---|---|---|---|
| | Q2 | Q3 | Q4[p] | Oct.[p] | Nov.[p] | Dec.[p] |
| Treasury financing | | | | | | |
| Total surplus/deficit (-) | -25.7 | -90.3 | -107.4 | -36.9 | -51.0 | -19.5 |
| Means of financing deficit: | | | | | | |
| Net cash borrowing from the public | 43.1 | 95.0 | 83.8 | 39.6 | 24.2 | 20.0 |
| Marketable borrowings/ repayments (-) | 38.6 | 103.5 | 80.8 | 38.2 | 24.2 | 18.4 |
| Bills | -11.7 | 43.0 | 27.1 | 21.1 | 4.8 | 1.2 |
| Coupons | 50.3 | 60.4 | 53.7 | 17.1 | 19.4 | 17.2 |
| Nonmarketable | 4.5 | -8.4 | 3.1 | 1.4 | .1 | 1.6 |
| Decrease in the cash balance | -11.6 | 2.0 | 26.0 | -7.0 | 38.4 | -5.4 |
| Memo: Cash balance at end of period | 43.5 | 41.5 | 15.5 | 48.5 | 10.1 | 15.5 |
| Other[2] | -5.8 | -6.8 | -2.4 | 4.3 | -11.6 | 4.9 |
| Federally sponsored credit agencies, net cash borrowing[3] | -7.1 | 5.1 | -- | -- | -- | -- |
| FHLBs | -6.5 | .7 | -- | -- | -- | -- |
| FHLMC | -2.6 | 2.7 | -- | -- | -- | -- |
| FNMA | 1.7 | .9 | -- | -- | -- | -- |
| Farm Credit Banks | -.2 | .3 | -- | -- | -- | -- |
| SLMA | .5 | .6 | -- | -- | -- | -- |

1. Data reported on a not seasonally adjusted, payment basis.
2. Includes checks issued less checks paid, accrued items and other transactions.
3. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
p--projected.
Note: Details may not add to totals due to rounding.

to sustain some credit losses, but not of the magnitude experienced by Westinghouse. Conversations with industry observers indicate that finance companies have tightened standards owing to economic weakness. Indeed, some customers turned away by banks reportedly have had difficulty in obtaining loans from finance companies. These same sources suggest, however, that finance companies remain willing to lend to creditworthy borrowers.

Treasury and Sponsored Agency Financing

The staff anticipates a fourth-quarter federal deficit of $107 billion, to be financed by $84 billion of borrowing and a sizable draw on the government's cash balance. The Treasury has cut back on the gross sizes of the weekly bill auctions from $21.6 billion to $20.8 billion in October. On October 9, the Treasury announced that, for the first time since 1962, it would call a bond issue before final maturity. On February 15, 1992, it will redeem $1.8 billion of 20-year bonds issued in August 1973. To lock in the interest savings on the call of the 7-1/2 percent notes, the Treasury increased the gross size of the October two-year note auction by $500 million and earmarked about $1 billion of the issue to hedge the amount of the called bonds held by private investors.

The Treasury's rulemaking authority under the Government Securities Act of 1986 expired on October 1. The Senate recently passed legislation that extends the Treasury's authority for one year and, additionally, makes it illegal to provide false or inaccurate information in bids at Treasury auctions or in allocations of securities issued by government sponsored enterprises (GSEs). A draft bill in the House would extend the Treasury's authority for five years and allow regulatory agencies to write sales practice rules. The bill also would increase the authority of the Securities and Exchange Commission in the government securities market.

Following the Salomon Brothers' admission in August that it had regularly overstated to several GSEs the amount of customer orders it claimed to have prearranged, many other dealers have admitted similar practices. In response, the Federal Home Loan Mortgage Corporation (Freddie Mac) has required those dealers to repay about $1 million in aggregate as a condition for remaining in the selling group. Other GSEs are said to be contemplating similar action.

During the intermeeting period, various bills regulating the GSEs have been moving through Congress. A bill passed by the House would create an independent bureau in HUD to regulate the safety and soundness of the Fannie Mae and Freddie Mac, giving the bureau the authority to request assistance from the Board of Governors in conducting examinations. A draft bill in the Senate would form a new three-member Federal Housing Finance Board composed of the Secretary of the Treasury, the Chairman of the Federal Reserve Board, and a chairperson appointed by the President. The new board would have safety and soundness authority over Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. One of the bills that establishes minimum capital requirements for the Student Loan Marketing Association calls for the phased replacement of the private-sector funded Guaranteed Student Loan Program by a loan program funded by new Treasury borrowing. The Senate version of a bill regulating the Farm Credit System puts a Federal Reserve Governor "familiar with agricultural economics" on the board of directors of the Farm Credit Administration.

## Municipal Securities

Gross issuance of tax-exempt securities is likely to be down slightly in October from the pace in September. The only sizable short-term offering this month has been New York City's $1.25 billion of revenue anticipation notes. The securities were priced to yield 4.90 percent, down from the 7.80 percent secondary-market rate on the city's short-term notes in June when the city faced a near-term crisis caused by the state's inability to adopt a budget. Despite the drop in yield, the interest rate on the notes is almost 70 basis points above that on high-grade notes.

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

| | 1989 | 1990 | 1991 | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Year | Year | Q1 | Q2 | Q3^p | Aug. | Sept.^p | Oct.^f |
| Total offerings | 11.90 | 13.10 | 11.39 | 17.51 | 18.92 | 23.82 | 15.35 | -- |
| Total tax-exempt | 11.65 | 12.85 | 11.25 | 17.20 | 18.16 | 22.14 | 15.20 | 14.00 |
| Long-term | 9.47 | 10.03 | 9.81 | 13.16 | 13.21 | 15.74 | 12.27 | 12.00 |
| Short-term | 2.17 | 2.82 | 1.44 | 4.04 | 4.95 | 6.40 | 2.93 | 2.00 |
| Total taxable | .25 | .25 | .14 | .31 | .76 | 1.68 | .15 | -- |

p--preliminary f--forecast.

Long-term volume this month appears to be little changed from that in September, which was down from the lofty levels seen in late spring and summer. Thus far in 1991, the volume of long-term offerings has run at its strongest pace since 1986 and is up more than 20 percent over the same period in 1990. Refunding volume is substantially higher this year, reflecting the declines in long-term municipal bond rates. In addition, a significant portion of the increase owes to measures adopted by state and local governments to cope with looming revenue shortfalls. Connecticut and New York have passed legislation authorizing the issuance of bonds to finance their deficits directly. Other states and cities, constrained by the requirement to balance operating budgets, have shifted expenditures to capital budgets, where they can be financed by bonds. Still others have sold assets to tax-exempt agencies that, in turn, have issued securities to finance the acquisitions. Finally, to alleviate prospective short-term financing needs, several states and municipalities have refinanced debt at longer maturities.

Demand by individuals for tax-exempt securities has been exceptionally strong, as reflected in the heavy inflows to open-end municipal bond funds, which through the first nine months of the year are about 83 percent above those in the same period in 1990. About half the inflows have been into those funds holding securities of only one state, which typically give residents of the state the added exemption of interest income from state and local taxes. Initial public offerings of closed-end tax-exempt mutual funds have already exceeded the volume for all of last year by 75 percent.

Changes in long-term debt ratings present a mixed picture of the overall direction of credit quality in the municipal sector in the third quarter. At Standard and Poor's, downgradings outstripped upgradings by a 3-to-1 margin, while upgradings exceeded downgradings by a 2-to-1 margin at Moody's. One reason for the discrepancy is the downgrading of New Jersey and Connecticut by Standard and Poor's, which triggered a large number of similar rating changes for state agencies. Neither state, however, has been downgraded by Moody's. Another source of the difference is the large number of upgrades given by Moody's to single-family housing bond programs as a result of the favorable performance of the mortgages supporting the bonds. Officials at both rating agencies, however, indicate that sectors of previous concern--primarily states, several major cities, hospitals, and most housing-related agencies--remain under stress and have not shown material improvement.

Mortgage Markets

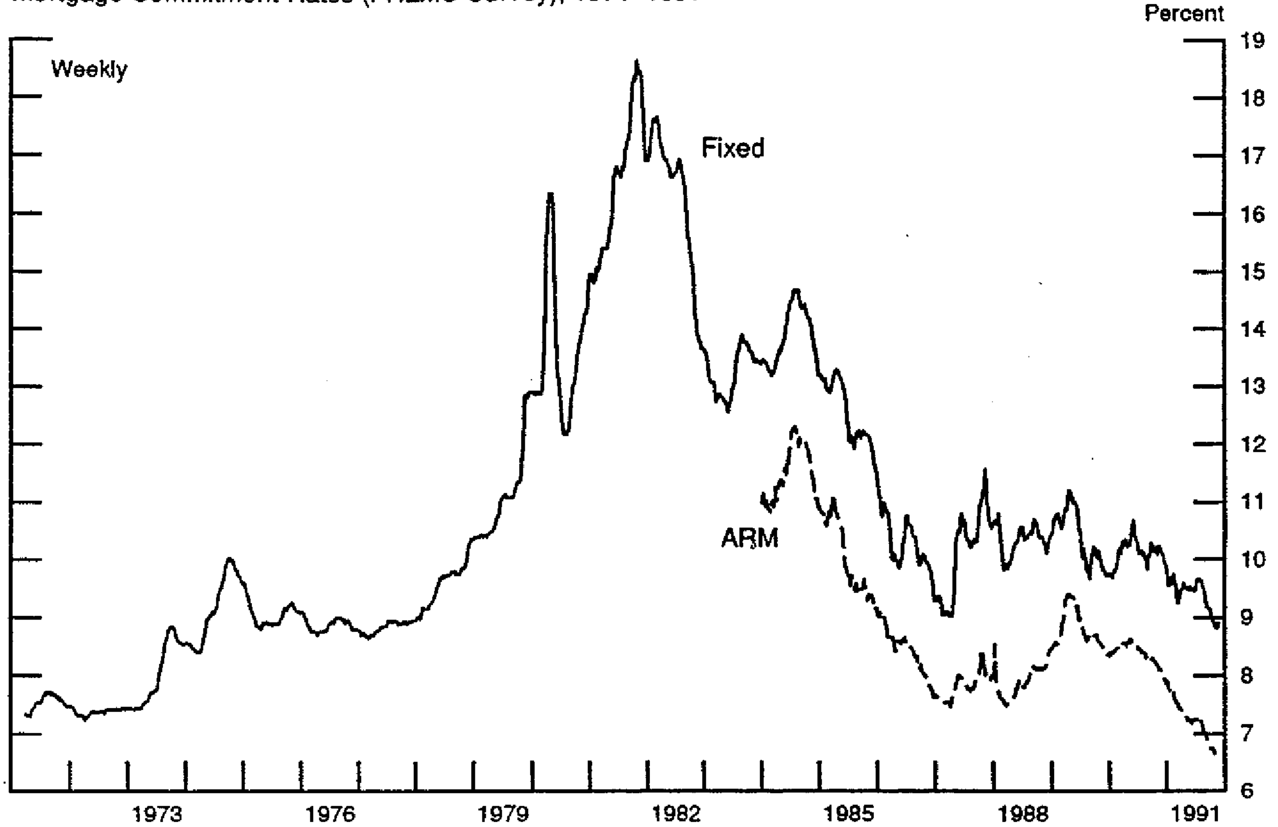
Interest rates on fixed-rate mortgages have declined to their lowest levels since 1977, and initial rates on adjustable-rate mortgages are now at their lowest levels since these loans became widely available ten years ago (chart). Consequently, the volume of home mortgage applications has jumped, according to industry data, press reports, and anecdotal evidence.

While mortgage applications associated with the purchase of homes have risen, industry sources estimate that as much as one-half of current mortgage applications represent refinancings. The Mortgage Bankers Association's index of the volume of refinancing applications shows a tripling since the end of July, while the volume of applications for mortgages for home purchases has picked up only slightly since June (chart).

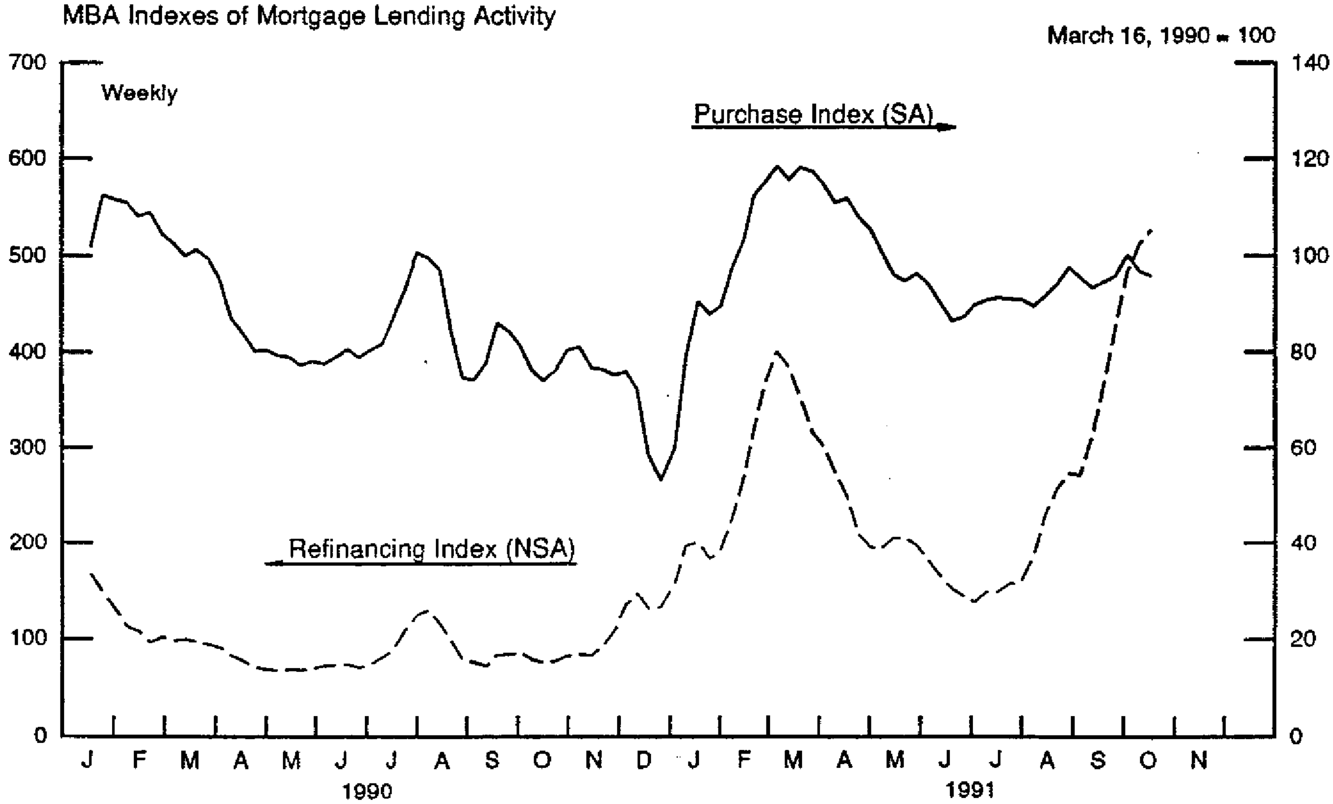
The surge in applications to refinance old loans suggests that, as these applications are processed, prepayment rates on outstanding mortgages may accelerate sharply in the fourth quarter. The actual timing of prepayments remains somewhat uncertain, however, because some lenders report that many homeowners are holding their refinancing applications open in anticipation of further interest rate declines. Historically, many homeowners wait until mortgage interest rates reverse direction before rushing to lock in lower rates.

Unlike some previous refinancing episodes, lenders report that the current wave of refinancing is characterized by far fewer "cash-out" refinancings, likely owing to the weakness in real estate prices. The primary motivating factor in today's market appears to

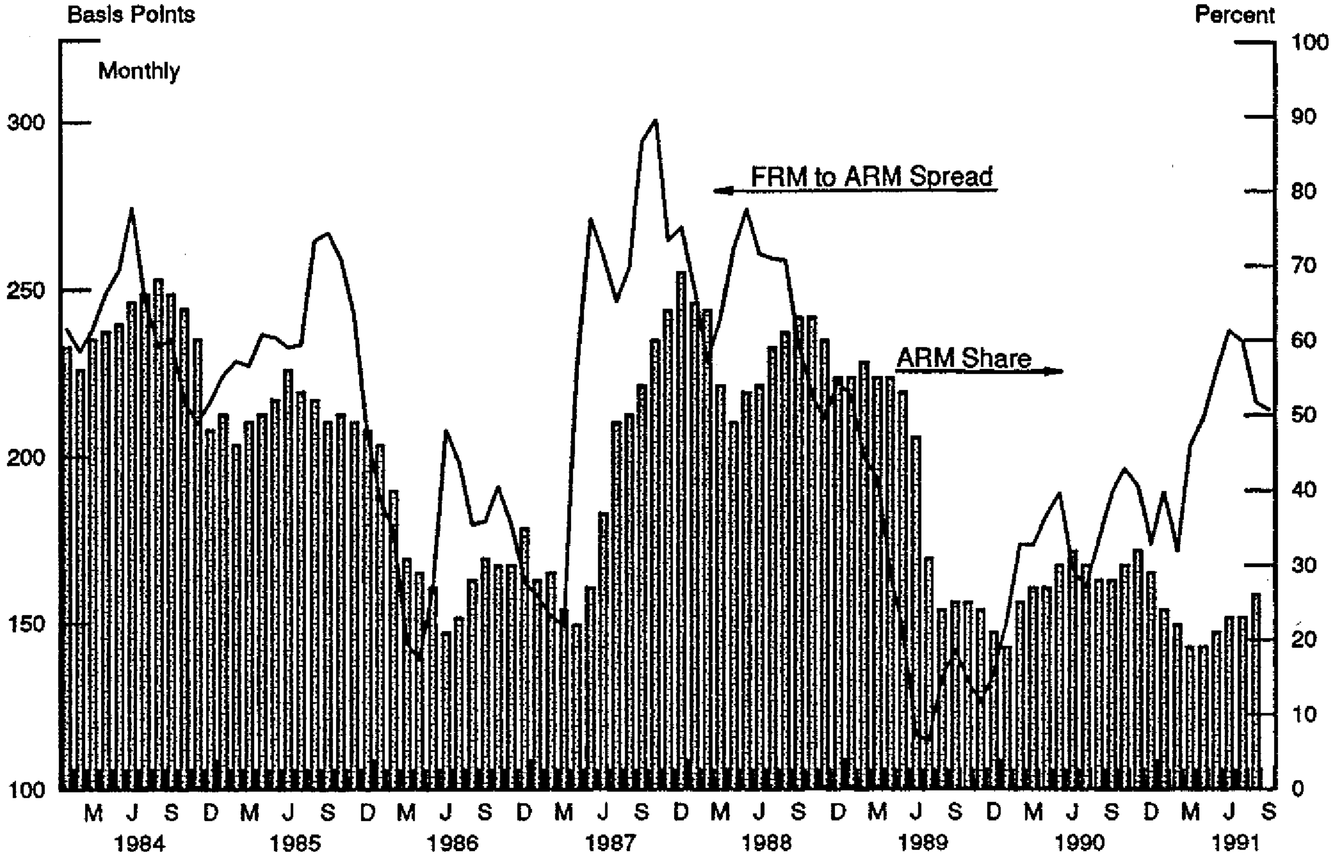
Mortgage Commitment Rates (FHLMC Survey), 1971–1991




MBA Indexes of Mortgage Lending Activity



ARM Share of Loans Closed vs. Spread of FRM Rate to ARM Rate




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

| | Federally related pass-through securities | | | Multiclass securities | | | | |
|---|---|---|---|---|---|---|---|---|
| | Total (SA) | Fixed-Rate | ARM-backed | Total | Private issues[1] | FNMA REMICs | FHLMC REMICS | Agency strips |
| 1989 | 16.5 | 14.1 | 2.7 | 8.4 | 1.6 | 3.1 | 3.2 | .3 |
| 1990 | 19.7 | 17.2 | 2.4 | 11.4 | 2.4 | 5.1 | 3.4 | .5 |
| 1990-Q2 | 19.9 | 16.3 | 2.2 | 11.1 | 3.0 | 4.7 | 3.0 | .4 |
| Q3 | 18.3 | 17.4 | 1.7 | 12.1 | 2.7 | 6.5 | 2.3 | .6 |
| Q4 | 19.0 | 16.6 | 4.2 | 11.0 | 2.3 | 4.0 | 4.5 | .3 |
| 1991-Q1 | 16.8 | 14.0 | 1.7 | 9.0 | 2.1 | 4.0 | 2.8 | .1 |
| Q2 | 24.7 | 21.4 | 1.7 | 18.6 | 3.0 | 8.2 | 6.8 | .5 |
| Q3 p | 24.5 | 23.7 | 2.0 | 24.4 | 3.4 | 11.9 | 7.1 | 2.0 |
| 1991-Feb. | 16.2 | 14.0 | 1.2 | 8.4 | 1.4 | 3.2 | 3.6 | 0.2 |
| Mar. | 18.4 | 15.1 | 2.9 | 13.2 | 3.2 | 6.3 | 3.7 | 0.0 |
| Apr. | 19.3 | 16.7 | 1.2 | 14.2 | 2.3 | 5.9 | 6.0 | 0.0 |
| May | 26.7 | 21.7 | 1.1 | 17.6 | 2.6 | 8.1 | 6.9 | 0.0 |
| June | 28.0 | 25.9 | 2.8 | 24.0 | 4.2 | 10.6 | 7.6 | 1.6 |
| July p | 23.5 | 22.5 | 1.2 | 19.4 | 2.7 | 8.9 | 6.3 | 1.6 |
| Aug. p | 27.1 | 25.7 | 2.0 | 25.8 | 4.7 | 12.2 | 7.5 | 1.5 |
| Sep. p | 22.9 | 22.7 | 2.6 | 28.0 | 2.8 | 14.6 | 7.4 | 3.2 |

1. Excludes pass-through securities with senior/subordinated structures.
p--preliminary

be rate reduction, with some homeowners also consolidating second mortgages and home equity loans with their first mortgage. To date, mortgage lenders evidently have been able to process applications on schedule and there has been little widening of spreads on FRMs, as occurred during the surge in refinancing activity in 1986 and 1987.

In addition, trade reports indicate that, despite the current steepness of the yield curve, many homeowners are refinancing to convert from adjustable-rate to fixed-rate borrowing. Historically, adjustable-rate mortgages tend to become more popular as the slope of the yield curve increases (chart). As demonstrated by the relatively low proportion of ARM originations in 1991, however, this relationship is less strong when long-term yields are perceived as relatively low.

The data that have become available since the last FOMC meeting suggest that mortgage credit growth remains rather subdued. Real estate loans at commercial banks remained weak in October. According to the October Senior Loan Officer Survey, banks have continued to tighten standards for commercial real estate loans. However, very few reported tightening standards for mortgage loan applications from individuals. The survey also indicated that while the demand for home equity loans was down, demand for other home mortgage credit was up slightly.

Issuance of agency pass-through securities continued brisk, likely sustained, at least in part, by the growing popularity of fixed-rate mortgages and the increased market share of mortgage bankers, who generally securitize all of their mortgage loans (table). Issuance of agency multiclass securities in the third quarter rose to another record, bolstered in part by higher issuance of interest-only and principal-only stripped mortgage-backed securities. The demand for CMOs from commercial banks and investment companies has remained strong.

Consumer Installment Credit

Consumer installment credit outstanding fell at a 2 percent annual rate in August (table). This drop marked the eighth decline in the last nine months and brought outstanding installment credit to a level 1 percent below its November 1990 peak. A sizable minority of banks responding to the Senior Loan Officer Survey reported that demand for consumer installment credit fell in the three month period ending in October. Most banks indicated no change in willingness to make such loans with a few indicating somewhat greater willingness.

As has been the case throughout most of this period, the August decline in installment credit was led by a sharp drop in automobile credit, as auto sales have continued to be lackluster. The use by consumers of alternative financing methods, such as leasing or home equity loans, also has shaved a little off the growth of auto credit recently. Revolving credit continued to expand, but all other installment credit fell again in August. Total consumer credit (installment plus noninstallment) dropped at a 4-1/2 percent annual rate in August.

Securitization of consumer loans was strong in the third quarter, despite investor unease stemming from the first early amortization of a credit card issue in July as well as concern about the portfolio quality of some other issues. The third-quarter total of $11 billion in gross public issuance of securities backed by consumer loans was second only to the $11.7 billion issued in the fourth quarter of 1989 (table). On a monthly basis, a record $7 billion in consumer loans was securitized in September--far surpassing the previous record (chart). Commercial banks, under

CONSUMER CREDIT
(Seasonally adjusted)

| | Percent change (at annual rate) | | | | | | | | Memo: Outstandings (billions of dollars) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | 1990 | 1991 | | 1991 | | 1991 |
| | 1988 | 1989[1] | 1990 | Q4 | Q1 | Q2 | July[r] | Aug.[p] | Aug.[p] |
| Installment | 8.8 | 5.9 | 2.3 | -.2 | -1.4 | -1.0 | -1.0 | -2.1 | 728.7 |
| Auto | 6.9 | 1.3 | -2.1 | -1.5 | -5.5 | -8.8 | -4.1 | -8.6 | 271.6 |
| Excluding auto | 10.2 | 9.2 | 5.2 | .5 | 1.1 | 3.8 | .8 | 1.8 | 457.1 |
| Revolving | 13.7 | 15.2 | 10.6 | 1.9 | 8.6 | 5.2 | 2.4 | 6.2 | 229.4 |
| All other | 7.4 | 4.5 | .6 | -.7 | -6.0 | 2.5 | -.8 | -2.6 | 227.7 |
| Noninstallment | 6.0 | 2.6 | -4.9 | -6.0 | -14.2 | -3.3 | -30.0 | -37.7 | 53.6 |
| Total | 7.2 | 5.8 | 1.7 | -.7 | -2.4 | -1.2 | -3.1 | -4.6 | 782.2 |

1. Growth rates are adjusted for discontinuity in data between December 1988 and January 1989.
r--revised. p--preliminary.
Note: Details may not add to totals due to rounding.

CONSUMER INTEREST RATES
(Annual percentage rate)

| | | | 1991 | | | |
|---|---|---|---|---|---|---|
| | 1989 | 1990 | May | June | July | Aug. |
| At commercial banks[1] | | | | | | |
| New cars (48 mo.) | 12.07 | 11.81 | 11.28 | ... | ... | 11.06 |
| Personal (24 mo.) | 15.44 | 15.46 | 15.16 | ... | ... | 15.24 |
| Credit cards | 18.02 | 18.17 | 18.22 | ... | ... | 18.24 |
| At auto finance cos.[2] | | | | | | |
| New cars | 12.62 | 12.54 | 12.95 | 12.77 | 12.55 | 12.40 |
| Used cars | 16.18 | 15.99 | 15.85 | 15.74 | 15.66 | 15.63 |

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.

Public Securitization of Consumer Loans
(Gross issuance; billions of dollars)

| | TOTAL | Type of Collateral | | | Type of Issuer | | |
|---|---|---|---|---|---|---|---|
| | | Auto Loans | Credit Cards | Other[1] | Commercial Bank | Finance Company | Other[2] |
| 1988 | 15.39 | 5.50 | 7.92 | 1.97 | 8.06 | 3.04 | 4.28 |
| 1989 | 22.50 | 7.83 | 12.02 | 2.65 | 11.03 | 7.70 | 3.77 |
| 1990 | 34.48 | 10.47 | 22.02 | 1.99 | 21.91 | 9.61 | 2.95 |
| 1991[3] | 28.11 | 11.00 | 15.79 | 1.32 | 15.80 | 9.00 | 3.31 |
| 1989 Q1 | 4.88 | .61 | 3.25 | 1.03 | 3.03 | 1.19 | .67 |
| Q2 | 2.90 | .10 | 2.60 | .20 | 2.15 | .20 | .55 |
| Q3 | 3.06 | .74 | 2.00 | .32 | 2.19 | .25 | .62 |
| Q4 | 11.66 | 6.39 | 4.18 | 1.10 | 3.67 | 6.06 | 1.93 |
| 1990 Q1 | 8.04 | 1.88 | 5.85 | .32 | 5.94 | 1.34 | .75 |
| Q2 | 9.28 | 3.01 | 5.94 | .34 | 6.21 | 2.57 | .50 |
| Q3 | 7.38 | .75 | 5.66 | .97 | 4.98 | 1.72 | .68 |
| Q4 | 9.78 | 4.83 | 4.58 | .37 | 4.78 | 3.98 | 1.03 |
| 1991 Q1 | 8.25 | 4.88 | 3.00 | .38 | 2.80 | 4.80 | .65 |
| Q2 | 8.87 | 1.42 | 7.17 | .28 | 6.64 | .86 | 1.37 |
| Q3 | 10.99 | 4.71 | 5.62 | .66 | 6.36 | 3.35 | 1.28 |
| 1991 July | 1.39 | .89 | .50 | .00 | .26 | .63 | .50 |
| Aug. | 2.57 | 1.17 | 1.41 | .00 | 2.40 | .00 | .18 |
| Sept. | 7.03 | 2.65 | 3.71 | .66 | 3.70 | 2.71 | .61 |
| Oct.[4] | 1.04 | .11 | .94 | .00 | .94 | .00 | .11 |

1. Includes boat, recreation vehicle, mobile home and personal loans.
2. Includes retailers and savings and loan institutions.
3. Through September 30, 1991.
4. Through October 18, 1991.

Note: Details may not add totals due to rounding.

continued pressure from risk-based capital requirements, remained the largest single institutional issuer of these securities. Finance companies and retailers also were prominent issuers in the third quarter. By type of collateral, credit cards again were the largest component, with auto loans running a close second.

Through the first three weeks of October, there have been two new issues backed by consumer loans, totaling $1 billion. Market analysts are looking for gross issuance of as much as $10 billion in the fourth quarter--somewhat below last year's fourth-quarter volume. If these expectations are realized, the total volume for the year would be slightly above the $34.5 billion securitized in 1990 and would bring the total since 1985 to about $130 billion. Despite the high issuance level of the third quarter, yield spreads on asset-backed securities have widened only about 10 basis points since summer.

# INTERNATIONAL DEVELOPMENTS

Merchandise Trade

The preliminary merchandise trade deficit for August worsened to $6.8 billion, from a revised July deficit of $5.9 billion. The August deficit was the largest registered since January of this year. The deterioration in August reflected a drop-off in export shipments, while imports were little changed from their high rate in July.

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

| | Exports | | | Imports | | | |
|---|---|---|---|---|---|---|---|
| | Total | Ag. | NonAg. | Total | Oil (nsa) | NonOil | Balance |
| 1991-Jan | 34.1 | 3.1 | 31.0 | 41.5 | 5.2 | 36.3 | -7.4 |
| Feb | 33.6 | 3.4 | 30.2 | 39.1 | 4.1 | 35.0 | -5.5 |
| Mar | 34.0 | 3.3 | 30.7 | 38.1 | 3.8 | 34.3 | -4.1 |
| Apr | 35.6 | 3.2 | 32.5 | 40.1 | 4.1 | 36.1 | -4.5 |
| May | 35.3 | 3.3 | 31.9 | 40.1 | 4.6 | 35.4 | -4.8 |
| Jun | 35.0 | 3.1 | 31.8 | 38.8 | 4.2 | 34.5 | -3.8 |
| Jul | 35.2 | 3.4 | 31.8 | 41.2 | 4.0 | 37.2 | -5.9 |
| Aug | 34.2 | 3.2 | 30.9 | 40.9 | 4.6 | 36.3 | -6.8 |

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

Looking at balance-of-payments data for July and August combined gives a clearer picture of the deterioration in the trade deficit since the second quarter. The deficit in July-August worsened $20 billion at an annual rate relative to the second-quarter average, reversing much of the improvement registered earlier this year. The worsening of the deficit in July-August was led by a rebound in the value of non-oil imports, up almost 17 percent at an annual rate relative to the second-quarter average. At the same time, exports were down slightly in July-August from their average in the second quarter.

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

| | Years | | Seasonally Adjusted A | | | | Memo: Percent Change 1991: Q3-e from | |
|---|---|---|---|---|---|---|---|---|
| | | | 1990 | 1991 | | | | |
| | 1989 | 1990 | Q4 | Q1 | Q2 | Q3-e | Year Ago | Prev. Qtr. |
| Exports | 361 | 390 | 402 | 404 | 416 | 414 | 7 | -1 |
| Imports | 477 | 498 | 513 | 477 | 479 | 496 | -1 | 4 |
| Oil | 51 | 62 | 72 | 53 | 52 | 52 | -17 | 0 |
| Non-oil | 426 | 436 | 441 | 424 | 427 | 444 | 1 | 4 |
| Balance | -116 | -108 | -111 | -74 | -62 | -82 | | |
| Ex Oil | -65 | -46 | -39 | -21 | -11 | -30 | | |

e--Average of first 2 months of quarter at an annual rate.
Source: U.S. Department of Commerce, Bureau of Economic Analysis, Balance-of-Payments Accounts.

The surge in the value of non-oil imports in July-August was concentrated entirely in automotive products and consumer goods, as small declines were registered in other major trade categories. While all components of the automotive import category rose in July-August relative to the second quarter, more than half of the increase was in imports of passenger cars from Canada and other trading partners, particularly Japan. The increase from Canada appears to have resulted largely from the increased production by U.S. subsidiaries, and is consistent with the overall recovery of U.S. automobile production during the third quarter. The number of cars imported from Japan (not seasonally adjusted) was unusually low in the second quarter of this year relative to earlier years, following a bunching of shipments into the first quarter. The rebound in these imports during July-August returned them to about the same rate as registered in the third quarter of 1990. Seasonal adjustment factors also tended to magnify the swing between the second quarter and July-August of this year. The substantial rise in imports of consumer goods during July-August was mostly in

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

| | Year 1990 | 1990 Q3 | 1990 Q4 | 1991 Q1 | 1991 Q2 | 1991 Q3-e | $Change Q3-Q3 | $Change Q3-Q2 |
|---|---|---|---|---|---|---|---|---|
| Total U.S. Exports | 389.6 | 386.6 | 402.3 | 403.6 | 416.4 | 414 | 27 | -3 |
| Agricultural Export | 40.2 | 39.3 | 37.8 | 39.8 | 38.0 | 40 | 1 | 2 |
| Nonagric. Exports | 349.3 | 347.3 | 364.5 | 363.8 | 378.4 | 373 | 26 | -5 |
| Industrial Suppl. | 96.7 | 95.4 | 106.0 | 105.1 | 101.6 | 102 | 6 | 0 |
| Gold | 3.0 | 3.0 | 4.4 | 4.1 | 3.3 | 4 | 1 | 0 |
| Fuels | 14.0 | 13.9 | 18.1 | 16.8 | 13.0 | 13 | -1 | 0 |
| Other Ind. Suppl. | 79.6 | 78.6 | 83.5 | 84.2 | 85.4 | 85 | 6 | 0 |
| Capital Goods | 153.8 | 153.1 | 156.0 | 155.8 | 170.5 | 162 | 9 | -9 |
| Aircraft & Parts | 32.3 | 31.6 | 30.9 | 30.8 | 38.9 | 34 | 2 | -5 |
| Computers & Parts | 25.9 | 26.5 | 26.4 | 27.3 | 27.3 | 26 | 0 | -1 |
| Other Machinery | 95.6 | 95.0 | 98.7 | 97.7 | 104.4 | 102 | 7 | -3 |
| Automotive Product | 37.4 | 38.4 | 37.1 | 34.2 | 40.3 | 45 | 6 | 4 |
| To Canada | 22.6 | 23.5 | 21.5 | 19.5 | 22.3 | 25 | 2 | 3 |
| To Other | 14.8 | 14.9 | 15.6 | 14.7 | 18.0 | 19 | 5 | 1 |
| Consumer Goods | 43.3 | 42.8 | 45.8 | 45.9 | 44.5 | 44 | 1 | 0 |
| Other Nonagric. | 18.2 | 17.6 | 19.6 | 22.9 | 21.5 | 21 | 3 | 0 |
| Total U.S. Imports | 497.7 | 501.6 | 513.2 | 477.2 | 478.9 | 496 | -6 | 17 |
| Oil Imports | 62.1 | 61.8 | 72.1 | 52.9 | 51.6 | 52 | -10 | 0 |
| Non-Oil Imports | 435.6 | 439.8 | 441.1 | 424.3 | 427.3 | 444 | 4 | 17 |
| Industrial Suppl. | 82.5 | 83.3 | 83.9 | 80.4 | 80.8 | 81 | -3 | 0 |
| Gold | 2.5 | 2.8 | 3.3 | 3.3 | 3.0 | 3 | 0 | 0 |
| Other Fuels | 3.6 | 3.5 | 4.3 | 3.9 | 4.3 | 4 | 0 | -1 |
| Other Ind. Suppl. | 76.4 | 77.0 | 76.4 | 73.2 | 73.5 | 74 | -3 | 1 |
| Capital Goods | 116.4 | 116.2 | 120.2 | 119.3 | 121.1 | 121 | 5 | 0 |
| Aircraft & Parts | 10.6 | 9.9 | 12.8 | 11.2 | 12.4 | 13 | 3 | 0 |
| Computers & Parts | 23.0 | 23.0 | 23.3 | 24.2 | 26.0 | 27 | 4 | 1 |
| Other Machinery | 82.8 | 83.3 | 84.1 | 83.9 | 82.7 | 81 | -3 | -2 |
| Automotive Product | 87.3 | 90.3 | 86.1 | 82.1 | 78.9 | 92 | 2 | 13 |
| From Canada | 29.7 | 32.2 | 27.3 | 23.5 | 28.5 | 36 | 4 | 7 |
| From Other | 56.5 | 58.1 | 58.8 | 58.5 | 50.5 | 56 | -2 | 6 |
| Consumer Goods | 106.2 | 106.6 | 106.9 | 100.5 | 100.3 | 108 | 1 | 8 |
| Foods | 26.6 | 25.8 | 26.0 | 25.6 | 28.0 | 26 | 0 | -2 |
| All Other | 16.4 | 17.5 | 18.1 | 16.6 | 18.2 | 16 | -1 | -2 |

e--Average of first 2 months of quarter at an annual rate.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

textiles, apparel, and household and kitchen appliances, and was consistent with the pickup in personal consumption expenditures.

The value of total exports fell 2 percent at an annual rate in July-August from the second quarter, as a greater decline in nonagricultural exports was partially offset by a strong increase in agricultural shipments from depressed levels in the second quarter. The increase was mostly in corn, and resulted from credit guarantees extended to the Soviet Union. The decline in nonagricultural exports can be traced to the partial reversal of a sharp increase in exports of aircraft and parts during the second quarter, and to smaller declines in exports of semiconductors and drilling equipment. Automotive exports to Canada as well as other destinations were up somewhat during July-August, but not enough to offset fully the decline in capital goods.

OIL IMPORTS
(BOP basis, value at annual rates)

| | 1991 | | | Months | | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3-e | Apr | May | Jun | Jul | Aug |
| Value (Bil. $) | 52.88 | 51.62 | 51.58 | 49.03 | 55.35 | 50.47 | 48.26 | 54.90 |
| Price ($/BBL) | 20.33 | 17.32 | 17.05 | 17.34 | 17.58 | 17.00 | 16.66 | 17.43 |
| Quantity (mb/d) | 7.13 | 8.16 | 8.28 | 7.74 | 8.62 | 8.13 | 7.93 | 8.62 |

e--Average of first 2 months of quarter at an annual rate.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

In July-August, the value of oil imports was essentially unchanged from the second-quarter average, as a rebound in both the price and quantity of imported oil in August reversed declines in June and July. The price of imported oil has begun to respond to the general firming of oil prices that began in June. Given the pattern of spot, posted, and futures prices between August and mid-October, import prices are likely to increase through December. The increase in oil prices is largely attributable to Iraq's apparent refusal to take advantage of the U.N. resolution allowing it to export limited quantities of oil (with the expenditure of the revenues controlled in large part by the United Nations). In addition, there is considerable uncertainty about the availability of Soviet exports of petroleum and products. The quantity of oil imports rose in August, according to preliminary Department of Energy (DOE) data, as stocks continued to be built and consumption picked up. DOE data for September suggest a roughly 0.3 mb/d decline in the quantity of imports, the result of a slowdown in stockbuilding activity.

Prices of Non-oil Imports and Exports

According to data compiled by the Bureau of Labor Statistics (BLS), prices of non-oil imports continued to decline in the third quarter at about 3 percent at an annual rate. While prices in all categories of non-oil imports dropped during the third quarter, the most significant declines were recorded in industrial supplies and capital goods. The monthly pattern underlying the third quarter reveals that prices of non-oil imports edged up in September, the first monthly increase since early this year.

Export prices also declined in the third quarter, largely reflecting a drop in agricultural prices of over 8 percent at an annual rate. Prices of nonagricultural exports fell almost 2 percent at an annual rate, somewhat less than the decline registered in the second quarter. The pattern of nonagricultural export prices so far this year has roughly followed the pattern of U.S. producer prices weighted by their shares in U.S. exports.

U.S. International Financial Transactions

U.S. banks and securities firms reported a $7 billion net capital outflow in August (line 1 of the Summary Table). The bulk of this outflow arose from RP transactions between securities firms

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

| | Year 1991-Q3 / 1990-Q3 | Quarters 1991 Q1 | Q2 | Q3 | Months 1991 Aug | Sep |
|---|---|---|---|---|---|---|
| | | (Quarterly Average, AR) | | | (Monthly Rates) | |
| | --------BLS Prices-------- | | | | | |
| Imports, Total | -0.4 | -11.9 | -7.2 | -3.4 | 0.3 | 0.3 |
| Foods, Feeds, Bev. | 3.1 | 7.8 | 3.1 | -3.5 | -0.1 | 0.2 |
| Industrial Supplies | -5.4 | -40.4 | -19.0 | -6.2 | 0.8 | 0.0 |
| Ind Supp Ex Oil* | -2.4 | -0.2 | -4.5 | -7.2 | -0.8 | -0.7 |
| Capital Goods | 0.7 | 4.9 | -5.2 | -4.6 | 0.4 | 0.1 |
| Automotive Products | 4.2 | 6.6 | 1.2 | -1.1 | 0.2 | 0.4 |
| Consumer Goods | 0.4 | 2.5 | -4.3 | -0.6 | 0.1 | 0.7 |
| Memo: | | | | | | |
| Oil | -11.4 | -73.1 | -41.1 | -4.4 | 4.0 | 1.5 |
| Non-oil | 1.0 | 3.7 | -2.7 | -3.2 | -0.1 | 0.2 |
| Exports, Total | 0.3 | 0.6 | -1.2 | -2.5 | 0.4 | -0.1 |
| Foods, Feeds, Bev. | -2.0 | 8.3 | 8.1 | -5.8 | 5.3 | -1.6 |
| Industrial Supplies | -4.0 | -9.6 | -11.9 | -8.0 | -1.0 | -0.4 |
| Capital Goods | 3.1 | 5.6 | 3.5 | 1.5 | 0.0 | 0.4 |
| Automotive Products | 2.8 | 3.5 | 2.0 | 2.1 | 0.0 | 0.0 |
| Consumer Goods | 3.3 | 6.0 | 6.3 | -2.4 | 0.0 | 0.5 |
| Memo: | | | | | | |
| Agricultural | -2.8 | 6.7 | 6.6 | -8.5 | 3.2 | -1.2 |
| Nonagricultural | 0.6 | -0.6 | -2.6 | -1.8 | -0.2 | 0.1 |
| | --------Prices in the GNP Accounts-------- | | | | | |
| Fixed-Weight | | | | | | |
| Imports, Total | -0.9 | -18.3 | -11.3 | -1.1 | -- | -- |
| Oil | -11.9 | -75.0 | -47.5 | 3.0 | -- | -- |
| Non-oil | 0.9 | 4.0 | -3.7 | -1.7 | -- | -- |
| Exports, Total | 0.7 | 0.4 | -0.4 | -2.6 | -- | -- |
| Ag | -1.0 | 7.8 | 13.6 | -11.1 | -- | -- |
| Nonag | 1.1 | -1.0 | -2.9 | -0.8 | -- | -- |
| Deflators | | | | | | |
| Imports, Total | -5.9 | -20.8 | -18.3 | -4.8 | -- | -- |
| Oil | -12.0 | -75.0 | -47.4 | 2.9 | -- | -- |
| Non-oil | -5.5 | -4.7 | -10.7 | -7.0 | -- | -- |
| Exports, Total | -2.0 | -5.2 | 0.8 | -6.7 | -- | -- |
| Ag | -1.0 | 7.8 | 13.6 | -11.1 | -- | -- |
| Nonag | -2.0 | -6.6 | 0.1 | -6.5 | -- | -- |

*/ Months not for publication.

in the United States and borrowers in Bermuda. This outflow differs in nature from the large outflow recorded in the second quarter, which reflected a shift in funding, especially by foreign-based banks, away from own foreign offices toward domestic sources. In September, foreign-based banks turned again to their own foreign offices as a sources of funds, borrowing $6 billion net, on a monthly average basis (line 1b of the International Banking Data table).

Net foreign purchases of U.S. stocks and bonds picked up further in August to total $5-1/2 billion (lines 2a and 2b of the Summary table). While Eurobond issuance by U.S. corporations was down slightly in the month, domestic issuance of both stocks and bonds was strong. Net foreign purchases of Treasury securities totaled $2-1/2 billion in the month (line 3). These were more than accounted for by purchases attributed to the Netherlands Antilles, indicating little about the residence of the beneficial owners. U.S. residents continued to acquire foreign securities in August (line 2c). Most of the $5-1/2 billion in net purchases was in the form of foreign stocks purchased in Japan, Canada, and the United Kingdom. Foreign bond issuance in the United States was very light in August, though it picked up markedly in September.

Foreign official reserves in the United States increased $6-1/2 billion in August (line 4). Increases by Taiwan and the BIS account for nearly all of the increase. Partial data from FRBNY indicate little change in official reserves in September.

Eurodollar holdings of U.S. nonbank residents continued to decline in August and September (line 3, International Banking table). Since the beginning of the year, declines in this series have roughly corresponded to increases in domestic large time

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

| | 1989 Year | 1990 Year | 1990 Q3 | 1990 Q4 | 1991 Q1 | 1991 Q2 | 1991 Jun. | 1991 Jul. | 1991 Aug. |
|---|---|---|---|---|---|---|---|---|---|
| Private Capital | | | | | | | | | |
| Banks | | | | | | | | | |
| 1. Change in net foreign positions of banking offices[1] in the U.S. (+ = inflow) | 27.2 | 31.0 | 21.4 | -1.4 | 0.6 | -29.9 | -7.9 | 4.3 | -7.0 |
| Securities | | | | | | | | | |
| 2. Private securities transactions, net[2] | 15.7 | -29.2 | -4.3 | -7.8 | -5.0 | 2.1 | -0.2 | -0.9 | -0.2 |
| a) foreign net purchases (+) of U.S. corporate bonds[3] | 31.8 | 16.2 | -0.4 | 6.3 | 3.5 | 7.6 | 3.5 | 1.9 | 3.8 |
| b) foreign net purchases (+) of U.S. corporate stocks | 7.9 | -13.7 | -2.2 | -5.0 | 1.8 | 7.7 | 1.4 | 1.0 | 1.6 |
| c) U.S. net purchases (-) of foreign securities | -24.0 | -31.7 | -1.7 | -9.0 | -10.3 | -13.2 | -5.1 | -3.9 | -5.5 |
| 3. Foreign net purchases (+) of U.S. Treasury obligations | 30.1 | -0.5 | 0.3 | -2.8 | 4.2 | 13.6 | 0.8 | 0.7 | 2.6 |
| Official Capital | | | | | | | | | |
| 4. Changes in foreign official reserves assets in U.S. (+ = increase) | 8.3 | 32.0 | 14.3 | 18.9 | 5.5 | -3.5 | -4.5 | 3.3 | 6.5 |
| a) By area | | | | | | | | | |
| G-10 countries | -5.2 | 10.0 | 8.6 | 8.6 | -12.1 | -4.7 | -0.9 | -0.8 | 1.5 |
| OPEC | 10.1 | 1.2 | -1.4 | -0.5 | 0.3 | -2.9 | -0.8 | * | -2.8 |
| All other countries | 3.4 | 20.8 | 7.1 | 10.8 | 17.3 | 4.1 | -2.8 | 4.1 | 7.9 |
| b) By type | | | | | | | | | |
| U.S. Treasury securities | 0.1 | 29.6 | 12.3 | 19.7 | 2.4 | -2.3 | -3.7 | 0.9 | 2.3 |
| Other[4] | 8.2 | 2.4 | 2.0 | -0.8 | 3.1 | -1.2 | -0.8 | 2.4 | 4.3 |
| 5. Changes in U.S. official reserve assets (+ = decrease) | -25.3 | -2.2 | 1.7 | -1.1 | -0.4 | 1.4 | 1.8 | 1.5 | 1.3 |
| Other transactions (Quarterly data)[5] | | | | | | | | | |
| 6. U.S. direct investment (-) abroad | -33.4 | -33.4 | -17.8 | -3.8 | -11.9 | -2.6 | n.a. | n.a. | n.a. |
| 7. Foreign direct investment (+) in U.S. | 70.6 | 37.2 | 7.1 | 4.5 | 4.3 | 3.3 | n.a. | n.a. | n.a. |
| 8. Other capital flows (+ = inflow)[6] | -5.3 | -6.3 | -0.3 | -2.2 | 1.0 | -9.0 | n.a. | n.a. | n.a. |
| 9. U.S. current account balance | -106.3 | -92.1 | -23.9 | -23.4 | 10.5 | 3.0 | n.a. | n.a. | n.a. |
| 10. Statistical discrepancy | 18.4 | 63.5 | 1.5 | 19.1 | -8.8 | 21.6 | n.a. | n.a. | n.a. |
| MEMO: | | | | | | | | | |
| U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted) | -115.9 | -108.1 | -28.8 | -27.7 | -18.4 | -15.6 | n.a. | n.a. | n.a. |

1. Includes changes in positions of all depository institutions, bank-holding companies, and certain transactions between brokers/dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements.)
2. 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.
3. Includes all U.S. bonds other than Treasury obligations.
4. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
. Seasonally adjusted.
6. 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.

INTERNATIONAL BANKING DATA
(Billions of dollars)

| | 1989 | | | | 1990 | | | | 1991 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Mar. | June | Sept. | Dec. | Mar. | June | Sept. | Dec. | Mar. | June | Aug. | Sept. |
| 1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS | -2.9 | -3.9 | -6.4 | -5.5 | -11.7 | -11.0 | -15.6 | -31.3 | -23.8 | -13.7 | -10.2 | -14.1 |
| (a) U.S.-chartered banks | 20.4 | 19.2 | 14.9 | 19.2 | 12.2 | 7.2 | 5.7 | 5.5 | 7.6 | 5.4 | 9.4 | 10.9 |
| (b) Foreign-chartered banks | -23.3 | -23.1 | -21.3 | -24.7 | -23.9 | -18.2 | -21.3 | -36.9 | -31.3 | -19.2 | -19.6 | -25.1 |
| 2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks | 24.0 | 26.0 | 21.6 | 20.7 | 21.8 | 22.2 | 24.0 | 24.7 | 26.0 | 23.9 | 23.4 | 23.7 |
| 3. Eurodollar Holdings of U.S. Nonbank Residents 1/ | 144.8 | 131.5 | 130.3 | 123.5 | 110.6 | 106.5 | 109.1 | 116.1 | 114.6 | 105.8 | 101.1 | 98.6 |

1. Includes term and overnight Eurodollars held by money market mutual funds. Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices. Line 2 is an average of daily data. Line 3 is an average of daily data for the overnight component and an average of Wednesday data for the term component.

deposits issued by agencies and branches of foreign banks. These large time deposits rose markedly in September but ran off some in the first part of October.

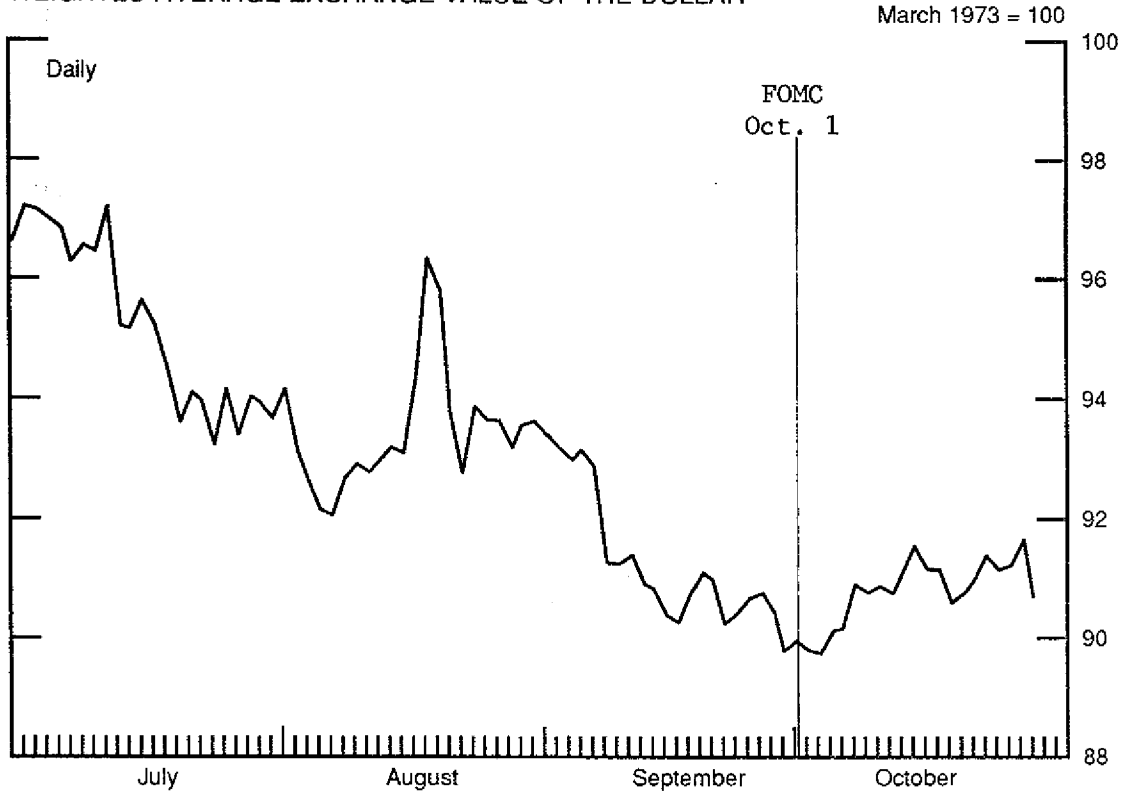
Foreign Exchange Markets

The weighted-average foreign-exchange value of the dollar, in terms of the other G-10 currencies, is about unchanged, on balance, since the October FOMC meeting, as shown in the accompanying chart. Throughout much of the intermeeting period, the dollar was supported by the belief that the expected easing in U.S. monetary policy had been postponed, in light of proposals to cut U.S. taxes and less-than-expected progress on reducing U.S. consumer price inflation. The dollar retreated somewhat late in the period amid evidence that the U.S. economic recovery may be sluggish.

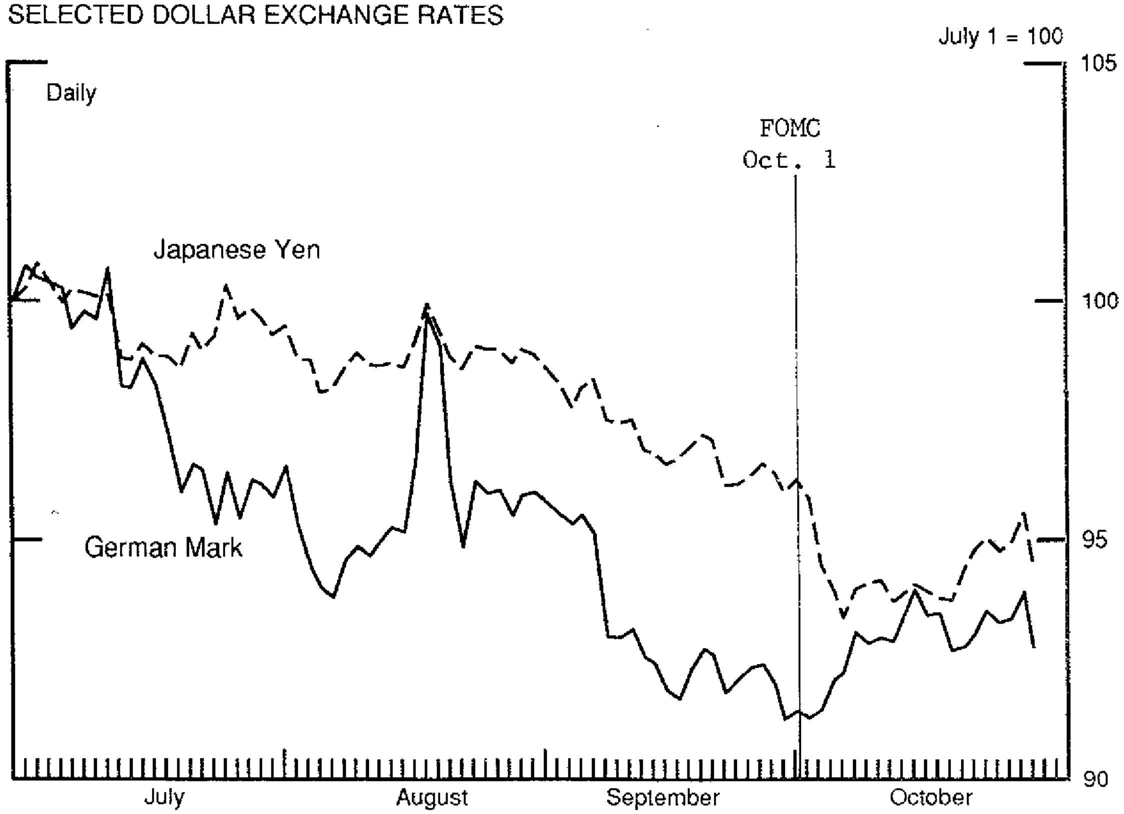
The dollar has risen more than 1/4 percent against the mark since the last FOMC meeting. The mark was weakened by concern that events in the former Soviet Union are moving out of control and that the government may default on its foreign debt, much of which is owned or guaranteed by the German government. Concern over high German wage settlements also may have hurt the mark.

The dollar has declined more than 1-1/2 percent, on balance, against the Japanese yen. Early in the intermeeting period, the yen strengthened in response to increased focus on the growing Japanese trade surplus and expectations that the G-7 meeting in Bangkok would result in a concerted effort to strengthen the yen in order to reduce the Japanese trade imbalance. More recently, the yen has given up some of its gains, amid speculation that the Bank of Japan will soon cut its official discount rate. That speculation was fueled by a further slowing of growth in the targeted Japanese monetary aggregate, M2+CDs, to 2.2 percent year-on-year in September.

WEIGHTED AVERAGE EXCHANGE VALUE OF THE DOLLAR




SELECTED DOLLAR EXCHANGE RATES



The Canadian dollar rose 3/4 percent against the U.S. dollar over the intermeeting period, reaching 13-year highs, amid reduced expectations of inflation in Canada. The Canadian dollar's strength occurred despite a decline in Canada-U.S. interest differentials, which still remain high relative to historical interest differentials. Within the EMS, the French franc eased slightly against the mark. The Bank of France reduced its money market intervention rate 1/4 percentage point.

Long-term interest differentials moved slightly in favor of the dollar, as the U.S. 10-year bond yield rose, on balance, while German and Japanese bond yields were little changed. The 17 basis point decline in Japanese 3-month interest rates mostly matched the net decline in U.S. 3-month rates, while German 3-month rates firmed 15 basis points. The price of gold rose about $6 (to $360 per ounce) since the last FOMC meeting, as reports that Soviet gold reserves are smaller than previously estimated reduced expectations of Soviet gold sales.

. The Desk did not intervene.

Developments in Foreign Industrial Countries

Recent indicators of economic activity in foreign industrial countries suggest a continued weak pace of growth in the third quarter, little changed from the previous quarter. In the latest month for which data are available, industrial production declined in western Germany, Italy, and the United Kingdom, but rose in Japan, Canada, and France. However, in countries where production advanced, other indicators were mixed. Unemployment rates continued to rise in the United Kingdom and France, while they remained relatively high in Canada, Italy and eastern Germany.

Corresponding to sluggish economic activity has been the recent slowdown in growth of broad monetary aggregates in Japan, the United Kingdom, and Canada. In the twelve months ending in September, Japanese M2+CDs grew only 2.2 percent, the lowest year/year rate since the series began in 1981. Growth of U.K. M4 is at its lowest rate in the past two decades. Canadian M3 growth slowed to a year/year rate of 5.8 percent in September, the slowest pace in five years. In contrast, growth of pan-German M3 has edged up towards the top of its 3-5 percent target range, while Italian money growth continues to exceed its 5-8 percent target range.

The trend towards lower inflation abroad continued in recent months. Rates of inflation have declined as last year's oil price increases have fallen out of the 12-month calculations, but in most of these countries underlying inflation appears to have moderated as well.

Individual country notes. In Japan, most recent indicators suggest that the pace of activity has remained weak. Industrial production (s.a.) increased 0.2 percent in September, but the third-quarter average was only 0.2 percent above the average level in the second quarter. New machinery orders (s.a.) increased 8.8 percent in August but were still 3.4 percent below their average level in the second quarter. Housing starts (s.a.) declined 6.1 percent in August, to a level nearly 7 percent below their second-quarter level. New car registrations (s.a.) dropped 12.5 percent in September and their average level in the third quarter was down slightly from the previous quarter. In September, corporate bankruptcies (s.a.) declined by 5.2 percent but were 4.7 percent higher than they were in the second quarter. In August, the index of leading indicators (s.a.) continued to point to weakness. Despite these signs of weakness, labor markets and industrial

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

| | Q4/Q4 1989 | Q4/Q4 1990 | 1990 Q4 | 1991 Q1 | 1991 Q2 | 1991 Q3 | 1991 May | 1991 June | 1991 July | 1991 Aug. | 1991 Sept. | Latest 3 months from year ago 2 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Canada** | | | | | | | | | | | | |
| GDP | 2.1 | -1.1 | -1.2 | -1.2 | 1.2 | n.a. | * | * | * | * | * | -1.5 |
| IP | -1.1 | -6.3 | -3.3 | -2.2 | 1.6 | n.a. | .7 | .4 | .5 | n.a. | n.a. | -4.5 |
| **France** | | | | | | | | | | | | |
| GDP | 3.9 | 1.9 | -.1 | .2 | .7 | n.a. | * | * | * | * | * | 1.5 |
| IP | 2.8 | -.3 | -2.7 | .3 | 1.3 | n.a. | -.4 | .2 | .8 | .0 | n.a. | -.4 |
| **West Germany** | | | | | | | | | | | | |
| GNP | 3.2 | 5.3 | .6 | 2.4 | -.6 | n.a. | * | * | * | * | * | 4.3 |
| IP | 4.8 | 5.4 | .4 | 2.0 | -.1 | n.a. | -1.0 | 3.8 | -1.4 | -2.1 | n.a. | 3.8 |
| **Italy** | | | | | | | | | | | | |
| GDP | 2.9 | 1.3 | .2 | .2 | .3 | n.a. | * | * | * | * | * | 1.4 |
| IP | 3.2 | -3.8 | -2.0 | .4 | -2.1 | n.a. | 1.3 | 5.6 | -3.8 | -1.7 | n.a. | -2.0 |
| **Japan** | | | | | | | | | | | | |
| GNP | 4.8 | 4.8 | .6 | 2.7 | .5 | n.a. | * | * | * | * | * | 5.0 |
| IP | 4.2 | 6.9 | 1.7 | -.1 | -.7 | n.a. | 2.0 | -2.8 | 3.2 | -2.5 | .2 | 1.1 |
| **United Kingdom** | | | | | | | | | | | | |
| GDP | 1.3 | -.7 | -.2 | -.8 | -.6 | n.a. | * | * | * | * | * | -3.7 |
| IP | .3 | -3.4 | -1.8 | -.3 | -1.2 | n.a. | -.4 | 3.0 | .1 | -1.5 | n.a. | -3.4 |
| **United States** | | | | | | | | | | | | |
| GNP | 1.8 | .5 | -.4 | -.7 | -.1 | .6 | * | * | * | * | * | -.7 |
| IP | 1.1 | .3 | -1.8 | -2.5 | .6 | 1.5 | .9 | .8 | .6 | -.0 | .1 | -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)

| | Q4/Q4 1989 | Q4/Q4 1990 | 1990 Q2 | 1990 Q3 | 1990 Q4 | 1991 Q1 | 1991 Q2 | 1991 Q3 | 1991 July | 1991 Aug. | 1991 Sept. | 1991 Oct. | Latest 3 months from year ago |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Canada** | | | | | | | | | | | | | |
| CPI | 5.2 | 4.9 | .9 | 1.1 | 1.4 | 2.9 | .7 | .6 | .1 | .1 | -.2 | n.a. | 5.7 |
| WPI | .2 | 1.6 | .3 | -.1 | 1.0 | .1 | -1.6 | n.a. | -.2 | -.4 | -.2 | n.a. | -1.4 |
| **France** | | | | | | | | | | | | | |
| CPI | 3.6 | 3.6 | .9 | 1.0 | 1.0 | .5 | .7 | .8 | .4 | .2 | .2 | n.a. | 3.0 |
| WPI | .9 | .7 | -.3 | .2 | 1.1 | -.5 | -1.3 | n.a. | * | * | * | * | -.5 |
| **West Germany** | | | | | | | | | | | | | |
| CPI | 3.0 | 3.0 | .5 | .4 | .9 | .8 | .9 | 1.5 | .9 | .0 | .2 | .3 | 3.8 |
| WPI | 4.3 | .9 | .6 | .2 | .4 | .5 | .3 | .7 | .8 | -.9 | .1 | n.a. | 1.8 |
| **Italy** | | | | | | | | | | | | | |
| CPI | 6.6 | 6.3 | 1.2 | 1.4 | 2.0 | 1.9 | 1.4 | 1.0 | .2 | .3 | .4 | n.a. | 6.4 |
| WPI | n.a. | 9.9 | -.0 | 3.9 | 4.3 | .2 | -1.0 | n.a. | -.3 | .3 | n.a. | n.a. | 5.7 |
| **Japan** | | | | | | | | | | | | | |
| CPI | 2.9 | 3.2 | 1.3 | .2 | 1.2 | .8 | .8 | .4 | .1 | .3 | .1 | .9 | 3.2 |
| WPI | 3.7 | 1.9 | .8 | .0 | .7 | .1 | -.4 | -.4 | -.2 | .0 | -.3 | n.a. | .0 |
| **United Kingdom** | | | | | | | | | | | | | |
| CPI | 7.6 | 10.0 | 4.7 | 1.6 | 1.6 | .6 | 2.0 | .4 | -.2 | .2 | .4 | n.a. | 4.8 |
| WPI | 5.2 | 5.9 | 2.1 | .9 | 1.1 | 2.0 | 1.8 | .7 | .4 | .1 | .1 | n.a. | 5.7 |
| **United States** | | | | | | | | | | | | | |
| CPI (SA) | 4.6 | 6.3 | 1.0 | 1.7 | 1.7 | .9 | .5 | .7 | .2 | .2 | .4 | n.a. | 3.9 |
| WPI (SA) | 4.9 | 6.5 | .1 | 1.6 | 2.6 | -.6 | -.1 | -.2 | -.2 | .2 | .1 | n.a. | 1.6 |

1. Asterisk indicates that monthly data are not available.

TRADE AND CURRENT ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES [1]
(Billions of U.S. dollars, seasonally adjusted except where otherwise noted)

| | 1989 | 1990 | 1990 Q2 | 1990 Q3 | 1990 Q4 | 1991 Q1 | 1991 Q2 | 1991 Q3 | 1991 June | 1991 July | 1991 Aug. | 1991 Sept. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Canada** | | | | | | | | | | | | |
| Trade | 6.0 | 9.4 | 2.7 | 2.8 | 2.3 | 2.3 | 2.6 | n.a. | .7 | .4 | 1.0 | n.a. |
| Current account | -14.1 | -14.0 | -3.6 | -2.9 | -3.1 | -4.8 | -4.8 | n.a. | * | * | * | * |
| **France** | | | | | | | | | | | | |
| Trade | -6.9 | -9.3 | -2.0 | -3.6 | -3.1 | -2.6 | -1.4 | -1.9 | -.7 | -.7 | -.7 | -.6 |
| Current account | -3.1 | -8.0 | -2.9 | -3.5 | -1.4 | -2.9 | n.a. | n.a. | * | * | * | * |
| **Germany** [2] | | | | | | | | | | | | |
| Trade (NSA) | 71.6 | 65.2 | 16.7 | 16.0 | 10.1 | 4.4 | -1.1 | n.a. | .2 | .1 | 1.8 | n.a. |
| Current Account (NSA) | 57.3 | 47.3 | 10.7 | 9.4 | 8.5 | -5.9 | -5.9 | n.a. | -1.8 | -3.3 | -1.8 | n.a. |
| **Italy** | | | | | | | | | | | | |
| Trade | -12.6 | -12.1 | -1.7 | -3.4 | -3.7 | -1.0 | -3.9 | n.a. | -.2 | -2.5 | -1.4 | n.a. |
| Current account (NSA) | -10.7 | -14.2 | -2.2 | .7 | -3.7 | n.a. | n.a. | n.a. | * | * | * | * |
| **Japan** | | | | | | | | | | | | |
| Trade | 64.6 | 51.8 | 14.2 | 14.2 | 8.5 | 17.4 | 18.8 | 20.9 | 7.0 | 5.9 | 7.3 | 7.7 |
| Current account | 57.7 | 35.8 | 7.9 | 7.0 | 6.4 | 17.8 | 18.8 | n.a. | 5.1 | 4.7 | 7.1 | n.a. |
| **United Kingdom** | | | | | | | | | | | | |
| Trade | -39.4 | -33.8 | -8.7 | -8.9 | -6.4 | -5.4 | -3.7 | -3.6 | -.6 | -1.0 | -1.3 | -1.3 |
| Current account | -32.5 | -26.7 | -8.3 | -5.9 | -3.9 | -4.9 | -1.6 | -2.6 | .0 | -.7 | -1.0 | -.9 |
| **United States** | | | | | | | | | | | | |
| Trade | -116.0 | -108.1 | -24.1 | -28.8 | -27.7 | -18.4 | -15.6 | n.a. | -4.7 | -6.5 | -7.2 | n.a. |
| Current account | -106.3 | -92.1 | -22.2 | -23.9 | -23.4 | 10.5 | 3.0 | n.a. | * | * | * | * |

1. The current account includes goods, services, and private and official transfers. Asterisk indicates that monthly data are not available.
2. Before July 1990, West Germany only.

capacity remained generally tight. In August, the capacity utilization rate (s.a.) was within 4.5 percent of its peak level of last October, and the unemployment rate (s.a.), at 2.2 percent, was only 0.2 percentage point above its 11-year low reached earlier this year.

Inflationary pressures have remained generally moderate in recent months. The consumer price index for the Tokyo area (n.s.a.) increased 0.9 percent in October and its 12-month increase rose to 3.1 percent. However, almost all of the October rise was due to a weather-related jump in vegetable prices. Excluding perishable foods, the 12-month inflation rate eased to 2.7 percent. Wholesale prices (n.s.a.) declined 0.3 percent in September, and were 0.4 percent below their level of 12 months earlier. Overall wholesale prices have been held down recently by import prices (n.s.a.), which have fallen 15.2 percent since the end of last year.

The growth rate of the most closely watched monetary aggregate, M2+CDs, has continued to slow, falling to 2.2 percent in September. This slowing is due in part to slowing of loan growth. Even more important has been a shift out of bank deposits into postal savings deposits (not included in M2+CDs) as relative returns have moved in favor of the latter with the decline in market interest rates.

The trade surplus (s.a.) on a customs basis rose again in September. Through the first nine months of the year, the customs-basis trade surplus was $76.1 billion (a.r.), compared with a $57.7 billion surplus rate in the comparable period last year. The balance of payments basis trade surplus, used in calculating the current account, has increased even more over this period, due mainly to a drop in recorded gold imports (excluded in customs basis trade data) related to a reduction in financial "gold savings accounts." For the first eight months of the year, the cumulative current account surplus was $72.5 billion (a.r.), well above the $40.6 billion surplus rate in the same period last year.

Industrial production in western Germany (s.a.) fell 2.1 percent in August, after falling 1.4 percent in July. The average level of industrial production for July and August was 0.4 percent below the average level for the second quarter. The volume of new orders for west German manufactured goods (s.a.) increased 1.1 percent in August, after falling slightly in July. New orders have increased by more than 1 percent in three of the last four months, and August's level was 4.3 percent above where it was in April. Since March, domestic orders (including orders from eastern Germany) have fallen 0.6 percent, while foreign orders have increased 5.7 percent. In August the volume of retail sales (s.a.) in western Germany fell 4.1 percent after falling 1.3 percent in July, and the average level of retail sales for the two months was 2 percent below the average level in the second quarter.

Industrial production in eastern Germany (n.s.a.) increased 7 percent between April and June. New orders for east German manufactured goods also increased sharply in June. Official east German unemployment (n.s.a.) fell in September to 11.6 percent. New construction orders in eastern Germany (n.s.a.) have increased steadily since February, and June's level was 61 percent above the average level for the second half of 1990.

Inflation has moderated since August after sharp increases in June and July. West German consumer prices (n.s.a.) increased 0.3 percent in October and on a year/year basis consumer price inflation fell to 3.5 percent, down from 4.4 percent in July, when new excise taxes on energy were introduced. Excluding energy products, west German consumer prices (s.a.) increased 0.2 percent in September, resulting in an annual rate of inflation of 4.1 percent for the first nine months of the year. In August west German producer prices (n.s.a.) were 2.6 percent above the level a year ago. There are continuing concerns about wage pressures. West German unions are demanding wage increases of 10 percent for 1992 compared with increases of 6 percent in 1990 and 7 percent in 1991.

Through September, M3 (s.a.) in western and eastern Germany had increased at an annual rate of 4.6 percent in 1991, relative to the fourth quarter of 1990, up from an annual rate of 3.7 percent through July.

The combined German trade balance (s.a.) moved from deficit into surplus this summer, resulting in a July-August surplus of $13 billion (a.r.) compared with a second-quarter deficit of $2 billion. The cumulative trade surplus for the first eight months of the year is $10 billion (a.r.). The combined German current account (n.s.a.) improved in August to a deficit of $22 billion (a.r.), compared with a deficit rate of $39 billion in July. The cumulative current account deficit through August is $17 billion including $8 billion of transfers associated with Gulf War payments.

The strength registered by second-quarter French GDP, which rose 2.8 percent (s.a.a.r.) after growing 0.8 percent in the first quarter, has shown signs of continuing. The July-August average level of industrial production rose 0.8 percent (s.a.) largely because of strong growth in production of consumption goods, but the average remained below its year-earlier level. Other indicators were mixed. The unemployment rate (s.a.) rose slightly in September to 9.6 percent. Retail sales rose during the summer. However, after declining in August, household consumption of manufactured products (s.a.) fell again in September to its lowest level this year.

In September the consumer price index (n.s.a.) rose 0.2 percent to a level 2.6 percent above its year-earlier level. In July average hourly wages (n.s.a.) were 1.7 percent above their level in the previous survey in April, and 4.8 percent above their level a year earlier.

To help reduce the unemployment rate, the French government announced a plan to encourage employment of the young. Under this plan firms with less than 500 workers could employ young persons without paying social insurance for them for the first six months. The cost of this plan, roughly FF7.5 billion, will be covered using revenues from the sale of minority stakes in public enterprises.

In Italy, a modest and uneven recovery appeared to stall during the summer. Real GDP rose 1.2 percent (s.a.a.r.) in the second quarter, up somewhat from the 0.8 percent increase of the previous quarter. The second-quarter increase was driven largely by a 6 percent rise in private consumption. Industrial production (s.a.) fell a preliminary 1.7 percent in August, following a 3.8 percent drop in July. The average for July and August was down 0.7 percent from the second-quarter average. The unemployment rate dipped in July to 10.6 percent from 10.9 percent in April.

Consumer prices (n.s.a.) rose 0.4 percent in September and were 6.2 percent above their year-earlier level, down from a 12-month inflation rate of 6.7 percent in July. The slowing of inflation in the past two months is largely due to technical factors; higher energy prices arising from the August 1990 Gulf crisis and higher indirect taxes introduced about a year ago no longer boost in the 12-month change in the CPI. Wholesale prices (n.s.a.) increased 0.3 percent in August and stood 3.1 percent above year-ago levels.

On September 30, the Italian government announced its budget plans for 1992. The target for the 1992 deficit is 128 trillion lire, or 8.3 percent of projected GDP; without policy changes the government projected that the deficit would balloon to about 188 trillion lire. It is unlikely that the Italian government will meet its deficit reduction targets. Many of the proposed measures, such as limits on public-sector wages and reductions in health benefits, have been proposed before but not implemented because of public or union opposition. With a national Parliamentary election scheduled for next May, the temptation to put off difficult choices will be immense. However, it is likely that Italy's EC partners (which, under new EC procedures, review Italian macroeconomic policy) will put considerable pressure on Italy to limit its deficit.

Recent data from the United Kingdom raise doubts about whether the recession has ended. After a slight rise in July, industrial production (s.a.) fell 1.5 percent in August. The average level of manufacturing output for the three months ending in August was 5.7 percent below its comparable year-ago level. U.K. retail sales remained weak in August and September, although business confidence improved. Unemployment (s.a.) continued to swell to a rate of 8.7 percent in September.

Doubts about the pace of recovery were reinforced by figures showing weak growth in the money supply. In September, the narrow M0 measure (s.a.), consisting mainly of notes and coins, rose at a year/year rate of 2.2 percent, the broad M4 measure of money rose 6.4 percent, the slowest rate for 21 years.

Consumer prices (n.s.a.) rose 0.4 percent in September to a level 4.1 percent above their year-ago levels. Excluding special factors (mortgage interest rates, the poll tax, VAT, gasoline, and excise duties), the retail price index was 6.2 percent above its year-earlier level, compared with a peak rate of 7.2 percent last October. Producers' output prices rose 0.1 percent in September to a level 5.6 percent above a year ago; this year-on-year increase is the lowest since March 1990. Average manufacturing pay settlements slowed to 5.5 percent in the third quarter from rises of 6.4 percent and 8.1 percent in the preceding two quarters.

In Canada, recent monthly data suggest that the economic recovery remains tenuous. In August, retail sales (s.a.) fell 1.3 percent, motor vehicle sales (s.a.) dropped 13 percent, and manufacturers' unfilled orders (s.a.) slipped 0.4 percent as shipments rose 0.9 percent. However, housing starts (s.a.) rebounded 7 percent in September and the average level grew 14.4 percent between the second and third quarters. Industrial production (s.a.) increased 0.5 percent in July, rising for the fourth consecutive month. The unemployment rate (s.a.) fell from 10.6 percent to 10.2 percent in September, although about half of the decline was due to a decrease in the labor force participation rate.

Recent price data continue to show that the government's anti-inflation program is taking hold. The consumer price index (n.s.a.) decreased 0.2 percent in September, causing twelve-month inflation to fall to 5.4 percent. The CPI excluding food and energy (n.s.a.) was up 0.1 percent in September, and has increased only 3.7 percent (a.r.) in the eight month period from January, when the 7 percent goods and services tax took effect. Industrial product prices (n.s.a.) posted their eighth straight monthly decline, falling 0.2 percent in September.

Recent announcements have added credibility to the government's anti-inflation rhetoric. In late September, as part of a constitutional reform package dubbed the National Unity Plan, the government proposed simplifying the mandate of the Bank of Canada from the pursuit of general economic welfare to a more specific goal of achieving and preserving price stability. Under this proposal, an amendment of the Bank of Canada Act would be necessary to force the Bank of Canada to abandon its current emphasis on low inflation. In mid-October, the Ministry of Finance announced that it will begin to issue inflation-indexed bonds later this year. If inflation turns out to be less than market expectations of inflation that are implied by nominal bond yields, indexed bonds may be a cheaper source of funds for the government, ex post. The issuance of such bonds decreases the government's incentive to reduce the real value of the public debt via inflation.

Developments in Eastern European Countries

In Poland, pro-reform parties failed to gain a clear majority of seats in the October 27 parliamentary elections, and will have to negotiate with a variety of splinter parties to form a new coalition government. Also, the former communist party did surprisingly well. The election results have generated concerns that the new government will slow or turn back the pace of economic reform.

Industrial sales rose 2.6 percent in September but remain 20.4 percent below a year earlier. The unemployment rate rose 0.6 percent to 10.4 percent in September. Led by a 6.4 percent increase in food prices, September inflation was 4.3 percent following monthly consumer price increases of 0.1 and 0.6 percent in July and August, respectively. Consumer prices have risen about 45 percent since December 1990. The trade balance registered a small surplus in the first nine months of 1991. The fiscal deficit continued to increase in August and September, and now is expected to reach 3-4 percent of GDP for 1991. The need for an improved fiscal position is likely to be a key ingredient of discussions with the IMF on targets for Poland's 1992 program.

In Hungary, industrial production rose 2.4 percent in August but has declined 17.8 percent in the first eight months of 1991 compared with the same period in 1990. In September, the unemployment rate rose 0.9 percent to 6.1 percent. Consumer prices rose 0.2 percent in August to a level 34.2 percent above their year-ago level. Inflation has declined steadily since January 1991. The current account registered a small surplus in the first nine months of 1991 against earlier predictions of a deficit for the year exceeding $1 billion.

In the Czech and Slovak Federal Republic, industrial production fell 19 percent during the first nine months of 1991 compared with the same period last year. The unemployment rate rose 0.5 percent to 5.6 percent in September. One bright spot in the economic setting was that prices have been roughly stable since June, rising 0.3 percent in September following a decline of 0.4 percent in August.

Economic Situation in Other Countries

The Mexican government is planning to use privatization proceeds to retire 12 percent of the country's internal debt. International reserves fell in the third quarter after rising steadily for five quarters. In Brazil, the government sold its shares in a large steel firm after many months of delays. A drain on reserves, caused by a narrowing of the trade surplus and the payment of overdue interest to foreign banks, led to a 15 percent devaluation on September 30. In late October, the markets were expecting another large devaluation. Preliminary data indicate that Argentina missed the third-quarter fiscal targets of its IMF program and may require a waiver to continue drawing on the Fund. Venezuela missed some of the June performance criteria of its IMF program. However, corrective measures, endorsed by the IMF staff, have begun to be taken. Preliminary indications are that the Philippines missed the base money target of its IMF program for the third quarter after missing it for the second quarter. Drawings under the stand-by agreement remain suspended. In Korea, high economic growth continues to put pressure on prices and imports. The current account deficit in the first eight months of 1991 was a record $7.9 billion. In Taiwan, economic activity has picked up moderately this year due to stronger exports and rising public investment.

Individual country notes. Mexico's Finance Secretary Aspe announced early in October that the government would retire 20 trillion pesos ($6.7 billion) of the country's internal debt, 12 percent of the total, using the bulk of the peso proceeds from the privatization of the telephone system, the commercial banks, and other public enterprises. In recent months, the stronger cash position of the public sector has enabled the government to reduce sharply the amount of new issues of securities in its weekly auctions. This contributed to the steady decline in interest rates through August. However, rates firmed in September, when a cash squeeze developed. While rates eased somewhat in October, they remain above earlier lows. At the auction of October 22, the 28-day Treasury bill rate was 17.4 percent, 165 basis points above the August low.

International reserves fell during the third quarter after rising steadily since March 1990, when the bank financing package was implemented. Lacking recent trade and capital account data, it is not known what lies behind the reversal. The decline may be estimated at about $1.5 billion. It was obscured by data reporting peculiarities and by adding to reported reserves most of the proceeds of the privatization of the telephone system, which were excluded up to now, although they were received before mid-year.

In the second quarter, the latest available period, real GDP was 5.3 percent higher than a year earlier. This was the highest second-quarter year-over-year increase since 1981. Consumer prices rose by 1 percent in September, when they were 11.9 percent higher than at the end of 1990 and 20 percent higher than in September 1990. In contrast, in September 1990, consumer prices were 28.7 percent higher than a year earlier.

The financial markets are awaiting President Salinas' state of the nation speech on November 1, his budget message on November 15, and the policy changes that may be made when the anti-inflation pact between government, business, and labor is renewed ahead of its scheduled year-end expiration date. However, the stock market index remains buoyant, most recently on expectations of favorable company earnings reports. The index was 116 percent higher on October 28 than at the end of 1990.

In Brazil, the first public sector firm to be privatized was sold on October 24, after many months of delays caused mainly by strong political opposition to the privatization program. The firm was the steel company USIMINAS, the largest of the first 19 firms slated for privatization. Only 6 percent of the shares were bought by foreign investors. 30 percent of the shares were bought by an industrial firm in which the government has a 51 percent interest and by a pension fund of a government-owned commercial bank.

In June, the latest available month, industrial production was 5.9 percent higher than a year earlier, a recession low, but it was little changed from February 1990, the month before the Collor government took office. Anecdotal evidence suggests that economic activity has fallen since June. Consumer prices rose 17 percent in September and about 23 percent in October. New selective price controls were imposed in mid-October.

The trade surplus averaged only $530 million in August and September, compared with a monthly average of $1.1 billion in the first seven months of the year. The trade surplus narrowed at a time when Brazil was beginning to reduce its interest arrears to foreign banks by paying about $1.5 billion in overdue interest during the third quarter. As a result, international reserves declined in August and September by an amount unofficially estimated at $2 billion. The squeeze on reserves led to a devaluation of about 15 percent on September 30, which took the markets by surprise. This was the largest one-day change since 1983. On October 28, amid speculation that another large devaluation was imminent, the central bank withdrew from trading in the gold market -- its usual method of intervening in the parallel foreign exchange market -- and raised the overnight interbank rate from 33 to 42 percent per month in an effort to preserve international reserves. On October 29, the spread between the parallel and commercial exchange rates was 30 percent, compared with a range of 10-13 percent over the past year.

Rumors are widespread that new stabilization measures will soon be announced. However, congressional approval of a tax reform appears unlikely. Without it, there will not be an IMF stand-by arrangement, and any agreement that may be reached with foreign commercial banks will remain inoperative. In the secondary market for external debt paper, Brazilian loans slumped on October 29 to 20 percent of face value from 30 percent the previous week, before recovering to 24 percent late that day.

Preliminary data indicate that <u>Argentina</u> missed the third-quarter fiscal targets specified under the IMF stand-by arrangement approved in July. Argentina apparently came close to meeting its overall fiscal surplus target, excluding interest payments.

However, a greater fraction of this surplus derived from the proceeds of asset sales, including the sales of shares in the state telephone company and of oil-exploration concessions, than was permitted under the stand-by arrangement. An IMF mission will visit Argentina in November to establish a definitive evaluation of its third-quarter fiscal performance. If the preliminary data are confirmed, the IMF Executive Board will need to approve a waiver in order to release the second drawing under the stand-by arrangement.

Monthly consumer price inflation edged up to 1.8 percent in September from 1.3 percent in August, largely due to increases in food prices and home rentals; however, the August price rise had been the lowest in 15 years. Short-term call money rates have continued to fluctuate near 1 percent per month, very low by recent standards. The stock market has continued its run-up, rising about 14 percent in the first three weeks in October after rising 11 percent during September. As a result of the improved outlook for financial conditions, seasonally adjusted industrial production in July, the latest available month, was 21 percent higher than the recent low in March and 17 percent higher than a year earlier.

Venezuela missed some of the June fiscal and monetary performance criteria of its IMF Extended Fund Facility arrangement. In part, this resulted from increased public investment, which, together with increased construction activity, pushed real GDP growth to a 10 percent annual rate in the first half of 1991, compared with 5.3 percent in all of 1990.

However, corrective measures, endorsed by the IMF staff, began to be implemented in August. The measures include spending reductions, tax revenue increases, and higher domestic prices for petroleum derivatives. In addition, required reserves for most components of the money stock are being raised in stages, not only to limit monetary growth, but also to allow a portion of outstanding central bank bills to be retired. These bills were issued to sterilize capital inflows. However, since they carried nominal interest rates of 35-40 percent, their growing stock added to the overall public sector deficit in the first half of 1991.

The restrictive measures already taken have contributed to a reduction in the average monthly inflation rate from 2.7 percent for January-July to 2.1 percent in August-September. The measures are estimated to restrict the 1991 fiscal deficit to 1.2 percent of GDP. In light of these developments, the IMF Executive Board is expected to approve a Venezuelan drawing from the Fund before year-end and to extend the program so as to restore the availability of two other drawings that were scheduled to occur earlier, but were suspended because Venezuela deviated from the program.

The Philippines, which missed the June base money target of its IMF program, also appears to have missed the September target, but by a smaller margin. An IMF team will visit Manila during the second week of November to discuss what steps need to be taken to put the program back on track. In the interim, drawings under the stand-by arrangement will remain suspended. An IMF Executive Board review of the Philippine program is not expected to be held until January at the earliest. Adherence to the IMF program is a condition of the debt restructuring agreement reached in principle with commercial banks on August 30.

In Korea, rapid economic activity in excess of potential continues to put pressure on prices and imports. In the first half of 1991, real GDP grew 9-1/4 percent at an annual rate. Consumer prices were 9.3 percent higher in September than a year earlier. The current account deficit rose to a record $7.9 billion in the first eight months of 1991 from $0.9 billion in the same period of last year, as a steep rise in imports of oil and capital goods more than offset a recovery in exports.

In Taiwan, economic activity has picked up moderately this year due to stronger exports and rising public investment. In the first half of 1991, real GDP grew 6.9 percent at an annual rate, compared with 4.9 percent in all of 1990. In the first three quarters of 1991, exports rose 14.1 percent, due in part to large increases in shipments to China (through Hong Kong). Over the same period, the cumulative trade surplus (on a customs basis) was $9.6 billion, up slightly from $9.3 billion in the first three quarters of 1990. Inflation has abated this year; consumer prices were 0.3 percent lower in September than a year earlier. The main opposition party's call on October 13 for independence from China (contrasted with the claim of the authorities on Taiwan that they are the legitimate government of all of China) led to a decline in Taiwan's stock price index of nearly 6 percent on October 14 and an additional 4 percent through October 29.