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May 11, 1988

# 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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Strong labor market data for April suggest that the economy was expanding vigorously as the second quarter began. The unemployment rate dropped two-tenths of a percent last month and aggregate hours were up sharply, especially in industries that are benefiting from the strength in U.S. exports and in domestic capital spending. Prices and wages also have picked up a bit in recent months.

Labor Markets

The rise in nonfarm payroll employment in April of about 175,000 was smaller than the average monthly increase in the first quarter, but that gain was accompanied by widespread increases in the length of workweeks, pushing aggregate hours of production workers up about 1 percent. Moreover, employment as measured by the household survey posted an especially large gain last month that more than reversed its sharp drop in March, and the civilian unemployment rate fell to 5.4 percent. Since the beginning of the year, both surveys have posted job gains totaling about 1 million, and the jobless rate has fallen 0.4 percentage point.

To a large extent, the slowing in payroll employment growth observed in April reflected a leveling off in construction jobs and a second month of weakness in retail trade. However, both of these industries had posted unusually large job gains earlier this year, and current employment levels remain well above those seen in December. In manufacturing, employment advanced 44,000 in April, and job gains were revised up in both February and March. Much of the recent strength in

## CHANGES IN EMPLOYMENT[1]

(Thousands of employees; based on seasonally adjusted data)

| | 1987 | 1987 Q3 | 1987 Q4 | 1988 Q1 | 1988 Feb. | 1988 Mar. | 1988 Apr. |
|---|---|---|---|---|---|---|---|
| | -Average monthly changes- | | | | | | |
| Nonfarm payroll employment[2] | 254 | 205 | 393 | 350 | 538 | 296 | 174 |
| Manufacturing | 34 | 51 | 71 | 17 | 20 | 12 | 44 |
| Durable | 19 | 31 | 45 | 6 | 12 | 7 | 40 |
| Nondurable | 15 | 21 | 26 | 11 | 8 | 5 | 4 |
| Construction | 15 | -6 | 44 | 48 | 127 | 80 | -3 |
| Trade | 50 | 41 | 67 | 96 | 108 | 6 | 31 |
| Finance and services | 107 | 85 | 119 | 137 | 224 | 100 | 71 |
| Total government | 29 | 6 | 74 | 33 | 35 | 69 | 3 |
| Private nonfarm production workers | 181 | 143 | 269 | 255 | 481 | 169 | 95 |
| Manufacturing | 28 | 38 | 56 | 9 | 24 | -6 | 36 |
| Total employment[3] | 257 | 191 | 291 | 120 | 280 | -306 | 610 |
| Nonagricultural | 252 | 193 | 280 | 123 | 346 | -283 | 586 |
| Memo: | | | | | | | |
| Aggregate hours of production workers (percent change) | .3 | .1 | .4 | .4 | 1.1 | -.5 | 1.0 |
| Manufacturing | .3 | .0 | .8 | .0 | -.1 | -.2 | .8 |

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

## SELECTED UNEMPLOYMENT RATES

(Percent; based on seasonally adjusted data)

| | 1987 | 1987 Q3 | 1987 Q4 | 1988 Q1 | 1988 Feb. | 1988 Mar. | 1988 Apr. |
|---|---|---|---|---|---|---|---|
| Civilian, 16 years and older | 6.2 | 6.0 | 5.9 | 5.7 | 5.7 | 5.6 | 5.4 |
| Teenagers | 16.9 | 16.1 | 16.6 | 16.0 | 15.4 | 16.5 | 15.9 |
| 20-24 years old | 9.7 | 9.5 | 8.8 | 9.0 | 8.7 | 9.1 | 8.7 |
| Men, 25 years and older | 4.8 | 4.6 | 4.4 | 4.4 | 4.3 | 4.3 | 4.1 |
| Women, 25 years and older | 4.8 | 4.7 | 4.7 | 4.4 | 4.7 | 4.1 | 4.2 |
| Memo: | | | | | | | |
| Total National[1] | 6.1 | 5.9 | 5.8 | 5.6 | 5.6 | 5.5 | 5.4 |

1. Includes resident armed forces as employed.

hiring has occurred in industries that have seen export-led production increases--most notably fabricated metals and nonelectrical machinery. In addition, factory workweeks and overtime hours have stayed at high levels in recent months, although the April figures may have been exaggerated by the difficulties of seasonally adjusting for the timing of the Easter holiday.[1] Elsewhere, employment in oil and gas extraction climbed 14,000 in April, apparently reflecting a pickup in oil drilling activity in late March and early April. In services, job gains totaled 55,000, led by continued growth in health services.

A combination of further increases in labor force participation--which currently stands at 65.9 percent, 0.2 percentage point above its fourth-quarter average--and continued population growth has pushed up the size of the labor force by an average 150,000 per month so far this year, close to the average monthly rise seen in 1987. However, in contrast to the patterns observed last year, when participation among adult women rose sharply, much of the recent rise reflects higher participation among adult men, whose rate had edged down in the second half of 1987. Participation among adult women has continued to move up, but at a less rapid pace than in 1987, while the participation rate for teenagers, which is quite volatile, has declined.

Over the past year, employment growth has become better balanced, and the regional and occupational dispersions in labor market

1. The seasonal adjustment procedures used by BLS do not make explicit allowance for changes in the timing of the Easter holiday, which could account for as much as half of the 0.8 percent increase in aggregate manufacturing hours, but at most, 0.1 of the 1.0 percent growth in total aggregate hours.

performance have narrowed. In particular, the pickup in industrial activity has fueled job gains in areas where labor markets were depressed in late 1986 and early 1987, and declines in unemployment rates in the rust belt and oil patch typically have been larger than those registered in the already tight labor markets of the New England and Mid-Atlantic regions.

Industrial Production and Capacity Utilization

Given the strength in production worker hours in manufacturing and the available physical product data, total industrial production appears to have posted a sizable gain in April.[2] The labor market data suggest that output of products--particularly machinery--continued to advanced rapidly last month, while materials production appears to have risen moderately. Among the available physical product data, auto assemblies, paper, crude oil extraction, and coal mining increased last month, while steel output, drilling rigs, electricity generation, and truck assemblies declined.

Strong domestic demand--especially for computers--and continued growth in exports has led to robust gains in the production of business equipment. Output of parts for capital goods--for example, semiconductors, computer parts, and bearings and gears--also has posted solid advances. As a result, operating rates at both suppliers and final goods producers in the capital goods lines have risen appreciably

2. Around 85 percent of the first estimate of industrial production is based on changes in production worker hours; the remaining 15 percent is based largely on physical product data (for example, auto and truck assemblies, drilling rigs, output of raw steel and paperboard, and refinery runs of petroleum products).

INDUSTRIAL PRODUCTION
(Percentage change from preceding period)

| | 1986 | 1987 | 1987 Q4 | 1988 Q1 | 1988 Jan. | 1988 Feb. | 1988 Mar. |
|---|---|---|---|---|---|---|---|
| | -------Annual rate------- | | | | ---Monthly rate--- | | |
| Total Index | 1.0 | 5.8 | 7.0 | 3.8 | .4 | .0 | .1 |
| Products | 1.8 | 4.9 | 4.3 | 5.9 | 1.0 | .3 | .1 |
| Final products | .8 | 4.6 | 4.3 | 6.1 | .9 | .3 | .2 |
| Consumer goods | 3.3 | 3.1 | 2.3 | 7.3 | 1.2 | .4 | .0 |
| Durable consumer goods | 4.2 | 4.2 | 9.5 | -3.9 | 1.1 | -.2 | .6 |
| Automotive products | .5 | 4.4 | 13.5 | -3.6 | 2.9 | -.7 | 2.6 |
| Home goods | 7.0 | 4.0 | 6.6 | -4.1 | -.2 | .1 | -.9 |
| Nondurable consumer goods | 3.1 | 2.7 | .0 | 11.4 | 1.3 | .6 | -.2 |
| Equipment | -2.1 | 6.3 | 6.6 | 4.7 | .6 | .2 | .5 |
| Business equipment | -1.1 | 6.9 | 8.8 | 7.2 | .7 | .3 | .6 |
| Defense & space equipment | 5.0 | 1.9 | .2 | 1.6 | .6 | .1 | -.3 |
| Oil & gas well drilling | -50.1 | 37.1 | 13.7 | -19.4 | -1.1 | -1.2 | 4.1 |
| Intermediate products | 5.4 | 5.8 | 4.4 | 5.3 | 1.4 | .2 | -.3 |
| Construction supplies | 5.0 | 4.7 | 3.5 | 6.3 | 2.3 | -.5 | -1.3 |
| Materials | -.2 | 7.2 | 11.4 | .6 | -.6 | -.5 | .2 |
| Durable goods materials | -.5 | 8.1 | 15.5 | 3.1 | -.3 | -.5 | .3 |
| Nondurable goods materials | 5.7 | 8.0 | 6.0 | .6 | -1.5 | -.3 | .3 |
| Energy materials | -5.2 | 4.6 | 8.7 | -4.7 | -.3 | -.7 | -.2 |

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

| | 1978-80 High | 1982 Low | 1967-87 Avg. | 1987 Dec. | 1988 Jan. | 1988 Feb. | 1988 Mar. |
|---|---|---|---|---|---|---|---|
| Total industry | 86.9 | 69.5 | 81.5 | 82.4 | 82.6 | 82.4 | 82.3 |
| Manufacturing | 86.5 | 68.0 | 80.6 | 82.6 | 82.8 | 82.6 | 82.5 |
| Primary processing | 89.1 | 65.0 | 81.7 | 87.6 | 87.2 | 86.5 | 86.3 |
| Advanced processing | 85.1 | 69.5 | 80.1 | 80.3 | 80.7 | 80.7 | 80.6 |
| Mining | 95.2 | 76.9 | 86.7 | 81.5 | 80.4 | 79.8 | 80.3 |
| Utilities | 88.5 | 78.0 | 86.9 | 80.0 | 82.4 | 82.8 | 81.8 |
| Industrial materials | 89.1 | 68.5 | 82.2 | 83.6 | 83.0 | 82.4 | 82.4 |
| Metal materials | 93.6 | 45.7 | 77.7 | 86.3 | 80.1 | 79.1 | 79.6 |
| Paper materials | 97.3 | 79.9 | 91.7 | 101.6 | 100.5 | 98.2 | n.a. |
| Chemical materials | 87.9 | 63.5 | 81.0 | 90.9 | 88.6 | 88.3 | n.a. |

this year. Nonetheless, utilization in most of these industries remains below 80 percent, suggesting that there still is considerable potential for further output growth.

Output of consumer goods has been mixed. Auto assemblies increased in March and rose further in April to a 7 million unit annual rate. Production of some types of nondurable consumer goods--for example, medicines and paper products--also has picked up. In contrast, output of appliances, furniture, and clothing has declined, apparently in part related to excess retail inventories of such items.

After declining sharply during the first two months of this year, materials output appears to have recovered somewhat in March and April. The weakness earlier this year was widespread. For example, production of textiles has declined since last fall, apparently owing to declines in output of clothing, carpeting and furniture, and, until recently, autos. Output in this industry seems to have continued weak in April. In addition, some industries, most notably paper, appear to be facing capacity constraints. Among durable materials, output of steel weakened during the first quarter, but has firmed in recent weeks.

Personal Income and Consumption

Real disposable personal income rose 3-1/4 percent in the first quarter after an even larger 5-1/4 percent gain in the second half of 1987. The rise in real DPI in the first quarter was bolstered by a reduction in income taxes and a relatively low rate of consumer price inflation, which partially offset a notable slowing in nominal personal income growth. Nominal income gains were damped by increases in

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from preceding period)

| | 1986[1] | 1987[1] | 1987 Q4 | 1988 Q1 | 1988 Jan. | 1988 Feb. | 1988 Mar. |
|---|---|---|---|---|---|---|---|
| | -------Annual rate------- | | | | ---Monthly rate--- | | |
| Personal consumption expenditures | 4.1 | 1.0 | -2.5 | 3.8 | -.2 | .8 | .2 |
| Excluding motor vehicles | 3.5 | 1.6 | .6 | 2.9 | -.1 | .6 | .2 |
| Durable goods | 12.4 | -3.6 | -20.3 | 12.7 | -.8 | 2.3 | -.2 |
| Motor vehicles | 12.0 | -6.9 | -36.2 | 18.1 | -2.4 | 3.5 | -.1 |
| Furniture | 10.9 | 1.7 | -2.1 | 13.7 | 1.2 | 1.4 | -1.1 |
| Nondurable goods | 2.9 | -.6 | -.5 | -.2 | -1.0 | .1 | .2 |
| Food | 1.0 | -1.2 | 1.4 | .4 | -1.3 | .8 | .1 |
| Apparel | 5.5 | .1 | -7.5 | -4.7 | -1.9 | -1.4 | -1.7 |
| Services | 2.4 | 3.7 | 2.4 | 3.9 | .5 | .7 | .4 |
| Memo: | | | | | | | |
| Personal saving rate (percent) | 4.3 | 3.7 | 4.8 | 4.6 | 4.7 | 4.7 | 4.5 |
| Real disposable personal income | 3.6 | 2.1 | 6.0 | 3.2 | .0 | .8 | .1 |

1. Annual changes are Q4/Q4.

SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, FRB seasonals)

| | 1986 | 1987 | 1987 Q4 | 1988 Q1 | 1988 Feb. | 1988 Mar. | 1988 Apr. |
|---|---|---|---|---|---|---|---|
| Autos and light trucks | 16.1 | 15.0 | 14.7 | 15.6 | 15.9 | 16.1 | 15.1 |
| Autos | 11.5 | 10.3 | 10.0 | 10.8 | 11.1 | 11.1 | 10.5 |
| Light trucks | 4.7 | 4.7 | 4.7 | 4.8 | 4.8 | 5.0 | 4.6 |
| Domestically produced[1] | 12.0 | 11.0 | 10.5 | 11.8 | 12.2 | 12.2 | 11.2 |
| Autos | 8.2 | 7.1 | 6.6 | 7.6 | 7.9 | 7.9 | 7.2 |
| Light trucks | 3.8 | 3.9 | 3.9 | 4.2 | 4.3 | 4.4 | 4.0 |
| Imports | 4.2 | 4.0 | 4.1 | 3.8 | 3.8 | 3.9 | 3.9 |
| Autos | 3.2 | 3.2 | 3.4 | 3.1 | 3.2 | 3.2 | 3.3 |
| Japanese | 2.4 | 2.2 | 2.4 | 2.1 | 2.1 | 2.2 | 2.2 |
| Korean | .2 | .3 | .3 | .5 | .5 | .5 | .5 |
| European | .7 | .7 | .7 | .6 | .6 | .6 | .5 |
| Light trucks | .9 | .8 | .8 | .6 | .6 | .7 | .6 |
| Memo: | | | | | | | |
| Auto production | 7.8 | 7.1 | 7.0 | 6.2 | 6.1 | 6.6 | 7.0 |

1. Includes vehicles produced in Canada and Mexico for General Motors, Ford, and Chrysler.
n.a.--not available.

personal contributions for social insurance, reflecting a hike in the FICA tax rate and an increase in the maximum taxable wage.[3] In addition, farm income fell sharply, and increases in interest income were much smaller than in recent quarters. In contrast, wages and salaries continued to rise at about the average pace of 1987, and transfer payments showed a pronounced rise, mainly owing to cost-of-living adjustments in social security benefits.

Real consumer spending rebounded in the first quarter, increasing 3-3/4 percent at an annual rate, after dropping 2-1/2 percent in the fourth quarter. In part, the growth in outlays reflected higher purchases of motor vehicles, which were boosted by automakers' incentive plans. However, spending on furniture--where inventory buildups had been evident at the beginning of the year--also rose sharply, and expenditures on services were up 4 percent, about the same pace as the average for 1987. In contrast, spending on nondurables remained soft, as outlays on clothing declined for the second quarter in a row, and spending in other major categories was little changed.

In April, sales of motor vehicles fell somewhat, owing to declines in both domestic cars and trucks; sales of imported vehicles were unchanged. Sales of domestically produced autos fell from a 7.9 million unit annual rate in March to a 7.2 million unit annual rate in April, and sales of light trucks were down as well. Auto incentives programs

3. The increase in the employee share of social security taxes resulting from the legislated changes in the tax rate and base is estimated to have been around $7 billion at an annual rate in the first quarter, somewhat smaller than the net reduction in personal income taxes attributable to tax reform.

were cut back after the first ten-day period in May; consequently, sales, while perhaps brisk in the first reporting period, may drop off significantly later this month.

Because strong sales and lower first-quarter production of domestic autos have reduced dealers' inventories to more comfortable levels, the manufacturers have revised up their assembly schedules. They now plan to produce more than 7-1/4 million units at an annual rate in both the second and third quarters, compared with 6-1/4 million units in the first quarter. All other things equal, the increase in auto production, if realized, will add 1-1/4 percentage points at an annual rate to real GNP growth in the second quarter.

Business Fixed Investment

Real outlays for business fixed investment jumped 21 percent at an annual rate in the first quarter, reflecting a surge in purchases of equipment.[4] Spending for nonresidential construction, in contrast, declined somewhat. Over the past year, investment spending has risen nearly 15 percent.

The rise in equipment outlays last quarter, which exceeded 30 percent at an annual rate, was fueled by a jump in spending on office and computing equipment. Outlays for other types of business equipment

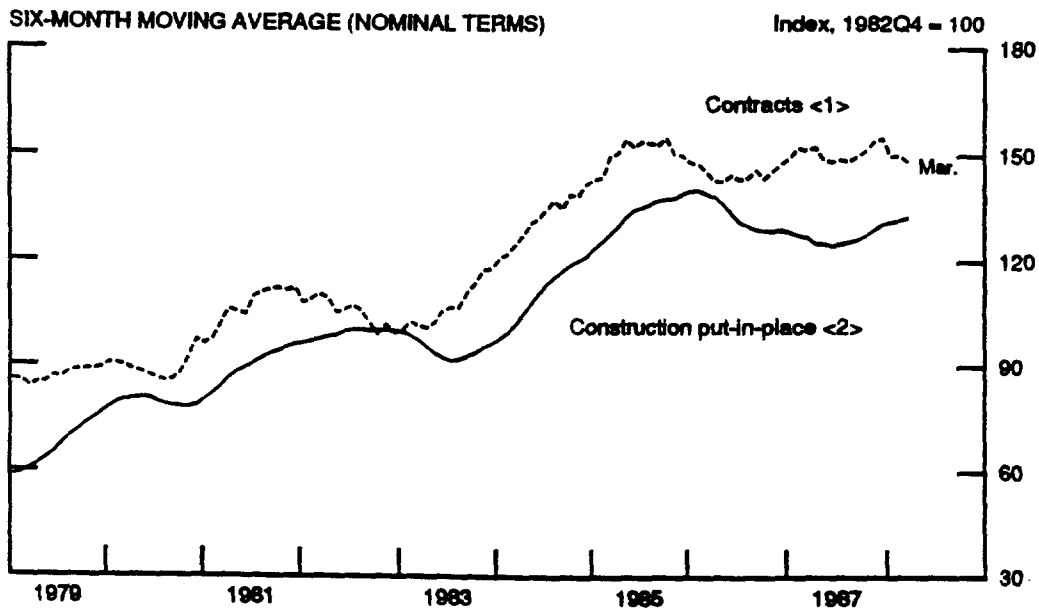
4. Although equipment spending undoubtedly was strong in the first quarter, the reported increase may have been overstated because of difficulties in seasonal adjustment related to major changes in tax laws in recent years. In particular, the Tax Act of 1986 reduced incentives that previously had caused equipment purchases to be bunched in the second and fourth quarters. However, current seasonal factors continue to reflect, in part, the quarterly pattern of outlays during 1986 and earlier years. As a result, these seasonals "expect" spending in the first and third quarters to be relatively weak, which artificially boosted spending growth last quarter on a seasonally adjusted basis.

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

| | 1987 | | 1988 | 1988 | | |
|---|---|---|---|---|---|---|
| | Q3 | Q4 | Q1 | Jan. | Feb. | Mar. |
| Producers' durable equipment | | | | | | |
| Shipments of nondefense capital goods | 5.1 | 2.4 | 5.4 | -.3 | .2 | 3.4 |
| Excluding aircraft and parts | 5.8 | 1.1 | 6.1 | 4.5 | -1.0 | 2.4 |
| Office and computing equipment | 6.2 | -3.2 | 19.0 | 19.0 | -3.5 | 3.2 |
| All other categories | 5.8 | 2.1 | 3.2 | 1.2 | -.3 | 2.2 |
| Shipments of complete aircraft (from CIR)[1] | 29.2 | -21.8 | n.a. | 41.6 | -3.9 | n.a. |
| Sales of heavy-weight trucks | 1.3 | 5.6 | 8.8 | 1.9 | 16.0 | -4.1 |
| Orders for nondefense capital goods | 3.3 | 3.4 | 7.1 | 2.7 | -3.0 | -3.8 |
| Excluding aircraft and parts | 4.9 | .5 | 6.9 | 8.0 | -5.2 | 2.8 |
| Office and computing equipment | 4.3 | -6.6 | 18.8 | 29.5 | -9.9 | -1.1 |
| All other categories | 5.0 | 2.2 | 4.3 | 3.6 | -4.0 | 3.7 |
| Nonresidential structures | | | | | | |
| Construction put-in-place | 3.6 | 2.5 | -2.4 | -3.4 | .6 | .1 |
| Office | 4.6 | 5.2 | -2.5 | -1.1 | -.4 | -.4 |
| Other commercial | .0 | 3.9 | -4.6 | -2.0 | .6 | -.9 |
| Public utilities | 5.5 | -1.5 | -5.3 | -6.9 | .5 | -.1 |
| Industrial | 8.3 | 1.0 | .8 | -1.9 | 3.0 | 7.4 |
| All other | 1.6 | 4.6 | .1 | -4.4 | 1.8 | -2.4 |
| Rotary drilling rigs in use | 17.1 | -3.7 | -2.1 | -.2 | .4 | 9.0 |

1. From the Current Industrial Report (CIR) entitled "Civil Aircraft and Aircraft Engines." To estimate PDE spending for aircraft, BEA uses the aircraft shipments shown in that report, not the corresponding M-3 series. The CIR does not provide information on aircraft orders.

Nonresidential Construction Put-in-Place and Construction Contracts




<1> From F.W.Dodge. Includes industrial, commercial, and institutional construction.
<2> Includes the building components of nonresidential construction, i.e., industrial, commercial, institutional, and hotels and motels.

also were strong, rising at a 15 percent annual rate, as demand for industrial machinery continued to expand and purchases of motor vehicles were boosted by renewed incentive programs.

Real outlays for nonresidential construction fell in the first quarter, with declines in office and other commercial construction, and petroleum drilling. After advancing for two quarters, office construction edged down last quarter. Industrial construction continued to rise, but the gains were slight, perhaps reflecting some reluctance on the part of manufacturers to undertake the major commitments implied by building new plants; reports still are widespread of concerns about a rebound in the dollar or a recession undercutting the profitability of long gestation period investments.

Given the extraordinary rise in business fixed investment in the first quarter, it would not be surprising to see a lull in business spending in the next few months. Indeed, orders, which rose rapidly through January, softened in February and March, and contracts for nonresidential construction have shown little trend for several quarters. Recent surveys of investment plans, taken by the Commerce Department and McGraw-Hill, both indicate that firms plan to increase nominal outlays 8-3/4 percent this year. Because the first-quarter level of nominal BFI already was 7-1/2 percent above the 1987 average, these surveys, if borne out, also suggest slower growth in business investment, even allowing for some conceptual differences between the survey-based spending figures and the BFI data.

Business Inventories

Nonfarm inventory investment slowed in the first quarter, reflecting the sizable liquidation of auto stocks. Outside of autos, the accumulation of inventories continued, but has generally been in line with growth in shipments and sales.

Manufacturers' inventories increased moderately in the first quarter. Most of the accumulation occurred at industries with firm order books; they include machinery and business equipment (especially office and computing equipment), aircraft, chemicals, printing, and paper products. The overall factory inventory-sales ratio has changed little, on net, since late 1987 and remains low by historical standards.

Inventories of merchant wholesalers expanded considerably early this year. However, most of the accumulation was at sellers of machinery, in part reflecting higher levels of activity in capital goods markets; and changes in other wholesale stocks have been relatively small. Thus, the buildup in stocks at this level does not appear to be a significant concern. Data on nonauto retail stocks, which are available only through February, show little change in inventory positions early this year. Although additions to stocks have been small, the inventory-sales ratio in this sector remains very high.

Housing Markets

Housing market activity was a bit stronger in March, but remained below the levels of recent years. Total housing starts edged up to a 1.54 million unit annual rate, as a robust gain in single-family starts

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

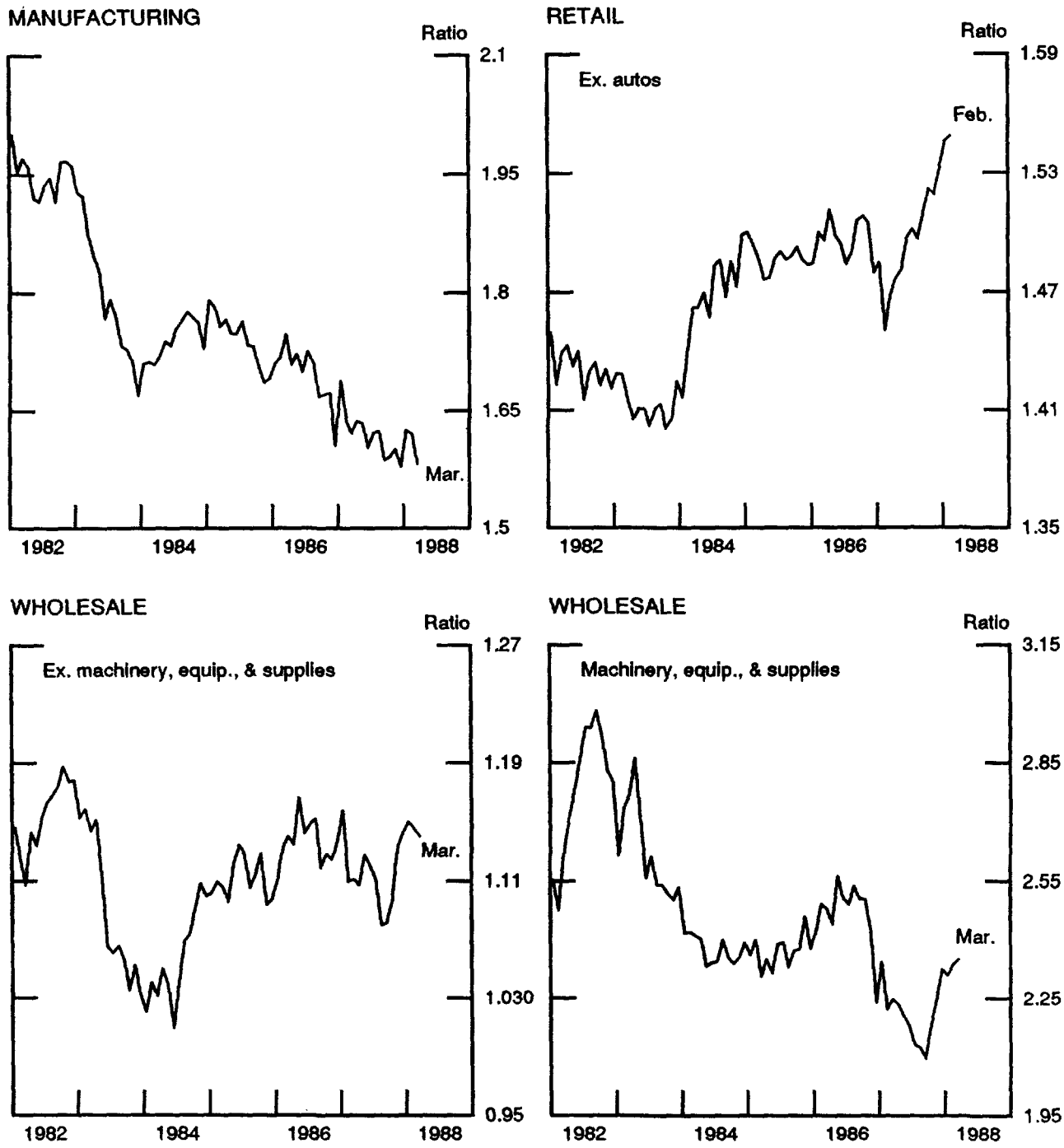
| | 1987 | | 1988 | 1988 | | |
|---|---|---|---|---|---|---|
| | Q3 | Q4 | Q1 | Jan. | Feb. | Mar. |
| Current cost basis: | | | | | | |
| Total | 34.5 | 81.4 | -- | 62.1 | 20.7 | -- |
| Manufacturing | 20.2 | 27.9 | 22.9 | 37.9 | 20.8 | 9.9 |
| Wholesale | 1.2 | 23.8 | 26.2 | 39.5 | 26.9 | 12.3 |
| Retail | 13.1 | 29.6 | -- | -15.3 | -27.0 | -- |
| Automotive | 4.5 | 14.2 | -- | -21.7 | -34.6 | -- |
| Ex. auto | 8.6 | 15.3 | -- | 6.4 | 7.5 | -- |
| Constant dollar basis: | | | | | | |
| Total | 5.3 | 42.9 | -- | 65.9 | 12.6 | -- |
| Manufacturing | 12.1 | 9.4 | -- | 33.3 | 15.2 | -- |
| Wholesale | 1.2 | 13.3 | -- | 39.1 | 13.7 | -- |
| Retail | -8.0 | 20.2 | -- | -6.5 | -16.3 | -- |
| Automotive | -11.9 | 14.1 | -- | -10.5 | -16.4 | -- |
| Ex. auto | 3.9 | 6.2 | -- | 4.0 | .1 | -- |

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

| | Range in Preceding 12 months:[2] | | 1987 | | 1988 | 1988 | | |
|---|---|---|---|---|---|---|---|---|
| | low | high | Q3 | Q4 | Q1 | Jan. | Feb. | Mar. |
| Current cost basis: | | | | | | | | |
| Total | 1.48 | 1.54 | 1.50 | 1.53 | -- | 1.54 | 1.52 | -- |
| Manufacturing | 1.58 | 1.64 | 1.62 | 1.60 | 1.61 | 1.63 | 1.62 | 1.58 |
| Wholesale | 1.21 | 1.30 | 1.23 | 1.27 | 1.31 | 1.30 | 1.30 | 1.29 |
| Retail | 1.56 | 1.64 | 1.59 | 1.65 | -- | 1.63 | 1.60 | -- |
| Automotive | 1.77 | 2.06 | 1.86 | 2.06 | -- | 1.92 | 1.78 | -- |
| Ex. auto | 1.47 | 1.55 | 1.51 | 1.54 | -- | 1.55 | 1.55 | -- |
| Constant dollar basis: | | | | | | | | |
| Total | 1.48 | 1.53 | 1.49 | 1.52 | -- | 1.53 | 1.53 | -- |
| Manufacturing | 1.60 | 1.65 | 1.63 | 1.61 | -- | 1.62 | 1.62 | -- |
| Wholesale | 1.23 | 1.33 | 1.24 | 1.29 | -- | 1.33 | 1.34 | -- |
| Retail | 1.50 | 1.60 | 1.54 | 1.61 | -- | 1.59 | 1.56 | -- |
| Automotive | 1.70 | 1.89 | 1.68 | 1.90 | -- | 1.79 | 1.70 | -- |
| Ex. auto | 1.42 | 1.53 | 1.50 | 1.53 | -- | 1.53 | 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.

## Ratio of Inventories to Sales
(Current-cost data)

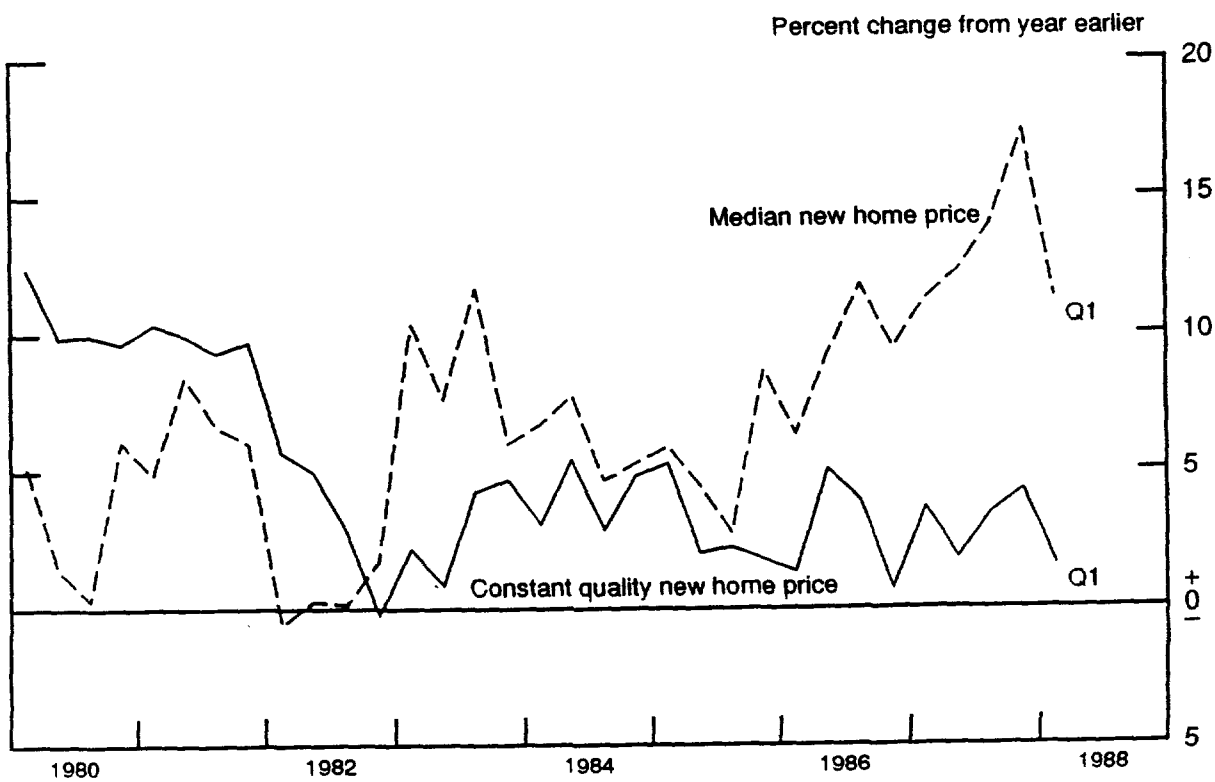


PRIVATE HOUSING ACTIVITY
(Seasonally adjusted annual rates; millions of units)

| | 1987 | 1987 | | 1988 | 1988 | | |
|---|---|---|---|---|---|---|---|
| | Annual | Q3 | Q4 | Q1 | Jan.[r] | Feb.[r] | Mar.[p] |
| All units | | | | | | | |
| Permits | 1.52 | 1.50 | 1.43 | 1.38 | 1.26 | 1.42 | 1.45 |
| Starts | 1.62 | 1.62 | 1.53 | 1.48 | 1.38 | 1.51 | 1.54 |
| Single-family units | | | | | | | |
| Permits | 1.03 | 1.00 | .98 | .98 | .92 | 1.00 | 1.03 |
| Starts | 1.15 | 1.15 | 1.09 | 1.10 | 1.02 | 1.11 | 1.19 |
| Sales | | | | | | | |
| New homes | .67 | .66 | .62 | .61 | .55 | .63 | .66 |
| Existing homes | 3.53 | 3.44 | 3.39 | 3.25 | 3.17 | 3.25 | 3.33 |
| Multifamily units | | | | | | | |
| Permits | .50 | .49 | .45 | .39 | .34 | .42 | .43 |
| Starts | .47 | .47 | .44 | .38 | .37 | .41 | .36 |

p--preliminary estimates.
r--revised.

Home Prices



more than offset another slump in the multifamily sector. Issuance of building permits also rose slightly.

The rise in single-family housing activity in February and March was spurred, in part, by lower interest rates, which were a touch below 10 percent for conventional fixed rate loans, and by an improvement in both consumer and builder attitudes. The March level of starts--1.19 million units at an annual rate--was toward the upper end of the range of the last year. New-home sales rose 4 percent in March to 655,000 units, and sales of existing homes increased by 3 percent to 3.3 million units.

In contrast to the single-family sector, multifamily starts dropped 12 percent in March to 358,000 units, the lowest rate in nearly six years. On a quarterly basis, multifamily starts have declined without interruption since the end of 1985, as near-record high vacancy rates have muted incentives to build. In the first quarter of 1988, the multifamily vacancy rate was nearly 10 percent, only slightly below the series high set in the third quarter of last year.

The moderate pace of housing activity has been accompanied by an apparent slowing in the year-to-year rate of increase in home prices. Constant-quality new home prices increased only 1-1/2 percent over the year ending in Q1, at the low end of the range observed in recent years. Increases in median prices of new (and existing) homes--not adjusted for changes in quality or regional mix--while quite volatile, also seem to have slowed from the extemely rapid year-over-year increases in late 1987.

Federal Government

A deficit of $29.1 billion was recorded in the federal unified budget in March. As shown in the accompanying table, the deficit for the fiscal year to date remains $4.3 billion below the total recorded over the comparable period of last year. However, such comparisons are potentially misleading as an indicator of the full year deficit because several special factors that worked to reduce last year's deficit did not affect the federal accounts until after March of 1987. They included the surge of capital gains tax receipts last April, a bunching of federal asset sales late in the year, and shifts in the timing of some spending.

Preliminary data for April and early May indicate that nonwithheld tax receipts--mostly from the final payments on taxpayers' prior year tax liabilities and the first estimated tax payments for the current year--were relatively large. This strength apparently reflects capital gains realizations generated in last year's unusually volatile financial markets, the base-broadening provisions of tax reform, and underwithholding early last year (when withholding tables and the value of withholding allowances were changed). Nonetheless, nonwithheld receipts were about $8 billion below a year earlier, when final payments had been swollen by the surge in capital gains realizations induced in 1986 by tax reform. Meanwhile, growth in refunds has been negligible.

Withheld taxes, which include income taxes and total social security contributions, have increased substantially in response to higher taxable incomes as well as the increase in the social security

MONTHLY BUDGET TOTALS FOR FISCAL YEARS 1987 AND 1988
(Billions of dollars; not seasonally adjusted)

| | Revenues | | Outlays | | Deficit | |
|---|---|---|---|---|---|---|
| | 1987 | 1988 | 1987 | 1988 | 1987 | 1988 |
| October | 59.0 | 62.4 | 84.3 | 93.1 | 25.3 | 30.7 |
| November | 53.0 | 57.0 | 80.1 | 83.9 | 27.1 | 26.9 |
| December | 78.0 | 85.5 | 90.4 | 109.8 | 12.4 | 24.2 |
| January | 81.8 | 81.8 | 83.9 | 65.8 | 2.2 | -16.0 |
| February | 55.5 | 60.4 | 83.8 | 84.3 | 28.4 | 23.9 |
| March | 56.5 | 65.0 | 84.4 | 94.1 | 27.9 | 29.1 |
| Total, fiscal year to date | 383.8 | 412.0 | 507.0 | 530.9 | 123.2 | 118.9 |

RECEIPTS DURING TAX FILING SEASON
(Billions of dollars)

| | Average 1984-1986 | 1987 | 1988[1] |
|---|---|---|---|
| Individual nonwithheld taxes[2] (January 1 through May 10) | 66.4 | 104.4 | 96.5 |
| Individual tax refunds (January through April) | 34.7 | 39.7 | 40.2[3] |
| Individual withheld taxes[4] (January through April) | 165.3 | 194.3 | 210.9 |
| Gross corporate income taxes | | | |
| March | 10.2 | 15.9 | 14.9 |
| April | 11.4 | 13.3 | 16.3[5] |

1. All 1988 individual tax data through March are from the Monthly Treasury Statement, April data are from the Daily Treasury Statement (DTS).
2. Primarily final payments on previous year's liability (includes social security taxes from self-employed individuals).
3. Figure limited to data from first 4 weeks of April to maintain comparability with prior years' data.
4. Includes both the employee and employer shares of social security payroll taxes, as well as withholding for personal income taxes.
5. Staff estimate based on DTS data.

tax rate. There has been some offset, however, from the cut in individual income tax withholding rates that went into effect on January 1, as mandated in the 1986 tax act.

Growth of corporate tax receipts appears weak when viewed in the context of the base-broadening and corporate accounting provisions of the 1986 tax act, which some analysts had expected to raise corporate payments substantially. March receipts, which are mostly the final payment on the prior year's liability, were down slightly from the year-earlier level. Preliminary April data indicate that the first quarterly estimated corporate tax payment on 1988 tax liability increased about $3 billion over last year. However, last April's receipts were depressed by safe harbor regulations that allowed corporations to defer some of their tax payments to September because of the difficulty of accurately determining tax liability immediately after the enactment of tax reform.

On the outlay side of the budget, spending in the first half of the fiscal year grew a bit more rapidly than last year. March data show some acceleration in entitlement spending, particularly for Medicare, whose growth had been restrained by cost containment provisions included in most of the deficit-cutting bills enacted in recent years. The pickup in overall spending occurred even though asset sales, which count as a negative outlay in the budget, restrained outlay growth more than during the corresponding year-earlier period. By March, about 27 percent of the $10.9 billion of asset sales and advance loan prepayments planned for 1988 had been completed. In 1987, only about

12 percent of $5.6 billion annual total in asset sales took place in the first half of the fiscal year.

Both houses of Congress have passed versions of a Congressional Budget Resolution that are broadly consistent with last fall's budget summit agreement with the administration. Nevertheless, the conference committee charged with reconciling differences in the details of the resolutions--primarily in the higher spending for space, science, and anti-drug programs proposed in the Senate version--failed to complete its work before suspending discussion in the first week of May for the Senate recess.

State and Local Governments

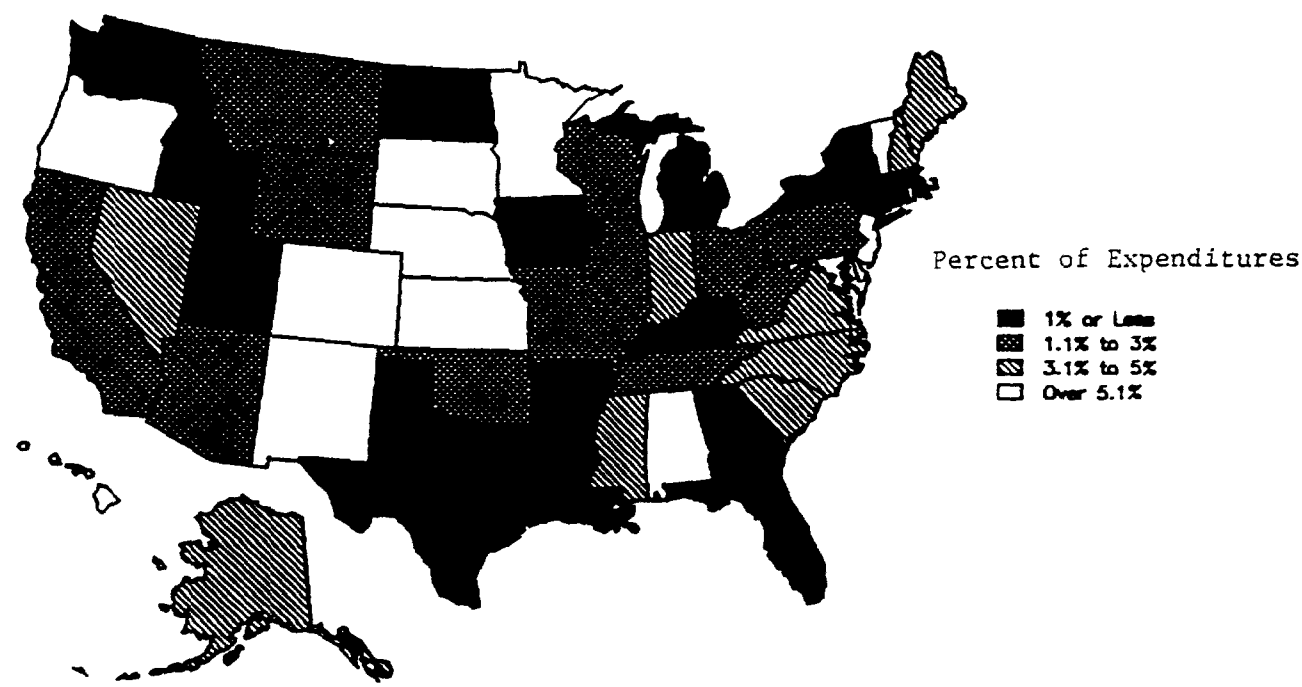
Growth in real purchases of goods and services by state and local governments apparently slowed in the first quarter after a strong gain in the fourth quarter of last year. Real spending on construction, based on BEA seasonals, increased slightly during the first quarter, and state and local employment moved up through April. Even so, the trend in total purchases seems subdued compared to the 1983-86 period, with the moderation likely stemming from recent fiscal problems.

Budgetary pressure among the states continued in fiscal 1988, but the adjustment process appears to be easing. During FY1988, which ends June 30 in most states, only 11 states have cut expenditures below planned levels, compared with 24 states the year before. In addition, just 14 states are planning tax increases this year, compared with 34 states last year. For the current year, real aggregate general funds outlays appear to be increasing at their slowest rate since 1983.

BALANCES[1] IN AGGREGATE STATE GENERAL FUNDS
(Fiscal year-end)

| | Year-end balance (billions of dollars) | Balance as a percent of expenditures |
|---|---|---|
| 1978 | 8.9 | 8.6 |
| 1979 | 11.2 | 8.7 |
| 1980 | 11.8 | 9.0 |
| 1981 | 6.5 | 4.4 |
| 1982 | 4.5 | 3.0 |
| 1983 | 2.0 | 1.3 |
| 1984 | 5.6 | 2.3 |
| 1985 | 8.0 | 4.3 |
| 1986 | 5.4 | 2.6 |
| 1987 | 4.7 | 2.1 |
| 1988[f] | 4.4 | 1.9 |

YEAR-END BALANCES[1] AS A PERCENT OF EXPENDITURES
(By state, fiscal year 1988[f])




Source: National Association of State Budget Officers (NASBO).
f--NASBO forecast.
1. Includes balance from previous year.

Nonetheless the overall year-end balance is expected to be about the same as last year, both in absolute terms and as a share of expenditures. Fifteen states are expecting year-end balances that are 1 percent or less of general funds expenditures in the current fiscal year, also about the same as in FY87.[5] The seemingly weakest fiscal positions are geographically widespread. While several of the energy states remain among the most troubled states, others are scattered.

Prices

Most broad measures of prices have been increasing at about a 3 to 4 percent annual rate so far this year. An exception was the 2-1/2 percent rise in the GNP implicit price deflator for the first quarter. A surge in spending on computers, which have a relatively low price level, was the principal factor holding down the rise in the deflator.

Prices at the consumer and producer levels rose more rapidly in March than in preceding months. The consumer price index for all urban consumers advanced 0.5 percent, after an increase of only 0.2 percent in February. Producer prices of finished goods, which dropped in February, rose 0.6 percent in March. In part, the pickup reflected an apparent bottoming out of energy prices, as declines in this component had held down inflation over the preceding four months. However, prices also picked up in March for food, apparel, and some other consumer goods; nonenergy service prices increased at a rate close to the average monthly pace of the past six months. So far this year, the CPI has

5. Bond analysts typically consider balances of 5 percent as a share of expenditures to be prudent.

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

| | Relative Importance Dec. 1987 | 1987 | 1987 Q3 | 1987 Q4 | 1988 Q1 | 1988 Feb. | 1988 Mar. |
|---|---|---|---|---|---|---|---|
| | | | ----Annual rate---- | | | -Monthly rate- | |
| All items[2] | 100.0 | 4.4 | 3.9 | 3.2 | 4.2 | .2 | .5 |
| Food | 16.1 | 3.5 | 2.1 | 2.8 | 1.4 | -.3 | .3 |
| Energy | 7.6 | 8.2 | 6.0 | -3.9 | -4.9 | -.6 | .0 |
| All items less food and energy | 76.3 | 4.2 | 3.8 | 4.4 | 5.4 | .2 | .6 |
| Commodities | 25.8 | 3.5 | 2.9 | 2.5 | 4.7 | .1 | .7 |
| Services | 50.6 | 4.5 | 4.3 | 5.0 | 5.9 | .4 | .5 |
| Memorandum: | | | | | | | |
| CPI-W[3] | 100.0 | 4.5 | 4.0 | 2.8 | 3.5 | .2 | .3 |

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

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

| | Relative Importance Dec. 1987 | 1987 | 1987 Q3 | 1987 Q4 | 1988 Q1 | 1988 Feb. | 1988 Mar. |
|---|---|---|---|---|---|---|---|
| | | | ----Annual rate---- | | | -Monthly rate- | |
| Finished goods | 100.0 | 2.1 | 3.8 | -2.6 | 3.1 | -.2 | .6 |
| Consumer foods | 25.9 | -.3 | -1.8 | -5.7 | 5.6 | -1.1 | .7 |
| Consumer energy | 9.6 | 10.3 | 16.5 | -12.5 | -16.9 | -.8 | .9 |
| Other consumer goods | 40.1 | 2.6 | 4.6 | 1.4 | 5.7 | .3 | .4 |
| Capital equipment | 24.4 | 1.3 | 4.0 | -.7 | 3.2 | .2 | .4 |
| Intermediate materials[2] | 95.0 | 5.6 | 5.6 | 4.8 | 3.5 | .0 | .6 |
| Exc. energy | 82.5 | 5.3 | 5.3 | 7.6 | 7.4 | .2 | .7 |
| Crude food materials | 39.5 | 1.7 | -4.8 | -5.2 | 17.2 | 2.3 | .8 |
| Crude energy | 41.9 | 10.5 | 5.9 | -15.7 | -23.2 | -.3 | -2.4 |
| Other crude materials | 18.6 | 22.4 | 39.4 | 16.9 | 14.8 | .8 | 1.4 |

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

risen at an annual rate of 4-1/4 percent, about 1/2 percentage point above the average rate in the second half of last year.

Retail energy prices leveled off in March, as small increases for gasoline and fuel oil offset some declines for natural gas and electricity. Spot prices of crude oil moved up about three dollars per barrel from early March through the end of April, but retraced about one-third of that increase when the recent meeting of OPEC and non-OPEC oil producers failed to produce an agreement on output cuts. Posted prices also have been higher in the past month and a half, which, in conjunction with higher spot prices, suggests some upward pressure on prices of refined petroleum products in the near term.

Retail food prices rose 0.3 percent in March, reversing their February decline. At the farm level, crude food prices increased 0.8 percent, and more recent developments in commodity prices suggest that this index may have risen further in April. So far this year, crude food prices have shown a marked uptrend, more than reversing their declines over the second half of 1987. Year-end futures prices for both livestock and crops also have generally moved higher since the last FOMC meeting; and for some farm commodities, further price increases may be in store, in view of the tightening inventory positions reported in the USDA's supply-demand projections of May 10.

Excluding both food and energy items, the CPI jumped 0.6 percent in March, after a February increase of 0.2 percent. The acceleration was concentrated in the commodities component, particularly apparel, which climbed more than 2 percent with the introduction of new higher-priced

spring and summer merchandise. In part, the rise in apparel prices reflected the ending of widespread markdowns to reduce inventories; the index for apparel commodities had dropped about 1 percent over the preceding three months.[6] But higher prices for imported goods also appear to have contributed to the rise in clothing prices. According to the BLS import price indexes for March, prices of imported clothing were 8 percent above their year-earlier levels. Import prices also continued to rise rapidly for a number of household and recreational goods.

Domestic producer prices of some consumer goods--notably apparel and furniture--also have picked up. In March, the PPI for finished consumer goods (less food and energy) rose 0.4 percent, with large increases in a number of categories. At the intermediate stage of processing, the PPI less food and energy rose 0.7 percent further in March. Large increases were registered for products of several industries operating at high rates of capacity utilization, notably chemicals, paper, plastics, and most metals. This index has risen at a 7-1/2 percent annual rate over the past six months, well above the 4-1/2 percent pace during the preceding nine months.

Prices of crude nonfood materials less energy advanced 1.4 percent in March, with further large increases for scrap metals and hides. From the mid-March pricing date through May 10, the pattern of spot price changes in industrial commodity markets was mixed, with net declines for

6. With the CPI revision of 1987, the BLS altered its procedures for introducing new apparel styles into the index. These changes, not yet reflected in the seasonal factors, have tended to result in sharp jumps in the (seasonally adjusted) apparel index in March and April, and again in September and October.

copper and steel scrap but firming for zinc. Aluminum prices registered wide swings over this period, and on balance, net gains with respect to mid-March. Prices of all of the above metals remain at historically high levels reflecting tight world markets.

Wages and Labor Costs

Recent data on labor costs generally show some firming in wages for workers in segments of the labor market that have experienced strong demand since the middle of last year, as well as sharp runups in some components of benefit costs. As measured by the employment cost index for private industry workers, compensation rose 3.9 percent over the 12 months ended in March, about 3/4 percentage point more than in the previous 12-month period. Wages and salaries were up 3.3 percent over the year, while benefits jumped 5.8 percent, boosted both by the January payroll tax increase and sharply higher employer costs for health insurance. Excluding sales workers, whose wages are heavily influenced by volatile commissions, wages and salaries rose 3.6 percent and compensation was up 4.2 percent.

A separate measure of nonfarm compensation, reported in the BLS release on productivity and costs, rose 3.4 percent at an annual rate in the first quarter to a level 3-1/2 percent above a year earlier, a smaller gain than indicated by the employment cost index. Although there are numerous conceptual differences between the two compensation measures, the discrepancy over the past year probably reflects differences in the treatment of benefits. In the ECI, benefit costs are surveyed directly and thus are likely to provide a relatively accurate

EMPLOYMENT COST INDEX
(Percentage change from 12 months earlier; not seasonally adjusted)

| | Mar. 1986 | Mar. 1987 | 1987 Sept. | 1987 Dec. | 1988 Mar. |
|---|---|---|---|---|---|
| Total private nonfarm compensation | 3.8 | 3.1 | 3.3 | 3.3 | 3.9 |
| Wages and salaries | 3.9 | 3.2 | 3.3 | 3.3 | 3.3 |
| Excluding sales | 3.9 | 3.1 | 3.5 | 3.7 | 3.6 |
| Benefits | 3.2 | 2.9 | 3.1 | 3.5 | 5.8 |
| By industry: | | | | | |
| Manufacturing | 3.1 | 2.3 | 2.6 | 3.1 | 4.7 |
| Union | 2.3 | .8 | 1.6 | 2.8 | 5.5 |
| Nonunion | 3.6 | 3.2 | 3.2 | 3.2 | 4.2 |
| Trade | 4.2 | 2.8 | 3.3 | 3.0 | 3.6 |
| Finance | 4.3 | 4.9 | 2.7 | 2.0 | .6 |
| Services | 4.9 | 4.3 | 5.2 | 5.2 | 5.2 |
| By occupation: | | | | | |
| White-collar | 4.4 | 3.7 | 3.7 | 3.7 | 3.7 |
| Blue-collar | 3.1 | 2.1 | 2.7 | 3.1 | 4.4 |
| Service workers | 3.6 | 2.9 | 2.7 | 2.4 | 2.9 |
| By bargaining status: | | | | | |
| Union | 2.9 | 1.6 | 2.0 | 2.8 | 3.9 |
| Nonunion | 4.2 | 3.6 | 3.7 | 3.6 | 4.0 |
| By region: | | | | | |
| Northeast | 5.2 | 4.4 | 4.5 | 5.0 | 4.6 |
| South | 3.6 | 2.6 | 2.7 | 3.0 | 3.8 |
| Midwest | 3.2 | 2.5 | 3.1 | 2.8 | 4.1 |
| West | 3.2 | 2.5 | 2.8 | 2.6 | 3.1 |
| Seasonally adjusted data:[1] | | | | | |
| Compensation | | | .9 | .9 | 1.4 |
| Wages and salaries | | | .9 | .8 | .8 |

1. Simple percentage change from three months earlier; seasonally adjusted by Board staff.

LABOR PRODUCTIVITY AND COSTS
(Nonfarm business sector)
(Percent change from preceding period at compound annual rates; based on seasonally adjusted data)

| | 1986[1] | 1987[1] | 1987 Q2 | 1987 Q3 | 1987 Q4 | 1988 Q1 |
|---|---|---|---|---|---|---|
| Output per hour | 1.5 | 1.3 | 1.4 | 4.2 | -1.0 | .9 |
| Compensation per hour | 3.4 | 2.8 | 3.0 | 3.6 | 3.5 | 3.4 |
| Unit labor costs | 1.9 | 1.5 | 1.5 | -.6 | 4.5 | 2.4 |

1. Changes are from final quarter of preceding period to final quarter of period indicated.

picture of current developments. However, in the productivity and costs measure of hourly compensation, benefits are based on an extrapolation of past trends, and, therefore, do not capture all of the pickup evident in the ECI survey.

Hourly compensation gains now appear more balanced across industries, occupations, and regions than had been the case in recent years. By industry, the largest pickup in compensation growth occurred in manufacturing (especially among durable goods producers), where increases in output have led to some firming in labor markets. Higher compensation inflation also is evident in the service-producing sector when compared to a year earlier, although much of this acceleration occurred before the stock market crash. After the crash, compensation increases dropped sharply for workers in finance, insurance, and real estate, and leveled off in most other service-producing industries.

The strength in the industrial sector also has been reflected in the pattern of compensation change by occupation, region, and union status. Larger increases recently have been evident for all blue-collar occupations. By region, compensation picked up more rapidly in the South and Midwest--areas benefiting from the improvement in heavy manufacturing. In addition, union compensation changes rose nearly 4 percent in the 12 months ended in March, matching the pace in the nonunion sector for the first time since 1983. Much of that acceleration, which occurred primarily in manufacturing, reflects sharply higher benefit costs for union workers, probably because union

contracts limit employers from adapting fringe benefit plans--especially for health insurance--to changes in the costs of those plans.

Despite the pickup in overall union wages, recent settlements suggest that wages remain restrained in industries that continue to face competitive pressures. In trucking, where competition from nonunion firms has reduced the number of employed union members by more than one-third since the industry was deregulated in 1980, the National Master Freight Agreement provides for an initial wage increase of only 2-1/4 percent and a maximum increase of 7 percent over three years. In the rubber industry, where union membership has dropped by nearly 40 percent over the past decade, recent contracts provide for a freeze of base wages over three years, although fairly generous COLA payments would still be made.

Finally, productivity in the nonfarm business sector is estimated to have risen about 1 percent at an annual rate in the first quarter, reversing the downward-revised decline in the fourth quarter of 1987. Over the past year, output per hour advanced about 1-1/2 percent, partially offsetting the 3-1/2 percent rise in hourly compensation and holding the increase in unit labor costs to 2 percent. Unit labor costs were even more restrained in manufacturing, owing both to better productivity performance and smaller increases in hourly compensation.

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

| | 1987 | | 1988 | | | Change from: | |
|---|---|---|---|---|---|---|---|
| | Jan.-Feb. lows | Oct. 16[2] | Feb lows | FOMC Mar 29 | May 10 | Oct. 16[2] | FOMC Mar 29 |
| **Short-term rates** | | | | | | | |
| Federal funds[3] | 5.95 | 7.59 | 6.38 | 6.56 | 6.99 | -.60 | .43 |
| Treasury bills[4] | | | | | | | |
| 3-month | 5.30 | 6.93 | 5.59 | 5.74 | 6.34 | -.59 | .60 |
| 6-month | 5.31 | 7.58 | 5.77 | 6.04 | 6.49 | -1.09 | .45 |
| 1-year | 5.35 | 7.74 | 6.10 | 6.36 | 6.89 | -.85 | .53 |
| Commercial paper | | | | | | | |
| 1-month | 5.81 | 7.94 | 6.41 | 6.62 | 7.05 | -.89 | .43 |
| 3-month | 5.73 | 8.65 | 6.45 | 6.68 | 7.17 | -1.48 | .49 |
| Large negotiable CDs[4] | | | | | | | |
| 1-month | 5.85 | 7.92 | 6.44 | 6.60 | 6.99 | -.93 | .39 |
| 3-month | 5.80 | 8.90 | 6.49 | 6.67 | 7.21 | -1.69 | .54 |
| 6-month | 5.78 | 9.12 | 6.55 | 6.88 | 7.50 | -1.62 | .62 |
| Eurodollar deposits[5] | | | | | | | |
| 1-month | 6.00 | 7.79 | 6.60 | 6.70 | 6.99 | -.80 | .29 |
| 3-month | 6.00 | 8.69 | 6.69 | 6.75 | 7.19 | -1.50 | .44 |
| Bank prime rate | 7.50 | 9.25 | 8.50 | 8.50 | 8.50 | -.75 | .00 |
| **Intermediate- and long-term rates** | | | | | | | |
| U.S. Treasury (constant maturity) | | | | | | | |
| 3-year | 6.34 | 9.52 | 7.28 | 7.66 | 8.23 | -1.29 | .57 |
| 10-year | 7.01 | 10.23 | 8.11 | 8.56 | 9.07 | -1.16 | .51 |
| 30-year | 7.29 | 10.24 | 8.32 | 8.81 | 9.20 | -1.04 | .39 |
| Municipal revenue[6] (Bond Buyer) | 6.92 | 9.59 | 7.76 | 8.27 | 8.27 | -1.32 | .00 |
| Corporate A utility (recently offered) | 8.78 | 11.50 | 9.63 | 10.07e | 10.58e | -.92 | .51 |
| Home mortgage rates[7] | | | | | | | |
| S&L fixed-rate | 9.10 | 11.58 | 9.84 | 9.99 | 10.32 | -1.26 | .33 |
| S&L ARM, 1-yr. | 7.52 | 8.45 | 7.59 | 7.52 | 7.63 | -.82 | .11 |

| | 1986 | 1987 | | 1988 | | Percent change from: | | |
|---|---|---|---|---|---|---|---|---|
| | Year-end | Record highs | Lows | FOMC Mar 29 | May 10 | Record highs | Lows | FOMC Mar 29 |
| **Stock prices** | | | | | | | | |
| Dow-Jones Industrial | 1895.95 | 2722.42 | 1738.74 | 1988.34 | 2003.65 | -26.40 | 15.24 | .77 |
| NYSE Composite | 138.58 | 187.99 | 125.91 | 147.22 | 145.75 | -22.47 | 15.76 | -1.00 |
| AMEX Composite | 263.27 | 365.01 | 231.90 | 294.33 | 299.81 | -17.86 | 29.28 | 1.86 |
| NASDAQ (OTC) | 348.83 | 455.26 | 291.88 | 372.96 | 375.43 | -17.54 | 28.62 | .66 |

1. One-day quotes except as noted.
2. Last business day prior to stock market decline on Monday, October 19, 1987.
3. Average for two-week maintenance period best to date shown except lows shown which are one-week average ending Feb.25 and Feb.10, respectively. Last observation is average to date for maintenance period ending 5/18/88.
4. Secondary market.
5. Average for statement week closest to date shown.
6. One-day quotes for Thursday.
7. Quotes for week ending Friday closest to date shown.

e--estimate.

Interest rates have risen considerably since the March FOMC meeting. Investment demand by the private sector appears to be pressing on available supplies of savings, and financial market participants have become increasingly concerned about inflationary risks associated with diminishing slack in labor and product markets. System actions have been subjected to close scrutiny; analysts generally concluded in the week after the meeting that reserve positions had been tightened slightly, and expectations of some further firming preceded the more recent snugging of the funds market.

The federal funds rate now has risen about 1/2 percentage point since late March, with trading around 7 percent in the past few days. Most other market rates of interest are up between 3/8 and 5/8 of a point from levels prevailing at the time of the last FOMC meeting, with only a modest diminution in the fairly steep slope of the yield curve. The spread between the prime rate and the 3-month CD rate has narrowed to about 130 basis points.

The narrower monetary aggregates grew rapidly in April. Expansion of M1 and M2 edged into the 10-percent area during a month in which tax-related flows often obscure underlying trends. Meanwhile, growth in M3 slowed a bit in April, reducing the aggregate's rate of increase since the fourth quarter to about 7 percent in contrast to 7-3/4 percent for M2.

Private credit demands showed signs of strength as the second quarter got under way. Business borrowing was robust in April, with

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

| | 1987[1] | 1987 Q4 | 1988 Q1 | 1988 Feb | 1988 Mar | 1988 Apr p | Growth Q4 87-Apr 88p |
|---|---|---|---|---|---|---|---|
| | Percent change at annual rates | | | | | | |
| 1. M1 | 6.2 | 3.9 | 3.9 | 1.1 | 5.5 | 11 | 5-1/4 |
| 2. M2 | 4.0 | 3.9 | 6.8 | 8.7 | 8.8 | 10 | 7-3/4 |
| 3. M3 | 5.3 | 5.4 | 6.8 | 10.4 | 7.3 | 6 | 7 |
| | | | | | | | Levels bil. $ Mar 88 |
| **Selected components** | | | | | | | |
| 4. M1-A | 2.8 | 4.0 | 1.4 | -2.7 | 4.1 | 9 | 496.1 |
| 5. Currency | 8.7 | 9.9 | 9.4 | 5.4 | 9.6 | 10 | 200.9 |
| 6. Demand deposits | -1.0 | 0.1 | -4.4 | -8.7 | 0.4 | 8 | 287.9 |
| 7. Other checkable deposits | 13.6 | 4.0 | 8.5 | 8.2 | 8.6 | 14 | 267.1 |
| 8. M2 minus M1[2] | 3.2 | 3.8 | 7.8 | 11.4 | 9.9 | 9 | 2204.6 |
| 9. Overnight RPs and Eurodollars, NSA | 4.0 | 7.5 | -12.3 | -66.7 | -49.2 | 37 | 74.9 |
| 10. General purpose and broker/dealer money market mutual fund shares, NSA | 5.8 | 12.0 | 19.5 | 32.5 | 20.3 | 6 | 235.0 |
| 11. Commercial banks | 2.5 | 3.5 | 7.2 | 10.1 | 9.9 | 6 | 941.4 |
| 12. Savings Deposits, SA, plus MMDAs, NSA[3] | 1.8 | -4.2 | 2.7 | 4.9 | 8.7 | 0 | 543.9 |
| 13. Small time deposits | 3.5 | 14.8 | 13.7 | 17.6 | 11.6 | 13 | 397.5 |
| 14. Thrift institutions | 3.5 | 3.4 | 8.7 | 12.2 | 12.7 | 10 | 956.5 |
| 15. Savings Deposits, SA, plus MMDAs, NSA[3] | 0.8 | -11.6 | -7.4 | -5.1 | 5.1 | 4 | 400.4 |
| 16. Small time deposits | 5.6 | 16.0 | 21.3 | 25.0 | 18.2 | 14 | 556.1 |
| 17. M3 minus M2[4] | 10.7 | 11.3 | 6.7 | 16.7 | 1.7 | -6 | 772.8 |
| 18. Large time deposits | 8.5 | 14.4 | 7.3 | 17.1 | 4.4 | 3 | 491.5 |
| 19. At commercial banks, net[5] | 11.2 | 10.5 | 3.4 | 17.2 | 5.9 | -3 | 326.4 |
| 20. At thrift institutions | 3.4 | 22.2 | 15.7 | 16.2 | 1.5 | 15 | 165.1 |
| 21. Institution-only money market mutual fund shares, NSA | 3.0 | 20.2 | 44.0 | 54.7 | -15.8 | -68 | 97.4 |
| 22. Term RPs, NSA | 29.9 | -4.1 | -0.4 | 37.5 | -34.2 | -1 | 105.7 |
| 23. Term Eurodollars, NSA | 12.9 | 11.1 | -28.2 | -8.5 | 44.0 | -26 | 87.6 |
| | Average monthly change in billions of dollars | | | | | | |
| **MEMORANDA:[6]** | | | | | | | |
| 24. Managed liabilities at commercial banks (25+26) | 6.1 | 5.3 | 0.5 | 2.5 | -1.2 | -3 | 567.8 |
| 25. Large time deposits, gross | 3.5 | 5.4 | 2.3 | 5.3 | 1.7 | -2 | 396.1 |
| 26. Nondeposit funds | 2.6 | -0.1 | -1.8 | -2.8 | -2.9 | -1 | 171.7 |
| 27. Net due to related foreign institutions, NSA | 2.9 | 1.0 | -6.6 | -6.4 | -6.4 | 0 | -4.5 |
| 28. Other[7] | -0.3 | -1.0 | 4.8 | 3.5 | 3.5 | -1 | 176.2 |
| 29. U.S. government deposits at commercial banks[8] | 0.3 | 0.4 | -0.4 | 4.0 | 2.3 | -3 | 24.9 |

1. Amounts shown are from fourth quarter to fourth quarter.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Commercial bank savings deposits excluding MMDAs grew during March and April at rates of 14.6 percent and 3 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during March and April at rates of 7.1 percent and 11 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
6. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
7. Consists of borrowing from other than commercial banks in the form of federal funds purchased, securitites sold under agreements to repurchase, and other liabilities for borrowed money (including borrowing from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
8. Consists of Treasury demand deposits and note balances at commercial banks.

p - preliminary

emphasis shifting back toward loans and away from bond issuance. A substantial part of business borrowing again was related to mergers and share buybacks. Few data are available yet for households, but growth in consumer loans at banks continued at a fast pace in April and mortgage borrowing may be on a mild upswing in line with increases in sales of new and existing homes in March. Public sector credit demands were not so strong: the Treasury's need to raise funds is typically light in the second quarter, and borrowing by state and local governments in April dipped well below the first-quarter average.

Monetary Aggregates and Bank Credit

Growth in M1 and M2 increased further in April to annual rates around 10 percent, owing partly to a buildup in transaction accounts to meet income tax payments. Demand and NOW deposits strengthened markedly around midmonth, at the same time that several types of liquid savings instruments--MMDAs, savings deposits, and M2-type MMMFs--were exhibiting weakness. The effect of tax obligations thus accentuated the already sluggish growth of MMDAs and savings deposits that was attributable in large part to a rise in the opportunity cost of holding such instruments as compared with small time deposits; the latter have been growing briskly since last fall.

M2 was also buoyed in April by an increase in overnight RPs and Eurodollar deposits. At the M3 level, this increase was offset by a comparable decline in term RPs and Eurodollars. Moreover, institution-only money market mutual funds contracted sharply in April, as rising market interest rates reduced their attractiveness. With growth in core

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

| | 1986:Q4 to 1987:Q4 | 1987 Q4 | 1988 Q1 | 1988 Feb. | 1988 Mar. | 1988 Apr.[p] | Levels bil.$ April[p] |
|---|---|---|---|---|---|---|---|
| | Commercial Bank Credit | | | | | | |
| 1. Total loans and securities at banks | 7.9 | 2.5 | 7.5 | 8.3 | 8.2 | 11.5 | 2296.2 |
| 2. Securities | 5.0 | 3.1 | 5.4 | 3.6 | 14.9 | 10.0 | 540.8 |
| 3. U.S. government securities | 9.1 | 2.2 | 6.8 | -0.4 | 17.6 | 14.2 | 342.9 |
| 4. Other securities | -1.3 | 4.7 | 2.7 | 10.5 | 10.4 | 3.0 | 197.9 |
| 5. Total loans | 8.8 | 2.3 | 8.2 | 9.8 | 6.2 | 11.9 | 1755.3 |
| 6. Business loans | 7.5 | 4.7 | 1.8 | 3.0 | -3.8 | 19.8 | 578.7 |
| 7. Security loans | 1.0 | -110.2 | 76.6 | 165.3 | -43.6 | -63.3 | 37.7 |
| 8. Real estate loans | 18.1 | 13.2 | 10.6 | 11.2 | 11.1 | 11.2 | 603.5 |
| 9. Consumer loans | 4.9 | 4.5 | 9.9 | 8.8 | 14.5 | 12.6 | 337.7 |
| 10. Other loans | -2.3 | -12.2 | 5.1 | -1.8 | 16.7 | 5.4 | 197.7 |
| | Short- and Intermediate-Term Business Credit | | | | | | |
| 11. Business loans net of bankers acceptances | 7.6 | 5.4 | 1.4 | 3.2 | -4.4 | 20.2 | 575.0 |
| 12. Loans at foreign branches[2] | -4.1 | -35.9 | 113.2 | 92.3 | 85.7 | - 6.2 | 19.4 |
| 13. Sum of lines 11 & 12 | 7.2 | 4.1 | 4.3 | 5.8 | -1.4 | 19.1 | 594.4 |
| 14. Commercial paper issued by nonfinancial firms | -1.6 | 23.9 | 8.8 | 11.3 | 40.6 | 8.1 | 89.3 |
| 15. Sum of lines 13 & 14 | 6.0 | 6.7 | 4.9 | 6.5 | 4.1 | 17.6 | 683.7 |
| 16. Bankers acceptances: U.S. trade related[3,4] | 13.3 | 7.1 | -11.6 | -24.6 | 3.6 | n.a. | 33.6[5] |
| 17. Line 15 plus bankers acceptances: U.S. trade related | 6.3 | 6.7 | 4.0 | 5.0 | 4.1 | n.a. | 706.2[5] |
| 18. Finance company loans to business[3] | 16.6 | 24.1 | n.a. | 4.1 | n.a. | n.a. | 207.0[6] |
| 19. Total short- and intermediate-term business credit (sum of lines 17 & 18) | 8.4 | 10.5 | n.a. | 4.8 | n.a. | n.a. | 910.8[6] |

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

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

deposits apparently strong enough to finance a pickup in bank credit growth, banks were able to run off some large time deposits. Together, these factors held M3 growth to a 6 percent rate.

Bank credit is estimated to have accelerated in April to an 11-1/2 percent annual rate of growth. Loan growth doubled, while security acquisitions remained rather brisk. The vigor in lending reflected a surge in business loans to a 20 percent rate, the strongest advance since the tax-related bulge around year-end 1986. Real estate loans continued to expand at the 11 percent pace maintained during the first quarter; increased write-offs of real estate loans, especially by large Texas banks, impeded expansion in that category, but sizable increases in revolving home equity loans (probably for tax payments) buttressed growth of real estate debt. Consumer loans slowed only a little from their rapid March pace.

Business Finance

Although the Commerce Department has yet to publish an estimate of corporate profits for the first quarter, the Board staff estimates that they edged lower. Capital expenditures apparently were about flat, as reduced inventory accumulation offset stronger fixed investment, so that the gap between outlays and internal funds probably widened. At the same time, the pace of net retirements of equity shares picked up, adding to borrowing needs. Nonfinancial firms increased their reliance on the bond markets in the first quarter, while business loan growth and issuance of commercial paper, which had been very strong at the end of last year, eased off.

FINANCING GAP AND MAJOR SOURCES OF FUNDS
NONFINANCIAL CORPORATIONS, EXCLUDING FARMS
($ billions, seasonally adjusted annual rates)

| | 1987 | 1987 | | 1988 |
|---|---|---|---|---|
| | Year | Q3 | Q4 | Q1[p] |
| Cash flow and capital outlays | | | | |
| 1. Internal funds[1] | 341 | 344 | 350 | 332 |
| 2. Capital expenditures[2] | 380 | 368 | 418 | 416 |
| 3. Fixed investment | 330 | 343 | 344 | 364 |
| 4. Inventory change[3] | 47 | 22 | 71 | 48 |
| 5. Financing gap (line 2 less line 1) | 39 | 24 | 69 | 84 |
| Market sources of funds | | | | |
| 6. Total funds raised in markets | 96 | 82 | 154 | 161 |
| 7. Net equity issuance | -77 | -78 | -88 | -95 |
| 8. Net borrowing | 173 | 160 | 242 | 256 |
| 9. Bonds and mortgages | 126 | 136 | 115 | 136 |
| 10. Loans and short-term paper | 46 | 24 | 127 | 120 |

1. Retained earnings and capital consumption allowances.
2. Includes mineral rights purchases not shown separately.
3. Before inventory valuation adjustment.
p--preliminary.

Available data for April suggest that total borrowing by nonfinancial firms strengthened a bit on balance from the already robust first-quarter pace, and that firms shifted the focus of their borrowing somewhat away from the bond market and back toward bank loans, as long-term financing costs rose. New bond offerings by nonfinancial firms of an estimated $7-1/4 billion in April were off $1/2 billion from March, while business loan demand rebounded strongly. The turnaround in business loans partly reflected unusual borrowing in late March and early April associated with the Texaco payment to Pennzoil and other merger-related loans.[1] Although commercial paper issuance slowed markedly in April, the sum of business loans plus commercial paper expanded at nearly an 18 percent rate, well above the pace of recent months.

The continuing heavy retirement of stock as a result of acquisitions and share repurchases has greatly influenced both the volume and the composition of borrowing. A substantial portion of March's commercial paper growth resulted from issuance to pay down a merger-related bank loan, and more than half of the April increase in business loans at large banks was associated with mergers. The volume of high-yield debt offerings, often used to help finance acquisitions and leveraged buyouts, has remained low both absolutely and relative to the level of investment-grade debt offerings. This may reflect both the uncertain

1. Pennzoil borrowed a total of $2.7 billion in advance of the Texaco payment in order to invest the funds gradually. Texaco borrowed $3 billion on April 6 for its scheduled payment to Pennzoil on April 7, after which the Pennzoil bank loans were repaid. In addition, Allegis borrowed an estimated $2.4 billion for its buyback of stock at the end of March.

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

| | 1987 | | | 1988 | | | |
|---|---|---|---|---|---|---|---|
| | Year | Q3 | Q4 | Q1[p] | Feb.[p] | Mar.[p] | Apr.[e] |
| Corporate securities - total[1] | 24.08 | 26.50 | 15.68 | 23.25 | 22.38 | 25.17 | 20.51 |
| Public offerings in U.S. | 21.89 | 23.72 | 14.78 | 21.91 | 20.49 | 24.30 | 18.30 |
| Stocks--total[2] | 4.45 | 5.07 | 1.52 | 3.83 | 3.89 | 4.90 | 2.80 |
| Nonfinancial | 2.32 | 2.36 | .73 | .79 | .87 | .70 | .90 |
| Utility | .57 | .71 | .14 | .30 | .54 | .20 | .30 |
| Industrial | 1.75 | 1.65 | .59 | .49 | .33 | .50 | .60 |
| Financial | 2.12 | 2.71 | .79 | 3.04 | 3.02 | 4.20 | 1.90 |
| Bonds--total[1] | 17.44 | 18.65 | 13.26 | 18.08 | 16.60 | 19.40 | 15.50 |
| Nonfinancial | 6.61 | 6.64 | 4.74 | 6.57 | 6.10 | 7.30 | 6.50 |
| Utility | 2.02 | 2.45 | 2.03 | 2.32 | 2.10 | 3.20 | 2.00 |
| Industrial | 4.59 | 4.19 | 2.71 | 4.34 | 4.00 | 4.10 | 4.50 |
| Financial | 10.83 | 12.01 | 8.52 | 11.51 | 10.50 | 12.10 | 9.00 |
| By quality[3] | | | | | | | |
| Aaa and Aa | 3.27 | 2.79 | 4.74 | 3.80 | 3.50 | 3.10 | 3.30 |
| A and Baa | 5.20 | 4.43 | 4.03 | 6.90 | 5.60 | 7.00 | 5.60 |
| Less than Baa | 2.77 | 3.67 | 1.32 | 1.34 | 1.65 | 2.00 | 1.70 |
| No rating (or unknown) | .07 | .05 | .03 | .05 | .15 | .05 | .20 |
| Memo items: | | | | | | | |
| Equity-based bonds[4] | .87 | .47 | .35 | .13 | .11 | .06 | .27 |
| Mortgage-backed bonds | 5.19 | 6.36 | 1.97 | 5.50 | 5.60 | 5.90 | 5.00 |
| Variable-rate notes | 1.88 | 2.79 | .64 | 1.41 | 1.38 | 2.02 | 1.10 |
| Bonds sold abroad - total | 2.03 | 2.51 | .85 | 1.29 | 1.79 | .85 | 2.10 |
| Nonfinancial | .94 | 1.27 | .39 | .39 | .50 | .48 | .75 |
| Financial | 1.09 | 1.24 | .46 | .90 | 1.29 | .37 | 1.35 |
| Stocks sold abroad - total | .16 | .27 | .05 | .05 | .10 | .02 | .11 |
| Nonfinancial | .12 | .16 | .05 | .04 | .06 | .02 | .04 |
| Financial | .04 | .11 | .00 | .01 | .04 | .00 | .07 |

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

access to junk bond financing by thinly capitalized raiders and the increased role in merger activity this year of investment-grade corporations with significant liquidity. In particular, foreign firms typically have relied less on borrowing to finance acquisitions than have their U.S. counterparts.

ACQUISITIONS OF NONFINANCIAL FIRMS
THROUGH MERGERS EXCEEDING $1 BILLION IN VALUE[1]

| | Value of transactions ($billion) | | | Numbers of acquisitions | | |
|---|---|---|---|---|---|---|
| Period | Foreign | Domestic | Total | Foreign | Domestic | Total |
| 1987-Year | 15.1 | 29.5 | 44.6 | 5 | 11 | 16 |
| 1988-April 30 | | | | | | |
| Completed | 3.6 | 8.5 | 12.1 | 2 | 4 | 6 |
| Pending | 10.9 | 22.3 | 33.2 | 4 | 12 | 16 |
| Total | 14.5 | 30.8 | 45.3 | 6 | 16 | 22 |

1. Mergers of nonfinancial firms with value of $1 billion or more that involve the retirement of stock. Data do not include any divestitures.

The sizable foreign participation in acquisitions activity that emerged in 1987 has persisted this year. Of the mergers of nonfinancial firms in 1987 that exceeded $1 billion, one-third of both the number of acquisitions and the value of transactions involved a foreign firm acquiring a domestic one. This pattern has continued in 1988, with foreign acquisitions accounting for $14 billion of the $45 billion total of completed or pending large mergers.[2] Moreover, the influence of

2. Mergers & Acquisitions, which tracks a broader set of corporate restructurings, including divestitures and mergers of both financial and nonfinancial firms, indicates a doubling in importance of the dollar volume of acquisitions by foreign corporations from 12 percent in 1986 to 26 percent in 1987.

foreign firms in the U.S. merger market extends beyond these figures on completed transactions in that some other foreign firms have been active competitors for target companies that ultimately were acquired by domestic firms.

Merger activity also appears to have put upward pressure on the yields of the debt of some potential takeover targets, although the limited price data for their bonds make estimates of the effect difficult. An examination of the yield spreads between outstanding debt of a small sample of firms that currently are takeover targets and Moody's indexes for bonds of the same rating classifications revealed a widening of spreads by 50 to 100 basis points when merger proposals first were announced. In two instances, yields on the debt of takeover candidates continued to rise in subsequent months, reaching levels 1-1/2 to 2 percentage points above the indexes. These results differ from the findings of past research on this topic, including some conducted at the Board, that generally showed little effect from takeovers on the wealth of bondholders in acquired firms.

In equity markets, share prices are little changed from their levels at the time of the last FOMC, although day-to-day price volatility has increased somewhat of late. Share offerings by nonfinancial firms were very light again in April, as corporations continued to delay offerings because of relatively low prices and continuing concerns about the possibility of large unpredictable price swings. Thus far in 1988, issuance of shares by nonfinancial firms has averaged less than a third of the pace seen over the first three quarters of 1987 when share

prices averaged nearly 20 percent higher than they have this year. The bulk of financial issues continue to be offered by closed-end mutual funds; large share flotations of this type boosted financial volume in March, but even these offerings tapered off in April.

Treasury and Sponsored Agency Financing

The federal government budget is expected to be about in balance in the second quarter, because of the seasonal inflow of tax revenues. The staff projects that the Treasury will borrow a total of $9 billion in the market this quarter and will end the quarter with a $30 billion cash balance.[3] Nonmarketable borrowing is expected to be fairly small, at $2.5 billion, in view of the limited needs of state and local governments to accommodate their relatively light advance refunding activity.

Over the second quarter, the Treasury is expected to continue to emphasize issuance of coupon securities. It will raise about $21 billion through coupon issues while the paydown in bills is expected to deepen to $12 billion as add-on purchases of bills by foreign central banks decline. Sizable exchange market intervention and portfolio diversification by some foreign central banks had caused an above-average volume of add-ons in December and January. Combined add-ons of coupons and bills are expected to fall from about $16 billion in the first quarter to about $8 billion in the second quarter. In April, add-ons totaled $2.8 billion, with about $1.1 billion occurring in bills, in line with projections for the quarter.

3. The Treasury sees a considerably smaller marketable financing need in the second quarter, but a correspondingly bigger need in the third quarter, than does the Board staff.

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

| | 1988 | | 1988 | | |
|---|---|---|---|---|---|
| | Q1 | Q2[p] | Apr.[p] | May[p] | June[e] |
| Treasury financing | | | | | |
| Total surplus/deficit (-) | -37.0 | .8 | 29.6 | -32.0 | 3.2 |
| Means of financing deficit: | | | | | |
| Net cash borrowing from the public | 42.8 | 12.4 | -1.8 | 7.9 | 6.2 |
| Marketable borrowings/ repayments (-) | 34.1 | 9.9 | -2.8 | 7.7 | 5.0 |
| Bills | 3.2 | -12.2 | -6.8 | -3.2 | -2.2 |
| Coupons | 30.9 | 22.1 | 3.9 | 10.9 | 7.2 |
| Nonmarketable | 8.7 | 2.5 | 1.0 | .3 | 1.2 |
| Decrease in the cash balance | -.4 | -3.3 | -23.3 | 26.8 | -6.8 |
| Memo: Cash balance at end of period | 22.9 | 26.1 | 46.2 | 19.4 | 26.1 |
| Other[2] | -5.4 | -9.9 | -4.4 | -2.8 | -2.7 |
| Federally sponsored credit agencies, net cash borrowing[3] | 6.5 | 10.5 | 1.0 | 4.7 | 4.9 |
| FHLBs | 2.5 | 5.1 | .6 | 2.0 | 2.5 |
| FNMA | 2.8 | 3.0 | .8 | 1.0 | 1.2 |
| Farm Credit Banks | .7 | -1.4 | -1.9 | .3 | .3 |
| FHLMC | -2.0 | .6 | .2 | .2 | .3 |
| FICO | .7 | 1.4 | .3 | .8 | .3 |
| SLMA | 1.8 | 1.8 | 1.0 | .5 | .3 |

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.
e--staff estimate.
p--preliminary.
Note: Details may not add to totals due to rounding.

Borrowing by federally sponsored credit agencies is expected to increase significantly during the second quarter, reflecting in part the seasonal need for funds of the housing-related agencies. Increased borrowing by FICO, the agency created last year to inject funds into the FSLIC, also is expected to boost the sponsored agencies' credit demands.

In early May, FICO sold $750 million of 30-year bonds to a single underwriter, who reoffered the securities to the market as coupon and principal strips. After the offering of the strips, which took many market participants by surprise, the yield spread between FICO's outstanding 30-year bonds and comparable 30-year Treasury securities narrowed from 113 basis points to 100 basis points. The structuring of the new issue and its success apparently caused market participants to lower their expectations of the near-term supply of whole, marketable 30-year bonds. In the three months prior to the offering, the spread had risen about 30 basis points, reflecting investors' expectation that supplies would swell because Congress eventually would raise FICO's current $10.8 billion borrowing limit in order for FSLIC to deal with the financial problems of the S&L industry. Investors also were concerned that a large new offering of bonds by FICO would reduce its ability to service its debt.

Concern about the financial condition of FSLIC has affected yields on the Federal Home Loan Banks' securities as well. Yield spreads between their securities and comparable Treasury securities were 8 to 14 basis points higher in the Banks' April financing than in March. In contrast to these wider spreads, the yield on the Farm Credit System's

6-month bond fell 15 basis points relative to the 6-month Treasury bill rate at the System's April offering. But the decline in that spread resulted from a smaller volume of issuance, rather than from a change in the market's view of the System's riskiness.

Municipal Securities

Issuance of long-term tax-exempt securities dropped off substantially in April. Long-term issuance has averaged $7-1/2 billion a month this year--still up marginally from last year's second half, but all of the gain reflects increased refunding volume. The raising of new capital so far in 1987 has averaged about $4.6 billion per month, compared with a $5 billion monthly pace over the second half of last year.

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

| | 1986 | 1987 | 1987 | | 1988 | 1988 | | |
|---|---|---|---|---|---|---|---|---|
| | Year | Year | Q3 | Q4 | Q1 | Feb. | Mar. | Apr.[p] |
| Total tax-exempt | 14.04 | 9.21 | 8.16 | 8.49 | 8.46 | 9.19 | 10.19 | 8.30 |
| Short-term[1] | 1.79 | 1.38 | 1.83 | 1.26 | .52 | .61 | .37 | 2.72[3] |
| Long-term | 12.25 | 7.92 | 6.33 | 7.23 | 7.94 | 8.58 | 9.82 | 5.58 |
| Refundings[2] | 5.29 | 3.45 | 1.69 | 1.87 | 3.05 | 2.81 | 3.78 | 1.73 |
| New capital | 6.96 | 4.48 | 4.63 | 5.36 | 4.89 | 5.77 | 6.04 | 3.85 |
| Total taxable | .35 | .32 | .15 | .58 | .22 | .10 | .14 | .07 |

1. Does not include tax-exempt commercial paper.
2. Includes all refunding bonds, not just advance refundings.
3. Includes $2.6 billion of short-term notes issued by the state of New York; large spring issuance by New York is not unusual. Last April N.Y. State issued $2.8 in short-term bonds.
p--preliminary.

The Supreme Court's recent adverse ruling on the tax-exempt status of municipal securities apparently had no lasting effect on prices in

the secondary market.[4] They fell sharply on news of the decision, but quickly rallied to pre-announcement levels. Few informed market observers expect any noticeable near-term effect on the market for municipal issues, although most expect to see renewed efforts by Congress to restrict further the tax-exempt status of private-purpose municipal bonds.

Mortgage Markets

The average contract rate on new commitments for 30-year, fixed-rate conventional home mortgages has risen 33 basis points in the primary market since the last FOMC meeting, about in step with increases in secondary mortgage market yields. In contrast, the average initial rate quoted on adjustable-rate mortgages (ARMs) indexed to the yield on one-year Treasuries has risen just 11 basis points since the March meeting. Consequently, the initial rate advantage of ARMs has widened to roughly 270 basis points, reversing the pattern that characterized the early part of the year when fixed-rate quotes were declining. That earlier narrowing of the initial rate advantage for ARMs had resulted in a steady decline in the proportion of conventional home mortgages closed with adjustable rates. Reflecting commitments made in previous months, the ARM share in early April fell for the fourth consecutive month, dropping to 48 percent compared with nearly 70 percent in December.

4. The Supreme Court overturned a 93-year-old interpretation of the constitutional basis for tax-exempt status of municipal bond interest, as part of reaching its decision on the narrow question posed by **South Carolina v. Baker**, which was: Can the federal government withhold tax-exempt status from municipal securities that are issued in "bearer" rather than "registered" form?

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

| | Mortgage transactions | | Net change in mortgage assets[1] | | |
|---|---|---|---|---|---|
| | Originations | Sales | Total | Mortgage loans | Mortgage-backed securities |
| 1985 | 16.4 | 8.2 | 4.1 | 4.2 | -.1 |
| 1986 | 22.2 | 14.1 | 4.7 | 1.3 | 3.4 |
| 1987-Q1 | 21.8 | 12.9 | 1.8 | -.5 | 2.3 |
| Q2 | 23.1 | 12.7 | 7.2 | 2.6 | 4.6 |
| Q3 r | 20.0 | 9.6 | 6.1 | 2.5 | 3.6 |
| Q4 r | 19.5 | 6.8 | 9.0 | 4.7 | 4.3 |
| 1987-Oct. r | 19.6 | 7.3 | 9.4 | 4.2 | 5.2 |
| Nov. r | 19.4 | 6.3 | 9.8 | 5.1 | 4.6 |
| Dec. r | 19.5 | 6.9 | 7.8 | 4.9 | 3.0 |
| 1988-Jan. r | 17.4 | 6.1 | 5.8 | 5.2 | .6 |
| Feb. r | 18.9 | 7.8 | 1.2 | 4.6 | -3.5 |
| Mar. p | 19.1 | 9.2 | 1.0 | 1.3 | -.3 |

1. Net changes are adjusted to account for structural changes caused by mergers, acquisitions, liquidations, terminations, or de novo institutions.

NEW ISSUES OF MORTGAGE-BACKED PASS-THROUGH SECURITIES
BY FEDERALLY RELATED AGENCIES
(Monthly averages, billions of dollars)

| | Seasonally adjusted | | | | Not seasonally adjusted | |
|---|---|---|---|---|---|---|
| Period | Total | GNMAs | FHLMCs | FNMAs | Total | ARM-backed |
| 1985 | 9.0 | 3.8 | 3.2 | 2.0 | 9.0 | .3 |
| 1986 | 21.6 | 8.2 | 8.4 | 5.0 | 21.6 | .7 |
| 1987 | 19.7 | 8.2 | 6.2 | 5.3 | 19.7 | 1.2 |
| 1987-Q1 | 26.7 | 10.8 | 10.1 | 5.9 | 24.0 | 1.0 |
| Q2 | 26.8 | 9.7 | 9.6 | 7.5 | 24.8 | 1.1 |
| Q3 | 16.2 | 7.4 | 4.7 | 4.0 | 17.7 | 1.6 |
| Q4 r | 11.8 | 5.0 | 2.7 | 4.2 | 12.4 | 1.3 |
| 1988-Q1 p | 9.3 | 3.5 | 2.6 | 3.1 | 8.2 | .9 |
| 1988-Jan. r | 8.2 | 3.8 | 2.4 | 1.9 | 7.3 | .5 |
| Feb. r | 9.8 | 3.8 | 3.0 | 3.0 | 9.2 | 1.2 |
| Mar. p | 9.9 | 2.7 | 2.7 | 4.5 | 8.2 | 1.0 |
| Apr. p | 12.0 | 3.3 | 2.8 | 5.9 | 10.3 | 3.0 |

r--revised. p--preliminary.

If the more recent increase in the cost of fixed-rate financing is sustained, homebuyers may shift back toward ARMs in coming months, however. Encouraging such a shift is the continued willingness of lenders to offer large initial-rate discounts on adjustable-rate products. According to the results of the March FHLBB survey, about half of the ARM loans closed in that month carried initial discounts of a percentage point or more. Aggressive pricing of ARMs also is evident in declining spreads between initial ARM rates and some common rates used to index ARMs.

The volume of mortgages closed at FSLIC-insured thrifts increased marginally to a seasonally adjusted $19.1 billion in March. The moderate pickup in loan originations during February and March, following January's 2-1/2-year low, was roughly in line with the pace of housing sales and construction during those months. Thrifts increased their holdings of mortgage-related assets in March by the smallest amount since January 1987. This resulted partly from a $2 billion sale of pass-through securities by the troubled American Savings and Loan of Stockton, California, which was directed by the Federal Home Loan Bank Board earlier this year to reduce its portfolio of mortgage-backed securities.

The recent shift in originations toward fixed-rate mortgages has fueled a slight increase in issuance of federally related mortgage-backed pass-through securities since January, although the volume remains well below the average monthly pace registered in 1987. Issuance of ARM-backed securities typically accounts for a very small

CONSUMER INSTALLMENT CREDIT
(Seasonally adjusted)

| | Percent change (at annual rate) | | | | | | Net change (billions of dollars) | | Memo: Outstandings (billions of dollars) |
|---|---|---|---|---|---|---|---|---|---|
| | | | 1987 | 1988 | 1988 | | 1988 | | 1988 |
| | 1986[r] | 1987[r] | Q4[r] | Q1[p] | Feb.[r] | Mar.[p] | Feb.[r] | Mar.[p] | Mar.[p] |
| Total[1] | 10.4 | 7.2 | 6.7 | 10.3 | 9.8 | 8.6 | 5.04 | 4.46 | 628.8 |
| Total, excluding auto | 5.7 | 6.2 | 5.6 | 7.6 | 6.1 | 4.3 | 1.79 | 1.25 | 352.4 |
| Selected types | | | | | | | | | |
| Auto | 17.4 | 8.6 | 8.1 | 13.7 | 14.5 | 14.1 | 3.25 | 3.21 | 276.3 |
| Revolving | 11.8 | 16.8 | 17.7 | 16.0 | 10.3 | 16.3 | 1.40 | 2.22 | 165.7 |
| All other | 1.7 | -1.5 | -4.2 | .4 | 2.5 | -6.2 | .39 | -.97 | 186.7 |
| Selected holders | | | | | | | | | |
| Commercial banks | 8.5 | 7.4 | 6.9 | 13.3 | 10.9 | 14.8 | 2.59 | 3.56 | 290.9 |
| Finance companies | 20.4 | 4.8 | 4.9 | 11.4 | 10.6 | 9.3 | 1.25 | 1.11 | 144.1 |
| Credit unions | 5.9 | 6.4 | 3.6 | 5.4 | 3.4 | 3.9 | .24 | .26 | 82.2 |
| Savings institutions[2] | 14.5 | 12.4 | 11.9 | 4.8 | 14.2 | -12.5 | .76 | -.68 | 64.7 |

1. Includes items not shown separately.
2. Savings and loans, mutual savings banks, and federal savings banks.
r--revised. p--preliminary.
Note: Details may not add to totals due to rounding.

CONSUMER INTEREST RATES
(Annual percentage rate)

| | | | | 1987 | | 1988 | | |
|---|---|---|---|---|---|---|---|---|
| | 1985 | 1986 | 1987 | Nov. | Dec. | Jan. | Feb. | Mar. |
| At commercial banks[1] | | | | | | | | |
| New cars (48 mo.) | 12.91 | 11.33 | 10.46 | 10.86 | ... | ... | 10.72 | ... |
| Personal (24 mo.) | 15.94 | 14.83 | 14.23 | 14.58 | ... | ... | 14.46 | ... |
| Credit cards | 18.69 | 18.26 | 17.92 | 17.82 | ... | ... | 17.80 | ... |
| At auto finance cos.[2] | | | | | | | | |
| New cars | 11.98 | 9.44 | 10.73 | 12.24 | 12.23 | 12.19 | 12.26 | 12.24 |
| Used cars | 17.59 | 15.95 | 14.61 | 14.90 | 14.97 | 14.56 | 14.75 | 14.77 |

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.

share of total federally related pass-throughs, reflecting the dominance in the ARM market of "portfolio lenders" who retain most of the loans they originate. In April, however, new ARM-backed issues jumped fairly sharply. The private ARM-backed pass-through market also seems poised for some expansion in coming months. Home Savings of America, one of the largest originators of ARM loans, announced recently that it plans to sell between $100 and $200 million of such pass-throughs each month, backed by ARMs that adjust monthly based on the FHLB Eleventh District cost-of-funds index.

Consumer Installment Credit

Consumer installment credit grew at an 8-1/2 percent annual rate in March, resulting in a first-quarter average (10-1/4 percent) that was well above the growth experienced during 1987. Auto credit, driven by strong sales of new cars and light trucks, advanced at a 14 percent rate in March. Because the auto makers in their recent promotions have emphasized cash rebates more than the reduced-rate loans available from their own finance subsidiaries, all lender groups have participated substantially in the auto credit surge this year. Revolving credit in March rose at a 16 percent rate and the "other" category contracted.

The strength in revolving credit continued the trend exhibited over the preceding 12 months, during which growth averaged about 18 percent at an annual rate, despite the maintenance of relatively high interest rates on credit cards and the phasing down of tax deductibility of consumer interest expense. At banks, revolving credit climbed at a 17 percent rate during the 12-month period, and increases in excess of a

50 percent rate were reported for thrift institutions, which hold roughly one-eighth of total revolving credit.[5] Benchmark revisions to the installment credit series show that the growth in revolving credit was more rapid at all financial institutions last year than originally estimated, as these institutions--especially thrifts--diverted customers from closed-end cash loans to credit card and other open-end plans.

5. Thrift institutions for this calculation include savings and loans, federal savings banks, mutual savings banks, and credit unions.

## Foreign Exchange Markets

The trade-weighted foreign exchange value of the dollar against the other G-10 currencies has appreciated about 1/4 percent on balance since the last FOMC meeting, as shown in Chart 1. The dollar strengthened early in the intermeeting period, bolstered by perceptions of tighter monetary policy in the United States. The release of disappointing U.S. trade data in mid-April prompted a sharp decline in the dollar.

U.S. interest rates rose more than interest rates in most foreign countries during the intermeeting period, and late in the period the firmness in U.S. bond yields spilled over into foreign bond markets. As indicated in Table 1, both short- and long-term rates in the United States were up about 1/2 percentage point over the intermeeting period. Short-term interest rates in Japan were flat, but long-term rates rose nearly 15 basis points from the March FOMC meeting and 35 basis points from mid-April. Three-month interbank rates in Germany firmed 20 basis points, and rates for longer maturities rose 50 basis points during the intermeeting period. Noting the movement in German interest rates through the end of April, Bundesbank Vice President Schlesinger remarked that German rates could be expected to increase if the dollar is steady and U.S. interest rates rise. Although this statement seemed to refer

Chart 1

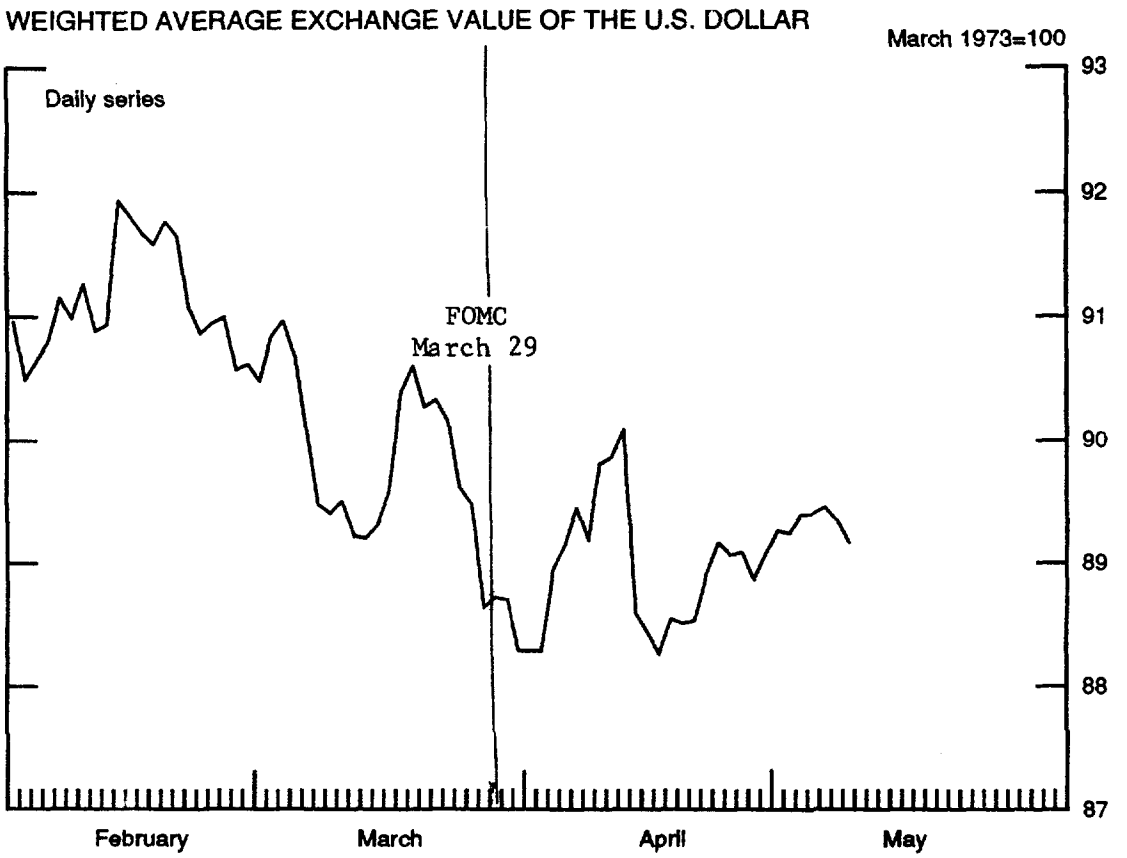



Table 1: Interest Rates in Selected Countries

| | U.S. | Japan | Germany | United Kingdom |
|---|---|---|---|---|
| | | 3-month interbank[1] | | |
| March 29 | 6.67 | 3.83 | 3.35 | 8.69 |
| April 12 | 6.85 | 3.79 | 3.35 | 8.19 |
| 26 | 6.99 | 3.80 | 3.40 | 8.38 |
| May 10 | 7.15 | 3.79 | 3.55 | 8.25 |
| | | Long-term[2] | | |
| March 29 | 8.56 | 4.49 | 5.67 | 8.90 |
| April 12 | 8.57 | 4.28 | 5.67 | 8.79 |
| 26 | 8.80 | 4.45 | 5.86 | 8.96 |
| May 10 | 9.07 | 4.62 | 6.16 | 8.96 |

1. U.S. rates are 90-day CDs.
2. U.S.--10-year constant maturity government bond yields; Japan--average yield on Japanese #105 bond; Germany--average yield on German public authority bond; and U.K.--3-1/2 percent war loan yield.

to a market-induced rise in long-term interest rates in Germany in the face of expectations of fairly stable exchange rates, some market participants interpreted these remarks as implying that the Bundesbank might follow any move towards a tighter monetary policy by the Federal Reserve. In Canada, both short- and long-term rates rose 30 basis points. In contrast, short-term interest rates in the United Kingdom fell, on balance, as the Bank of England again cut its money market dealing rate 1/2 percentage point to just below 8 percent early in the intermeeting period to curb sterling's strength. In other changes in official rates, the Bank of Sweden raised its discount rate a full percentage point to 8-1/2 percent in an effort to dampen credit creation and high levels of consumer demand.

. The Desk purchased $500 million

. Desk purchases were divided about equally against yen for the Treasury account and against marks for the System account.

U.S. International Financial Transactions

Foreign official reserve assets in the United States increased by $25 billion in the first quarter of 1988. (See line 4 of the Summary of U.S. International Transactions Table.) Partial information from FRBNY indicates additional inflows of $2.5 billion in April. Most of the inflows were accounted for by the G-10 countries,

OPEC holdings in the United States continued to decline in the first quarter of 1988, after dropping almost $9 billion in 1987. Holdings of all other countries increased during the first quarter,

Reflecting the large increases in foreign official holdings in the United States, net official purchases of U.S. Treasury securities (line 4b) were $27 billion in the first quarter of 1988. Of this total, $20 billion was in the form of bonds and notes and only $7 billion was in the form of bills and certificates. Net private foreign purchases of U.S. Treasury securities were also very large in the first quarter, particularly in February. (See line 3.) A large part of the private purchases was from financial centers, particularly London, so that the identity of the ultimate investors is unknown. Net private foreign purchases of Treasury securities were also concentrated in maturities of

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

| | 1986 Year | 1987 Year | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Q4 | 1988 Q1 | 1988 Jan. | 1988 Feb. | 1988 Mar |
|---|---|---|---|---|---|---|---|---|---|---|
| Private Capital | | | | | | | | | | |
| Banks | | | | | | | | | | |
| 1. Change in net foreign positions of banking offices in the U.S. (+ = inflow) | 22.3 | 48.4 | 13.1 | -5.6 | 31.2 | 9.8 | -0.2 | -3.7 | 2.7 | 0.9 |
| Securities | | | | | | | | | | |
| 2. Private securities transactions, net <1> | 65.5 | 36.9 | 16.6 | 15.6 | 11.7 | -6.9 | -2.2 | -0.7 | -1.8 | 0.4 |
| a) foreign net purchases (+) of U.S. corporate bonds | 53.5 | 26.6 | 8.5 | 7.5 | 7.7 | 2.8 | 2.6 | 0.1 | 0.5 | 2.0 |
| b) foreign net purchases (+) of U.S. corporate stocks | 18.0 | 16.8 | 10.1 | 8.7 | 5.4 | -7.4 | * | * | -0.2 | 0.3 |
| c) U.S. net purchases (-) of foreign securities | -6.0 | -6.5 | -2.1 | -0.7 | -1.5 | -2.2 | -4.8 | -0.9 | -2.1 | -1.8 |
| 3. Foreign net purchases (+) of U.S. Treasury obligations | 4.0 | -7.3 | -2.8 | -2.3 | -2.8 | 0.6 | 7.1 | -0.2 | 5.4 | 1.9 |
| Official Capital | | | | | | | | | | |
| 4. Changes in foreign official reserves assets in U.S. (+ = increase) | 33.5 | 47.8 | 15.3 | 11.6 | 0.9 | 20.0 | 24.9 | 7.4 | 9.3 | 8.2 |
| a) By area | | | | | | | | | | |
| G-10 countries (incl. Switz.) | 30.8 | 38.8 | 15.7 | 13.2 | -5.7 | 15.7 | 17.4 | 7.1 | 7.4 | 2.7 |
| OPEC | -8.3 | -8.9 | -2.7 | -2.0 | -1.3 | -2.8 | -1.5 | -1.1 | -0.3 | -0.1 |
| All other countries | 10.8 | 17.8 | 2.3 | 0.5 | 7.9 | 7.1 | 9.1 | 1.3 | 2.2 | 5.6 |
| b) By type | | | | | | | | | | |
| U.S. Treasury securities | 34.4 | 43.4 | 12.2 | 11.1 | 0.8 | 19.2 | 27.1 | 6.9 | 9.9 | 10.2 |
| Other <2> | -1.0 | 4.4 | 2.9 | 0.6 | 0.1 | 0.7 | -2.2 | 0.5 | -0.6 | -2.0 |
| 5. Changes in U.S. official reserve assets (+ = decrease) | 0.3 | 9.1 | 2.0 | 3.4 | * | 3.7 | n.a. | 1.3 | -0.3 | n.a. |
| Other transactions (Quarterly data) | | | | | | | | | | |
| 6. U.S. direct investment (-) abroad <3> | -28.0 | -38.2 | -10.0 | -5.6 | -6.2 | -16.4 | n.a. | n.a. | n.a. | n.a. |
| 7. Foreign direct investment (+) in U.S. <4> | 25.1 | 40.6 | 7.7 | 9.5 | 12.3 | 11.1 | n.a. | n.a. | n.a. | n.a. |
| 8. Other capital flows (+ = inflow) <3> <4> | -5.2 | 1.5 | 0.2 | 7.8 | 7.9 | 0.1 | n.a. | n.a. | n.a. | n.a. |
| 9. U.S. current account balance <4> | 141.4 | -160.7 | -36.9 | -41.3 | -43.4 | -39.0 | n.a. | n.a. | n.a. | n.a. |
| 10. Statistical discrepancy <4> | 23.9 | 21.9 | -5.2 | 6.9 | 3.2 | 17.0 | n.a. | n.a. | n.a. | n.a. |
| MEMO: | | | | | | | | | | |
| U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted) | -144.3 | -159.2 | -38.9 | -39.7 | -40.4 | -40.2 | n.a. | n.a. | n.a. | n.a. |

<1> These data have not been adjusted to exclude commissions on securities transactions and therefore, do not match exactly the data on U.S. international transactions as published by the Department of Commerce.

<2> Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.

<3> 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 of the data in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

<4> Includes seasonal adjustment for quarterly data.

<*> Less than $50 million.

NOTE: Details may not add to total because of rounding.

longer than one year; bills and certificates accounted for only about one-tenth of the total.

Foreign participation in U.S. stock markets recovered gradually in the first quarter. Net purchases were virtually zero (line 2b), but by March, the gross volume of purchases and sales rose almost to the monthly average for 1987. Foreign private net purchases of U.S. corporate bonds (on a payments basis) were $2.6 billion in the first quarter (line 2a). However, new issues of Eurobonds by U.S. corporations were sharply depressed in March, and were almost exclusively denominated in foreign currencies (marks, pounds, and Canadian dollars). In contrast, new bond issues by U.S. corporations in the domestic market did not show a similar decline. U.S. net purchases of foreign securities picked up in the first quarter of 1988; most of the increase consisted of bonds, although net purchases of stocks in Japan were also substantial.

Banks reported a small net outflow in the first quarter of 1988. (See line 1.) Inflows resulting from transactions with the World Bank and reduced claims on Mexico were more than outweighed by outflows to own foreign offices. As indicated on the International Banking Data table (line 1), these outflows did not continue in April. The sharp shift from inflows in 1987 to outflows in the first quarter was probably related to several factors: strong growth in core deposits relative to credit demands in the United States, an increase in loans booked offshore because of a widening of the prime-Libor differential, a decline in U.S. nonbank residents' holdings of Eurodollar deposits, and,

INTERNATIONAL BANKING DATA
(Billions of dollars)

| | 1984 | 1985 | 1986 | 1987 | | | | 1988 | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Dec. | Dec. | Dec. | Mar. | June | Sept. | Dec. | Feb. | Mar. | Apr.<2> |
| 1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS | 33.0 | 28.2 | 22.3 | 9.1 | 5.0 | -7.8 | -10.9 | 2.4 | 8.8 | 6.7 |
| (a) U.S.-chartered banks | 32.1 | 32.4 | 31.7 | 21.6 | 16.3 | 12.6 | 15.2 | 22.4 | 27.8 | 26.8 |
| (b) Foreign-chartered banks | .9 | -4.2 | -9.4 | -12.4 | -11.3 | -20.3 | -26.1 | -20.0 | -19.0 | -20.1 |
| 2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks | 20.7 | 18.7 | 16.8 | 16.0 | 15.6 | 17.1 | 15.8 | 18.1 | 19.0 | 19.1 |
| 3. Eurodollar Holdings of U.S. Nonbank Residents <1> | 117.6 | 111.1 | 124.5 | 134.0 | 135.7 | 141.1 | 132.6 | 125.4 | 127.1 | 126.4 |

<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.
<2> Through April 25, 1988.

perhaps, the shift of funds out of the Euromarkets by certain official monetary authorities. The end of outflows in April was associated with a surge in bank credit at domestic banking offices and a narrowing of the prime-Libor differential.

U.S. Merchandise Trade and Prices

Data on merchandise trade in February, released by the Census Bureau last month, show that the nominal trade balance registered a deficit of $13.8 billion (at a monthly rate, on a not seasonally adjusted CIF basis) in February. The increase in the February deficit from January's $12.4 billion figure can be traced primarily to a surge in the value of non-oil imports, while nonagricultural exports grew less than expected . (Census merchandise trade data for March will be released on May 17.)

Census Data on U.S. Monthly Merchandise Trade
(Billions of dollars, CIF valuation, n.s.a.)

| | Exports | | | Imports | | | |
|---|---|---|---|---|---|---|---|
| | Total | Ag. | Nonag. | Total | Oil | Non-oil | Balance |
| 1987 | | | | | | | |
| Oct. | 21.8 | 2.7 | 19.0 | 39.4 | 4.3 | 35.0 | -17.6 |
| Nov. | 23.8 | 2.9 | 20.9 | 37.0 | 4.0 | 33.0 | -13.2 |
| Dec. | 24.8 | 3.0 | 21.8 | 37.0 | 3.6 | 33.4 | -12.2 |
| 1988 | | | | | | | |
| Jan. | 22.3 | 2.9 | 19.4 | 34.8 | 3.6 | 31.1 | -12.4 |
| Feb. | 23.6 | 3.2 | 20.3 | 37.4 | 3.8 | 33.6 | -13.8 |

Correcting for seasonal factors and late documents, and translating to a balance of payments basis, the February deficit is estimated to have been $179 billion (at an annual rate), almost $40 billion worse than the January deficit and about $20 billion worse than

the 1987-Q4 average. Taken together, the January and February deficits averaged about $155 billion, roughly in line with staff expectations for the first quarter. (First quarter merchandise trade data on a balance of payments basis will be available May 25; in addition, revised data for earlier years will be released at that time.) The slight improvement in the January-February average relative to the fourth quarter figure can be traced to increases in agricultural exports, primarily corn and wheat, which supplemented the modest growth in nonagricultural exports, and a decline in the value of imported oil, which partially offset the rise in non-oil imports. The decline in oil imports in the first quarter was due to falling oil prices, which averaged $16.70 per barrel in the first two months of this year (on a CIF basis), relative to the fourth quarter average of $18.40 per barrel.

U.S. Merchandise Trade
(BOP basis, billions of dollars, SAAR)
(Monthly BOP basis data are for OFFICIAL USE only)

| | Exports | | | Imports | | | |
|---|---|---|---|---|---|---|---|
| | Total | Ag. | Nonag. | Total | Oil | Non-oil | Balance |
| 1987 | | | | | | | |
| Oct. | 258.3 | 32.5 | 225.8 | 441.0 | 49.6 | 391.4 | -182.7 |
| Nov. | 275.4 | 28.9 | 246.5 | 425.7 | 43.9 | 381.8 | -150.3 |
| Dec. | 295.0 | 31.4 | 263.6 | 444.1 | 39.6 | 404.5 | -149.1 |
| Q4 | 276.2 | 30.9 | 245.3 | 436.9 | 44.4 | 392.6 | -160.7 |
| 1988 | | | | | | | |
| Jan.-e | 281.3 | 36.2 | 245.1 | 413.2 | 39.7 | 373.5 | -131.9 |
| Feb.-e | 287.5 | 35.6 | 251.9 | 466.2 | 42.9 | 423.3 | -178.7 |
| Jan.-Feb. | 284.4 | 35.9 | 248.5 | 439.7 | 41.3 | 398.4 | -155.3 |

e/ Estimated.

The preliminary estimate for first quarter GNP, released by BEA late last month, showed an improvement in NIA net exports of goods and services in both nominal terms and real terms, relative to the fourth quarter of last year. Real NIA net exports of goods and services, which have shown quarterly improvements since mid-1986, are estimated to have shown only a small improvement in the first quarter.

GNP Net Exports of Goods and Services
(Billions of dollars, annual rate)

| Current Dollars: | 1987 | 1987-Q3 | 1987-Q4 | 1988-Q1 |
|---|---|---|---|---|
| Exports | 427.8 | 439.2 | 458.1 | 470.6 |
| Merchandise | 257.6 | 267.2 | 280.3 | 292.4 |
| Nonagricultural | 227.7 | 233.6 | 249.2 | 255.7 |
| Imports | 547.4 | 562.9 | 582.4 | 586.0 |
| Merchandise | 411.3 | 421.7 | 435.4 | 437.2 |
| Non-oil | 368.7 | 371.1 | 390.6 | 395.0 |
| Net Balance | -119.6 | -123.7 | -124.3 | -115.4 |
| Constant 1982 Dollars: | | | | |
| Exports | 425.8 | 437.1 | 453.5 | 464.6 |
| Merchandise | 281.1 | 291.4 | 303.8 | 315.6 |
| Nonagricultural | 245.8 | 251.2 | 267.9 | 274.5 |
| Imports | 561.3 | 575.6 | 589.3 | 596.8 |
| Merchandise | 444.5 | 454.9 | 465.3 | 472.3 |
| Non-oil | 367.1 | 367.4 | 384.8 | 385.9 |
| Net Balance | -135.5 | -138.4 | -135.8 | -132.2 |

The NIA implicit deflator for nonagricultural exports was relatively flat in the first quarter, while the deflator for non-oil imports rose only modestly. The increase of 3.2 percent (at an annual rate) in the deflator for non-oil imports can be contrasted with the 7.5 percent rise in the fixed-weighted price of non-oil imports (based on FR staff estimates). In recent history, the implicit deflator for non-oil imports has increased less rapidly than the fixed-weighted price due to

both the growing proportion of business machinery imports, and the decline in the prices of those imports. BEA's estimate of the implicit deflator for non-oil imports could well be revised upward in subsequent estimates of first quarter GNP, as BLS export and import price data (discussed below) were not available when BEA made its preliminary estimate.

NIA Implicit Deflators and Fixed-Weighted Prices
(% change, annual rate)

| | 1987 | 1987 | | | 1988 |
|---|---|---|---|---|---|
| | | Q2 | Q3 | Q4 | Q1 |
| Implicit Deflator: | | | | | |
| Exports | -0.4 | 1.6 | 0.8 | 2.4 | 1.6 |
| Nonagricultural | 0.4 | 2.0 | 2.0 | 0.0 | 0.4 |
| Imports | 5.6 | 9.5 | -0.4 | 4.0 | -2.8 |
| Non-oil | 4.1 | 6.6 | 2.8 | 2.0 | 3.2 |
| Fixed-Weighted Price: | | | | | |
| Exports | | | | | |
| Imports | 8.2 | 13.6 | 9.4 | 3.4 | -0.8 |
| Non-oil* | 6.4 | 8.4 | 8.0 | 6.7 | 7.5 |

*Estimated by FR staff.

According to BLS, prices of non-oil imports (not seasonally adjusted) rose 9.5 percent at an annual rate in the first quarter, somewhat below the 12.6 percent annual rate of increase recorded in the fourth quarter of last year, but substantially above the increase in BEA's implicit deflator shown in the preliminary GNP estimate (and somewhat above FR staff estimates of the increase in the non-oil import fixed-weighted price index). BLS information on prices of capital goods excluding business machines, consumer goods, and automobiles will be used in the revision of the GNP accounts. All of these components showed increases in the first quarter, and taken together with recorded increases in the prices of industrial supplies (unit value indexes),

imply an upward revision to the implicit deflator. Prices of exports showed a 5.7 percent annual rate of increase in the first quarter, less than the fourth quarter 1987 rate of 8.2 percent.

With this BLS press release, the weighting structure of import and export price indexes has been updated to reflect U.S. international trading patterns as of 1985. Indexes for 1985, 1986, and 1987 have been recalculated using the updated weighting structure. The most significant change in index behavior was related to the decline in the relative importance of imported fuels.

BLS Price Indices for Merchandise Exports and Imports

| BLS Price Indices | 1987 (Revised) June | Sept. | Dec. | 1988 Mar. | March 1987 to March 1988 |
|---|---|---|---|---|---|
| Exports | 9.5 | 2.4 | 8.2 | 5.7 | 6.5 |
| Imports | 13.9 | 3.2 | 6.6 | 4.9 | 7.1 |
| Oil | 45.8 | 1.2 | -33.2 | -28.3 | -8.3 |
| Non-oil | 10.4 | 3.6 | 12.6 | 9.5 | 8.9 |
| Food | 12.1 | 2.8 | 13.0 | 5.7 | 8.5 |
| Chemicals | 8.7 | 3.2 | 18.3 | 15.6 | 11.3 |
| Crude Materials | 4.1 | 14.8 | 6.1 | 25.3 | 12.3 |
| Int. Mfg. Products | 15.2 | 14.3 | 18.3 | 14.3 | 15.5 |
| Machinery & Transp. | 8.2 | 0.0 | 11.2 | 7.0 | 6.6 |
| Machinery | 9.1 | -1.2 | 13.9 | 6.1 | 6.9 |
| Passenger Cars | 6.1 | 0.0 | 5.3 | 7.0 | 4.6 |
| Misc. Mfg. Products | 12.1 | 2.4 | 11.7 | 7.8 | 8.4 |

Developments in the Foreign Industrial Countries

Indicators of economic activity in the major industrial countries during the first months of 1988 show continued strength in Japan, and, on balance, in Europe as well. Industrial production in Japan registered a large 3.7 (s.a.) percent increase in the first quarter. In Germany, it increased by 1 percent (s.a.), despite a sharp fall in the

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

| | Q4/Q4 1986 | Q4/Q4 1987 | 1987 Q2 | 1987 Q3 | 1987 Q4 | 1988 Q1 | 1987 Nov. | 1987 Dec. | 1988 Jan. | 1988 Feb. | 1988 Mar. | Latest 3 months from year ago 2/ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Canada** | | | | | | | | | | | | |
| GDP | 1.8 | 5.7 | 1.3 | 1.3 | 1.5 | n.a. | * | * | * | * | * | 5.7 |
| IP | -.5 | 7.5 | 1.4 | 2.1 | 2.1 | n.a. | .5 | .4 | .1 | -.4 | n.a. | 6.5 |
| **France** | | | | | | | | | | | | |
| GDP | 2.0 | 2.2 | 1.0 | 1.0 | .4 | n.a. | * | * | * | * | * | 2.2 |
| IP | -.3 | 3.6 | 1.6 | .6 | 1.0 | n.a. | .0 | 1.0 | .0 | -.9 | n.a. | 4.3 |
| **Germany** | | | | | | | | | | | | |
| GNP | 2.4 | 2.3 | .7 | 1.4 | .7 | n.a. | * | * | * | * | * | 2.3 |
| IP | .6 | 1.3 | 2.2 | .3 | .8 | .9 | -.1 | .5 | .7 | 1.2 | -2.5 | 4.4 |
| **Italy** | | | | | | | | | | | | |
| GDP | 3.2 | 2.8 | 1.2 | 1.0 | .2 | n.a. | * | * | * | * | * | 2.8 |
| IP | 2.8 | 5.7 | 2.0 | -2.8 | 3.3 | n.a. | -1.1 | -3.9 | 8.9 | -4.5 | n.a. | 5.8 |
| **Japan** | | | | | | | | | | | | |
| GNP | 2.0 | 5.3 | .0 | 2.0 | 1.7 | n.a. | * | * | * | * | * | 5.3 |
| IP | -.5 | 9.2 | -.2 | 3.6 | 4.1 | 3.7 | .8 | 2.0 | .5 | 2.2 | .4 | 11.8 |
| **United Kingdom** | | | | | | | | | | | | |
| GDP | 4.4 | 4.3 | .8 | 1.9 | .7 | n.a. | * | * | * | * | * | 4.3 |
| IP | 2.4 | 4.1 | .8 | 1.5 | 1.0 | n.a. | .3 | .3 | -.3 | -2.6 | n.a. | 3.1 |
| **United States** | | | | | | | | | | | | |
| GNP | 2.2 | 4.0 | .6 | 1.1 | 1.2 | .6 | * | * | * | * | * | 3.5 |
| IP | 1.0 | 5.8 | 1.1 | 2.1 | 1.7 | 1.0 | .5 | .5 | .4 | .0 | .1 | 6.0 |

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 1986 | Q4/Q4 1987 | 1986 | 1987 | | | | 1988 | 1988 | | | | Latest 3 months from year ago |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Jan. | Feb. | Mar. | Apr. | |
| **Canada** | | | | | | | | | | | | | |
| CPI | 4.3 | 4.2 | 1.0 | .9 | 1.4 | 1.2 | .7 | .8 | .2 | .4 | .5 | n.a. | 4.1 |
| WPI | .3 | 4.3 | .6 | .5 | 1.3 | 1.4 | 1.1 | n.a. | .8 | -.7 | n.a. | n.a. | 4.7 |
| **France** | | | | | | | | | | | | | |
| CPI | 2.1 | 3.2 | .7 | 1.2 | .9 | .6 | .5 | .5 | .2 | .2 | .3 | n.a. | 2.4 |
| WPI | -3.4 | 3.0 | -.7 | .7 | .5 | .7 | 1.1 | n.a. | * | * | * | * | 3.0 |
| **Germany** | | | | | | | | | | | | | |
| CPI | -1.0 | 1.0 | -.3 | .6 | .4 | .0 | .0 | .5 | .2 | .2 | .1 | .2 | 1.0 |
| WPI | -9.0 | -.7 | -1.6 | -.2 | .0 | -.4 | -.2 | .1 | .2 | -.1 | .2 | n.a. | -.4 |
| **Italy** | | | | | | | | | | | | | |
| CPI | 4.7 | 5.2 | 1.2 | 1.3 | 1.0 | 1.1 | 1.7 | 1.1 | .5 | .3 | .4 | .3 | 4.9 |
| WPI | -2.4 | 4.6 | .7 | 1.5 | 1.0 | .8 | 1.2 | 1.1 | .3 | .5 | .2 | n.a. | 4.1 |
| **Japan** | | | | | | | | | | | | | |
| CPI | .1 | 1.1 | .0 | -.3 | 1.2 | -.2 | .4 | -.2 | -.2 | -.1 | .4 | .5 | 1.1 |
| WPI | -9.1 | -.6 | -1.0 | -.7 | -.7 | 1.3 | -.4 | -1.2 | -.7 | -.1 | .1 | n.a. | -1.0 |
| **United Kingdom** | | | | | | | | | | | | | |
| CPI | 3.4 | 4.1 | 1.3 | 1.2 | 1.5 | .2 | 1.1 | .5 | .0 | .4 | .4 | n.a. | 3.4 |
| WPI | 4.2 | 3.9 | .8 | 1.3 | 1.1 | .5 | 1.1 | 1.3 | .7 | .4 | .5 | .6 | 4.1 |
| **United States** | | | | | | | | | | | | | |
| CPI (SA) | 1.3 | 4.4 | .7 | 1.3 | 1.2 | .9 | .9 | .8 | .3 | .2 | .5 | n.a. | 3.9 |
| WPI (SA) | -1.9 | 2.5 | .7 | .7 | 1.1 | .7 | -.0 | .2 | .4 | -.2 | .6 | n.a. | 1.9 |

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)

| | 1986 | 1987 | 1986 | 1987 | | | | 1988 | 1987 | 1988 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Dec. | Jan. | Feb. | Mar. |
| **Canada** | | | | | | | | | | | | |
| Trade | 7.5 | 7.8 | 1.8 | 2.4 | 2.3 | 2.1 | 1.1 | n.a. | .2 | .5 | 1.1 | n.a. |
| Current account | -6.7 | -7.3 | -2.1 | -1.2 | -1.5 | -1.9 | -2.7 | n.a. | * | * | * | * |
| **France** | | | | | | | | | | | | |
| Trade | .1 | -5.3 | .4 | -1.0 | -2.2 | -1.1 | -1.1 | -.7 | -.2 | -.1 | -.9 | .3 |
| Current account | 3.0 | -4.9 | .7 | -.0 | -1.2 | -1.0 | -2.6 | n.a. | * | * | * | * |
| **Germany** | | | | | | | | | | | | |
| Trade (NSA) | 52.5 | 65.8 | 16.2 | 15.1 | 15.4 | 15.2 | 20.1 | n.a. | 8.0 | 5.1 | n.a. | n.a. |
| Current account (NSA) | 38.5 | 44.7 | 13.8 | 11.1 | 10.6 | 7.8 | 15.2 | n.a. | 5.5 | 2.9 | n.a. | n.a. |
| **Italy** | | | | | | | | | | | | |
| Trade | -1.5 | -7.5 | .2 | -1.3 | -3.7 | -1.2 | -1.3 | n.a. | -.8 | -1.9 | -1.0 | n.a. |
| Current account (NSA) | 2.9 | -.8 | .6 | -2.8 | -.9 | 2.8 | .1 | n.a. | * | * | * | * |
| **Japan** | | | | | | | | | | | | |
| Trade | 82.5 | 79.6 | 22.5 | 23.6 | 19.0 | 18.3 | 18.6 | 20.8 | 6.7 | 7.8 | 6.5 | 6.6 |
| Current account 2/ | 85.4 | 86.6 | 24.0 | 25.3 | 21.3 | 19.9 | 20.2 | 23.2 | 7.5 | 8.0 | 7.9 | 7.3 |
| **United Kingdom** | | | | | | | | | | | | |
| Trade | -12.4 | -15.9 | -3.7 | -1.7 | -3.9 | -5.0 | -5.3 | -6.5 | -1.8 | -2.6 | -2.3 | -1.6 |
| Current account | .0 | -2.9 | -.9 | 1.2 | -.8 | -1.5 | -1.8 | -3.3 | -.6 | -1.5 | -1.3 | -.5 |
| **United States** | | | | | | | | | | | | |
| Trade 2/ | -144.3 | -159.2 | -38.6 | -38.9 | -39.7 | -40.4 | -40.2 | n.a. | * | * | * | * |
| Current account | -141.4 | -160.7 | -38.0 | -36.9 | -41.3 | -43.4 | -39.0 | n.a. | * | * | * | * |

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

preliminary estimate for March. In France, Canada, and the United Kingdom, the average levels of industrial production (s.a.) declined in the first two months of the year from their December levels. However, in each of these three countries unemployment has also declined, suggesting that the weakness displayed by their industrial sectors is not broadly based. Inflation remains low in most of the foreign G-7 countries.

Trends in external adjustment have been mixed so far in 1988. Merchandise trade (s.a.) and current account (n.s.a.) surpluses narrowed slightly in Germany during January. In Japan, both surpluses (s.a.) increased during the first quarter but remained below their level of a year ago. However, in real terms, Japan's external adjustment continued in the first quarter. Merchandise trade deficits deteriorated in Italy during the first two months of 1988 and in the United Kingdom during the first quarter.

Individual country notes. The pace of real economic activity in Japan remained strong in the first quarter of 1988 after a 6.9 percent rise in real GNP (s.a.a.r.) and a 10.1 percent increase in total domestic demand in the fourth quarter. Industrial production grew a further 3.7 percent (s.a.) in the first quarter, attaining a level almost 12 percent above a year earlier. Capacity utilization continued to rise, while unemployment declined to 2.6 (s.a.) percent of the labor force in March. Other indicators also suggest a tightening of labor market conditions: the ratio of job offers to applicants rose to 0.88 in February, the highest level since November 1974, and overtime hours

remained high. Surveys of investment intentions of large corporations indicate continued strength of capital spending in 1988, with growth of investment in the manufacturing sector outpacing that in the non-manufacturing sector. In contrast, residential investment has been weakening: housing starts (s.a.) declined for the third consecutive month in February, but remain considerably above the level of a year ago. This slowdown in the housing sector is expected to continue through 1988.

Inflation remains low in Japan. Wholesale prices in the first quarter were one percent below a year ago, and the Tokyo index of consumer prices in April was only 0.8 percent above its year-earlier level. Preliminary indications from the spring wage negotiations suggest an average nominal wage increase of about 4-1/2 percent, up from the 3.6 percent gain of the preceding year.

Japan's custom-cleared trade surplus (s.a.) edged up in March to $6.6 billion from $6.5 billion in February, as nominal exports fell 2.4 percent but imports declined by an even greater amount, 3.9 percent. The current account surplus for the first quarter was $92.7 billion (s.a.a.r.) compared with a surplus of $86.6 billion in 1987. Adjustment in volume terms continues, as import volume rose 6.5 percent (s.a.) in the first quarter while export volume rose by 3.3 percent.

The pace of money growth remains rapid, with M2+CDs increasing 11.8 percent in March from a year ago after 12.4 percent growth in February. For the first quarter, the aggregate rose 12.1 percent from a year earlier, in line with the Bank of Japan's projection of 12 percent

growth for the quarter. The Bank of Japan attributed the slower growth of M2+CDs in March to a decline in M1 and to a shift of funds from market-determined large denomination time deposits and MMCs to securities. The Bank of Japan continues to urge restraint in lending by the major city banks due to concern about the recent rapid growth of corporate time deposits.

In Germany, growth continued at a moderate pace. In the first quarter, industrial production (s.a.) was nearly 1 percent above the fourth quarter, and 4.4 percent above the first quarter of 1987, despite a decline of 2.5 percent in the preliminary estimate for March. The unemployment rate (s.a.) increased slightly in March to 8.8 percent, and remained at that level in April. The volume of domestic and foreign new manufacturing orders rose again in February and was unchanged in March, bringing the volume closer to the previous peak set late last summer.

Consumer prices increased in April, rising to a level 1 percent above a year ago. Producer prices in March were only 0.6 percent above year-earlier levels. Import prices declined in March to a level 0.3 percent below that of a year earlier.

In January the trade surplus (s.a.) fell slightly to $6.5 billion, while the current account surplus (n.s.a.) fell sharply to $2.9 billion.

Monetary growth in Germany eased in March to an annualized rate of 5.4 percent (s.a.) over the previous month. However, in March average M3 stood 7.5 percent above the target base level in 1987 Q4, well above the 3-6 percent target range.

The five economic institutes in Germany revised their consensus forecast for 1988 to 2 percent (yr/yr) from 1-1/2 percent. They also issued a forecast for growth in 1989 of only 1-1/4 percent. The institutes called for an acceleration of tax cuts planned for 1990 and the elimination of planned consumer-tax increases. In response, Economics Minister Bangemann and Finance Minister Stoltenberg released a joint statement asserting that "the best fiscal-policy contribution ... is the realization of the tax reform in the planned shape and time frame", i.e., in which the bulk of the tax reduction is in 1990. Only DM5 billion, of a total of DM39.7 billion (a net reduction of DM20.6 billion), was brought forward into 1988 as part of the Louvre agreement. In late March, Finance Minister Stoltenberg had indicated that growth in the first quarter was well in excess of 2 percent. The official government forecast for 1988 is 2 percent (yr/yr).

In the United Kingdom, industrial production declined in February by 2.6 percent (s.a.), 0.3 percent above its year-earlier level. However, officials said that this decline reflected the impact of the Ford strike. Inflation increased in the first quarter was 2.0 percent (n.s.a.a.r.), down somewhat from the 4.4 percent rate registered in the fourth quarter. The Ministry of Trade and Industry reported that the exceptionally large trade deficits reported for January and February are partly the result of problems encountered in adjusting to new, EC-wide, trade reporting rules, and are likely to be revised in the future.

In France, unemployment (s.a.) fell to 10.3 percent in March, chiefly as a result of temporary retraining programs for youths, and the

long-term unemployed. The trade balance (s.a.) deteriorated sharply in February but then recovered in March, resulting in a first-quarter deficit of about $0.7 billion, somewhat smaller than the deficit of $1.1 billion in the fourth quarter of 1987.

On May 8, Francois Mitterrand was reelected president winning 54 percent of the vote against Jacques Chirac. President Mitterrand has announced that he will halt the privatization program, and institute a wealth tax on the 100,000 wealthiest individuals in France. President Mitterrand appointed former agricultural minister Michel Rocard prime minister on May 9, after receiving Chirac's resignation from his post of prime minister and leader of a center-right coalition. Rocard, who is on the right of the Socialist Party and has ties to several centrist leaders, will attempt to form a center-left coalition government that meets parliamentary approval. If he fails, President Mitterrand is likely to call new parliamentary elections.

In Canada, industrial production (s.a.) declined 0.4 percent in February, the first monthly decline since July 1987, while manufacturing new orders (s.a.) fell 2.8 percent and inventories accumulated. In addition, retail sales (s.a.) declined 0.9 percent in both January and February. These trends suggest that there may be some slowing of the rapid 1987 pace of economic activity. Inflation in the first quarter increased by 3.2 percent (n.s.a.a.r.), roughly equal to the fourth quarter rate.

In Italy, a new Government, headed by Christian Democrat Party Chairman Ciriaco De Mita, received a vote of confidence from parliament

on April 23. Economic Policy is unlikely to change significantly, however, this government should prove to be more durable than its predecessor.

Economic Situation in Major Developing Countries

Completion of an agreement between Brazil and creditor banks is being held up because of remaining differences over the nature of the linkage of bank disbursals to an IMF accord and the inclusion of a clause permitting creditors to seize Brazilian assets before a judgment has been made. In late March, the Mexican government announced an extension through May of the freeze on the exchange rate, public sector prices, and minimum wages as part of its efforts to restrain prices and wages. President Alfonsin has called for greater adherence to programmed public sector budgets as part of an effort to reduce Argentina's deficit. Ecuador has tentatively agreed to accept a $330 million commercial bank loan, but the country's recently elected president has said that he will seek to reopen discussions with the banks in order to obtain a loan that meets expanded financing needs. Cote d'Ivoire has reached an innovative agreement with banks on a rescheduling, which may penalize non-participating banks.

Individual Country Notes. Brazil continues negotiating with its bank advisory committee in an effort to reach a final agreement on a package that would provide Brazil with approximately $5.2 billion in new money at a spread of 13/16 over LIBOR, stretch repayment of nearly $62 billion over 20 years, maintain $15.5 billion in short-term credit lines, and permit a comprehensive menu of financing options including

relending, new-money bonds and exit bonds. Brazil is unwilling to accept two points favored by the banks: direct linkage between an IMF accord and bank disbursals, and the inclusion of a prejudgment attachment clause that would permit creditors to seize Brazilian assets before a judgment had been made.

Brazilian trade surpluses continue very strong, with a surplus of $1.2 billion for March. March inflation fell to 16 percent owing to postponed price adjustments. However, April inflation incorporated these price adjustments resulting in an inflation rate of 19.3 percent. In an effort to contain the public sector deficit to 4 percent in 1988 and 2 percent in 1989, the government announced a series of measures in February and April: a ceiling on public sector indebtedness, a two-month freeze (April and May) on public sector wages, and the elimination of the consumer wheat subsidy. Brazil held its second debt conversion auction on April 28. Bidders paid $198 million in debt to obtain the right to purchase $150 million worth of Brazilian investment.

The Mexican government announced in late March that the freeze on the exchange rate, public sector prices, and minimum wages would be extended through May. Also, price increases on private sector goods, subject to price control, would not be authorized during the freeze. The government urged businesses and organized labor to continue to exercise restraint in contractual wage negotiations, and urged the former to continue to hold down prices of goods not subject to price control. As a result of the government's efforts to restrain prices and wages, the CPI increased by only 3.1 percent in April, the smallest

monthly increase since June 1985. Interest rate declines continue; the nominal annual rate on 28-day Treasury bills was 59.2 percent at the auction of May 3, down from 59.6 percent at the April 26 auction, and from 88.5 percent on March 15. A key contributing factor to the fall in rates has been short-term inflows from abroad under the exchange rate freeze. Although through March the Bank of Mexico continued to make net sales of Treasury bills in the secondary market, the 12-month rate of increase of M1 continued to rise, reflecting an inflow of funds from abroad.

On April 20, the government announced new cuts in budgeted public sector expenditures. The new cuts amount to 14 percent of the original budget and are in addition to cuts of 8 percent announced in January. The new cuts appear to reflect the government's expectation that the inflation rate will abate more than earlier thought possible during the balance of the year. However, the freeze cannot be continued for an extended period without producing adverse effects on the balance of payments and the budget, and creating difficulties for the management of monetary policy. Already, the cost of forward exchange cover has risen significantly since early April, indicating that the authorities must tread a narrow path as they implement their anti-inflation program.

In a speech on May 1, Argentina's President Alfonsin called for greater adherence to programmed public sector budgets as part of an effort to reduce the country's budget deficit. He asked that "realistic and rational" solutions to the debt crisis be explored, but stated that unilateral actions are costly and would not provide a solution to the

debt issue. The President also spoke out against corruption in the public sector and indicated his intention to introduce legislation to limit the Central Bank's ability to provide favored borrowers with low interest rediscount credit.

Real GDP growth was only 1.6 percent in 1987 (year-end over year-end), following a 5.4 percent increase in 1986. Inflation has been accelerating of late; the CPI was 9.1 percent in January, 10.4 percent in February, and 14.7 percent in March. The removal of price controls on most goods and services in April has led to a further increase in inflation to 17.2 percent, but inflation should begin to decline if the authorities are better able to control the fiscal deficit in upcoming months in accordance with Argentina's economic program with the IMF.

Preliminary evidence indicates that industrial production in basic industries (s.a.) rose by about 1.1 percent in the first quarter of 1988 compared with the fourth quarter of 1987. The production of consumer goods (e.g., beef products, milk, cigarettes) dropped substantially in the first quarter, primarily due to an ongoing decline in aggregate demand associated with a fall in real wages in the Argentine economy. For example, the real purchasing power of industrial wages for the first quarter of 1988 is about 13 percent below year-earlier levels.

Ecuador tentatively agreed to accept a $330 million commercial bank loan after protracted negotiations. However, on May 8, center-left candidate Rodrigo Borja won the election for the presidency and stated that he would reject this loan and seek a new package that would take into account Ecuador's expanded financing needs.

Cote d'Ivoire and its bank creditors have decided to move forward with a financial package involving $150 million in new money and a $2.5 billion rescheduling of debt. The agreement had been delayed while legal opinions were sought on an innovation that would effectively allow a debtor country to penalize those banks that refuse to extend new loans. The Cote d'Ivoire will offer to reclassify all medium-term loans as debts of a newly created and legally independent vehicle, thereby replacing former loan agreements with a single new agreement. Lenders will have to contribute to the new money package for their loans to be included in the restructuring. All debt originally falling due in 1983-95 will be repaid over 14 years, including five years grace at LIBOR plus 1-1/4 percent. New money will be extended to cover 1987 interest arrears. Those banks that do not provide new money will be given the option to take exit bonds that capitalize interest and pay a fixed rate over 20 years. Banks declining to extend new money or take exit bonds will continue as creditors under the former loan agreements. It is argued that payments made to participating banks under the new agreement would not have to be shared with banks that refuse to participate, thereby evading the clause in previous bank loan agreements that typically require that any payments made to any bank be shared among all lenders. However, the legal issues are far from clear.