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Confidential (FR) Class III FOMC

June 22, 1988

RECENT DEVELOPMENTS

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

TABLE OF CONTENTS

DOMESTIC FINANCIAL DEVELOPMENTS continued III

INTERNATIONAL DEVELOPMENTS IV

Incoming data suggest some moderation in the pace of economic expansion from the rapid first-quarter rate. The industrial sector has remained robust, with employment rising and output up strongly in April and May. Outside of manufacturing, however, job gains have diminished a little this spring, and growth in real disposable income also appears to have slowed. Consumer demand has been lackluster on the whole of late, and capital spending and exports seem unlikely to repeat their spectacular first-quarter increases. General wage and price trends have changed little in recent months, although drought has prompted a surge in grain and oilseed prices on top of an upward movement in industrial materials prices.

Industrial Production and Capacity Utilization

Total industrial production posted solid gains in April and May, making it likely that output growth in this sector in the current quarter will be at least as high as the 4 percent annual rate of advance observed during the first quarter. Output of business equipment continued to rise briskly, reflecting strength in both foreign and domestic demand. In recent months, production advances in this sector have been widespread, with particularly strong gains in construction, mining, and farm equipment, machine tools, and capital goods for the food, textiles, and paper industries. Production of computers, which registered large increases earlier this year, is estimated to have remained at a high level in May.

Output of consumer goods has been mixed in recent months. Auto assemblies have trended up since early this year, providing an

INDUSTRIAL PRODUCTION
(Percentage change from preceding period;
based on seasonally adjusted data)

	1986	1987	1987 Q4	1988 Q1	1988 Mar.	1988 Apr.	1988 May
	-------Annual rate-------				---Monthly rate---		
Total index	1.0	5.8	7.0	3.9	.2	.6	.4
Products	1.8	4.9	4.3	6.2	.2	.3	.3
Final products	.8	4.6	4.3	6.1	.2	.4	.4
Consumer goods	3.3	3.2	2.3	5.8	-.1	.3	.3
Durable consumer goods	4.2	4.2	9.5	-5.8	.1	2.0	1.9
Automotive products	.5	4.4	13.5	-4.5	2.6	1.2	4.8
Home goods	7.0	4.0	6.6	-6.8	-1.8	2.7	-.2
Nondurable consumer goods	3.1	2.8	.0	10.0	-.2	-.2	-.3
Equipment	-2.1	6.3	6.6	6.4	.4	.5	.5
Business equipment	-1.1	7.0	8.8	9.4	.6	.8	.8
Defense & space equipment	5.0	1.9	.2	2.5	-.6	-.4	-.2
Oil & gas well drilling	-50.1	37.1	13.7	-19.4	4.1	-1.2	-.9
Intermediate products	5.4	5.9	4.4	6.8	.2	.0	.1
Construction supplies	5.0	4.7	3.5	10.5	-.6	.1	-.1
Materials	-.2	7.2	11.4	.2	.3	1.1	.6
Durable goods materials	-.5	8.0	15.5	3.9	.0	1.2	1.0
Equipment parts	-.5	6.3	9.3	9.8	-.2	.7	.7
Basic metal materials	-7.3	21.3	39.9	-21.5	-1.1	1.2	2.3
Nondurable goods materials	5.7	8.1	6.0	-2.1	1.5	.7	.4
Energy materials	-5.2	4.5	8.7	-5.1	-.4	1.1	-.3

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

	1978-80 High	1982 Low	1967-87 Avg.	1987 Dec.	1988 Mar.	1988 Apr.	1988 May
Total industry	86.9	69.5	81.5	82.4	82.4	82.7	82.9
Manufacturing	86.5	68.0	80.6	82.6	82.7	82.9	83.1
Primary processing	89.1	65.0	81.7	87.6	86.8	87.0	87.1
Advanced processing	85.1	69.5	80.1	80.3	80.8	81.1	81.3
Mining	95.2	76.9	86.7	81.5	80.1	81.8	81.3
Utilities	88.5	78.0	86.9	80.0	81.1	80.4	80.9
Industrial materials	89.1	68.5	82.2	83.6	82.3	83.1	83.4
Raw steel[1]	98.9	36.1	80.2	89.2	86.5	83.4	88.3
Aluminum[1]	97.4	58.8	87.3	95.8	99.2	99.5	99.9
Paper material[1]	97.3	79.9	91.7	101.6	98.0	98.1	98.1
Chemical materials[1]	87.9	63.5	81.0	90.9	87.4	87.4	87.6

1. Unpublished estimates for May 1988.

appreciable boost to growth in total production. Production in May was at a seasonally adjusted annual rate of 7.5 million units, up 500,000 units from the April pace. Although assembly schedules point to another small rise in auto production in June, output is scheduled to tail off in the third quarter. In contrast, truck assemblies generally have been flat during the past four months after rising to a new high in January. Output of home goods edged down in May and, on balance, has been little changed since January. Production of nondurable consumer goods rose appreciably faster than consumer spending early this year, and the recent slackening in production may be a response to retailers' attempts to bring their inventories of softgoods into better alignment with sales.

Production of materials, which was virtually unchanged during the first quarter, rose briskly in April and May. In particular, output of various types of steel and nonferrous metals, which declined earlier this year, has increased during the past few months.[1] Among nondurable materials, output of textiles has risen in recent months, owing, in part, to increased demand from producers of autos and furniture. In addition, output of chemical materials, which fell during the first quarter, has rebounded in recent months.

Capacity utilization in manufacturing, mining, and utilities advanced 0.2 percentage point in May to 82.9 percent. This rate has risen 0.5 percentage point in the last two months after a pause in the

1. The recent reported changes in output of metals may be related, in part, to problems of seasonal adjustment. The unadjusted data indicate that production of some types of metals was little changed earlier this year, at levels very close to capacity. The seasonal factors expected increases in output; consequently, the seasonally adjusted data showed a decline.

first three months of the year. Although the utilization rate for advanced processing industries moved up to 81.3 percent in May--a bit above its 1967-87 average--the key story continues to be the relatively tight conditions in primary processing industries. Utilization in this sector has fluctuated around 87 percent since last November, and is within 2 percentage points of its 1978-80 high. These high utilization rates generally are consistent with purchasing managers' reports that many industrial materials were in short supply in May, including steel, aluminum, copper, zinc, castings, dynamic random access memory chips (DRAMs), printing paper, and a variety of industrial chemicals.

Employment and Unemployment

Recent labor market data point to continued strength in employment, although hiring appears to have slowed somewhat from the rapid pace seen in the first quarter of this year. Nonfarm payroll employment rose 209,000 in May, somewhat less than in April. Hiring in both services and trade has dropped off significantly from its first-quarter pace. In particular, employment in finance moved down further last month, reflecting ongoing belt-tightening in the wake of the October stock market break. In construction, employment leveled off in May after three months of strong gains.

Factory employment rose 16,000 in May, and gains in earlier months were revised up somewhat as well. Recent employment growth has been fairly widespread by industry, but increases in the machinery and metals industries have been especially notable. Moreover, manufacturers have continued to utilize their existing workforces intensively by keeping workweeks and overtime schedules at high levels.

One puzzle in the recent labor market data has been the volatility of the household survey's measure of employment and its weakness relative to the payroll survey. Household employment plummetted more than 500,000 in May after a 600,000 rise in April and a 300,000 decline in March. The Bureau of Labor Statistics has urged caution in interpreting month-to-month movements in employment reported in the household survey, particularly between May and July when seasonal labor force flows are large. Nevertheless, since the turn of the year, employment in the household survey has increased roughly one million less than the payroll figure. Although there are no ready explanations for the recent discrepancy in behavior, over relatively short periods the payroll survey is considerably less volatile than the household survey and likely provides a better signal of underlying strength in labor demand.[2] Because the large swings in household employment have been mirrored in the labor force numbers, the unemployment rate appears to have been little affected by problems in the household survey.

Thus far this year, the unemployment rate has fallen about 1/4 percentage point to 5-1/2 percent. Recent changes in joblessness have been consistent with the movements suggested by Okun's law, with assumed growth in potential output of about 2-1/2 percent. Nevertheless, the current level of the unemployment rate is about 1/2 percentage point lower than predicted by a simulation of an Okun's law equation that begins in 1985-Q4 (chart). That discrepancy largely reflects declines

2. A reconciliation of the two surveys that adjusts household employment to the payroll concept results in an even wider unexplained discrepancy between the household and payroll surveys, largely owing to an unusual increase this year in the number of self-employed workers, who are counted in the household survey but not in the payroll report.

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

	1987	1987 Q3	1987 Q4	1988 Q1	1988 Mar.	1988 Apr.	1988 May
	-Average Monthly Changes-						
Nonfarm payroll employment[2]	286	276	365	340	291	249	209
Manufacturing	38	58	64	19	15	54	16
Durable	21	34	40	7	7	47	12
Nondurable	16	24	24	12	8	7	4
Construction	21	10	35	25	42	48	-6
Trade	68	59	83	114	31	61	69
Finance	16	12	10	11	15	-2	-10
Services	99	87	103	118	103	78	79
Total government	28	24	51	38	66	-8	44
Private nonfarm production workers	208	191	257	242	174	191	87
Manufacturing production workers	30	45	47	12	2	28	22
Total employment[3]	257	191	291	120	-306	610	-518
Nonagricultural	252	193	280	123	-283	586	-325

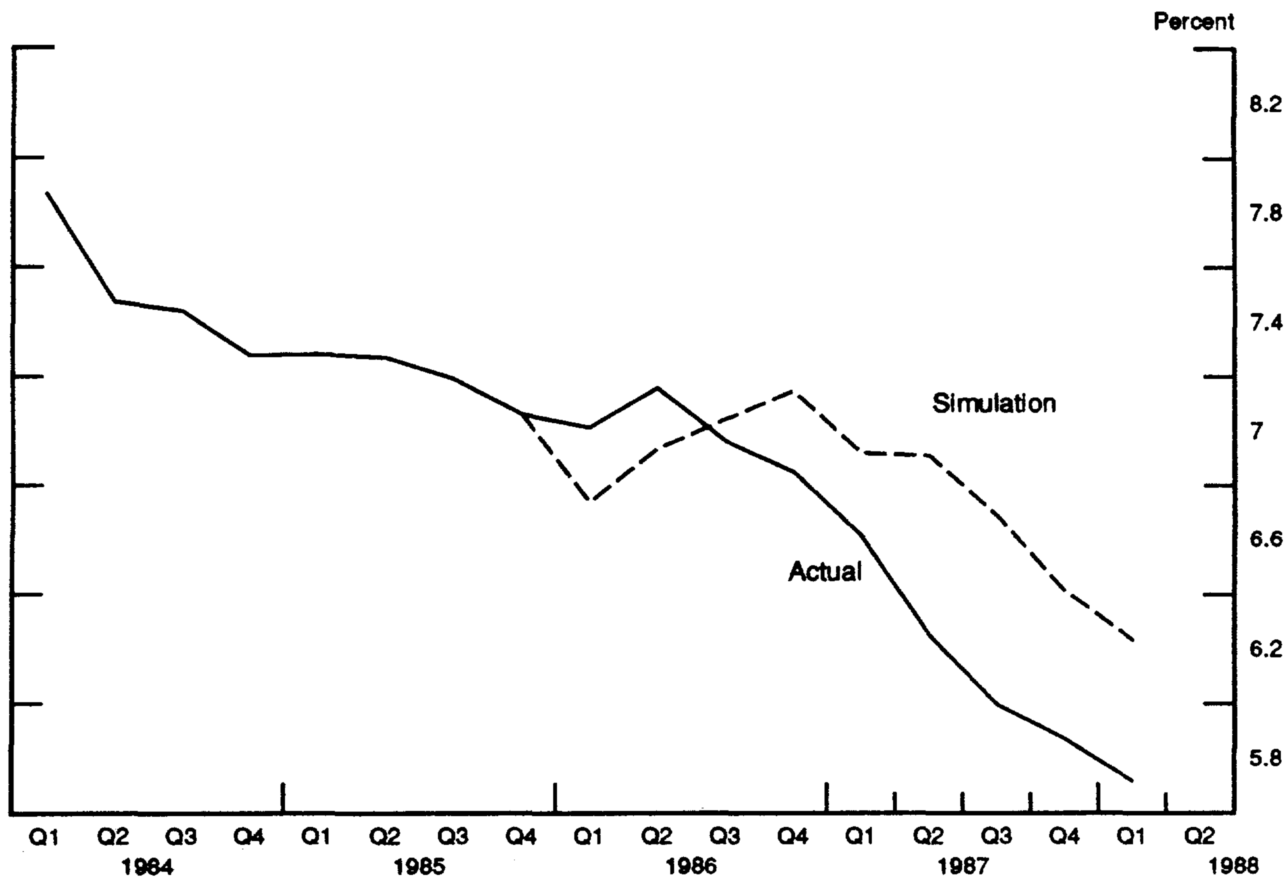
1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments.
3. Survey of households.

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

	1987	1987 Q3	1987 Q4	1988 Q1	1988 Mar.	1988 Apr.	1988 May
Civilian, 16 years and older	6.2	6.0	5.9	5.7	5.6	5.4	5.6
Teenagers	16.9	16.1	16.6	16.0	16.5	15.9	15.6
20-24 years old	9.7	9.5	8.8	9.0	9.1	8.7	8.9
Men, 25 years and older	4.8	4.6	4.4	4.4	4.3	4.1	4.3
Women, 25 years and older	4.8	4.7	4.7	4.4	4.1	4.2	4.3
White	5.3	5.1	5.0	4.8	4.7	4.6	4.7
Black	13.0	12.5	12.2	12.5	12.8	12.2	12.4
Fulltime workers	5.8	5.6	5.5	5.4	5.3	5.1	5.2
Memo:							
Total national[1]	6.1	5.9	5.8	5.6	5.5	5.4	5.5

1. Includes resident armed forces as employed.

Actual and Okun's Law Projection of the Unemployment Rate



Simulation begins in 1985 Q4, and potential GNP growth is assumed to be at an annual rate of 2.4 percent.

in unemployment in late 1986 and early 1987. Although slower-than-assumed potential GNP growth or statistical problems with the household survey could explain the error, a more likely possibility is that the level of GNP in 1987 will be revised up when the NIPA data are revised in July. This hypothesis receives additional support from recent annual revisions to data on retail sales and inventories, as well as additional information on wages and salaries, all of which show somewhat higher estimates than reported previously.

Personal Income and Consumption

Reflecting recent employment trends, nominal private payrolls rose about $6 billion in April, quite a bit less than the $12 billion average monthly gain in the first quarter. Growth in disposable personal income was held down by a $36 billion jump in personal tax payments in April, reflecting a large one-time increase in nonwithheld income taxes attributable to the new tax code and capital gains realizations associated with last year's financial market activity. Moreover, in real terms, the rise in disposable income is expected to be restrained by sharply higher consumer prices in the current quarter.

Rapid income growth late last year and early this year supported gains in real, nonauto consumption of 3-1/2 percent at an annual rate in the first quarter. However, the retail sales reports for April and May point to slower growth in spending in the second quarter. Sales at the retail control group of stores, which excludes auto dealers, building material and supply stores, and gasoline stations, rose 0.5 percent in nominal terms in May, after a 0.2 percent decline in April. At stores carrying largely discretionary consumption goods--general merchandise, apparel, and furniture and appliances--sales edged up 0.3 percent in

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

	1986	1987	1987 Q4	1988 Q1[r]	1988 Feb.[r]	1988 Mar.[r]	1988 Apr.[p]
Total personal income	14.2	21.3	28.6	23.4	23.6	43.5	4.4
Wages and salaries	7.5	12.2	13.8	14.3	15.6	15.0	7.9
Private	5.6	9.8	11.1	12.1	13.5	13.1	6.0
Other labor income	.7	.8	.8	.5	.5	.5	.5
Proprietors' income	2.6	2.5	4.8	5.6	4.6	22.3	-4.3
Farm	.5	.2	2.6	3.9	2.3	19.4	-7.6
Rent, dividends and interest	1.7	4.9	8.6	.9	1.2	.6	1.3
Transfer payments	2.5	2.0	1.6	7.5	2.7	6.2	-.8
Less: Personal contributions for social insurance	.8	1.0	.9	5.4	1.0	1.0	.4
Less: Personal tax and nontax payments	3.2	3.7	4.9	-.6	-3.3	10.9	36.2
Equals: Disposable personal income	11.0	17.7	23.8	24.0	26.8	32.6	-31.8
Memo: Real disposable income	6.3	4.9	14.8	12.0	22.0	13.6	-43.1

r--Revised.
p--Preliminary.

RETAIL SALES
(Seasonally adjusted percentage change)

	1987		1988	1988		
	Q3	Q4	Q1	Mar.	Apr.	May
Total sales	2.4	-.6	2.2	1.6	-.4	.1
Total less auto dealers, nonconsumer stores, and gasoline stations	1.0	.5	1.2	1.5	-.2	.5
Durable	4.6	-2.2	4.9	1.6	-.2	-.6
Automotive dealers	6.6	-3.9	5.9	1.3	-.8	-1.2
Furniture and appliances	1.6	-2.3	5.7	2.2	1.3	-.2
Other durable goods	1.6	2.1	1.2	1.1	.7	.7
Nondurable	1.1	.3	.6	1.7	-.5	.5
Apparel	2.3	-.3	-1.0	2.3	-1.0	1.7
Food	.5	-.4	1.2	1.6	-.1	1.3
General merchandise[1]	.7	1.6	-.2	1.8	-1.2	-.1
Gasoline stations	3.5	-1.4	.8	3.2	-.7	.6
Memo: GAF[2]	1.3	.2	1.1	2.0	-.5	.3

1. General merchandise excludes mail order nonstores; mail order sales are also excluded in the GAF grouping.
2. General merchandise, apparel, furniture and appliance stores.

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

	1987		1988	1988		
	Q3	Q4	Q1	Mar.	Apr.	May
Autos and light trucks	16.4	14.7	15.6	16.2	15.1	15.8
Autos	11.4	10.0	10.8	11.1	10.5	10.7
Light trucks	5.0	4.7	4.8	5.0	4.6	5.1
Domestically produced[1]	11.9	10.5	11.8	12.2	11.2	12.1
Autos	7.8	6.6	7.6	7.9	7.2	7.6
Light trucks	4.1	3.9	4.2	4.4	4.0	4.4
Imports	4.5	4.1	3.8	3.9	3.9	3.7
Autos	3.6	3.4	3.1	3.2	3.3	3.1
Japanese	2.4	2.4	2.1	2.2	2.2	2.1
Korean	.5	.3	.5	.5	.5	.4
European	.7	.7	.6	.6	.5	.5
Light trucks	.9	.8	.6	.7	.6	.6
Memo:						
Auto production	6.3	7.0	6.2	6.6	7.0	7.5

1. Includes vehicles produced in Canada and Mexico for General Motors, Ford, and Chrysler.

May, after falling 0.5 percent in the preceding month. Moreover, consumer goods prices have picked up sharply in the second quarter, suggesting, that in real terms, spending at the retail control group has been flat. Taken together with data implying lower gasoline sales, nonauto consumption now appears weaker than was expected at the time of the May Greenbook.

Domestic autos sold at a 7.5 million unit annual rate since early May, about the same pace as in the first four months of the year. Sales of domestic light trucks rose to a 4.4 million unit annual rate in May over the same period. Sales promotion plans that were scheduled to expire in mid-May have been extended, on less generous terms, for another two months.

Business Fixed Investment

Outlays for fixed investment appear to have leveled off in recent months, after expanding more than 20 percent at an annual rate in the first quarter. Nevertheless, investment spending has remained at a very high level in the current quarter.

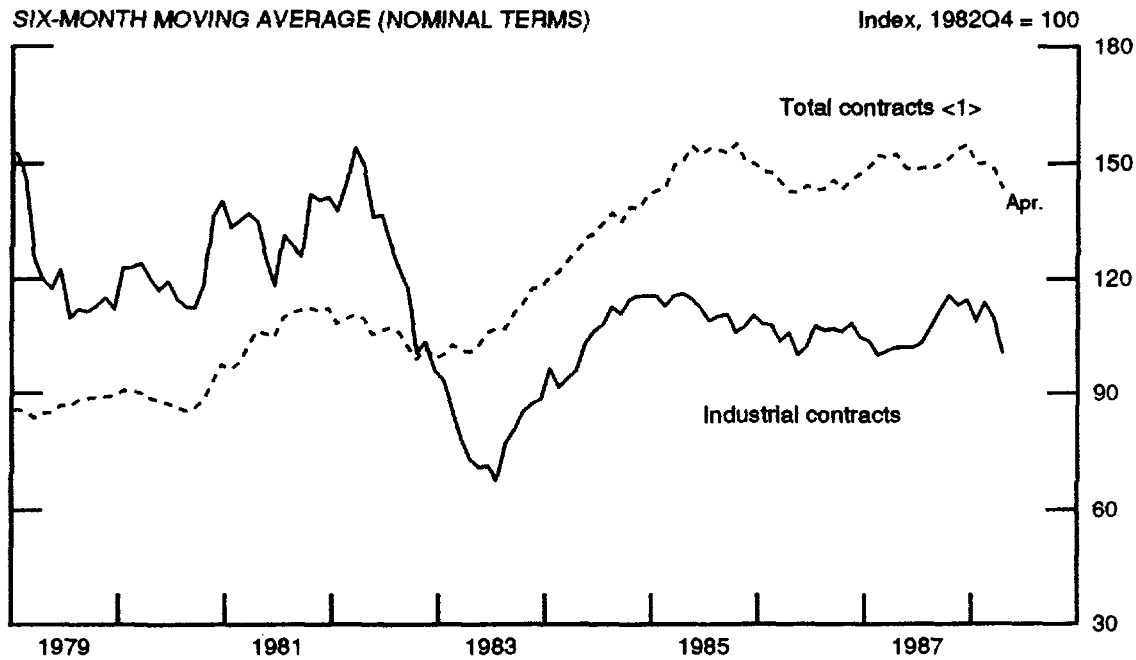
So far this year, movements in aggregate equipment outlays have been dominated by the gyrations in the office and computing equipment category. Shipments of such equipment jumped 19 percent (not at an annual rate) in the first quarter, but the April-May average was considerably lower. Despite the sharp quarter-to-quarter swings in spending, the underlying demand for computers appears to be robust. Industry analysts generally expect real outlays for office and computing to be up sharply this year, a marked pickup from the sluggish advances registered during 1986 and 1987, when concerns about the usefulness of available software and the failure of businesses to absorb fully

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

	1987		1988	1988		
	Q3	Q4	Q1	Mar.	Apr.	May
Producers' durable equipment						
Shipments of nondefense capital goods	5.1	2.4	5.3	3.2	-2.5	
Excluding aircraft and parts	5.8	1.1	6.0	2.1	-2.0	
Office and computing equipment	6.2	-3.2	18.9	3.0	-8.8	
All other categories	5.8	2.1	3.1	1.9	-.3	
Shipments of complete aircraft[1] (from CIR)	29.2	-21.8	n.a.	-3.9	n.a.	
Sales of heavy-weight trucks	1.6	5.5	8.7	-4.1	-3.1	3.2
Orders for nondefense capital goods	3.3	3.4	7.0	-3.8	1.9	
Excluding aircraft and parts	4.9	.5	6.9	2.9	-1.9	
Office and computing equipment	4.3	-6.6	19.1	-.1	-.6	
All other categories	5.0	2.2	4.3	3.6	-2.3	
Nonresidential structures						
Construction put-in-place	3.6	2.5	-2.4	.0	2.0	n.a.
Office	4.6	5.2	-1.0	-1.6	1.0	n.a.
Other commercial	.0	3.9	-4.1	.2	2.8	n.a.
Public utilities	5.5	-1.5	-5.5	-.9	3.1	n.a.
Industrial	8.3	1.0	.7	6.3	9.2	n.a.
All other	1.6	4.6	.7	-.7	-3.4	n.a.
Rotary drilling rigs in use	17.1	-3.7	-2.1	9.0	2.2	n.a.

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 Contracts



<1> From F.W.Dodge. Includes industrial, commercial, and institutional construction.

previous purchases apparently limited sales. Among the other components of equipment, shipments continued to rise in April and May.

After a sluggish first quarter, nonresidential construction put-in-place advanced in April to a level 2-1/4 percent above the first-quarter average. Most of this growth occurred in the industrial sector, with activity elsewhere up only modestly in recent months. Although industrial construction has moved up sharply over the past three months, one should not read much into the recent strength in this sector. Even though capacity utilization is high by historical standards, other indicators suggest that manufacturers remained cautious about building new plants; in particular, new contracts for industrial construction have fallen back recently.

Near-term indicators point to some moderation in the growth of equipment spending; excluding aircraft, new orders for nondefense capital goods were little changed in April and May, after sharp rises earlier this year. For the year as a whole, the Commerce Department and the McGraw-Hill surveys of planned capital spending, taken in April and May, reported that nominal outlays are expected to rise roughly 10 to 11 percent, with the biggest gains anticipated in manufacturing. Given the pattern of business fixed investment in recent quarters, a year-over-year rise in the 10 percent range implies moderate spending gains over the remainder of 1988.[3] The bulk of such purchases are likely to be

3. On a quarterly basis, the change in plant and equipment spending reported by the Commerce survey often diverges significantly from the estimate of business fixed investment in the GNP accounts. This occurred in the first quarter, when the survey reported flat spending, even though BFI posted a strong increase. A reversal of this difference appears likely to have taken place this quarter, with the survey indicating rapid growth in nominal outlays, while BFI may have been up much less. Some of this pattern may reflect timing differences in the
(Footnote continues on next page)

for equipment, as continued overhangs of commercial space probably will restrain overall construction activity.

Business Inventories

Nonauto business inventories expanded in April at about the same pace as in March. In most sectors, inventories remained in line with sales; the most significant exception was at retail establishments selling nondurable goods, primarily apparel and general merchandise, where stocks appear to be high by historical standards.

In manufacturing, stockbuilding this year generally has been concentrated in industries experiencing relatively high levels of demand--aircraft, business equipment, metals, chemicals, and paper. As of the end of April, there did not appear to be any significant inventory imbalances within manufacturing.

In the trade sector, inventory investment at wholesale establishments remained strong in early spring; these stocks expanded \$19.2 billion at an annual rate in April, after rising \$26.5 billion, on average, in the first three months of this year. As in manufacturing, much of the wholesale inventory accumulation in recent months has been in machinery and equipment, where domestic and export demand has been particularly strong. However, wholesale distributors of some housing-related merchandise--lumber and construction materials, furniture and home furnishings--also have reported fairly sizable increases in their inventory-sales ratios since the turn of the year. At this point, these

(Footnote continued from previous page)
collection of data for BFI and for the Commerce survey. In any case, the growth of outlays shown in the Commerce survey between the first half and the second half of 1988 can be taken as a rough guide of growth in BFI.

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

	1987		1988	1988		
	Q3	Q4	Q1	Feb.	Mar.	Apr.
Current cost basis:						
Total	34.5	81.4	41.0	34.3	26.6	43.4
Ex. auto	30.0	67.1	62.6	60.6	43.4	40.0
Manufacturing	20.2	27.9	23.6	20.8	11.9	17.2
Wholesale	1.2	23.8	26.5	26.9	13.2	19.2
Retail	13.1	29.6	-9.1	-13.5	1.5	7.0
Automotive	4.5	14.2	-21.6	-26.3	-16.8	3.3
Ex. auto	8.6	15.3	12.5	12.8	18.3	3.7
Constant dollar basis:						
Total	5.3	42.9	28.5	19.2	9.1	n.a.
Ex. auto	17.2	28.8	42.6	46.3	4.7	n.a.
Manufacturing	12.1	9.4	13.8	17.7	-9.6	n.a.
Wholesale	1.2	13.3	21.0	22.2	1.7	n.a.
Retail	-8.0	20.2	-6.3	-20.6	17.1	n.a.
Automotive	-11.9	14.1	-14.1	-27.0	4.4	n.a.
Ex. auto	3.9	6.2	7.8	6.4	12.7	n.a.

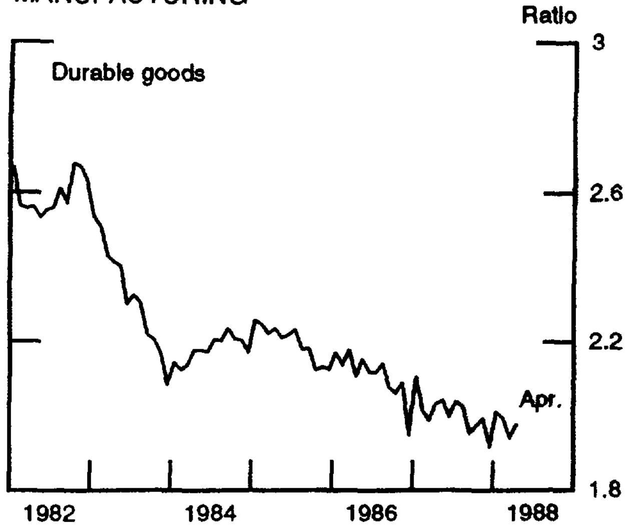
INVENTORIES RELATIVE TO SALES[1]
(Months supply; based on seasonally adjusted data)

	Range in Preceding 12 months:[2]		1987		1988	1988		
Current cost basis:	low	high	Q3	Q4	Q1	Feb.	Mar.	Apr.
Total	1.48	1.54	1.50	1.53	1.53	1.53	1.50	1.51
Ex. auto	1.46	1.51	1.48	1.49	1.51	1.51	1.49	1.50
Manufacturing	1.58	1.64	1.62	1.60	1.62	1.62	1.58	1.59
Wholesale	1.21	1.30	1.23	1.27	1.31	1.30	1.29	1.31
Retail	1.56	1.64	1.59	1.65	1.60	1.60	1.58	1.59
Automotive	1.74	2.06	1.86	2.06	1.76	1.81	1.74	1.76
Ex. auto	1.48	1.55	1.51	1.54	1.55	1.54	1.53	1.54
Constant dollar basis:								
Total	1.49	1.53	1.49	1.52	1.52	1.52	1.51	n.a.
Ex. auto	1.47	1.51	1.48	1.50	1.51	1.51	1.51	n.a.
Manufacturing	1.60	1.65	1.63	1.61	1.61	1.61	1.59	n.a.
Wholesale	1.23	1.34	1.24	1.29	1.34	1.34	1.35	n.a.
Retail	1.53	1.60	1.54	1.61	1.56	1.55	1.54	n.a.
Automotive	1.64	1.89	1.68	1.90	1.66	1.64	1.63	n.a.
Ex. auto	1.44	1.53	1.50	1.53	1.53	1.52	1.52	n.a.

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

Ratio of Inventories to Sales
(Current-cost data)

MANUFACTURING



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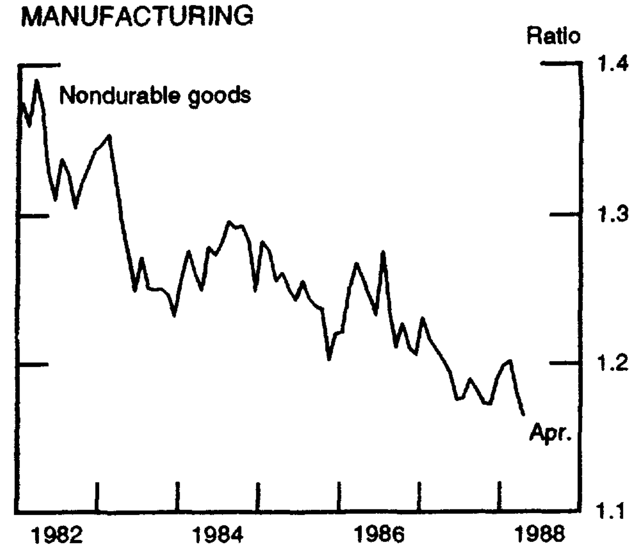
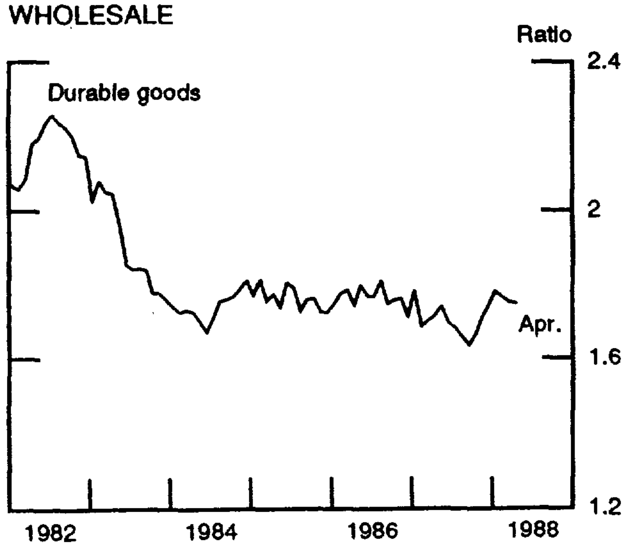


WHOLESALE



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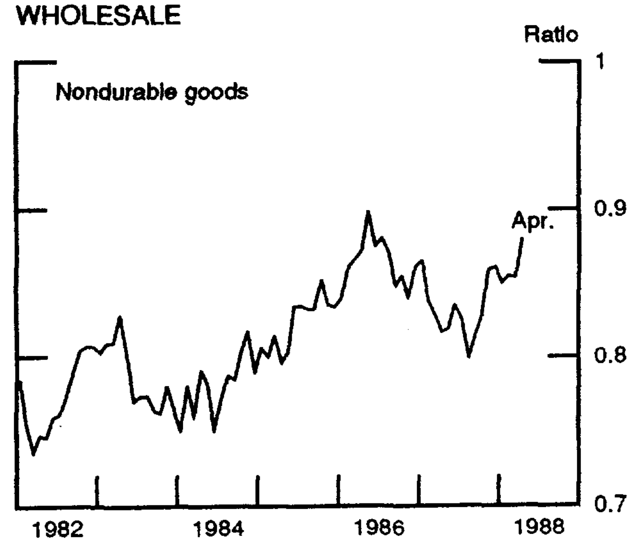
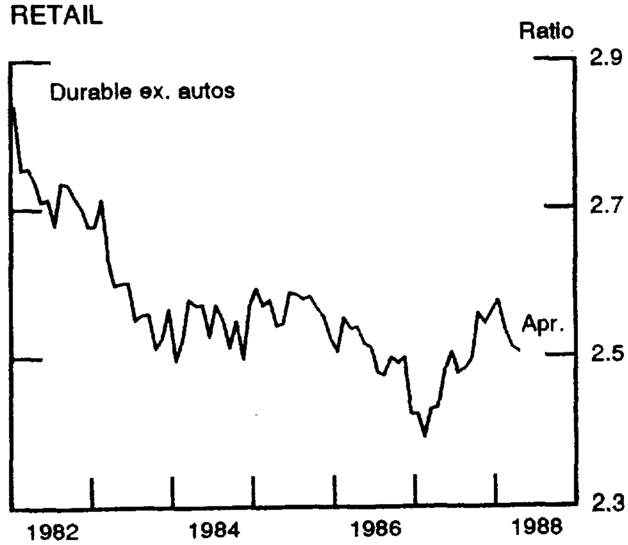


RETAIL



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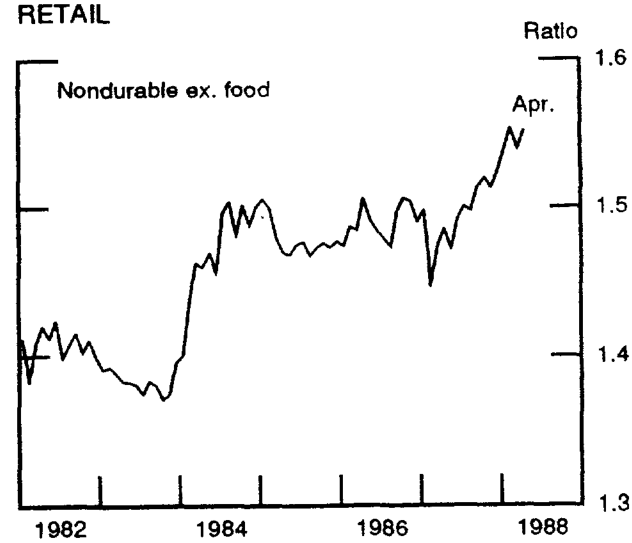


establishments do not appear to be experiencing inventory problems, but are, perhaps, a bit more vulnerable to a downturn in sales.

In nonauto retailing, inventory-sales ratios of nondurable goods stores--most notably general merchandisers and apparel stores--have been hovering at levels that are high by historical standards, but there are only scattered reports of overhangs in these areas. In addition to reports of price discounting, there is some evidence that retailers may have adjusted their ordering to restrain the accumulation of inventories; shipments of home goods and apparel from domestic factories have trended down since the turn of the year. The April shipments of these consumer goods were about 2 percent below the January level. Elsewhere in the retail trade sector, inventories appeared to be in line with sales.

Housing Markets

Housing starts dropped sharply in May to 1.38 million units at an annual rate. Building permit issuance, a coincident and less volatile indicator of housing construction, registered a much smaller decline.

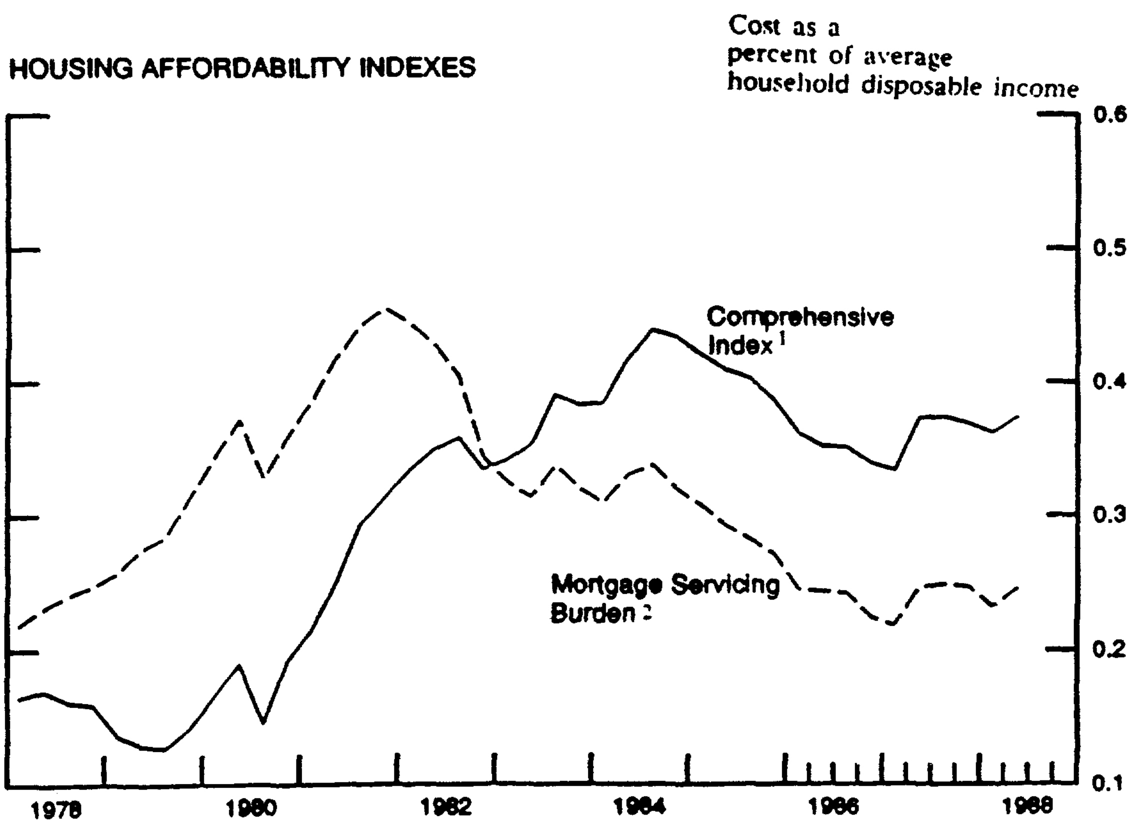
In the single family sector, starts fell further to around 1.0 million units in May, well below the average level seen in the first quarter of this year. Some weakening in this sector had been expected in response to the uptrending in fixed-rate mortgage interest rates in recent months, which reached an average 10-1/2 percent in May. However, the May level of activity appears to be lower than warranted by market conditions. Single-family permits edged up last month, and sales had moved upward through April. Moreover, despite the recent rise in interest rates, mortgage servicing burdens are only moderately above the six-year low recorded in early 1987 (chart), and a more comprehensive

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

	1987	1987		1988	1988		
	Annual	Q3	Q4	Q1[r]	Mar.[r]	Apr.[r]	May[p]
All units							
Permits	1.53	1.51	1.43	1.38	1.48	1.45	1.43
Starts	1.62	1.62	1.53	1.48	1.53	1.58	1.38
Single-family units							
Permits	1.02	1.00	.98	.98	1.03	.96	.97
Starts	1.15	1.15	1.09	1.10	1.17	1.09	.99
Sales							
New homes	.67	.66	.62	.63	.65	.68	n.a.
Existing homes	3.53	3.44	3.39	3.25	3.33	3.48	n.a.
Multifamily units							
Permits	.51	.51	.45	.40	.45	.49	.46
Starts	.47	.47	.44	.38	.36	.49	.40

p--preliminary estimates.
r--revised.
n.a.--not available.

HOUSING AFFORDABILITY INDEXES



1. This measure accounts for operating and transactions expenses, tax effects, and expected changes in asset value, in addition to mortgage servicing expenses, in the calculation of homeownership costs. Expected capital gains are represented by changes in constant-quality new home prices over the preceding three years.
2. Mortgage payment calculation is based on conventional fixed-rate mortgage interest rates and constant-quality new home prices.

measure of ownership costs--which reflects the effects of capital gains--is only near the middle of its range of recent years. Furthermore, consumer evaluations of home sales conditions were at an optimistic level in May, having fully retraced declines recorded since the October stock market crash.

In the multifamily sector, construction fell back last month from the surprisingly strong April pace to near the depressed first-quarter average. Construction in this market segment is expected to remain flat for some time, largely because of the near-record high vacancy rates and the 1986 tax law changes that lowered the rate of return on rental property investments.

Looking ahead, demographic trends likely will serve to limit housing demand during the next several years. The coming of age of the "baby bust" generation--the cohort born during the 1965-76 period of declining number of births--should result in a slowdown in the overall rate of household formations to about 1.2 million by 1990, down from an annual average of 1.4 million over the past several years. Factoring in demand for replacement units and vacation properties, this demographic outlook appears consistent with total housing starts averaging within the 1.4 million to 1.6 million unit range during the next several years, assuming no sharp changes in mortgage market conditions or income growth.

The Federal Government

The total federal budget deficit in May bounced back to $22.5 billion, following the April surplus when personal tax payments surged. For the fiscal year to date, receipts have risen at a 5 percent pace, with growth restrained by the net revenue-losing effects of the 1986 tax reform. Outlays are up slightly more than 5 percent, led by growth in spending for major entitlement programs, interest, and defense; deposit insurance outlays are also contributing to higher spending this year while lower agriculture support payments and asset sales are offsetting some of the rise.

Although growth in nominal defense spending on a total budget basis has been slowing in response to the reduced levels of appropriations in recent years, outlays have been stronger than expected through much of this year. The unanticipated strength appears in the operating and maintenance accounts and its source is a subject of speculation. It may be related to the higher costs of supporting military bases and activities overseas, possibly associated with the reduced value of the dollar. Nominal procurement outlays for the fiscal year to date are about even with the first eight months of FY1987.

In the National Income and Product Accounts, real defense purchases dropped more than 4 percent at an annual rate in the first quarter. The fall in purchases largely reflected declining weapons deliveries. According to NIPA conventions, purchases of big-ticket military items are recorded on a delivery basis, in contrast to the unified budget accounts, which record progress payments when made. For the year as a whole, several weapon modernization programs have peaked or are winding down after major surges a few years ago. The final seven B1 bombers (100 had been ordered) were delivered in April, and shipments of MX missiles and C-5B Galaxy transport planes are expected to end late this year or early next year.[4] This implies a downtrend in defense purchases, although the underlying pattern may be obscured by sharp quarterly fluctuations.[5]

Attention in Congress is focused on the FY1989 budget; the House has passed eight of the thirteen regular appropriation bills and the Senate has passed three. The bills appear to be consistent with the budget resolution passed earlier in the month and, therefore, would be within the limits set in the summit agreement for fiscal year 1989. The major, recently enacted Medicare bill is purported to be self-financing, at least in its first year, and thus also would fall within the summit agreement. That agreement was intended to be consistent with meeting the Gramm-Rudman target for the deficit of $136 billion. As detailed in the table, legislation enacted by August 15 will be incorporated in the Gramm-Rudman-Hollings compliance report due on August 20. This report will use the updated economic assumptions in the Mid-session Review of the FY1989 budget, due from the Office of Management and Budget in mid-July.[6] The compliance report determines whether or not there will be a sequester. That determination will be influenced importantly by the estimated effects of higher interest rates and higher farm prices on outlays, and the extent of projected FDIC and FSLIC spending. Although

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4. Contrary to some press reports, the military has continued to take deliveries of the MX, although it is not accepting delivery of its inertial measurement unit (guidance system), which accounts for less than a fourth of the total cost.

5. Additional uncertainty in the recording of spending in the NIPA arises because there are delays in the acceptance process. Even after manufacturers deliver the equipment, the military may delay certification and many units may be accepted within a short period.

6. In last year's Gramm-Rudman-Hollings amendments, Congress stated emphatically that the Mid-session Review should be published on time on July 15. Nonetheless, there continue to be reports that the July deadline may slip, and that the Review will be delayed until August.

GRAMM-RUDMAN-HOLLINGS PROCEDURES FOR FY1989 BUDGET

- July 15: Office of Management and Budget issues its Mid-session Review of the FY1989, updating economic assumptions and budget estimates for this year and for the 1989-1993 period. In recent years, the Mid-session Review has been delayed until early August, although updated economic assumptions have been announced in July.

- August 20: Congressional Budget Office issues an "advisory" report with updated budget estimates. The report is designed to provide a benchmark with which Congress and others may access the forthcoming OMB compliance report.

- August 25: OMB issues an initial compliance report stating whether or not the FY1989 deficit will exceed $146 billion (the $136 billion target plus a $10 billion margin for error). The budget estimate uses the economic assumptions from the Mid-session Review, legislation enacted since August 15, and other special G-R-H rules. If it appears that the deficit limit is exceeded, then an initial sequestration order is also issued. The order specifies the across-the-board cuts in authority needed to reduce the deficit to the $136 billion target.[1] Congress has until October 10 to pass legislation that would reduce the deficit without a sequestration.

- October 10: CBO issues a revised report.

- October 15: OMB issues a revised G-R-H compliance report taking account of legislation enacted through October 10. The economic assumptions may not be changed. The final order canceling budgetary resources is issued, if the deficit exceeds the $146 billion trigger.

1. The maximum sequester is the lesser of the amount necessary to achieve the $136 billion target or $36 billion less any deficit reducing actions taken by Congress since the beginning of the year.

most outside forecasts show the actual deficit to exceed the Gramm-Rudman-Hollings target in 1989, a plausible set of economic and technical assumptions could provide an estimate below the trigger.

The State and Local Government Sector

Real spending by state and local governments has posted moderate gains during the second quarter, after only a small rise from January to March. Employment advanced nearly 60,000 in May, after little change in April, to a level well above the first-quarter average. Although real construction outlays fell in April, their level was, nonetheless, considerably above the first-quarter pace.

This growth in spending and employment is occurring even though the fiscal situation for the sector does not appear to be strengthening. Taken together, state and local governments have now shown a deficit in their operating and capital accounts (which exclude social insurance funds) for one and half years. Most of the problems appear to be occurring among state governments; local governments, whose own-source revenue comes largely from relatively stable property tax receipts, have enjoyed sound fiscal health since 1981. The recent pressure on state budgets in part reflects errors in revenue projections in a number of states that were misled by the strength in capital gains taxes in 1987. These include California, New York, and Massachusetts. All three governments are considering spending cuts to deal with the deficits; other options include using the cash reserve in California and Massachusetts, and deferring a planned tax cut in New York.

Prices

Producer price inflation picked up this spring, reflecting the effects of higher costs of farm products and a rebound in energy costs.

Producer finished goods prices rose 0.4 percent in April and 0.5 percent in May, well above the average pace earlier in the year. However, consumer prices rose 0.4 percent and 0.3 percent in April and May, respectively, about at the first-quarter pace.

After rising slowly in the first quarter of this year, the CPI for food was up 0.7 percent in April and 0.4 percent in May. The increases, particularly in April, were led by prices for meats and poultry, reflecting higher livestock prices at the farm level. Although spot prices for beef and pork have begun to decline in recent weeks, prices for grains and soybeans have surged in commodity markets.

Much of this runup in crop prices is the result of unusually hot and dry weather in the major growing regions, but the risks of tight supplies also are compounded by the drawdowns of stocks that have resulted from government-induced acreage reductions and strong export growth. Indeed, as seen in the charts, the USDA has been predicting sharp reductions in grain inventories at current rates of consumption, even assuming normal crop yields this year. These estimates likely will be revised down as the extent of the crop damage becomes clearer. These grain price increases should be reflected quickly in poultry price rises, because of poultry producers' ability to adjust production quickly. In coming months, the effect of grain and poultry price increases will be offset somewhat by lower beef prices, as many ranchers are forced to slaughter cattle from pastures reduced by drought. In contrast, by 1989, increased grain production resulting from higher prices and lessened government acreage reduction requirements, together with increased poultry production, should help offset beef price increases.

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 Apr.	1988 May
			----Annual rate----			-Monthly rate-	
All items[2]	100.0	4.4	3.9	3.2	4.2	.4	.3
Food	16.1	3.5	2.1	2.8	1.4	.7	.4
Energy	7.6	8.2	6.0	-3.9	-4.9	.8	.5
All items less food and energy	76.3	4.2	3.8	4.4	5.4	.4	.2
Commodities	25.8	3.5	2.9	2.5	4.7	.6	.2
Services	50.6	4.5	4.3	5.0	5.9	.2	.4
Memorandum:							
CPI-W[3]	100.0	4.5	4.0	2.8	3.5	.4	.4

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

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

	Relative importance Dec. 1987	1987	1987 Q3	1987 Q4	1988 Q1	1988 Apr.	1988 May
			----Annual rate----			-Monthly rate-	
Finished goods	100.0	2.2	3.8	-1.9	2.3	.4	.5
Consumer foods	25.9	-.2	-1.8	-5.7	5.6	.4	.9
Consumer energy	9.7	11.2	16.5	-9.6	-19.6	3.1	.2
Other consumer goods	40.1	2.7	4.6	1.7	5.3	.0	.3
Capital equipment	24.4	1.3	4.0	-.7	3.2	.2	.4
Intermediate materials[2]	95.0	5.4	5.6	4.3	3.9	.8	.6
Exc. energy	82.5	5.2	5.3	7.2	7.8	.7	.5
Crude food materials	39.5	1.8	-4.8	-4.8	16.7	.4	2.4
Crude energy	41.9	10.7	5.9	-15.2	-23.6	2.5	1.3
Other crude materials	18.6	22.6	39.4	18.0	13.8	.2	-1.7

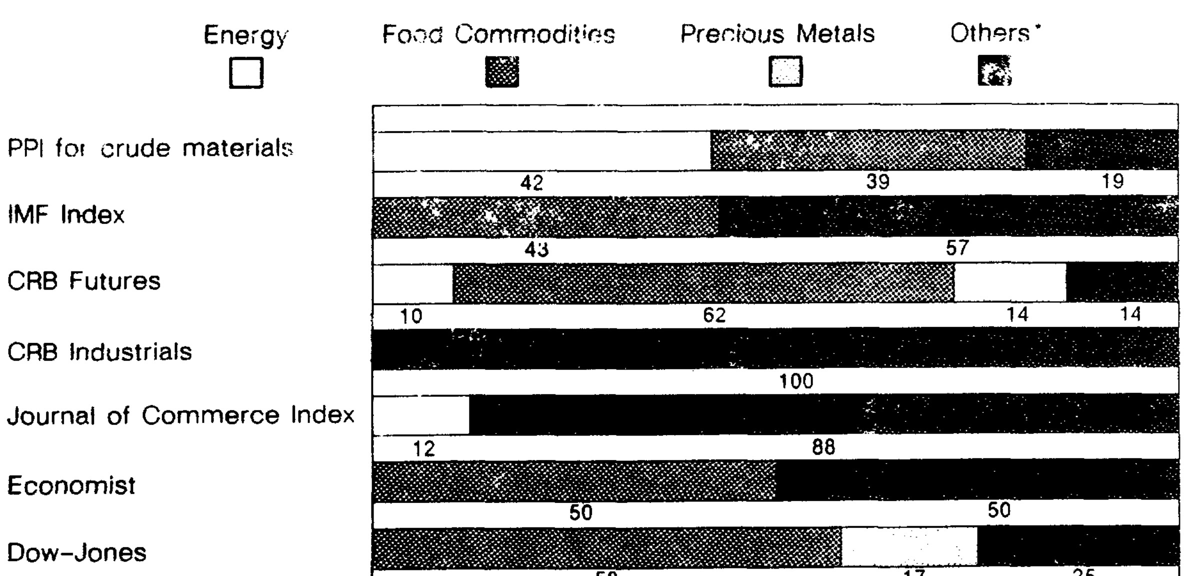
1. Changes are from final month of preceding period to final month of period indicated.
2. Excludes materials for food manufacturing and animal feeds.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last Observation	Percent change[2] 1986	1987	1988 To May 10*	1988 May 10* to date
1. PPI for crude materials[3]	May	-8.9	8.8	2.9	n.a.
1a. Ex. food and energy	May	1.8	22.4	3.0	n.a.
1b. Ex. food and energy, seasonally adjusted	May	1.7	22.5	1.7	n.a.
2. IMF commodity index[3]	May	-7.9	30.8	6.3	n.a.
2a. Metals	May	-.5	51.9	21.6	n.a.
2b. Nonfood agric.	May	8.5	47.5	-2.1	n.a.
3. Commodity Research Bureau					
3a. Futures prices	June 20	-9.1	11.7	2.7	12.3
3b. Industrial spot prices	June 19	5.1	19.0	1.8	2.1
4. _Journal of Commerce_ industrials	June 20	-1.4	10.7	-.1	3.8
5. _Economist_ (U.S. dollar index)	June 14	-4.7	42.5	10.0	11.7
5a. Industrials	June 14	5.8	62.6	15.0	11.9
6. Dow-Jones Spot	June 20	-8.9	17.0	.6	9.1

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

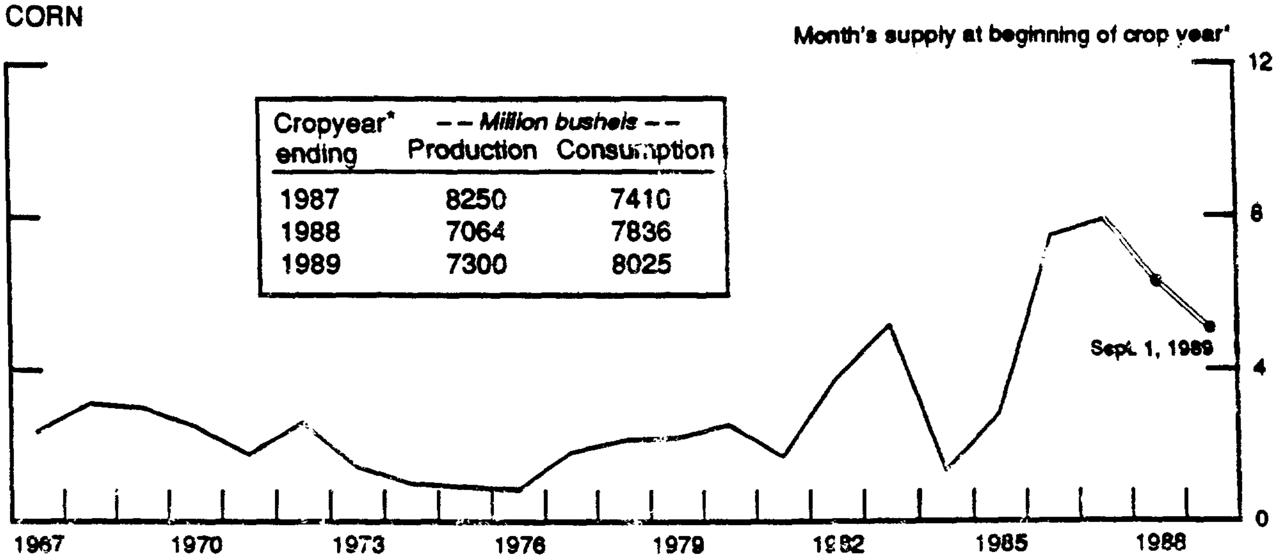
Index Weights



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

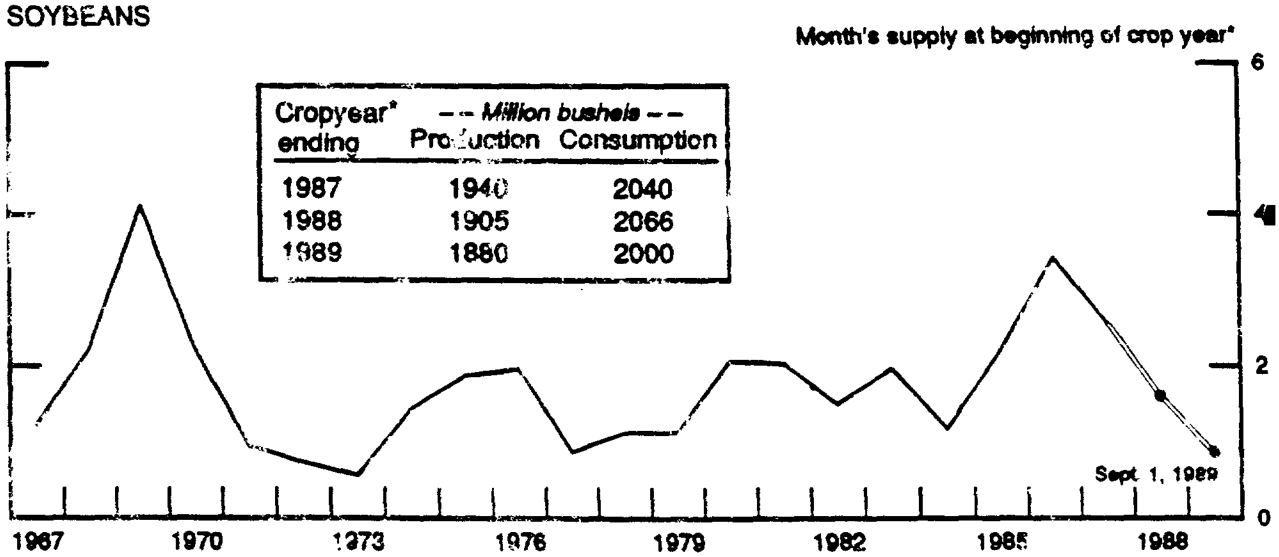
Grain Inventories

CORN



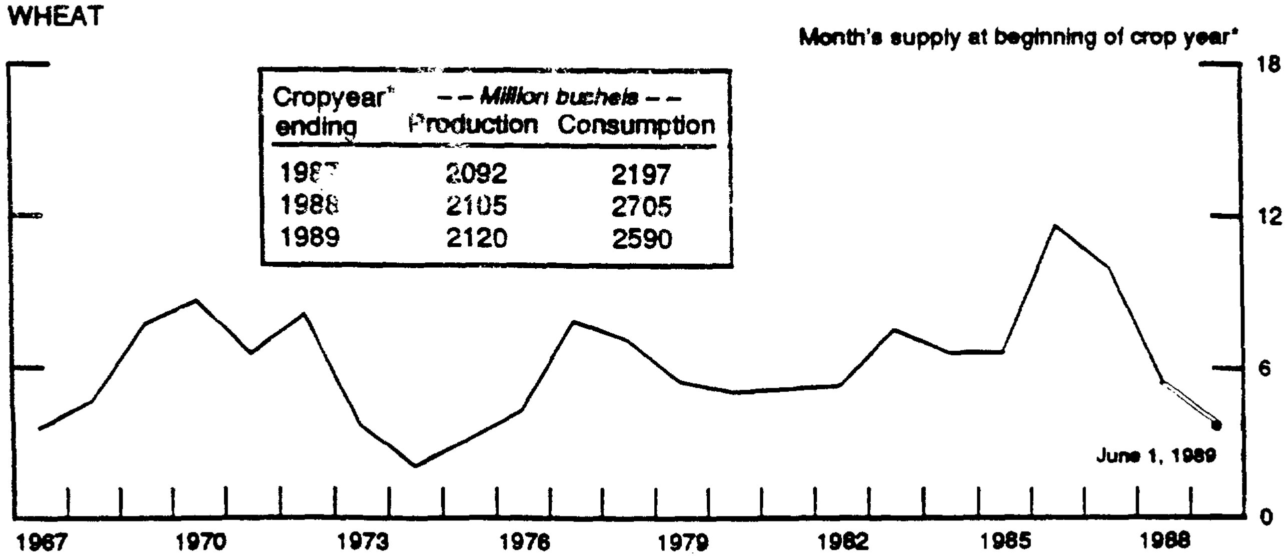
Cropyear* ending	-- Million bushels -- Production	Consumption
1987	8250	7410
1988	7064	7836
1989	7300	8025

SOYBEANS



Cropyear* ending	-- Million bushels -- Production	Consumption
1987	1940	2040
1988	1905	2066
1989	1880	2000

WHEAT



Cropyear* ending	-- Million bushels -- Production	Consumption
1987	2092	2197
1988	2105	2705
1989	2120	2590

*Cropyear begins with the harvest: September 1 for corn and soybeans, June 1 for wheat.

Retail energy prices also turned up sharply in April, and rose somewhat further in May. Price increases for gasoline and fuel oil through May suggest that most of the advance in crude oil prices in March and April has reached the retail level. More recently, price pressures in world petroleum markets appear to have eased somewhat: spot and, to a lesser extent, posted prices weakened this month, as the OPEC meeting failed to agree on production restraints.

Excluding food and energy items, the CPI rose an average of 0.3 percent in April and May, below the average monthly gains in the first quarter. Apparel prices were up sharply further in April--boosting the commodities component for the second month--but leveled off in May. In contrast, service prices rose 0.4 percent last month--about the average pace for more than a year--after an unusually small advance in April. On the whole, consumer prices outside of food and energy have shown few signs of sustained acceleration over the past year.

At earlier stages of processing, producer prices for intermediate materials less food and energy again rose sharply in April and May. Producer prices of crude materials less food and energy, which had risen rapidly in 1987 and the first quarter of this year, were little changed in April and dropped back 1.7 percent in May. However, since the PPI pricing date in the second week of May, the available measures of commodity prices have picked up markedly, moving above the relatively narrow ranges that have prevailed since last fall. These increases mainly reflect jumps in nonferrous metals prices, which have been affected by tight supplies worldwide. In particular, aluminum prices surged to new highs this month; prices also rose substantially further for zinc and, turned up again for copper. Among other commodities, rubber prices rose rapidly until mid-June, but prices of hides have receded.

Wages and Labor Costs

The limited wage data available through May suggest some acceleration in wage inflation this year. The hourly earnings index for production and nonsupervisory workers was up 0.5 percent in May, bringing the rise in the index to about 3-1/2 percent over the past year--1 percentage point more than in the preceding 12-month period.

Nonfarm compensation per hour--as reported in the productivity and cost data--rose about 3-1/2 percent at an annual rate in the first quarter. Because nonfarm productivity also grew 3-1/2 percent at an annual rate during this period, unit labor costs were little changed. For the four-quarter period ended in 1988-Q1, nonfarm compensation per hour rose 3-1/2 percent, while unit labor costs advanced 1-1/4 percent. In the manufacturing sector, average compensation rose more than 4-1/2 percent in the first quarter. With productivity growth of nearly 3 percent--near its recent trend--unit labor costs in manufacturing rose about 1-1/2 percent in the first quarter of 1988, in contrast to a 2 percent drop in 1987.

HOURLY EARNINGS INDEX[1]
(Percentage change; based on seasonally adjusted data)[2]

	1987	1987 Q3	1987 Q4	1988 Q1	1988 Mar.	1988 Apr.	1988 May
	-------Annual rate-------				---Monthly rate---		
Total private nonfarm	2.6	2.8	3.4	3.1	.2	.5	.5
Manufacturing	1.9	2.4	2.2	1.6	.2	.3	.3
Durable	1.6	2.3	2.3	1.6	.2	.3	.1
Nondurable	2.3	2.7	2.2	1.6	.0	.2	.6
Contract construction	.7	.1	2.0	4.1	.5	.0	.1
Transportation and public utilities	2.9	2.5	2.5	2.7	.2	.0	.6
Finance, insurance and real estate	4.1	1.5	5.9	8.0	-.4	.8	1.2
Total trade	2.3	3.1	2.7	2.8	.2	.7	.3
Services	4.6	4.7	6.1	4.2	.3	.7	1.2

1. Excludes the effect of interindustry shifts in employment and fluctuations in overtime hours in manufacturing.
2. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Quarterly changes are compounded annual rates.

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

	1987[1]	1987 Q2	1987 Q3	1987 Q4	1988 Q1	1987 Q1 to 1988 Q1
Nonfarm business sector						
Output per hour	1.3	1.4	4.2	-1.0	3.6	2.1
Compensation per hour	2.8	3.0	3.6	3.5	3.4	3.4
Unit labor costs	1.5	1.5	-.6	4.5	-.2	1.3
Manufacturing						
Output per hour	3.0	5.9	3.3	.5	2.8	3.1
Compensation per hour	1.1	2.0	1.3	2.1	4.6	2.5
Unit labor costs	-1.9	-3.7	-1.9	1.5	1.7	-.6

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

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

	1987		1988			Change from:	
	Jan.-Feb. lows	Oct. 16[2]	Feb lows	FOMC May 17	June 21	Oct. 16[2]	FOMC May 17
Short-term rates							
Federal funds[3]	5.95	7.59	6.38	7.07	7.55	-.04	.48
Treasury bills[4]							
3-month	5.30	6.93	5.59	6.30	6.56	-.37	.26
6-month	5.31	7.58	5.77	6.55	6.86	-.72	.31
1-year	5.35	7.74	6.10	6.89	7.08	-.66	.19
Commercial paper							
1-month	5.81	7.94	6.41	7.09	7.45	-.49	.36
3-month	5.73	8.65	6.45	7.20	7.54	-1.11	.34
Large negotiable CDs[4]							
1-month	5.85	7.92	6.44	7.07	7.47	-.45	.40
3-month	5.80	8.90	6.49	7.27	7.60	-1.30	.33
6-month	5.78	9.12	6.55	7.51	7.81	-1.31	.30
Eurodollar deposits[5]							
1-month	6.00	7.79	6.60	7.09	7.44	-.35	.35
3-month	6.00	8.69	6.69	7.34	7.51	-1.18	.17
Bank prime rate	7.50	9.25	8.50	9.00	9.00	-.25	.00
termediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	6.34	9.52	7.28	8.25	8.34	-1.18	.09
10-year	7.01	10.23	8.11	9.12	9.03	-1.20	-.09
30-year	7.29	10.24	8.32	9.22	9.10	-1.14	-.12
Municipal revenue[6] (Bond Buyer)	6.92	9.59	7.76	8.26	8.10	-1.49	-.16
Corporate A utility (recently offered)	8.78	11.50	9.63	10.60e	10.40e	-1.10	-.20
Home mortgage rates[7]							
S&L fixed-rate	9.10	11.58	9.84	10.40	10.35	-1.23	-.05
S&L ARM, 1-yr.	7.52	8.45	7.59	7.66	7.79	-.66	.13

	1986	1987		1988		Percent change from:		
	Year-end	Record highs	Lows	FOMC May 17	June 21	Record highs	Lows	FOMC May 17
Stock prices								
Dow-Jones Industrial	1895.95	2722.42	1738.74	1986.41	2109.17	-22.53	21.30	6.18
NYSE Composite	138.58	187.99	125.91	144.65	153.29	-18.46	21.75	5.97
AMEX Composite	263.27	365.01	231.90	296.57	306.88	-15.93	32.33	3.48
NASDAQ (OTC)	348.83	455.26	291.88	372.27	387.75	-14.83	32.85	4.16

1. One-day quotes except as noted.
2. Last business day prior to stock market line on Monday, October 19, 1987.
3. Average for two-week maintenance period closest 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 6/29/88.
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.

Money markets hav firmed a bit since mid-May, but bond yields have eased a little, on balance, and share prices have risen. While further tightening actions by the Fed have increased the cost of carry, they evidently have provided a measure of reassurance to many traders at a time when commodity prices have been soaring.

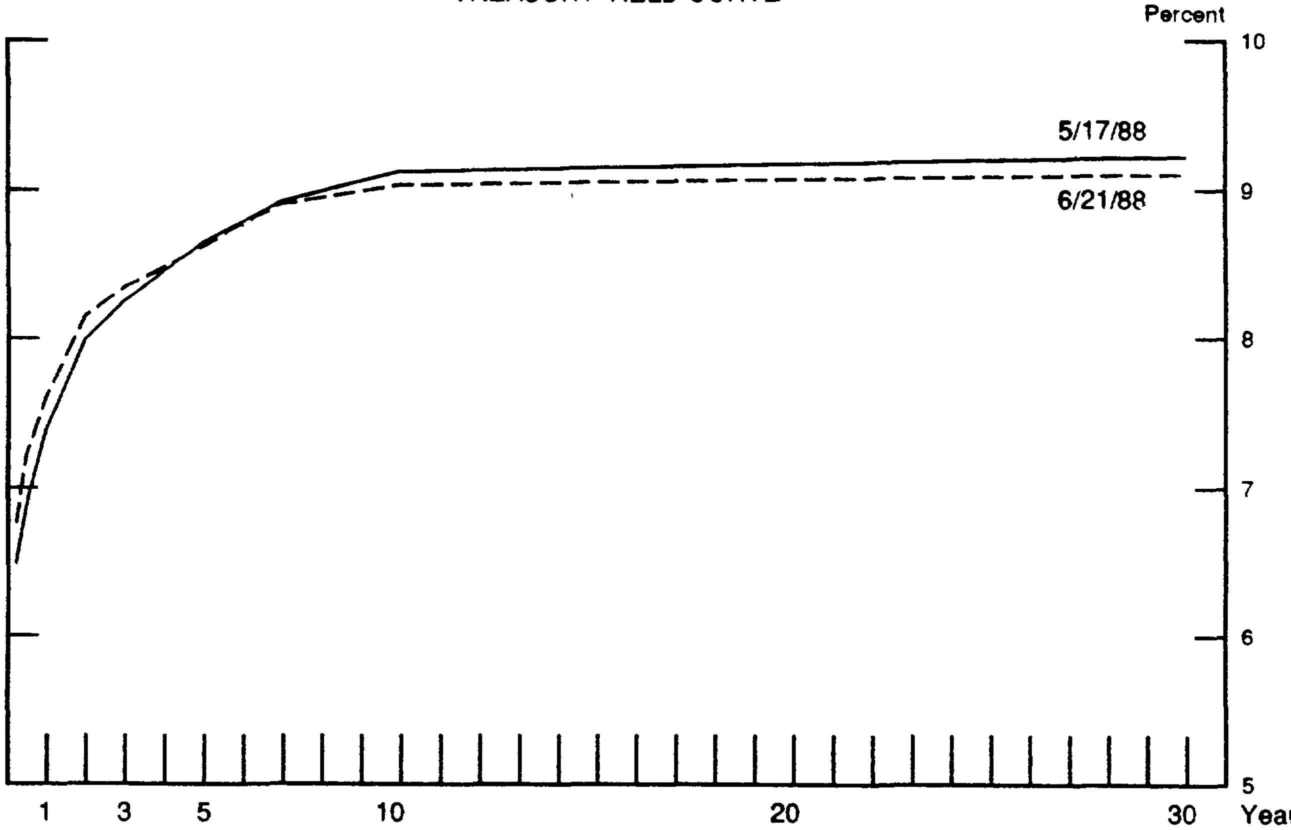
The broader monetary aggregates grew slowly in May, as tax-related payment flows worked their way through the financial system. M2 and M3 grew about 5 percent, while M1 was essentially flat. Somewhat faster growth in the aggregates for June seems likely, as the effects of tax payments disappear.

The enlarged business credit demands that were evident in April persisted in May. Borrowing at banks was particularly strong last month, with both nonmerger- and merger-related financing needs of firms apparently contributing to the increase. In early June, financing by businesses picked up in the bond and equity markets but slowed in the commercial paper market. In the household sector, though, mortgage lending evidently has remained below the average pace of recent years, and other consumer borrowing has slowed. Borrowing by the public sector has been light this quarter, with the Treasury flush with cash from income tax payments, and until most recently, state and local governments continuing to issue only moderate amounts of bonds.

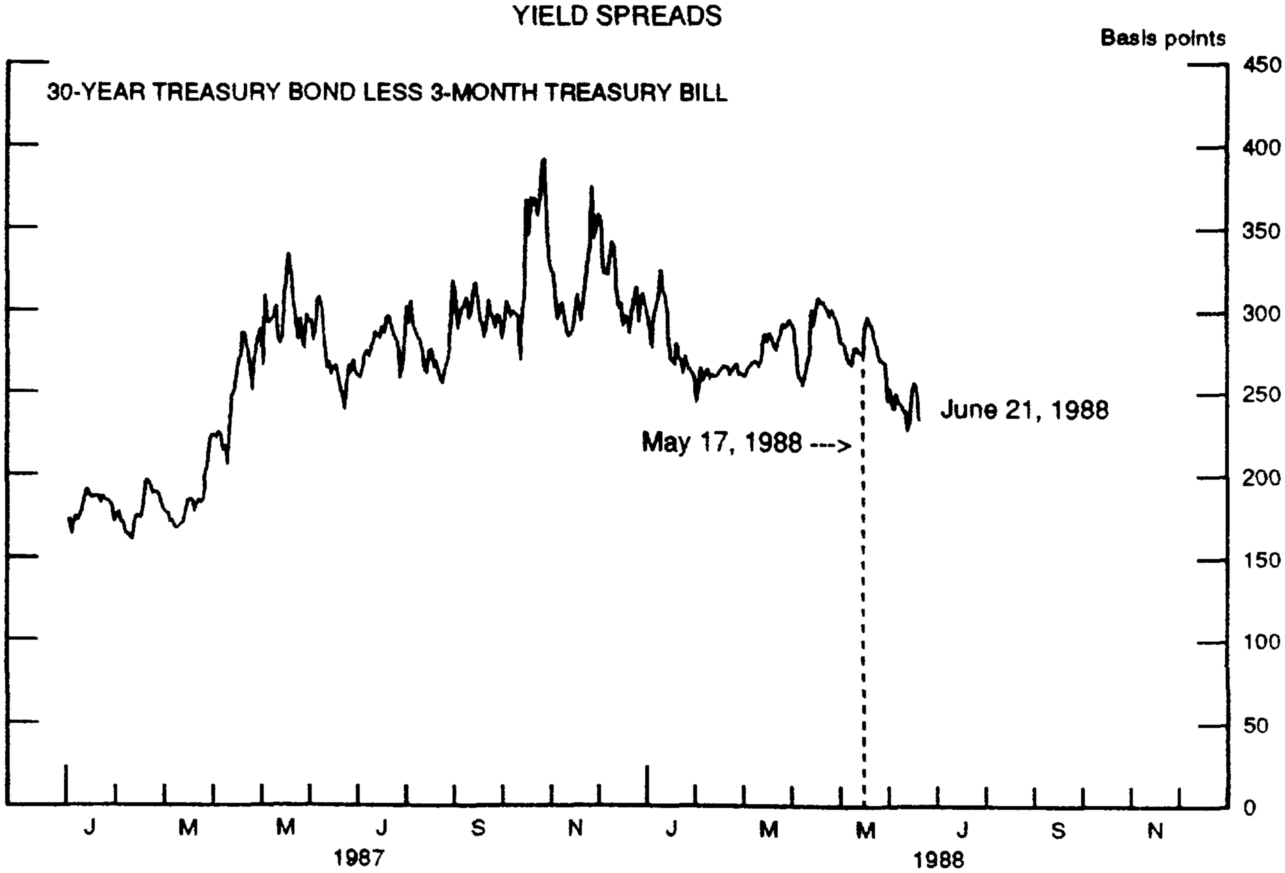
Interest Rates

Since the last FOMC meeting, the federal funds rate has risen almost 1/2 percentage point to about 7-1/2 percent. Other rates have

TREASURY YIELD CURVE



YIELD SPREADS



note: daily data

fluctuated erratically, however, as traders have reacted violently at times to news suggesting possible shifts in inflationary risks, in particular. The markets generally reacted favorably to signs of slackening domestic demand, such as the less robust employment and retail sales figures and the sharp drop in imports in the latest trade report; through much of the period, these indications appeared to offset the adverse psychological effects of rising farm commodity prices. Most recently, however, the continuing drought conditions and expected "limit-up" moves in the grain and bean futures markets seem to have exerted a greater force on the fixed-income markets, with the added negative of concerns about a concerted tightening move by key foreign central banks in the wake of reports of strong first-quarter growth.

Key Treasury bill rates have moved up, on balance, roughly 1/4 percentage point. Private short-term rates have risen about 3/8 percentage point. In contrast, long-term Treasury yields have decreased at least 1/8 percentage point, and corporate bond yields, as measured by the index of recently offered high-grade utility bonds, are down a little more since mid-May. In the mortgage market, yields on fixed-rate loans have been somewhat restrained by a relative shortage of this product in the secondary market; the average contract rate for new fixed-rate mortgage commitments has fallen somewhat from the 10-1/2 percent level that prevailed between mid-May and early June.

Monetary Aggregates and Bank Credit

Growth in the monetary aggregates slowed in May, largely reflecting the unwinding of April's tax-related bulge in checkable deposits. M1

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

	1987[1]	1987 Q4	1988 Q1	1988 Mar	1988 Apr	1988 May	Growth Q4 87- May 88
	------------Percent change at annual rates--------------------						
1. M1	6.2	3.9	3.9	5.5	11.2	-0.2	4.5
2. M2	4.0	3.9	6.7	8.8	10.0	4.9	7.4
3. M3	5.3	5.4	6.9	7.8	7.2	4.7	6.9
	------------Percent change at annual rates------------						Levels bil. $ May 88
Selected components							
4. M1-A	2.8	4.0	1.4	4.1	9.2	-4.1	498.2
5. Currency	8.7	9.9	9.4	9.6	9.6	6.5	203.6
6. Demand deposits	-1.0	0.1	-4.4	0.4	9.2	-11.6	287.3
7. Other checkable deposits	13.6	4.0	8.5	8.6	14.4	7.1	271.9
8. M2 minus M1[2]	3.3	3.9	7.7	9.9	9.6	6.6	2234.3
9. Overnight RPs and Eurodollars, NSA	4.1	8.0	-12.8	-50.7	36.9	80.9	82.3
10. General purpose and broker/dealer money market mutual fund shares, NSA	5.8	12.0	19.3	20.3	6.1	-17.3	232.7
11. Commercial banks	2.5	3.5	7.2	9.9	6.8	1.0	947.5
12. Savings deposits, SA, plus MMDAs, NSA[3]	1.8	-4.2	2.7	8.7	0.9	-3.1	542.9
13. Small time deposits	3.5	14.8	13.7	11.6	15.1	6.6	404.7
14. Thrift institutions	3.5	3.4	8.7	12.6	9.5	6.2	969.0
15. Savings deposits, SA, plus MMDAs, NSA[3]	0.8	-11.6	-7.3	5.1	3.6	0.9	401.9
16. Small time deposits	5.6	16.0	21.3	18.0	13.6	10.2	567.1
17. M3 minus M2[4]	10.7	11.3	7.5	4.2	-3.4	3.7	775.6
18. Large time deposits	8.5	14.4	7.3	4.2	2.7	9.0	496.2
19. At commercial banks, net[5]	11.2	10.5	3.2	5.5	-3.7	10.7	328.2
20. At thrift institutions	3.4	22.2	15.7	1.5	15.3	5.7	168.0
21. Institution-only money market mutual fund shares, NSA	3.0	20.2	44.0	-15.8	-67.8	-24.8	90.0
22. Term RPs, NSA	29.9	-3.7	3.4	-28.4	7.8	33.3	111.0
23. Term Eurodollars, NSA	12.9	11.1	-27.8	48.3	-17.7	22.2	88.2
	-----Average monthly change in billions of dollars----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	6.1	5.4	0.8	-0.9	5.1	12.8	586.8
25. Large time deposits, gross	3.5	5.4	2.3	1.7	-2.0	2.4	396.5
26. Nondeposit funds	2.6	0.0	-1.5	-2.6	7.1	10.4	190.3
27. Net due to related foreign institutions, NSA	2.9	0.9	-6.5	-6.3	4.8	8.4	8.7
28. Other[7]	-0.3	-0.9	5.1	3.8	2.1	2.1	181.6
29. U.S. government deposits at commercial banks[8]	0.3	0.4	-0.4	2.3	-3.1	2.9	24.7

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 April and May at rates of 5.9 percent and 11.7 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during April and May at rates of 10.1 percent and 3.5 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.

was virtually flat, while M2 and M3 both expanded at around a 5 percent annual rate. Unusually large tax payments by individuals apparently had a particularly pronounced effect on the demand deposit component of the aggregates, which swung from expansion at a 9-1/4 percent rate in April to contraction at about an 11-1/2 percent rate in May. The 7 percent growth of other checkable deposits in May was about half that of April.

The MMDA and money market mutual fund components of M2 contracted during the first part of May, as processing of tax payments evidently drew down these balances also, and as opportunity costs increased with the rise in short-term market rates in late April and early May. Growth of M3 was held down by withdrawals from institution-only MMMFs, as their yields lagged increases in market rates, and by very sizable borrowings by banks from their foreign offices. These inflows from foreign offices, which occurred even with a strong pickup in growth of large time deposits, were needed to fund continued rapid asset growth.

Data for early June indicate a pickup in M1 growth and a moderate rebound in growth of the broader aggregates, as well, but expansion of all the aggregates evidently is being restrained by increased opportunity costs. Both M2 and M3 are likely to remain in the upper half of their target ranges through midyear.

Bank credit expanded at a 13 percent annual rate in May, the second consecutive month of double-digit growth, and indications in early June point to continued brisk expansion of credit at large banks. Despite heavy acquisitions of mortgage-backed securities by large banks,

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 Mar.	1988 Apr.	1988 May p	Levels bil.$ May p
		Commercial Bank Credit						
1.	Total loans and securities at banks	7.9	2.5	7.8	7.9	11.4	12.9	2322.4
2.	Securities	5.0	3.1	5.4	13.3	10.7	5.3	543.6
3.	U.S. government securities	9.1	2.2	6.8	14.3	14.5	10.1	345.9
4.	Other securities	-1.3	4.7	2.9	11.7	4.3	-3.0	197.7
5.	Total loans	8.8	2.3	8.6	6.3	11.6	15.3	1778.8
6.	Business loans	7.5	4.7	2.7	-3.6	17.5	17.4	587.3
7.	Security loans	1.0	-110.2	76.6	-43.6	-51.3	22.0	38.8
8.	Real estate loans	18.1	13.2	10.8	10.5	12.8	16.1	612.5
9.	Consumer loans	4.9	4.5	10.4	13.8	10.8	5.3	339.1
10.	Other loans	-2.3	-12.2	4.5	21.7	5.4	22.4	201.1
		Short- and Intermediate-Term Business Credit						
11.	Business loans net of bankers acceptances	7.6	5.4	2.3	-4.2	17.8	18.2	583.9
12.	Loans at foreign branches[2]	-4.1	-35.9	115.8	92.3	-12.2	61.9	20.4
13.	Sum of lines 11 & 12	7.2	4.1	5.2	-1.4	16.8	19.8	604.3
14.	Commercial paper issued by nonfinancial firms	-1.6	23.9	8.8	40.6	16.2	28.0	92.0
15.	Sum of lines 13 & 14	6.0	6.7	5.7	4.1	16.5	20.9	696.3
16.	Bankers acceptances: U.S. trade related[3,4]	13.3	7.1	-11.6	3.6	7.1	n.a.	33.8[5]
17.	Line 15 plus bankers acceptances: U.S. trade related	6.3	6.7	4.9	4.1	16.3	n.a.	718.3[5]
18.	Finance company loans to business[3]	16.6	24.1	8.4	9.5	15.6	n.a.	217.5[5]
19.	Total short- and intermediate-term business credit (sum of lines 17 & 18)	8.4	10.5	5.6	5.2	16.0	n.a.	935.7[5]

1. Average of Wednesdays.
2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
3. Based on average of data for current and preceding ends of month.
4. Consists of acceptances that finance U.S. imports, U.S. exports, and domestic shipment and storage of goods.
5. April data.
n.a.--not available
p--preliminary

growth in securities holdings slowed substantially in May. Total loans, however, accelerated to a robust 15 percent pace--reflecting another strong month for real estate and business loan growth and an uptick in security loans. The acceleration in real estate loans was attributable to a surge in home equity loans. Consumer loans grew at only a 5-1/4 percent rate, but the packaging of such loans into credit card-backed securities trimmed growth of the consumer-loan category by about 2 percentage points, and the pickup in home equity loans likely had a further depressing influence. Security loans rose in May after two months of decline, apparently reflecting increased credit needs associated with security issuance and trading.[1] Business loan growth at U.S. banking offices exceeded 17 percent for the second month in a row, markedly above the 2-1/4 percent pace of the first quarter. Moreover, bookings of LIBOR-based loans at foreign branches of U.S. banks picked up noticeably in the wake of the prime rate increase in May.

Business Finance

Available data for the second quarter indicate a marked increase in borrowing by nonfinancial corporations. In addition to bank borrowing, commercial paper issuance by nonfinancial firms also rose noticeably in April and May. Meanwhile, gross bond issuance by such firms remained at first-quarter levels. Short-term borrowing appears to have slowed in early June, but bond issuance has surged. The step-up in credit demands

1. According to the Senior Loan Officers' Opinion Survey of Bank Lending Practices completed in late May, the runoff in security loans since last fall had reflected reduced demand for such credit.

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

	1987		1988			
	Year	Q4	Q1 p	Apr. p	May p	June e
Corporate securities - total[1]	24.08	15.68	23.50	21.01	22.44	27.50
Public offerings in U.S.	21.89	14.78	22.11	18.80	20.80	24.70
Stocks--total[2]	4.45	1.52	3.85	2.80	3.80	3.70
Nonfinancial	2.32	.73	.76	.90	1.30	2.40
Utility	.57	.14	.32	.30	.15	.20
Industrial	1.75	.59	.44	.60	1.15	2.20
Financial	2.12	.79	3.09	1.90	2.50	1.30
Bonds--total[1]	17.44	13.26	18.26	16.00	17.00	21.00
Nonfinancial	6.61	4.74	6.58	6.60	6.60	9.00
Utility	2.02	2.03	2.25	2.10	2.20	1.80
Industrial	4.59	2.71	4.33	4.50	4.40	7.20
Financial	10.83	8.52	11.68	9.40	10.40	12.00
By quality[3]						
Aaa and Aa	3.27	4.74	3.83	3.40	2.70	3.50
A and Baa	5.20	4.03	7.05	5.70	6.30	9.30
Less than Baa	2.77	1.32	1.32	1.70	2.10	3.50
No rating (or unknown)	.07	.03	.05	.30	.20	.20
Memo items:						
Equity-based bonds[4]	.87	.35	.13	.27	.06	.80
Mortgage-backed bonds	5.19	1.97	5.47	4.70	4.25	2.50
Variable-rate notes	1.88	.64	1.44	1.10	2.25	.50
Bonds sold abroad - total	2.03	.85	1.34	2.10	1.60	2.50
Nonfinancial	.94	.39	.39	.74	.64	.90
Financial	1.09	.46	.95	1.36	.96	1.60
Stocks sold abroad - total	.16	.05	.05	.11	.04	.30
Nonfinancial	.12	.05	.04	.04	.04	.30
Financial	.04	.00	.01	.07	.00	.00

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. 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.

appears to have reflected a need for financing of both capital expenditures and heavy merger activity. Although further growth in profits of nonfinancial corporations is expected for the second quarter, the gap between internal funds and capital outlays is likely to have widened with the pickup in inventory financing needs after the falloff in the first quarter. At the same time, net equity retirements are expected to reach a record quarterly level, despite revival of new equity offerings late in the second quarter.

Foreign purchasers have been active participants in recent corporate restructurings--accounting for more than half of this quarter's total of $21 billion in large acquisitions. A reduced calendar of prospective deals suggests some slowing of the merger pace. Offerings of new shares by nonfinancial firms, which had been quite light since the stock market crash, picked up a bit in May and surged in early June, when most stock price indexes reached post-crash highs. The sharply higher June estimate for equity issuance is based, in part, on the recent announcement of a $1.3 billion stock offering by Occidental Petroleum--one of the largest equity offerings ever.[2]

The recent stock price surge has been accompanied by an increase in trading volume. But, to an even greater extent than earlier in the year, a substantial portion of recent trading activity continues to be attributable to short-term trading associated with "dividend rolls." Dividend income is effectively exchanged for capital loss through this

2. Most of the proceeds from the issue will be used to pay down debt, presumably that associated with Occidental's recent acquisition of Cain Chemical.

tactic, enabling many Japanese institutions to circumvent their country's restrictions on distributions of capital gains to their investor clientele. Such dividend plays, for example, have led to 98 million shares of Pacific Gas and Electric and 104 million shares of Occidental Petroleum changing hands on two recent days. Dividend roll volume has built up from small amounts a year ago to more than 30 million shares per day so far in June. Although major brokers and dealers have halted program trading for their own accounts, large block trading reached another peak in May--accounting for 57 percent of total NYSE volume. This peak likely reflects the effect of both dividend rolls and light retail trading.

When the bond markets rallied in the first part of the intermeeting period, corporate bond issuance surged. The offerings involved a wide range of companies, but especially low-rated firms. Junk volume in the first two weeks of June exceeded that of any full post-crash month, and even convertible bond offerings have been revived from their recent dormancy. Reports of legal action against Drexel appear to have had little effect on the market for low-rated issues, with spreads over Treasury yields narrowing noticeably this year to about their October levels and within 1/2 percentage point of the unusually tight spreads of last August.

Treasury and Sponsored Agency Financing

The federal government is likely to run a negligible budget deficit in the second quarter as compared with $37 billion in the first. In line with the lower deficit, Treasury marketable borrowing is estimated to fall to $10 billion from $34 billion in the first quarter. Factoring in other flows, the Treasury's cas' balance is likely to increase by about $12 billion.

During the second quarter, the Treasury maintained the size of its 3- and 6-month bill auctions at $12.8 billion. Excluding a $4 billion cash management bill that was issued in the first quarter and settled in the second quarter, the Treasury is expected to pay down $7 billion in bills in the current quarter, owing to the diminished pace of add-ons and to reductions in the size of the 1-year bill auctions. Over the previous three quarters, bills were paid down only marginally.

In mid-June, after having pared back its coupon auctions during most of the second quarter, the Treasury announced that the size of its 2- and 4-year note auctions would each be raised $250 million. The move was prompted, in part, by the increasing likelihood that the statutory authority to issue long-term bonds will not be raised in time for the August refunding, which would leave Treasury with only $1.66 billion of remaining authority. Another factor is the projected sizable increase in Treasury marketable borrowing needs in the third and fourth quarters.

Borrowing by federally sponsored credit agencies in the second quarter is expected to show a slight increase from its first-quarter pace. The pickup largely reflects seasonal fluctuation in the credit needs of the housing-related sponsored agencies, especially the Federal Home Loan Banks. Their increased credit demand has more than offset the

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

	1988 Q1	1988 Q2[e]	1988 Apr.	1988 May[p]	1988 Jun.[e]
Treasury financing					
Total surplus/deficit (-)	-37.0	-1.4	13.9	-22.5	7.1
Means of financing deficit:					
Net cash borrowing from the public	42.8	16.2	-.3	7.5	9.0
Marketable borrowings/ repayments (-)	34.1	9.8	-2.7	6.5	6.0
Bills	3.2	-10.8	-6.6	-2.9	-1.3
Coupons	30.9	20.6	3.9	9.4	7.3
Nonmarketable	8.7	6.4	2.4	1.0	3.0
Decrease in the cash balance	-.4	-12.3	-23.3	27.3	-16.2
Memo: Cash balance at end of period	23.0	35.3	46.3	19.0	35.3
Other[2]	-5.4	-2.5	9.7	-12.3	.1
Federally sponsored credit agencies, net cash borrowing[3]	11.1	12.3	.3	5.0	6.5
FHLBs	2.5	5.9	-.1	2.5	3.5
FNMA	2.8	3.3	1.1	1.0	1.2
Farm Credit Banks	.9	-1.3	-1.8	.3	.3
FHLMC	2.5	2.5	.8	.9	.8
FICO	.7	1.1	.3	.8	0
SLMA	1.8	.9	.6	-.4	.7

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.

falloff in borrowing by the Student Loan Marketing Association and the paydown by the Farm Credit Banks.

Although borrowing by the Financing Corporation (FICO) increased during the second quarter, the agency's borrowing during its first full year of operation likely will fall short of the $3.75 billion annual limit placed upon its debt issuance by Congress. Since its inception, FICO has raised $2.9 billion and thus has room to borrow an additional $850 million before the close of its first year in August. However, in spite of several recent large liquidations of insolvent S&Ls, the FSLIC is reported to have adequate funds available to fill its near-term needs, which should permit FICO to postpone most, if not all, additional borrowing until late in the summer. The above-mentioned liquidations have had little effect on the yield spread of FICO's 30-year bonds over comparable Treasury securities, which varied between 100 and 110 basis points until recently when it widened after release of first-quarter financial reports for thrifts.

In the most significant action for the Farm Credit System since passage last year of new assistance legislation, the system placed the Federal Land Bank of Jackson, Mississippi, in receivership last month. This action, taken several days prior to the system's May offering of securities, was said to have had little effect on its yield spreads. At that offering, yields on its 3- and 6-month issues fell relative to rates on comparable Treasury securities, leaving spreads at levels well below those prevailing throughout most of 1987.

Municipal Securities

Long-term tax-exempt issuance in May totaled $6.9 billion--up from April but about $1 billion below the first quarter's monthly average. Most of the recent monthly pickup reflected issuance to raise new capital, as refunding volume totaled only $2.2 billion. Activity so far this month and the remaining calendar suggest a substantial further rise in long-term volume, with several large issues coming to market.

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

	1986	1987	1987		1988	1988		
	Year	Year	Q3	Q4	Q1	Apr.	May[p]	June[e]
Total offerings[1]	14.39	10.44	9.12	9.99	8.68	9.04	7.69	--
Total tax-exempt	14.04	10.05	8.84	9.38	8.46	8.88	7.34	12.00
Long-term	12.25	8.53	6.82	7.84	7.94	5.85	6.88	9.00
Refundings[2]	5.29	3.80	2.05	2.16	3.05	1.90	2.20	--
New capital	6.96	4.73	4.77	5.68	4.89	3.95	4.68	--
Short-term[3]	1.79	1.52	2.02	1.54	.52	3.03[4]	.46	3.00
Total taxable	.35	.39	.28	.61	.22	.16	.35	--

1. Includes issues for public and private purposes; also includes taxable issues.
2. Includes all refunding bonds, not just advance refundings.
3. Does not include tax-exempt commercial paper.
4. Includes $2.6 billion of short-term notes issued by the state of New York; large Spring issuance by New York is not unusal. Last April N.Y. State issued $2.8 short-term bonds.
p--preliminary.
e--staff estimate.

Residential Mortgage Markets

Fixed-rate mortgage (FRM) interest rates have fallen over the past few weeks, along with yields on secondary mortgage market instruments, and are now slightly below their mid-May levels. The average contract rate on new commitments for 30-year, fixed-rate conventional home loans has dipped to 10.35 percent, down roughly 25 basis points from the reading at the beginning of June but only 5 basis points below the level at the time of the last FOMC. In contrast, the average initial rate quoted on adjustable-rate mortgages (ARMs) with one-year rate adjustments has risen since mid-May, but at about 255 basis points, the FRM/ARM spread remains quite wide by historical standards. As a consequence, the proportion of mortgage loan originations containing adjustable-rate features is expected to remain around the 53 percent share observed in early May.

Mortgage lending may have increased somewhat in the current quarter, while remaining below the average pace of recent years. Commercial banks, in particular, increased the volume of their lending in April and May. At FSLIC-insured thrift institutions, net acquisitions of mortgage-related assets jumped in April, with significant increases in both loans and mortgage-backed securities. Mortgage originations at these thrifts edged off, however, and recent loan applications and commitment levels suggest continuing near-term sluggishness.

Issuance of federally related pass-through securities, another indicator of mortgage lending activity, has been running well below the average monthly pace of 1986 and 1987 as ARMs, which are seldom securitized, have accounted for the bulk of mortgage loan originations. Nonetheless, preliminary data for May show that pass-through issuance to-

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	21.1	12.5	6.0	2.6	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	20.0	9.6	6.1	2.5	3.6
Q4	19.5	6.8	9.0	4.7	4.3
1988-Q1	18.6	7.8	2.7	2.6	.1
1988-Jan. r	17.4	6.1	5.6	5.1	.5
Feb. r	18.9	7.8	1.2	4.7	-3.5
Mar. r	19.5	9.4	1.5	-1.9	3.3
Apr. p	18.2	9.3	6.3	2.6	3.7

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	11.8	5.0	2.7	4.2	12.4	1.3
1988-Q1 r	9.5	3.7	2.7	3.1	8.5	.9
1988-Jan. r	8.7	4.4	2.4	1.9	7.9	.5
Feb. r	9.3	3.3	3.0	3.0	8.7	1.2
Mar. r	10.5	3.3	2.7	4.5	8.8	1.0
Apr. p	12.6	3.4	2.8	6.4	10.8	3.0
May p	12.6	4.0	3.2	5.5	10.9	2.0

r--revised. p--preliminary.

taled a seasonally adjusted $12.6 billion, unchanged from April but notably above the pace of the first quarter.

While issuance of federally related pass-throughs has remained subdued this year, offerings of multiclass mortgage-backed pass-through securities have rebounded sharply from the three-year low registered during the fourth quarter of 1987. Agency issues have accounted for a large portion of the nearly $7 billion average monthly volume since March, but private issuers--primarily investment banks--also have been active. The increased issuance of these derivative mortgage products has enhanced demand for the FNMA and FHLMC pass-through securities that are used to collateralize them; as a result, new fixed-rate mortgages have commanded a higher price when sold into the secondary market, enabling lenders to extend fixed-rate mortgage credit at narrower spreads to Treasuries. Indeed, between January and mid-May, the spread between the average initial rate on conventional, fixed-rate mortgages and the ten-year constant-maturity Treasury yield narrowed to a four-year low. More recently the spread has widened some, however, as the high costs of collateral and some decline in long-term Treasury yields have begun to deter issuance of derivative securities.

Consumer Installment Credit

Consumer installment credit outstanding grew in April at a seasonally adjusted annual rate of 7 percent, down from the 10-3/4 percent first-quarter pace. The deceleration reflected sharply lower growth of auto loans, as the ending of or significant reduction in many of the auto sales incentive programs in April contributed to a dip in auto

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	1987	Q4	Q1 r	Mar. r	Apr. p	Mar. r	Apr. p	Apr. p
Total[1]	10.4	7.2	6.7	10.7	10.0	7.0	5.19	3.65	633.1
Total, excluding auto	5.7	6.2	5.6	8.0	5.3	7.1	1.56	2.10	354.8
Selected types									
Auto	17.4	8.6	8.1	14.4	15.9	6.7	3.63	1.55	278.3
Revolving	11.8	16.8	17.7	15.9	16.0	11.7	2.18	1.61	167.7
All other	1.7	-1.5	-4.2	1.2	-4.0	3.2	-.62	.49	187.6
Selected holders									
Commercial banks	8.5	7.4	6.9	13.2	14.6	8.8	3.49	2.14	293.0
Finance companies	20.4	4.8	4.9	11.4	9.3	3.9	1.11	.46	144.5
Credit unions	5.9	6.4	3.6	7.6	10.2	8.1	.70	.56	83.2
Savings institutions[2]	14.5	12.4	11.9	7.1	-5.8	6.6	-.32	.36	65.4

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)

				1988				
	1985	1986	1987	Jan.	Feb.	Mar.	Apr.	May
At commercial banks[1]								
New cars (48 mo.)	12.91	11.33	10.46	...	10.72	...	...	10.55
Personal (24 mo.)	15.94	14.83	14.23	...	14.46	...	...	13.49
Credit cards	18.69	18.26	17.92	...	17.80	...	...	17.78
At auto finance cos.[2]								
New cars	11.98	9.44	10.73	12.19	12.26	12.24	12.29	...
Used cars	17.59	15.95	14.61	14.56	14.75	14.77	14.82	...

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.

sales. Growth of revolving credit slowed somewhat in April but remained at a strong 11-3/4 percent, while "other" consumer borrowing rose moderately after a prolonged period of relative stagnation. This grouping includes diverse elements (such as financing for home improvements, mobile homes, some big-ticket durables, and educational outlays) that may be especially amenable to mortgage financing. As a result, the downward trend in this category of consumer indebtedness may be reflective of continuing shifts into real-estate secured credit, as the continued tax deductibility of interest on most real-estate loans makes them more desirable borrowing means.

Measures of the quality of household debt in the first quarter presented a mixed picture, with some improvement in delinquencies for home mortgages and other closed-end credit but further deterioration in the status of late payments on open-ended loans and in the number of personal bankruptcy filings. Indeed, personal bankruptcy filings in the first quarter exceeded 135,000--a pace that would eclipse the record annual number of filings (493,353) established last year.

CONSUMER AND MORTGAGE LOAN DELINQUENCY RATES
(Number Delinquent as Percent of Total Number Outstanding)
All Series Seasonally Adjusted

	Installment loans 30 days or more delinquent			First mortgage loans 60 days or more delinquent
	Commercial banks		Automobile	
	Closed-end	Credit card	finance cos.	MBA series
1979	2.43	2.39	2.25	1.24
1980	2.61	2.73	2.27	1.42
1981	2.38	2.56	1.89	1.52
1982	2.25	2.42	1.68	1.71
1983	2.01	2.24	1.41	1.77
1984	1.96	2.18	1.38	1.81
1985	2.31	2.67	1.72	1.90
1986	2.34	3.13	1.95	1.93
1987	2.42	2.36	1.92	1.73
1987 - Q1	2.37	2.46 r	1.94	1.83
Q2	2.38	2.37 r	1.86	1.79
Q3	2.35	2.29	1.93	1.59
Q4	2.56	2.33	1.93	1.70
1988 - Q1	2.32	2.58	2.09	1.59

Sources: American Bankers Association, Federal Reserve Board, Mortgage Bankers Association.
r--revised by ABA to correct misreporting. Series discontinuous between 1986 and 1987.

U.S. Merchandise Trade

In April, the seasonally adjusted U.S. merchandise trade deficit was $9.9 billion (Census basis, CIF valuation), compared with an $11.7 billion (revised) deficit in March. The deficit fell as imports dropped sharply and exports fell more moderately (see table below).

U.S. MERCHANDISE TRADE
(Billions of dollars, monthly rates, Census basis)

	Exports	Imports CIF	Balance CIF	Exports	Imports CIF	Balance CIF
	Not seasonally adjusted			Seasonally adjusted		
1988-Jan	23.0	34.5	-11.5	24.5	35.8	-11.3
Feb	24.1	37.1	-13.0	24.5	38.9	-14.4
Mar[r]	29.1	38.6	-9.5	26.9	38.6	-11.7
Apr[p]	26.5	36.3	-9.8	26.2	36.1	-9.9

r--revised
p--preliminary

The decline in the seasonally adjusted value of imports from March to April was widespread across commodity categories. Automotive imports and imports of consumer and capital goods decreased, especially imports of *office machinery* (which had been strong for several months). The value of imports of industrial supplies fell largely because of declines in imports of steel and chemicals. Exports declined only slightly in April from the very strong March level, with much of the decrease due to smaller exports of automotive products.

For the first quarter, the merchandise trade deficit was $144 billion at a seasonally adjusted annual rate (balance-of-payments basis), substantially below the fourth quarter rate and the average for

1987 as a whole. The value of both exports and imports reached record levels in the first quarter, with exports continuing to expand rapidly and import growth slowing noticeably (see table below).

U.S. MERCHANDISE TRADE
(Billions of dollars, annual rates, BOP basis, seasonally adjusted)

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil	Non-oil	Balance
	- - - - - - - - - - Current dollars - - - - - - - - - - - -						
1985	216	30	186	338	50	288	-122
1986	224	27	197	369	34	335	-144
1987	250	30	220	410	43	367	-160
1986-1	216	29	188	358	42	317	-142
-2	228	26	202	363	31	332	-135
-3	225	27	199	372	32	340	-147
-4	227	28	199	381	32	348	-154
1987-1	227	26	201	387	35	352	-159
-2	239	28	211	398	40	357	-158
-3	260	33	226	418	51	367	-159
-4	272	31	242	437	45	392	-165
1988-1	299	36	263	442	40	403	-144
	- - - - - - - - Constant 1982 dollars - - - - - - - - - -						
1987-1	249	31	218	422	69	353	-173
-2	261	34	227	425	72	353	-164
-3	282	40	242	448	87	360	-166
-4	293	35	258	461	81	380	-168
1988-1	317	40	277	464	82	382	-147

In constant dollars, exports expanded by 32 percent in the first quarter (annual rate), after having risen by 24 percent (annual rate) over the preceding three quarters. The first-quarter increase was especially strong in machinery (particularly business machines), industrial supplies (gold, other metals, and chemicals), and consumer goods. The volume of agricultural exports also increased strongly in the first quarter, particularly shipments of wheat (50 percent of which was sold under the Export Enhancement Program), corn, and soybeans. By area, the largest percentage increases in the value of exports were to Western Europe, newly industrialized countries in Asia, Japan, and Mexico.

In the first quarter, the volume of imports rose by less than 1 percent, noticeably less than the growth rate recorded in 1987. Most of the first-quarter increase was in imports of capital goods and certain industrial supplies. The strong rate of U.S. domestic investment expenditures in recent quarters and some uptrend in foreign direct investment in the United States has stimulated demand for imported capital goods. Most of the increase in imports of industrial supplies was in metals and chemicals, reflecting growing pressures on domestic output capacity in these sectors.

The volume of petroleum imports rose by about 1 percent from the fourth-quarter rate, as drawdowns in inventories were offset by higher consumption resulting from colder-than-average weather. The price per barrel declined to $15.24 from $17.46 in the fourth quarter.

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

		1987				1988	
	1987	Q1	Q2	Q3	Q4	Q1	Apr
Value (Bil. $)	42.88	35.04	40.30	51.04	45.15	39.93	37.92
Price ($/BBL)	17.33	15.76	17.58	18.26	17.46	15.24	14.70
Volume (mbd.)	6.78	6.09	6.28	7.66	7.08	7.16	7.05

Current Account

The U.S. current account deficit increased to an annual rate of $159 billion in the first quarter, compared with $134 billion (revised) in the fourth quarter of 1987. The increase resulted from a sharp drop in net investment income receipts (see table below). Capital gains reported on the book value of U.S. direct investments abroad fell sharply, because the dollar depreciated much less in the first quarter than in the fourth quarter. Direct investment income payments also increased because of a change in a financial accounting standard that increased reported income of some foreign-owned U.S. affiliates. Both income receipts and payments on other private investment decreased

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

	1987 Year r	1987 Q4 r	1988 Q1	$ change Q1-Q4
Trade balance	-160.3	-164.8	-143.8	21.0
Exports	249.6	272.1	298.7	26.6
Imports	409.9	436.8	442.5	5.7
Investment income, net	20.4	50.2	-2.4	-52.5
Direct investment, net	41.8	75.1	21.9	-53.4
Capital gains or losses <1>	15.8	44.7	2.8	-41.9
Other direct investment	26.0	30.7	19.1	-11.6
Portfolio income, net	-21.4	-25.2	-24.3	0.9
Military, net	-2.4	-5.0	-3.6	1.5
Other services, net	1.8	3.1	3.4	0.3
Unilateral transfers	-13.4	-17.5	-12.6	4.9
Current account balance	-154.0	-134.1	-159.0	-24.9

<1> Gains or losses on foreign currency assets owing to their revaluation at current exchange rates, and other valuation adjustments. Plus = gains; minus = losses.
r--revised

slightly in the first quarter due to lower U.S. and foreign interest rates.

The reduction in the merchandise trade deficit in the first quarter only partly offset the drop in investment income receipts. Unilateral transfers declined from a fourth-quarter rate that had been boosted by an unusually heavy drawing on U.S. government grant funds by a country in the Middle East. Among other services, travel and passenger fare receipts increased somewhat, but were nearly matched by an increase in U.S. payments for foreign travel and passenger fares. Transfers under military sales contracts increased from a low fourth-quarter rate; there was little change in military payments for services.

U.S. International Financial Transactions

Recorded capital inflows through the banking system were an unusually large $15-1/2 billion in April (Summary of U.S. International Transactions Table, line 1). These data, which are as of end-of-month, were affected by large swings in U.S. banks' net claims on own foreign offices occurring on the last days of March and April. Monthly averages of daily data show a smaller, but still substantial, $5 billion inflow in April and a further $8-1/2 billion inflow in May. (See International Banking Data Table, line 1.) These strong inflows resulted from both supply and demand pressures. Recent stability of the dollar, relatively high interest rates on short term dollar assets, and expectations that U.S. interest rates would rise further appear to have induced an increase in the demand for Eurodollar deposits. At the same time, rapid loan growth and slow growth of core deposits in the United States have

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

	1986 Year	1987 Year	1987 Q1	Q2	Q3	Q4	1988 Q1	Feb.	Mar.	Apr.
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	1.1	2.8	2.0	15.4
Securities										
2. Private securities transactions, net <1>	65.5	36.9	16.6	15.6	11.7	-6.9	-2.2	-1.8	0.4	2.7
a) foreign net purchases (+) of U.S. corporate bonds	53.5	26.6	8.5	7.5	7.7	2.8	2.6	0.5	2.1	1.2
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	1.3
c) U.S. net purchases (-) of foreign securities	-6.0	-6.5	-2.1	-0.7	-1.5	-2.2	-4.8	-2.1	-1.9	0.2
3. Foreign net purchases (+) of U.S. Treasury obligations	4.0	-7.3	-2.8	-2.3	-2.8	0.6	7.0	5.4	-1.7	-0.2
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	24.8	9.3	8.1	2
a) By area										
G-10 countries (incl. Switz.)	30.8	38.8	15.7	13.2	-5.7	15.7	18.2	7.4	3.6	3.1
OPEC	-8.3	-8.9	-2.7	-2.0	-1.3	-2.8	-1.6	-0.3	-0.2	-0.3
All other countries	10.8	17.8	2.3	0.5	7.9	7.1	8.2	2.2	4.7	-0.6
b) By type										
U.S. Treasury securities	34.4	43.4	12.2	11.1	0.8	19.2	27.7	9.9	10.8	2.5
Other <2>	-1.0	4.4	2.9	0.6	0.1	0.7	-2.9	-0.6	-2.8	-0.3
5. Changes in U.S. official reserve assets (+ = decrease)	0.3	9.1	2.0	3.4	*	3.7	1.5	-0.3	0.5	n.a.
Other transactions (Quarterly data)										
6. U.S. direct investment (-) abroad <3>	-27.8	-44.5	-10.7	-6.2	-7.9	-19.7	-4.8	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S. <4>	34.1	42.0	8.0	7.2	15.0	11.7	10.2	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow) <3> <4>	-8.7	3.1	2.6	4.1	-1.7	-2.0	-0.8	n.a.	n.a.	n.a.
9. U.S. current account balance <4>	-138.8	-154.0	-37.6	-40.9	-42.0	-33.5	-39.8	n.a.	n.a.	n.a.
10. Statistical discrepancy <4>	15.6	18.5	-6.5	13.1	-4.4	16.3	3.0	n.a.	n.a.	n.a.
MEMO:										
U.S. merchandise trade balance — part of line 9 (Balance of payments basis, seasonally adjusted)	-144.5	-160.3	-39.9	-39.6	-39.7	-41.2	-35.9	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.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1984	1985	1986	1987				1988		
	Dec.	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.	Apr.	May
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	8.7	3.9	-4.6
(a) U.S.-chartered banks	32.1	32.4	31.7	21.6	16.3	12.6	15.2	27.8	25.0	18.5
(b) Foreign-chartered banks	.9	-4.2	-9.4	-12.4	-11.3	-20.3	-26.1	-19.0	-21.1	-23.1
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	19.1	19.2	20.0
3. Eurodollar Holdings of U.S. Nonbank Residents <1>	117.6	111.1	124.5	134.0	135.7	141.1	132.6	127.2	126.9	132.7

<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.

induced U.S. banks to seek funds from the Euromarkets. The rapid increase in U.S. nonbank residents' Eurodollar deposits in May (line 3) likely reflects increased deposits by bank holding companies at their own foreign offices.

Private foreigners purchased net $2-1/2 billion of private securities in April, split about evenly between corporate stocks and bonds, while they sold net a small amount of U.S. Treasury securities (Summary of U.S. International Transactions Table; lines 2a, 2b, and 3). The pickup in stocks marked the first significant monthly net purchase since October 1987, while the net purchase of corporate bonds coincided with relatively heavy new issuances of Eurobonds by U.S. corporations in April (new issuances remained strong in May).

Net inflows from official transactions were down markedly in April, to a rate less than one third of those in the fourth quarter of 1987 and the first quarter of 1988; partial data for May indicate a continued inflow near the reduced April pace. This decline in official inflows reflects the slower pace of exchange market intervention since the fourth quarter of 1987 and less shifting of previously purchased dollar assets from the Euromarkets.

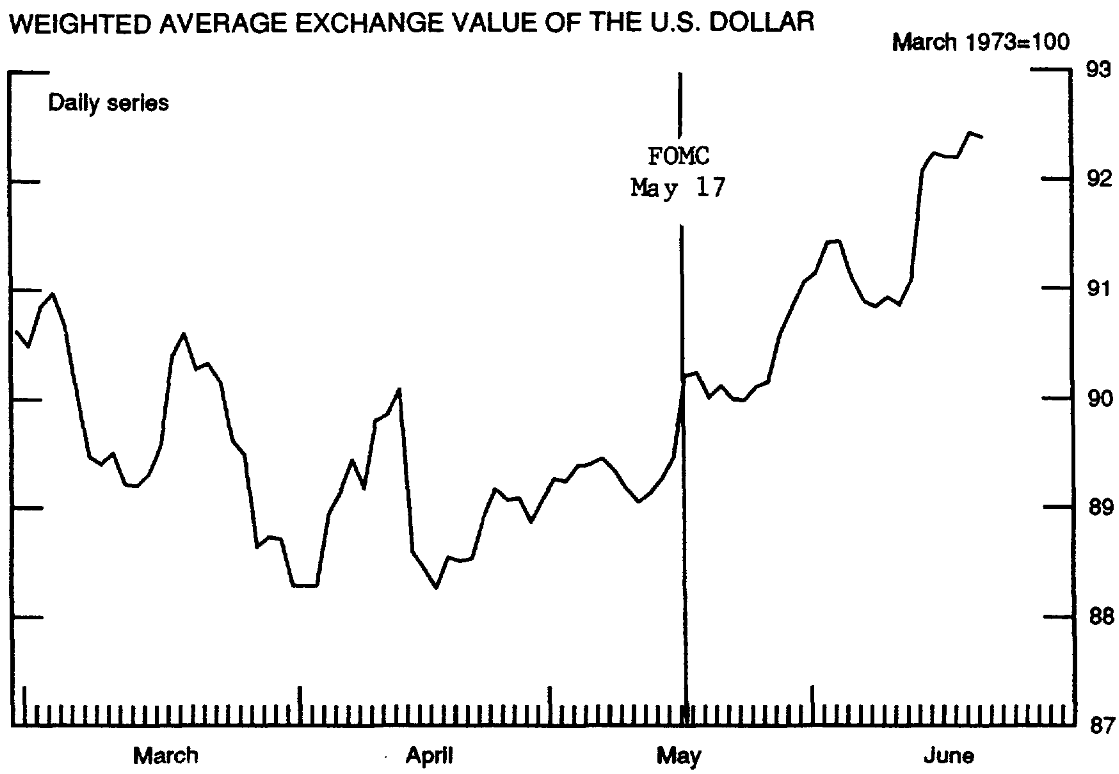
Recently released data on U.S. international transactions (first quarter of 1988 and revisions to past data) report a swing in net direct investment flows in the first quarter of 1988. For 1987 as a whole, these data show a net outflow on direct investment of $2-1/2 billion; for the first quarter of 1988 they show an inflow of $5-1/2 billion. (See lines 6 and 7 of the Summary table.) The swing is partly attributable to the slower depreciation of the dollar during the first quarter of 1988, which reduced the capital gains recorded to U.S. direct investment abroad from $16 billion in 1987 to $1 billion in the first quarter of 1988. In addition, certain U.S. companies sold petroleum interests abroad in the first quarter. Foreign direct investment in the United States was $10 billion in the first quarter of 1988, near its quarterly average for 1987.

Foreign Exchange Markets

Exchange-market developments in the intermeeting period were dominated by reaction to further tightening of U.S. monetary policy and to the larger-than-expected reduction in the U.S. merchandise trade deficit for April. The trade-weighted, foreign-exchange value of the dollar in terms of the other G-10 currencies rose 3-1/2 percent since the May FOMC meeting, as the new trade data prompted market participants to revise their views about the prospects for international adjustment. The weighted-average dollar is now about 9 percent above its level at the end of last year but still 8 percent below its recent peak in August.

Some market interest rates in Germany and Japan rose during the intermeeting period in anticipation of official interest rate increases, while interest rates in the United Kingdom and Canada firmed in response to actual tightening. As shown in the table of selected interest rates, the three-month interest rate in Germany rose 40 basis points, and the call money rate rose 65 basis points, reflecting market expectations that the Bundesbank would raise its RP rate. On June 21 the Bundesbank

Chart 1



Selected Interest Rates

	Germany	Japan	United States
CALL MONEY			
May 17	3.20	3.13	6.98
June 21	3.85	3.31	7.57
3-MONTH			
May 17	3.55	3.79	7.27
June 21	3.95	3.83	7.60
LONG-TERM			
May 17	6.04	4.70	9.12
June 21	6.12	4.73	9.03

did in fact announce that it would accept tenders for its RP operation that week at a fixed rate of 3.50 percent, up 25 basis points from the previous rate. Call money rates in Japan rose nearly 20 basis points during the intermeeting period, as the extraordinary growth in Japanese economic activity during the fourth and first quarters combined with two small but suggestive increases in commercial-bill discount rates since the middle of May reinforced expectations of more significant moves by the Bank of Japan.

Financial markets in the United Kingdom digested four changes in official interest rates, as sterling declined 5-1/4 percent against the dollar and about 1 percent against the mark. Early in the period, the Bank of England lowered its money-market dealing rates 50 basis points following sterling's rise to DM3.18. Later, after sterling fell to DM3.10 and below, presumably as financial markets began to respond to the steady deterioration in the U.K. external accounts, the Bank of England took the opportunity to reverse the previous decline in interest rates by raising official rates in three moves of 50 basis points each. Money-market dealing rates in the United Kingdom are now at 8-7/8 percent. Three-month interbank sterling interest rates have moved up more than 100 basis points on balance since the May FOMC to 9-1/8 percent, and sterling has rebounded somewhat to DM3.14.

Three-month interest rates in Canada firmed about 40 basis points to 9.40 percent, and the Canadian dollar strengthened about 2-1/4 percent against the U.S. dollar during the period. Commodity price increases and bidding for Canadian dollars in connection with Amoco's bid to take over Dome Petroleum may have lent some additional support to the Canadian dollar.

Several European central banks lowered official interest rates during this period. As the French franc strengthened within the EMS following statements by new government officials indicating that the franc would not be devalued, the Bank of France lowered its money-market intervention rate and its seven-day RP rate 25 basis points each to 7 and 7-1/2 percent, respectively. The National Bank of Belgium dropped the rate on one-month certificates 10 basis points to 6 percent and the rate on two-month certificates 5 basis points to 6.05 percent. The Bank of Norway lowered its overnight lending rate 50 basis points to 12.8 percent. And the National Bank of Denmark lowered its official lending rate to 8-3/4 percent from 9 percent.

U.S. bank lending to foreigners

The (nominal) dollar value of U.S.-chartered banks' claims on foreigners decreased by $12.6 billion in the first quarter of 1988. The foreign exchange value of the dollar in terms of other G-10 currencies rose on average 3.2 percent during the period. After adjustment for the effect of exchange rate changes on non-dollar claims, total claims on foreigners are estimated to have declined by $9 billion.

CLAIMS ON FOREIGNERS OF U.S.-CHARTERED BANKS
(Billions of dollars)

	Changes (no sign = increase)						Out-standing
	1985	1986	1987	1987		1988	
	Year	Year	Year	Q3	Q4	Q1	03/31/88
Total, all countries	-20.4	4.3	-8.4	1.5	-3.2	-12.6	368.6
Non-OPEC developing countries	-7.6	-4.5	-3.0	-3.0	0.1	-3.5	93.2
of which:							
(Latin America)	-3.9	-0.2	-2.7	-1.2	-1.5	-2.7	67.2
(Asia and Africa)	-3.5	-4.3	-0.4	-1.9	1.5	-0.4	26.3
OPEC countries	-3.6	-1.7	-2.3	0.1	-1.8	0.2	17 5
Eastern Europe	-0.3	-0.9	-0.2	0.0	-0.3	-0.1	2.9
Smaller developed countries	-3.7	-3.7	0.1	0.7	0.4	0.1	26.4
G-10 countries	-2.1	12.0	2.4	-3.0	5.7	-4.2	156.2
Offshore banking centers	-2.7	0.3	-10.0	2.9	-9.9	-2.1	51.1
Miscellaneous	-0.4	2.9	4.6	3.7	2.7	-3.0	21.4
Memorandum:							
Total, adjusted for exchange rate changes (staff estimate)	-29	-11	-25	2	-17	-9	

Claims on the G-10 countries fell during the first quarter. The $2.1 billion decline in claims on the off-shore centers included a $1.3

billion, or nearly 30 percent, decline in claims on Panama. This decline appears to have been related largely to an unwinding of interbank transactions.

The value of claims on non-OPEC developing countries fell by $3.5 billion in the first quarter, or approximately 3 1/2 percent. There were declines in claims on all of the heavily indebted Latin American countries with the exception of Argentina, which made a $550 million drawing under its new money package of April 1987. This contributed to an increase in U.S.-chartered banks' claims on that country of $100 million. Claims on Mexico declined $1.4 billion, or approximately 6 percent. A small fraction of the decline was probably related to U.S. bank participation in the Mexican exchange offering, which took place in the first quarter.

In 1987 and the first quarter of 1988, 10 regional U.S. banks acted to eliminate or substantially reduce their exposure to less developed countries through secondary market sales of loans. These regional banks had claims on 31 developing countries totalling $2.9 billion at the end of 1986, which was 3 1/2 percent of the claims on these countries held by a reference group of 45 major U.S. banks. Secondary market sales of loans to these countries by the 10 regional banks amounted to $1.5 billion over the last five quarters, including sales of more than $700 million in the first quarter of 1988. However, there have not been publicized accounts of large loan sales by regional banks during the second quarter.

Indicative secondary market prices for debt of the Baker-15 countries declined somewhat during the first two months of the year, perhaps because of increased supplies to the market as the regional banks reduced their exposures. Since the beginning of March, secondary market prices have risen 6 percent on average, largely as a result of increases in the prices of Brazilian and Mexican loans.

INDICATIVE PRICES FOR BANK LOANS TO
HEAVILY INDEBTED DEVELOPING COUNTRIES
(Average of bid and offer price, expressed
as a percentage of face value)

Countries[1]	6/29/87	9/21/87	12/31/87	3/2/88	6/9/88	Change from 3/2/88 to 6/9/88 (percent)
Brazil	61.5	39.5	46.5	46.4	52.9	14.0
Mexico	56.4	47.6	50.5	48.0	52.1	8.5
Argentina	48.0	37.5	34.5	28.8	26.5	-8.0
Venezuela	70.5	54.5	58.0	53.9	55.9	3.7
Chile	69.8	57.0	61.8	59.3	60.5	2.0
Philippines	69.5	59.8	50.4	51.0	54.3	6.5
Yugoslavia	75.5	61.0	49.8	46.8	45.8	-2.1
Nigeria	30.0	26.0	30.5	29.8	29.0	-2.7
Colombia	85.3	79.5	66.5	66.0	65.8	-0.3
Ecuador	49.5	33.8	37.3	34.3	28.3	-17.5
Peru	13.5	10.8	8.0	6.5	6.5	0.0
Morocco	66.3	64.0	53.5	50.5	49.8	-1.4
Cote d'Ivoire	63.5	61.0	42.5	34.5	30.0	-13.0
Uruguay	74.3	67.5	60.0	60.5	60.5	0.0
Bolivia	10.0	10.0	12.0	12.0	12.0	0.0
Baker-15 countries[2]	59.2	45.9	47.4	45.2	48.0	6.2

[1] Ranked by December 1986 BIS quarterly bank claims.

[2] Weighted-average of secondary market prices. The weight of each of the 15 countries is the value in December 1986 of BIS quarterly bank claims on that country divided by total claims on the 15 countries.

Source: Salomon Brothers.

Developments in the Foreign Industrial Countries

Real economic activity increased strongly in the first quarter in most of the major foreign industrial countries, although preliminary indications suggest some slowing in several countries in the second quarter. Real GNP increased by 11.3 percent (s.a.a.r.) in the first quarter in Japan and by 6 percent in Germany. Real GDP grew less strongly in the first quarter in France (a 4.9 percent annual rate), Canada (3.2 percent) and the United Kingdom (2.7 percent). Inflation rates in major foreign industrial countries have remained little changed in recent months.

The cumulative net trade surplus of the foreign G-7 countries has been reduced so far in 1988 compared with the same period last year. The Japanese and Canadian surpluses are lower compared with last year, while the German surplus rate is unchanged. Both Italy and the United Kingdom have registered larger trade deficits so far this year. In France, the trade deficit has been reduced.

Individual country notes. Real GNP in Japan expanded by a very strong 11.3 percent (s.a.a.r.) during the first quarter. This growth was more than accounted for by domestic demand, which rose at an 11.7 percent rate. Plant and equipment investment grew 15.2 percent and was the strongest spending component. Residential investment grew only 4 percent after rising sharply during the second half of 1987. Private consumption spending rose 10.8 percent, substantially above its pace during the fourth quarter of last year. Real exports grew 14.8 percent

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	1988 Jan.	1988 Feb.	1988 Mar.	1988 Apr.	1988 May	Latest 3 months from year ago 2/
Canada												
GDP	1.8	6.3	1.3	1.7	1.6	.8	*	*	*	*	*	5.6
IP	-.5	7.5	1.4	2.1	2.1	.5	.1	-.4	.6	n.a.	n.a.	6.3
France												
GDP	1.9	2.6	.9	.8	.5	1.2	*	*	*	*	*	3.5
IP	-.3	3.6	1.6	.6	1.0	.6	.0	.0	.0	n.a.	n.a.	3.9
Germany												
GNP	2.4	2.3	.7	1.4	.7	1.4	*	*	*	*	*	4.3
IP	.6	1.3	2.2	.3	.8	1.5	.7	1.2	-.9	.8	n.a.	4.0
Italy												
GDP	3.0	2.8	1.2	1.0	.2	n.a.	*	*	*	*	*	2.8
IP	2.8	5.7	2.0	-2.8	3.3	2.6	8.9	-4.4	.5	2.3	n.a.	3.3
Japan												
GNP	2.0	5.5	.0	2.0	1.8	2.7	*	*	*	*	*	6.7
IP	-.6	7.9	-.1	3.6	3.7	3.4	.5	2.4	.5	-.9	n.a.	11.8
United Kingdom												
GDP	4.4	4.3	.8	1.9	.7	.7	*	*	*	*	*	4.0
IP	2.3	4.1	.9	1.6	.9	-.9	-.4	-2.1	1.8	1.5	n.a.	2.4
United States												
GNP	2.2	4.0	.6	1.1	1.2	1.0	*	*	*	*	*	3.9
IP	1.0	5.8	1.1	2.1	1.7	1.0	.4	.0	.2	.6	.4	6.1

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 Q4	1987 Q1	1987 Q2	1987 Q3	1987 Q4	1988 Q1	1988 Feb.	1988 Mar.	1988 Apr.	1988 May	Latest 3 months from year ago
Canada													
CPI	4.3	4.2	1.0	.9	1.4	1.2	.7	.8	.4	.5	.4	.6	4.1
WPI	.3	4.3	.6	.5	1.3	1.4	1.1	.8	-.7	.3	.2	n.a.	4.3
France													
CPI	2.1	3.2	.7	1.2	.9	.6	.5	.5	.2	.3	.5	.3	2.5
WPI	-3.5	3.1	-.7	.8	.5	.7	1.1	n.a.	*	*	*	*	3.1
Germany													
CPI	-1.0	1.0	-.3	.6	.4	.0	.0	.5	.2	.1	.2	.2	1.0
WPI	-9.0	-.7	-1.6	-.2	.0	-.4	-.2	.1	-.1	.2	.5	.3	.2
Italy													
CPI	4.7	5.2	1.2	1.3	1.0	1.1	1.7	1.1	.3	.4	.3	.3	4.9
WPI	-2.4	4.6	.7	1.5	1.0	.8	1.2	1.1	.5	.2	.6	n.a.	4.3
Japan													
CPI	.1	1.1	.0	-.3	1.2	-.2	.4	-.2	-.1	.4	.5	-.1	.8
WPI	-9.1	-.6	-1.0	-.7	-.7	1.3	-.4	-1.2	-.1	.1	-.3	-.1	-.7
United Kingdom													
CPI	3.4	4.1	1.3	1.2	1.5	.2	1.1	.5	.4	.4	1.6	.4	3.9
WPI	4.2	3.9	.8	1.3	1.0	.5	1.1	1.3	.4	.5	.7	.3	4.2
United States													
CPI (SA)	1.3	4.4	.7	1.3	1.2	.9	.9	.8	.2	.5	.4	.3	3.9
WPI (SA)	-1.9	2.5	.7	.7	1.1	.7	.0	.1	-.3	.6	.4	.5	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	1988			
			Q4	Q1	Q2	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
Canada												
Trade	7.5	7.8	1.8	2.4	2.3	2.1	1.1	2.1	.9	.6	.5	n.a.
Current account	-6.7	-7.3	-2.1	-1.2	-1.5	-1.9	-2.7	n.a.	*	*	*	*
France												
Trade	.1	-5.2	.5	-1.1	-2.0	-1.0	-1.0	-.7	-.9	.3	-.4	n.a.
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	15.1	4.8	5.1	n.a.	n.a.
Current account (NSA)	39.7	45.3	14.2	11.3	10.7	7.7	15.5	8.7	3.1	2.8	n.a.	n.a.
Italy												
Trade	-1.9	-8.9	-.3	-1.1	-2.7	-2.7	-2.5	-2.9	-.6	-1.4	-.4	n.a.
Current account (NSA)	2.9	-.8	1.2	-2.8	-.9	2.8	.1	n.a.	*	*	*	*
Japan												
Trade	82.4	79.5	22.3	23.8	19.5	17.8	18.3	20.8	6.5	6.5	6.4	5.0
Current account 2/	85.8	87.0	24.0	25.3	21.3	19.9	20.5	23.2	7.9	7.3	6.4	n.a.
United Kingdom												
Trade	-12.4	-15.9	-3.7	-1.7	-3.9	-5.0	-5.3	-6.6	-2.3	-1.6	-2.1	n.a.
Current account	.0	-3.0	-.8	1.2	-.5	-1.4	-2.3	-3.3	-1.3	-.5	-1.0	n.a.
United States												
Trade 2/	-144.3	-159.2	-38.5	-39.9	-39.6	-39.7	-41.2	-35.9	*	*	*	*
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.

while real imports rose 18.2 percent; net exports withdrew 0.4 percentage point from output growth.

In April, preliminary data suggest industrial production declined slightly (s.a.), but remained above its first-quarter average. Housing starts declined as well in April. However, April data for new machinery orders rose 24 percent from the March figure. Retail sales increased strongly as well in April, rising by 3.3 percent (s.a.) and almost completely reversing their March decline. The index of leading economic indicators rose again in April to 54.2 from 50 in March, where 50 demarks the boom/bust distinction. The unemployment rate declined slightly in April to 2.6 percent (s.a.), its lowest value since May 1987.

Inflation remains low in Japan. The consumer price index for Tokyo was only 0.5 percent above its year-earlier level in May, slightly below the rate experienced in April. Wholesale prices were 0.5 percent below their year-earlier level in May, about equal to the April change.

The May trade balance decreased to $5.0 billion (s.a.) as exports fell and imports were little changed. The aggregate trade balance so far this year of $77.3 billion (s.a.a.r.) is below the $89.5 billion rate recorded for the same period last year. The current account surplus declined again in April, to $6.4 billion (s.a.), bringing the cumulative total for the first four months to $88.5 billion (s.a.a.r.), below the 1987 figure of $99 billion for the same period. Through May, exports to the United States were 5 percent above the total for the same period last year while imports were almost 43 percent greater.

The government has approved the proposal for reform of Japanese taxes recently announced by the Tax Council of the Liberal Democratic Party. The plan calls for reduction of income tax rates retroactive to January 1988. Rates are to be reduced on personal income, corporate income, and inheritances. The revenue losses are to be partly offset by a proposed 3 percent indirect consumption tax that would take effect April 1989, the start of the next fiscal year. At the same time, however, some current excise taxes are to be eliminated, lowering the net revenue obtained. Because the tax increase is not expected to take effect until several months after the lowering of income tax rates, the reform implies some fiscal stimulus for this year. The proposal will will be submitted to the parliament at an extraordinary session called for mid-July.

In Germany, real GNP increased at a seasonally and calendar adjusted annual rate of 6 percent in the first quarter. Incomplete data indicate that both government and private consumption increased at a 2 percent rate, while outlays for construction increased 24 percent. Machinery and equipment expenditures were also reported to have increased. Net export data are unavailable, but net exports and inventories combined appear to have contributed little to growth.

More recent data indicate a slowing of growth so far in the second quarter. Industrial production increased 0.8 percent (s.a.) in April, almost completely offsetting the decline in March. However, industrial production for March and April combined was only 0.1 percent above production in the January-February period. A further sign of slower growth was a rise in the unemployment rate in April to 8.9 percent (s.a.), a rate which continued through May. In addition, manufacturing orders in both March and April were unchanged (n.s.a.) from February's level, and still below the peak level of orders achieved late last summer.

Although inflation has picked up (n.s.a.) in recent months, it continues to remain relatively low measured on a twelve-month basis. Consumer prices increased 0.2 percent (n.s.a.) in May, but the increase in consumer prices over twelve months was only 1.3 percent. Wholesale prices increased 0.3 percent (n.s.a.) in May, but were only 0.5 percent above last May's level. Import prices declined (n.s.a.) in March to a level 0.3 percent below that of a year earlier.

In March, the German trade surplus increased slightly to $5.1 billion (n.s.a.). The cumulative trade surplus for the first three months of the year was $15.1 billion, matching last year's surplus over the same period. The current account surplus fell to $2.8 billion (n.s.a.) in March, bringing the cumulative current account surplus so far this year to $8.7 billion, compared with $11.3 billion over the comparable period last year.

Monetary growth continued above target in May. Growth in the average level of M3 in May was 8.7 percent (s.a.a.r.) from the average level in March, and 7.5 percent from the target base period of 1987-Q4, exceeding the 3 to 6 percent target range set in January of this year.

In the German parliament, the coalition parties have agreed on excise tax measures that will raise an additional DM6 billion in revenue in 1989. The proposed excise tax increases partially implement a portion of Finance Minister Stoltenberg's January commitment to reduce the 1989 federal deficit by DM10 billion. Agreement has also been reached to increase the basic unemployment insurance contribution rate to offset an emerging deficit in the federal unemployment insurance program.

In the United Kingdom, the pace of real activity has continued to be strong. The average measure of real GDP increased by 2.7 percent (s.a.a.r.) in the first quarter and was 4 percent above its year-earlier level. Industrial production in April increased by 1.5 percent (s.a.), and registered a 12-month increase of 4.3 percent. Unemployment decreased for the 22nd consecutive month in May. Stronger inflationary pressures appeared to be signaled by the increase in the 12-month consumer price inflation rate to 4.2 percent in May and the rise in the underlying rate of increase of average earnings to 8-3/4 percent in April. Reflecting the strong growth of domestic demand, the cumulative current account deficit was $12.8 billion (s.a.a.r.) through April, compared with a surplus of $2.6 billion in the first four months of last year.

Economic activity in France accelerated in the first quarter of 1988, with real marketable GDP growing 4.9 percent (s.a.a.r.). Total domestic demand contributed about 2.8 percentage points to first-quarter growth, mainly as a result of strong investment. The external sector made more than a 2 percentage point contribution, as exports surged while imports contracted slightly. In April, the trade balance worsened after registering its best performance in 15 months in March. The cumulative trade deficit through April was $3.3 billion (s.a.a.r.) compared with a deficit of $6.8 billion in the first third of 1987. France has been in a state of political uncertainty since the general elections of June 5 and 12, in which the Socialist Party failed to win an outright majority in the National Assembly despite the recent landslide reelection of President Mitterrand. Socialist Prime Minister Michel Rocard has resigned but agreed to remain in a caretaker capacity until the new parliament convenes on June 23.

Canadian real GDP grew by 3.2 percent (s.a.a.r.) in the first quarter. The main source of strength was plant and equipment investment and government spending. Industrial production increased by only 2 percent (s.a.a.r.) in the first quarter. Through April, Canada's cumulative trade surplus was $7.7 billion (s.a.a.r.), below the $14.4 billion surplus rate in the same period last year.

In Italy, the economy has shown signs of continued strength. Industrial production increased by 2.7 percent (s.a.) in the first quarter, and rose a further 2.3 percent in April. The cumulative trade deficit through April was $9.9 billion (s.a.a.r.), compared with a deficit of only $5.4 billion in the same period last year. The Cabinet and the Senate have approved a package of measures designed to achieve a State Sector deficit of 11 percent of GDP in 1988. However, a three-year 50 percent wage increase recently won by school teachers suggests that this program could be undermined by public sector wage increases, as was the case in 1987.

Economic Situation in Major Developing Countries

Since the last Greenbook, Brazil has concluded substantive negotiations on an IMF stand-by arrangement and the Brazilian Constituent Assembly voted President Sarney a five-year term. The Mexican government announced in May an extension of the freeze on the exchange rate, public sector prices, and minimum wages through August. In addition, controlled prices of some private sector goods will continue to be frozen. Argentina has paid no interest to creditor banks on its medium- and long-term public sector debt since end-March 1988. The IMF granted approval in principle to a new stand-by arrangement for Yugoslavia and full approval should be granted shortly because creditor banks have achieved the critical mass of commitments on $300 million of financing. Venezuelan reserves continue to fall, partly due to weaker than expected oil export prices.

Individual country notes. In late May, Brazil reached substantive agreement on a stand-by arrangement with the IMF for somewhat less than SDR 1.2 billion; Board approval could occur by the beginning of August. In June, the Brazilian Constituent Assembly voted that President Sarney's mandate should be five years, allowing him to turn his attention to a macroeconomic program designed to alleviate the country's economic ills. Brazil and its foreign bank creditors have resolved essentially all their differences on a financing package.

A new industrial policy, announced May 19, aims to reverse the government's long-standing emphasis on import substitution. The new policy is aimed at establishing mechanisms to reduce government controls of exports and imports, as well as to carry out tariff reform. The trade surplus is running at a record rate in 1988, reaching a high of $1.9 billion in April before falling slightly to $1.7 billion in May. For the year to date, the trade surplus has totalled $6.7 billion. In part because of various measures recently introduced to cut government expenditures, May inflation was 17.8 percent, down from April's 19.3 percent. Since mid-May, the demand for dollars has intensified and the spread between the parallel and official rates has risen 12 percentage points to 46 percent. The spread is typically about 25 percent due to differences in the effective tax treatment of transactions at the two rates.

The Mexican government announced on May 22 that the freeze on the exchange rate, public sector prices, and minimum wages would be extended through August, and that controlled prices of some private sector goods would continue to be frozen. The government obtained from business and organized labor renewed pledges of restraint in contractual wage negotiations and in setting prices of goods not subject to price control. As a result of previous actions along the same lines and continuing fiscal and monetary efforts to curb inflation, the CPI increased by only 1.9 percent in May, the smallest monthly increase since November 1981.

Interest rates continue to decline. The nominal annual rate on 28-day Treasury bills at the June 14 auction was 40 percent, down from 59.2 percent on May 3 and 151.7 percent on February 23. Short-term inflows of funds, induced by still high interest rates in the face of the exchange rate freeze, have been an important factor contributing to the fall in rates. The Bank of Mexico is continuing to make net sales of Treasury bills in the secondary market. At the end of May, the 12-month rate of increase of M1, which had been rising almost every month since October 1986, was about 135 percent, about 3 percentage points below the April rate. In real terms, M1 has declined by 5 percent since April 1987.

The trade surplus was $539 million in March and $514 million in April. These were the smallest monthly surpluses since August 1986. The trade surplus was as large as $1 billion in June 1987. Its decline mainly reflects a recovery of imports and, this year, weaker oil prices. In January-April, imports were 47 percent higher than in the same period of 1987, while the value of petroleum exports was 12.5 percent lower. Manufactured exports were 23 percent higher, but 1 percent lower than in the last four months of 1987.

Argentina has paid no interest to creditor banks on its medium- and long-term public sector debt since end-March 1988 when it was last able to become current with non-Argentine external bank creditors, after disbursements from the IMF and banks totalling nearly $1 billion were made. Argentina may pay some of the interest arrears soon to avoid forcing creditor banks to put Argentine debt on non-accrual status. Argentina completed the repayment of a $550 million U.S. Treasury bridge loan on May 31.

The monthly CPI inflation rate accelerated steadily from 9.1 percent in January to 17.2 percent in April, before declining slightly to 15.7 percent in May. The spread between the commercial and parallel market exchange rates has fluctuated between 25 and 35 percent in recent weeks. Strong international price increases for Argentina's principal agricultural exports, on the order of 35 to 55 percent for some items over the past year, have improved the current account outlook for 1988 and 1989.

A Fund mission left for Argentina in mid-June. Argentina may have missed one of three end-March quantitative performance criteria on the fiscal deficit, but was in compliance on other criteria. It is unlikely that Argentina will be able to draw the next SDR 165.5 million tranche from its current stand-by arrangement because it has not opened negotiations on its 1988-89 financing with the commercial banks, which is a condition for the drawing. Argentina is beginning discussions with the IMF for a new stand-by arrangement to last through end-1989.

Yugoslavia's IMF stand-by arrangement for SDR 306 million was approved in principle on June 1. In late-June, the critical mass of bank financing had been assembled and final approval of the program is expected soon. The ambitious program requires devaluation, exchange liberalization, price decontrol, reduction of import controls, positive real interest rates, a restriction of increases in personal income, and financial market reform. In addition to seeking $300 million in new money from commercial banks, Yugoslavia seeks to reschedule $7 billion of commercial bank debt. In early June, agreement was reached on the main elements of a rescheduling of about $1 billion of both previously rescheduled and non-rescheduled Paris Club principal and interest. The BIS has arranged a $200 million bridge loan that, with a parallel $50 million U.S. Treasury bridge loan, was disbursed on June 15.

In Venezuela, official reserves continue to decline, in part due to weaker oil export prices. At end-April, central bank gross reserves were $8.8 billion, down $600 million from end-1987. Liquid operating reserves stood at $3 billion. In addition, the government has drawn approximately $700 million in foreign reserves from the state-owned Venezuelan Investment Fund in 1988. The government has made some progress in arranging about $2 billion in new money for 1988-89, signing a number of agreements for project finance and expanding trade lines. Perhaps reflecting a reduced level of government intervention, the free market exchange rate recently rose above 30 bs./$ for the first time since February, and on June 21 was 32.5 bs./$. By comparison, the main controlled exchange rate is 14.5 bs./$.