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January 30, 1992

RECENT DEVELOPMENTS

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

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DOMESTIC NONFINANCIAL DEVELOPMENTS

The economy has continued to struggle. In the fourth quarter, the only bright spots in final demand were strong growth in exports and the continued uptrend in homebuilding. With real incomes flat and confidence depressed, retail sales were weak during the holiday shopping season. Although there was a spurt in business purchases of computers in the fall, overall investment spending continued to be dragged down by weak nonresidential construction activity. In response to the sluggishness in aggregate final demand and the emergence of some inventory imbalances, factory output was flat in December and probably declined in January. Slack in labor and product markets has damped wage and price increases; underlying inflation trends appear to be headed downward.

Employment and Unemployment

Labor market conditions remained poor in December. Private payroll employment fell another 35,000 in December, and the unemployment rate moved up to 7.1 percent. However, a lengthening of the workweek led to a small rise in aggregate hours of production or nonsupervisory workers in December, and the average level of hours in the fourth quarter was about the same as in the third quarter.

Payroll reductions were widespread in December. Manufacturing employment moved down another 32,000, the fourth consecutive monthly decline. Nearly all of the recent factory job losses have been in durable goods industries. Construction employment, depressed by unseasonably severe weather in November, failed to recover much in December; on net, this industry continued to lose jobs at a rapid pace in the fourth quarter. In retail trade, hiring for the holiday shopping season was well below the seasonal norm. The shutdowns of Pan Am and Midway airlines led to sizable job losses in

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

	1991 H1	1991 Q3	1991 Q4	1991 Oct.	1991 Nov.	1991 Dec.
	------- Average monthly changes ------					
Nonfarm payroll employment[2]	-123	60	-76	7	-265	31
Private	-140	71	-111	-36	-263	-35
Manufacturing	-62	12	-36	-37	-39	-32
Durable	-49	-1	-35	-38	-34	-34
Nondurable	-13	13	-1	1	-5	2
Construction	-34	-4	-34	-28	-88	13
Wholesale trade	-16	-6	-11	-2	-15	-15
Retail trade	-39	-2	-53	-50	-92	-16
Transportation, public utilities	-10	7	-11	-1	-9	-23
Finance, insurance, real estate	-5	-4	1	5	-5	4
Services	27	75	37	82	-10	38
Total government	17	-11	36	43	-2	66
State and Local	13	-13	35	39	2	65
Private nonfarm production workers	-116	64	-103	-36	-222	-52
Manufacturing production workers	-44	15	-22	-21	-32	-12
Total employment[3]	-95	60	-120	-222	-95	-44
Nonagricultural	-95	61	-87	-143	-163	45
Memo:						
Aggregate hours of production or nonsupervisory workers (percent)	-.2	.1	-.2	-.8	.1	.2
Average weekly hours of production or nonsupervisory workers (hours)	34.3	34.3	34.4	34.3	34.4	34.5
Manufacturing (hours)	40.4	40.9	41.0	40.9	41.0	41.1

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 H1	1991 Q3	1991 Q4	1991 Oct.	1991 Nov.	1991 Dec.
Civilian unemployment rate (16 years and older)	5.5	6.6	6.8	6.9	6.9	6.9	7.1
Teenagers	15.5	18.3	19.0	19.0	18.9	18.7	19.3
20-24 years old	8.8	10.4	11.0	11.4	11.3	11.1	11.9
Men, 25 years and older	4.4	5.6	5.8	5.8	5.7	5.7	5.9
Women, 25 years and older	4.3	5.1	5.0	5.3	5.2	5.3	5.4
Labor force participation rate	66.4	66.2	65.9	65.9	66.0	65.8	65.9

transportation. Services was the only private industry to post notable job gains in December, and health services accounted for all of the advance.

Local government employment was reported to be up sharply in December; however, figures for this sector are often revised appreciably and, given the fiscal problems of local governments, the size of the increase appears fishy. But even discounting the December figures, employment in local governments was up for the fourth quarter as a whole, apparently reflecting continued hiring by relatively healthy governments at the same time that many planned layoffs have yet to materialize.

The monthly survey of households also pointed to continued labor market weakness in December. Total employment registered another small decline, and the number of unemployed rose nearly 300,000, pushing the civilian unemployment rate up 0.2 percentage point in December.

Sentiment about the state of the labor market--as evidenced, for example, by the Conference Board's survey question about whether jobs are plentiful or hard to get--is currently near the lows of the 1982 recession. However, the data do not seem consistent with such negative assessments. To be sure, one should view the current labor market indicators cautiously. The BLS has recently indicated that it anticipates a sizable downward revision to payroll employment when it releases its benchmark revisions later this year. In addition, the dramatic slowing in labor force growth raises questions about the interpretation of the recent behavior of the unemployment rate. The accompanying table presents a range of labor market indicators for the fourth quarter of 1982 (the trough of the last recession) and for the fourth quarter of 1991. Virtually every one of these indicators was weaker in 1982 than in 1991.

SELECTED LABOR MARKET INDICATORS, 1982:Q4 AND 1991:Q4
(Based on seasonally adjusted data)

	1982:Q4	1991:Q4
	(1)	(2)
Civilian unemployment rate (percent)	10.7	6.9
By region[1,2]		
Northeast	9.2	7.0
South	9.4	6.4
North Central	11.8	6.2
West	10.5	6.6
By occupation[3]		
Managerial, professional	3.6	2.9
Technical, sales, administrative support	6.8	5.4
Services	11.6	7.9
Precision production, craft, repair	11.6	8.2
Operators, fabricators, laborers	17.9	10.3
Farming, forestry, fishing	9.8	7.8
Other labor market indicators		
Percent of civilian labor force		
Discouraged workers	1.6	.9
Part time for economic reasons	5.8	4.9
Unemployed fifteen weeks or longer	4.0	2.1
U-7[4] (percent)	15.4	10.4
Mean duration of unemployment (weeks)	17.5	14.9
Change from business-cycle peak		
Household employment (percent)	-1.4	-.9
Unemployment rate (percentage point)	3.3	1.1
U-7[4] (percentage point)	4.8	2.1
Labor force participation rate (percentage point)	.4	-.4

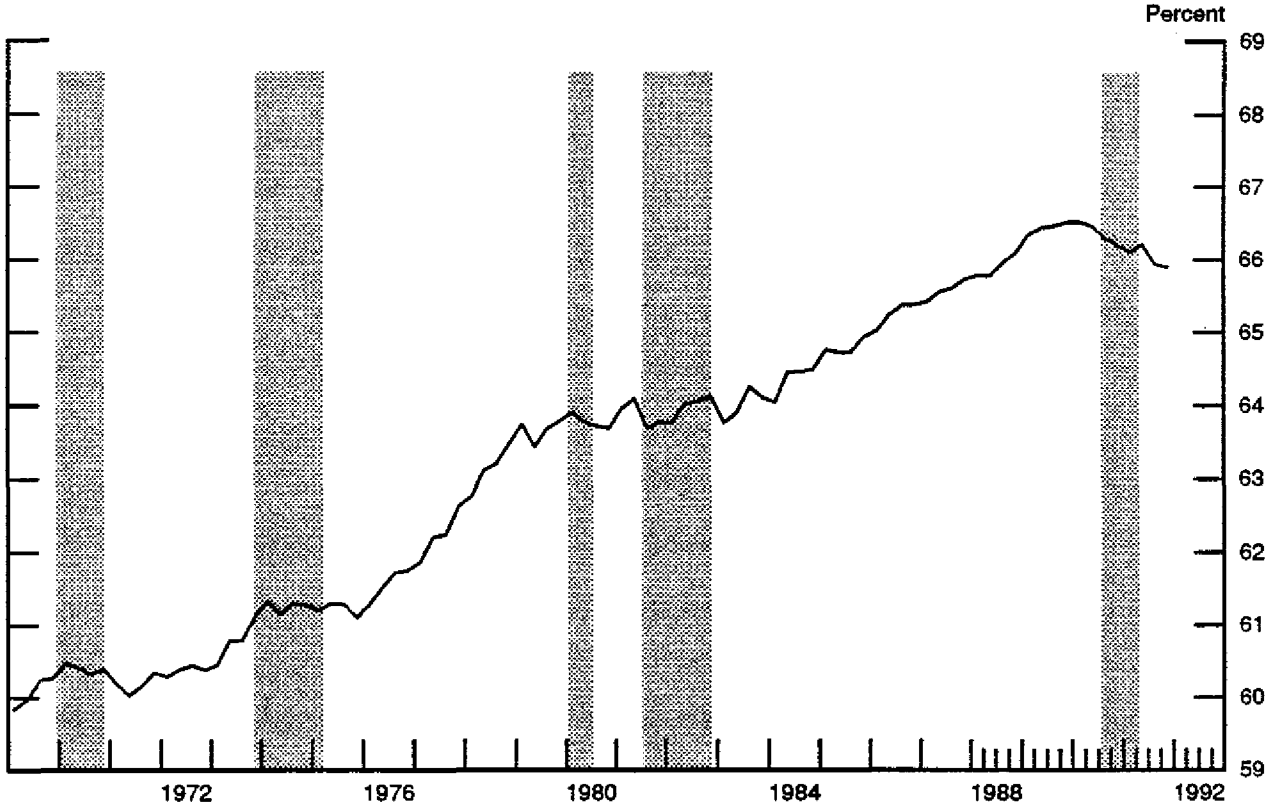
1. Based on not seasonally adjusted data.
2. Values in column (2) are average for October and November, 1991.
3. Values in column (1) are for 1983:Q1.
4. Unemployment rate that incorporates discouraged workers, one-half of part-time jobseekers, and one-half of individuals working only part time for economic reasons.

Perhaps most interesting are the regional data. Even in the Northeast--where the current recession has been the most severe, and where the 1982 recession was the mildest--the current unemployment rate is significantly lower than it was in 1982. Similarly, all six major occupational groups had lower unemployment rates in late 1991 than in 1982. The same is true of the "U-7" measure of unemployment, which adjusts the unemployment rate to take account of discouraged workers and involuntary part-time workers.

The only labor market indicator to deteriorate more in the current episode than in 1982 is the labor force participation rate, which has fallen 0.4 percentage point since the business-cycle peak in the summer of 1990. The December labor market report provided information on individuals who are out of the labor force--that is, nonparticipants--during the fourth quarter (table). Since the fourth quarter of 1989 (when the participation rate reached its peak), the number of nonparticipants has been growing more than 300,000 per quarter. In contrast, during the three years of labor market weakness ending in 1982:Q4, the number of nonparticipants increased, on average, 191,000 persons per quarter. The difference is even more striking when it is recognized that the working-age population was growing more rapidly in the earlier period.

The increase in nonparticipation relative to the 1979 to 1982 period can be traced to those who report that they do not want a job now, particularly those who characterize themselves as "at school" or "ill." Comparing the growth in nonparticipation during these two recessionary periods with the growth during the long expansion from 1982 to 1989 makes clear that some of the components of nonparticipation--even among individuals who claim not to want a job now--display cyclicality. For example, during the expansionary period, stronger job prospects helped draw people out of school,

LABOR FORCE PARTICIPATION RATE



PERSONS NOT IN THE LABOR FORCE
(thousands)

	Percent distribution 1991:Q4 (1)	1979:Q4-1982:Q4 (2)	1982:Q4-1989:Q4 (3)	1989:Q4-1991:Q4 (4)
		average quarterly changes		
Not in labor force	100.0	191	11	304
Do not want a job now	91.1	74	67	202
Current activity:				
School	12.7	29	-15	59
Ill, disabled	7.8	-47	25	53
Keeping house	35.0	-91	-151	-119
Retired	29.8	168	204	173
Other	5.8	15	5	37
Want a job now	8.9	117	-56	102
Reason not looking:				
Discouraged workers	1.7	84	-33	37
School	2.1	27	-20	21
Ill, disabled	1.6	-3	5	13
Home responsibilites	1.9	6	-3	10
Other	1.6	2	-5	21
Memo:				
Noninstitutional population		583	499	429
Civilian labor force		392	488	125

while the number of nonparticipants in school increased during the two recessionary periods. Also, the number of nonparticipants keeping house declined at a faster rate when the economy was expanding. These findings suggest that, even though many nonparticipants claim not to want a job now, some nevertheless will enter the labor market when job opportunities improve.

Industrial Production and Capacity Utilization

Industrial production contracted somewhat in November and December and finished the year at about the same level as it reached in July when the recovery in the industrial sector faltered. Output has been held down in recent months by a decline in motor vehicle production; assemblies were 9.3 million units at an annual rate (FRB seasonals) in December versus 10.0 million in October. In addition, production at utilities has been held down since September by unseasonably warm weather, which has damped the demand for natural gas and electricity.

Total industrial production excluding motor vehicles and utilities was essentially flat, on balance, in November and December. Output of consumer durable goods retraced part of the gains registered during the summer, owing largely to a decline in demand for appliances and other household goods such as carpeting and furniture. By contrast, output of nondurable consumer goods continued to advance, reflecting increases in production of a wide variety of items, including food, clothing, and chemicals.

Production of business equipment other than motor vehicles was held down in November and December by a decline in industrial equipment, reflecting an ongoing strike at Caterpillar, Inc. However, production in other equipment-producing industries has begun to firm in recent months after showing virtually no improvement since its low in March. In particular, computer

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	1991 Mar. - July	1991 July - Dec.	1991 Nov.	1991 Dec.
			--------Average--------- ------Monthly Rate------			-Monthly Rate-	
Total index	100.0	.3	-.9	.7	.0	-.2	-.2
Motor vehicles and parts	3.8	-9.9	-4.6	4.9	-.3	-4.5	-1.1
Utilities	7.6	-2.1	-.6	1.1	-.8	1.3	-3.0
EXCLUDING MOTOR VEHICLES AND PARTS AND UTILITIES:							
Total index	90.2	.8	-.8	.6	.0	-.2	.1
Products, total	51.5	1.5	-.5	.2	.1	.0	.2
Final products	37.1	2.6	-.4	.1	.1	-.1	.3
Consumer goods	22.5	.1	-.3	.5	.3	.3	.0
Durables	3.0	-3.9	-1.3	1.6	-.1	.0	-.7
Nondurables	17.8	1.0	-.1	.4	.4	.3	.1
Business equipment	14.8	5.3	-.5	.1	-.1	.0	.1
Office and computing	2.7	9.0	.2	.2	.4	1.0	1.1
Industrial	4.3	1.3	-1.2	-.1	-.9	-2.2	-.2
Other	7.8	6.3	-.3	.2	.1	.7	-.2
Defense and space equip.	4.8	-.2	-.6	-1.1	-.7	-.5	-1.5
Construction supplies	5.7	-4.6	-1.6	.8	-.2	.5	.4
Materials	27.3	.5	-1.2	1.0	.2	-.4	.5
Durables	18.5	.4	-1.5	.9	.2	.0	.3
Nondurables	8.8	.5	-.7	1.3	.2	-1.2	.8
Memo:							
Manufacturing	84.9	.3	-.9	.7	.1	-.3	.1

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

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1967-90 Avg.	1988-89 High	1990 Dec.	1991 Mar.	1991 Oct.	1991 Nov.	1991 Dec.
Total industry	82.2	85.0	80.6	78.4	79.6	79.3	79.0
Manufacturing	81.5	85.1	79.4	77.2	78.6	78.2	78.1
Primary processing	82.4	89.0	81.5	77.9	81.2	80.7	80.9
Advanced processing	81.1	83.6	78.5	76.8	77.6	77.2	77.0

production has picked up noticeably, apparently reflecting stepped-up production of IBM's new generation of mainframes as well as of other types of information-processing equipment.

Total industrial production may have contracted appreciably further this month. Through late January, domestic producers are estimated to have assembled autos and trucks at only an 8-1/4 million unit pace (FRB seasonals)--down sharply from the rate recorded in December, and considerably less than makers' reported schedules. Domestic manufacturers are currently planning for a rebound in motor vehicle assemblies in February to just a touch under the level during the fourth quarter of last year. Other weekly measures of industrial activity for the first couple of weeks in January were mixed: Production of steel and lumber was up slightly, while output of appliances continued to decline.

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

	1991		1991			1992	
	Q3	Q4	Oct.	Nov.	Dec.	Jan.	Feb.
						-schedules-	
Domestic production	9.4	9.6	10.0	9.5	9.3	8.7	9.5
Autos	5.8	5.7	5.9	5.7	5.6	5.4	5.7
Trucks	3.6	3.9	4.1	3.8	3.7	3.3	3.8

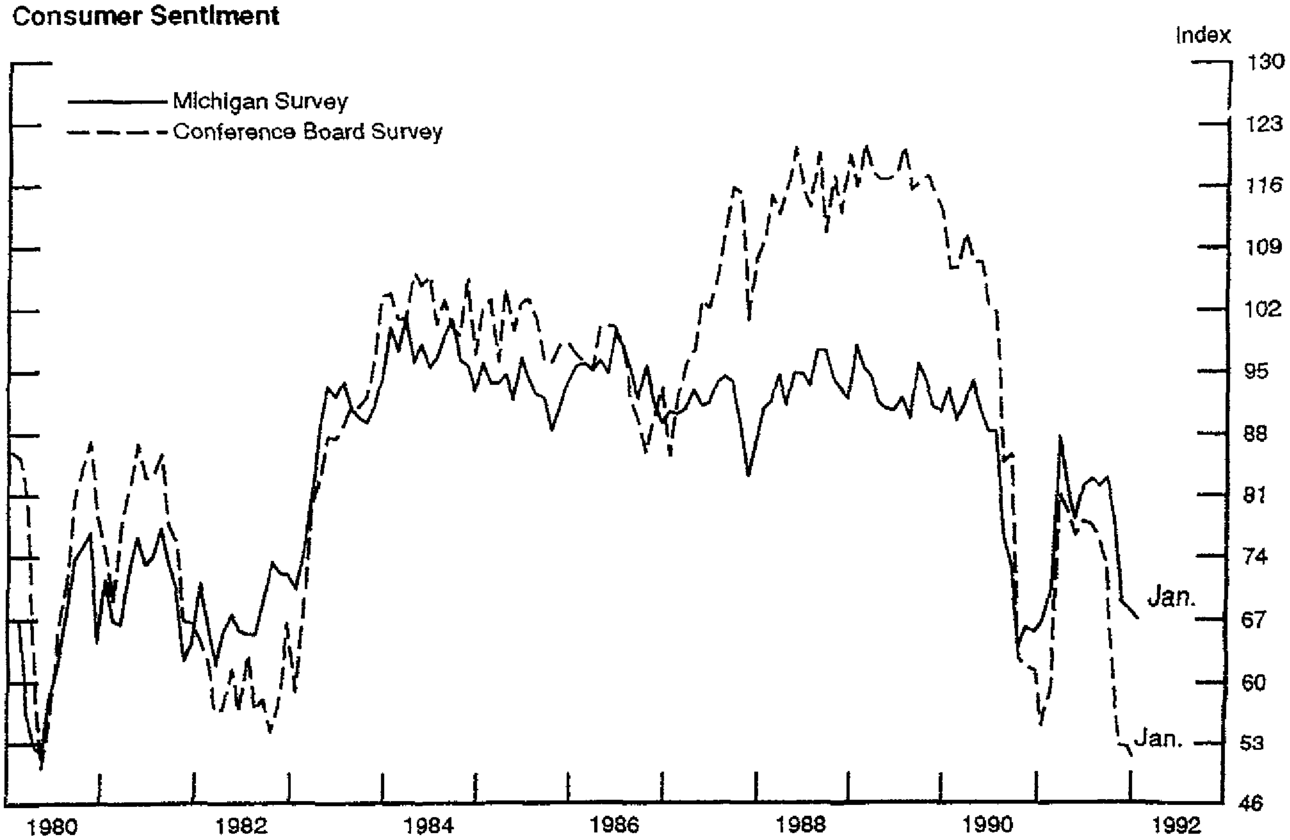
Capacity utilization in manufacturing fell almost 1/2 percentage point during the fourth quarter of last year, after rising somewhat from its earlier low in March. The operating rate for advanced processing industries has fallen back in the past few months to a level that is about 4 percentage points below the average during 1967-90. The recent declines mainly reflect reduced output of motor vehicles and nonelectrical machinery other than computers. Capacity utilization at primary processing industries

PERSONAL INCOME
(Percent change)

	1990[1]	1991[1]	1991 Q1	Q2	Q3	Q4
			-------Annual rate------			
Total personal income	6.5	2.7	.3	4.5	2.7	3.3
Wages and salaries	5.6	2.1	-1.0	4.4	3.2	2.1
Other labor income	7.0	6.1	6.3	6.2	6.1	5.9
Proprietors' income	6.4	4.8	-10.0	18.5	2.7	10.2
Dividend	3.9	1.9	5.5	-4.0	4.1	2.2
Interest	6.5	-3.8	-3.6	-4.5	-2.8	-4.2
Transfer payments	9.6	11.1	19.0	8.0	6.7	11.1
Less: Personal contributions for social insurance	5.9	5.7	14.6	2.7	3.9	1.9
Less: Personal tax and nontax payments	4.0	-1.4	-6.3	-2.2	1.0	2.1
Equals: Disposable personal income	6.9	3.3	1.3	5.6	3.0	3.5
Memo: Real disposable income	1.0	.4	-1.7	2.6	.3	.5
Memo: Savings Rate (Level)	5.1	5.3	5.1	5.5	5.0	5.4

1. Percent change, fourth quarter to fourth quarter.

Consumer Sentiment



has decreased relatively little since the summer and stands just slightly below its 1967-90 average.

Personal Income and Consumption

Nominal personal income rose at a 3-1/4 percent annual rate in the fourth quarter. However, after adjusting for taxes and inflation, real DPI increased only 1/2 percent, bringing growth over the four quarters of the year to an anemic 0.4 percent. Among the components of nominal income, wages and salaries increased at about a 2 percent annual rate in the fourth quarter, as increases in hourly compensation and the workweek offset sizable job losses. Although transfer payments increased rapidly in the fourth quarter of last year, personal tax payments also were up. Elsewhere, personal dividend income posted a small increase, while personal interest income continued to trend lower, reflecting the general reduction in interest rates that has occurred over the past two years.

Consumer confidence edged down in December and again in January according to both the Conference Board and the Michigan Survey Research Center (SRC) indexes, as consumers' assessments of expected business conditions continued to weaken. By contrast, according to the SRC survey, consumers' appraisals of current buying conditions for houses improved sharply in January, with respondents citing lower interest rates as the main reason. The appraisals of buying conditions for cars also strengthened relative to their weak autumn readings, although buying conditions for household durables remained depressed.

The demand for motor vehicles was uneven in December and appeared to worsen in the first twenty days of January. In December, sales of cars and light trucks held up at a 12.3 million unit annual rate because a jump in sales of domestically produced

RETAIL SALES
(Seasonally adjusted percentage change)

	1991			1991		
	Q2	Q3	Q4	Oct.	Nov.	Dec.
Total sales	1.3	.4	-.6	-.1	-.5	-.4
Previous estimate		.4		.0	.3	
Retail control[1]	.8	.4	-1.0	-.3	-.2	-.2
Previous estimate		.4		-.4	.3	
Total excl. automotive group	.9	.4	-1.1	-.3	-.2	-.2
Previous estimate		.4		-.4	.2	
GAF[2]	2.2	.9	-2.4	-1.1	.1	-1.4
Previous estimate		.9		-1.1	.6	
Durable goods stores	2.5	.2	.1	.1	-1.4	-.5
Previous estimate		.2		.6	.0	
Bldg. material and supply	4.6	-.1	-2.4	-1.0	-2.2	.6
Automotive dealers	2.9	.1	1.3	.6	-1.5	-1.1
Furniture and appliances	1.9	.2	-2.8	-1.4	-.8	-.1
Other durable goods	-.6	.7	.6	.5	-.2	.9
Nondurable goods stores	.7	.5	-.9	-.2	.0	-.3
Previous estimate		.5		-.3	.4	
Apparel	4.4	.0	-3.2	-1.4	.0	-.7
Food	1.0	-.3	-.4	-.2	-.5	.3
General merchandise[3]	1.3	1.6	-2.0	-.9	.6	-2.2
Gasoline stations	-3.4	-.2	-1.6	-.1	.8	-2.4
Other nondurables[4]	-.6	.9	-.1	.4	-.1	1.0
Memo:						
Motor vehicle sales[5]	12.3	12.7	12.2	12.1	12.3	12.3
Autos	8.4	8.6	8.2	8.3	8.3	8.0
Light trucks	3.9	4.1	4.0	3.8	4.0	4.3

1. Total retail sales less building material and supply stores and automotive dealers, except auto and home supply stores.
2. General merchandise, apparel, furniture, and appliance stores.
3. General merchandise excludes mail order nonstores; mail order sales are also excluded in the GAF grouping.
4. Includes sales at eating and drinking places, drug and proprietary stores.
5. Millions of units at an annual rate; BEA seasonals.

light trucks offset lower sales of cars. This year-end surge of light truck sales reflected intense competition between Ford and GM, who enhanced their sales incentives in an effort to raise their market share and become the nation's number one truck maker in 1991. However, a payback occurred in the first twenty days of January as sales of domestically produced light trucks dropped substantially. Sales of domestically produced passenger cars appeared to weaken further in early January; on average, sales in December and thus far in January came in at a 5.85 million unit pace, weaker than in the fourth quarter as a whole.

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

			1991			1991		
	1990	1991	Q2	Q3	Q4	Nov.	Dec.	Jan.[3]
Total	13.86	12.30	12.34	12.69	12.22	12.27	12.30	n.a.
Autos	9.50	8.39	8.43	8.60	8.19	8.31	7.98	n.a.
Light trucks	4.36	3.91	3.90	4.09	4.03	3.96	4.32	n.a.
Domestic total[2]	10.84	9.73	9.70	10.06	9.79	9.84	9.98	9.27
Autos	6.90	6.14	6.11	6.31	6.06	6.18	5.94	5.77
Light trucks	3.95	3.59	3.59	3.75	3.73	3.96	4.04	3.51
Imports total	3.01	2.57	2.64	2.63	2.42	2.43	2.32	n.a.
Autos	2.60	2.25	2.32	2.29	2.13	2.13	2.04	n.a.
Light trucks	.41	.32	.32	.34	.29	.30	.28	n.a.

1. Components may not add to totals due to rounding.
2. Includes vehicles produced in Canada and Mexico and vehicles made in U.S. plants of foreign manufacturers.
3. First twenty days, FRB seasonals.

Widespread declines in nominal retail sales occurred in the fourth quarter of last year. In the retail control category, which excludes spending at automotive dealers and at building material and supply stores, sales fell, on average, 0.2 percent per month. The largest absolute reduction in sales during this three-month period was at general merchandise, apparel, and furniture and appliance stores; expenditures on items at these stores were lackluster

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

	1991			1991		
	Q2	Q3	Q4	Oct.	Nov.	Dec.
<u>Producers' durable equipment</u>						
Shipments of nondefense capital goods	1.4	-.2	1.8	2.4	.8	-6.4
Excluding aircraft and parts	.5	-.5	2.1	1.5	.7	-3.2
Office and computing	-.8	-2.0	7.5	12.3	4.3	-10.0
All other categories	.9	.0	.6	-1.4	-.4	-1.0
Shipments of CIR complete aircraft[1]	7.3	-4.5	-23.0	-9.7	-3.3	-30.5
Sales of heavy-weight trucks	-5.4	1.6	-1.8	-9.1	3.4	15.4
Orders of nondefense capital goods	-13.6	13.6	-2.7	3.4	12.2	-16.6
Excluding aircraft and parts	-1.8	2.8	.4	-1.9	.1	-.7
Office and computing	-1.6	-4.2	1.1	10.6	3.4	-14.5
All other categories	-1.9	5.0	.1	-5.1	-.8	3.5
<u>Nonresidential structures</u>						
Construction put-in-place	-2.7	-5.6	n.a.	-.7	-2.3	n.a.
Office	-5.4	-9.0	n.a.	-2.3	-9.9	n.a.
Other commercial	-3.5	-8.8	n.a.	-2.7	-4.1	n.a.
Industrial	-4.2	-6.4	n.a.	5.5	.9	n.a.
Public utilities	1.4	.3	n.a.	-.2	1.2	n.a.
All other	-3.1	-6.3	n.a.	-2.6	-1.8	n.a.
Rotary drilling rigs in use	-8.4	-11.3	-12.6	-1.8	-3.3	-3.0
Footage drilled[2]	-4.9	-10.2	n.a.	18.0	-18.3	n.a.

1. From the Current Industrial Report "Civil Aircraft and Aircraft Engines". Seasonally adjusted with BEA seasonal factors.
2. From Department of Energy. Not seasonally adjusted.
n.a. Not available.

earlier in 1991 as well. By contrast, relatively small gains over the final three months of 1991 were posted in sales of "other durable goods."[1]

Given the weakness in retail sales and motor vehicles sales, the goods component of real personal consumption expenditures is estimated by the BEA to have declined 5.2 percent at an annual rate in the fourth quarter. However, real personal consumption expenditures on services rose at a 2.3 percent annual rate; in total, real personal consumption expenditures declined 1.1 percent at an annual rate in the fourth quarter.

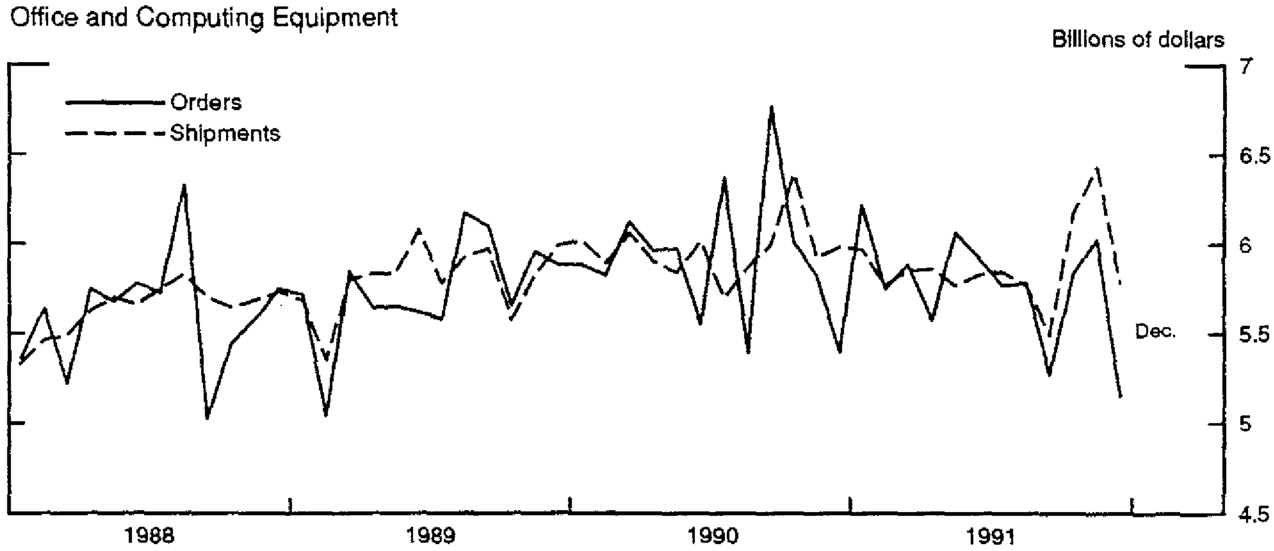
Business Fixed Investment

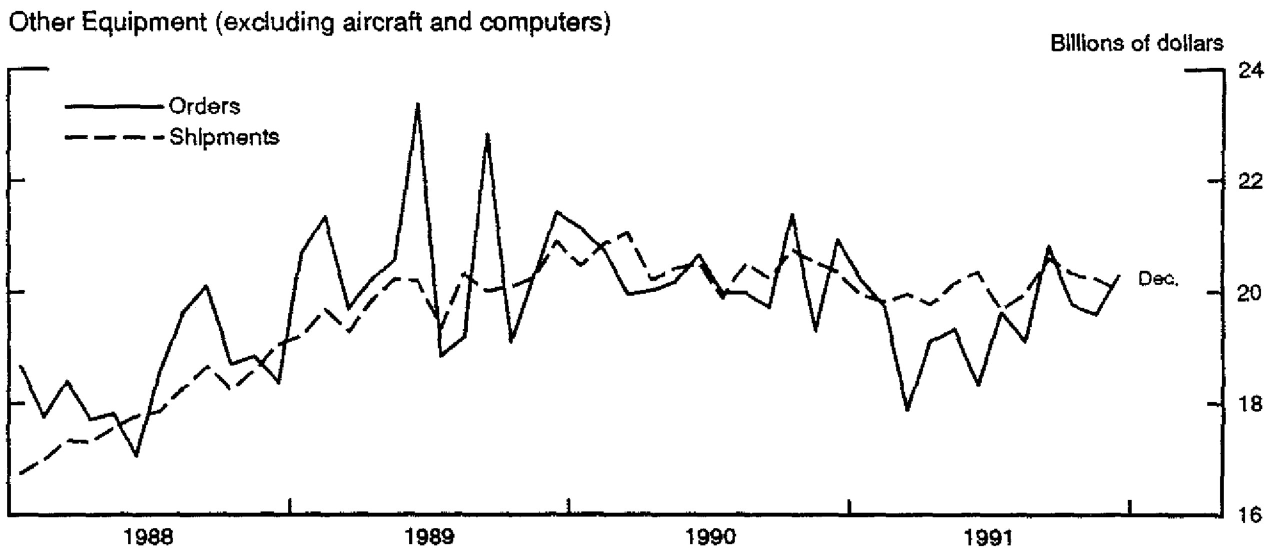
According to BEA's advance estimate, real business fixed investment fell 2.4 percent at an annual rate in the fourth quarter, as another sharp drop in nonresidential construction was offset by a small rise in spending on equipment. On the equipment side, a 40 percent jump in real spending for computers was offset by a collapse in aircraft investment. The surge in computer spending largely reflected the initial deliveries of a new generation of IBM mainframes, while an extraordinary drop in the share of aircraft deliveries to domestic airlines pushed aircraft investment down to its lowest level since the middle of 1984. Real outlays for nonresidential structures were estimated by BEA to have fallen at a 9.4 percent annual rate in the fourth quarter--led by another double-digit decline in commercial construction.

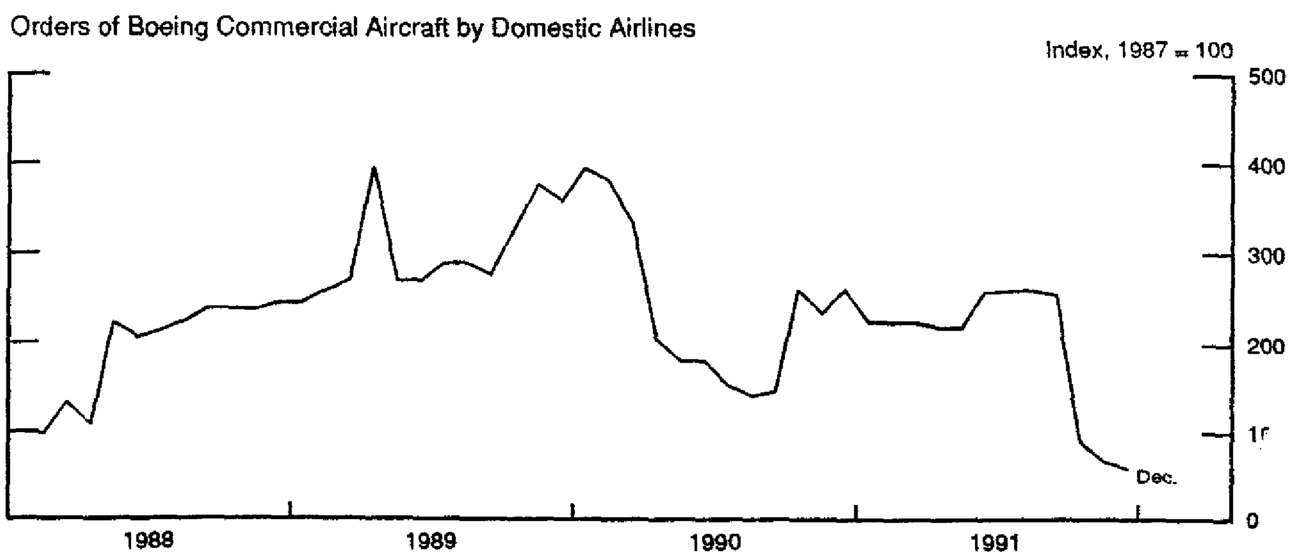
Looking ahead, it appears likely that near-term growth in equipment outlays will be modest. Equipment investment tends to lag overall economic activity; thus, the early recovery last spring was followed by a brief resurgence in investment last fall, and the recent deceleration of economic activity likely will damp investment

1. The "other durable goods" category includes sales of optical goods, sporting goods, books, jewelry, and cameras.

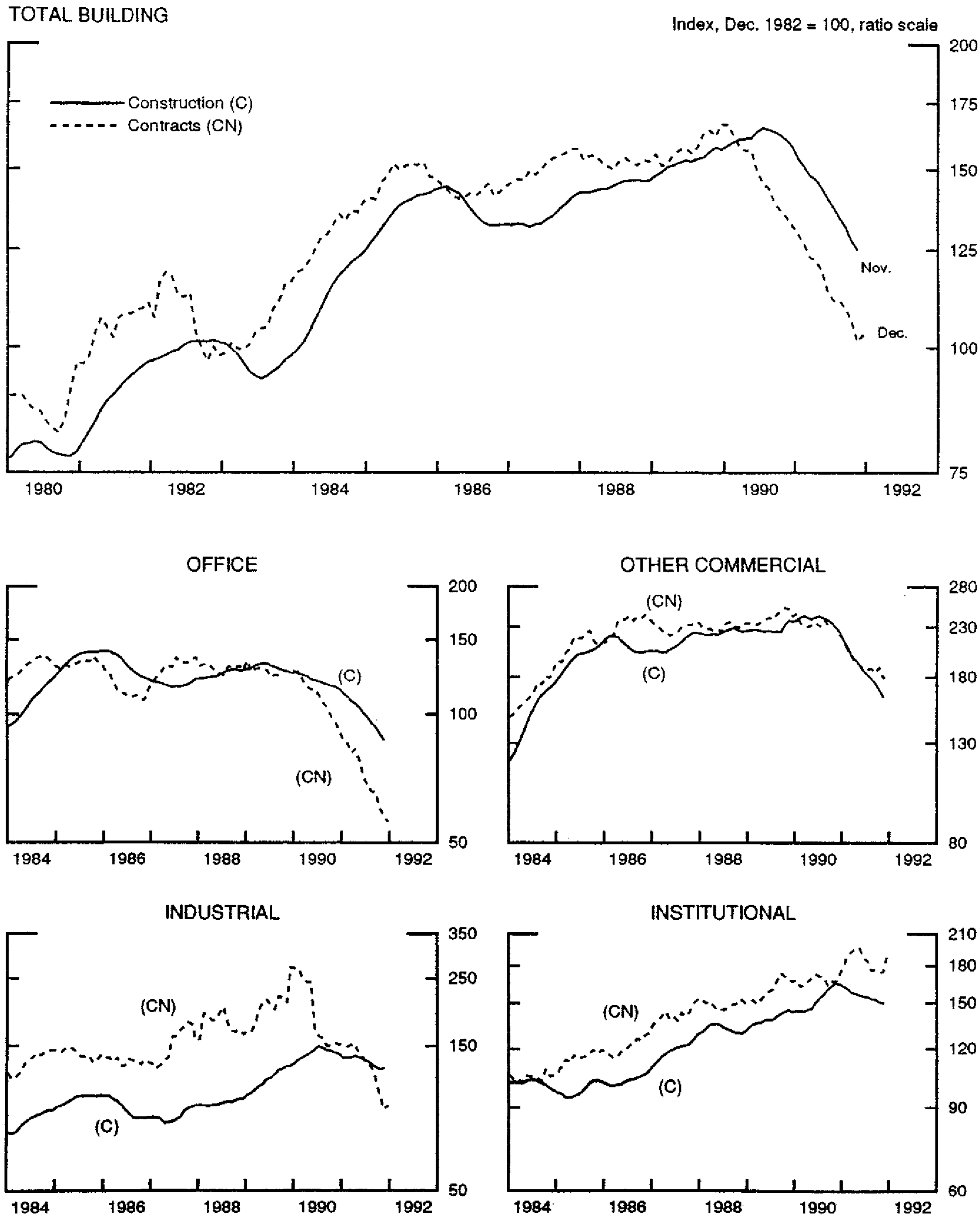
RECENT DATA ON ORDERS AND SHIPMENTS







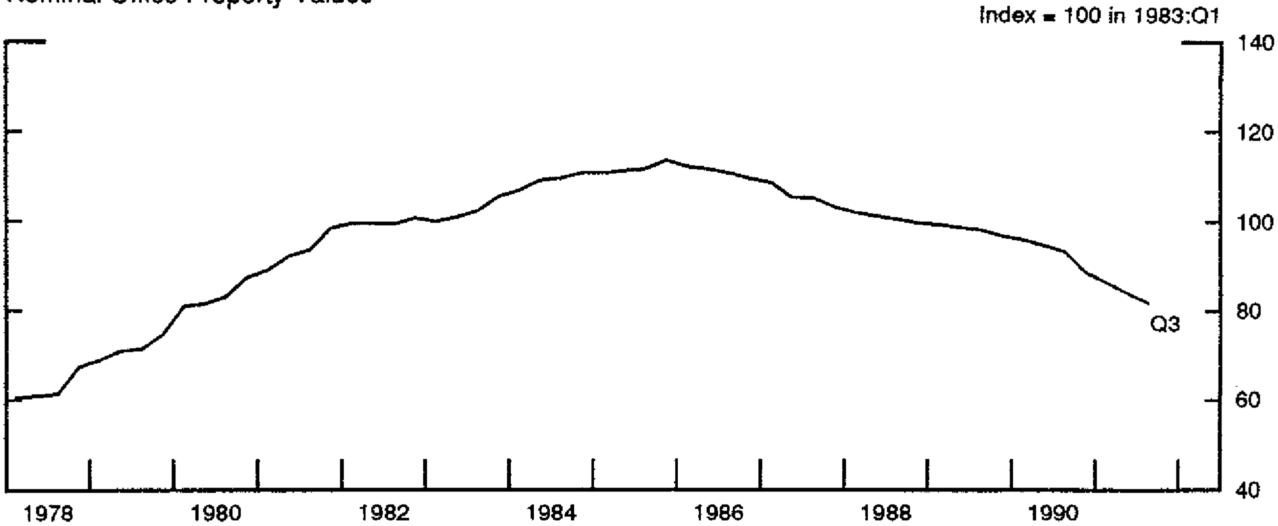
Nonresidential Construction and Contracts <1>



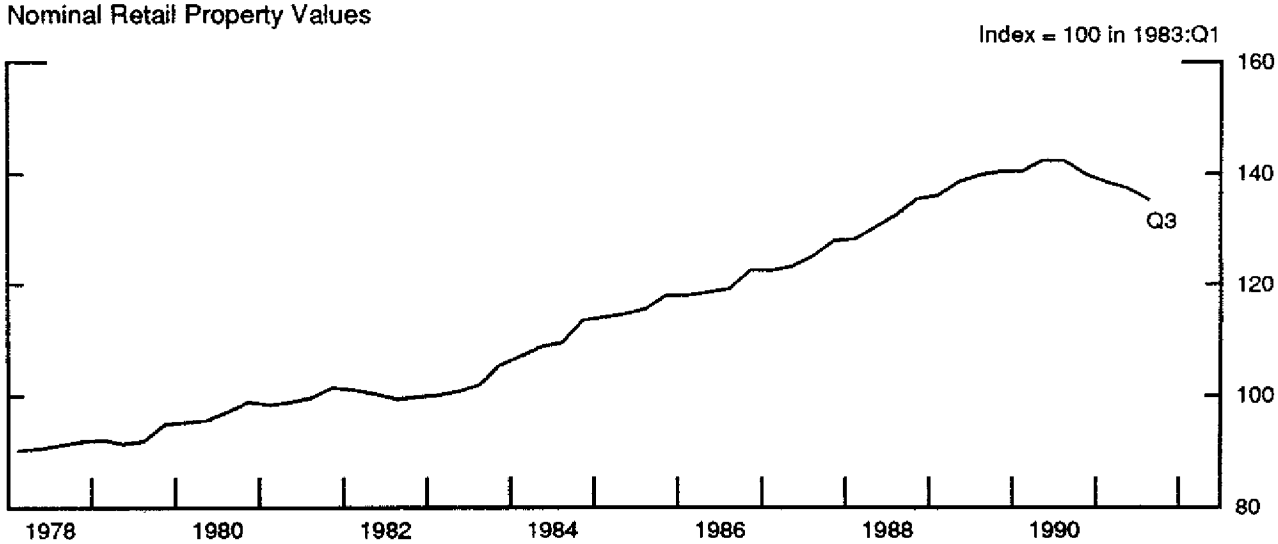
<1> Six-month moving average for all series shown. For contracts, total only includes private, while individual sectors include private and public. Contracts extend through December.

RUSSELL–NCREIF COMMERCIAL PROPERTY VALUES

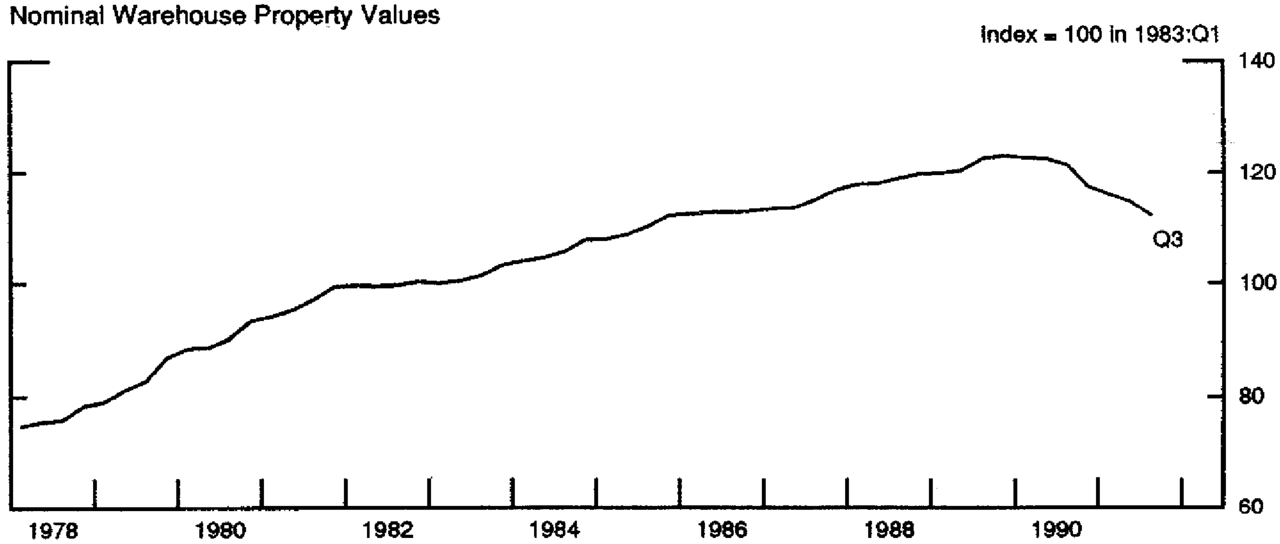
Nominal Office Property Values



Nominal Retail Property Values



Nominal Warehouse Property Values



during the first half of this year. Indeed, in the fourth quarter, (nominal) orders for nondefense capital goods (excluding aircraft and computers) edged up only 0.1 percent from the third-quarter level and point to little change in shipments during the current quarter. Moreover, new orders from domestic carriers for Boeing jetliners have plummeted since midyear. Although Boeing's backlog of domestic aircraft orders is still quite high and new orders are filled with a long lag, the current climate suggests that, even after a rebound from the low fourth quarter, spending is likely to remain cautious. Finally, a slowing in the growth of computer purchases has followed quickly on the heels of the early fourth-quarter surge at IBM, with computer shipments dropping 10 percent in December.

Indicators for nonresidential structures continue to paint a bleak picture. Total construction contracts have not deviated from the steep downward trend that began in late 1989 (chart). Commercial construction has borne the brunt of this decline, as the persistent oversupply of existing space continues to depress property values and curtail new construction. Appraised values of office properties trended down further in the third quarter of 1991 (chart) and have declined nearly 30 percent since 1985.[2] For the other commercial sector, which comprises primarily retail and warehouse properties, values have been dropping steadily since 1989.

Business Inventories

Business inventories began to rise noticeably last fall after months of substantial liquidation earlier in the year. Total manufacturing and trade inventories expanded at a $30.7 billion annual rate (current cost) from September to November, with the

2. 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 appraised values of commercial properties owned by major institutional investors.

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

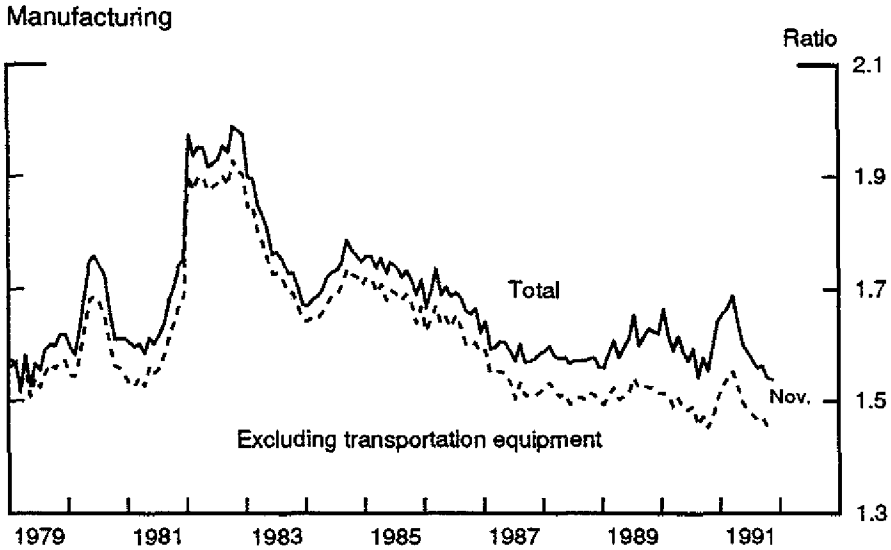
	1991			1991		
	Q1	Q2	Q3	Sep.	Oct.	Nov.
Current-cost basis:						
Total	-29.3	-50.0	10.8	37.7	38.8	15.8
Total excluding retail auto	-14.4	-42.2	1.8	22.1	28.7	21.5
Manufacturing	-11.3	-24.1	-4.5	17.4	-9.3	-.4
Wholesale	4.7	-18.8	-3.3	-15.5	21.5	13.7
Retail	-22.7	-7.2	18.6	35.9	26.5	2.4
Automotive	-14.9	-7.9	9.0	15.6	10.1	-5.7
Excluding auto	-7.8	.7	9.6	20.2	16.4	8.1

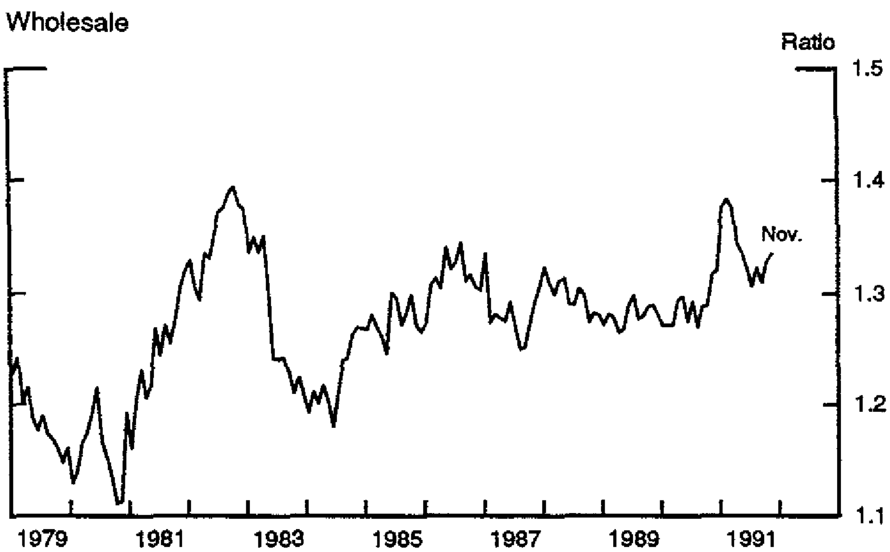
INVENTORIES RELATIVE TO SALES[1]
(Months supply; based on seasonally adjusted data)

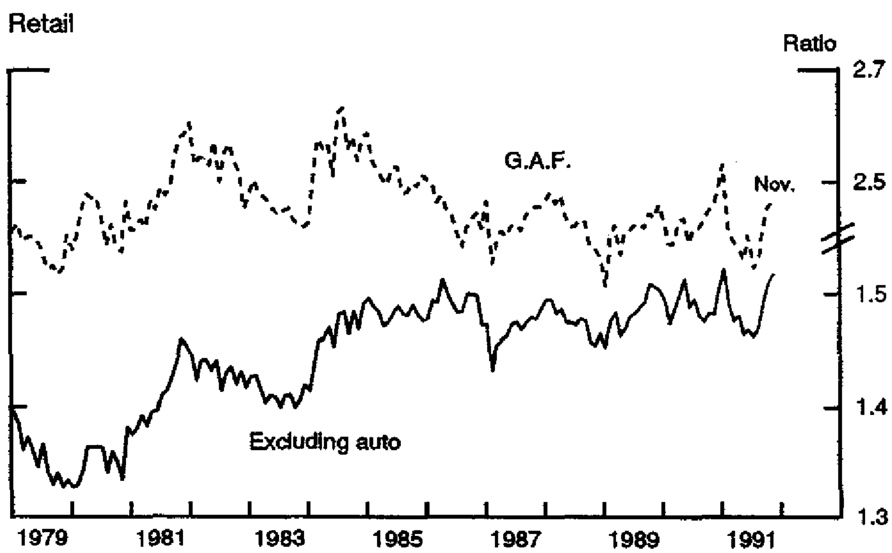
	Range in preceding 12 months:[2] Low	High	1991 Q1	Q2	Q3	1991 Sep.	Oct.	Nov.
Current-cost basis:								
Total	1.49	1.58	1.56	1.51	1.50	1.50	1.50	1.50
Total excluding retail auto	1.47	1.55	1.53	1.49	1.47	1.47	1.47	1.48
Manufacturing	1.54	1.69	1.66	1.60	1.57	1.56	1.54	1.54
Wholesale	1.31	1.38	1.37	1.32	1.31	1.31	1.33	1.33
Retail	1.54	1.65	1.58	1.55	1.57	1.57	1.59	1.60
Automotive	1.82	2.18	1.96	1.84	1.91	1.87	1.88	1.90
Excluding auto	1.46	1.52	1.48	1.47	1.48	1.49	1.51	1.52

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.

Ratio of Inventories to Sales
(Current-cost data)







runup concentrated at retail and wholesale outlets. Coming at a time of sluggish sales, the stockbuilding has caused some deterioration in trade inventory-sales ratios and points to the possibility of paring in the coming months.

Among the major sectors, manufacturing inventories at present are the leanest. Although slowing shipments in October and November led to some buildup in stocks of finished goods, especially in the motor vehicle, chemical, and paper industries, manufacturers were able to reduce their holdings of production materials and work-in-process inventories. As a result, except for a brief upsurge in September, manufacturing inventories, on net, have continued the downtrend that began in December of 1990.

Wholesale inventories expanded sharply in October and November, rising at an average pace of $17-1/2 billion. A sizable part of the accumulation was in nonconsumer goods such as machinery, building materials, chemicals, and farm products. For most types of wholesale distributors, inventory-sales ratios have moved up in recent months, but have remained well below their recent peaks posted last winter.

Outside of motor vehicles, retail inventories continued to build through November, and the inventory-sales ratios of most types of non-auto retailers, particularly that for the GAF grouping, have been moving up since late summer. However, the pace of accumulation appears to have slowed. Non-auto retail establishments reported an $8 billion (current-cost, annual rate) buildup in November, less than half of the $18.3 billion average pace reported in the previous two months.

Housing Markets

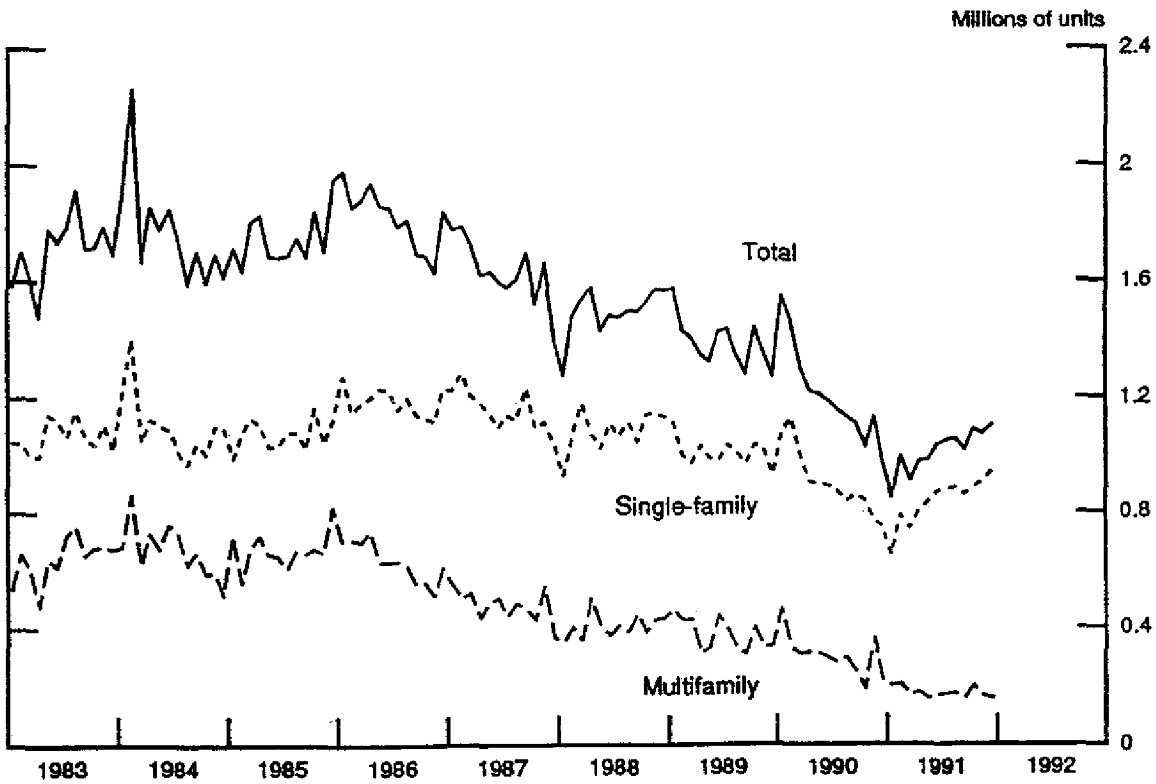
Production and sales of homes continued to expand through year-end. Furthermore, January surveys show improvement both in consumer attitudes toward homebuying and in homebuilders' perceptions of home

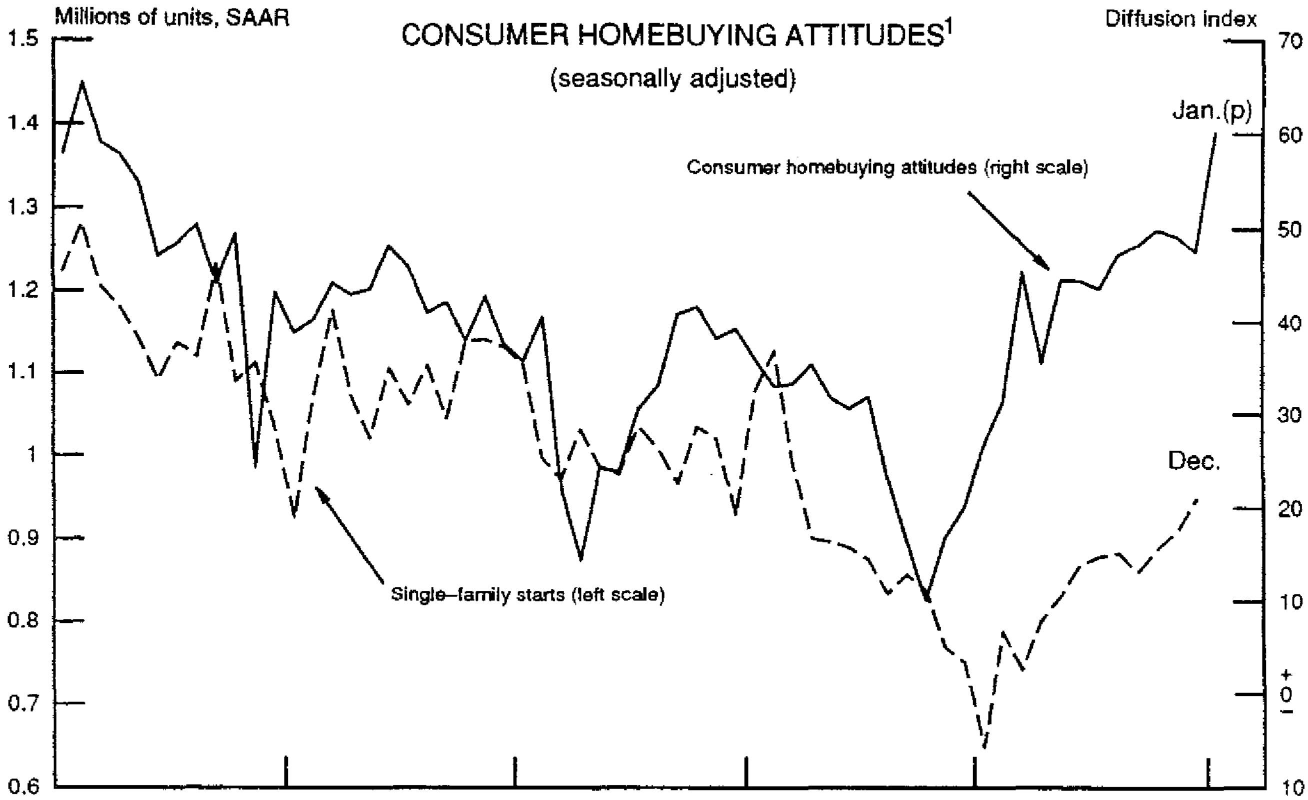
PRIVATE HOUSING ACTIVITY
(Seasonally adjusted annual rates; millions of units)

	1991[p]	1991			1991		
	Annual	Q2	Q3	Q4[p]	Oct.[r]	Nov.[r]	Dec.[p]
All units							
Permits	.96	.96	.98	1.02	1.03	.99	1.05
Starts	1.01	1.00	1.04	1.09	1.09	1.08	1.10
Single-family units							
Permits	.76	.76	.78	.81	.80	.79	.84
Starts	.84	.83	.87	.92	.89	.91	.95
Sales							
New homes	n.a.	.51	.51	n.a.	.52	.52	n.a.
Existing homes	3.29	3.48	3.23	3.27	3.16	3.31	3.34
Multifamily units							
Permits	.20	.20	.20	.22	.23	.21	.21
Starts	.17	.16	.17	.17	.20	.17	.16

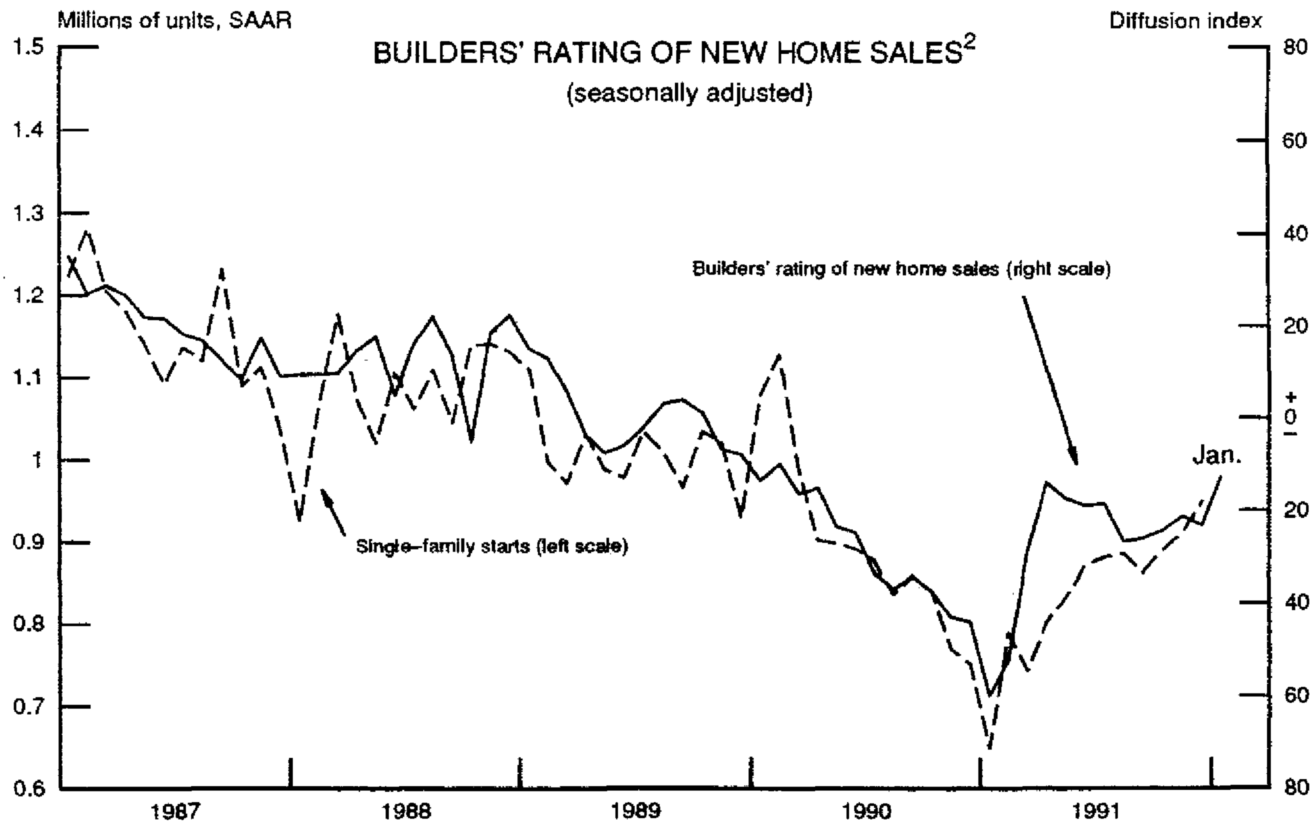
p Preliminary. r Revised estimates. n.a. Not available.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)





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.



2 The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good to excellent minus the proportion rating them as poor.

sales. Total housing starts rose 2.6 percent in December to 1.10 million units at an annual rate, because of an increase in single-family home construction. For 1991 as a whole, however, starts totaled only 1.01 million units, the lowest annual average in the postwar era.

In the single-family sector, starts increased 4.2 percent in December, as continued declines in mortgage interest rates further pared the cash flow burden of home purchases. Also, starts for November were revised upward by 20,000 units. Permit issuance for single-family homes rose nearly 7 percent in December, substantiating the increase in building activity. Sales of existing homes edged up about 1 percent in December to 3.34 million units, the highest level since last June. New home sales in November were unchanged after a moderate increase in October. However, sales in the Northeast plummeted an inexplicably large 45 percent in November. The sharp decline in new home sales is in marked contrast to strong December increases in both total housing starts and existing home sales in the Northeast. This evidence suggests that the national estimate of new home sales may bounce back in December--or that the November figure may be revised upward.

The early indications are that housing demand strengthened in January. According to preliminary data, consumer attitudes toward homebuying improved sharply (chart). Furthermore, builders' rating of new home sales turned more positive in January, suggesting that some households were acting upon the improvement in homebuying attitudes (chart). Most prominent among the reasons given by consumers with a favorable view of homebuying conditions in early January was the low level of interest rates. Conceivably, the very recent mortgage rate backup may tip the balance for some potential buyers even further in favor of purchasing now instead of waiting for further rate declines.

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

	October-December 1990	October-December 1991	Dollar change	Percent change
Outlays	335.6	338.1	2.5	.7
Deposit insurance (DI)	14.2	-5.0	-19.1	-135.0
Defense cooperation account (DCA) contributions (-)	-4.3	-3.8	.5	-12.5
Outlays excluding DI and DCA	325.8	346.8	21.1	6.5
National defense excluding DCA	80.9	77.5	-3.4	-4.2
Net interest	46.2	49.8	3.6	7.8
Social Security	63.4	68.5	5.1	8.1
Medicare and health	40.2	50.9	10.7	26.5
Income security	40.5	44.9	4.4	10.8
Other	54.6	55.3	.7	1.3
Receipts	249.4	254.9	5.5	2.2
Personal income taxes	114.3	113.0	-1.3	-1.1
Social insurance taxes	85.8	90.9	5.1	6.0
Corporate income taxes	25.4	24.4	-1.0	-4.0
Other	23.8	26.6	2.7	11.4
Deficit	86.2	83.1	-3.1	-3.6
Deficit excluding DI and DCA	76.4	91.9	15.5	20.3

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

CBO BUDGET ESTIMATES[1]
(Billions of dollars)

	Fiscal years 1992	1993	1994	1995	1996	1997
Outlays	1454	1505	1523	1536	1593	1718
Receipts	1102	1179	1263	1342	1415	1492
Deficit	352	327	260	194	178	226
Deficit excluding deposit insurance and Desert Storm contributions	290	258	227	210	220	254
Memo:						
Deposit insurance	67	68	33	-16	-44	-28
Desert Storm contributions(-)	5	0	0	0	0	0

Multifamily housing starts dropped to 155,000 units at an annual rate in December, a level just above the series low set last May. Multifamily starts averaged 173,000 units for the year, the lowest since the 1950s. Multifamily housing production continues to be hampered by the persistence of very high vacancy rates on apartment units and the resulting restraint on rents. After accounting for seasonal patterns, the multifamily vacancy rate continued to edge up in the fourth quarter of 1991.

Federal Sector

In the fourth quarter of 1991, the unified budget deficit totaled $83 billion (not at an annual rate), a bit less than its level of a year earlier. That figure is deceptive, however: If outlays for deposit insurance (DI) and contributions to the defense cooperation account (DCA) are excluded, the fourth-quarter deficit was up $15.5 billion from its year-ago level. (With the recent approval of a $25 billion appropriation for the RTC, which is projected to satisfy RTC needs through the end of March, outlays for deposit insurance are expected to rise substantially in the current quarter.) Outlays were boosted in the fourth quarter by continued sizable growth in spending on social security, income security, and medicare and health. Revenues were up only about 2 percent relative to a year earlier, as increases in social insurance and excise taxes (boosted by legislation enacted in late 1990) were offset by weakness in personal and corporate income taxes associated with the weakness in economic activity.

The CBO released its economic and budget outlook on January 23. CBO's baseline estimates show the federal budget deficit rising $83 billion to $352 billion in FY1992, and then declining steadily through FY1995 as economic activity strengthens, outlays for deposit insurance decline, and spending reductions mandated by the 1990 Budget Enforcement Act take effect. After FY1995, the deficit is

REVISIONS TO CBO'S BUDGET ESTIMATES FOR FY1992 AND FY1993
(Billions of dollars)

	Actual	January forecast		Change from August forecast	
	1991	1992	1993	1992	1993
Total revenues	1054	1102	1179	-39	-45
Total outlays	1323	1454	1505	-49	4
Deposit Insurance (DI)	66	67	68	-48	10
Contributions to Defense Cooperation Account (DCA)	-43	-5	0	-5	0
Deficit	269	352	327	-11	49
Deficit excluding DI and DCA	246	290	258	42	38

CBO ECONOMIC ASSUMPTIONS

	Calendar years					
	1992	1993	1994	1995	1996	19
	--------Percent change, year over year-----					
Real GDP	1.6	3.6	2.7	2.5	2.6	2.6
Implicit GDP deflator	2.9	3.2	3.2	3.2	3.2	3.2
CPI-U	3.3	3.6	3.6	3.6	3.6	3.6
	-----------Percent, annual average---------					
Civilian unemployment rate	6.9	6.4	6.2	6.0	5.9	5.7
Interest rates						
Treasury bills	4.4	5.1	5.2	5.4	5.5	5.6
Treasury notes	7.1	7.1	7.1	7.1	7.1	7.1

Source: CBO, The Economic and Budget Outlook, January 1992.

projected to begin an upward drift in response to increased entitlement spending. Relative to CBO's August projections, the forecast for the deficit excluding DI and DCA has been adjusted up in FY1992 and FY1993 about $40 billion, reflecting lower receipts estimates attributable to slower income growth and lower capital gains realizations than were forecast in August.

CBO's projections assume adherence to the 1990 Budget Enforcement Act, which for FY1993 requires that discretionary defense and domestic outlays be cut $12 billion and $9 billion respectively from their FY1992 levels. For fiscal years 1994 and 1995, the spending caps apply to total discretionary spending, which is slated to fall $7 billion in FY1994 and then remain flat in FY1995.

CBO now projects that deposit insurance outlays in fiscal years 1992 and 1993 will remain essentially unchanged from their FY1991 level. Over the next five fiscal years, the undiscounted total of projected deposit insurance outlays is essentially unchanged relative to CBO's August projections, as higher projected spending on the Bank Insurance Fund about offsets $30 billion of projected RTC spending that has been pushed beyond the forecast horizon.

The Administration released its FY1993 budget Wednesday morning. OMB now expects the federal deficit to approach $400 billion in FY1992, before dropping to about $350 billion in FY1993. The FY1992 deficit projection is up about $50 billion relative to OMB's July mid-session budget review estimate, primarily because of the effect on revenues of weaker income assumptions and lower technical effective tax rate estimates. These same factors, in addition to higher projections for deposit insurance and medicaid outlays, have pushed OMB's FY1993 deficit up about $100 billion relative to the level estimated in July.

ADMINISTRATION POLICY BUDGET PROJECTIONS
(Billions of dollars)

	Fiscal years					
	1992	1993	1994	1995	1996	1997
Outlays	1475	1516	1475	1536	1608	1684
Receipts	1076	1165	1263	1344	1428	1502
Deficit	399	352	211	192	180	182
Deficit ex deposit insurance and Desert Storm contributions	324	276	236	219	202	214
Memo:						
Deposit insurance	80	76	-25	-27	-22	-32
Desert Storm contributions(-)	5	0	0	0	0	0
Deficit ex policy changes	394	356	228	212	--	--
Deficit ex policy changes, deposit insurance, and Desert Storm contributions	319	280	253	239	--	--

ADMINISTRATION ECONOMIC ASSUMPTIONS

	Calendar years					
	1992	1993	1994	1995	1996	1997
	------Percent change, Q4 over Q4------					
Real GDP	2.2	3.0	3.0	3.0	2.9	2.8
GDP deflator	3.2	3.4	3.3	3.3	3.2	3.2
Consumer Price Index (CPI-W)	3.1	3.3	3.2	3.2	3.2	3.1
	--------Percent, annual average--------					
Civilian unemployment rate	6.9	6.5	6.1	5.8	5.4	5.3
Interest rates						
Treasury bills	4.1	4.9	5.3	5.3	5.2	5.1
Treasury notes	7.0	6.9	6.7	6.6	6.6	6.6

Source: OMB, Budget of the United States Governmemt, Fiscal Year 1993, January 1992.

16.43a(01/29/92)

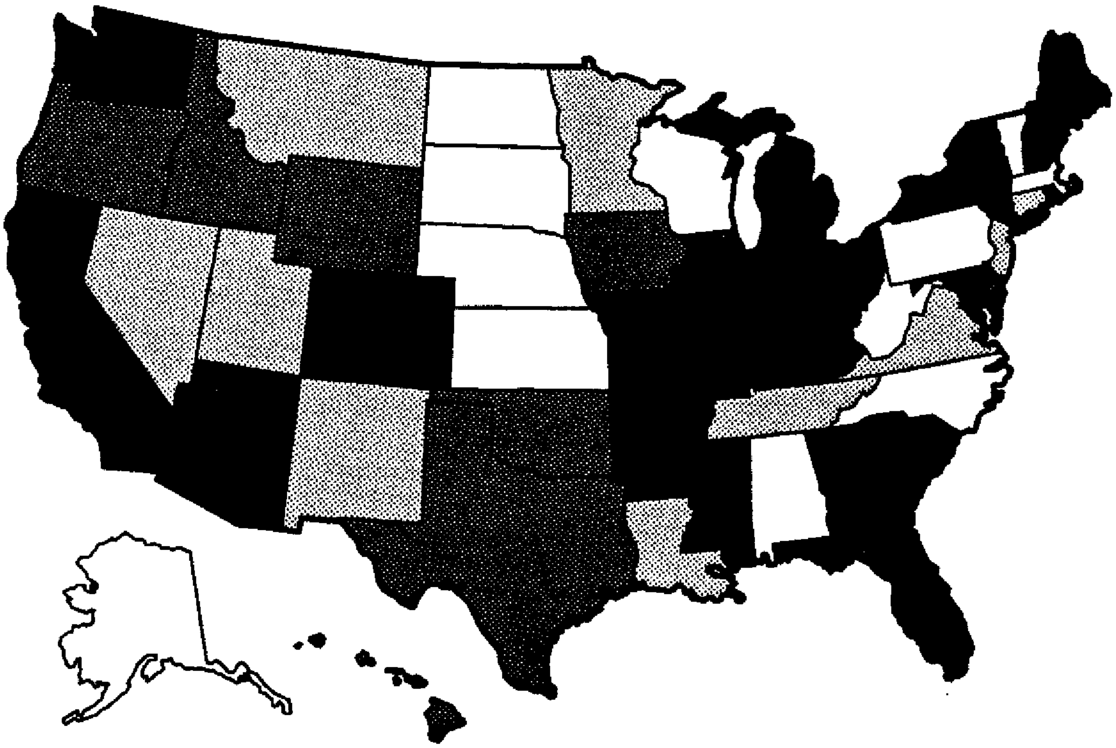
The budget includes proposals to (1) exclude up to 45 percent of capital gains from tax, the portion depending on the holding period, (2) accelerate depreciation allowances for equipment acquired in the remainder of CY1992, (3) make the 20 percent tax credit for incremental R&D expenditures permanent, (4) create flexible individual retirement accounts for low- and middle-income taxpayers, (5) waive the penalty for early IRA withdrawals for the purchase of a first home and for medical and educational expenses, (6) grant a 10 percent tax credit (capped at $5,000) on a first home purchase transacted during the remainder of CY1992, (7) increase the exemption for dependent children by $500, and (8) cut defense spending by $50 billion over the next five fiscal years. In addition, the budget reports that the President has taken action to permanently reduce withholding taxes by about 5 percent beginning in March 1992, thereby reducing individual taxes by a projected $21 billion in CY1992. Because a decrease in withholding results in increased net final payments the following year, this change leaves revenues in future years approximately unchanged.

State and Local Government Sector

The state and local government sector remains under budgetary pressure. Real purchases of goods and services were essentially unchanged in the fourth quarter, and were down 1/2 percent over 1991 as a whole. The slowing in purchases follows several years of sizable increases; in fact, 1983 was the last year to show a gain much below 3 percent. Among the major components of spending, real construction outlays continued to advance in the fourth quarter, but compensation was essentially unchanged and purchases of other goods and services fell.

Anecdotal reports and a national survey indicate that state and local governments are continuing to experience grave fiscal conditions, and another round of budget-balancing measures can be

STATES EXPECTING FISCAL YEAR 1992 BUDGET GAPS
(As of Mid-December, 1991)



- ☐ no problem
- ▩ revenue shortfalls
- ▩ expenditures over budget
- ■ revenue shortfalls and expenditures over budget

Source: *State Fiscal Outlook for 1992*, National Conference of State Legislatures, Jan. 1992.

expected. According to a December survey by the National Association of State Legislatures, about thirty states are expecting revenues--notably sales tax receipts--for FY1992 to come in below target, and a similar number are experiencing expenditure overruns, especially for medicaid (chart). Moreover, many of these states have relatively low reserves in their general and rainy-day funds. Spending cuts are anticipated to be the most frequently used budget remedy this year; a few state legislatures reduced outlays during special sessions held in late 1991, and governors in several states have ordered cuts. Officials are looking to eliminate and reorganize programs; for example, Michigan, California, and New Jersey are revamping their medicaid and welfare programs. In addition, many states are likely to lay off or furlough employees and to reduce aid to local governments. So far, only a few states, notably Maryland and Florida, are considering hikes in taxes; efforts to roll back recent tax increases in Connecticut and New Jersey failed.

Labor Costs

The incoming data on labor costs suggest that the rate of increase in wages continues to trend downward. The employment cost index for hourly compensation in private industry rose 4.0 percent at a seasonally adjusted annual rate in the fourth quarter, and for 1991 as a whole, compensation costs were up 4.4 percent, only a little less than in 1990. This gradual deceleration was seen in the wages and salaries component and in the benefits component, both of which came down about 1/4 percentage point from their 1990 increase.

By industry, the deceleration in 1991 was evident in both the goods-producing and service-producing sectors. By occupation, however, the slowing was most pronounced for white-collar workers. Hourly compensation for this group of workers decelerated about 1/2 percentage point from its 1990 pace. In contrast, compensation

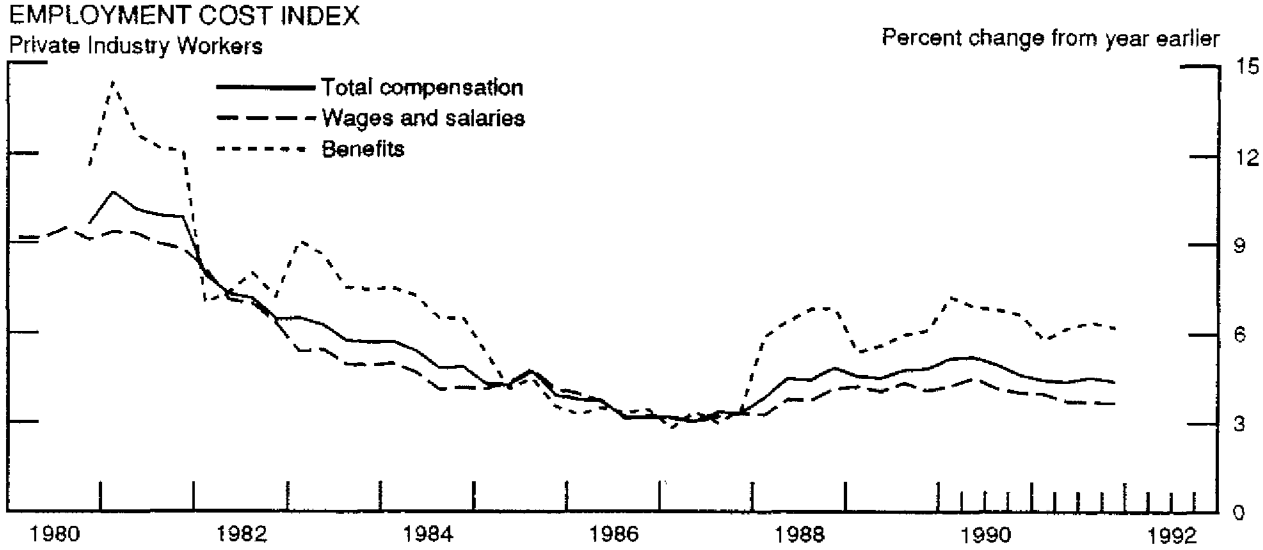
EMPLOYMENT COST INDEXES
(Three month percent changes at compound annual rates; seasonally adjusted)

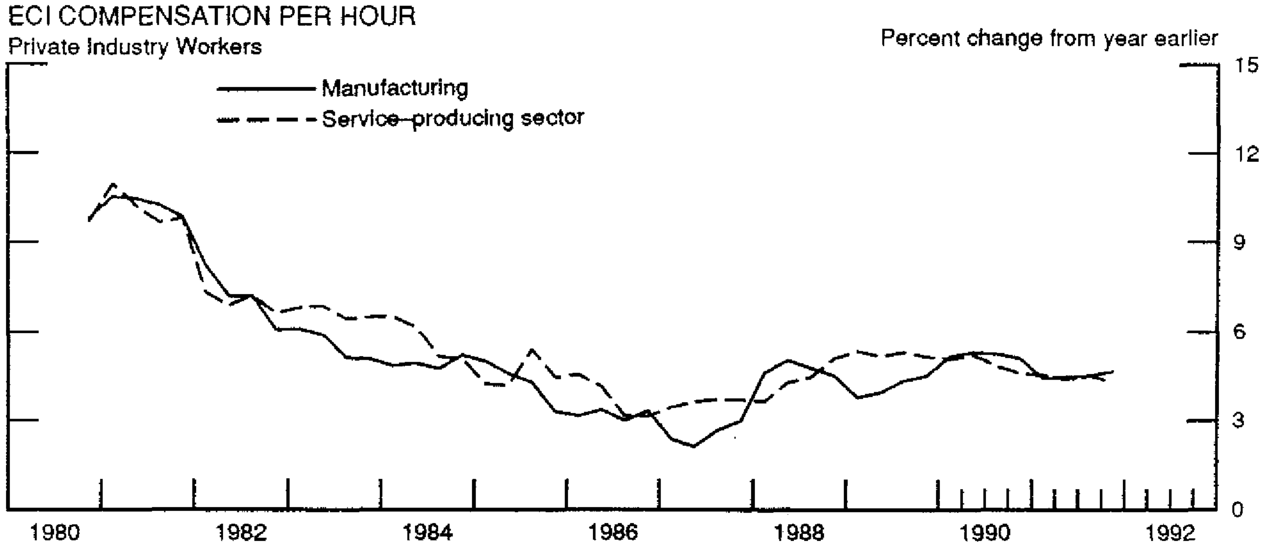
	1990 Sep.	1990 Dec.	1991 Mar.	1991 June	1991 Sep.	1991 Dec.
Total compensation costs						
Private industry workers	4.7	3.8	4.9	4.5	4.1	4.0
By industry						
Goods-producing	4.3	3.8	4.6	4.9	4.1	4.4
Service-producing	4.3	4.2	4.9	4.5	4.1	4.0
By occupation						
White-collar	4.6	2.7	6.1	4.9	4.0	2.9
Blue-collar	3.9	3.8	4.6	4.1	4.9	3.7
Service workers	3.1	5.4	3.8	6.1	6.3	3.3
By bargaining status						
Union	3.9	4.3	5.0	4.9	4.9	3.7
Nonunion	4.2	2.7	5.7	4.9	4.1	2.5
Memo:						
Wages and salaries	3.9	3.1	4.2	4.2	3.0	3.3
Benefits	6.1	6.0	5.6	6.6	6.9	5.7

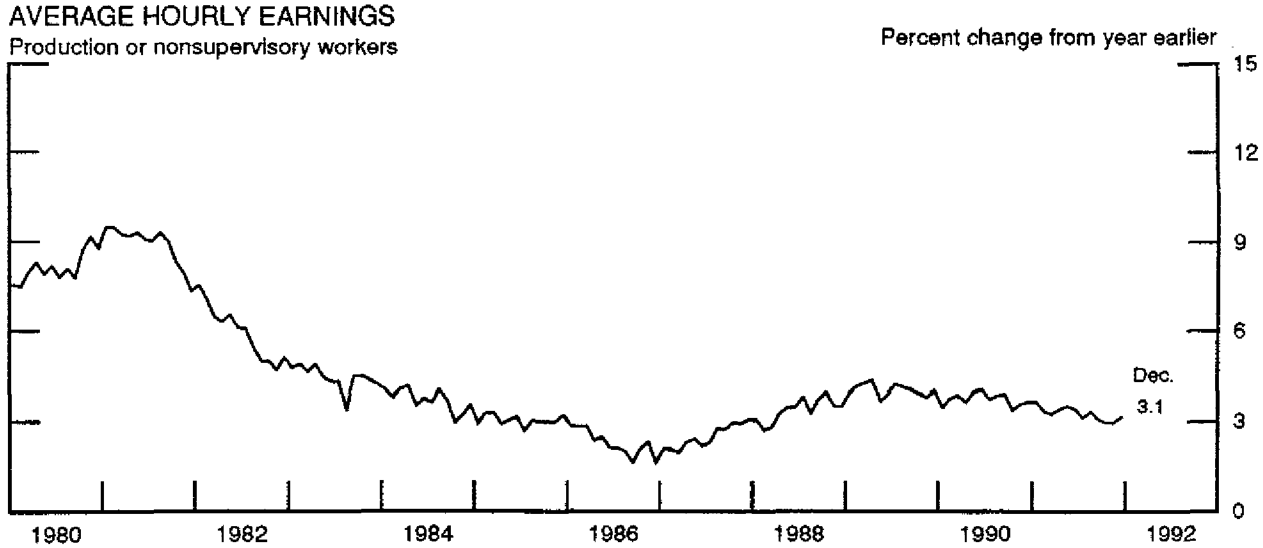
EMPLOYMENT COST INDEXES
(Percent change from year earlier; not seasonally adjusted)

	1989	1990	1991 Mar.	1991 June	1991 Sep.	1991 Dec.
Total compensation costs						
Private industry workers	4.8	4.6	4.4	4.4	4.5	4.4
By industry						
Goods-producing	4.3	4.8	4.4	4.4	4.5	4.6
Service-producing	5.1	4.6	4.5	4.4	4.5	4.3
By occupation						
White-collar	5.2	4.9	4.7	4.5	4.4	4.5
Blue-collar	4.1	4.4	4.3	4.1	4.4	4.3
Service workers	4.4	4.7	4.2	4.8	5.5	4.8
By bargaining status						
Union	3.7	4.3	4.1	4.5	4.8	4.6
Nonunion	5.1	4.8	4.5	4.4	4.3	4.3
Memo:						
Wages and salaries	4.1	4.0	4.0	3.7	3.7	3.7
Benefits	6.1	6.6	5.8	6.2	6.4	6.2

LABOR COST MEASURES







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

			1991		
	1990	1991	Q3	Q4	Q4 parties under prior settlements
All industries					
First-year adjustments	4.0	3.6	3.4	3.8	3.2
Average over life of contract	3.2	3.2	3.0	3.3	2.8
Workers affected (in thousands)	2004	1744	437	353	---

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

AVERAGE WAGE CHANGE IN MAJOR UNION CONTRACTS AND ITS COMPONENTS
(Percent)

	1987	1988	1989	1990	1991
Total effective wage change	3.1	2.6	3.2	3.5	3.5
Contribution of:					
New settlements	.7	.7	1.2	1.3	1.1
Prior settlemements	1.8	1.3	1.3	1.5	1.9
COLAs	.5	.6	.7	.7	.5

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

			1991			1991		
	1990	1991	Q2	Q3	Q4	Oct.	Nov.	Dec.
			--Annual rate--			--Monthly rate--		
Total private nonfarm	3.7	3.1	5.2	1.6	3.5	-.1	.3	.7
Manufacturing	3.6	3.0	5.2	2.2	2.5	.1	.4	.2
Excluding overtime	3.7	2.6	3.8	1.9	2.2	.1	.3	.2

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

gains for blue-collar and service workers were about the same in 1991 as in 1990.

By bargaining status, the deceleration in hourly compensation was most marked for nonunion workers; in contrast, union compensation gains were a bit higher in 1991 than in 1990. Data on major collective bargaining agreements from the BLS indicate that the overall wage change in contracts covering 1,000 or more workers remained about the same in 1991 as in 1990. However, average first-year adjustments slowed from 4 percent in 1990 to 3.6 percent in 1991, and the contribution to total union wage inflation from new settlements was smaller last year. (The contribution from deferred increases under existing contracts was somewhat greater.) Data from Bureau of National Affairs (BNA; a private publishing company) on settlements covering fifty or more workers also point to some slowing in first-year wage adjustments, although not as much as in the BLS data. After factoring in lump-sum provisions, the BNA series estimates median first-year settlements at 4.0 percent in 1991, down from the 4.3 percent average increase negotiated in 1990.

Prices

The consumer price index rose 0.3 percent in December, while the producer price index--held down by declines for food and energy--fell 0.2 percent. Excluding food and energy items, these measures registered moderate increases of 0.3 percent and 0.2 percent respectively. On a twelve-month basis, aggregate inflation rates slowed sharply from their elevated pace in 1990, reflecting the swing in energy prices, a marked deceleration for food, and continued slack in labor and product markets. The CPI rose only 3.1 percent in 1991, half the increase in the preceding year, while the PPI edged down.

Food prices toward year-end continued to reflect volatility in the prices of fruits and vegetables. The rise in the CPI for food

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

	Relative importance Dec. 1990	1990	1991	1991 Q2	1991 Q3	1991 Q4	1991 Nov.	1991 Dec.
				-----Annual rate------			-Monthly rate-	
All items[2]	100.0	6.1	3.1	3.0	3.3	3.2	.4	.3
Food	16.2	5.3	1.9	5.1	-3.2	3.3	.6	.3
Energy	8.2	18.1	-7.4	-1.2	1.6	5.6	.8	.4
All items less food and energy	75.6	5.2	4.4	3.2	4.6	3.1	.3	.3
Commodities	24.5	3.4	4.0	3.2	4.1	.9	.4	-.1
Services	51.1	6.0	4.6	3.0	4.6	4.3	.3	.5
Memorandum:								
CPI-W[3]	100.0	6.1	2.8	3.3	2.7	3.3	.5	.2

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	1990	1991	1991 Q2	1991 Q3	1991 Q4	1991 Nov.	1991 Dec.
				-----Annual rate------			-Monthly rate-	
Finished goods	100.0	5.7	-.1	.7	.3	2.3	.2	-.2
Consumer foods	23.7	2.6	-1.6	-.6	-6.3	-.3	-.1	-.4
Consumer energy	16.8	30.7	-9.6	.0	5.3	1.0	.0	-1.4
Other finished goods	59.5	3.5	3.1	1.5	1.5	4.0	.3	.2
Consumer goods	36.4	3.7	3.4	1.2	2.4	4.2	.4	.1
Capital equipment	23.1	3.4	2.5	1.6	1.0	2.9	.2	.2
Intermediate materials[2]	95.2	4.6	-2.7	-.7	.4	-.3	.1	-.1
Excluding food and energy	78.5	1.9	-.8	-1.0	-.3	.3	.1	.1
Crude food materials	34.4	-4.2	-5.6	-12.5	-8.1	-1.9	-.2	-.4
Crude energy	50.7	19.1	-16.7	.5	.0	4.2	1.2	-3.9
Other crude materials	14.9	.6	-8.0	-13.3	-4.0	-10.1	-1.8	-.4

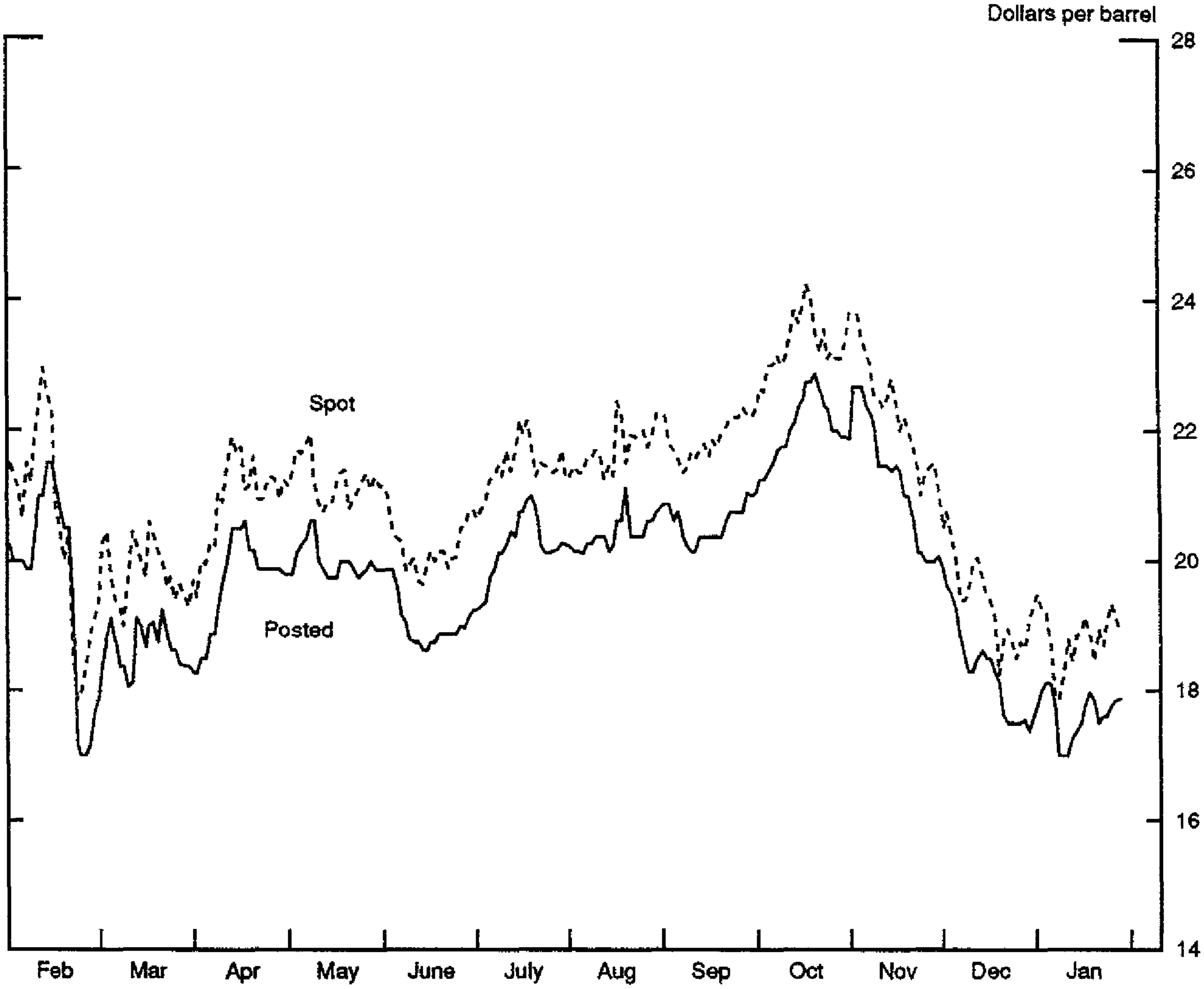
1. Changes are from final month of preceding period to final month of period indicated.
2. Excludes materials for food manufacturing and animal feeds.

slowed to 0.3 percent in December, as price increases for fruits and vegetables were down sharply after their November climb. Over the year, CPI for food rose only about 2 percent, after three years of increases in the 5 to 5-1/2 percent range. In large part, this slowing owed to a decline in meat prices; but even excluding livestock products and fruits and vegetables (about 30 percent of CPI for food), average food price increases slowed nearly 2 percentage points from their 1990 pace. The rise for food away from home was the smallest in more than twenty-five years, likely reflecting soft demand, slowing in labor costs, and reduced prices for inputs of food products.

The CPI for energy rose 0.4 percent in December, less than in November, as prices dropped back for heating oil and natural gas. However, electricity rates turned up. More recent information points to a marked near-term decline in prices of petroleum products. Private survey data for January indicate lower prices of gasoline at both the wholesale and retail levels. Moreover, wholesale prices for heating oil were down sharply as of mid-January. The recent steep declines in prices of heating oil likely reflect the high inventory levels, in part as a result of relatively warm weather during the fourth quarter, and lower crude oil costs.

Excluding food and energy, goods prices edged down in the December CPI. Apparel prices fell 0.6 percent, mainly reflecting a large decline for jewelry, while prices of new vehicles were little changed. The index for tobacco products posted another large increase, but prices declined for a second month for house furnishings and recreational goods. In contrast to goods, the rise in prices of nonenergy services picked up to 0.5 percent in December, boosted by large increases for airfares and lodging out of town.

Daily Spot and Posted Prices of West Texas Intermediate [1]



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

MONTHLY AVERAGE PRICES—WEST TEXAS INTERMEDIATE

Year and Month	Posted	Spot
<u>1991</u>		
February	19.61	20.52
March	18.66	19.86
April	19.56	20.82
May	19.99	21.24
June	19.04	20.20
July	20.15	21.42
August	20.40	21.69
September	20.55	21.86
October	21.96	23.23
November	21.40	22.47
December	18.47	19.52
<u>1992</u>		
January [1]	17.63	18.81

1. Price through January 29.

On a year-over-year basis (table), deceleration was evident last year in the underlying measures of inflation, reflecting continued slack in product and labor markets (and the associated slowing in compensation), smaller increases in import prices, and markedly lower inflation expectations. However, the pattern of deceleration was uneven. The CPI excluding food and energy rose 4.4 percent in 1991, 3/4 percentage point less than in the preceding year; services more than accounted for this slowing. Rent increases eased markedly last year as a result of the weakness in housing markets, and auto financing costs fell 7 percent as interest rates declined. Despite the year-end pickup, airline fares registered a net decline of 6 percent--after a surge in 1990--in response to the dropback in fuel costs after the Gulf War as well as sluggish demand. Prices for medical care and several labor-intensive services also rose less than in 1990 (not shown).

In contrast to services, the CPI for goods other than food and energy rose more in 1991 than in 1990--4 percent compared with 3.4 percent. About half of the pickup can be attributed to higher excise taxes, mainly the hike in federal taxes early last year on alcoholic beverages, cigarettes, and luxury cars. A swing in prices of used cars, which declined in 1990, can account for the remainder of this acceleration. The prices of new vehicles were up 3.2 percent in 1991, compared with an increase of 2 percent in 1990. However, there was a marked slowing for some other goods, notably apparel. This pattern--acceleration for cars and slowing for other consumer goods--also is evident in import prices (lower part of table).

At the producer level, the PPI for finished goods less food and energy rose 3.1 percent last year, 0.4 percentage point less than in 1990. Deceleration was limited for consumer goods but notable for capital equipment excluding motor vehicles; prices of imported

INFLATION RATES EXCLUDING FOOD AND ENERGY
(Percent change from tweleve months earlier)

	Dec. 1989	Dec. 1990	Dec. 1991
CPI	4.4	5.2	4.4
Goods	2.7	3.4	4.0
excluding used cars	2.9	3.7	4.0
Alcoholic beverages	4.8	4.2	9.9
New vehicles	2.4	2.0	3.2
Apparel	.7	5.0	3.4
Personal care commodities	2.5	4.2	2.7
Services	5.3	6.0	4.6
Owners' equivalent rent	5.1	4.8	3.7
Tenants' rent	4.2	4.1	2.9
Other renters' costs	5.5	14.4	8.1
Auto finance charges	4.3	.0	-7.1
Airline fares	5.3	22.7	-6.0
Medical care	8.6	9.9	8.0
PPI Finished goods	4.2	3.5	3.1
Consumer goods	4.4	3.7	3.4
Capital equipment excluding motor vehicles	4.0	3.5	2.2
PPI intermediate materials	.9	1.9	-.8
PPI crude materials	-3.6	.6	-8.0
Factors Affecting Price Inflation			
ECI hourly compensation	4.8	4.6	4.4
Civilian unemployment rate[1]	5.3	6.1	7.1
Inflation expectations[2]	4.6	5.5	4.0
Non-oil import prices[3]	1.4	2.4	.4
Consumer goods excluding autos, food and beverages	3.6	3.6	.4
Autos	1.6	.2	5.1
Capital goods excluding automotive and computers	1.8	5.1	.6

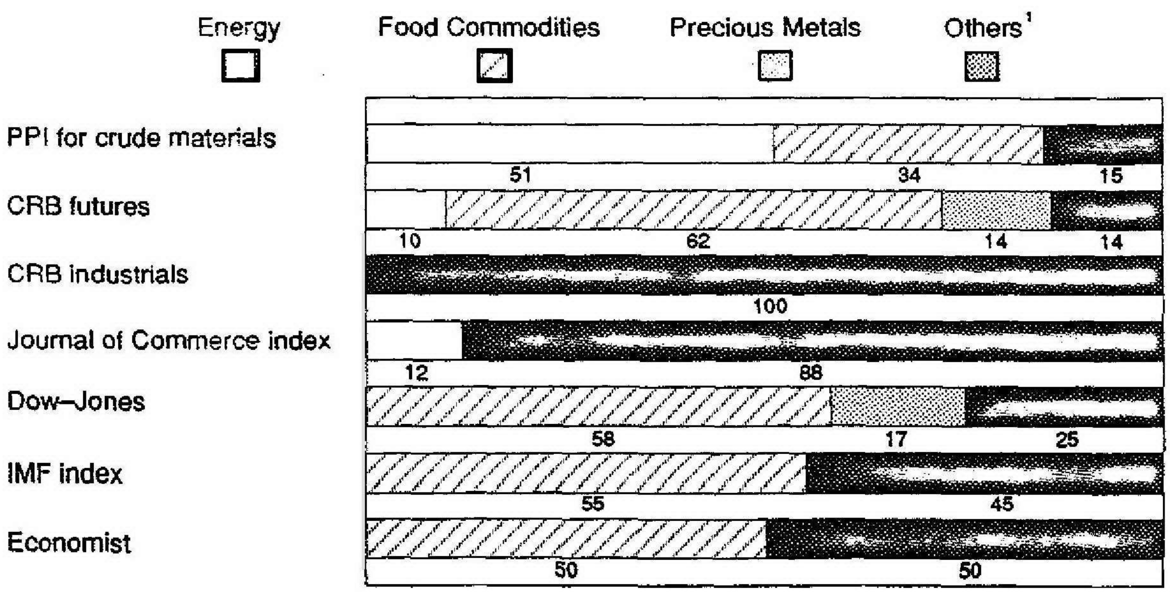
1. End-of-period value.
2. University of Michigan Survey, tweleve-month horizon.
3. BLS import price index, tweleve-month period ending in September.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last observation	1989	1990	1991	Dec. 10, 1991[3] to date	Memo: Year earlier to date
PPI for crude materials[4]	Dec.	7.1	6.0	-11.6	n.a.	-11.6
Foods and feeds	Dec.	2.8	-4.2	-5.6	n.a.	-5.6
Energy	Dec.	.9	-2.7	-16.7	n.a.	-16.7
Excluding food and energy	Dec.	-3.6	.6	-8.0	n.a.	-8.0
Excluding food and energy, seasonally adjusted	Dec.	-3.6	.5	-8.1	n.a.	-8.1
Commodity Research Bureau						
Futures prices	Jan. 28	-9.0	-2.7	-6.5	.2	-1.8
Industrial spot prices	Jan. 28	-5.9	.6	-11.3	-2.1	-10.8
urnal of Commerce industrials	Jan. 28	1.3	-2.4	-7.2	.9	-2.5
Metals	Jan. 28	-7.2	-3.9	-7.1	1.8	-3.8
Dow-Jones Spot	Jan. 28	-10.1	-1.7	-12.1	1.5	-5.4
IMF commodity index[4]	Dec.	-12.9	-5.6	.2	n.a.	.2
Metals	Dec.	-23.4	-3.0	-10.4	n.a.	-10.4
Nonfood agriculture	Dec.	-4.6	-3.5	1.3	n.a.	1.3
Economist (U.S. dollar index)	Jan. 21	-22.8	-4.4	-9.1	1.9	-6.2
Industrials	Jan. 21	-23.8	-3.2	-14.9	3.1	-10.5

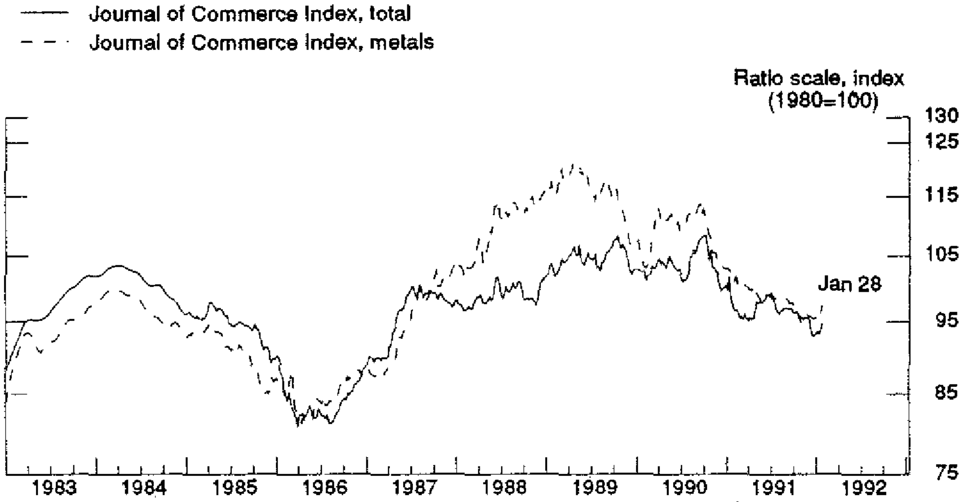
1. Not seasonally adjusted.
2. Change is measured to end of period, from last observation of previous period
3. Week of the December Greenbook.
4. Monthly observations. IMF index includes items not shown separately.
n.a. Not available

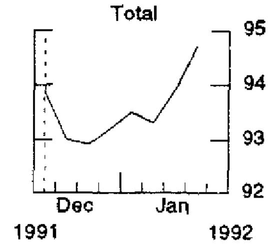
Index Weights

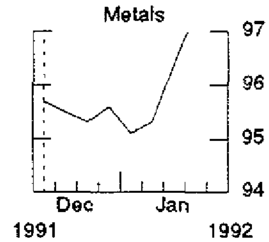


1. Forest products, industrial metals, and other industrial materials.

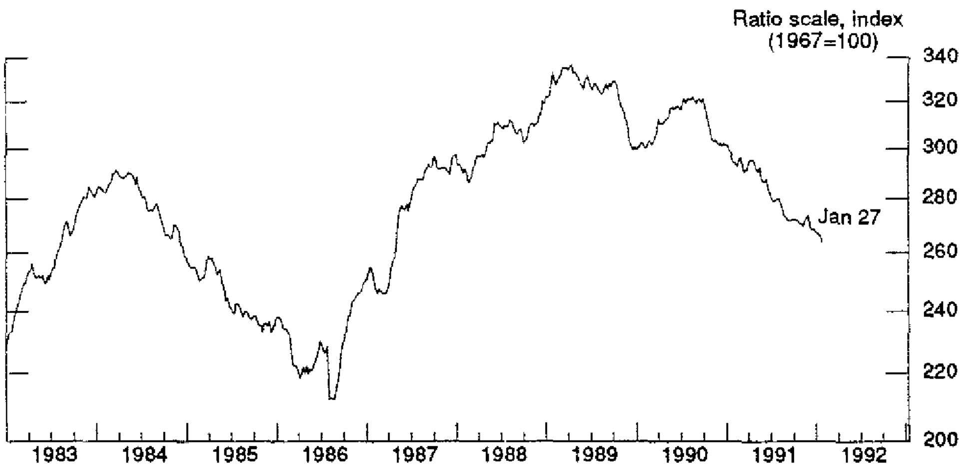
COMMODITY PRICE MEASURES *

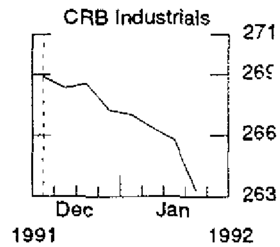




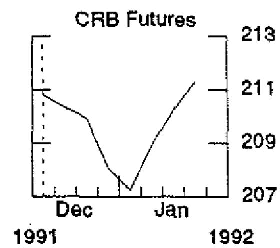


CRB Spot Industrials





CRB Futures



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

Dotted lines indicate week of last Greenbook.

capital goods slowed even more sharply. At earlier stages of processing, in which labor costs tend to have a smaller effect, prices of intermediate materials (nonfood, nonenergy) receded 0.8 percent last year--affected by sluggish activity in the industrial sector and the pass-through of the climb and subsequent dropback of petroleum-based materials costs associated with the Gulf War. The PPI for crude materials less food and energy fell 8 percent last year, in large part reflecting declines for scrap metals, as industrial demand weakened and metal supplies remained ample.

More recently, there are signs that some commodity prices may be bottoming out. Aluminum prices have picked up markedly from their recent low levels, and large increases also were posted this month for lumber, plywood, and silver. The Journal of Commerce index of industrial prices has turned up in the past few weeks, largely reflecting the increases for aluminum and plywood; on net, since the week of the last Greenbook, the index total moved up about 1 percent and the metals component 1-3/4 percent. In contrast, the CRB spot industrials index has continued to decline, reflecting weakness in the prices of steel scrap and cotton. The CRB futures index, based mainly on foods and precious metals, turned up in recent weeks but has registered little net change over the inter-meeting period.

DOMESTIC FINANCIAL DEVELOPMENTS

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(percent)

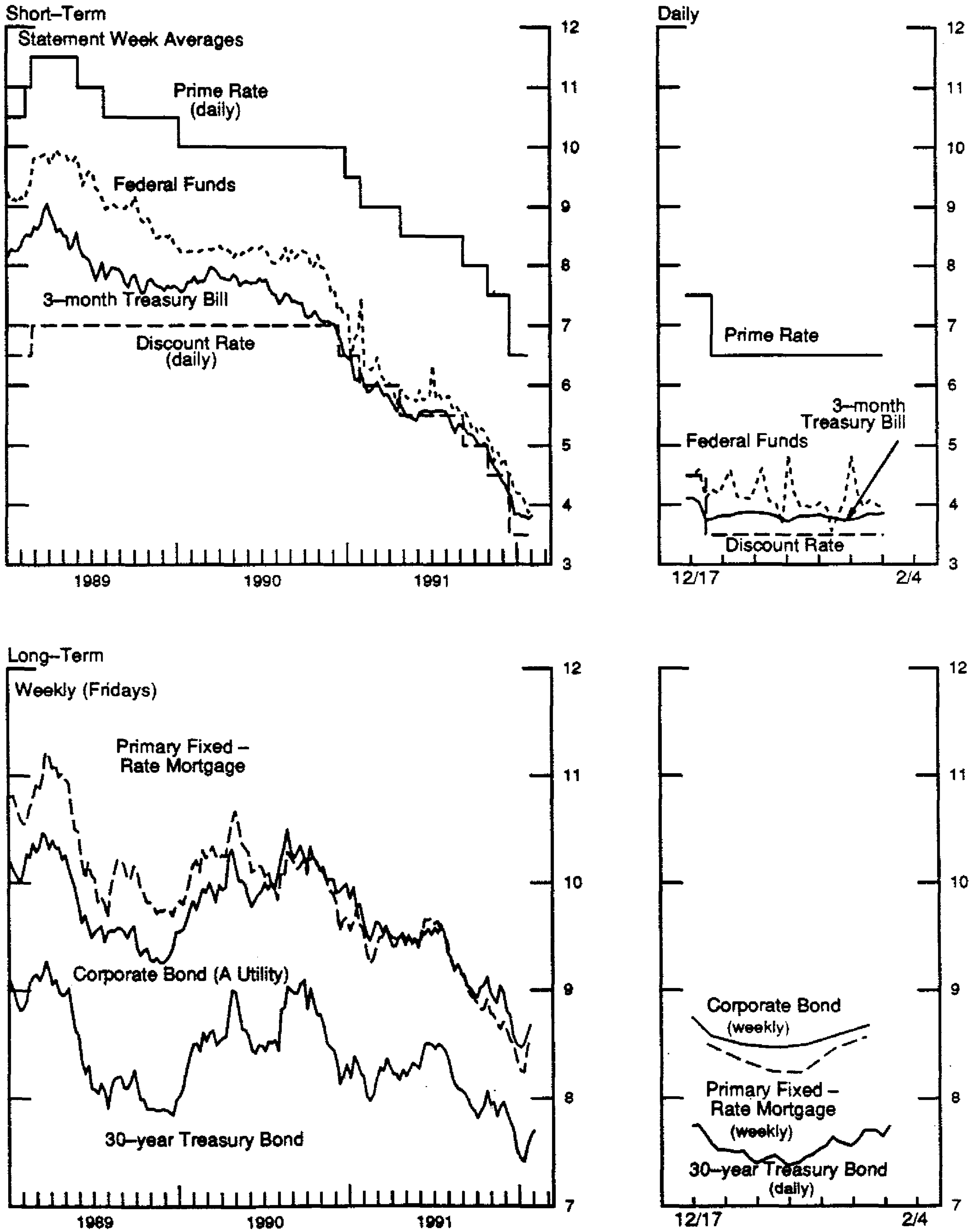
	1989 March highs	1991 FOMC Dec 17	1992 Dec-Jan Lows	1992 Jan 29	Change from: Mar 89 highs	Change from: Dec-Jan Lows	Change from: FOMC Dec 17
Short-term rates							
Federal funds[2]	9.85	4.49	3.94	4.01	-5.84	0.07	-0.48
Treasury bills[3]							
3-month	9.10	4.11	3.72	3.86	-5.24	0.14	-0.25
6-month	9.11	4.16	3.76	3.92	-5.19	0.16	-0.24
1-year	9.05	4.17	3.81	4.01	-5.04	0.20	-0.16
Commercial paper							
1-month	10.05	4.87	4.01	4.05	-6.00	0.04	-0.82
3-month	10.15	4.56	3.94	4.05	-6.10	0.11	-0.51
Large negotiable CDs[3]							
1-month	10.07	4.79	3.95	4.03	-6.04	0.08	-0.76
3-month	10.32	4.44	3.89	4.03	-6.29	0.14	-0.41
6-month	10.08	4.39	3.89	4.06	-6.02	0.17	-0.33
Eurodollar deposits[4]							
1-month	10.19	4.75	3.94	4.00	-6.19	0.06	-0.75
3-month	10.50	4.44	3.88	4.00	-6.50	0.12	-0.44
Bank prime rate	11.50	7.50	6.50	6.50	-5.00	0.00	-1.00
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	9.88	5.39	5.05	5.67	-4.21	0.62	0.28
10-year	9.53	7.18	6.71	7.25	-2.28	0.54	0.07
30-year	9.31	7.75	7.39	7.75	-1.56	0.36	0.00
Municipal revenue[5] (Bond Buyer)	7.95	6.90	6.53	6.70	-1.25	0.17	-0.20
Corporate--A utility recently offered	10.47	8.74	8.46	8.63	-1.84	0.17	-0.11
Home mortgage rates[6]							
FHLMC 30-yr. FRM	11.22	8.53	8.23	8.56	-2.66	0.33	0.03
FHLMC 1-yr. ARM	9.31	6.23	5.79	5.90	-3.41	0.11	-0.33

	Record highs	Date	1989 Lows Jan 3	1991 FOMC Dec 17	1992 Jan 29	Percent change from: Record highs	Percent change from: 1989 lows	Percent change from: FOMC Dec 17
Stock prices								
Dow-Jones Industrial	3272.14	1/28/92	2144.64	2902.28	3224.96	-1.44	50.37	11.12
NYSE Composite	231.85	1/15/92	154.00	211.21	226.64	-2.25	47.17	7.31
AMEX Composite	415.32	1/17/92	305.24	369.81	409.64	-1.37	34.20	10.77
NASDAQ (OTC)	630.82	1/15/92	378.56	539.70	616.31	-2.30	62.80	14.19
Wilshire	4121.28	1/15/92	2718.59	3773.53	4030.22	-2.21	48.25	6.80

1/ One-day quotes except as noted.
2/ Average for two-week reserve maintenance period closest to date shown. Observation for December 17 FOMC is average for week of Dec 18. Last observation is average to date for maintenance period ending February 5, 1992.
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 previous to date shown.

Selected Interest Rates*

(percent)



* Friday weeks are plotted through January 24, statement weeks through January 29.

Treasury bill rates have declined about 25 basis points since the December FOMC meeting, responding primarily to the larger than expected easing action by the System near the end of the year. Following the full percentage point cut in the discount rate, major banks slashed their prime rate by 1 percentage point, to 6-1/2 percent. The federal funds rate decreased 1/2 percentage point in association with the discount rate move, and most other private money market rates have declined 1/4 to 3/4 percentage points. Yields on Treasury securities and fixed-rate mortgages fell sharply early in the intermeeting period, although subsequently most long-term yields have retraced those declines, as the market's expectation for additional near-term easing has diminished and prospects for a fiscal stimulus package have increased.

Equity market indexes are up 7 to 14 percent over the intermeeting period; the major indexes set record highs in early January, reflecting lower interest rates and growing optimism about future corporate earnings. Cyclical stocks posted significant gains, while bank stocks benefited from lower interest rates and the more positive tone of the industry's fourth-quarter earnings reports.

Growth of M2 and M3 slowed further on average in January, although both aggregates strengthened in mid-month after a period of unusual weakness around year-end. The nontransactions component of M2 declined and large time deposits fell sharply. M3 money funds also weakened considerably from a brisk fourth-quarter pace. Bank credit growth slowed in December, as loans posted a small decline, and early data for January point to anemic growth this month.

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

	1991[1]	1991 Q3	1991 Q4	1991 Nov	1991 Dec	1992 Jan pe	Growth Q4 91- Jan 92pe
	Percent change at annual rates						
1. M1	8.0	7.5	11.1	14.3	9.2	15	13
2. M2	3.1	1.1	3.3	5.0	2.8	2½	3
3. M3	1.3	-1.1	1.3	2.6	1.8	½	1½
	Percent change at annual rates						Levels bil. $ Dec 91
Selected components							
4. M1-A	5.6	4.4	8.7	11.2	7.1	12	564.9
5. Currency	8.4	6.9	7.4	5.4	5.4	9	267.2
6. Demand deposits	3.4	2.6	10.0	16.1	7.9	15	289.5
7. Other checkable deposits	12.5	12.9	15.1	19.6	12.4	20	333.2
8. M2 minus M1[2]	1.5	-1.0	0.7	1.7	0.5	-2	2544.7
9. Overnight RPs and Eurodollars, NSA	-8.1	-15.1	38.1	62.3	36.2	35	75.1
10. General purpose and broker/dealer money market mutual fund shares	4.6	-3.4	-3.1	-1.0	0.3	-3	362.2
11. Commercial banks	7.6	7.9	4.3	0.0	-0.2	4	1258.9
12. Savings deposits (including MMDAs)	13.3	12.5	13.2	14.3	14.0	28	660.4
13. Small time deposits	2.1	3.4	-4.8	-15.0	-15.4	-22	598.5
14. Thrift institutions	-6.9	-10.5	-8.2	-4.4	-4.4	-2	844.0
15. Savings deposits (including MMDAs)	9.2	9.9	9.7	13.7	14.2	24	377.2
16. Small time deposits	-16.5	-24.2	-21.2	-18.4	-19.0	-22	466.8
17. M3 minus M2[3]	-6.1	-11.0	-7.6	-8.1	-2.6	-10	735.4
18. Large time deposits	-12.7	-16.7	-24.1	-20.8	-15.2	-28	436.6
19. At commercial banks, net[4]	-6.6	-10.4	-20.6	-18.2	-11.8	-29	353.6
20. At thrift institutions	-31.7	-40.5	-37.4	-31.6	-29.6	-26	83.0
21. Institution-only money market mutual fund shares	33.4	11.4	37.0	38.5	38.0	20	179.1
22. Term RPs, NSA	-21.6	-11.5	-23.6	-28.6	-47.2	-2	70.9
23. Term Eurodollars, NSA	-8.1	-2.5	-0.6	-11.4	-26.8	-27	61.4
	Average monthly change in billions of dollars						
MEMORANDA:[5]							
24. Managed liabilities at commercial banks (25+26)	-1.2	-2.4	3.7	-0.6	8.7	-14	706.9
25. Large time deposits, gross	-0.7	-3.0	-5.7	-3.4	-2.3	-9	423.8
26. Nondeposit funds	-0.5	0.6	9.4	2.8	11.0	-5	283.1
27. Net due to related foreign institutions	0.6	0.5	6.9	2.5	6.8	0	41.3
28. Other[6]	-1.0	0.1	2.4	0.3	4.2	-5	241.8
29. U.S. government deposits at commercial banks[7]	0.2	-0.1	0.9	5.0	-7.7	1	26.5

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.
pe - preliminary estimate

In response to low interest rates and high stock prices, nonfinancial corporations issued long-term bonds and shares in near record volumes. Public bond offerings soared in January to the second largest monthly level ever; proceeds are targeted in many cases for the repayment of short-term debt or callable bonds. Much of the equity issuance has been by firms seeking to reduce debt and strengthen balance sheets, and it continues to include a substantial number of reverse LBOs. Commercial paper dropped slightly in December but increased again in January, and bank business loans declined in both months. In the household sector, increased housing activity near the end of the year and growth in real estate loans at banks suggest some recovery in net mortgage borrowing in the fourth quarter, while mortgage refinancing activity has soared. Consumer credit growth showed signs of firming in December following no change in November.

Net borrowing by the federal government declined in the fourth quarter on a not-seasonally-adjusted basis, and is expected to fall somewhat further in the first quarter. After raising significant funds in November and December, state and local governments borrowed much less in January. Borrowing by the sector is expected to accelerate, however, as the calendar for new municipal bonds has begun to build.

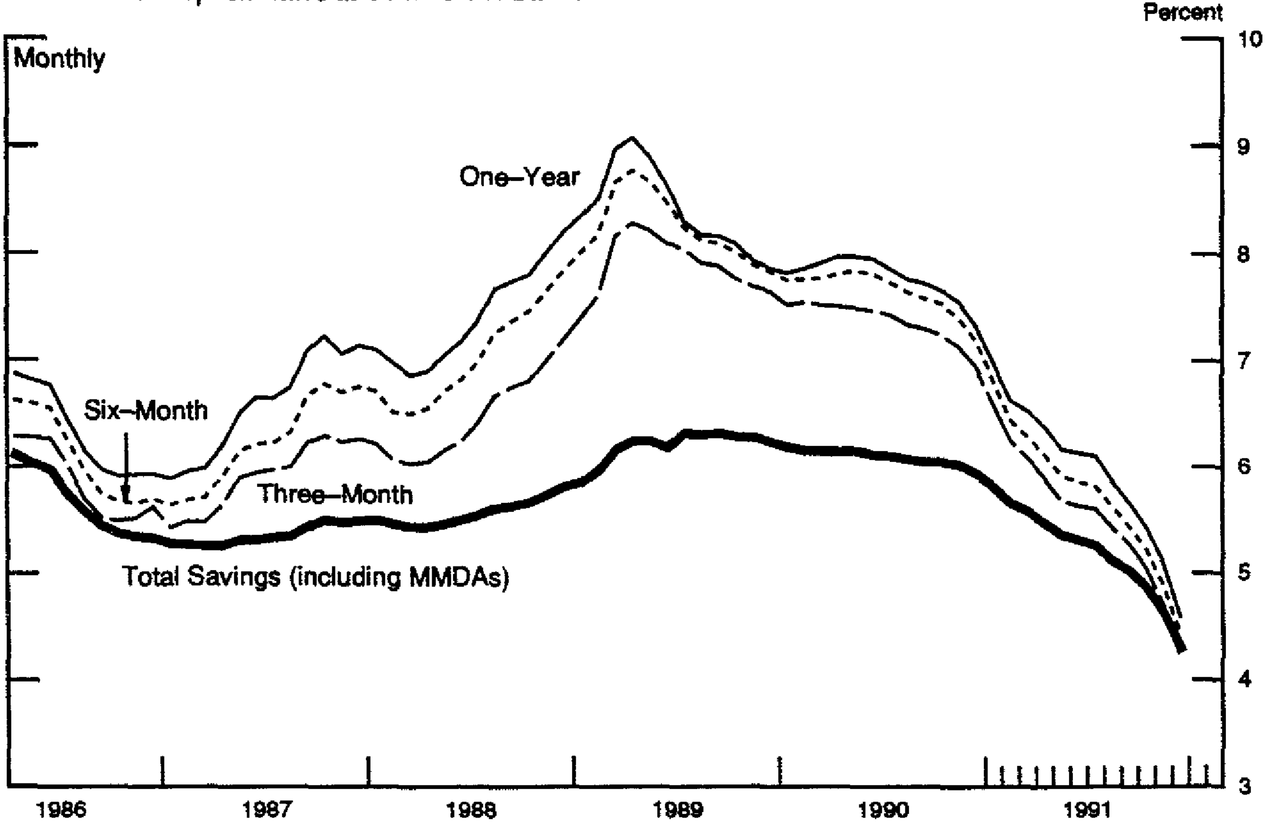
Monetary Aggregates and Bank Credit[1]

M2 grew at a 3-1/4 percent annual rate in the fourth quarter, leaving its fourth-quarter-to-fourth-quarter growth in 1991 at 3 percent--somewhat above the lower bound of its target range. M3 grew at a 1-1/4 percent annual rate in the fourth quarter and over

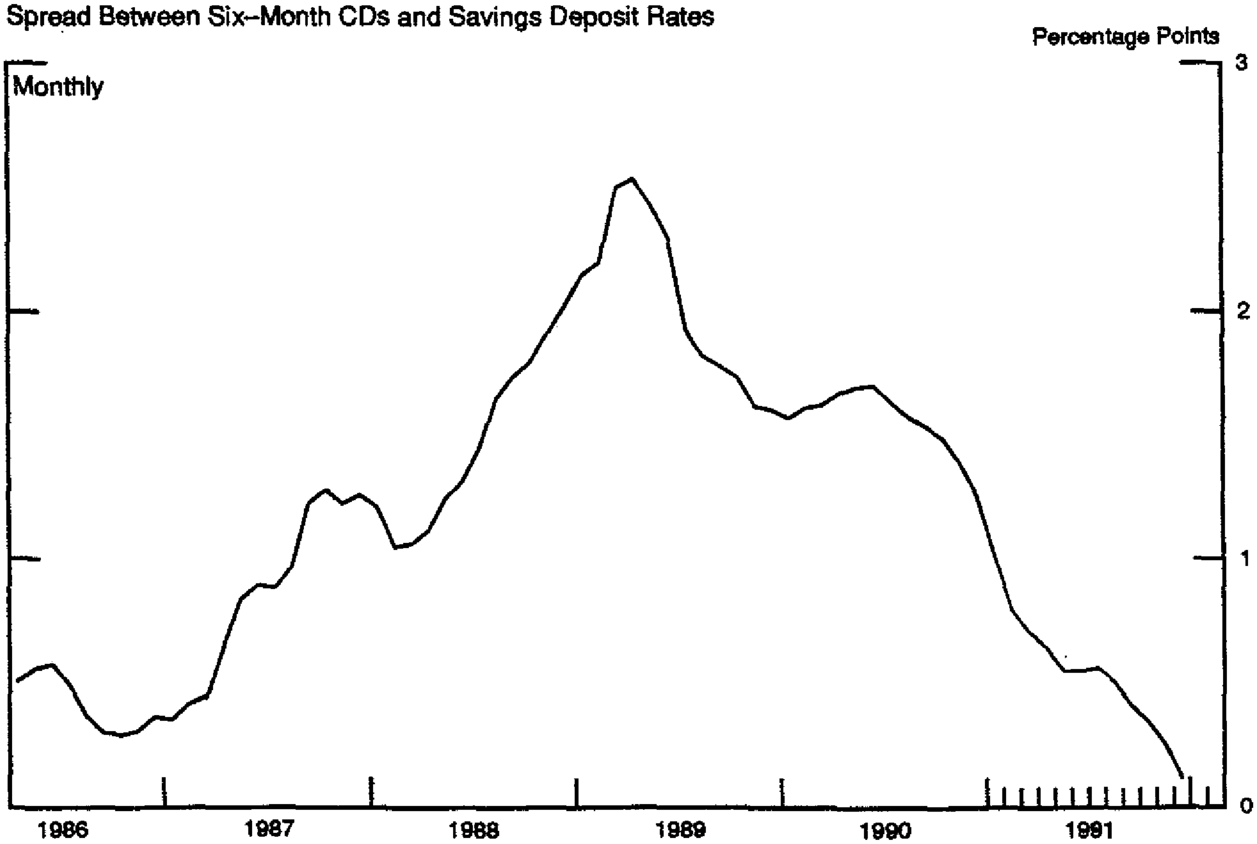
1. The monetary data in this document incorporate benchmarks and updates to seasonal adjustment factors that should be treated as confidential until their public release, tentatively scheduled for February 13, 1992.

Certificate of Deposit Rates Relative to Savings Rates

Certificate of Deposit Rates at Commercial Banks



Spread Between Six-Month CDs and Savings Deposit Rates



1991 as a whole, also a bit above the lower bound of its target range. M2 and M3 continued to expand sluggishly in January.

M1 growth accelerated significantly in January, propelled by higher growth rates in all three of its major components. By contrast, the nontransactions component of M2 declined at a 2 percent rate in January, after two months of slight gains. After a small increase in December, M2 money funds contracted again in January, largely reflecting declines around year-end. Runoffs of small time deposits, which had occurred throughout 1991, picked up this month, as interest rates offered on these deposits fell roughly in line with market yields. A substantial portion of these time deposit outflows evidently was shifted to savings deposits (including MMDAs), which have accelerated sharply in January.

M2 growth would have been stronger were it not for recent sharp cuts in rates paid on OCDs and on savings deposits. Rates on NOW accounts and on total savings accounts (including MMDAs) fell by more than 1/2 percentage point between October and December. Since mid-December, NOW account rates at commercial banks have tumbled 65 to 75 basis points to an average of just over 3 percent, while rates on MMDAs have dropped another 60 basis points. The reductions in total savings deposit rates, which have brought them more in line with retail CD rates (chart), may have been motivated in part by a desire to limit internal shifts of funds. Conversations with senior bank financial officers indicate most banks are not concerned that lower rates on savings deposits will result in a significant loss of these funds; in the past, longstanding savings account customers have not been sensitive to changes in relative interest rates.

The non-M2 portion of M3 declined at a 10 percent annual rate in January. The decline in large time deposits (net of money fund holdings) accelerated to nearly a 30 percent annual rate, and

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

Category	Dec. 1990 to Dec. 1991	1991 Q3	1991 Q4	1991 Oct.	1991 Nov.	1991 Dec.	Levels bil.$ 1991 Dec.
	Commercial bank credit						
1. Total loans and securities at banks	3.2	0.8	6.0	6.8	6.4	4.8	2,810.6
2. Securities	16.6	14.7	23.5	30.3	19.1	19.8	733.6
3. U.S. government	23.2	21.7	29.3	37.0	24.7	24.0	560.3
4. Other	-0.8	-5.3	5.9	9.8	0.7	7.0	173.3
5. Loans	-0.8	-3.6	0.2	-1.1	2.0	-0.3	2,077.0
6. Business	-3.9	-4.2	-3.3	0.0	-3.9	-6.0	616.8
7. Real estate	1.9	-2.8	1.8	1.1	3.1	1.3	857.0
8. Consumer	-4.2	-7.2	-3.9	-8.5	-3.3	0.0	361.8
9. Security	16.3	58.5	30.1	-2.7	71.2	20.7	47.2
10. Other	0.2	-10.2	5.0	0.6	10.6	3.7	194.1
	Short- and intermediate-term business credit						
11. Business loans net of bankers acceptances	-3.9	-4.4	-3.8	0.6	-4.9	-7.0	610.2
12. Loans at foreign branches[2]	-1.2	-3.4	41.2	20.6	40.5	58.8	25.7
13. Sum of lines 11 and 12	-3.8	-4.3	-2.1	1.3	-3.2	-4.5	635.8
14. Commercial paper issued by nonfinancial firms	-10.7	-26.3	-5.3	-22.9	18.0	-10.6	134.3
15. Sum of lines 13 and 14	-5.1	-8.4	-2.7	-2.9	0.5	-5.6	770.2
16. Bankers acceptances, U.S. trade-related[3]	-16.4	-20.5	-2.9	4.3	-4.3	-8.7	27.5
17. Finance company loans to business[4]	n.a.	11.6	n.a.	11.4	8.2	n.a.	311.3[5]
18. Total (sum of lines 15, 16, and 17)	n.a.	-3.4	n.a.	1.2	2.4	n.a.	1,113.0[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. Consists of acceptances that finance U.S. imports, U.S. exports, and domestic shipment and storage of goods. Based on average of data for current and preceding ends of month.
4. Based on average of data for current and preceding ends of month.
5. November 1991 data.
p--Preliminary.
n.a.--Not available.

institution-only money market funds contributed less strength. M3 money funds grew at a 20 percent annual pace in January, after several months of very rapid increases spurred by a widening gap between their own yields and Treasury rates. However, money fund balances plunged around year-end, in part as institutions temporarily shifted funds into short-term money market instruments to take advantage of an anticipated year-end spike in rates. In addition, some institutional holders reportedly moved funds into the stock market so that on their annual financial statements they would appear to be more heavily invested in equities. The end-of-year decline was more than recovered by a rebound in subsequent weeks.

Bank credit growth slowed in December to a 4-3/4 percent rate, a touch stronger than its 3-1/4 percent advance for the year as a whole. As previously in 1991, bank credit growth in December was due primarily to acquisitions of U.S. government securities, which offset declines in total loans. Business loans weakened further in December and declined 4 percent for the year as a whole, in part a result of an extraordinary pace of longer-term debt and equity issuance by nonfinancial firms looking to strengthen their balance sheets. January data from the Survey of the Terms of Bank Lending show that only a few respondents indicated any further tightening in standards for approval of loan applications or the terms of business loans. Respondents characterized recent loan demand as having weakened for firms of all sizes.

Real estate loans edged up in December and expanded in 1991 by only 2 percent, the slowest rate in at least three decades, despite a nearly 14 percent increase last year in home equity loans. Reflecting an increase in consumer lending and a slower pace of securitization, consumer loans on commercial bank balance sheets, for the first time since last February, did not decline. For the year, consumer loans contracted but managed a small gain when adjusted for estimated securitization. Security loans advanced briskly again in December, continuing a pattern of stronger growth that began in July, likely as a result of increased security positions during the rally in equity and bond markets. Partial data suggest bank credit growth slowed further in January. Securities acquisitions decelerated and, aside from security loans, growth of the loan components remained sluggish.

Some evidence suggests that weak credit demand and restraint on bank credit also were evident in off-balance-sheet items in 1991 (table). For example, considerable weakness in commercial real estate through the third quarter was accompanied by a 40 percent drop in credit lines for this type of loan, as banks aggressively tightened loan approval standards. Similarly, unused lines for

CHANGES IN SELECTED UNUSED COMMITMENTS AT BANKS
($ billions, year ending September 30, 1991)

Borrowing Category	Percent Change	Outstandings 9-30-91
Home Equity	12.3	54.6
Credit Cards	22.3	453.7
Commercial Real Estate	-40.9	43.9
Other (includes C&I)	-1.3	600.0
Standby Letters of Credit	-2.8	119.5

commercial and industrial (C&I) loans apparently also declined along with outstanding balances. On the other hand, growth in loans taken down under home equity lines of credit was about matched in the growth of unused lines, at least through the third quarter. The surge in available credit card lines may indicate continued aggressive marketing of credit cards by banks.

Business Finance

Over the intermeeting period, financing by nonfinancial firms continued to be dominated by balance sheet restructuring. In response to lower interest rates and higher stock prices, firms issued long-term bonds and equity at near record levels. Reflecting this substitution into longer maturity financing, commercial paper declined slightly in December and increased only modestly in January, while bank loans in December ran off at a 6 percent annual rate and in January apparently declined slightly again. Overall, borrowing by nonfinancial firms probably weakened somewhat in December, but firmed in January as a result of strong bond issuance.

Public bond offerings exploded in January, sparked by the drop in long-term rates following the discount rate cut in December. Total gross bond issuance by nonfinancial firms in January could reach $16 billion, the second largest monthly issuance after the record of April 1986. Most of January's volume has been in the form of large offerings of non-callable bonds issued by investment-grade firms, including a number of utilities. Despite the heavy issuance, yield spreads on investment-grade bonds have remained relatively narrow. The favorable conditions for bond issuance currently appear to extend at least into the higher grades of the junk bond market, where spreads have narrowed somewhat since the last FOMC meeting. Although still light relative to a few years ago, junk issuance in December continued to show some strength; offerings in the final two months of the year constituted almost 40 percent of total offerings for 1991. Currently, the market appears receptive to BB-rated issuers and to certain B-rated issuers.

A desire to refinance more expensive debt at lower interest rates has spurred much of the recent public bond issuance. Of the

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

	1990	1991p	1991 Q3	1991 Q4p	1991 Nov.p	1991 Dec.p	1992 Jan.e
Corporate securities - total[1]	19.88	31.77	30.72	32.96	34.32	28.77	39.25
Public offerings in U.S.	17.75	29.05	28.26	30.65	31.55	27.52	35.50
Stocks--total[2]	1.95	5.44	4.94	8.48	9.05	7.52	5.50
Nonfinancial	1.03	3.72	3.50	6.07	6.47	5.51	3.30
Utility	0.35	0.42	0.16	0.36	0.26	0.29	0.30
Industrial	0.68	3.30	3.34	5.72	6.21	5.22	3.00
Financial	0.92	1.72	1.44	2.41	2.58	2.01	2.20
Bonds	15.79	23.61	23.31	22.17	22.50	20.00	30.00
Nonfinancial	5.65	9.61	9.27	9.67	9.80	10.50	16.00
Utility	1.97	2.98	2.73	3.37	3.40	3.50	8.00
Industrial	3.69	6.61	6.54	6.23	6.40	6.80	8.00
Financial	10.14	14.02	14.05	12.57	12.70	9.70	14.00
By quality[3]							
Aaa and Aa	3.43	3.59	2.80	2.90	2.50	3.70	5.00
A and Baa	6.49	11.91	11.16	10.96	12.46	8.99	16.51
Less than Baa	0.15	1.03	0.47	1.91	2.54	2.38	1.50
No rating (or unknown)	0.04	0.01	0.01	0.00	0.00	0.00	0.14
Memo items:							
Equity-based bonds[4]	0.40	0.63	0.41	0.46	0.29	0.10	0.87
Mortgage-backed bonds	2.43	2.99	3.66	2.97	2.35	2.03	5.00
Other asset-backed	3.27	4.08	5.21	3.43	2.66	2.90	1.85
Variable-rate notes	0.82	0.81	0.89	0.81	0.97	0.84	0.00
Bonds sold abroad - total	1.92	2.26	2.11	1.81	2.00	1.00	3.50
Nonfinancial	0.46	1.05	1.04	0.50	0.50	0.30	1.80
Financial	1.46	1.22	1.06	1.30	1.50	0.70	1.70
Stocks sold abroad - total	0.22	0.46	0.36	0.51	0.77	0.25	0.25
Nonfinancial	0.10	0.38	0.29	0.43	0.63	0.21	0.25
Financial	0.12	0.08	0.07	0.07	0.14	0.04	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.

$38 billion of investment-grade nonfinancial corporate bonds that will become callable in 1992, call options on around $25 billion of these bonds are "in the money" at current interest rate levels and likely will be exercised. To this end, firms already have announced calls this year on $10 billion of outstanding issues.

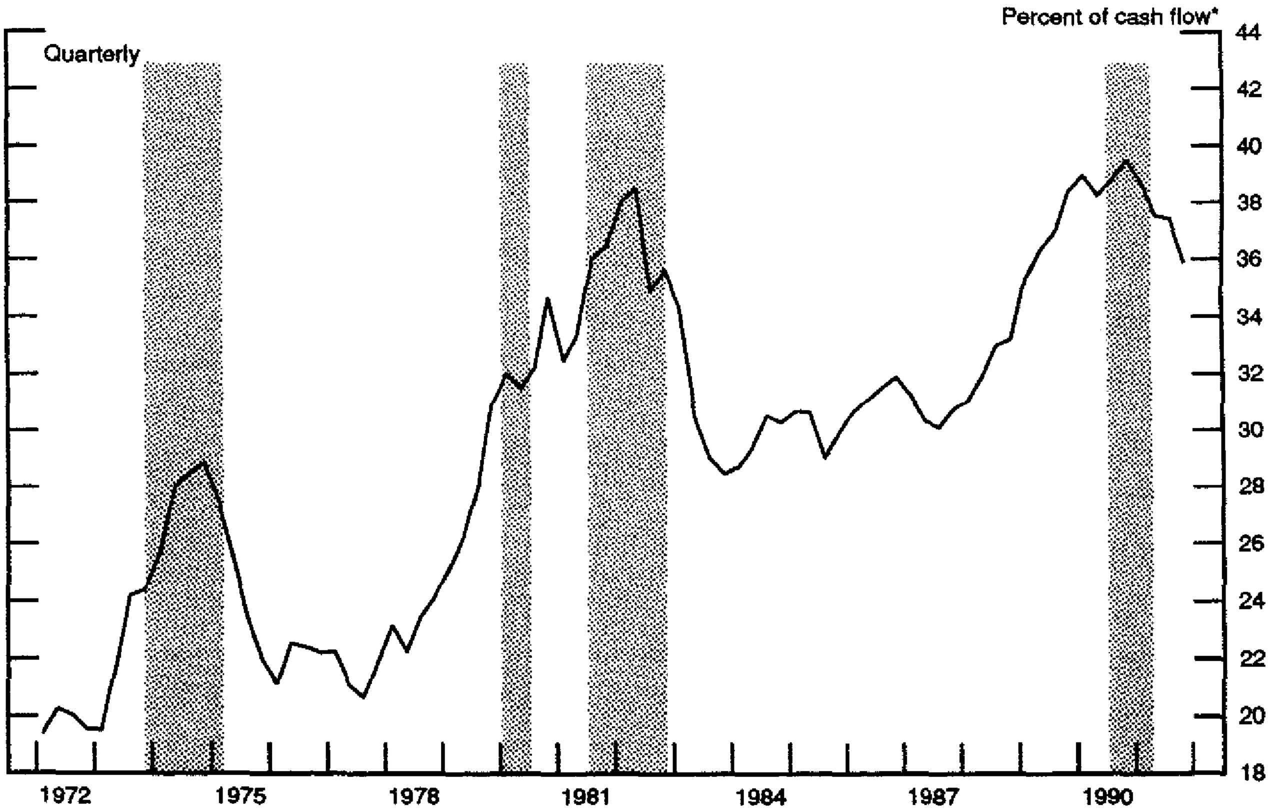
Conversations with participants in the private placement market suggest that much of the borrowing activity over the last half of 1991 was to refinance short-term bank loans. In addition to locking in low long-term rates, many borrowers at weaker banks reportedly are concerned that their lines of credit may not be renewed.

Fueled by rising stock prices, equity issuance by nonfinancial firms continued at a very strong pace over the intermeeting period. December issuance totaled more than $5-1/2 billion, bringing the fourth-quarter total to a record $18 billion. As in the bond market, much of the equity issuance has been by firms attempting to raise funds to strengthen balance sheets, and it continues to include a healthy number of reverse LBOs. December's issuance included reverse LBOs, each more than $500 million, by Owens-Illinois and HealthTrust, Inc. In both cases, proceeds were used to retire outstanding high-yield bonds. In addition, Goodyear, Tenneco, The Marriott Corporation, and International Paper issued a combined $1.5 billion of equity in December and January, devoted primarily toward debt retirement. Plans for additional initial public offerings (IPOs) have been filed by a large number of companies, and numerous reverse LBOs are on the calendar. Foremost among them is Burlington Industries' plan for an $850 million offering, which, combined with a new bank line, would be used to retire outstanding junk bonds.

The restructuring of balance sheets by nonfinancial firms is beginning to show through to some measures of corporate financial health. According to staff estimates, gross interest payments by nonfinancial firms as a share of cash flow have declined to less than 36 percent in the fourth quarter of 1991 from more than 39 percent a year earlier (chart). The level of gross interest payments itself appears to have peaked in the first quarter of 1990; since then, it has fallen roughly $60 billion, or almost 20 percent.

Bond rating changes suggest that financial restructuring also is paying off in credit evaluations. According to Moody's, downgrades among nonfinancial firms fell slightly from the third quarter and were well below the levels of last winter and spring. Upgrades increased from the third quarter. Many of the upgrades have stemmed from equity issuance or debt retirement, as well as

GROSS INTEREST PAYMENTS OF NONFINANCIAL CORPORATIONS



*Cash flow is profits before tax plus interest payments and depreciation.
Note: Last observation is for 1991: Q4.

actual or expected improvement in operating earnings. The most prominent upgrade of the quarter was RJR Nabisco, which returned to investment-grade status after successfully restructuring its balance sheet through a series of large equity offerings and substantial high-yield debt retirements.

Reflecting lower interest rates and growing optimism about the economic outlook, stock prices are up between 7 and 14 percent since the December FOMC meeting, with the major indexes setting record highs. Over-the-counter stocks have performed especially well, with trading activity on NASDAQ often exceeding that on the NYSE. Bank stocks, benefiting from lower interest rates and the more positive tone of the sectors' fourth-quarter earnings reports, were up more than 15 percent over the intermeeting period. "Cyclical" stocks also have posted significant gains. Reflecting the high level of the major stock indexes, the S&P 500 price-earnings ratio currently is at an all-time high of 23.6, while the S&P dividend-price ratio is at its lowest level since October 1987. Some market analysts are suggesting that corporate earnings will rebound sharply in 1992 after extraordinary chargeoffs in 1991.

Satisfying a regulatory requirement for approval of its proposed merger with Manufacturers Hanover, Chemical Bank in late January took advantage of the rise in stock prices and issued almost $1.6 billion in common stock. As part of its successful merger with Security Pacific, BankAmerica in December issued $300 million in preferred stock and announced plans to issue another $300 million early in 1992.

Stock prices of the major life insurance companies rose less than 4 percent over the intermeeting period, reflecting evidence of continued financial problems. Prudential announced plans to cut its 1992 dividend to policyholders by about 7 percent, citing lower interest rates and weak real estate markets. The announcement followed dividend cuts by Metropolitan and Mutual Benefit in the fourth quarter. In addition, Prudential was downgraded by Moody's in January from Aaa to Aa1, primarily reflecting Moody's concerns about Prudential's commercial real estate portfolio and its above-average holdings of high-yield securities. Another top-twenty life insurance company, Nationwide, also was downgraded from Aaa to Aa1 in January.

Treasury and Sponsored Agency Financing

The staff expects a first-quarter federal deficit of $127 billion, financed by $80 billion of marketable borrowing and a substantial drawdown in the cash balance. Although first-quarter marketable borrowing is projected to be about unchanged from the fourth-quarter level, gross auction sizes will have to be increased to repay a bulge in maturing debt. The staff anticipates that weekly bill auctions will be raised to $22 billion, from the current level of $20.8 billion, and that coupon auctions will be raised between $250 million and $1.25 billion. A large cash management bill likely will be needed in early March to bridge seasonal declines in the cash balance before tax inflows in mid-April. The Treasury recently stated that it is considering cutting back on thirty-year bond auctions and shifting its borrowing toward shorter maturities. Such a move would attempt both to lower borrowing costs by taking advantage of the unusual steepness of the Treasury yield curve, and to stimulate the economy by lowering long-term interest rates.

In the market for government sponsored enterprise (GSE) debt, spreads remain tight by historical standards as the total debt outstanding continued to hover near the peak established in

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

	1991		1992			
	Q3	Q4	Q1[p]	Jan.[p]	Feb.[p]	Mar.[p]
Treasury financing						
Total surplus/deficit (-)	-91.3	-84.1	-126.6	-13.7	-50.6	-62.2
Means of financing deficit:						
Net cash borrowing from the public	95.0	89.1	81.9	11.0	21.8	49.1
Marketable borrowings/ repayments (-)	103.5	81.0	83.3	14.3	21.6	47.5
Bills	43.0	25.8	24.3	-3.7	1.9	26.1
Coupons	60.4	55.2	59.1	18.0	19.6	21.4
Nonmarketable	-8.5	8.2	-1.4	-3.3	.2	1.6
Decrease in the cash balance	2.1	-7.3	36.9	-2.3	32.4	6.8
Memo: Cash balance at end of period	41.5	48.8	11.9	51.1	18.7	11.9
Other[2]	-5.8	2.3	7.8	5.0	-3.6	6.3
Federally sponsored credit agencies, net cash borrowing[3]	5.1	3.6	--	--	--	--
FHLBs[4]	.7	.8	--	--	--	--
FHLMC[4]	2.7	-1.2	--	--	--	--
FNMA	.9	2.7	--	--	--	--
Farm Credit Banks	.3	-.2	--	--	--	--
SLMA	.6	1.5	--	--	--	--

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.
4. Borrowilng reflects October and November only.
p--projected.
Note: Details may not add to totals due to rounding.

mid-1989. A number of GSEs recently issued new debt on a competitive-bid basis, rather than through their regular syndication process. The issues typically are in the $100 million to $300 million range. The bidding by dealers is reported to have been quite aggressive, with some looking to enhance their overall bond sales standings. Indeed, some issues have been purchased at yields 10 basis points below comparable-maturity Treasury securities.

In January, the Securities and Exchange Commission imposed fines on ninety-eight banks and broker-dealers that admitted to overstating customer interest in GSE debt offerings. The fines, which ranged from $5,000 to $100,000 and totaled $5 million, were based on the amount of business conducted with the GSEs rather than on the level of infractions. Salomon Brothers, whose admissions of wrongdoing led to the SEC investigation, did not participate in the settlement.

In late January, the Federal Reserve, the Treasury, and the SEC released their joint study of the government securities market, undertaken in response to the Salomon Brothers scandal. The study recommends more vigilant enforcement of auction rules, enhanced surveillance of market rate movements to discern market manipulation, and reopenings of outstanding securities to offset unusually severe market shortages. Such reopenings are expected to reduce the need for added reporting or other restrictions to impede market manipulation. The study also supports accelerated auction automation and experimentation with alternative auction formats to broaden bidder participation, lessen the threat of manipulation, and, perhaps, provide cost savings to the Treasury. However, underwriting premiums at recent Treasury coupon auctions have been very slim, suggesting that bidding currently is extremely aggressive and that potential cost savings from alternative auction formats would be relatively small. For the sixty-six coupon auctions from January 1990 to September 1991, the average markup of the auction-average rate over the rate at which investors could have purchased the same security in the when-issued market at the time of auction was only 3/4 of a basis point, according to staff estimates. With regard to GSEs, the study recommended that their equity and unsecured debt securities not be exempt from federal securities laws and that they be required to register those securities with the SEC.

Municipal Securities

After heavy issuance in November and December, long-term municipal bond sales declined in January, but nonetheless remained strong. With long-term municipal bond yields near twelve-year lows, refunding issuance also remains strong. The forward calendar has begun to build again, pointing to a pickup in new offerings in coming weeks.

For 1991 as a whole, gross issuance of long- and short-term debt jumped 30 percent to about $204 billion, the second highest annual total ever. Reflecting widespread budget problems, short-term issuance surged to a record level of nearly $45 billion. Moreover, as many financially strapped state and local governments turned to funding capital expenditures with bond proceeds rather than tax revenues, long-term issuance surged 28 percent. In response to lower interest rates, refunding volume also picked up.

Changes in long-term debt ratings in 1991 present a mixed picture of the overall direction of credit quality in the municipal sector. Upgrades by Moody's Investors Service exceeded downgrades by a 2-to-1 margin. Moody's tends to give considerable weight to the long-term prospects of issuers, and, as a result, its rating changes are not very sensitive to cyclical changes in financial conditions. In contrast, Standard & Poor's rating changes seem more

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

	1990	1991	1991 Q3	1991 Q4	1991 Nov.	1991 Dec.[p]	1992 Jan.[f]
Total offerings[1]	13.10	16.99	21.04	16.88	18.41	18.39	--
Total tax-exempt	12.85	16.57	20.23	16.50	18.25	17.65	--
Long-term	10.03	12.87	13.54	14.95	17.74	15.77	11.00
Refundings[2]	1.68	3.09	3.12	3.34	4.24	3.40	--
New capital	8.35	9.78	10.42	11.61	13.50	12.37	--
Short-term	2.82	3.70	6.69	1.55	.51	1.88	--
Total taxable	.25	.42	.81	.38	.16	.74	--

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

in line with the near-term cyclical financial difficulties of issuers. Based on preliminary figures, a total of $53 billion of municipal debt was downgraded by Standard & Poor's, compared with $8 billion upgraded. Downgrades by Standard & Poor's exceeded upgrades by a more than 4-to-1 margin. General obligation issues bore the brunt of Standard & Poor's downgrades. Ratings on more than $33 billion of general obligation debt were lowered in 1991, including that of eight states.[2] Analysts at Standard & Poor's emphasize that although credit quality eroded in 1991, it remains relatively high for the sector as a whole. For example, of the forty-one states rated by Standard & Poor's, twenty-six are rated AA or better and only one is rated lower than A-.

Standard & Poor's largest downgrade occurred in mid-December, when it cut the rating of the State of California to AA from AAA, affecting approximately $15 billion of state debt. The credit agency cited two consecutive years of operating deficits as the primary cause of the downgrade. The deficits resulted from rising

2. California, Illinois, Connecticut, New Jersey, Maine, New Hampshire, Rhode Island, and Vermont were downgraded during the year.

social service costs and reduced tax receipts; they led to elimination of budget reserves and to sharp tax increases last July. The credit agency expressed concern that the unpopularity of the tax increases would hamper the ability of the state to take further prompt action to correct the state's widening budget gap. A recent projection by the state indicates that California faces a $2.2 billion deficit in the current fiscal year. Market participants were not surprised by California's downgrade; however, they had thought it unlikely that California would drop below AA+. Nevertheless, secondary market yield spreads on California issues have widened only about 10 basis points since the downgrade.

Standard & Poor's joined with Moody's in lowering ratings of New York State issues in early January. Standard & Poor's dropped the rating on the state's general obligation debt from A to A-. Moody's action was less dramatic; the credit agency reduced the rating of New York State appropriation debt--revenue debt backed by leases--from A to Baa1 and placed the state's general obligation debt on review for a possible downgrade. Both credit agencies cited the state's inability to formulate a plan to close the 1992 budget gap, now estimated at $938 million, without resorting to borrowing. The governor recently announced a package of $407 million of spending cuts and $531 million of short-term note financing, thus marking the fourth consecutive year of deficit financing.[3] For the 1993 fiscal year, which starts on April 1, the state faces an estimated budget gap of $4.8 billion. Yield spreads on actively traded New York State appropriation bonds have widened approximately

3. The accumulated general fund deficit stood at approximately $6.2 billion at the beginning of the 1992 fiscal year, excluding $800 million that was converted to long-term debt in the form of Local Government Assistance Corporation bonds issued in fiscal year 1991.

30 basis points since the downgrades, while yield spreads on New York State general obligation bond indexes have widened about 10 basis points.

Mortgage Markets

Despite a relatively weak housing market, residential mortgage originations in 1991 reportedly topped $500 billion, a new high (table). The growth of mortgage originations, combined with the contraction of the thrift industry, contributed to record issuance of mortgage-backed pass-through securities in 1991 of $320 billion, exceeding the previous record of $269 billion set in 1986. More impressive, new-issue collateralized mortgage obligations (CMOs) soared to $195 billion, a 75 percent increase over new-issue volume the previous year.

Supporting the robust growth of the CMO market, issuance of Fannie Mae and Freddie Mac mortgage-backed securities (MBSs) in 1991

MORTGAGE MARKET ORIGINATIONS
($ Billions)

Year	Residential Mortgage Loans	Pass-Through Securities GNMA	FNMA	FHLMC	Private[1]	Total	Agency CMOs
1985	243.6	46.0	23.6	38.8	2.0	110.4	16.0
1986	454.8	101.4	60.6	100.2	7.0	269.2	48.3
1987	450.0	94.9	62.9	75.0	11.1	243.9	59.9
1988	375.6	55.2	55.0	39.8	15.4	165.4	78.8
1989	352.8	57.1	69.0	73.5	14.2	213.8	97.8
1990	439.2	64.5	96.7	73.8	24.4	259.4	111.7
1991 p	515.0	64.3	113.3	93.3	49.3	320.2	195.0

1. Includes privately issued CMOs.
p--preliminary

grew 21 percent to $207 billion. Only new-issue Ginnie Maes were unchanged from the previous year at $64 billion, a relatively anemic performance due in part to higher mortgage insurance premiums and downpayment requirements on FHA mortgages (the bulk of GNMA pools) that became effective in the middle of 1991. Prior to these changes, mortgagors were allowed to finance up to 100 percent of their closing costs and were required to pay only a one-time, up-front mortgage insurance premium. Reflecting increased product knowledge and investor preference for mortgage securities that provide some measure of prepayment protection in an environment of declining yields, nearly all new-issue conventional MBSs now are repackaged in the form of CMOs.

The non-agency sector of the mortgage securities market issued a record $49 billion in 1991, more than double the $24 billion issued in 1990. Non-agency MBSs generally are collateralized by higher-yielding, nonconforming mortgages that are not eligible for purchase by Fannie Mae or Freddie Mac. These securities receive their credit enhancement in the form of letters of credit, private mortgage pool insurance, cash reserve accounts, or various forms of senior/subordinated structures. The Resolution Trust Corporation was the largest issuer of private-label mortgage securities in 1991, issuing $9.6 billion.

Over the intermeeting period, contract rates on thirty-year, conventional, fixed-rate mortgages declined 25 basis points before moving higher near the end of the period. Initial rates on adjustable-rate mortgages followed a similar pattern, but remain about 30 basis points lower than at the time of the last FOMC meeting. In response to lower market rates, the ceiling rate on VA-guaranteed loans was reduced 50 basis points to 8 percent.

Lower market rates continue to spur refinancings. The latest Mortgage Bankers Association's (MBA) weekly survey indicates that applications for mortgage refinancing have nearly tripled since weakening slightly during the year-end holiday period (chart). Prepayments of high-rate mortgages also have soared. Prepayment rates on 10 percent Fannie Mae MBSs rose from 12 percent in September to 41 percent in December (SAAR).[4] Consistent with the usual time between application and closing, changes in mortgage prepayment rates appear to lag by about two months changes in the MBA refinancing index.

Conventional mortgage yield spreads to comparable-maturity Treasury securities have widened about 30 basis points from a relatively narrow 160 basis points last July (chart). Much of the wider spread compensates investors for the increased refinancing risk, as measured by the volatility of seven-year Treasury yields. The investor faces the risk that, should long-term yields decline further, principal must be reinvested at lower yields. Nevertheless, mortgage yield spreads appear unlikely to repeat their experience of 1986, when significant declines in market yields and unprecedented mortgage refinancings caused mortgage spreads to widen by up to 150 basis points. A larger secondary market, strong investor demand, and the refinancing protection provided by some CMO bonds should allow the market to handle the expected wave of refinancings in a more orderly manner.

Significant rates of mortgage refinancing will help households reduce total debt servicing burdens in 1992. The staff has estimated household mortgage interest savings using data from individual mortgage pools on the actual and projected refinancing

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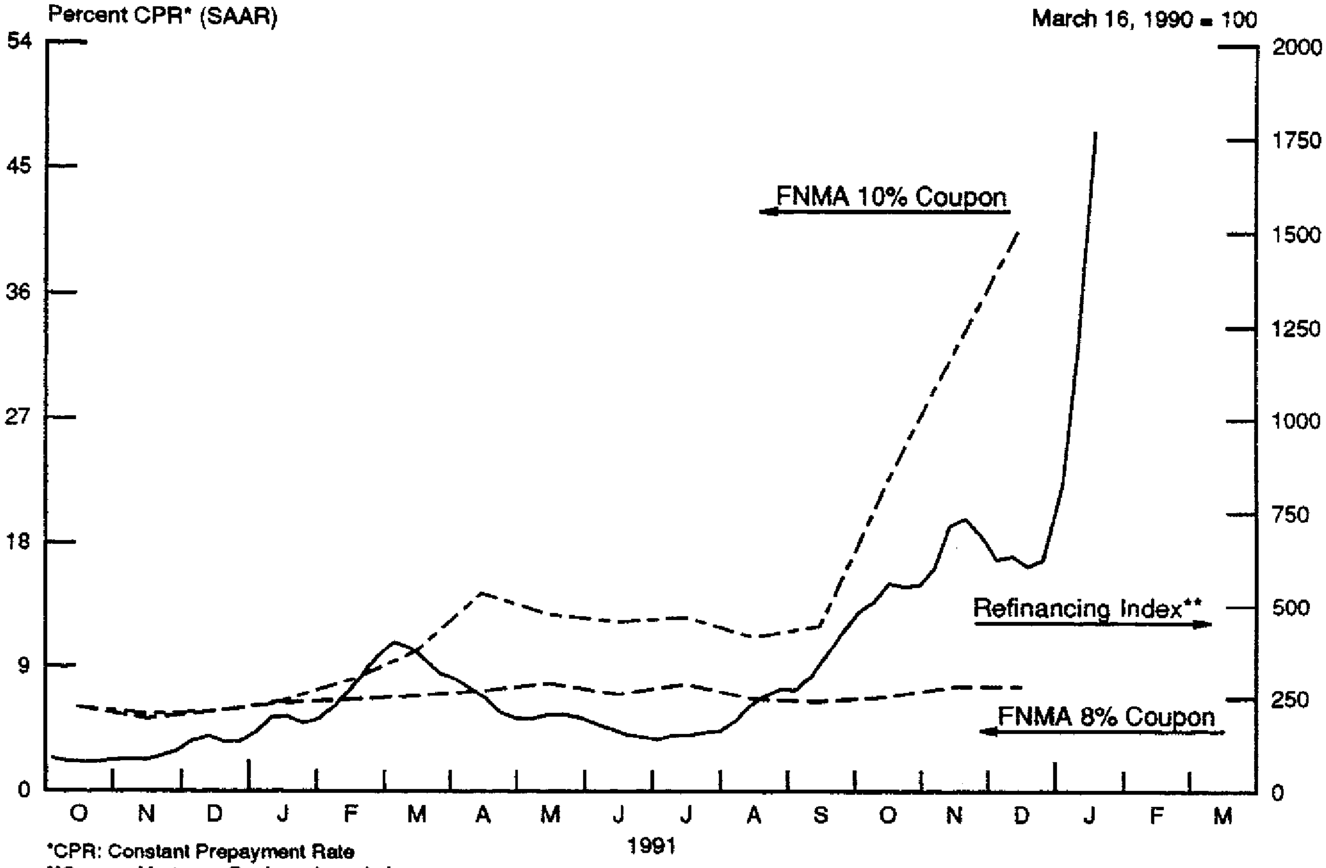
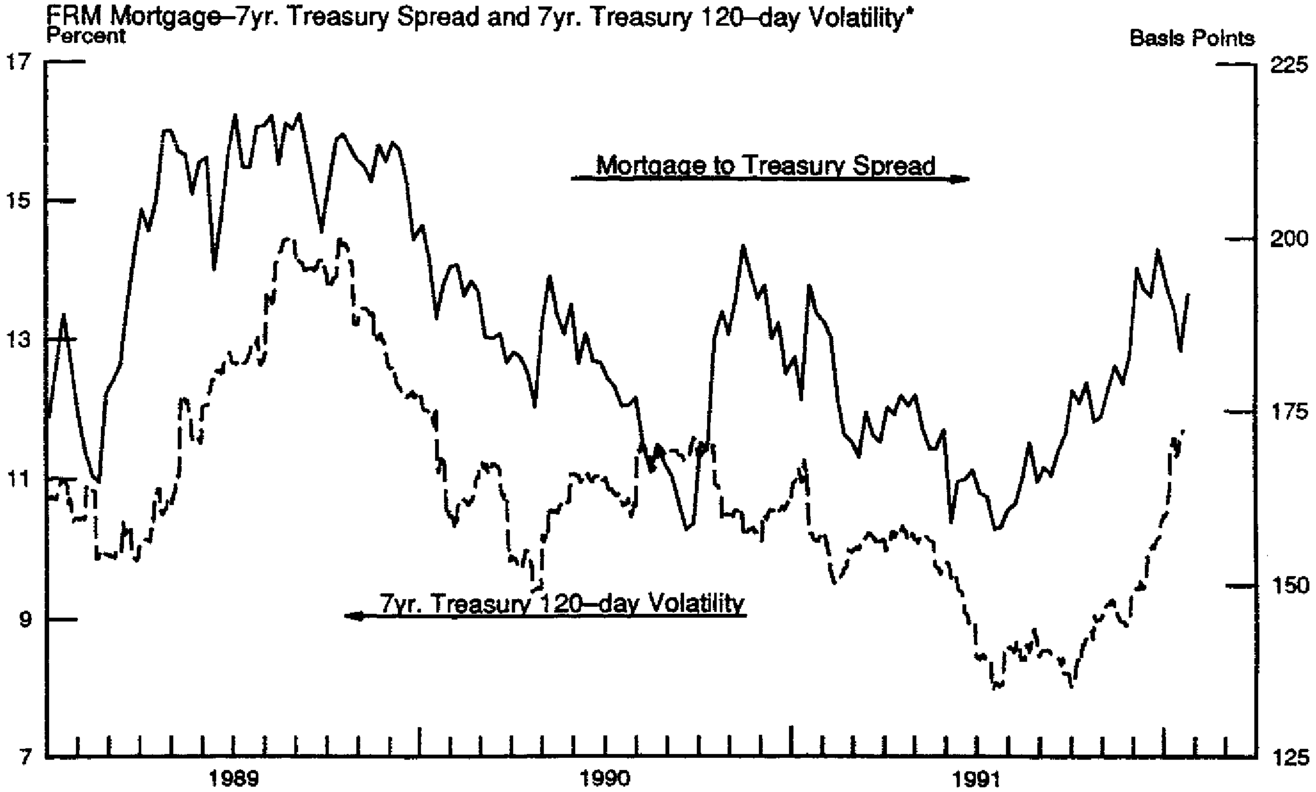
4. Mortgage prepayment rates are measured by the Constant Prepayment Rate or CPR. Quoted on an annualized basis, a 20 percent CPR means that 20 percent of the principal outstanding at the beginning of the year prepays by the end of the year.

MBA Refinancing Index vs. Prepayment Rates on Selected Fannie Mae Coupons



*CPR: Constant Prepayment Rate
**Source: Mortgage Bankers Association

FRM Mortgage–7yr. Treasury Spread and 7yr. Treasury 120–day Volatility*



*Volatility figures are annualized.

experience of securitized residential mortgage debt. Assuming mortgage interest rates remain at year-end 1991 levels, total interest savings on residential mortgage debt in 1992 from the refinancing of fixed-rate mortgages and the resetting of adjustable-rate mortgages are projected to be between $7 billion and $10 billion. However, refinancing transactions will be distributed throughout the year, increasing the annual rate of interest savings at the end of 1992 to be between $10 billion and $14 billion.

Consumer Credit

Outstanding consumer installment credit in November was unchanged from its October level (table). Revolving credit continued to grow in November but at a slower pace than in October; outstandings for auto and other consumer loans fell in November. Total consumer credit (installment plus noninstallment) declined again in November.

Over the eleven months from December 1990 to November 1991, consumer installment credit fell at a 1/2 percent annual rate. Should December prove to be anemic, which seems likely given weak auto and retail sales, 1991 will be the first year since the end of World War II in which installment credit contracted. The decline in 1991 outstandings was mainly in automobile loans, which were strongly affected by dismal auto sales and, to a lesser extent, by shifts to alternative means of financing such as home equity loans or leases. Revolving credit, although it continued to grow, probably posted its smallest annual increase since 1980, when credit controls and a recession sharply curtailed consumer borrowing.

One consequence of this net repayment of consumer debt has been a decline in the ratio of installment credit to disposable personal income (chart; solid line). After reaching a peak of 18-1/2 percent

CONSUMER CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)								Memo: Outstandings (billions of dollars)
				1991			1991		1991
	1988	1989[1]	1990	H1	Q3	Q4[2]	Oct.[r]	Nov.[p]	Nov.[p]
Installment	8.8	5.9	2.3	-1.2	-.8	1.4	2.7	.0	730.8
Auto	6.9	1.3	-2.1	-7.1	-6.2	-2.6	-.9	-4.2	269.1
Excluding auto	10.2	9.2	5.2	2.5	2.5	3.7	4.9	2.6	461.8
Revolving	13.7	15.2	10.6	6.9	7.6	6.7	8.2	5.2	234.7
All other	7.4	4.5	.6	-1.8	-2.6	.7	1.5	-.2	227.1
Noninstallment	6.0	2.6	-4.9	-8.7	-34.0	-44.4	-63.9	-26.3	48.1
Total	7.2	5.8	1.7	-1.8	-3.2	-1.7	-1.7	-1.6	778.9

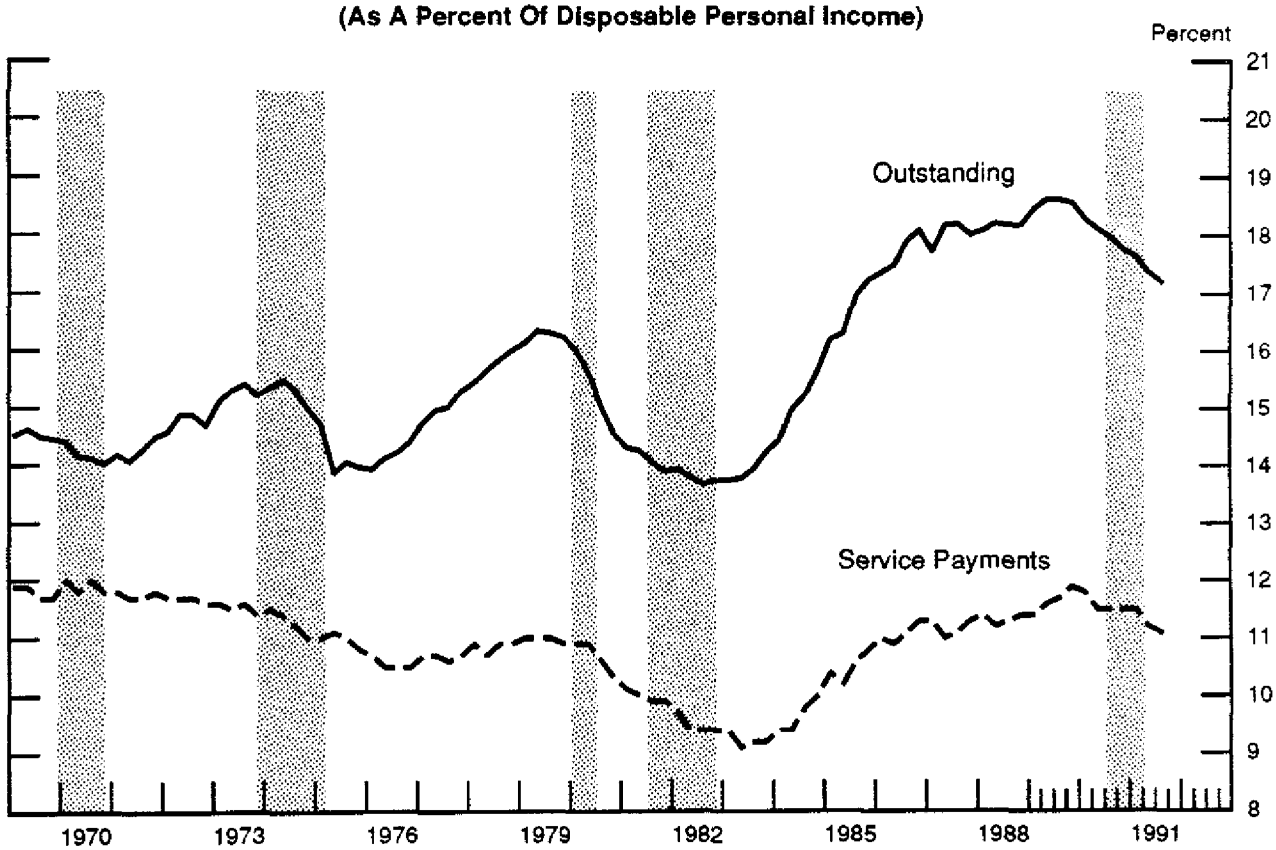
1. Growth rates are adjusted for discontinuity in data between December 1988 and January 1989.
2. Q4 is the annualized rate of change from September to November.
r--revised. p--preliminary.
Note: Details may not add to totals due to rounding.

CONSUMER INTEREST RATES
(Annual percentage rate)

				1991			
	1989	1990	1991	Aug.	Sept.	Oct.	Nov.
At commercial banks[1]							
New cars (48 mo.)	12.07	11.81	11.14	11.06	...	...	10.61
Personal (24 mo.)	15.44	15.46	15.18	15.24	...	...	14.88
Credit cards	18.02	18.17	18.23	18.24	...	...	18.19
At auto finance cos.[2]							
New cars	12.62	12.54	...	12.40	12.38	12.23	10.79
Used cars	16.18	15.99	...	15.63	15.60	15.46	15.06

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.

Outstanding Consumer Debt And Service Payments
(As A Percent Of Disposable Personal Income)



in 1989, the ratio had declined about 1-1/2 percentage points to about 17 percent by late 1991. However, the ratio remains high relative to cyclical experience over the past twenty years.

The ratio of outstanding debt to income, of course, overstates the actual current claims of principal amortization and interest on current earnings. Therefore, the dashed line on the chart presents an estimate of the proportion of disposable personal income required to service current debt levels. Mainly reflecting the lengthening of debt maturities during the 1980s, this latter measure is considerably lower than the outstanding ratio. To a lesser extent, however, some of the difference also may be due to the increasing proportion of revolving credit, which has relatively low minimum monthly repayment requirements. Although this debt service ratio

PUBLIC SECURITIZATION OF CONSUMER LOANS
Gross Issuance, in billions of dollars

	1985-1987	1988	1989	1990	1991	Cumulative total
Total	20.17	15.39	22.50	34.48	36.78	129.25
Commercial banks	4.53	8.06	11.03	21.91	20.41	65.94
Finance companies	13.84	3.04	7.70	9.61	12.65	46.84
Savings institutions	1.74	2.14	1.10	.40	1.37	6.75
Retail firms	--	2.15	2.67	2.55	2.35	9.72
Auto loans	17.08	5.50	7.83	10.47	14.79	55.67
Commercial bank	2.33	1.91	1.77	2.37	2.36	10.73
Finance companies	13.66	2.04	5.51	7.70	11.06	39.97
Savings institutions	1.10	1.55	.56	.40	1.37	4.97
Credit cards	2.41	7.92	12.02	22.02	20.40	64.77
Commercial banks	2.20	5.78	8.90	19.47	18.05	54.39
Savings institutions	.21	--	.45	--	--	.66
Retail firms	--	2.15	2.67	2.55	2.35	9.72
Other loans	.61	1.97	2.65	1.99	1.58	8.81
Commercial banks	--	.38	.36	.08	--	.82
Finance companies	.18	1.00	2.19	1.92	1.58	6.87
Savings institutions	.43	.59	.10	--	--	1.12
Memo:						
Home equity[1]			2.70	5.54	9.05	17.29

1. Home equity loans are not included in consumer credit since they are considered mortgages. This line is included here only to indicate the securitization of a specialized "consumer-type" asset.
Note: Details may not add to totals due to rounding.

rose during the 1980s, it never quite reached the peak level of 1970 and now stands at about the same level recorded in 1979 and 1986.

Gross public issuance of consumer asset-backed securities in 1991 reached a record $37 billion, up from the previous record of $34.5 billion recorded last year (table); the number of new issues in 1991 remained unchanged at 70. Although credit card-backed securities accounted for the largest dollar volume in 1991, the $20.4 billion issued was down somewhat from 1990's record $22 billion, reflecting concerns about the possible downgrade early last year of several bank issues. Securities backed by auto loans increased to $14.8 billion in 1991 as all three of the domestic captive finance companies returned to the market; Chrysler Financial was most active, with a new issue about every other month.

Overall, fourth-quarter activity was the slowest since 1988, following the very high issuance volume of the third quarter--the second highest in seven years. The issuance of new credit card asset-backed securities (ABSs) slowed, particularly in December, when retailers were completely absent from the market and banks retreated after issuing $2.5 billion in November. The slow December credit card market may have been due, in part, to the wider yield spreads that resulted from the scare caused by Senate passage of a proposed interest rate cap on credit cards. However, yield spreads subsequently have narrowed and now are only slightly above the early November levels.

INTERNATIONAL DEVELOPMENTS

Merchandise Trade

The U.S. merchandise trade deficit widened in September to $6.8 billion (seasonally adjusted, Census basis) from a revised deficit of $6.5 billion in August, as imports rose more than exports. Most of the increase in imports in September was in consumer goods, especially apparel and toys. Data for October will be released on December 19.

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

	Exports			Imports			
	Total	Ag.	NonAg.	Total	Oil	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	34.4	3.3	31.1	40.9	4.5	36.4	-6.5
Sep	35.4	3.3	32.2	42.2	4.5	37.8	-6.8

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

In the third quarter, the trade deficit was larger than that recorded in either of the two preceding quarters. Exports were at about the same record level as in the second quarter, well above levels in previous quarters (particularly machinery exports).

Imports in the third quarter were 5 percent above the second-quarter level. Most of the increase was in consumer goods and in automotive products from Canada and Japan. Imports of consumer goods rose 10 percent with strong increases recorded in apparel, TVs and VCRs, toys, and household appliances. Automotive imports from Canada continued to rise steadily from the low recorded

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

	Year	1990		1991			$ Change	
	1990	Q3	Q4	Q1	Q2	Q3	Q3-Q3	Q3-Q2
Trade Balance	-108.1	-115.0	-110.9	-73.6	-61.6	-81.9	33.1	-20.4
Total U.S. Exports	389.6	386.6	402.3	403.6	417.0	418.1	31.6	1.1
Agricultural Export	40.2	39.3	37.8	39.8	38.2	40.6	1.4	2.4
Nonagric. Exports	349.3	347.3	364.5	363.8	378.8	377.5	30.2	-1.3
Industrial Suppl.	96.7	95.4	106.0	105.1	101.8	100.4	5.0	-1.3
Gold	3.0	3.0	4.4	4.1	3.3	3.4	0.4	0.2
Fuels	14.0	13.9	18.1	16.8	13.0	12.8	-1.1	-0.2
Other Ind. Suppl.	79.6	78.6	83.5	84.2	85.5	84.2	5.6	-1.3
Capital Goods	153.8	153.1	156.0	155.8	170.5	166.2	13.2	-4.3
Aircraft & Parts	32.3	31.6	30.9	30.8	38.9	35.6	3.9	-3.3
Computers & Parts	25.9	26.5	26.4	27.3	27.3	26.7	0.2	-0.6
Other Machinery	95.6	95.0	98.7	97.7	104.4	104.0	9.1	-0.4
Automotive Product	37.4	38.4	37.1	34.2	40.3	44.9	6.5	4.5
To Canada	22.6	23.5	21.5	19.5	22.3	25.7	2.2	3.4
To Other	14.8	14.9	15.6	14.7	18.1	19.2	4.3	1.1
Consumer Goods	43.3	42.8	45.8	45.9	44.5	44.8	2.0	0.3
Other Nonagric.	18.2	17.6	19.6	22.9	21.6	21.1	3.6	-0.[illegible]
Total U.S. Imports	497.7	501.6	513.2	477.2	478.5	500.1	-1.5	21.5
Oil Imports	62.1	61.8	72.1	52.9	51.7	52.0	-9.8	0.3
Non-Oil Imports	435.6	439.8	441.1	424.3	426.9	448.1	8.3	21.2
Industrial Suppl.	82.5	83.3	83.9	80.4	80.8	80.5	-2.8	-0.3
Gold	2.5	2.8	3.3	3.3	3.0	2.3	-0.5	-0.6
Other Fuels	3.6	3.5	4.3	3.9	4.3	3.9	0.4	-0.5
Other Ind. Suppl.	76.4	77.0	76.4	73.2	73.5	74.3	-2.8	0.8
Capital Goods	116.4	116.2	120.2	119.3	121.1	122.1	5.8	0.9
Aircraft & Parts	10.6	9.9	12.8	11.2	12.4	12.5	2.6	0.1
Computers & Parts	23.0	23.0	23.3	24.2	26.0	27.6	4.6	1.6
Other Machinery	82.8	83.3	84.1	83.9	82.7	82.0	-1.3	-0.8
Automotive Product	87.3	90.3	86.1	82.1	78.7	92.1	1.8	13.5
From Canada	29.7	32.2	27.3	23.5	28.4	34.1	1.9	5.7
From Other	56.5	58.1	58.8	58.5	50.2	58.0	-0.1	7.7
Consumer Goods	106.2	106.6	106.9	100.5	100.3	110.5	3.9	10.3
Foods	26.6	25.8	26.0	25.6	27.9	26.3	0.5	-1.6
All Other	16.4	17.5	18.1	16.6	18.0	16.6	-0.9	-1.5

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

in the first quarter as Big Three producers began shipping for the new model year. The increase in automotive imports from Japan partially reversed the sharp decline recorded in the second quarter and reflected, in part, increased shipments of luxury cars. Imports of computers continued to climb in the third quarter, reaching a new high. Aside from computers, imports of machinery declined for the third consecutive quarter.

The recent rise in imports appears to have been associated with a large buildup in retail inventories, most notably in September. Data on industrial production, retail inventories, and imports suggest that more than three fourths of the increase in inventories of apparel and miscellaneous non-durable goods (which include toys) in September was imported goods. To the extent that these inventories might now be viewed by retailers as excessive (given the recent slowdown in economic activity), any inventory correction in these categories is likely to be borne in large part by foreign producers.

The value of oil imported in the third quarter was about the same as recorded in the second quarter. The quantity of oil imports remained near 8.2 mb/d as an increase in domestic consumption was offset by a lower rate of stockbuilding. Weekly Department of

OIL IMPORTS
(BOP basis, seasonally adjusted annual rates)

	1991			Months			
	Q1	Q2	Q3	Jun	Jul	Aug	Sep
Value (Bil. $)	52.88	51.69	52.01	50.69	48.26	54.36	53.42
Price ($/BBL)	20.33	17.31	17.24	16.97	16.66	17.42	17.61
Quantity (mb/d)	7.13	8.18	8.26	8.18	7.93	8.54	8.31

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

Energy data indicate that stocks were drawn down rapidly in October (depressing imports), as market participants apparently expected prices to recede; this expectation was evidenced by a large discount of long term futures relative to near-term futures over most of October.

Spot oil prices have fallen almost $3 per barrel since late October, likely reflecting strong production by OPEC coupled with sluggish economic activity world wide. However, given past increases in spot prices and shipping and contract lags, import prices are likely to have increased through November.

Prices of Non-oil Imports and Exports

Prices of non-oil imports (as reported by the Bureau of Labor Statistics (BLS)) rose 0.5 percent in October, the second consecutive month of increase. These increases followed five months of declining prices. The largest increase in October was in automotive imports and reflected introduction of the new 1992 model year vehicles. All other major categories of imports showed small increases in prices with the exception of consumer goods, which remained unchanged from September.

Prices of nonagricultural exports increased 0.2 percent in October, with increases recorded in every major category. October was the second consecutive month of increase, following seven months of flat or falling prices. Prices of agricultural exports increased 3.5 percent in October, paced by an increase in the price of wheat.

National Income and Product Account fixed-weight prices will not be available until December 20th. The fixed-weight prices for the third quarter from the BLS showed a 3.2 percent decline in prices of non-oil imports and a 1.8 percent decline in prices of non-agricultural exports. Both non-oil imports and nonagricultural exports showed the largest declines in the industrial supplies category.

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

	Year 1991-Q3 / 1990-Q3	Quarters 1991 Q1	Q2	Q3	Months 1991 Sep	Oct
		(Quarterly Average, AR)			(Monthly Rates)	
		----BLS Prices----				
Imports, Total	-0.4	-11.9	-7.2	-3.4	0.3	0.6
Foods, Feeds, Bev.	3.1	7.8	3.1	-3.5	0.2	0.1
Industrial Supplies	-5.4	-40.4	-19.0	-6.2	0.0	0.6
Ind Supp Ex Oil*	-2.4	-0.2	-4.5	-7.2	-0.7	0.0
Capital Goods	0.7	4.9	-5.2	-4.6	0.1	0.8
Automotive Products	4.2	6.6	1.2	-1.1	0.4	1.3
Consumer Goods	0.4	2.5	-4.3	-0.6	0.7	0.0
Memo:						
Oil	-11.4	-73.1	-41.1	-4.4	1.5	1.7
Non-oil	1.0	3.7	-2.7	-3.2	0.2	0.5
Exports, Total	0.3	0.6	-1.2	-2.5	-0.1	0.6
Foods, Feeds, Bev.	-2.0	8.3	8.1	-5.8	-1.6	4.0
Industrial Supplies	-4.0	-9.6	-11.9	-8.0	-0.4	0.3
Capital Goods	3.1	5.6	3.5	1.5	0.4	0.1
Automotive Products	2.8	3.5	2.0	2.1	0.0	0.4
Consumer Goods	3.3	6.0	6.3	-2.4	0.5	0.1
Memo:						
Agricultural	-2.8	6.7	6.6	-8.5	-1.2	3.5
Nonagricultural	0.6	-0.6	-2.6	-1.8	0.1	0.2
		---- NIPA Prices ----				
Fixed-Weight+						
Imports, Total					--	--
Oil					--	--
Non-oil					--	--
Exports, Total					--	--
Ag					--	--
Nonag					--	--
Deflators						
Imports, Total	-1.8	-14.8	-10.8	-2.8	--	--
Oil	-11.3	-76.1	-47.3	-1.5	--	--
Non-oil	-0.5	1.1	-5.0	-3.1	--	--
Exports, Total	-1.3	1.7	-2.6	-3.9	--	--
Ag	-2.4	15.9	-0.1	-6.3	--	--
Nonag	-1.2	0.4	-2.8	-3.8	--	--

*/ Months not for publication.
+/ Fixed-Weight prices will not be available for the NIPA until December 20th, the final revision to third quarter GNP.

U.S. Current Account

The U.S. current account balance fell from a surplus of $12.1 (SAAR) billion in the second quarter to a deficit of $41.8 billion in the third quarter, as the balance on both trade and transfers deteriorated. Net transfers declined by $36.3 billion (AR), largely the result of a $28 billion (AR) reduction in cash grants from coalition partners in Operation Desert Storm and the provision of $11.6 billion (AR) in debt forgiveness to several countries, including Poland. (Approximately $1.2 billion (AR) of these grants was used to pay interest arrears, boosting portfolio receipts). Net service receipts rose slightly with an increase in receipts from foreigners traveling in the United States and a small gain in net military transactions.

U.S. CURRENT ACCOUNT
(Billions of dollars, seasonally adjusted annual rates)

	Trade Balance	Services net	Net Income: Direct Invest.	Net Income: Portfolio net	Transfers net	Current Account Balance
1988	-127.0	10.3	36.8	-31.5	-14.9	-126.2
1989	-115.9	22.4	42.5	-39.8	-15.5	-106.3
1990	-108.1	26.4	52.7	-40.7	-22.3	-92.1
1990-1	-110.1	23.6	51.9	-39.8	-16.1	-90.7
2	-96.4	26.4	43.6	-43.6	-18.8	-88.7
3	-115.0	25.6	53.5	-42.3	-17.3	-95.5
4	-110.9	29.9	61.7	-37.2	-37.1	-93.6
1991-1	-73.6	28.3	61.3	-41.8	67.8	42.0
2	-61.6	35.8	52.2	-42.8	28.5	12.1
3	-81.9	37.9	51.1	-41.1	-7.8	-41.8
$Change						
91Q3-91Q2	-20.3	2.1	-1.1	1.7	-36.3	-53.9
91Q2-91Q1	12.0	7.5	-9.1	-1.0	-39.3	-29.9
91Q1-90Q4	37.3	-1.6	-0.4	-4.6	104.9	135.6

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

U.S. International Financial Transactions

Banks and securities firms in the United States reported substantial capital outflows in October, partially reversing the inflows reported in the third quarter (line 1 of the Summary of U.S. International Transactions table). These month-end data have swung widely this year. Contributing to these swings have been sharp movements in lending by securities firms to Bermuda and the Netherlands Antilles to finance holdings of U.S. Treasury securities by certain mutual funds.

There was a small net outflow of $4.1 billion on securities transactions for the third quarter, which continued into October (lines 2 plus 3). A major element was the continued robust level of net purchases of foreign securities by U.S. residents ($13 billion for the third quarter and $6.5 billion in October, line 2c). The cumulative flow for the first three quarters has already surpassed the previous annual record registered in 1990. Two-thirds of the third quarter outflow was for net stock purchases, but in October the share shifted heavily toward foreign bonds. In September and October, a large share of the stock purchases was in Japan (a total of $2.4 billion). In October, purchases of foreign bonds by U.S. residents rose to $4.2 billion; they were primarily from the United Kingdom and, to a lesser extent, from Canada.

Foreign net purchases of U.S. corporate bonds were substantial, for both the third quarter and October (line 2a). By contrast, foreign net purchases of U.S. stocks were small in the third quarter and virtually zero in September and October (line 2b). Foreign net purchases of Treasury obligations were also very small (line 3).

Foreign official reserves in the United States fell by $6.2 billion in September, limiting the overall increase in the third quarter to $3.5 billion (line 4). For the quarter, substantial

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

	1989 Year	1990 Year	1990 Q4	1991 Q1	1991 Q2	1991 Q3	1991 Sep.	1991 Oct.	1991 Nov.
Private Capital									
Banks									
1. Change in net foreign positions of banking offices[1] in the U.S. (+ = inflow)	27.2	36.6	*	0.1	-29.2	9.2	13.5	-9.1	9.4
Securities									
2. Private securities transactions, net[2]	15.7	-29.1	-7.8	-5.1	3.4	-2.6	-1.8	-3.7	1.7
a) foreign net purchases (+) of U.S. corporate bonds[3]	31.8	16.2	6.3	3.5	7.9	8.1	1.9	2.4	2.0
b) foreign net purchases (+) of U.S. corporate stocks	7.9	-13.7	-5.0	1.8	7.7	2.3	-0.4	0.4	0.5
c) U.S. net purchases (-) of foreign securities	-24.0	-31.6	-9.0	-10.3	-12.2	-12.9	-3.3	-6.6	-0.8
3. Foreign net purchases (+) of U.S. Treasury obligations	30.1	-1.0	-2.9	4.0	13.4	-1.3	-4.8	1.1	-1.4
Official Capital									
4. Changes in foreign official reserves assets in U.S. (+ = increase)	8.3	32.1	18.9	6.1	-3.5	3.4	-6.4	6.7	7.1
a) By area									
G-10 countries	-5.2	10.0	8.6	-11.4	-4.7	-1.9	-2.5	2.1	0.6
OPEC	10.1	1.2	-0.5	0.3	-2.9	-4.4	-1.5	0.2	0.6
All other countries	3.4	20.8	10.8	17.3	4.1	9.7	-2.4	4.4	5.9
b) By type									
U.S. Treasury securities	0.1	29.6	19.7	2.9	-2.3	5.8	2.7	4.6	5.5
Other[4]	8.2	2.5	-0.8	3.2	-1.2	-2.4	-9.0	2.1	1.6
5. Changes in U.S. official reserve assets (+ = decrease)	-25.3	-2.2	-1.1	-0.4	1.4	3.9	1.1	0.3	0.8
Other transactions (Quarterly data)[5]									
6. U.S. direct investment (-) abroad	-33.4	-33.4	-3.8	-11.9	-1.8	-5.9	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	70.6	37.2	4.5	4.3	7.5	1.4	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[6]	-5.3	-6.3	-2.2	1.0	-2.4	-2.1	n.a.	n.a.	n.a.
9. U.S. current account balance	-106.3	-92.1	-23.4	10.5	3.0	-10.5	n.a.	n.a.	n.a.
10. Statistical discrepancy	18.4	63.5	19.1	-8.8	8.5	-0.4	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	-27.7	-18.4	-15.4	-20.5	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.
5. 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.

increases were registered by Taiwan, Spain and Mexico, with decreases in OPEC countries and Japan. In October, official holdings rose an additional $6.3 billion, with major increases reported for the United Kingdom, the BIS, and Taiwan.

Recently released data show virtually no capital inflow in the third quarter for foreign direct investment in the United States (line 7); although the second quarter inflow was revised upward, the total inflow in 1991 through three quarters ($13.2 billion) is less than half of the corresponding inflow last year ($32.7 billion). Direct investment outflows were $5.9 billion in the third quarter (line 6); given the cumulative outflow through three quarters ($19.6 billion), it is likely that, for the year, U.S. direct investment abroad will outweigh foreign direct investment in the United States.

The statistical discrepancy for the third quarter was essentially zero, and the discrepancy for the second quarter was revised downward by over $13 billion to $8.5 billion (line 10). More than half of the revision was the result of the correction of a reporting error, where a bank had reported its customers' claims in lira rather than dollars.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1989				1990				1991				
	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Nov.	Dec.
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	-14.1	-29.4	-38.1
(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	11.0	6.9	6.1
(b) Foreign-chartered banks	-23.3	-23.1	-21.3	-24.7	-23.9	-18.2	-21.3	-36.9	-31.3	-19.2	-25.2	-36.4	-44.2
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	23.7	24.5	24.4
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	100.8	103.8	104.0

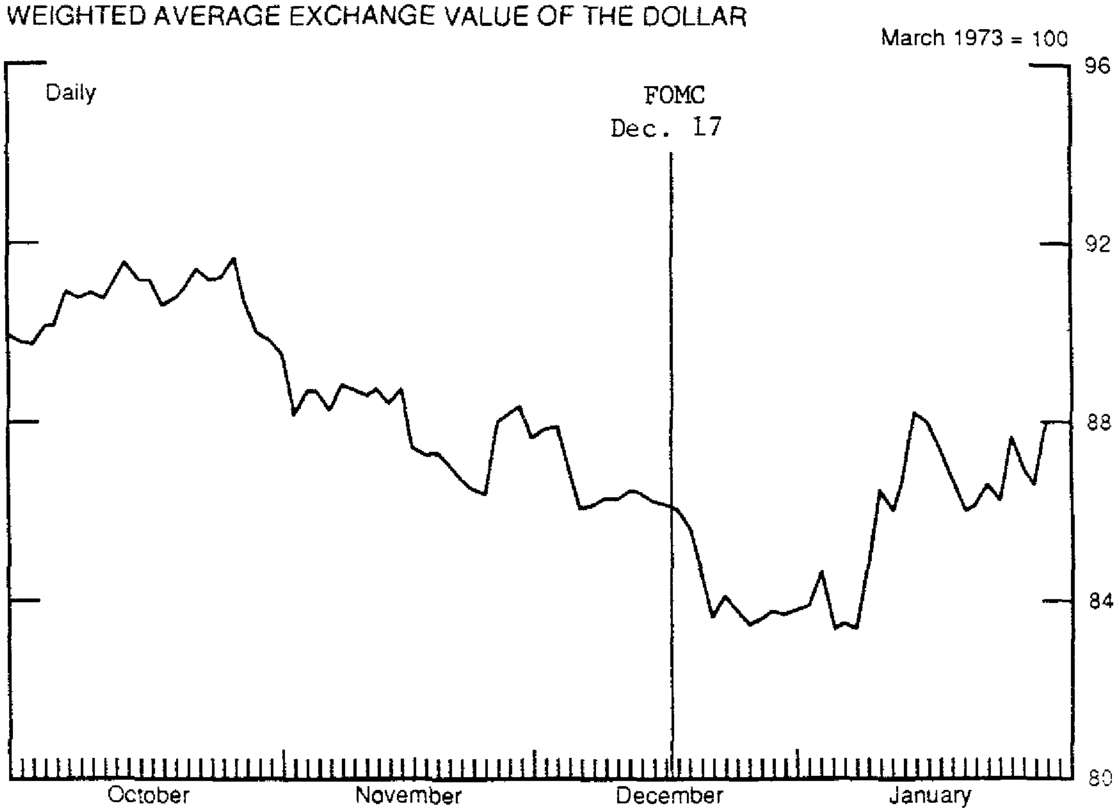
1. Includes term and overnight Eurodollars held by money market mutual funds. Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices.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

Foreign Exchange Markets

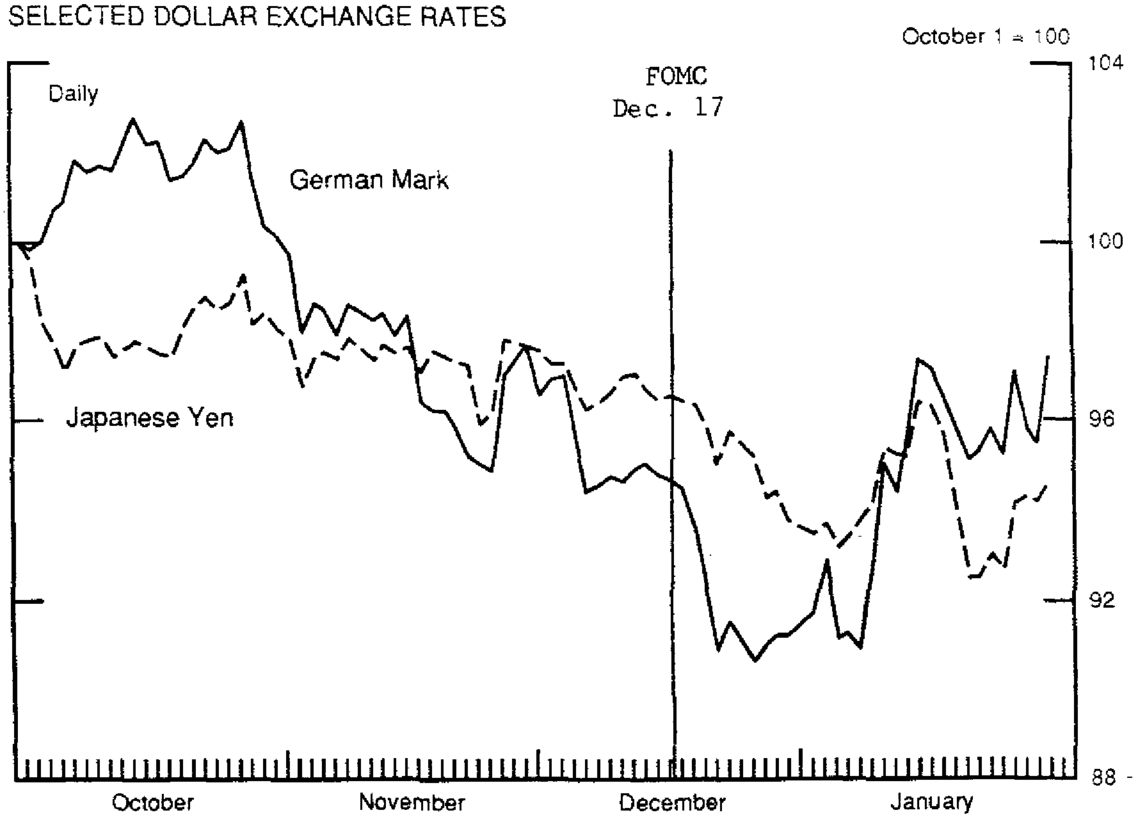
The weighted-average foreign-exchange value of the dollar, in terms of the other G-10 currencies, has been highly volatile, rising nearly 2 percent on balance since the December 17 FOMC meeting, as shown in the accompanying chart. The dollar has risen more than 2-1/2 percent against the German mark, amid expectations that U.S. interest rates have hit bottom and that German interest rates may have passed their peak. The dollar has declined more than 2 percent against the Japanese yen, as markets focussed on the trade imbalance between Japan and the United States.

Against the mark, the dollar has moved generally in line with differentials between interest rates on U.S. and German assets. The dollar declined sharply following the Federal Reserve's easing action on December 20, which came one day after the Bundesbank raised its Lombard and discount rates by half a percentage point. At its low point in early January, the dollar had declined 4 percent against the mark and 3 percent on a weighted-average basis. By that time, the half-point reduction in the federal funds rate had been fully passed through to U.S. three-month interest rates, and the U.S. ten-year bond yield had declined by nearly that amount, while the German three-month rate had risen 10 basis points and the German bond yield had eased about 15 basis points. Since early January, the dollar has rebounded sharply against the mark as U.S. interest rates have moved back up amid expectations of a turnaround in the U.S. economy and German interest rates have moved lower in response to signs of a German economic slowdown and favorable news on German inflation. The dollar's strength against the mark was tempered by speculation about G-7 intervention to hold down the dollar and by concern that accelerating German money growth may prompt the Bundesbank to keep interest rates high.

WEIGHTED AVERAGE EXCHANGE VALUE OF THE DOLLAR



SELECTED DOLLAR EXCHANGE RATES



After the recent rebound in U.S. interest rates, the net movement in long-term differentials over the period has been in favor of the dollar. The U.S. 10-year bond yield has risen 10 basis points on net since December 17, while the Japanese bellwether bond yield has declined 35 basis points and the German yield has declined 30 basis points. Changes in short-term differentials are mixed: German three-month rates are unchanged on balance, while U.S. three-month rates have eased 35 basis points. Japanese three-month rates have declined a full percentage point, perhaps anticipating more easing than the half percentage point decrease in the Bank of Japan's official discount rate on December 30 and the subsequent 75 basis point decline in the Japanese call money rate.

Despite lower Japanese interest rates, the yen has strengthened on balance since the last FOMC meeting. The dollar weakened against the yen ahead of President Bush's trip to Japan, with both U.S. and Japanese officials indicating that an easing of the dollar against the yen would help reduce trade imbalances. The dollar subsequently rebounded to above its December 17 level against the yen, prompting the Desk to sell dollars against yen on January 17. The intervention surprised the market and drove the dollar sharply lower against the yen, to a low of ¥122 in Asian trading the following Monday. Late in the period, the dollar rose somewhat after the G-7 communique on January 25 failed to call for a stronger yen.

The Canadian dollar has declined about 2-1/2 percent against the U.S. dollar over the intermeeting period. Canadian three-month and long-term interest rates have declined about 10 basis points more than U.S. rates. Late in the period, the Canadian dollar was hurt by the announcement of a large increase in the Ontario budget deficit and by worries about a possible downgrading of Ontario provincial debt.

. The only U.S. intervention was the action on January 17, when the Desk sold $50 million against yen, evenly split between System and Treasury accounts.

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Developments in Foreign Industrial Countries

Recent data on economic activity in the major foreign industrial countries suggest that relatively weak growth continued into the fourth quarter. Real GNP in Germany appears to have been unchanged in the fourth quarter, although there have been some positive monthly indicators. Evidence continues to accumulate of an uneven recovery in eastern Germany. Recent monthly indicators show weak activity in Japan and mixed performance in France, Italy, Canada, and the United Kingdom.

Inflation appears to have remained steady or continued to decline modestly in the foreign industrial countries. In Japan, a sharp decrease in consumer prices in December largely reflected a weather-related fall in the price of perishable foods. Consumer-price inflation moderated in western Germany and the United Kingdom, but high wage growth continues to be a concern for policymakers in both countries. Recent price data for Canada and France show continued progress on inflation.

Individual country notes. In Japan, most recent indicators continue to suggest relatively weak growth in activity. Industrial production (s.a.) fell 0.9 percent in December and was 1.4 percent below its year-earlier level. New passenger car registrations (s.a.) fell 8.1 percent in December, and new machinery orders (s.a.) declined 13.9 percent in October. Bankruptcies (s.a.) rose a

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

	Q4/Q4 1990	Q4/Q4 1991	1991 Q1	Q2	Q3	Q4	1991 Aug.	Sept.	Oct.	Nov.	Dec.	Latest 3 months from year ago 2
Canada												
GDP	-1.1	n.a.	-1.2	1.4	.2	n.a.	*	*	*	*	*	-.8
IP	-6.3	n.a.	-2.2	1.3	1.0	n.a.	-.4	.6	-.6	n.a.	n.a.	-2.3
France												
GDP	1.8	n.a.	.3	.7	.7	n.a.	*	*	*	*	*	1.3
IP	-.3	n.a.	.3	1.3	.5	n.a.	.0	-1.4	1.2	-.6	n.a.	.4
West Germany												
GNP	5.3	n.a.	2.4	-.6	-.5	n.a.	*	*	*	*	*	1.9
IP	5.4	n.a.	2.0	-.1	-.5	n.a.	-2.1	.5	.2	1.2	n.a.	1.2
Italy												
GDP	.9	n.a.	.6	.4	.1	n.a.	*	*	*	*	*	1.0
IP	-3.8	n.a.	.4	-2.1	-.1	n.a.	-2.1	3.4	-2.0	n.a.	n.a.	-3.3
Japan												
GNP	4.7	n.a.	2.0	.7	.4	n.a.	*	*	*	*	*	4.1
IP	6.9	-1.4	-.1	-.7	.3	-.9	-2.5	.5	-.1	.0	-.9	-1.4
United Kingdom												
GDP	-.7	n.a.	-.9	-.7	.2	n.a.	*	*	*	*	*	-2.2
IP	-3.2	n.a.	-.3	-1.1	.9	n.a.	-1.8	.3	.8	-.7	n.a.	-1.4
United States												
GNP	-.1	n.a.	-.6	.3	.5	n.a.	*	*	*	*	*	-.8
IP	.3	-.4	-2.5	.6	1.6	-.1	-.1	.4	-.1	-.2	-.2	-.4

1. Asterisk indicates that monthly data are not available.
2. For quarterly data, latest quarter from year ago.

CONSUMER AND WHOLESALE PRICES IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change from previous period) 1

	Q4/Q4 1990	Q4/Q4 1991	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1991 Q3	1991 Q4	1991 Oct.	1991 Nov.	1991 Dec.	1992 Jan.	Latest 3 months from year ago
Canada													
CPI	4.9	4.1	1.1	1.4	2.9	.7	.6	-.1	-.2	.4	-.5	n.a.	4.1
WPI	1.9	-2.9	.2	1.2	-.3	-1.6	-.8	-.3	.0	-.1	.1	n.a.	-2.9
France													
CPI	3.6	2.9	1.0	1.0	.5	.7	.8	.9	.4	.3	.1	n.a.	2.9
WPI	.7	n.a.	.2	1.1	-.5	-1.3	n.a.	n.a.	*	*	*	*	-.5
West Germany													
CPI	3.0	3.9	.4	.9	.8	.9	1.5	.7	.3	.4	.1	.5	4.1
WPI	.9	n.a.	.2	.4	.5	.3	.7	n.a.	.3	.5	n.a.	n.a.	1.3
Italy													
CPI	6.3	6.1	1.4	2.0	1.9	1.4	1.0	1.7	.8	.7	.3	n.a.	6.1
WPI	9.9	n.a.	3.9	4.3	.2	-1.0	.5	n.a.	.6	.9	n.a.	n.a.	1.4
Japan													
CPI	3.2	3.2	.2	1.2	.8	.8	.4	1.1	1.0	.3	-.7	n.a.	3.2
WPI	1.9	-1.3	.0	.7	.1	-.4	-.4	-.7	-.4	.0	.0	n.a.	-1.3
United Kingdom													
CPI	10.0	4.2	1.6	1.6	.6	2.0	.4	1.0	.4	.4	.1	n.a.	4.2
WPI	5.9	5.1	.9	1.1	2.0	1.9	.6	.6	.1	.4	.1	n.a.	5.1
United States													
CPI (SA)	6.3	2.9	1.7	1.7	.9	.5	.7	.8	.1	.4	.3	n.a.	2.9
WPI (SA)	6.5	-.1	1.6	2.6	-.6	-.1	-.2	.8	.7	.2	-.2	n.a.	-.1

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)

	1990	1991	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1991 Q3	1991 Q4	1991 Sept.	1991 Oct.	1991 Nov.	1991 Dec.
Canada												
Trade	9.4	n.a.	2.8	2.3	2.3	2.6	.9	n.a.	-.2	.1	.3	n.a.
Current account	-14.0	n.a.	-2.9	-3.1	-4.8	-4.8	-6.3	n.a.	*	*	*	*
France												
Trade	-9.3	-5.4	-3.6	-3.1	-2.6	-1.4	-1.9	.4	-.5	1.2	.1	-.8
Current account	-8.0	n.a.	-3.5	-1.4	-2.9	-1.6	n.a.	n.a.	*	*	*	*
Germany [2]												
Trade (NSA)	65.2	n.a.	16.0	10.1	4.4	-1.1	2.8	n.a.	.9	1.3	2.2	n.a.
Current Account (NSA)	47.3	n.a.	9.4	8.5	-5.9	-5.9	-6.1	n.a.	-1.0	-2.0	1.0	n.a.
Italy												
Trade	-12.1	n.a.	-3.2	-3.5	-1.2	-4.2	-5.3	n.a.	-1.6	-1.3	-1.6	n.a.
Current account (NSA)	-14.2	n.a.	.7	-3.7	-7.6	-4.7	n.a.	n.a.	*	*	*	*
Japan												
Trade	51.8	78.1	14.2	8.5	17.4	18.8	20.8	21.2	7.6	6.5	7.4	7.3
Current account	35.8	n.a.	7.0	6.4	17.8	18.8	19.4	n.a.	7.6	6.4	7.2	n.a.
United Kingdom												
Trade	-32.0	-17.4	-7.3	-6.2	-5.8	-3.6	-3.7	-4.4	-1.4	-1.5	-1.7	-1.3
Current account	-25.8	-11.6	-4.8	-4.1	-5.0	-1.3	-2.5	-2.8	-.9	-1.0	-1.1	-.7
United States												
Trade	-108.1	n.a.	-28.8	-27.7	-18.4	-15.4	-20.5	n.a.	-7.0	-7.0	-4.4	n.a.
Current account	-92.1	n.a.	-23.9	-23.4	10.5	3.0	-10.5	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.

further 5.1 percent in November, making their 12-month increase 75.1 percent. The index of leading indicators (s.a.) fell to its lowest level in more than 11 years in November. Only housing starts showed some strength, increasing 4.3 percent (s.a.) in November, but they remained 19.3 percent below their year-earlier level.

Reflecting weaker economic activity, the unemployment rate (s.a.) edged up to 2.1 percent in November, while the ratio of job offers to applicants (s.a.) declined for the seventh time in eight months to a level 8.4 percent below that of November 1990. Nonetheless, the unemployment rate remains near record low levels.

Underlying inflationary pressures appear to have remained unchanged. Consumer prices in the Tokyo area (n.s.a.) decreased 0.7 percent in December, and their 12-month increase slowed to 2.9 percent. Much of the decrease was due to a weather-related fall in prices for perishable foods. Wholesale prices (n.s.a.) were unchanged in December and showed a 12-month decrease of 1.6 percent.

The trade surplus (s.a.) narrowed slightly in December. For 1991 as a whole, however, the trade surplus increased $26 billion to $78 billion. The volume of both imports and exports rose 3 percent in 1991. The unit value of imports in yen terms fell 8.2 percent, reflecting the effects of yen appreciation and lower average oil prices, while export unit value in yen terms declined only 0.5 percent.

On December 28, the Cabinet approved a budget for the new fiscal year beginning in April. The proposed FY1992 budget appears to be about neutral in its macroeconomic impact. Central government spending is set to increase by only 2.7 percent. However, spending under the separate capital budget is up 7.2 percent. The general government balance, including social security, should remain in substantial surplus. At the time of President Bush's early January visit to Japan, Prime Minister Miyazawa agreed that the Japanese government would monitor economic activity closely and consider additional measures if growth falters.

According to preliminary data, real GNP in western <u>Germany</u> increased 3.2 percent in 1991, compared with an annual average increase of 4.5 percent in 1990. Data for the fourth quarter will not be released for about six weeks, but an official of the Statistical Office stated that real GNP appeared to have been unchanged in the fourth quarter.

Monthly indicators for the fourth quarter present a somewhat more positive picture. Industrial production in western Germany (s.a.) increased 1.2 percent in November, following an increase of 0.2 percent in October. The volume of retail sales (s.a.) in western Germany increased 0.7 percent in both September and October. Also, the volume of new orders for west German manufactured goods (s.a.) increased 0.2 percent in November, reversing a decline of the same magnitude in October. Between September and November, domestic orders increased 1.7 percent, while foreign orders fell 3.4 percent. The west German unemployment rate (s.a.) fell 0.1 percentage point to 6.2 percent in December.

Evidence continues to accumulate that an uneven recovery is underway in eastern Germany. Industrial production in eastern Germany (n.s.a.) increased 8.4 percent in September, putting this volatile series 10.3 percent above its April trough. The pace of new orders for construction in eastern Germany (n.s.a.) has increased steadily since February, and September's level was almost twice the average level for the second half of 1990. Official east German unemployment (n.s.a.) increased 0.1 percentage point to 11.8 percent in December, but it remained below the July peak of 12.1 percent. The number of "short-time" workers subsidized by the government declined to 11.6 percent (n.s.a.) of the labor force in December, its lowest level since July 1990.

Consumer prices (n.s.a.) increased 0.5 percent in January and stood 4 percent above year-earlier levels, down from 4.2 percent in December. In the fourth quarter, consumer prices on a seasonally adjusted basis increased at an annual rate of 3.3 percent. West German producer prices (n.s.a.) fell 0.1 percent in November and were 2.5 percent above year-earlier levels. West German import prices (n.s.a.) fell 0.6 percent in November and are 2 percent below where they were a year earlier.

Accelerating unit labor costs in western Germany continue to be a source of concern. Average hourly earnings in western Germany (s.a.) increased 8.3 percent in the year to October, compared with 6.5 percent at the end of 1990. In contrast, output per hour in west German industry (s.a.) increased only 2.3 percent in the year to October, compared with 3.8 percent at the end of 1990.

Wage negotiations for 1992 are continuing in the steel industry with discussion focusing on a range of wage increases between 5-1/2 and 6 percent. Although the steel workers union is relatively small, these negotiations in the past have set a precedent for other more important contracts. Both the public sector employees and metal workers unions are asking for wage increases of 9-1/2 percent this year.

On December 19, the Bundesbank raised its discount and Lombard rates by 1/2 percentage point. This action was taken in response to increased inflation since mid year, an acceleration in money growth, and concerns over the outcome of current wage negotiations. Through December, M3 (s.a.) in western and eastern Germany had increased at an annual rate of 5.7 percent in 1991, relative to the fourth quarter of 1990, up from 4.5 percent through September. The recent acceleration in M3 primarily reflects strong demand for bank loans.

In France, real GDP rose 2.8 percent (s.a.a.r.) in the third quarter, following an increase of the same size in the second quarter. Moderate growth in consumption and exports, and a significant amount of inventory accumulation contributed to the third-quarter result. Monthly indicators for the fourth quarter are mixed. Industrial production fell 0.6 percent (s.a.) in November, partially reversing a 1.2 percent rise in October. Consumption of manufactured products also declined in November after rising sharply in October. The unemployment rate in December remained unchanged at 9.8 percent.

The consumer price index in December was 3.1 percent above its level a year earlier. A lessening of inflationary pressures was evident in the 0.6 percent (n.s.a.) third-quarter increase in hourly wages in the private sector, about half the second-quarter increase.

In December, France registered a trade deficit of $0.8 billion (s.a.), following a small surplus in November. The trade deficit for 1991 was $5.4 billion, a significant improvement from the 1990 deficit of $9.3 billion, as the bilateral deficit with Germany narrowed sharply. Exports grew 3-3/4 percent, compared with 3 percent growth in 1990, while import growth declined to 2 percent from 3.3 percent in 1990.

In Italy, the economy has stagnated in recent months, with no sign of the recovery that was widely forecast for the second half of 1991. Third-quarter GDP rose only 0.4 percent (s.a.a.r.), down from a modest 1.6 percent rise in the previous quarter. Fixed investment was a source of strength, increasing 6.6 percent (s.a.a.r.) in the third quarter following a 7.4 percent increase in the second quarter. Weakness was concentrated in net exports. Industrial production (s.a.) fell 2 percent in October. The unemployment rate (n.s.a.) rose to 11 percent in October, up from 10.6 percent in the previous reporting month (July).

Inflation has eased in Italy but remains well above rates in key EMS partners, Germany and France. Consumer prices in December were 6 percent above their level a year earlier, down from 6.2 percent in November. Wholesale prices in November were 2.4 percent above a year earlier. The index of wages and salaries in major union contracts was up 9.4 percent in September from a year earlier.

The 1992 budget, approved by parliament just prior to the January 1 deadline, aims to reduce the 1992 central government budget deficit (including certain off-budget entities such as the postal service) to 128 trillion lire, or 8.4 percent of GDP. The 1991 deficit was 150-155 trillion lire, roughly 10-1/2 to 11 percent of GDP. Unfortunately, the new budget package once again puts off major reforms. Most outside observers project a deficit in excess of 9 percent of GDP, in which case additional fiscal measures will be needed after general elections occur this spring. With public debt now estimated to be over 100 percent of GDP, interest payments consume over one-fifth of total government revenue.

In the United Kingdom, the latest data provide little evidence of a strong recovery. Real GDP grew 0.7 percent (s.a.a.r.) in the third quarter, after contracting 2.8 percent in the second quarter. In the third quarter, inventories contributed more than 4 percent (s.a.a.r.) to growth as the runoff of inventories during the previous three quarters came to an end. Government spending grew 1.6 percent (s.a.a.r.), contributing 0.3 percentage points to growth. Consumer spending remained flat and was down 3 percent from its pre-recession level, while investment fell 2.5 percent to a level more than 15 percent below that preceding the recession. Net exports made a negative contribution to growth.

In November, manufacturing production (s.a.) rose 0.1 percent after several months of decline and was 1.1 percent below the third-quarter average level. Retail sales (s.a.) fell 1 percent in December; the average for the fourth quarter was 0.3 percent below the third-quarter average. After increasing steadily since the end of the Gulf War, consumer confidence has recoiled since October. Business confidence about prospects for sales and orders has fallen since September as well. The unemployment rate (s.a.) has continued to climb, reaching 9 percent in December.

Consumer prices rose 0.1 percent in December, to a level 4.5 percent above December 1990. The government's measure of underlying inflation, which excludes mortgage interest rates, stood at 5.8 percent. Producers' output prices rose 0.1 percent in December to a level 5 percent above year-ago levels. However, wages continued to increase at an underlying rate of 7-1/2 percent in November.

The recession has contributed to a narrowing of Britain's current account deficit. The 1991 current account deficit was $11.6 billion compared with a deficit of $25.8 billion in 1990.

In Canada, monthly data for the fourth-quarter indicate that the recovery that began in the second quarter remains tentative. In October, industrial production (s.a.) dropped 0.6 percent, but a 0.1 percent increase in GDP at factor cost suggested some compensating strength in the service sector. November saw more robust demand in goods markets, as retail sales (s.a.) rose 0.7 percent, factory shipments (s.a.) increased 0.6 percent, new orders rose 0.2 percent, and unit sales of motor vehicles were up 9.6 percent. In December, further weakness was evident, as the unemployment rate (s.a.) was unchanged at 10.3 percent, while total employment (s.a.) fell 0.2 percent, and housing starts (s.a.) were down 3 percent.

The weaker-than-expected economy caused the federal government budget deficit to increase in 1991. On January 27, Finance Minister Don Mazankowski announced a freeze on federal government hiring and discretionary expenditure for the remainder of the fiscal year which ends March 31.

Recent price data show that the government's anti-inflation efforts have achieved some results. The all-items consumer price index (n.s.a) fell 0.5 percent in December, and twelve-month consumer price inflation decreased from 4.2 percent to 3.8 percent. The CPI excluding food and energy (n.s.a.) dropped 0.3 percent, and has increased only 3 percent (a.r.) since the 7 percent Goods and Services Tax was introduced in January 1991. Industrial product prices (n.s.a.) rose 0.1 percent in December, but stand 3.1 percent lower than they were twelve-months earlier. On average, wage settlements increased only 3.7 percent (s.a.a.r.) in the first 11 months of 1991, compared with 5.7 percent in 1990.

The combined merchandise trade surplus for October and November was only $2.3 billion (s.a.a.r.) compared with a $7.8 billion surplus (s.a.a.r) in the first nine months of the year.

Little progress has been made in discussions of the National Unity Plan constitutional reform proposals announced by the federal government last September. The Cabinet intends to submit specific constitutional amendments to Parliament by early April. Should it deem the revised proposals to be unacceptable, the provincial government of Quebec has promised to hold a referendum this autumn, in which voters may choose among alternatives including secession.

Developments in the Former Soviet Union and East European Countries

On December 21, 1991, Russia was joined by all former Soviet republics except Georgia and the Baltics in forming the Commonwealth of Independent States to replace the Soviet Union. Despite initial statements on coordination of economic policies, no agreement has been reached on long-term monetary, banking, or trade policies. The Russian central bank has essentially assumed the functions of the former USSR Gosbank. By all reports, monetary emission is continuing to increase without control as the Russian central bank attempts to meet the rising demand for rubles from each of the former republics. Some republics, such as Ukraine, are proceeding with plans to introduce their own currencies.

On January 2, 1992, the Russian republic proceeded with its widely anticipated price reform measures; other republics, most notably Ukraine and Byelarus, followed. Prices on basic goods and services were increased to three to five times their former level. Prices of items not subject to controlled increases are supposed to find market-clearing levels. However, reports indicate that competitive pricing is still the exception rather than the norm in state stores. Output in the Russian republic is estimated to have fallen about 9 percent of GNP in 1991.

The Russian government faces a formidable task in controlling the budget deficit. Expenditures are likely to be fueled by promised wage increases and pressures to raise pensions to soften the effect of increased prices. The government is hoping to stabilize the budget deficit through a new value-added tax, cuts in military expenditures, and reduced subsidies. The budget deficit of the Russian republic, including the portion of the former Soviet Union budget taken over by the Russian republic, appears to have exceeded 20 percent of GNP in 1991.

The Russian central bank recently announced establishment of a "market rate" of 110 rubles per dollar and a commercial exchange rate of 55 rubles per dollar. Selected export enterprises (mainly agriculture, minerals, forestry, and chemicals) are obliged to sell 40 percent of their hard currency earnings to the Russian government at the commercial exchange rate and will also be required to sell 10 percent of their foreign exchange proceeds at the market rate of 110 rubles per dollar. In late January, the black market exchange rate was quoted between 120 and 150 rubles per dollar.

Russia has applied for membership in the IMF, as have Ukraine, Azerbaijan, Armenia, Kazakhstan, and the Baltic states.

Throughout Eastern Europe, the move to a market system has had severe effects on measured economic activity. From negligible levels at the start of their reform efforts, reported unemployment rates have moved steadily up to 11.4 percent in Poland, 11 percent in Bulgaria, 8.3 percent in Hungary, 6.6 percent in Czechoslovakia, and 4 percent in Romania. Measures of real GNP and industrial production for the region in 1991 are estimated to have fallen about 15 percent and 20 percent, respectively, with real GNP declines ranging from about 8 percent in Hungary to 20 percent or more in Bulgaria, Romania, and Yugoslavia. However, these numbers underreport activity in fast-growing private sectors. In some countries, increases in consumer prices have stabilized after large increases in the initial stages of reform, and monthly inflation at the end of 1991 was on the order of 1-2 percent in Hungary and Czechoslovakia, and 3 percent in Poland. Bulgaria, Czechoslovakia, Hungary, Poland, and Romania have IMF programs (all but Poland are adhering to the targets set out in those agreements), and Albania hopes to receive its first IMF program in 1992.

In Poland, in late December the Parliament approved the new center-right government of Prime Minister Jan Olszewski. However, President Walesa's recent nominee for Central Bank President was rejected by the Parliament, and the Central Bank has been without a President since August 1991. The fiscal deficit, which nearly doubled in 1991 to 6 percent of GDP and caused Poland's IMF program to go off track in mid year, has been stabilized at that level for the first quarter of 1992 through a variety of one-time measures (mostly expenditure cuts or deferrals), but longer-term goals of creating a less-distortionary, broad-based tax system and imposing discipline on state enterprise spending have not been addressed.

Economic Situation in Other Countries

The IMF approved a 20-month $2 billion stand-by arrangement for Brazil on January 29, following assurances by the Brazilian government that court-ordered increases in pensions would not be allowed to throw the program out of compliance. Negotiations between Brazil and the Paris Club and its commercial bank creditors are continuing. On December 20, the IMF approved a modified stand-by arrangement for Argentina, as well as a waiver for missing its fiscal targets in the third quarter of 1991; preliminary data indicate that Argentina met its fiscal targets in the fourth quarter. In Mexico, real GDP was 3.1 percent above its year-earlier level in the third quarter of 1991, down from a revised 4.9 percent increase in the second quarter; growth in all of 1991 officially is estimated at 4.5 percent, up from 3.9 percent in 1990. Mexico's trade deficit for the first ten months of 1991 registered $5.1 billion compared with $0.5 billion in 1990. The Philippines missed its 1991 fourth quarter monetary targets under its IMF program by a small margin, prompting the IMF staff to delay its report to the Executive Board pending additional actions to be taken by the government in early February. Venezuela's 1991 real GDP growth of 9.2 percent was among the world's highest. Korea registered a record $9.8 billion current account deficit in the first 11 months of 1991, while consumer price inflation was 9.5 percent for the year. In Taiwan, both economic activity and the trade surplus strengthened in 1991 while inflation remained about unchanged at 4.4 percent.

Individual country notes. Brazil's request for a 20-month $2 billion stand-by arrangement was approved by the IMF Executive Board January 29. The Brazilian authorities have assured IMF management that, despite fiscal pressures, including regional court orders to increase certain social security pensions by 147 percent, they are determined to adhere to the conditions of the standby. To underscore the government's commitment to fiscal discipline, on January 20 President Collor issued a decree halting the pension increases mandated by the courts. While the decree was ruled constitutional by the Supreme Court on January 22, the large states of Rio and Sao Paulo are defying it. The administration is moving to negotiate with Congress ways to offset the increase in social security spending.

The government has been maintaining real interest rates at very high levels, in the 3-7 percent per month range, but is facing intense pressures to reduce them. Industrial production in October 1991, the latest available month, was 0.5 percent below its year-earlier level. Monthly consumer price inflation registered 24.2 percent in December, down marginally from 26.5 percent in November, but is expected to rise in January.

The trade surplus for 1991 was $10.6 billion, about the same as in 1990. The latest official estimate of liquid international reserves is $7 billion as of the end of November, down from a recent peak of $9.2 billion in June. However, according to unofficial estimates, international reserves rose by $2 billion in December, as high domestic interest rates have induced heavy capital inflows.

In mid-December, Brazil's bank advisory committee presented a proposal to resolve the issue of whether interest on restructured obligations would carry guarantees. One option would have a portion of the interest on the debt collateralized when the agreement is signed, with the remaining collateral to be put up within a specified time. Under the second option, only a portion of the debt would be restructured in the near future and have its interest collateralized. The proposal also would reduce the period for rolling interest guarantees from 18 months to 15 months and would decrease interest rates on the new instruments. So far, Brazil has not responded to this initiative.

Brazil has completed its payments of $2 billion in cash, out of $8 billion in interest arrears that had accumulated between mid-1989 and December 1990, as agreed last April. The rest of the arrears will be converted into bonds when the overall restructuring agreement is concluded. Brazil recently announced that it will continue to pay 30 percent of interest currently falling due and is expected to continue partial payment until a commercial debt restructuring package is completed. Interest arrears accumulated since January 1991 totaled an estimated $2.6 billion as of end-1991.

Paris Club creditors held a "preliminary" meeting in late January to prepare for Brazil's formal request for a rescheduling, possibly in late February. Brazil has estimated total arrears of about $8.5 billion (about $4.4 billion in interest) to official creditors.

On December 20, 1991, the IMF approved a modification of Argentina's stand-by arrangement and a waiver allowing Argentina to receive the second drawing under the arrangement, since a greater fraction of the overall fiscal surplus for the third quarter was derived from asset sales than was specified under the program. Preliminary data indicate that Argentina met its performance targets for the fourth quarter. In consequence, considerable progress has been made toward negotiation of a three-year Extended Fund Facility, which would replace the one-year program approved in July 1991. The EFF, which is expected to be approved in early Spring, will provide part of the financing necessary to support a restructuring of Argentina's $31 billion in commercial bank debt, including about $8 billion in interest arrears. Negotiations on this package started at the end of January.

Economic conditions have remained stable since the last Greenbook. The monthly rate of CPI inflation edged up to 0.6 percent in December from 0.4 percent in November; it is expected to register between 1 and 2 percent in January, due to transitory upticks in food and services prices. Industrial production in October, the latest available month, was 12 percent above its year-earlier level, up from 9 percent in September.

Mexico's real GDP growth, year-over-year, slowed to 3.1 percent in the third quarter of 1991 from a downward-revised 4.9 percent in the second quarter. The slower growth rate in the third quarter reflected a reduction in liquidity in late August and September, attributable mainly to the sale by the government of Mexico's leading commercial bank, and the fact that third-quarter growth in 1990 was especially high. The latest official estimate of growth for 1991 as a whole is 4.5 percent, up from 3.9 percent in 1990.

The U.S. recession appears to have had only a modest impact on Mexican exports. Notwithstanding some slowing since mid-1991, non-oil exports in the first 10 months of 1991 were 13 percent above their year-earlier values. However, oil export earnings were 10.8 percent lower in the first ten months of 1991 than their year-earlier level, reflecting the decline in oil prices following the end of the Gulf War. As a result, the increase in total exports was only 5.5 percent. With imports 23.4 percent higher in the first ten months of 1991 than in the same period of 1990, the ten-month trade deficit was $5.1 billion compared with $544 million in 1990.

International reserves, including gold, are estimated to have increased by about $8 billion during 1991 to $18 billion at the end of December. The floating peso/dollar exchange rate has tended to remain in the lower half of its target zone,

. The rate was about 3,073 pesos on January 27, compared with a lower limit of 3,056 pesos and an upper limit of 3,102 pesos, and was about the same level as when the target-zone system was adopted last November.

. At the January 29 auction, the 28-day Treasury bill rate was 15.5 percent, compared with 16.1 percent on December 3. The December-over-December rate of consumer price inflation was 18.8 percent in 1991, down from 29.9 percent in 1990.

An IMF team that visited the <u>Philippines</u> in early January found that the country had missed its end-December targets for base money and broad money, although by relatively small amounts. The staff report to the IMF Board will be delayed until early February, by which time the Philippine authorities should have enacted a second increase in electricity prices (the first increase took place January 5), as required under the IMF program, and a group of revenue measures now being considered by the Senate. The Aquino administration has promised to reduce government expenditures in

1992 in order to meet the agreed IMF budget deficit target if the Senate fails to act.

Venezuela was one of the world's fastest growing economies last year. According to preliminary data, real GDP rose 9.2 percent, compared with 5.3 percent in 1990, based on sharp increases in investment in the petroleum and construction sectors. Inflation on a December-over-December basis declined from 36 percent in 1990 to 31 percent in 1991. Lower oil export earnings and a surge in imports cut the current account surplus from $7.5 billion in 1990 to an estimated $1.1 billion last year. The consolidated government fiscal account registered a surplus estimated at 1 percent of GDP in 1991, thanks to extraordinary revenues of 3.5 percent of GDP from privatization of the national airline and telephone companies.

In 1991, Korean consumer prices were 9.5 percent higher in December than a year earlier. M2 rose 18.6 percent on average, which was near the top of the central bank's targeted range of 17-19 percent. Real GDP was 8.8 percent higher in the first three quarters of 1991 than its year-earlier level, down from 9.8 percent in the same period of 1990. Korea's current account deficit was a record $9.8 billion in the first eleven months of last year. External debt increased $6.5 billion to $38.2 billion in the first ten months of 1991.

In Taiwan, economic activity picked up in 1991 due to stronger exports and rising public investment. Industrial activity rose 7.2 percent after falling 1 percent in 1990. Exports rose 13.3 percent due in part to large increases in shipments to China (through Hong Kong); the cumulative trade surplus (on a customs basis) was $13.3 billion, up somewhat from $12.5 billion in 1990. Consumer prices were 4.4 percent higher in December than a year earlier, nearly unchanged from the 4.6 percent increase in 1990. On December 21, the ruling party won 78 percent of the seats in National Assembly elections, the first general elections in Taiwan. On January 8, Taiwan's central bank lowered its rediscount rate 0.375 percentage points to 5.875 percent, the fifth reduction in six months. In addition, reserve requirements were lowered further. Despite these moves, the NT dollar has continued to appreciate to record highs against the U.S. dollar.