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Confidential (FR) Class III FOMC

June 28, 1989

RECENT DEVELOPMENTS

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

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DOMESTIC FINANCIAL DEVELOPMENTS III

INTERNATIONAL DEVELOPMENTS IV

Indications of slower economic growth have continued to accumulate in the period since the May FOMC meeting, with the production and spending data painting a fairly consistent picture of softness in housing, motor vehicles, and other consumer goods. Business fixed investment has been strong so far this year, but recent data on orders indicate that some deceleration is likely. Inflation remained rapid through May, paced by large price increases in the food and energy areas.

Labor Market Developments

Growth in demand for labor slackened during the spring; the unemployment rate continues to be low, however, suggesting that pressures on labor supplies have yet to ease.

In the payroll survey, increases in employment have been below the rapid pace of the previous two years in every month since February, and the May rise of 100,000 was the smallest in some time. Manufacturing employment, which had turned down in April, slipped further in May, with small declines in several industries. Construction employment also fell in May and, like manufacturing, has changed little on net since January. In the service-producing sector, the growth of jobs in May was relatively slow by recent standards, as increases in trade and business services were small. Both the average workweek and the aggregate hours of production and nonsupervisory workers fell in May, reversing April increases that undoubtedly had been exaggerated by seasonal adjustment problems associated with an unusually early Easter holiday. Nevertheless, the factory workweek, at 41 hours, remained high by historical standards.

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

	1987	1988	1988 Q3	1988 Q4	1989 Q1	1989 Mar.	1989 Apr.	1989 May
	---------------	Average	Monthly	Changes	---------------			
Nonfarm payroll employment[2]	268	276	215	297	264	177	206	101
Strike-adjusted	265	275	218	291	274	205	210	100
Manufacturing	29	29	10	53	30	32	-11	-18
Durable	16	20	11	34	13	10	-5	-13
Nondurable	13	9	-1	19	17	22	-6	-5
Construction	15	14	8	17	13	-18	23	-14
Trade	61	64	45	65	77	54	13	19
Finance and services	122	128	105	130	107	97	134	71
Total government	27	27	36	17	25	10	25	32
Private nonfarm production workers	199	197	139	223	202	152	105	24
Manufacturing production workers	25	20	4	41	19	16	-9	-5
Total employment[3]	257	189	123	213	376	283	-23	102
Nonagricultural	252	191	105	207	371	300	79	93

1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments. Strike-adjusted data noted.
3. Survey of households.

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

	1987	1988	1988 Q3	1988 Q4	1989 Q1	1989 Mar.	1989 Apr.	1989 May
Civilian, 16 years and older	6.2	5.5	5.5	5.3	5.2	5.0	5.3	5.2
Teenagers	16.9	15.3	15.3	14.6	15.0	13.7	14.4	15.2
20-24 years old	9.7	8.7	8.5	8.7	8.4	7.7	8.4	7.7
Men, 25 years and older	4.8	4.2	4.1	4.1	4.0	3.8	4.2	3.7
Women, 25 years and older	4.8	4.3	4.4	4.2	4.0	4.0	4.1	4.4
White	5.3	4.7	4.8	4.6	4.4	4.2	4.6	4.4
Black	13.0	11.7	11.2	11.3	11.6	10.9	10.8	11.0
Fulltime workers	5.8	5.2	5.1	5.0	4.9	4.8	5.0	4.8
Memo:								
Total national[1]	6.1	5.4	5.4	5.3	5.1	4.9	5.2	5.1

1. Includes resident armed forces as employed.

After moving down fairly steadily from early 1987 through the end of 1988, the civilian unemployment rate has fluctuated narrowly in a range of 5.0 to 5.3 percent over the past four months, with the May reading at 5.2 percent. Even so, the 5-1/4 percent jobless rate of recent months is lower than that observed in any period since 1973-74. Other indicators also have pointed in the direction of labor market tautness: for example, the number of involuntary part-time workers and the number of job losers continued to trend down in May. Moreover, the level of initial claims edged up only a little through mid-June, suggesting that layoffs have continued to be limited.

Industrial Production and Capacity Utilization

The monthly changes in industrial production have been a bit erratic this year. On average, however, the data of recent months--while still preliminary--seem to be pointing toward growth in the range of 2 percent at an annual rate in both the first and second quarters of this year, down from the 5 to 6 percent pace of the two previous years.

By and large, the composition of growth in industrial production in recent months has mirrored the patterns of change in final demand. In May, the output of construction supplies was down 0.8 percent--the fourth month of decline. Auto assemblies, which had turned up temporarily in April, fell 300,000 units in May to a seasonally adjusted annual rate of 7.1 million units (FRB seasonals); a further decline is likely in June, as the assembly rate through the first three weeks of the month was 6.8 million units at an annual rate. The production of light trucks fell nearly 4 percent in May, and current schedules indicate that production will be flat in June. Output of consumer goods other than motor vehicles was down 0.2 percent in May and

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

	1987[1]	1988[1]	1988 Q4	1989 Q1	1989 Mar.	1989 Apr.	1989 May
			--Annual Rate--		-----Monthly rate-----		
Total Index	5.8	5.0	4.6	2.0	.1	.6	.0
Previous	5.8	5.0	4.6	1.9	.0	.4	--
Ex. motor vehicles	5.9	4.9	3.9	2.2	.2	.5	.1
Products	4.9	5.4	4.4	4.2	.2	.5	-.2
Consumer goods	3.2	6.0	7.5	4.0	-.3	.6	-.4
Motor vehicles	4.4	8.8	20.5	.1	-2.0	1.8	-2.0
Ex. motor vehicles	3.0	5.6	6.0	4.5	-.1	.4	-.2
Business equipment	7.0	8.3	3.1	9.5	.8	.7	.2
Motor vehicles	3.9	10.7	35.9	-14.1	-4.3	3.7	-3.8
Computers	9.4	8.7	.1	27.0	2.3	1.3	.1
Other	6.4	8.0	1.6	5.9	.6	.2	.6
Construction supplies	4.7	5.2	7.1	-1.4	-.4	-.3	-.8
Materials	7.2	4.6	4.9	-1.3	-.1	.8	.2
Durable	8.0	6.9	6.5	-1.9	-.6	.5	.0
Consumer dur. parts	1.8	9.0	8.6	-3.9	-1.2	-.5	-.7
Equipment parts	6.3	6.8	1.9	1.0	-.1	.9	.3
Basic metals	21.3	3.6	8.8	-9.2	-2.5	1.1	.3
Nondurable	8.1	4.1	7.8	3.1	.2	.9	.3
Memo:							
Manufacturing	5.9	5.6	5.1	3.1	-.1	.6	-.1

1. From the fourth quarter of the previous year to the fourth quarter of the year indicated.

PERCENT CHANGE IN ORDERS FOR MANUFACTURED GOODS[1]
(For industries that report unfilled orders; seasonally adjusted)

	1988 Q3	1988 Q4	1989 Q1	1989 Apr.-May/Q1	1989 Apr.	1989 May
Durable goods ex. civilian aircraft, defense, and motor veh.	2.9	1.6	1.0	1.5	4.2	-2.4
Nondefense cap. goods ex. aircraft	4.5	-2.3	4.9	.6	2.5	-3.2
Nondurable goods	2.0	1.6	.3	n.a.	2.2	n.a.

1. Percent change from previous comparable period.

has changed little since January, a period in which consumer outlays for goods also have been relatively sluggish.

The output of business equipment excluding motor vehicles, which rose at an annual rate of 11 percent in the first quarter, continued to exhibit strong growth into the second quarter, with gains of 0.5 percent in both April and May. Although a significant portion of the advance this year has reflected a surge in the output of computers, gains in production of a variety of other types of equipment, particularly capital goods for manufacturing industries, also have been quite strong.

On balance, production of materials has been nearly flat since late last year, after advancing briskly earlier. Part of this weakness stems from a decline in the output of parts for consumer durable goods, a development related to the weakness in motor vehicle assemblies. In addition, manufacturers began to reduce their inventories of materials and supplies late last year, and this trend continued in the first quarter. This reduction followed sizable buildups earlier in 1988, when rapid demand growth, reports of short supplies, and the anticipation of rising prices were encouraging producers to build stocks.

Capacity utilization in manufacturing, mining, and utilities has slipped since January. The rate for the advanced processing industries has been essentially flat since the start of the year. However, utilization at primary processing industries, which by late last year had risen close to the 1978-80 peak, has since turned down; the May figure, at 86.3 percent, was nearly 2 percentage points below the level of last November. This softening in the primary processing industries has coincided with lower

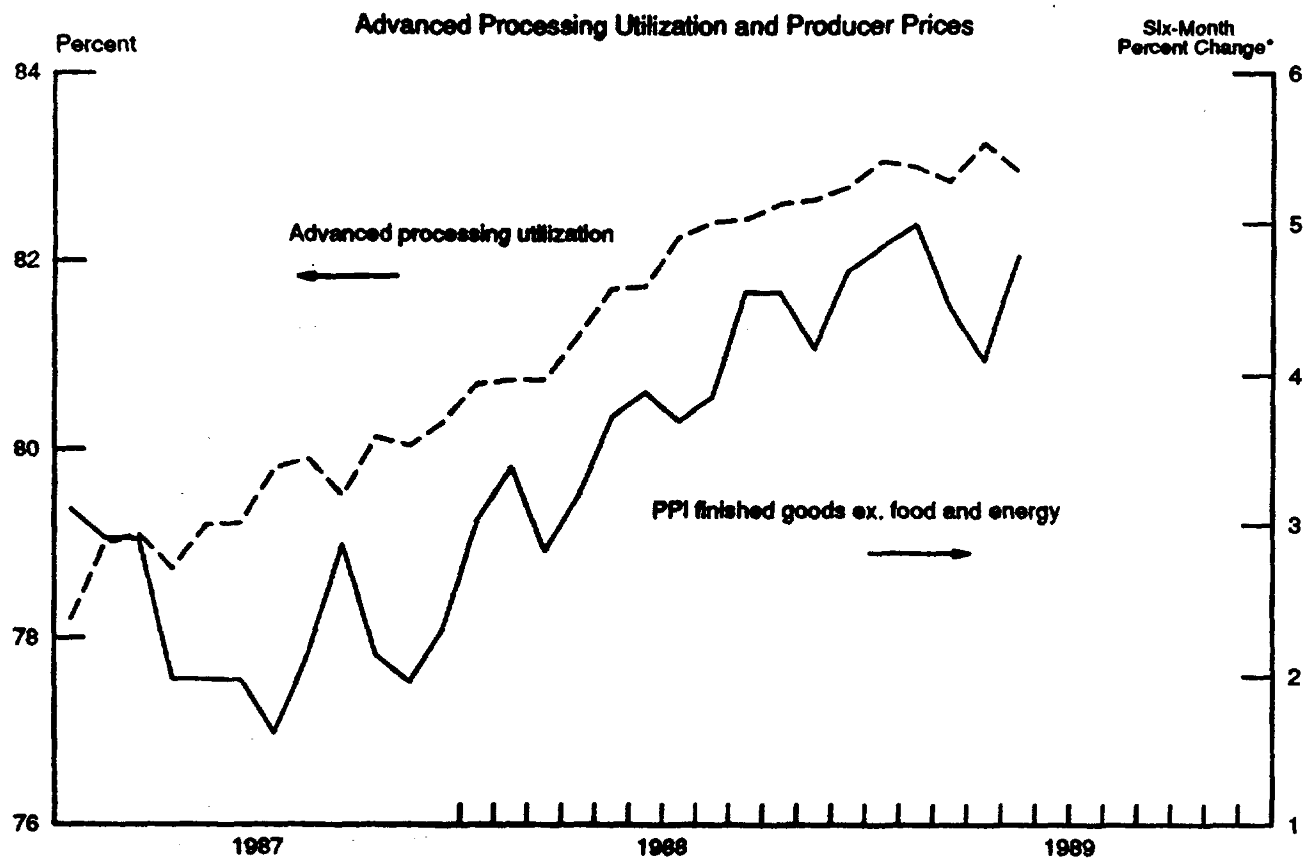
CAPACITY UTILIZATION IN INDUSTRY[1]
(Percent of capacity; seasonally adjusted)

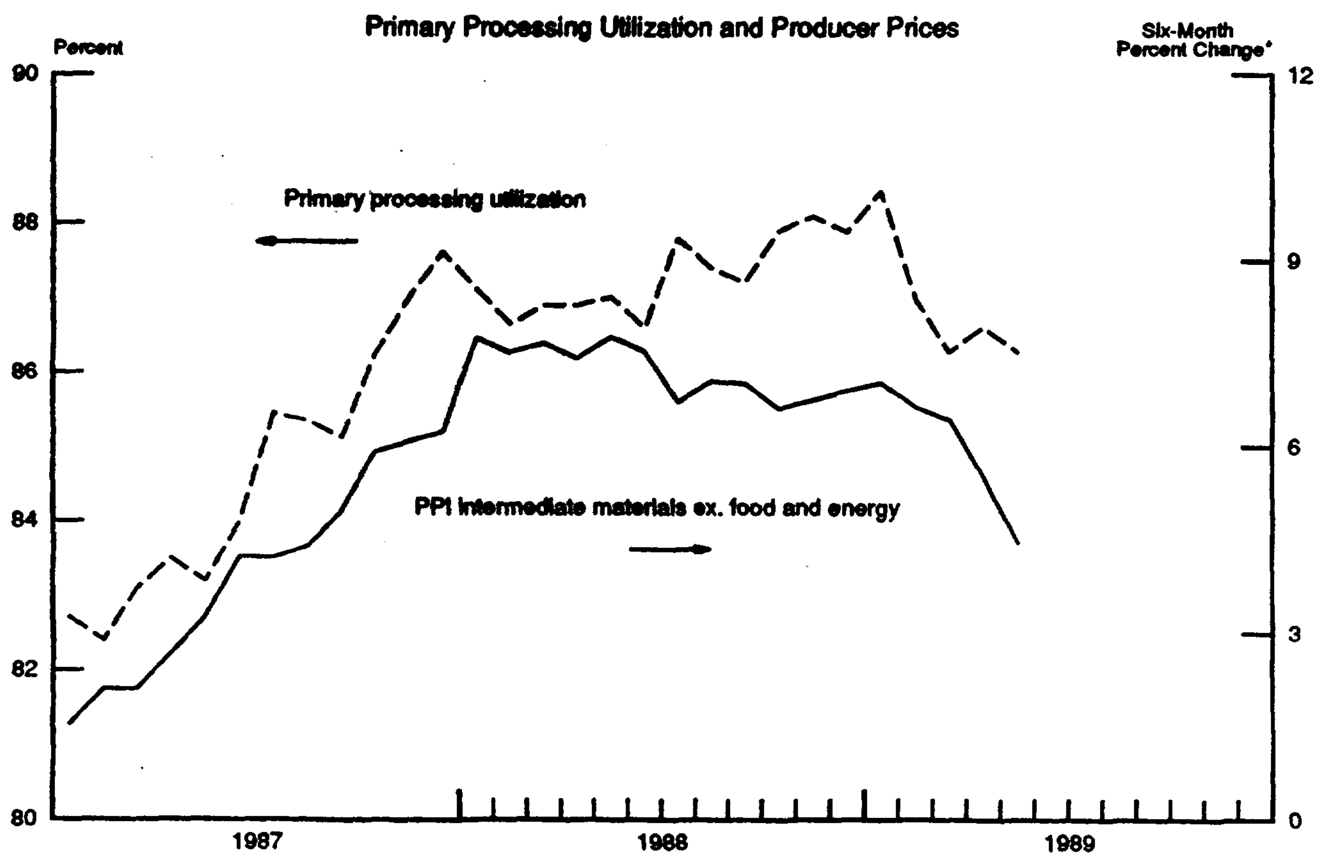
	1967-88 Ave.	1973 Ave.	1978-79 Ave.	1988 May	1989 Mar.	1989 Apr.	1989 May
Total industry	81.6	87.9	85.0	82.9	83.8	84.1	83.8
Manufacturing	80.7	87.0	84.4	83.3	84.0	84.3	84.0
Primary processing	82.0	91.3	86.3	87.0	86.3	86.6	86.3
Advanced processing	80.2	85.1	83.3	81.7	82.8	83.2	83.0
Durable manufacturing	78.8	86.2	83.5	81.8	82.5	82.8	82.5
Stone, clay & glass prod.	78.5	86.3	85.1	81.8	83.4	83.0	82.4
Primary metals	79.9	96.6	87.8	87.5	85.6	86.3	86.2
Iron and steel	79.0	97.9	88.2	88.0	84.1	85.6	85.7
Nonferrous metals	81.5	94.2	87.1	86.8	87.5	87.3	86.9
Fabricated metal products	78.0	84.0	84.6	82.9	83.5	83.1	83.1
Nonelectrical machinery	78.2	86.6	83.2	81.4	85.1	85.5	85.6
Motor vehicles & parts	78.2	94.5	83.6	83.8	83.2	84.7	82.8
Autos	76.1	89.3	81.7	75.3	72.2	75.2	73.1
Aerosp. & misc. trans. eq.	78.1	75.4	77.6	86.4	86.1	86.8	86.7
Nondurable manufacturing	83.6	88.1	85.7	85.4	86.1	86.3	86.0
Textile mill products	85.2	90.1	86.7	88.9	90.4	91.2	91.4
Chemicals and products	79.3	86.9	81.4	86.1	88.6	88.3	88.1
Petroleum products	86.9	97.1	87.8	85.5	86.6	87.1	85.3
Mining	86.5	91.4	90.5	80.8	81.5	82.4	83.5
Utilities	86.7	92.8	85.3	79.7	82.9	82.8	82.3
Memo:							
Industrial materials	82.3	91.1	86.7	83.0	83.8	84.2	84.2
Raw steel	80.7	100.4	90.7	89.7	86.3	84.4	84.7
Aluminum	87.8	93.8	94.0	98.8	100.0	101.5	101.1
Paper materials	92.0	96.8	92.1	98.1	95.4	95.9	95.4
Chemical materials	81.3	91.1	85.9	86.9	89.7	90.2	90.1
Energy materials	88.9	93.7	89.4	83.3	85.6	86.6	87.2

1. Data for stone, clay, and glass products, iron and steel, nonferrous metals, textile mill products, chemicals and products, raw steel, aluminum, paper materials, and chemical materials are unpublished estimates for May.

CAPACITY UTILIZATION AND PRODUCER PRICES

(Based on seasonally adjusted data)





* Annual rate.

PERSONAL INCOME
(Average monthly change; billions of dollars)

	1988	1988 Q4	1989 Q1	1989 Mar.	1989 Apr.	1989 May
Total personal income	21.8	28.7	51.6	37.5	21.0	13.0
Wages and salaries	14.7	18.2	21.4	22.4	17.6	4.9
Private	12.6	16.0	17.9	20.3	15.4	2.5
Other labor income	.9	1.0	1.0	1.0	1.0	1.0
Proprietors' income	.1	1.0	12.5	-5.5	-5.4	-1.1
Farm	-1.5	-1.4	12.1	-5.3	-7.4	-1.3
Rent, dividends and interest	4.9	7.0	11.6	12.5	8.3	8.1
Transfer payments	3.3	2.7	8.6	8.5	.7	.4
Less: Personal contributions for social insurance	2.0	1.2	3.4	1.2	1.3	.3
Less: Personal tax and nontax payments	.2	4.0	12.9	9.0	45.2	-39.3
Equals: Disposable personal income	21.7	24.7	38.7	28.5	-24.2	52.3
Memo: Real disposable income	7.4	10.8	17.0	4.7	-38.8	23.8

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from preceding period)

	1988	1988 Q4	1989 Q1	1989 Mar.	1989 Apr.	1989 May
	----Annual rate---			----Monthly rate----		
Personal consumption expenditures	3.7	3.5	1.3	-.2	.4	-.3
Durable goods	7.5	6.1	-4.0	-1.0	4.1	-1.6
Excluding motor vehicles	7.2	9.3	4.8	-.1	1.0	-.5
Nondurable goods	1.9	1.3	1.8	-.6	-1.1	-.8
Excluding gasoline	1.9	1.1	2.3	-1.0	-.9	-.5
Services	3.9	4.2	2.8	.3	.3	.6
Excluding energy	3.7	4.6	4.2	.3	.6	.5
Memo:						
Personal saving rate (percent)	4.2	4.3	5.4	5.9	4.3	5.3
Real disposable personal income	3.6	4.1	6.1	.2	-1.3	.8

inflation in materials prices. The producer price index for intermediate materials excluding food and energy has risen at an annual rate of 4-1/2 percent over the last six months and at only a 2-1/2 percent rate over the last three months--a noticeable slowdown from the 6 to 7 percent rate of increase of the previous two years (chart).

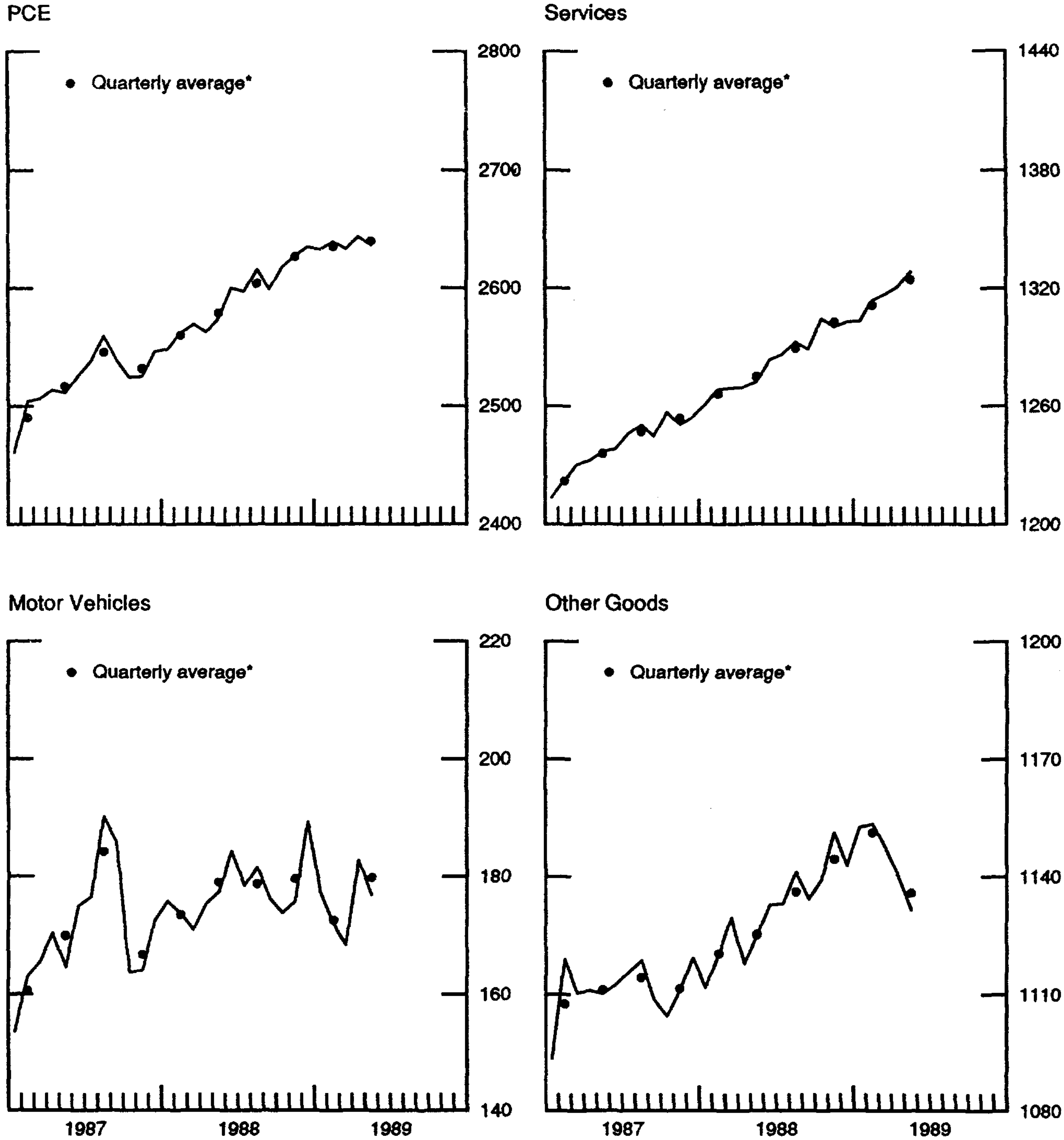
Personal Income and Consumption

A weakening in consumer spending has contributed notably to the economic deceleration this year. Real consumption spending grew only about 1-1/2 percent, at an annual rate, in the first quarter, and given the data currently available--which still are preliminary and subject to substantial revision--growth seems to have been similarly sluggish in the second quarter.

The causes of this slowdown are not entirely clear. Although real disposable income has softened very recently, growth on net in the first half of this year has been reasonably strong. In addition, stock market gains of recent months have added appreciably to the wealth of households. And, while higher interest rates may have provided some incentives to defer spending for durables, it is somewhat curious that much of the recent softness actually has been in the nondurables area. Consumer surveys taken before the recent drop in interest rates suggested that, while sentiment remained favorable on the whole, there were some concerns about economic prospects, perhaps related to high interest rates and the bad news on inflation.

In May, real disposable personal income jumped 0.8 percent, reversing much of a steep April decline. In large part, the April-May swing reflected the influence of nonwithheld tax payments, which have been sizable so far

Personal Consumption Expenditures, 1987-1989
(Billions of 1982 dollars, annual rate)



* Figures for the second quarter of 1989 are the average of April and May only.

this year, especially in April.[1] Growth in wages and salaries remained sluggish in May; in real terms, they were no higher than the first-quarter average. Among nonwage components of income, growth of personal interest income slowed a bit in April and May. Farm proprietors' income moved down in May for a third month and is back to a more normal range; farm income had soared in February when federal payments for drought assistance surged.

Real personal consumption expenditures declined 0.3 percent in May, led by a reduction in outlays for motor vehicles. In addition, spending on other goods moved down in real terms for the third consecutive month. On net, real PCE in May was essentially unchanged from the December 1988 level (chart). Growth in outlays for services was maintained over this period, with the second quarter getting a boost from a weather-related swing in outlays for residential service fuels. In contrast, spending on both motor vehicles and other goods declined, on net, over the first five months of the year. Spending has been especially weak for gasoline, apparel, and food and for durables such as jewelry and recreational goods; outlays for furniture and household equipment, however, have held up well.

Autos and Trucks

Sales of domestically produced cars averaged 70 million units at an annual rate during the first 20 days of June--a bit less than in May. Sales have been lackluster in recent months despite ongoing incentive programs

1. The BEA has revised up sharply its estimates of personal tax and nontax payments for the first quarter (by $17-1/2 billion at an annual rate) and for April (a $44 billion upward revision, at an annual rate). The revisions were based on the additional information about actual payments through May. The new estimates incorporate a higher and smoother path for the "normal" growth in these taxes. In addition, the April figure included "transitory" tax payments of $36 billion at an annual rate.

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

	1988	1988 Q4	1989 Q1	1989 Apr.	1989 May	1989 June
Autos and light trucks	15.45	15.15	14.21	15.74	14.54	n.a.
Autos	10.64	10.49	9.72	10.78	10.08	n.a.
Light trucks	4.81	4.65	4.49	4.96	4.46	n.a.
Domestically produced[2]	11.74	11.59	10.91	11.95	11.24	10.88*
Autos	7.54	7.47	6.91	7.52	7.24	6.95*
Light trucks	4.21	4.12	4.01	4.43	4.00	3.93*
Imports	3.70	3.55	3.30	3.79	3.30	n.a.
Autos	3.10	3.02	2.81	3.26	2.84	n.a.
Light trucks[3]	.60	.53	.49	.53	.46	n.a.

Note: Data on sales of trucks and imported autos for the current month are preliminary and subject to revision.
1. Components may not add to totals due to rounding.
2. Includes vehicles produced in Canada and Mexico and vehicles made in U.S. plants of foreign manufacturers.
3. Based on seasonals for domestic light trucks.
*Sales for the first 20 days; FRB seasonals were used for light trucks.

that are quite generous by historical standards. The most likely explanation of these developments is that the underlying demand for autos has weakened this year. However, it also is possible that consumers have been anticipating extensions--or perhaps expansions--of the existing programs and have delayed purchases until closer to the end of the model year.

Dealers' inventories at the end of May remained on the high side, little changed from their month-earlier level. The 1.7 million units on dealers' lots equalled roughly 72 days of supply at the May level of sales. In addition to some chronically slow movers such as Chrysler's E-Class cars and GM's luxury "personal" cars, the current inventory problem is acute for many subcompacts, including the Escort/Lynx made by Ford and the Geo

Prism/Nova jointly produced by General Motors and Toyota. With little time remaining before model changeover is in full swing, the domestic automakers cannot eliminate these inventory excesses via cuts in production of 1989-model cars.[2] Instead, the current round of incentives likely will be extended through the end of the model year and probably will be sweetened a bit to clear the showroom floors for the arrival of 1990-model cars.

Sales of imported cars declined in May to a 2.8 million unit annual rate, following April's robust pace of 3.3 million units. Inventories of foreign-made cars also are at relatively high levels by historical standards. As one indicator of the current oversupply of foreign nameplates, this model year has seen the introduction, for the first time, of dealer incentives on Hondas.

Business Fixed Investment

Business equipment spending has been strong so far this year. Shipments of equipment excluding aircraft (aggregated with PDE weights) were little changed in May, but because of a strong advance in April, the April-May average was 2-3/4 percent above the first-quarter level and suggests that the second-quarter growth will be well-maintained. When one looks beyond the current quarter, however, the data on new orders suggest a slowing in the growth of equipment outlays. The orders for equipment other than aircraft dropped 3-1/4 percent in May after a substantial April gain; the April-May average was slightly above the first-quarter level.

Total real spending for nonresidential structures has been relatively flat in recent quarters. Among the latest developments, industrial

2. General Motors has five plants closed for changeover, with another four plants scheduled to shut on or before July 3rd. Chrysler currently has one plant shut.

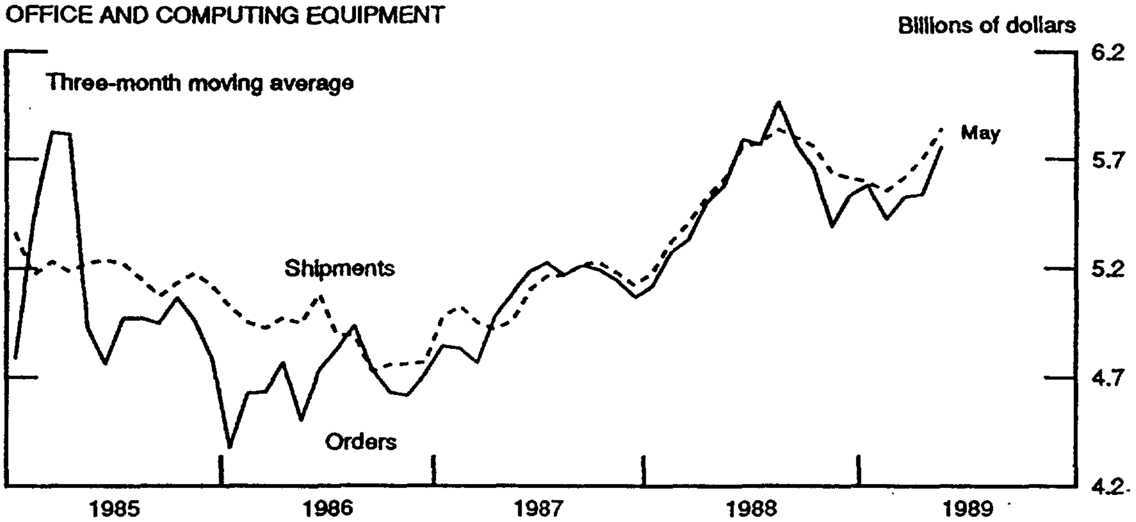
BUSINESS CAPITAL SPENDING INDICATORS
(Percentage change from preceding comparable periods; based on seasonally adjusted data)

	1988		1989	1989		
	Q3	Q4	Q1	Mar.	Apr.	May
Producers' durable equipment						
Shipments of nondefense capital goods	2.6	.9	3.2	1.9	1.5	-.2
Excluding aircraft and parts	2.4	.8	3.2	-.1	2.9	-.7
Office and computing equipment	.7	-3.3	.0	10.0	-.4	-1.9
All other categories	2.8	1.9	4.0	-2.3	3.8	-.4
Weighted PDE shipments[1]	2.2	.8	3.0	-.3	2.3	-.1
Shipments of complete aircraft[2]	-8.8	-14.8	13.8	5.4	11.2	--
Sales of heavy-weight trucks	-2.3	7.7	-3.0	-9.6	9.2	-.7
Orders of nondefense capital goods	9.1	.0	5.3	2.5	5.8	-8.3
Excluding aircraft and parts	4.5	-2.3	4.9	1.0	2.5	-3.2
Office and computing equipment	-.4	-4.1	-.1	19.5	-4.0	-1.5
All other categories	5.8	-1.8	6.1	-2.7	4.1	-3.5
Weighted PDE orders[1]	4.1	-.3	2.4	.0	2.3	-3.4
Nonresidential structures						
Construction put-in-place	1.6	1.1	2.8	3.3	-2.6	--
Office	1.0	-1.4	6.5	3.8	-2.3	--
Other commercial	-2.4	-4.1	8.3	4.5	-11.7	--
Public utilities	10.1	1.2	-5.6	-.5	2.9	--
Industrial	.1	11.3	1.5	6.8	2.3	--
All other	-3.4	4.1	6.0	4.3	-2.4	--
Rotary drilling rigs in use	-8.5	-16.0	-5.4	7.9	8.2	1.1

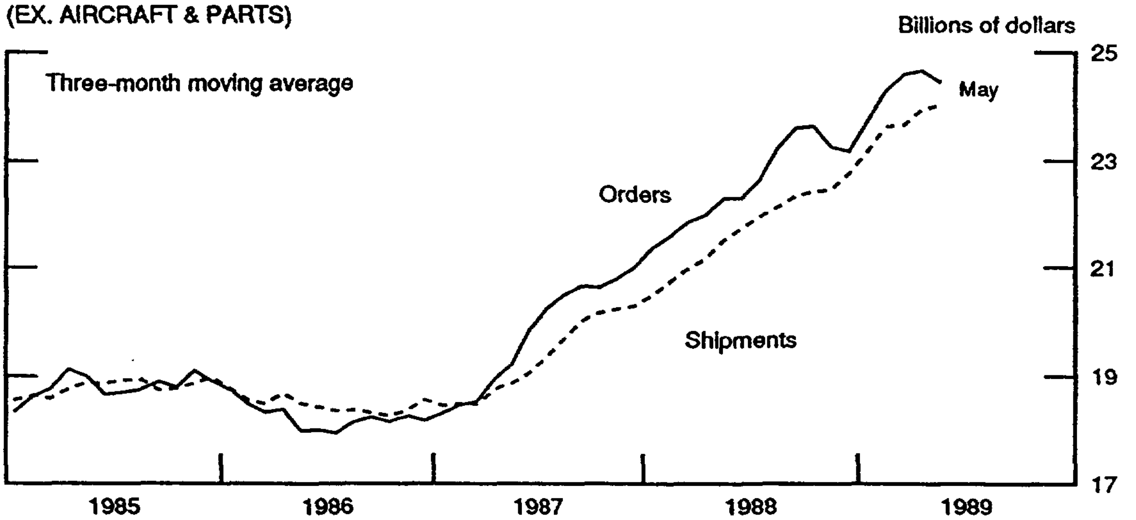
1. Computed as a weighted sum of 25 individual equipment series (excluding aircraft) from the Census M-3 report with weights equal to the fraction of final business spending for each type of equipment.
2. From the Current Industrial Report (CIR) titled "Civil Aircraft and Aircraft Engines." Seasonally adjusted with BEA seasonal factors. To estimate PDE spending for aircraft, BEA uses the aircraft shipments shown in that report, not the corresponding Census M-3 series. The CIR does not provide information on aircraft orders.

Indicators of Business Fixed Investment

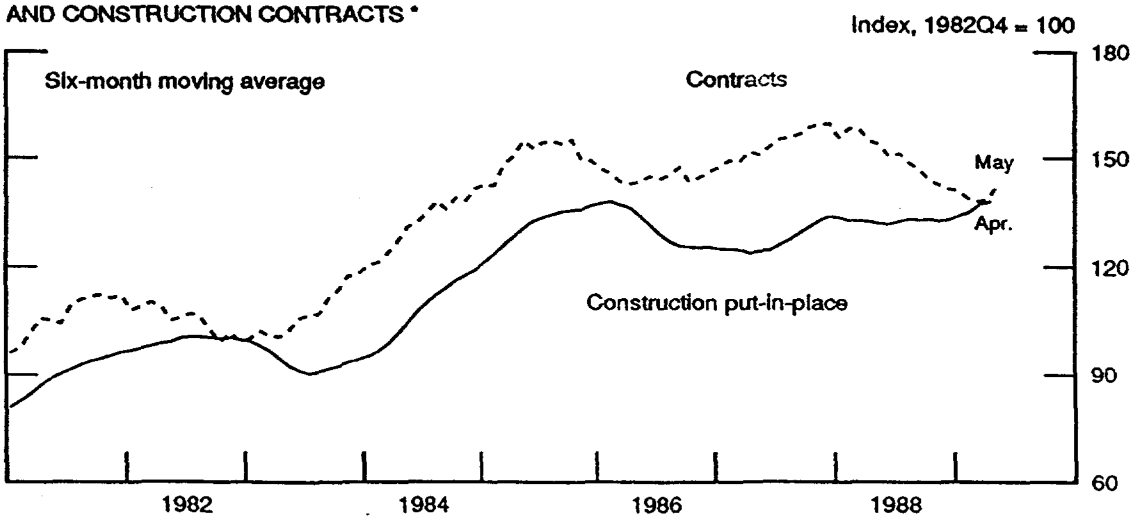
OFFICE AND COMPUTING EQUIPMENT



OTHER NONDEFENSE CAPITAL GOODS
(EX. AIRCRAFT & PARTS)



NONRESIDENTIAL CONSTRUCTION PUT-IN-PLACE
AND CONSTRUCTION CONTRACTS *



* Includes industrial, commercial, and institutional construction; derived from source data that are in current dollars.

construction put in place has begun to show a mild uptrend; however, many other categories, including non-office commercial and institutional building, have changed little on balance from levels attained during 1988.

The outlook for nonresidential structures remains weak. The Dodge data on the total value of new construction contracts have been trending down, especially for the commercial and institutional sectors. Indicators of current-quarter investment in oil and gas drilling are mixed despite the surge in crude oil prices this year. The average number of drilling rigs used in April and May is 16-1/2 percent above the first-quarter level, but the total footage drilled declined in April, according to preliminary estimates. The BEA uses the data both on rigs and on footage drilled in its estimate of the oil-drilling component of expenditures for nonresidential construction.

The latest Commerce Department and McGraw-Hill surveys of planned capital spending, taken in April and May, indicate that firms expect to increase nominal outlays 10 percent or so this year. These survey results, however, imply a spending trajectory that seems somewhat high, given other recent indicators of investment spending. The average absolute error of the Commerce Department survey in projecting year-over-year spending on plant and equipment is 1.4 percentage points, whereas that of the McGraw-Hill survey is 1.9 percentage points.

Business Inventories

Inventory investment remained moderate early in the second quarter; but even so, reports of concern about possible overstocking--for example, some accounts in the "Beige Book"--seem more numerous of late. In terms of 1982 dollars, the inventories in all manufacturing and trade rose $21.4 billion

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

	1988		1989	1989		
	Q3	Q4	Q1	Feb.	Mar.	Apr.
Current-cost basis:						
Total	76.4	38.7	47.1	39.0	29.4	52.9
Total ex. auto	53.2	41.3	42.2	32.9	29.1	33.0
Manufacturing	23.3	25.5	27.9	19.2	24.9	27.8
Wholesale	19.2	5.4	5.5	.6	-1.5	2.8
Retail	33.9	7.8	13.8	19.2	6.1	22.3
Automotive	23.2	-2.6	4.9	6.1	.3	19.9
Ex. auto	10.7	10.4	8.9	13.1	5.8	2.4
Constant-dollar basis:						
Total	25.5	26.3	16.7	1.9	2.9	21.4
Total ex. auto	16.8	18.8	6.7	-4.8	-5.1	1.8
Manufacturing	5.7	11.2	6.7	-4.0	2.0	12.6
Wholesale	8.1	2.2	-.8	-4.3	-5.4	-4.5
Retail	11.7	12.9	10.8	10.3	6.2	13.3
Automotive	8.7	7.5	10.0	6.8	8.0	19.6
Ex. auto	3.0	5.5	.8	3.5	-1.7	-6.3

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

	Range in preceding 12 months:[2]		1988		1989	1989		
	Low	High	Q3	Q4	Q1	Feb.	Mar.	Apr.
Current-cost basis:								
Total	1.48	1.52	1.52	1.50	1.50	1.50	1.51	1.49
Total ex. auto	1.46	1.49	1.49	1.48	1.47	1.47	1.48	1.46
Manufacturing	1.53	1.59	1.58	1.57	1.58	1.57	1.58	1.55
Wholesale	1.28	1.32	1.31	1.30	1.28	1.29	1.28	1.27
Retail	1.55	1.62	1.61	1.59	1.61	1.61	1.61	1.61
Automotive	1.71	2.01	1.98	1.88	1.96	1.98	1.97	1.98
Ex. auto	1.48	1.51	1.51	1.51	1.51	1.50	1.51	1.50
Constant-dollar basis:								
Total	1.51	1.54	1.52	1.52	1.52	1.53	1.54	1.52
Total ex. auto	1.48	1.50	1.50	1.49	1.49	1.49	1.50	1.48
Manufacturing	1.55	1.60	1.59	1.58	1.59	1.59	1.60	1.58
Wholesale	1.31	1.33	1.33	1.32	1.31	1.31	1.32	1.29
Retail	1.57	1.65	1.61	1.61	1.64	1.64	1.65	1.67
Automotive	1.74	2.13	1.93	1.94	2.11	2.09	2.13	2.18
Ex. auto	1.50	1.53	1.52	1.52	1.52	1.51	1.52	1.54

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.

at an annual rate in April, only slightly above the pace of the first quarter. Excluding auto dealers, real inventories edged up in April, after two months of small declines.

Manufacturers' inventory investment through April was concentrated in aircraft and other capital goods industries, where market demand had remained firm. By stage of fabrication, increases in work-in-process stocks, especially in the aircraft industry, continued to dominate factory inventory movements in recent months; materials inventories declined somewhat in the first four months of this year, and stocks of finished goods were little changed on net. The inventory-to-shipments ratio for manufacturing in April was about the same as the average observed over the past year.

In the trade sector, auto dealers' stocks still are on the high side. Elsewhere, the picture is somewhat ambiguous. Among those retail establishments that carry mostly discretionary consumption goods (general merchandise, apparel, and furniture and appliances), the current-cost inventory-sales ratio fell back in April as sales of these items advanced sharply. However, the constant-dollar data for April show the inventory-sales ratio rising further from an already high level. All told, it appears that some overhang of stocks may be present in retail lines other than autos, but at the same time they probably are not widespread or severe. As noted above, the domestic production of nondurable consumer goods (largely clothing and consumer staples carried by general merchandisers, specialty stores, and variety stores) has been flat since January, suggesting that producers have moved quickly to adjust production in the face of weakening sales. In addition, imports of nonauto consumer goods in the first quarter dropped considerably from the fourth quarter level and appear to have remained flat in April.

In the wholesale trade sector, drawdowns of stocks of unprocessed farm products continued through April, but inventory changes elsewhere have been moderate since January. Overall, the inventory-sales ratio for all wholesalers has trended down since late last year.

Housing Markets

Mortgage interest rates have dropped sharply since the May FOMC meeting, but most of the available housing data still reflect the previous runup in rates. Anecdotal reports and surveys of attitudes remained predominantly negative in tone into June.

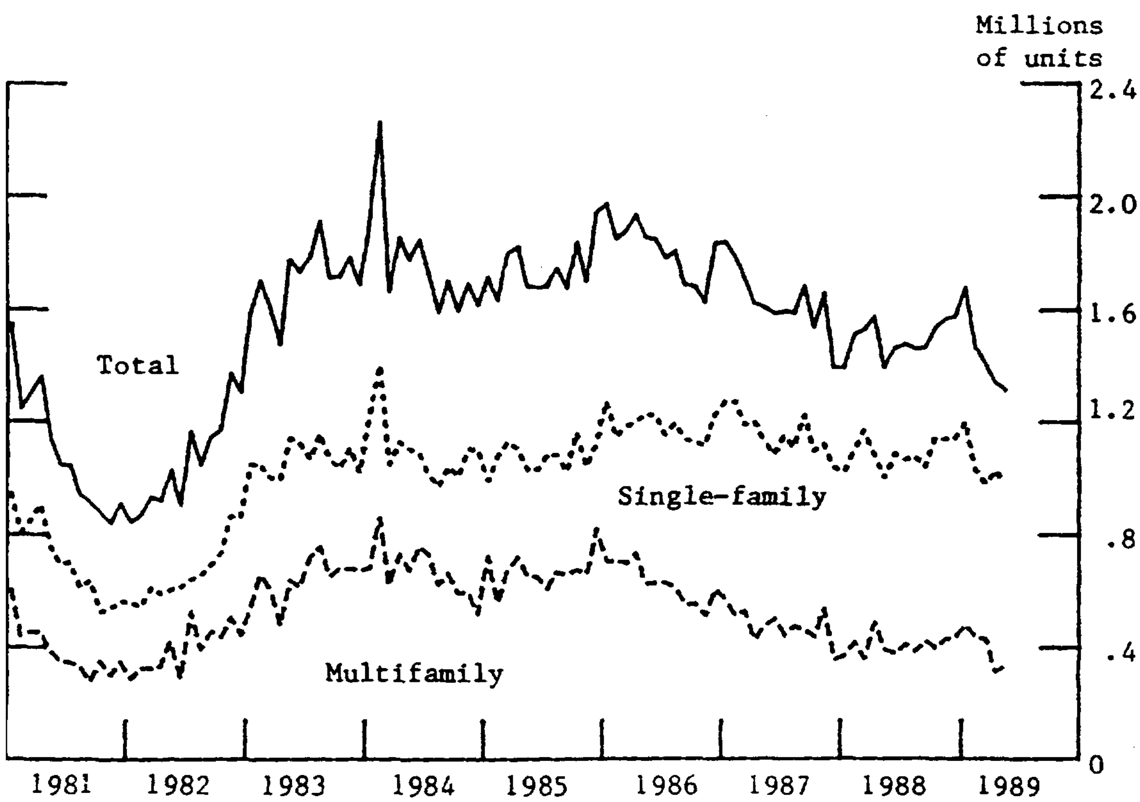
Total private housing starts fell 2 percent in May to an annual rate of 1.31 million units, as single-family starts dropped back to the March low. Multifamily construction in May was little changed from the seven-year low recorded in April. Total issuance of building permits also was about unchanged last month, as a decrease in single-family permits offset a rise in permit issuance for multifamily housing construction. So far in 1989, total starts are down 3 percent from the average for all of 1988; total permits are off by nearly 7 percent.

In the single-family sector, the annual rate of starts averaged about 1 million units from March to May, down about 8 percent from the average pace during 1988; permits for new construction and sales of new and existing homes also have been running below the 1988 average. Interest rates on conventional fixed-rate mortgages remained close to their springtime peak of 11 percent through the first half of May, well above the 1988 average of 10-1/4 percent. In addition, over the period from March to mid-May, the

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

	1988	1988		1989	1989		
	Annual	Q3	Q4	Q1	Mar.	Apr.	May
All units							
Permits	1.46	1.44	1.52	1.37	1.23	1.33	1.34
Starts	1.49	1.47	1.56	1.52	1.41	1.34	1.31
Single-family units							
Permits	.99	.99	1.04	.97	.87	.95	.91
Starts	1.08	1.06	1.14	1.07	.98	1.03	.98
Sales							
New homes	.68	.70	.68	.63	.56	.62	n.a.
Existing homes	3.59	3.66	3.77	3.48	3.40	3.40	3.21
Multifamily units							
Permits	.46	.45	.48	.40	.36	.38	.42
Starts	.41	.41	.42	.45	.43	.31	.33

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



initial interest rate on adjustable-rate mortgages rose to the highest level since late 1985. High initial rates diminish purchases of homes by buyers who typically use ARMs, including those who anticipate a relatively short period of residence in a new home and those who may not meet qualifications for fixed-rate mortgages.

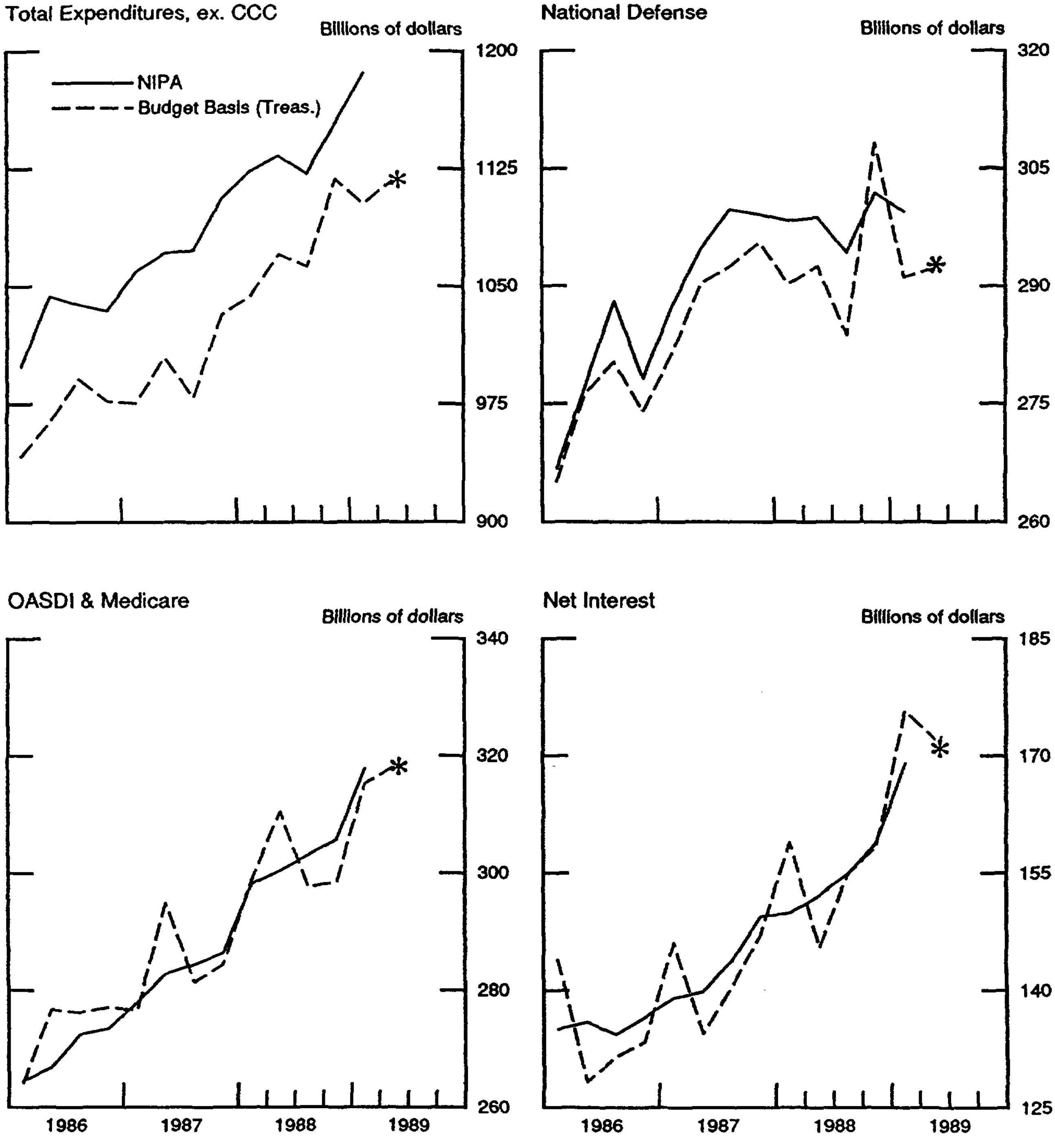
Preliminary survey results suggest that, as of the end of the third week of June, consumer attitudes toward homebuying had not changed significantly in response to the recent drop in interest rates. Possibly, consumers' expectations of a further drop in rates explain this apparent lack of response. Similarly builders' expectations for single-family starts changed little in June.

In the multifamily sector, starts still are being limited by the adverse effects of 1986 tax law changes and by a persistent substantial oversupply of multifamily units, especially for higher-rent units in which builders have increasingly concentrated since tax reform took effect. Even so, the figures on multifamily starts for April and May were surprisingly low, and an upturn seems likely. In this regard, permits for multifamily construction jumped 12 percent in May to 424 thousand units, well above the average level for the first quarter of 1989; ordinarily, the permits series is less subject than starts to statistical error and may thus be a better indication of the underlying trends.

Federal Government

According to the Monthly Treasury Statement, federal spending recovered somewhat in May from an unexpectedly low April figure, and receipts fell back after the April surge in personal tax payments. Consequently, the

FEDERAL SECTOR EXPENDITURES
NIPA and Budget Basis



Note: All data are quarterly at annual rates. NIPA are seasonally adjusted; the budget basis data from the Monthly Treasury Statement are not seasonally adjusted, but have been adjusted for calendar effects on pay and benefits.

*-- Estimated from April-May average.

total budget position returned to deficit, amounting to $25.5 billion for the month.

Cutting through the monthly swings, it appears that, on a budget basis, non-CCC federal spending in the second quarter of this year will be about unchanged from the fourth quarter of last year; these outlays had grown at a 9 percent annual rate in the second half of 1988 (chart), owing in part to a bulge in FSLIC outlays around year-end. Nominal outlays for defense seem to have subsided from a fourth-quarter spike, probably implying a decline in real NIPA defense purchases as well. However, social security and medicare benefits (the dominant elements in federal transfer payments) have continued to grow, and the seasonal drop in interest payments in the second quarter of 1989 looks smaller than those of past years.

On the income side of the accounts, total receipts for April and May together were $31 billion, or 18-1/2 percent above a year earlier. For reasons that are not altogether clear, nonwithheld personal tax receipts for this period rose especially rapidly and were 27 percent above a year earlier. Daily tax receipts data for June, when the second estimated personal tax payment for 1989 was due, suggest growth in nonwithheld taxes of a bit less than 7 percent relative to June of last year. In contrast, the daily data suggest a decline in corporate profits taxes from a year ago, as corporate profits have weakened recently.

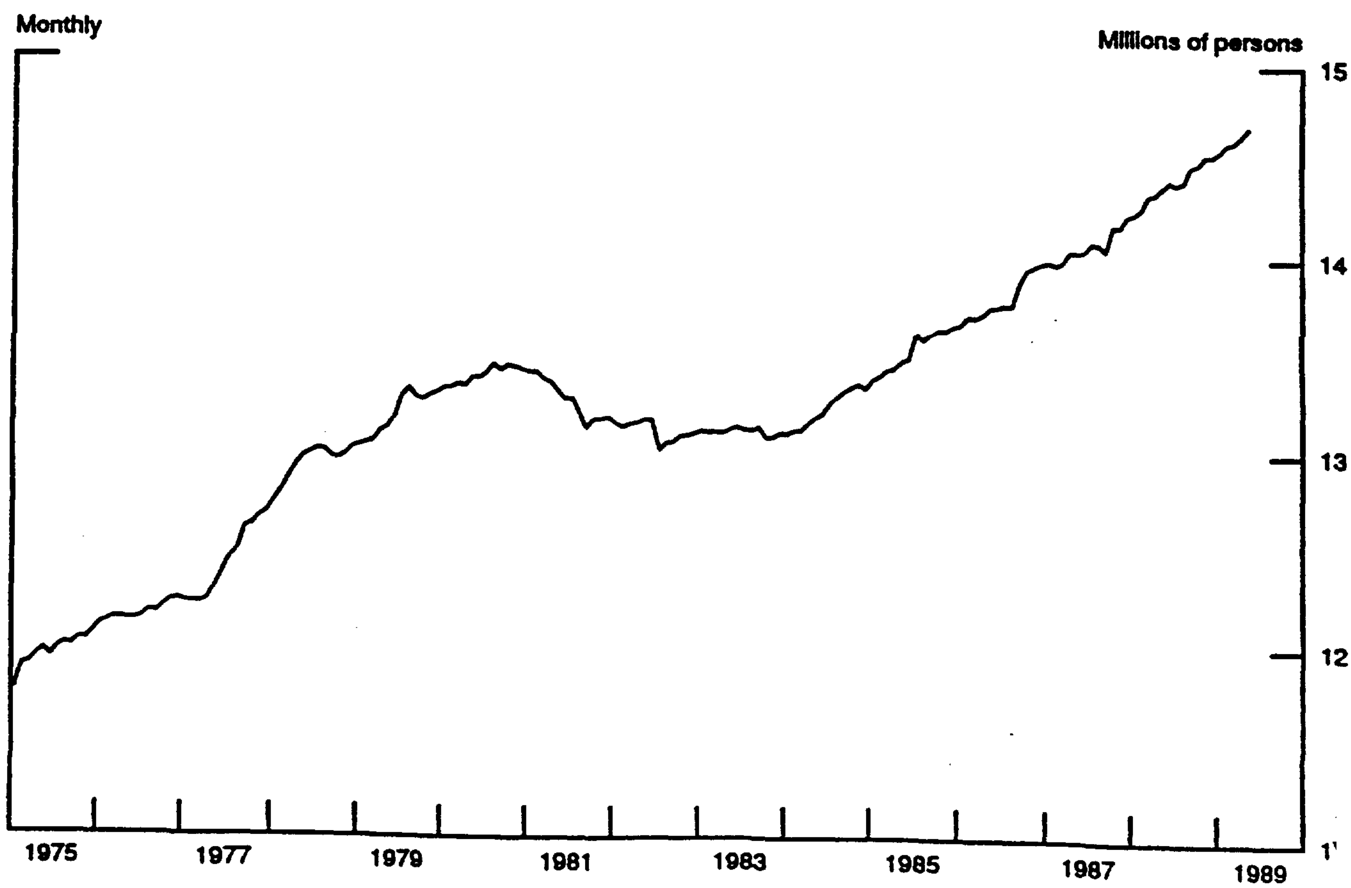
In view of the moderation in the growth of outlays for fiscal year 1989 and the favorable receipts developments in April and May, most forecasters of the budget deficit for the fiscal year as a whole are revising their projections downward. New official projections will not become available from the Administration and the Congressional Budget Office until mid-July

STATE AND LOCAL GOVERNMENT CONSTRUCTION OUTLAYS
(Percent change in 1982 dollars, based on seasonally adjusted data)

	1985	1986	1987	1988	1988-Q4 to Apr. 1989 (Annual rate)	Memo: Percent of total Apr. 1989
	------ Q4 to Q4 ------					
Total	6.6	10.3	3.0	6.9	0.0	100
Selected components:						
Education	23.2	31.3	-4.8	21.4	39.7	18
Other building	13.6	28.1	-2.5	1.4	39.4	15
Highways	2.9	-2.2	15.0	8.1	-19.0	36
Water, sewer, & misc.	3.1	9.6	-2.8	1.6	-8.4	31

Source: Department of Commerce data on construction put-in-place.

STATE & LOCAL EMPLOYMENT



and August, respectively. It now appears likely, however, that both agencies will revise their estimates to show a deficit somewhat below $155 billion for fiscal year 1988, down from their previous respective estimates of $164 billion and $159 billion.

State and Local Governments

Growth in real purchases of goods and services by state and local governments has been moderate, on balance, this year. In April, the first-quarter weakness in construction spending was reversed, with the level returning to its fourth-quarter average (table). One of the largest gains over this period was in spending on "other buildings," which includes correctional facilities, a high budget priority for many state and local governments in recent years.

Employment by state and local governments increased 75,000, about 3 percent at an annual rate, over the first two months of the second quarter. This increase extends the uptrend of the past five years (chart). On average since 1985, state and local employment increased around 300,000 per year, after declining somewhat during the early part of the decade. In each of the past five years, approximately half of the increase was among educational personnel employed by local governments. Also, fairly steady gains at both levels of government were registered among general administrative employees, which include police and firemen, as well as office workers.

The fiscal situation has placed many state and local governments under some stress; the operating and capital account deficit (excluding social insurance funds) was over $17 billion in the first quarter. However, as at the federal level, some improvement may have occurred during the second

VALUE OF THE OUTPUT OF SELECTED FARM CROPS
(Billions of 1982 dollars)

	1986	1987	1988	1989[1]
Wheat	7.4	7.4	6.4	7.1
Soybeans	11.2	11.1	8.9	11.3
Corn	19.6	16.8	11.7	18.6
Other feed grains[2]	4.3	3.6	2.4	3.4
Total for these crops	42.5	38.9	29.4	40.4

1. Derived from the USDA's June 12 projection of crop production.
2. Barley, oats, and sorghum.

INDEXES OF CROP CONDITIONS[1]
(Range: 100=excellent; 0=very poor)

	Week ended				
	May 28	June 4	June 11	June 18	June 25
Corn	n.a.	65.5	66.5	66.3	66.8
(Previous year)	(n.a.)	(63.3)	(60.0)	(55.5)	(47.3)
Spring wheat	72.3	73.3	70.8	72.8	71.3
(Previous year)	(53.0)	(45.8)	(33.5)	(29.3)	(24.5)
Soybeans	n.a.	n.a.	62.8	62.5	64.0
(Previous year)	(n.a.)	(n.a.)	(53.8)	(49.0)	(44.8)

1. Indexes are constructed by the staff of the Federal Reserve, using data from the Weekly Weather and Crop Bulletin. The data in that report show the proportion of respondents who characterize crop conditions as excellent, good, fair, poor, or very poor. In constructing the indexes these proportions have been weighted as follows: excellent=1.0; good=.75; fair=.5; poor=.25; very poor=.0. A crop that is viewed as excellent by all respondents in all locations would thus have an index value of 100.0.

n.a.--not available

quarter; most states appear to have collected higher-than-expected income tax receipts. For example, in California, collections for fiscal year 1989 came in about $1 billion higher than expected. Generally, states have attributed such increases, at least in part, to higher-than-expected 1988 personal income, as well as to higher capital gains.

Agricultural Production

With the 1989 agricultural production cycle now entering its most critical phase, conditions still seem to be pointing toward a sizable rebound in total farm output this year. Drought clearly has hurt the winter wheat crop, which is likely to fall 10 percent short of last year's level, according to the Agriculture Department's June 1 assessment of crop conditions. However, total wheat production is expected to be up 12 percent, because of an anticipated rise in the production of spring wheat, which had been almost wiped out by drought in the Upper Midwest in 1988. The USDA also is projecting higher output of soybeans, corn, and most other grains. If the current production projections are borne out, then the constant-dollar output of the major crops (wheat, feed grains, and soybeans) should be up about $11 billion in 1989, more than reversing last year's decline (table).[3]

Qualitative reports of crop conditions (table) indicate that the condition of the spring-planted crops remained fairly stable through the month of June, in contrast to the massive deterioration that already was

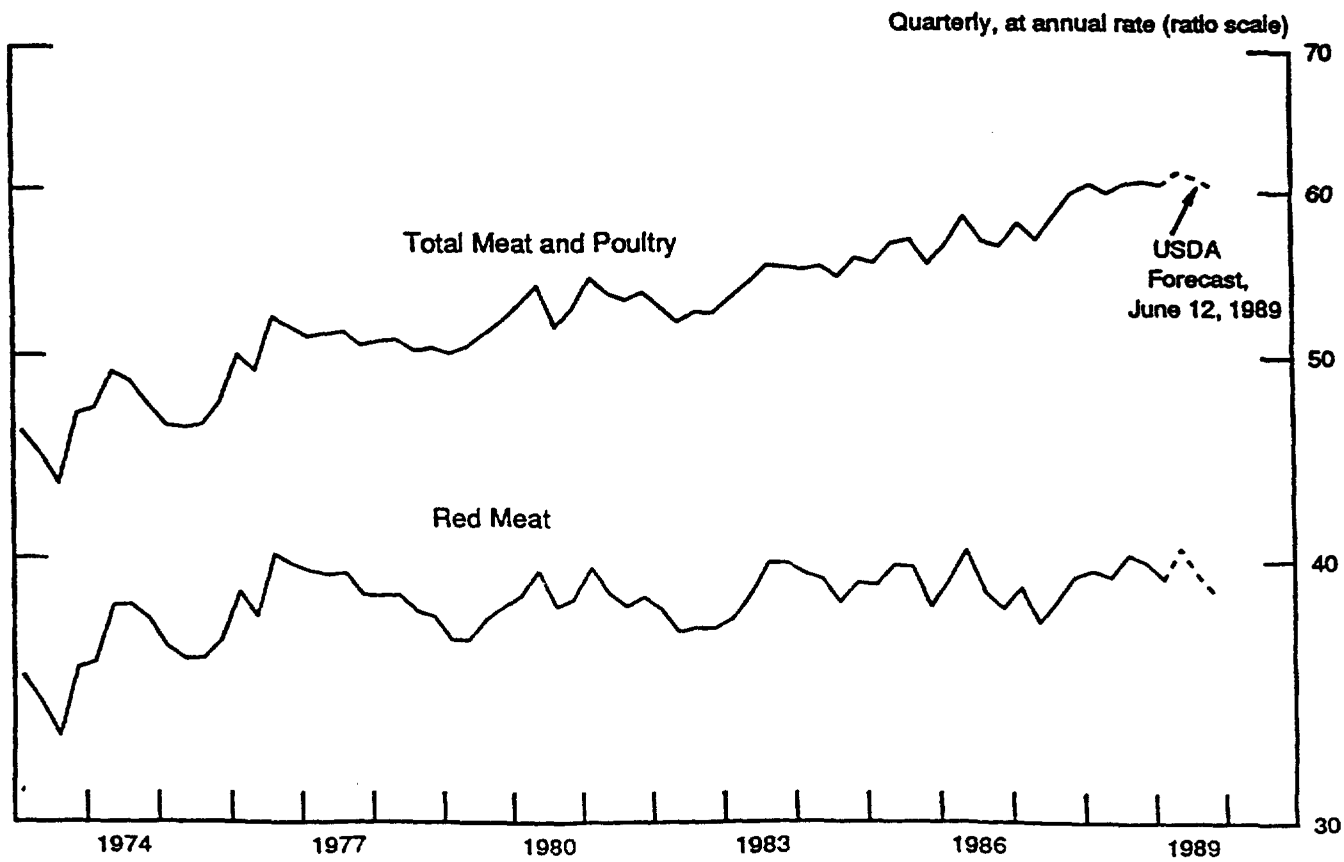
3. These calculations, which are based on year-to-year changes in actual production, differ conceptually from the BEA's estimates of drought losses, which were computed by comparing actual production in 1988 to what likely would have occurred in that same year in the absence of drought.

MEAT AND POULTRY PRODUCTION
(Millions of pounds)

		1988	USDA Projection for 1989 as of May 11	USDA Projection for 1989 as of June 12
1.	Total red meat and poultry	60350	60813	60943
2.	Red meat[1]	39763	39402	39398
3.	Beef	23424	23104	23004
4	Pork	15623	15587	15687
5.	Poultry	20587	21411	21545

1. Includes veal and lamb, in addition to beef and pork.

Meat and Poultry Production
(Billions of pounds, seasonally adjusted)*



* USDA data, seasonally adjusted by the staff of the Federal Reserve Board.

evident at this time last year. Conditions for spring wheat, in particular, look to be on track for a big rebound from last year's very poor harvest.

In the livestock area, the Agriculture Department has revised up further its projection of total meat and poultry production for 1989, which now is expected to be about 1 percent above that of 1988. Since December, the forecast for 1989 has been revised up about 2 percentage points, mainly because of a smaller-than-expected decline in the production of beef, a sector in which liquidations of some cattle in regions still afflicted by drought appear to have added to the normal flow of marketings. Looking ahead, the USDA projections point to moderate declines in the output of both beef and pork over the second half of 1989. However, the output of poultry is expected to grow rapidly in the second half, rising to a level about 6 percent above a year earlier. All told, the USDA figures suggest that total meat and poultry production should hold fairly steady over the remainder of the year (chart), closing out a decade in which the trend in the output of these items has been reasonably stable relative to the turbulence of the 1970s.[4]

4. Thus far in 1989 the strongest price pressures in agriculture have come not from the major crop and livestock commodities, but rather from items such as eggs and fresh vegetables, which have been affected by adverse supply developments. Egg producers had started to curtail production early in 1988 in response to poor profitability, and with the drought boosting feed costs, that curtailment has lasted longer and cut deeper than otherwise would have been the case; however, prices have been above the break-even point this year, and the USDA's projections show production rising moderately over the balance of 1989.

The lingering effects of the 1988 drought also have affected the prices of some fresh vegetables that are on an annual production cycle. For example, potato stocks were low coming into 1989, and price increases have been sizable this year. In addition, prices recently have been strong for a number of vegetables that have shorter production

(Footnote continues on next page)

Prices

Aggregate price increases continued to be large in April and May, extending the surge of the first quarter. So far this year, both the PPI and the CPI have risen substantially faster than they did in 1988; indeed, this year's increases in the two indexes have been running well above those of any year since the early 1980s.

However, the underlying inflation situation clearly has not deteriorated as much as the overall price numbers have. A substantial part of the price surge has been concentrated among energy and food items and reflects supply influences that seem likely to be transitory. Excluding food and energy, the rate of increase in consumer prices so far this year has differed little from last year's pace, owing partly to the dollar's effect in damping import prices. Even so, the underlying tendency of inflation--as reflected in inflation expectations, increases in compensation, and the price numbers excluding food and energy--seems to be centering on the 4-1/2 to 5 percent mark at present, up a notch from the norm that prevailed during the first several years of the expansion.

Among the recent developments, consumer energy prices climbed about 5 percent in April and 1-1/2 percent in May, mainly reflecting hikes for gasoline. Prices of the latter have risen more than 20 percent (not at an annual rate) since last December. However, posted prices for West Texas

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(Footnote continued from previous page)
cycles (notably tomatoes). Acreage of these crops apparently rose substantially in the second quarter, but weather may either have hurt yields or caused delays in harvesting. In any event, wholesale prices for a number of fresh vegetables still were high as of mid-June, and pressures at the retail level may therefore persist in that month's CPI.

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

	Relative importance Dec. 1988	1987	1988	1988 Q4	1989 Q1	1989 Apr.	1989 May
				-Annual rate-		-Monthly rate-	
All items[2]	100.0	4.4	4.4	4.1	6.1	.7	.6
Food	16.2	3.5	5.2	3.0	8.2	.5	.6
Energy	7.3	8.2	.5	-.4	10.2	5.1	1.6
All items less food and energy	76.5	4.2	4.7	4.9	5.2	.2	.5
Commodities	25.7	3.5	4.0	4.2	4.1	.2	.4
Services	50.8	4.5	5.0	5.4	5.9	.2	.5
Memorandum:							
CPI-W[3]	100.0	4.5	4.4	4.1	6.2	.7	.6

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. 1988	1987	1988	1988 Q4	1989 Q1	1989 Apr.	1989 May
				-Annual rate-		-Monthly rate-	
Finished goods	100.0	2.2	4.0	3.0	10.2	.4	.9
Consumer foods	25.8	-.2	5.7	2.1	13.5	-.6	.8
Consumer energy	8.8	11.2	-3.6	1.4	39.2	7.2	3.3
Other consumer goods	39.6	2.7	4.8	4.4	6.1	-.1	.5
Capital equipment	25.8	1.3	3.6	1.7	4.6	-.1	.4
Intermediate materials[2]	94.8	5.4	5.3	4.5	9.1	.4	.3
Excluding energy	83.4	5.2	7.2	6.7	6.2	.0	.2
Crude food materials	43.8	1.8	14.2	-7.9	16.5	-2.8	.4
Crude energy	36.9	10.7	-9.5	12.3	45.9	5.2	2.2
Other crude materials	19.3	22.6	7.5	12.5	10.9	-1.1	-.4

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

Intermediate crude oil have come down a bit since May. Retail gasoline prices in the summer are likely to reflect both crude oil costs and the effect of stricter environmental standards for gasoline.

The CPI for food rose about half a percent per month in April and May. Prices in the meat and poultry grouping were up similarly, but these increases were well above those posted in the first quarter. In May, the index was boosted by a hike in the prices of fresh vegetables, particularly tomatoes (up 30 percent). Such increases typically are transitory and tend to be reversed as new crops become available. Excluding both the livestock and produce-based components, retail food prices (70 percent of total food) slowed appreciably in May relative to the rapid pace observed over much of the past year.

Apart from food and energy, the CPI for commodities rose 0.2 percent in April and 0.4 percent in May. Over these two months, prices were down a bit for housefurnishings and motor vehicles but up sharply for pharmaceuticals and household paper products. Apparel prices also have risen markedly since March but remained, nonetheless, only 3-1/4 percent above their levels of a year earlier. Over the first five months of the year, the CPI for commodities (nonfood, nonenergy) has risen at an average annual rate of nearly 4 percent, a bit below the pace in 1988.

A slowing in non-oil import prices this year may have helped to hold down the retail prices of a broad range of consumer goods. For example, among those consumer goods that the BLS has identified as having higher than average import proportions, price increases over the past six months have generally been smaller than those of similar periods in 1987 and 1988.

Prices of nonenergy services rose only 0.2 percent in April but were up 0.5 percent in May. The April index was held down by a sharp drop for lodging out of town (a late ski season in the West had boosted the March figure), while the May CPI included a large increase for owners' equivalent rent. Over the past twelve months, the CPI for nonenergy services has risen 5.1 percent, nearly 1/2 percentage point more than in the preceding year (table). Almost half of this pickup is attributable to increases in auto finance charges, which, according to the BLS, reflect higher loan rates at

RECENT DEVELOPMENTS IN CPI NONENERGY SERVICES PRICES

	Relative Importance	Twelve-month percent change to May of: 1985	1986	1987	1988	1989
Nonenergy services	50.8	5.5	5.8	4.8	4.7	5.1
"Nonlabor" services						
Owners' equivalent rent	19.3	5.6	5.7	4.4	4.8	4.8
Rent	6.0	6.2	6.0	4.0	3.8	3.8
Auto insurance	2.2	9.5	13.1	9.1	6.8	6.8
Telephone services	2.0	2.5	6.3	-.1	.2	1.1
Auto finance	.8	.5	-9.6	-4.2	6.3	15.4
"Labor-related" services						
Medical services	4.7	5.8	7.7	6.8	6.4	7.1
Entertainment services	2.3	5.5	5.3	4.5	4.7	5.5
Tuition and fees	2.1	9.3	8.5	8.3	7.8	7.6
Housekeeping services	1.5	3.5	2.3	2.1	3.8	2.2
Public transportation	1.4	4.6	6.4	3.8	1.5	5.3
Personal care services	.6	4.7	3.4	3.4	3.5	5.6
Apparel services	.6	5.2	4.4	3.9	2.9	5.8
Memo:						
ECI, compensation for private-industry service-producing sector (March-to-March)		4.2	4.5	3.4	3.6	5.3

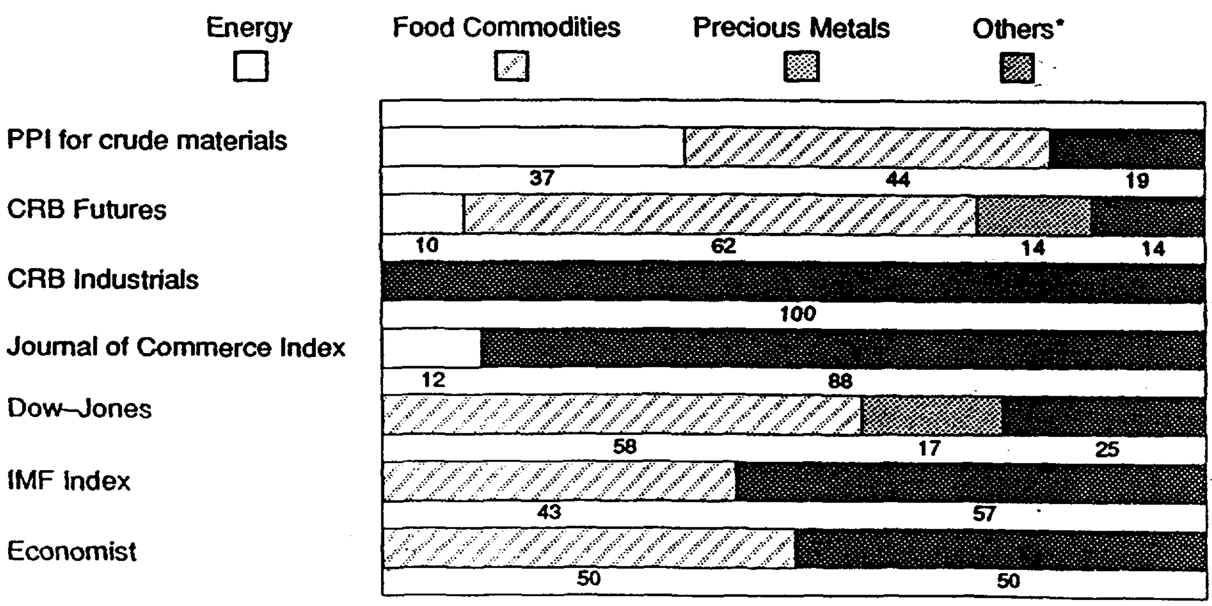
1. Relative importance in the CPI for all urban consumers, December 1988.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last Obser-vation	Percent change[2] 1987	1988	1989 To May 9*	1989 May 9* To Date	Memo: Year Earlier To Date
1. PPI for crude materials[3]	May	8.9	3.1	9.2	n.a.	9.4
1a. Foods and feeds	May	1.8	14.2	5.0	n.a.	9.8
1b. Energy	May	10.7	-9.5	18.2	n.a.	10.2
1c. Ex. food and energy	May	22.6	7.5	2.1	n.a.	6.5
1d. Ex. food and energy, seas. adj.	May	22.8	7.6	1.2	n.a.	6.6
2. Commodity Research Bureau						
2a. Futures prices	June 20	11.7	8.5	-4.2	-3.3	-13.0
2b. Industrial spot prices	June 20	19.2	7.3	3.9	.0	6.6
3. Journal of Commerce industrials	June 20	10.7	3.8	3.4	.2	3.5
4. Dow-Jones Spot	June 20	17.0	6.9	-3.3	-3.3	-6.8
5. IMF commodity index[3]	May	30.8	12.6	-3.8	n.a.	1.9
5a. Metals	May	51.9	33.7	-9.2	n.a.	-.8
5b. Nonfood agric.	May	47.5	-9.4	-2.5	n.a.	-8.7
6. Economist (U.S. dollar index)	June 13	42.5	17.7	-7.3	-8.5	-18.9
6a. Industrials	June 13	62.6	18.9	-9.2	-9.7	-24.4

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.
*Week of the May Greenbook.
n.a.--Not available.

Index Weights



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

commercial banks over this period. Among the other components of nonenergy services, the acceleration has been most pronounced for the more "labor-related" services. Particularly large increases were registered over-the-year for public transportation services (mainly airfares), medical services, and a variety of other components. On balance, these increases are broadly consistent with the 1-3/4 percentage points acceleration in ECI compensation for the service-producing sector.

At earlier stages of processing, prices of intermediate materials (less food and energy) rose only 0.2 percent in May, after leveling off in April. Both increases and declines were fairly widespread in the past two months, with declines most notable in the nonferrous metals categories. Prices of crude nonfood materials less energy dropped back in April and May, in large part reflecting declines for nonferrous ores and scrap. Since the week of the May FOMC meeting, prices in spot commodity markets have declined for most foods and for nonferrous metals but have been mixed for other industrial materials.

<u>Wages and Labor Costs</u>

Wage information for the second quarter is limited to the data on average hourly earnings, which, as of May, were up 3-3/4 percent from a year earlier. After accelerating from late 1986 through mid-1988, the year-to-year rise in this measure shows a fairly flat trend over the past several months, and although the series covers only production and nonsupervisory workers, the second-quarter data suggest that any acceleration in the broader wage measures may turn out to be fairly limited.

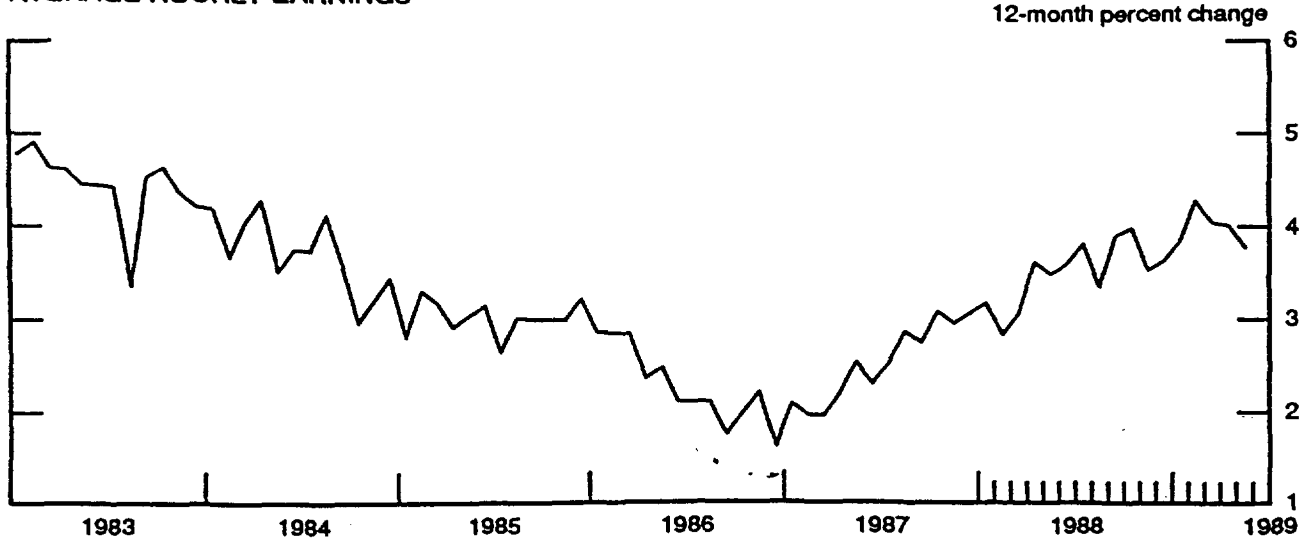
As reported in the previous Greenbook, the employment cost index, which is available only through March, has shown some easing of wage trends

SELECTED MEASURES OF LABOR COSTS IN THE NONFARM BUSINESS SECTOR
(Percentage change at annual rates)

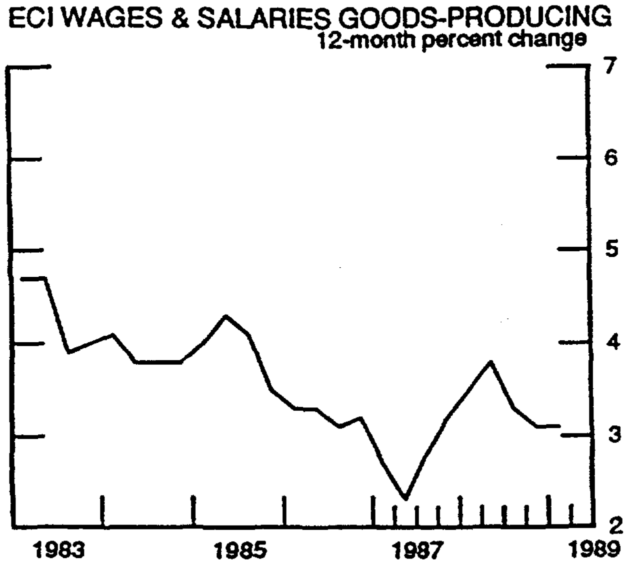
	1987	1988	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 May Monthly
Employment cost index[1]								
Compensation, all persons	3.3	4.9	5.4	5.3	3.9	4.8	4.3	--
By occupation:								
White collar	3.7	5.0	4.6	5.5	4.4	5.7	5.4	--
Blue collar	3.1	4.4	6.3	4.8	2.8	3.8	3.0	--
Service workers	2.4	5.3	4.9	6.0	5.3	4.9	3.4	--
By sector:								
Goods-producing	3.1	4.4	6.5	4.5	2.8	3.7	3.2	--
Service-producing	3.7	5.1	4.3	6.0	4.4	5.9	5.1	--
By bargaining status:								
Union	2.8	3.9	5.8	4.4	3.0	2.4	2.3	--
Nonunion	3.6	5.1	5.1	5.4	4.2	5.7	5.1	--
Wages and salaries, all persons	3.3	4.1	3.3	4.6	3.7	5.0	3.7	--
Benefits, all persons	3.5	6.8	12.6	6.0	4.2	4.5	7.0	--
Labor costs and productivity, all persons[2]								
Nonfarm Business Sector								
Output per hour	1.9	1.0	3.4	-2.4	2.0	1.0	-1.1	--
Compensation per hour	4.1	4.7	3.5	4.2	5.7	5.2	5.4	--
Unit labor costs	2.1	3.6	.1	6.8	3.7	4.1	6.6	--
Manufacturing								
Output per hour	3.4	3.4	3.2	3.7	5.2	1.6	2.1	--
Compensation per hour	1.6	4.6	5.4	3.0	4.8	5.1	4.1	--
Unit labor costs	-1.8	1.1	2.2	-.7	-.5	3.5	2.0	--
Major collective bargaining agreements[3]								
First-year wage adjustments	2.2	2.6	2.1	2.6	2.5	2.6	3.2	--
Total effective wage change	3.1	2.6	3.2	3.0	2.8	2.6	2.7	--
Average hourly earnings, production workers[2]								
Total private nonfarm	3.0	3.7	2.2	4.7	3.5	4.4	3.6	.1
Manufacturing	2.3	3.0	1.6	4.2	2.7	3.4	2.6	.1
Services	4.7	4.9	3.9	5.4	4.9	5.2	5.4	.3
Hourly earnings index, wages of production workers[4]								
Total private nonfarm	2.6	3.5	3.1	3.8	2.9	4.1	3.0	.1

1. Changes are from final month of preceding period to final month of period indicated at a compound annual rate. The data are seasonally adjusted by FRB staff.
2. Changes over periods longer than one quarter are measured final quarter of preceding period to final quarter of period indicated at a compound annual rate. Seasonally adjusted data.
3. Agreements covering 1,000 or more workers; not seasonally adjusted. The numbers reported are cumulative averages from the beginning of the year through the indicated quarter.
4. Values for the HEI after 1988 were produced by FRB staff.

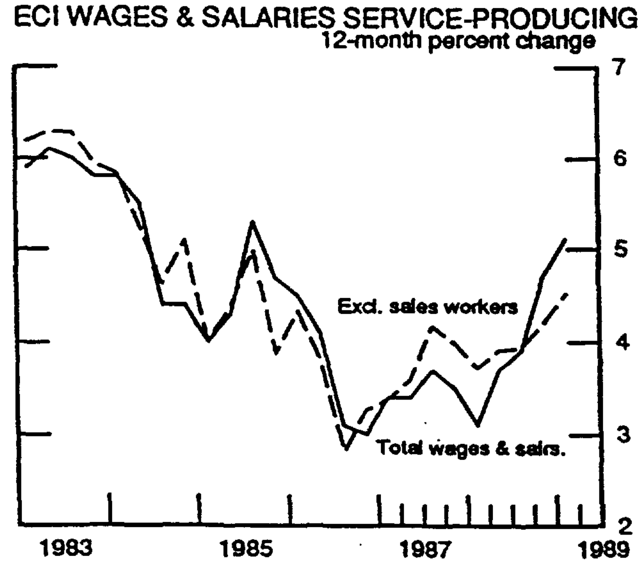
AVERAGE HOURLY EARNINGS



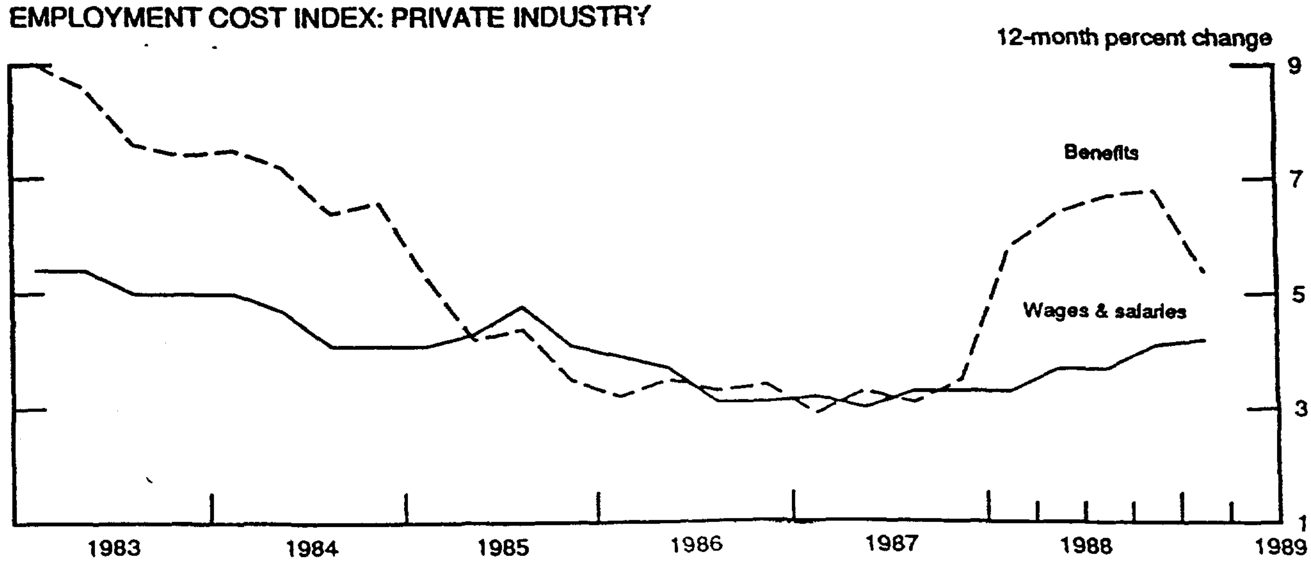
ECI WAGES & SALARIES GOODS-PRODUCING



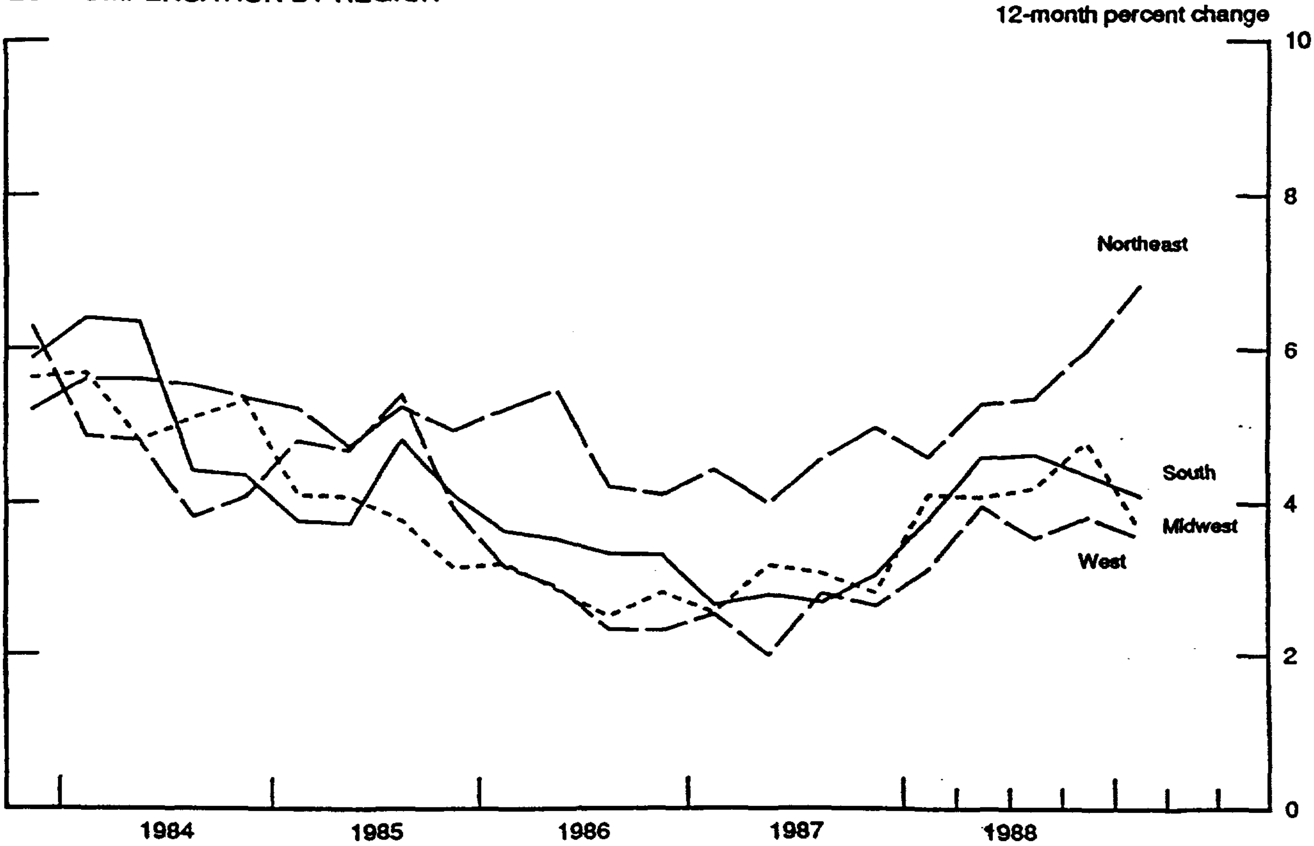
ECI WAGES & SALARIES SERVICE-PRODUCING



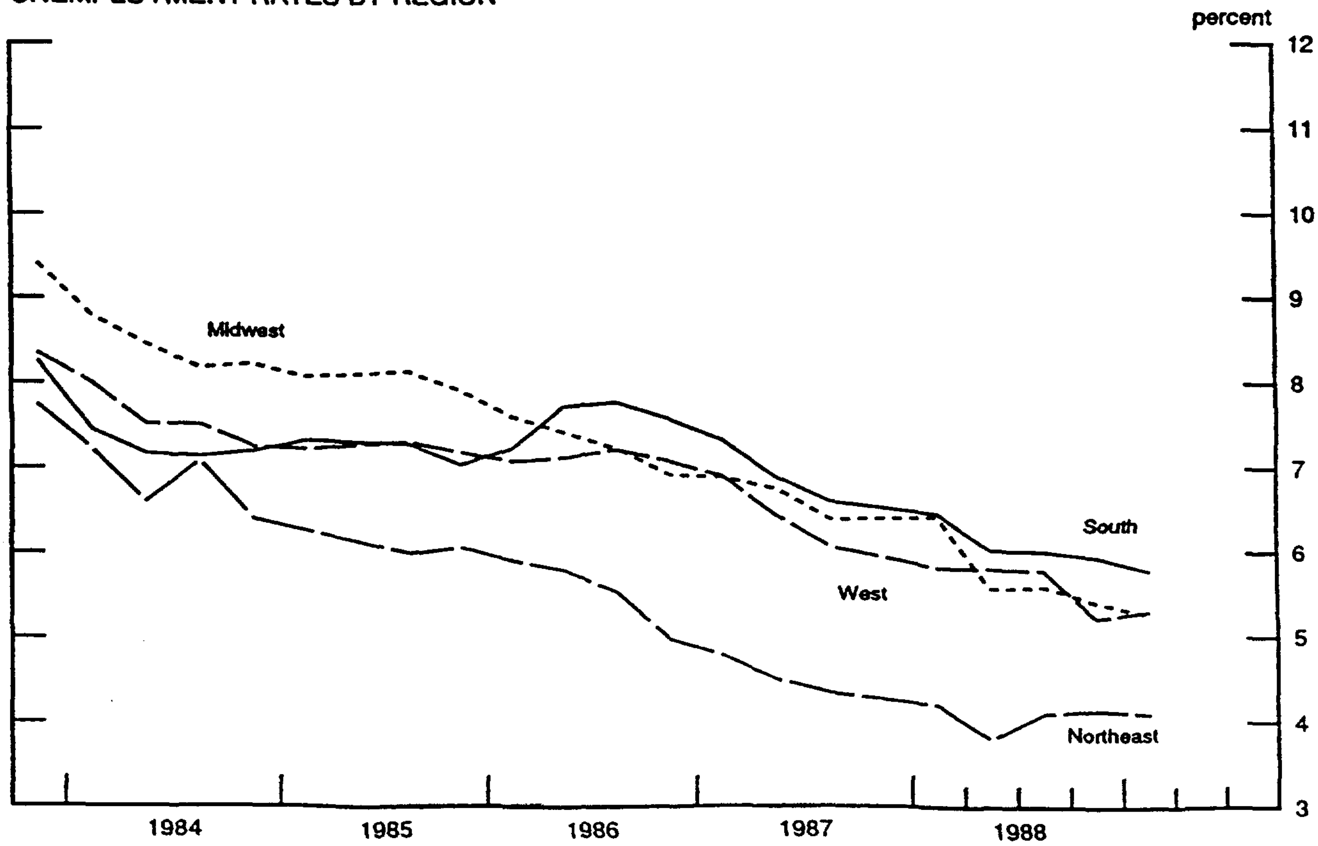
EMPLOYMENT COST INDEX: PRIVATE INDUSTRY



ECI COMPENSATION BY REGION



UNEMPLOYMENT RATES BY REGION



in the goods-producing industries, an area where the coverage of the ECI is most similar to that of hourly earnings. However, in the service-producing sector--where the ECI's coverage is much broader than that of hourly earnings--the trend of recent quarters has been sharply upward, by enough to keep the overall ECI wage trend on a moderate upward course. Benefit costs in the ECI were up slightly faster than wages over the twelve months ended in March, and total compensation was up 4.6 percent over that period. Geographically, by far the biggest rise in labor costs over the year ended in March occurred in the Northeast (chart), an area with an exceptionally low unemployment rate. In contrast to the Northeast, rates of labor cost inflation in other areas of the country appear to have leveled off or fallen slightly.

Other data still hint at the potential for some additional acceleration in wages in the months ahead. As noted earlier, the unemployment rate is low by postwar standards. In addition, inflation expectations have been holding at the 5 percent mark or better for some time now, noticeably higher than they were before mid-1988. Also, some indicators of labor market conditions still look strong--perhaps surprisingly so in view of the softening evident in the monthly labor market surveys. In particular, the Conference Board index of help-wanted advertising has climbed steadily since January of this year, and several independent employer surveys, including the Bureau of National Affairs, the Conference Board, and Manpower Inc., report continued strong hiring prospects for the third quarter.

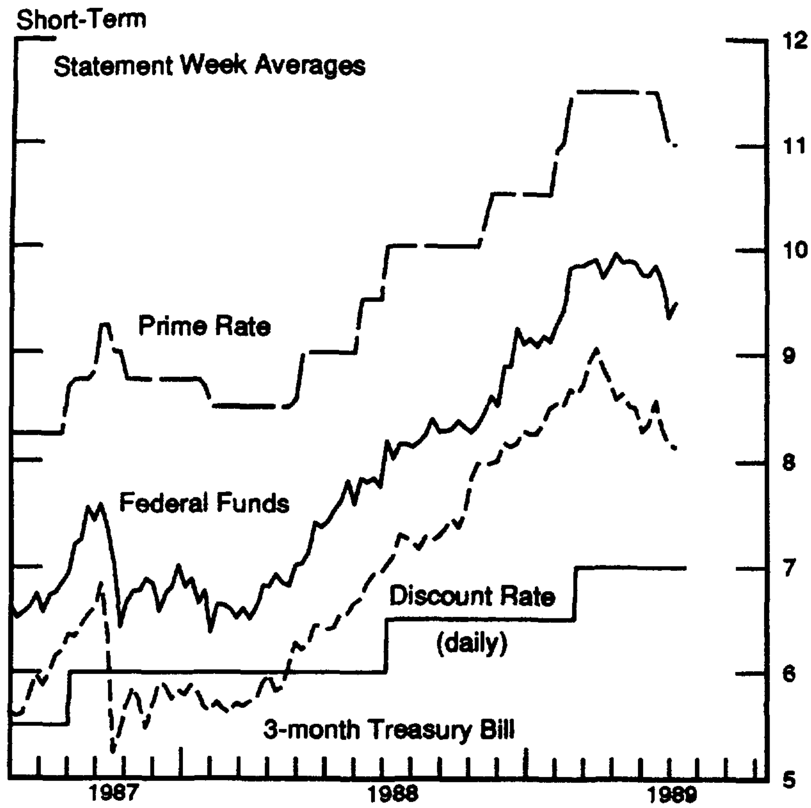
SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

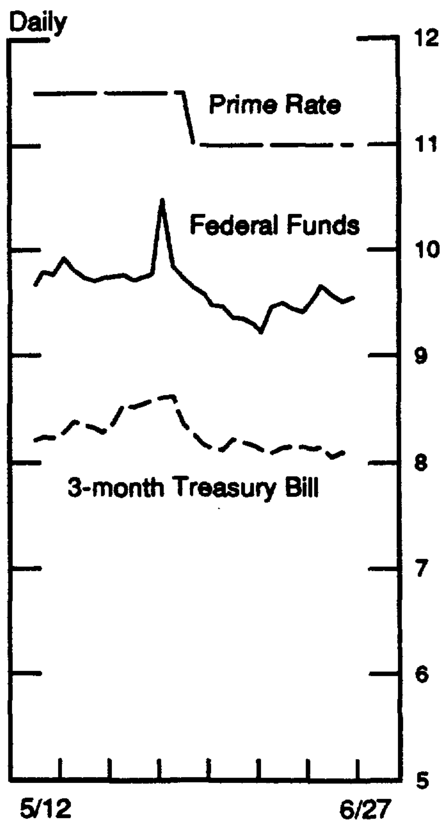
	1987	1988	1989		Change from:	
	Oct. 16[2]	Feb lows	FOMC May 16	June 27	Feb 88 lows	FOMC May 16
Short-term rates						
Federal funds[3]	7.59	6.38	9.79	9.52	3.14	-.27
Treasury bills[4]						
3-month	6.93	5.59	8.23	8.05	2.46	-.18
6-month	7.58	5.77	8.28	7.78	2.01	-.50
1-year	7.74	6.10	8.23	7.78	1.68	-.45
Commercial paper						
1-month	7.94	6.41	9.49	9.34	2.93	-.15
3-month	8.65	6.45	9.37	9.10	2.65	-.27
Large negotiable CDs[4]						
1-month	7.92	6.44	9.51	9.38	2.94	-.13
3-month	8.90	6.49	9.48	9.17	2.68	-.31
6-month	9.12	6.55	9.47	9.00	2.45	-.47
Eurodollar deposits[5]						
1-month	8.00	6.44	9.56	9.44	3.00	-.12
3-month	9.06	6.50	9.50	9.25	2.75	-.25
Bank prime rate	9.25	8.50	11.50	11.00	2.50	-.50
Intermediate- and long-term rates						
U.S. Treasury (constant maturity)						
3-year	9.52	7.28	8.90	8.25	.97	-.65
10-year	10.23	8.11	8.82	8.11	.00	-.71
30-year	10.24	8.32	8.84	8.08	-.24	-.76
Municipal revenue[6] (Bond Buyer)	9.59	7.76	7.64	7.36	-.40	-.28
Corporate A utility (recently offered)	11.50	9.63	10.12	9.51	-.12	-.61
Home mortgage rates[7]						
S&L fixed-rate	11.58	9.84	10.93	10.19	.35	-.74
S&L ARM, 1-yr.	8.45	7.59	9.36	9.00	1.41	-.36

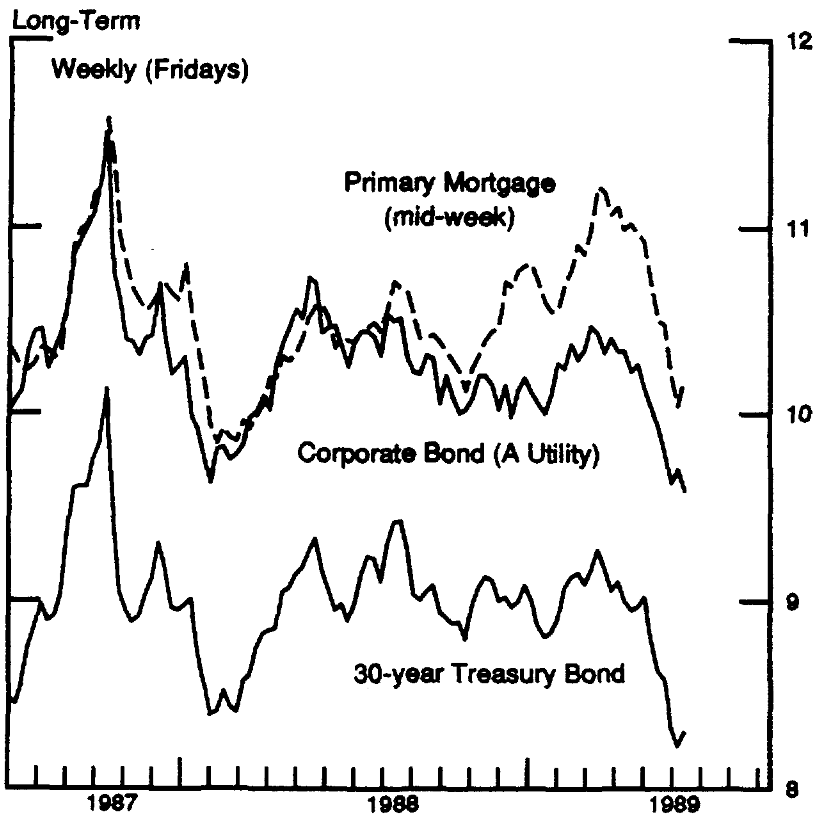
	1987		1989		Percent change from:	
	Record highs	Lows	FOMC May 16	June 27	Record highs	FOMC May 16
Stock prices						
Dow-Jones Industrial	2722.42	1738.74	2453.45	2526.37	-7.20	2.97
NYSE Composite	187.99	125.91	175.92	183.18	-2.56	4.13
AMEX Composite	365.01	231.90	349.92	366.43	.39	4.72
NASDAQ (OTC)	455.26	291.88	435.66	448.55	-1.47	2.96

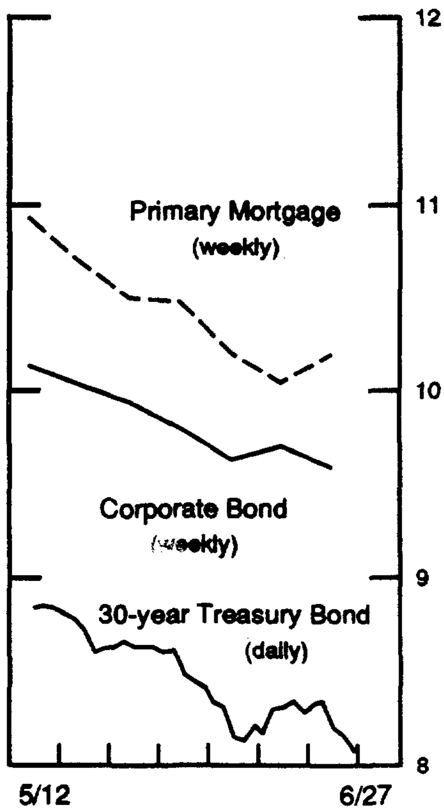
1. One-day quotes except as noted.
2. Last business day prior to stock market decline on Monday, October 19, 1987.
3. Average for two-week reserve maintenance period closest to date shown except Feb. low which is the average for the statement week ended 2/10/88. Last observation is average to date for maintenance period ending 6/28/89.
4. Secondary market.
5. Bid rates for Eurodollar deposits at 11 a.m. London time.
6. Based on one-day Thursday quotes and futures-market index changes.
7. Quotes for week ending Friday closest to date shown.

Selected Interest Rates*
(percent)









*--Friday weeks through June 23, Wednesday weeks through June 21.

Interest rates have declined considerably since the May 16 meeting of the FOMC--by about a quarter percentage point in the short-term money market to three-quarters of a point at the long end of the maturity spectrum. An easing in the federal funds rate to around 9-1/2 percent supported this rally, but the major boost has been supplied by a series of data releases confirming a slowing in economic growth and by an influx of international capital reportedly bolstered by concerns about events in China. At this juncture, the markets appear to be much imbued with the idea that the economy is on track toward a "soft landing" and that, with risks of greater inflation thus averted, the System will be taking further easing actions in the next few months.

A spate of articles stimulated by the publication of a staff paper on the P^* model may have caused market participants to focus a little more attention on the sluggish growth of the monetary aggregates. Owing to a substantial runoff of deposits in the first half of May when an unusually large volume of checks for April tax payments cleared, all the monetary aggregates registered declines for the month; M2 fell to the lower end of its "parallel band," while M3 placed just below its annual growth cone. Weekly data, however, give evidence of a rebound in the broader aggregates in late May and extending into June, with impetus coming from the decline in market rates relative to deposit rates as well as a replenishing of tax-depleted holdings.

While greater-than-anticipated second-quarter tax revenues have reduced Treasury borrowing, credit use by other sectors may have picked up recently.

Commercial bank lending in May matched its brisk first-quarter rate and bond issuance burgeoned of late, as corporate and municipal financial officers sought to take advantage of the declines in long-term yields. Household indebtedness likely has grown at a moderate pace, given sluggish consumer spending and weak housing activity.

Monetary Aggregates and Bank Credit

In May, weakness in liquid deposits showed through to the broader aggregates, and M2 and M3 declined at annual rates of 3-1/4 and 3/4 percent respectively. Data through mid-June point to a rebound in these measures of money. M1, however, is not turning up, although its rate of decline appears to have slowed.

Payments for nonwithheld taxes were unexpectedly large this year, depressing holdings of liquid balances at the end of April and into May as those payments were processed. Other checkable deposits (OCDs), the main personal payment medium, fell 30 percent at an annual rate in May after having declined 2-1/2 percent in April. The drop in OCDs, along with a plunge in demand deposits at a 14 percent rate and the second consecutive month of sluggish currency growth, pulled M1 down 15 percent at an annual rate in May.

The nontransactions component of M2 was essentially flat for the month of May, as tax payments apparently contributed to unusual weakness in liquid instruments that were drawn down to meet tax obligations directly or through transfer to M1 accounts. Money market funds registered their first monthly decrease in almost a year, and savings deposits and MMDAs declined at 23 and 36 percent annual rates respectively. As has been the case for some months, small time deposits were the only component of M2 to register strong growth.

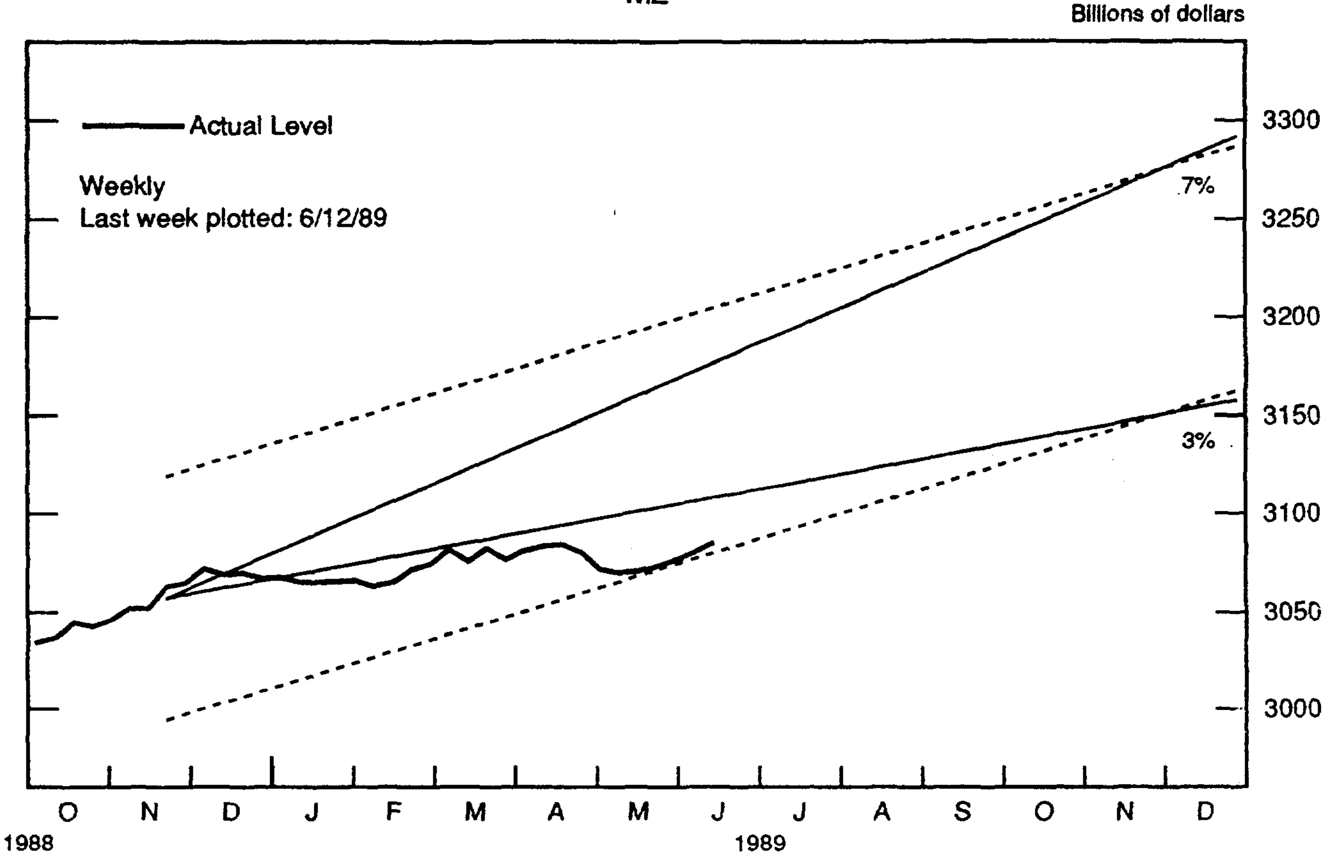
MONETARY AGGREGATES
(based on seasonally adjusted data unless otherwise noted)

	1988[1]	1988 Q4	1989 Q1	1989 Mar	1989 Apr	1989 May p	Growth Q4 88- May 89p
	------------Percent change at annual rates						
1. M1	4.3	2.3	-0.4	-1.7	-4.7	-14.9	-3.5
2. M2	5.2	3.6	1.9	3.7	0.9	-3.2	1.0
3. M3	6.2	4.8	3.7	6.7	2.6	-0.8	3.1
	------------Percent change at annual rates						Levels bil. $ May 89p
Selected components							
4. M1-A	2.5	1.7	-0.2	1.7	-5.9	-6.4	502.0
5. Currency	8.1	6.6	7.0	7.3	1.7	2.8	216.4
6. Demand deposits	-1.2	-1.8	-5.5	-2.1	-11.8	-14.1	278.2
7. Other checkable deposits	7.7	3.3	-0.7	-7.7	-2.6	-30.2	271.5
8. M2 minus M1[2]	5.5	4.1	2.6	5.6	2.9	0.7	2299.4
9. Overnight RPs and Eurodollars, NSA	-5.8	-8.7	13.6	-24.4	-54.4	-22.8	72.3
10. General purpose and broker/dealer money market mutual fund shares, NSA	7.4	9.5	20.8	42.7	19.7	-1.4	259.9
11. Commercial banks	6.9	6.8	5.4	8.3	8.0	-0.7	1006.8
12. Savings deposits, SA, plus MMDAs, NSA[3]	1.4	-1.7	-8.4	-9.2	-15.4	-28.1	509.7
13. Small time deposits	14.7	18.0	22.4	28.6	34.6	28.7	497.2
14. Thrift institutions	4.6	0.3	-3.1	-3.9	-1.9	1.8	961.3
15. Savings deposits, SA, plus MMDAs, NSA[3]	-4.3	-8.6	-14.0	-15.3	-32.5	-32.8	352.4
16. Small time deposits	11.7	6.6	4.3	3.3	17.5	22.9	609.0
17. M3 minus M2[4]	10.0	9.1	10.6	17.2	8.1	7.5	881.8
18. Large time deposits	11.0	11.3	12.6	15.7	19.1	9.3	572.1
19. At commercial banks, net[5]	12.2	13.0	18.0	23.2	22.1	9.5	395.7
20. At thrift institutions	8.8	8.0	1.2	0.0	12.5	7.5	176.3
21. Institution-only money market mutual fund shares, NSA	-0.8	10.9	10.6	-26.8	1.4	53.4	91.6
22. Term RPs, NSA	13.7	3.9	5.8	21.7	-22.3	5.7	127.6
23. Term Eurodollars, NSA	9.8	6.8	0.4	67.6	-42.3	3.6	101.6
	-----Average monthly change in billions of dollars----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	4.9	4.7	4.6	6.9	-0.8	7.0	663.9
25. Large time deposits, gross	3.3	3.2	5.8	6.3	6.1	4.1	456.8
26. Nondeposit funds	1.6	1.5	-1.2	0.6	-6.9	2.9	207.1
27. Net due to related foreign institutions, SA	-0.4	-0.5	0.4	-2.7	-5.1	-2.9	0.0
28. Other[7]	2.0	2.0	-1.6	3.1	-1.7	5.8	207.1
29. U.S. government deposits at commercial banks[8]	0.0	0.5	-1.5	0.0	0.6	6.2	27.1

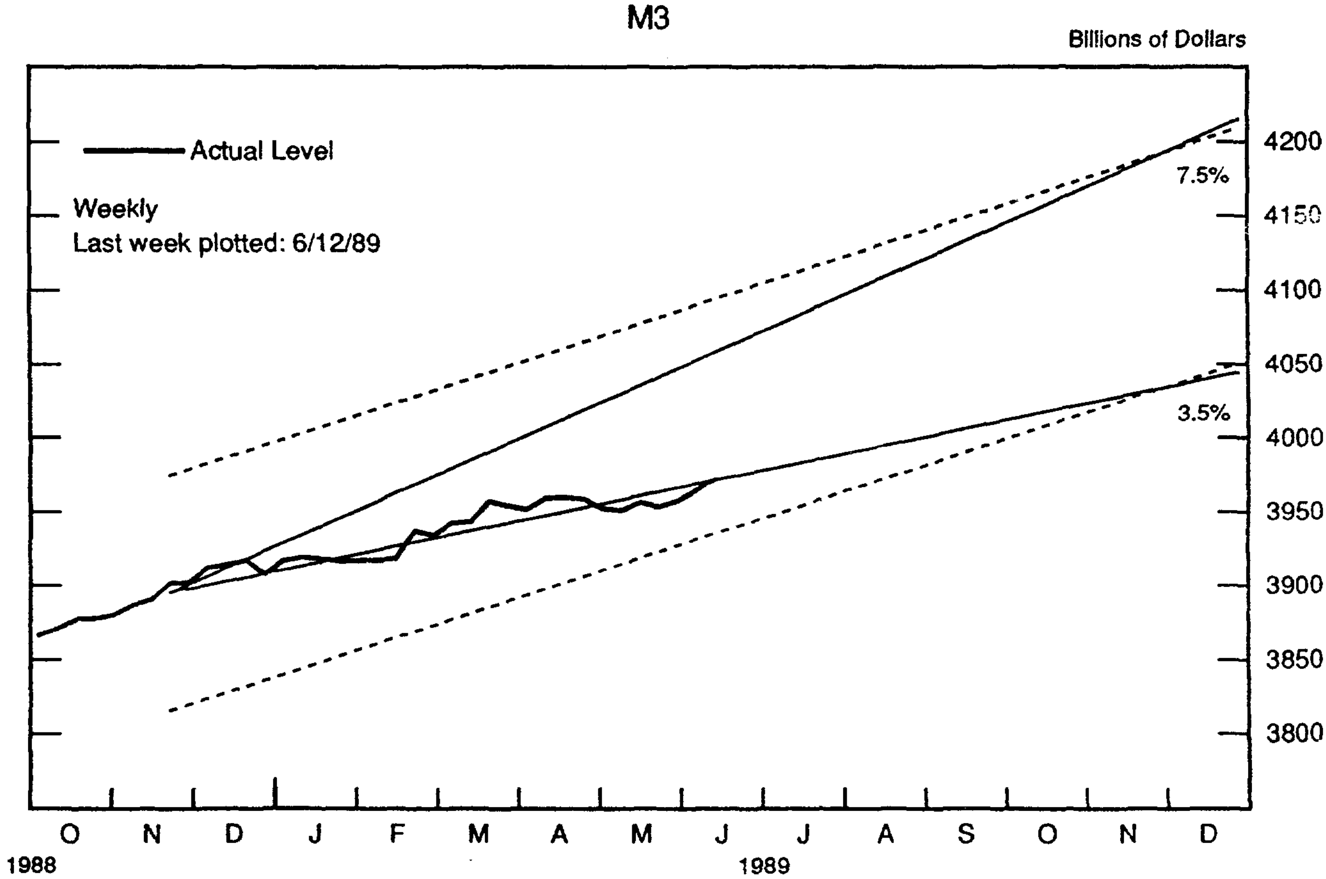
1. Amounts shown are from fourth quarter to fourth quarter.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Commercial bank savings deposits excluding MMDAs grew during April and May at rates of -19.1 percent and -20 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during April and May at rates of -25.3 percent and -25.9 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
6. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
7. Consists of borrowing from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowing from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
8. Consists of Treasury demand deposits and note balances at commercial banks.

p - preliminary

M2


Billions of dollars
Actual Level
Weekly
Last week plotted: 6/12/89
7%
3%
3300
3250
3200
3150
3100
3050
3000
O N D J F M A M J J A S O N D
1988
1989

M3


Billions of Dollars
Actual Level
Weekly
Last week plotted: 6/12/89
7.5%
3.5%
4200
4150
4100
4050
4000
3950
3900
3850
3800
O N D J F M A M J J A S O N D
1988
1989

Earlier in the year, rising market interest rates had buoyed the growth of small time deposits at the expense of more liquid deposits while rates on these latter accounts adjusted only sluggishly to market movements. Now, however, given that market rates have fallen, the opportunity costs of holding most types of M2 balances have dropped. As households respond to falling opportunity costs and rebuild their liquid balances, M2 has begun to recover from its mid-May lows, as can be seen in recent weekly data (chart).

The outflows of core deposits in May were offset by inflows of Treasury deposits, a non-M3 source of funds. Banks were thus able to reduce their reliance on large time deposits, which slowed to a 9 percent rate of growth from the double-digit rates of the preceding months, and turned instead to non-M3 borrowings, such as federal funds from nonbank institutions, as well as Treasury tax and loan balances. Offsetting some of this weakening, institution-only money market funds, which were not affected by the swings related to individual tax payments, enjoyed strong inflows in May. Like M2, weekly data suggest a rebound in M3 growth, returning this aggregate to the lower bound of its annual range (chart).

Bank credit grew at a 7-3/4 percent annual rate in May, about its pace in the first quarter but 5 percentage points above April's growth. Holdings of U.S. government securities expanded more rapidly, and the runoff of other securities decelerated. Real estate loan growth remained in double digits, and consumer loans grew at an 8-1/2 percent annual rate in May, about their growth in 1988. Business loan growth was up sharply in May to an 11 percent annual rate, with little of this borrowing attributable to merger-related financing; but preliminary data for the first part of June suggest a

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

		1987:Q4 to 1988:Q4	1988 Q4	1989 Q1	1989 Mar.	1989 April	1989 May p	Levels bil.$ May p
		Commercial Bank Credit						
1.	Total loans and securities at banks	7.3	6.1	7.8	6.4	2.9	7.8	2476.8
2.	Securities	4.7	5.0	1.9	13.3	-1.1	5.4	560.0
3.	U.S. government securities	7.4	10.4	8.7	22.8	6.2	10.0	375.3
4.	Other securities	.2	-5.1	-10.8	-5.1	-15.3	-3.9	184.7
5.	Total loans	8.1	6.4	9.5	4.4	4.2	8.5	1917.0
6.	Business loans	6.3	4.0	9.9	-3.9	3.3	11.1	621.9
	Security loans	-6.2	15.3	51.4	-32.6	-103.3	-58.0	37.4
8.	Real estate loans	13.4	11.0	12.5	12.7	16.3	10.5	700.9
9.	Consumer loans	8.6	8.3	5.2	6.7	7.3	8.6	364.7
10.	Other loans	.2	-5.9	-2.5	5.6	-17.9	6.9	192.1
		Short- and Intermediate-Term Business Credit						
11.	Business loans net of bankers acceptances	6.4	4.1	10.3	-3.3	3.5	10.8	619.3
12.	Loans at foreign branches [2]	30.3	11.4	51.9	168.2	-4.9	69.1	25.7
13.	Sum of lines 11 & 12	7.1	4.4	11.7	2.3	3.6	12.8	645.0
14.	Commercial paper issued by nonfinancial firms	15.6	50.0	37.5	31.6	45.6	35.7	121.0
15.	Sum of lines 13 & 14	8.2	10.3	15.5	6.8	9.8	16.4	766.0
16.	Bankers acceptances: U.S. trade related [3,4]	-6.8	11.0	16.7	6.9	-3.4	10.3	35.2 [5]
17.	Line 15 plus bankers acceptances: U.S. trade related	7.4	10.3	15.5	6.8	9.2	16.2	801.2 [5]
18.	Finance company loans to business [3]	12.4	12.1	8.0	10.6	18.6	n.a.	242.5 [6]
19.	Total short- and intermediate-term business credit (sum of lines 17 & 18)	8.5	10.8	13.7	7.7	11.5	n.a.	1033.1 [6]

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

deceleration, owing to the paydown of some loans associated with the RJR-Nabisco acquisition.

Business Finance

Net borrowing by nonfinancial firms apparently strengthened in May from its subdued April pace. The stronger growth in business loans at commercial banks was accompanied by continued heavy issuance of commercial paper. Only low-grade commercial pa r, a small segment of the overall market, was affected by the recent announcement that Integrated Resources Inc., a diversified financial services firm, would not make payment on about $300 million of outstanding paper as it matures. Boosted by the RJR-Nabisco buyout financing in early May and by falling interest rates throughout the month, gross public bond issuance posted a sizable gain in May, which has continued into June.

To minimize borrowing costs, recent bond offerings have increasingly included poison put indentures to ease investors' concerns about event risk and convertibility features to take advantage of the recent runup in equity prices. Additionally, several financial and a few nonfinancial borrowers have issued a large volume of bonds that include straight put options that allow the owner unconditionally to sell the bond back to the issuer at par after a specified date; as opposed to the poison put, the straight put option limits investor exposure to both event and interest rate risks.

Yields on junk bonds, which increased by 20 to 30 basis points in advance of RJR-Holdings' $5.2 billion issuance in early May, have since fallen by about 30 basis points, a little less than the yields on investment-grade bonds. Despite the recent drop in junk bond yields,

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

	1987 Year	1988 Year	1989 Q1[p]	1989 Mar.[p]	1989 Apr.[p]	1989 May[p]	1989 June[e]
Corporate securities - total[1]	24.08	22.23	18.49	25.63	14.49	20.12	22.04
Public offerings in U.S.	21.89	20.21	15.94	23.04	11.99	18.04	20.00
Stocks--total[2]	4.45	3.53	1.50	.60	.99	1.64	3.00
Nonfinancial	2.32	1.14	.59	.30	.68	.94	1.13
Utility	.57	.24	.10	.00	.26	.45	.20
Industrial	1.75	.90	.49	.30	.42	.49	1.10
Financial	2.12	2.39	.91	.30	.31	.70	1.70
Bonds--total[1]	17.44	16.68	14.44	22.44	11.00	16.40	17.00
Nonfinancial	6.61	6.08	4.51	7.81	4.00	10.10	6.00
Utility	2.02	1.77	.60	.18	2.05	.50	4.70
Industrial	4.59	4.31	3.91	7.63	1.95	9.60	1.30
Financial	10.83	10.60	9.93	14.63	7.00	6.30	11.00
By quality[3]							
Aaa and Aa	3.25	2.68	3.28	5.80	3.85	2.00	4.15
A and Baa	5.20	5.57	4.91	8.76	4.30	5.30	8.30
Less than Baa	2.77	2.51	1.91	2.22	1.30	7.60	1.00
No rating (or unknown)	.07	.07	.02	.00	.10	0.00	.15
Memo items:							
Equity-based bonds[4]	.87	.28	.12	.04	.10	1.02	.60
Mortgage-backed bonds	5.19	4.69	2.66	3.70	.60	.50	.90
Other asset-backed	.96	1.26	1.66	1.96	.87	1.00	2.50
Variable-rate notes	1.88	1.19	.96	1.47	.85	3.42	.80
Bonds sold abroad - total	2.03	1.93	2.54	2.58	2.50	2.00	2.00
Nonfinancial	.94	.69	.89	.65	.60	.30	.50
Financial	1.09	1.24	1.65	1.93	1.90	1.70	1.50
Stocks sold abroad - total	.16	.09	.01	.01	.00	.08	.04
Nonfinancial	.12	.08	.01	.01	.00	.08	.04
Financial	.04	.01	.00	.00	.00	.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. Excludes equity issues associated with equity for equity swaps that have occured in restructurings. Such swaps totaled $2.2 billion in 1989 Q1 and $4.2 billion in 1989 Q2.
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.

issuance has been light since mid-May and the calendar of prospective offerings suggests little pickup in the near term.

Spurred by a strong dollar, falling interest rates, and brightened prospects for a soft landing, the stock market rallied, reaching postcrash highs. Most major stock indexes are now about 3 to 5 percent above their levels at the last FOMC meeting. Gross equity issuance has picked up in recent weeks but remains anemic. Owing to a slowdown in merger activity in the current quarter, net equity retirements are projected at roughly a $125 billion rate, down from a $180 billion annual rate in the first quarter. Net retirements, however, should rise over the second half of the year; the calendar of proposed mergers and acquisitions has begun to build.

Municipal Securities

Issuance of long-term municipal securities is projected to total about $10 billion in June, sharply higher than May's slow pace. The stronger June volume reflects both a pickup in issuance of bonds for new capital and an increase in the volume of refunding bonds, encouraged by the appreciable drop in long-term municipal yields over the spring.

The decline in municipal yields has not fully matched that in Treasury bond rates. The ratio of tax-exempt to Treasury yields, which fell to a five-year low of 0.85 in May, has since risen to 0.89. Apart from the usual greater responsiveness of Treasury rates to general changes in financial market sentiment, the Treasury sector probably has benefited most from the flight from foreign assets as well as from more favorable near-term supply conditions than in the municipal sector.

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

	1988		1988		1989		1989	
	Year	Q2	Q3	Q4	Q1	Apr.	May[p]	June[f]
Total offerings[1]	10.88	11.73	11.50	11.58	9.20	12.68	7.48	--
Total tax-exempt	10.60	11.41	11.30	11.21	8.92	12.40	7.35	14.00
Long-term	9.01	9.20	8.00	10.09	7.77	7.46	6.58	10.00
Refundings[2]	2.75	3.18	1.87	2.91	2.49	1.40	1.12	3.00
New capital	6.26	6.02	6.93	7.18	5.28	6.06	5.46	7.00
Short-term[3]	1.59	2.21	2.52	1.12	1.15	4.94	.77	4.00
Total taxable	.28	.32	.23	.37	.28	.28	.13	--
Memo item:								
Bank-qualified[4]	.58	.80	.63	.40	.42	.54	.40	--

p--preliminary. f--forecast.
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. Bank-qualified bonds are the only tax-exempt bonds that banks can purchase and still deduct 80 percent of the carrying costs. Bonds are bank-qualified if issued by local governments that do not expect to issue more than $10 million of municipal bonds during the year.

Treasury and Sponsored-Agency Financing

The staff estimate of the second-quarter federal budget surplus has been revised upward, to $20.5 billion, and its distribution among months shifted as the dimensions of the surge in tax receipts in April have become clearer. Treasury borrowing dropped sharply in the second quarter but still remained positive on a net basis, as the Treasury used its surplus to build up its cash balances.

In keeping with its usual practice of adjusting bill issuance to variations in cash needs, the Treasury aggressively cut the gross sizes of its weekly bill auctions when the large size of the tax inflows became

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

	1989				
	Q1	Q2[e]	Apr.	May	June[e]
Treasury financing					
Total surplus/deficit (-)	-60.8	20.5	40.6	-25.5	5.4
Means of financing deficit:					
Net cash borrowing from the public	37.9	8.5	-1.3	10.2	-.5
Marketable borrowings/ repayments (-)	32.0	5.2	-2.1	8.7	-1.5
Bills	3.0	-20.2	-6.5	-4.0	-9.6
Coupons	29.0	25.3	4.4	12.7	8.1
Nonmarketable	6.0	3.4	.8	1.5	1.0
Other borrowing[2]	-.2	-.1	.0	.0	.0
Decrease in the cash balance	19.0	-29.7	-38.8	21.4	-12.3
Memo: Cash balance at end of period	14.7	44.3	53.5	32.1	44.3
Other[3]	4.0	0.7	-.5	-6.1	7.3
Federally sponsored credit agencies, net cash borrowing[4]	15.1	-	-	-	-
FHLBs	14.1	-	4.2	2.2	-
FNMA	-.8	-	.0	.7	-
Farm Credit Banks	-1.1	-	-.4	-	-
FAC	.0	-	.2	.0	.0
FHLMC	.6	-	-.7	-	-
FICO	.6	-	.5	.0	.5
SLMA	1.7	-	-	-	-

1. Data reported on a not seasonally adjusted, payment basis.
2. Securities issued by federal agencies under special financing authorities (primarily FSLIC).
3. Includes checks issued less checks paid, accrued items and other transactions.
4. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
e--staff estimate.
Note: Details may not add to totals due to rounding.

evident. The gross auction size was moved down in a series of steps from $14.4 billion to $12.8 billion, resulting in an estimated $13 billion paydown in weekly bills, after three consecutive quarters in which the weekly auctions were needed to raise new cash. The coupon auctions continue to raise new cash, but at a slightly reduced pace, owing to the $250 million to $500 million cutbacks in gross auction sizes. The staff anticipates that, absent congressional action, Treasury borrowing will begin to be constrained in early August as outstanding debt nears the $2.8 trillion ceiling.

In the market for securities of federally sponsored credit agencies, borrowing by the Federal Home Loan Banks appears to have fallen off sharply from earlier in the year owing to the drop in their advances to thrifts in the second quarter. Public offerings of FHLB bonds in June were $2.2 billion, the smallest total since April 1988 and down markedly from the $6 billion average gross size over the preceding five months. Reflecting this reduced issuance, spreads on FHLB securities over Treasuries narrowed sharply. For example, the spread on one-year paper fell from 30 basis points in May to 10 basis points at the June offering, while spreads on longer maturities have fallen by less.

Thrift Institutions

The losses of thrift institutions in the first quarter of 1989 totaled $3.4 billion, and the FHLBB revised the previous quarter's losses upward by $900 million, to $3.2 billion.[1] Although the earnings of GAAP-solvent thrifts increased to $800 million in the first quarter of 1989, the

1. Amended reports filed by six institutions accounted for $600 million of the $900 million revision to the fourth-quarter figure.

industry's overall profits were pulled down by the $4.2 billion of losses incurred by GAAP-insolvent thrifts. As a result of continuing aggregate losses, the industry GAAP capital-to-asset ratio declined to 2.9 percent in the first quarter of 1989 from 3.4 percent at year-end. Tangible capital, which excludes goodwill and other intangible assets, totaled only 1.4 percent of industry assets. For GAAP-solvent thrift institutions, the tangible-capital-to-asset ratio stood at 3.3 percent, while for GAAP-insolvent thrifts it was -15 percent.

After strong runoffs during the first quarter, total thrift deposits increased in April. Deposit inflows were flat in May, but this apparently reflected the overall weakness in M2 rather than any condition specific to thrifts; thrift deposits have increased in the first half of June at a rate in line with that of commercial banks, perhaps owing to more competitive deposit pricing by thrift institutions. Rates on retail deposits at thrift institutions have generally responded more sluggishly to the decline in market rates than those at commercial banks, resulting in a widening of the rate advantage that thrifts offer. Advances from Federal Home Loan Banks (FHLBs) mirrored the turnaround in deposits, rising rapidly over the first quarter and registering sizable declines thereafter. This lessened need for funds was reinforced by an administrative change by several Federal Home Loan Banks, including Dallas, which lowered the ceiling on advances to member institutions as a share of their FHLB stock.

Mortgage Markets

Available data suggest that the net growth in mortgage debt outstanding in the second quarter probably remained near the moderate first-quarter rate of increase, a situation consistent with the recent weakness in home sales

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

	Mortgage transactions			Net change in mortgage assets[1]		
	Origina-tions	Commit-ments	Sales	Total	Mortgage loans	Mortgage-backed securities
1986	22.1	19.8	14.1	4.7	1.3	3.4
1987	21.1	20.1	10.3	6.1	2.4	3.7
1988	19.9	19.4	8.8	4.8	3.8	1.0
1988-Q2	19.6	18.8	9.4	6.1	4.1	2.0
Q3	21.4	20.9	8.5	6.4	5.7	.7
Q4	19.8	19.9	9.5	3.9	2.7	1.2
1989-Q1 r	20.5	19.2	8.2	4.3	2.5	1.8
1989-Jan.	21.3	19.3	7.6	.7	2.6	-1.9
Feb. r	19.6	19.8	8.6	4.8	1.7	3.1
Mar. r	20.5	18.6	8.5	7.4	3.2	4.2
Apr. p	16.2	14.0	6.1	3.4	4.8	-1.4

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

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

	Federally related pass-through securities			Multiclass securities				
	Total (SA)	Total	ARM-backed	Total	Private issues[1]	FNMA REMICs[2]	FHLMC REMICs	Agency strips
1986	21.3	21.6	.7	4.0	4.0	0	0	0
1987	20.2	19.6	1.2	5.9	5.0	.1	0	.8
1988	12.4	12.6	2.4	7.1	4.2	.9	1.2	.6
1988-Q2	12.1	12.5	3.0	7.7	4.1	1.3	1.2	.5
Q3	13.3	14.9	3.0	6.1	3.7	.7	1.1	.6
Q4	14.6	14.5	2.6	8.0	4.3	1.2	1.8	.7
1989-Q1	16.1	13.7	3.1	6.9	2.5	1.3	2.8	.4
1989-Jan.	14.1	12.1	.9	6.6	2.2	.9	3.5	0
Feb.	15.9	13.7	3.5	4.8	1.7	1.4	1.5	.2
Mar.	18.4	15.4	4.8	9.4	3.6	1.5	3.4	.9
Apr. r	15.3	13.9	3.0	5.7	.4	1.8	1.5	.2
May p	n.a.	n.a.	2.2	4.0	.2	1.4	2.4	0

1. Excludes pass-through securities with senior/subordinated structures.
2. FNMA's first REMIC, a $500 million strip security issued in January 1987, is included in the FNMA REMIC category rather than in the strip category.
r--revised. p--preliminary.

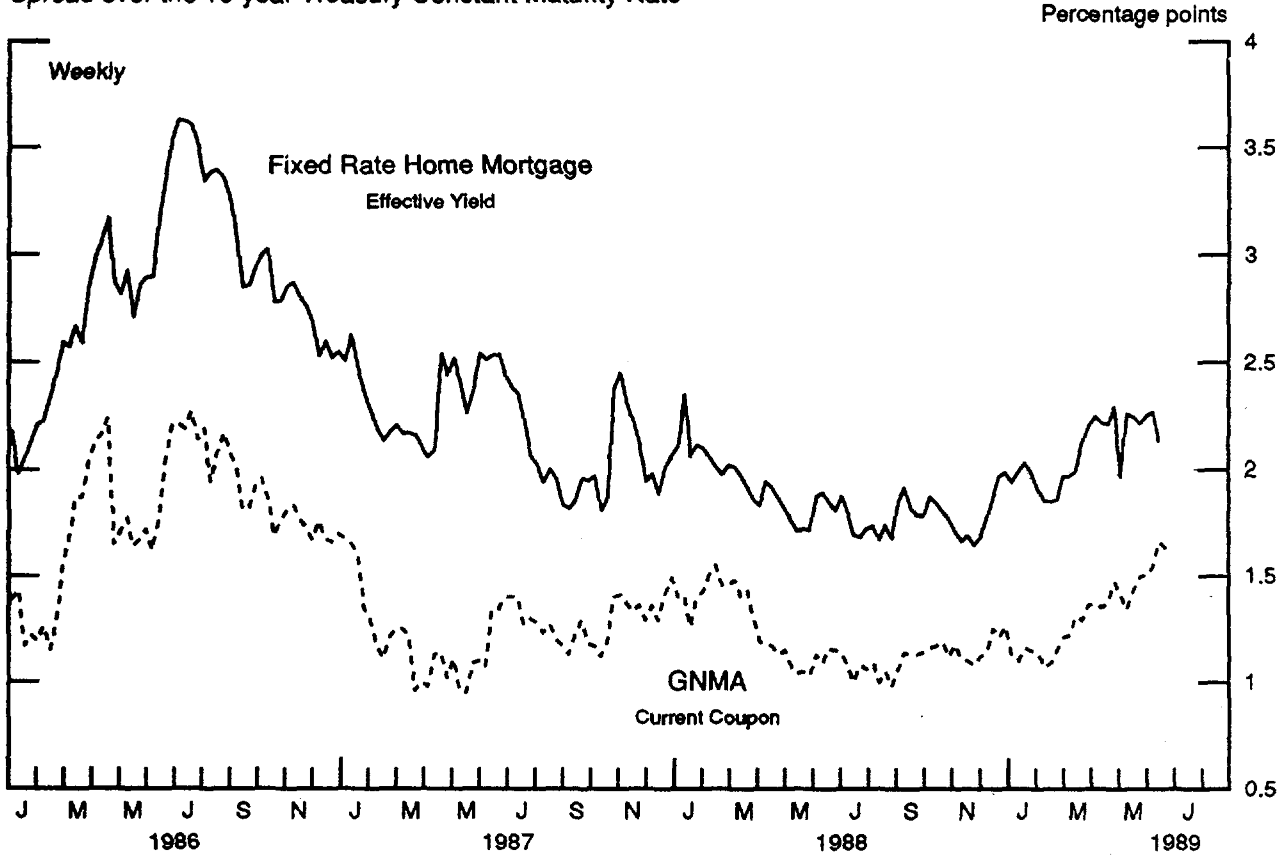
and construction. Net acquisitions of mortgage-related assets by FSLIC-insured institutions were down somewhat in April from the pace earlier in the year, as a runoff in holdings of mortgage-backed securities (MBS) partially offset increases in whole mortgage loans (table). Adjustable-rate mortgages (ARMs) accounted for the bulk of thrift acquisitions of unsecuritized mortgages as these institutions continued to sell off fixed-rate mortgages (FRMs). Mortgage originations at thrifts were down sharply in April to levels last observed in mid-1985. Real estate lending by commercial banks, however, appears to have been maintained in recent months at about the first-quarter pace.

FSLIC-insured institutions have continued their relatively heavy reliance on ARMs, which have accounted for more than two-thirds of their mortgage loan originations in recent months. Average monthly issuance of federally related ARM pass-throughs has been running well ahead of the pace of the past few years. A number of mortgage borrowers have taken advantage of narrowed spreads between short- and intermediate-term rates and have opted for loans indexed to three- and five-year constant maturity Treasury yields. Many of these loans, according to trade reports, are being securitized. Thus, issuance of longer-term ARM securities, in particular, has been strong and may continue at higher levels if the yield curve maintains its current contour. The pickup in issuance of pass-throughs by the agencies has not been confined to ARM-backed securities: Issuance of fixed-rate pass-throughs also has increased to the fastest pace in more than a year.

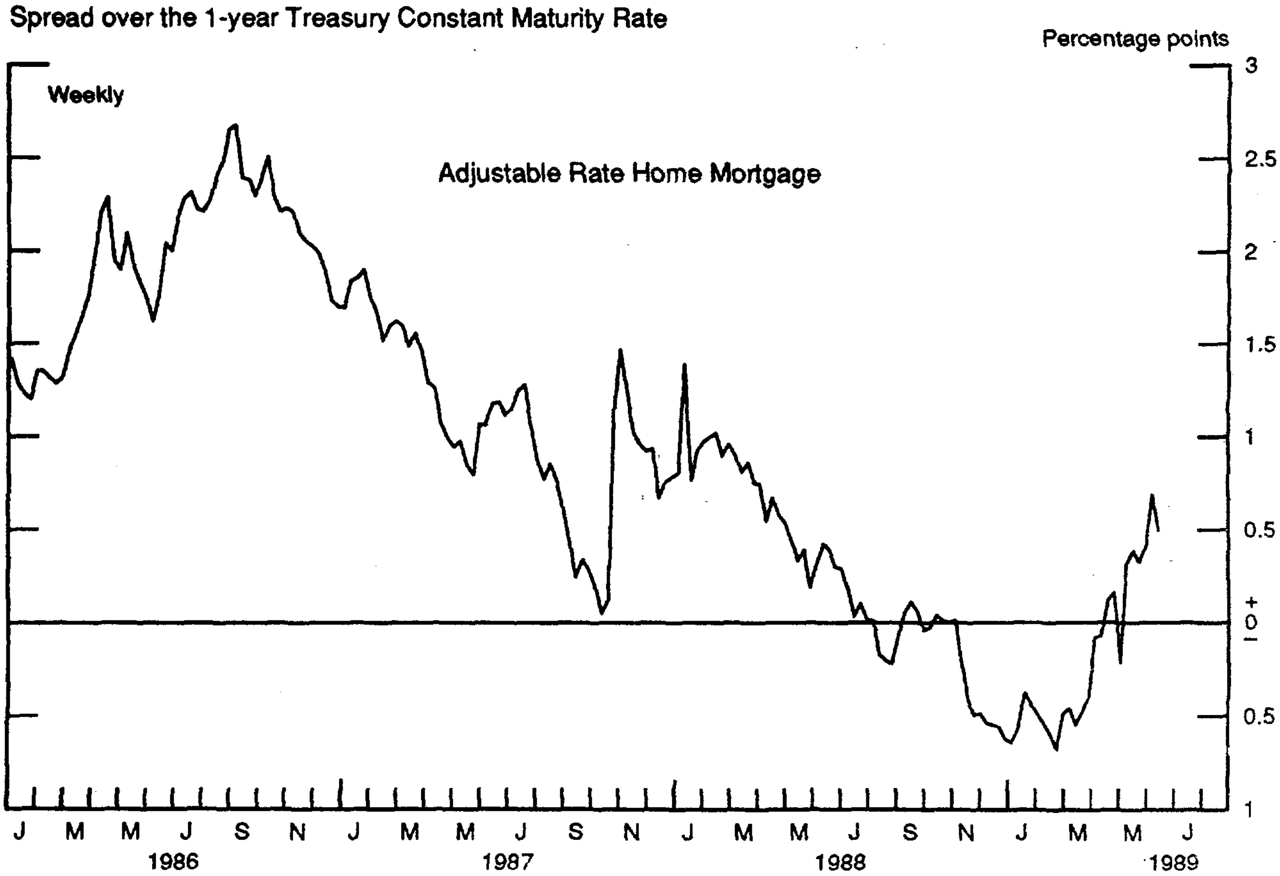
Neither the announcement that Gibraltar Savings Association, operating under regulatory conservatorship, would liquidate a sizable portion of its

Spreads of Mortgage-Related Rates over Treasury Rates*

Spread over the 10-year Treasury Constant Maturity Rate



Spread over the 1-year Treasury Constant Maturity Rate



*--Home mortgage rates through the week of 6/16/89, GNMA through 6/22/89.

$4.4 billion portfolio of conventional pass-throughs nor its subsequent sales of $1-1/2 billion of FHLMC pass-throughs had a lasting effect on securities prices. Nonetheless, rumors that other thrifts will be forced to liquidate their portfolios continue to circulate and have contributed to a further widening of the spreads of mortgage-backed securities to comparable Treasuries since the May FOMC meeting. These increases brought the spread over ten-year Treasuries about 1/2 percentage point above its 1988 lows but left it well within its range of recent years (chart).

In the primary mortgage market, the average contract rate on new commitments for 30-year, fixed-rate conventional home loans is currently 75 basis points below its level at the time of the last FOMC meeting. The average initial rate on ARMs indexed to the one-year constant maturity Treasury yield, meanwhile, has declined 35 basis points over this period, narrowing the initial rate advantage of ARMs over FRMs to 119 basis points, near its five-year low. Moreover, data on ARM pricing suggest that lenders have become less aggressive in pricing those loans. For example, initial ARM rates have exceeded the one-year constant maturity Treasury yield by more than 50 basis points on average in June; in the latter part of 1988 and the first quarter of this year the spread was negative (chart).

Consumer Installment Credit

Growth of consumer installment credit outstanding slowed in April to a 4-3/4 percent annual rate after a 6-1/2 percent March rise (table). Preliminary data for May suggest that credit growth continued at April's reduced pace. The slowing in April occurred in the revolving credit category; although such debt still rose at better than an 11 percent annual rate, the advance was less than half as rapid as in the previous month and

CONSUMER CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)						Net change (billions of dollars)		Memo: Outstanding (billions of dollars)
			1988	1989	1989		1989		1989
	1987	1988	Q4	Q1 r1	Mar. r	Apr. p	Mar. r	Apr. p	Apr. p
Total installment[2]	6.2	8.5	8.0	8.6	6.4	4.7	3.68	2.73	693.8
Installment, excluding auto	5.2	10.7	12.0	9.8	11.1	5.9	3.70	1.98	404.3
Selected types									
Auto	7.5	5.7	2.8	7.0	-.1	3.1	-.01	.75	289.5
Revolving	12.3	13.6	15.5	15.6	27.2	11.6	4.04	1.77	184.4
All other	.1	8.3	9.0	5.1	-1.9	1.2	-.35	.21	219.9
Selected holders									
Commercial banks	7.6	12.7	11.3	4.3	.5	8.2	.13	2.19	320.7
Finance companies	4.7	3.5	6.0	10.0	-2.9	11.0	-.35	1.31	144.4
Credit unions	5.1	7.5	5.7	10.7	8.2	9.8	.60	.72	89.1
Savings institutions[3]	6.6	3.8	-2.6	3.1	-10.2	-16.3	-.53	-.85	61.7
Asset pools (NSA)	n.a.	n.a.	n.a.	63.6	143.8	-26.7	3.58	-.75	32.7
Memorandum:									
Total Consumer Credit	4.9	7.3	8.2	10.0	8.5	5.4	5.33	3.42	761.8

1. Growth rates are adjusted for discontinuity in data between December 1988 and January 1989.
2. Includes items not shown separately.
3. 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		1989			
	1987	1988	Aug.	Nov.	Feb.	Mar.	Apr.	May
At commercial banks[1]								
New cars (48 mo.)	10.46	10.86	10.93	11.22	11.76	...	...	12.44
Personal (24 mo.)	14.23	14.68	14.81	15.06	15.22	...	...	15.65
Credit cards	17.92	17.79	17.79	17.77	17.83	...	...	18.11
At auto finance cos.[2]								
New cars	10.73	12.60	12.64	13.20	13.07	13.07	12.10	...
Used cars	14.61	15.11	15.16	15.75	15.90	16.12	16.39	...

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.

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[1]	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	1.53
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
1988	2.40	2.34	2.21	1.61
1985 - Q1	2.27	2.42	1.62	1.95
Q2	2.32	2.51	1.66	1.83
Q3	2.34	2.81	1.75	1.92
Q4	2.30	2.93	1.85	1.91
1986 - Q1	2.32	2.86	2.01	1.93
Q2	2.50	3.23	1.97	1.98
Q3	2.26	3.23	1.91	1.93
Q4	2.28	3.18	1.89	1.87
1987 - Q1	2.37	2.46 r	1.94	1.84
Q2	2.38	2.37 r	1.86	1.76
Q3	2.35	2.29	1.93	1.61
Q4	2.56	2.33	1.93	1.70
1988 - Q1	2.32	2.58	2.09	1.61
Q2	2.32	2.39	2.21	1.65
Q3	2.42	2.21	2.22	1.60
Q4	2.53	2.18	2.32	1.59
1989 - Q1	2.38	2.53	2.40	1.53

1. Data revised by MBA from 1972 forward.
Sources: American Bankers Association, Federal Reserve Board, Mortgage Bankers Association.
r--revised by ABA to correct misreporting. Series discontinuous between 1986 and 1987.

well under the first-quarter pace. Automobile credit accelerated in response to stronger sales incentives--both cash rebates and reduced interest rates. The growth in auto loans was about evenly split between finance companies and commercial banks. Total consumer credit, including noninstallment loans, decelerated to a 5-1/2 percent annual rate in April from 10 percent in the first quarter.

Measures of strains on household balance sheets continued to present a mixed picture in the first quarter (table). While delinquencies on mortgages and some types of consumer loans at commercial banks were down, filings for personal bankruptcy increased, up 3-1/2 percent from the fourth quarter and 8-1/2 percent from a year earlier. Perhaps reflecting the aging of the low-interest rate loans made in 1985 and 1986, delinquency rates on finance company auto loans rose further to 2.40 percent, but repossessions of autos by finance companies have been relatively stable.

Still adjusting to earlier market movements, interest rates on consumer loans at commercial banks increased 30 to 70 basis points between early February and early May, at a time when open market rates actually fell 1/8 to 1/4 of a percentage point. By May, the most common rate on two-year personal loans had risen 43 basis points to 15.6 percent and the rate on four-year auto loans had increased to 12.4 percent, placing both rates at their highest levels since late 1985. After-tax borrowing costs for many consumers have been further boosted by the phased elimination of the deductibility of interest paid on consumer borrowing. Only 20 percent of this interest expense incurred in 1989 is deductible, and after next year none of this expense will be deductible.

U.S. Merchandise Trade

In April, the seasonally adjusted merchandise trade deficit was $8.3 billion (Census basis, customs valuation); the deficit in March was revised to $9.5 billion from $8.9 billion. The improvement in the trade deficit so far this year reflects the strength of economic activity abroad, the continuing (albeit diminished) positive effects on U.S. price competitiveness of the past depreciation of the dollar, and the temporary favorable effect of the recent rise in the dollar on holding down prices of imports. Data for May will be available on July 18.

Exports in April were 1 percent higher than in March. A decline in agricultural exports from high March levels was more than offset by

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil (nsa)	Non-oil	Balance
1988-Apr	26.0	3.3	22.7	34.8	3.1	31.7	-8.8
May	27.5	3.1	24.3	35.7	3.6	32.1	-8.3
Jun	26.3	3.0	23.3	37.9	3.3	34.6	-11.7
Jul	26.5	3.1	23.4	34.5	3.1	31.4	-8.0
Aug	27.5	3.4	24.1	38.1	3.4	34.7	-10.6
Sep	28.0	3.6	24.4	37.2	3.0	34.1	-9.2
Oct	27.8	3.0	24.8	36.6	2.9	33.7	-8.8
Nov	27.5	3.0	24.5	38.2	2.9	35.3	-10.7
Dec	29.1	3.3	25.8	40.1	3.3	36.8	-11.0
1989-Jan	28.7	3.2	25.5	37.4	3.5	33.9	-8.7
Feb	28.7	3.4	25.3	38.5	3.2	35.2	-9.8
Mar[r]	30.3	3.9	26.4	39.9	3.7	36.2	-9.5
Apr[p]	30.6	3.7	26.9	38.8	4.0	34.8	-8.3

r--revised p--preliminary

increases in most other major trade categories (especially industrial supplies and machinery). Imports declined 3 percent as a rise in oil imports was more than offset by declines in other items (especially imports of automotive products, machinery, and foods). The rise in oil imports was due largely to a 12 percent jump in price as the quantity of oil imported rose only slightly (see the table on oil imports below).

For the first quarter, the deficit was $110.5 billion at an annual rate (balance-of-payments basis), $17.5 billion smaller than in the fourth quarter (revised). The first-quarter deficit was the lowest since 1985-Q1.

Exports rose 6 percent in value and 4 percent in quantity in the first quarter, and follow similarly strong growth in the fourth quarter. Increases in quantity in the first quarter were largely in agricultural exports (especially wheat and corn to the Soviet Union), industrial supplies (primarily fuel of various types), and consumer goods (particularly manufactured durables). By geographic region, most of the increase in the value of exports was to Western Europe, Canada, and Japan. These data include estimates of the commodity distribution of undocumented exports to Canada based on newly available disaggregated data from Canada.

While the value of imports rose marginally in the first quarter, quantity declined 1 percent. The increase in value was accounted for entirely by the rise in oil prices. The average price per barrel rose

U.S. MERCHANDISE TRADE: QUARTERLY DATA
(Billions of dollars, seasonally adjusted annual rates)

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil	Non-oil	Balance
	- - - - - - - - BOP basis (current dollars) - - - - - - - -						
1987	250	30	220	410	43	367	-160
1988	319	38	281	446	39	407	-127
1988-1	306	36	270	440	40	399	-133
-2	314	38	276	440	41	399	-126
-3	322	40	283	444	39	405	-121
-4	335	39	296	463	37	426	-128
1989-1	354	44	310	465	43	421	-110
	- - - - - BOP basis (constant 1982 dollars)[1] - - - -						
1988-1	334	39	295	462	83	378	-128
-2	336	40	297	459	85	374	-123
-3	337	36	301	466	86	380	-129
-4	349	36	313	480	90	390	-131
1989-1	365	41	324	474	88	387	-109
Percent Change:							
Q1/Q1	8.9	3.3	9.8	2.8	5.2	2.2	
Q1/Q4 (not AR)	4.4	12.0	3.5	-1.2	-2.7	-0.8	
	- - - - - - - GNP basis (constant 1982 dollars) - - - - -						
1988-1	329	39	290	463	82	381	-134
-2	339	40	299	459	85	374	-120
-3	346	38	308	471	87	384	-125
-4	352	36	316	486	91	395	-134
1989-1	366	40	326	480	88	392	-114
Percent Change:							
Q1/Q1	11.1	0.5	12.6	3.6	7.3	2.8	
Q1/Q4 (not AR)	3.9	11.0	3.1	-1.3	-2.8	-1.0	

1. Constant dollar estimates are derived using deflators from the GNP accounts.

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

	1988					1989	
	Year	Q1	Q2	Q3	Q4	Q1	Apr
Value (Bil. $)	39.31	40.27	40.99	39.10	36.87	43.34	50.46p
Price ($/BBL)	14.39	15.23	15.20	14.24	12.85	15.53	18.29p
Volume (mbd.)	7.48	7.22	7.37	7.50	7.84	7.65	7.56p

p--Preliminary

more than 20 percent in the first quarter; the increase occurred largely in response to a cut in production by OPEC. In April, the price of imported oil rose $1.97 per barrel; the cumulative increase in the price of imported oil from the low recorded last November through this April has been about $5.70 per barrel. Spot and posted prices peaked in April as markets responded to disruptions in supply caused by accidents in the North Sea and Alaska. Since the peak, spot and posted prices of oil have fallen about $1.00 per barrel, partly in response to an increase in OPEC production. The quantity of imported oil declined in the first quarter and in April from the strong fourth-quarter pace as inventories were drawn down.

The value of non-oil imports declined 1 percent in the first quarter, primarily because of lower quantity. The largest declines in quantity were in consumer goods and automotive products, both of which had increased sharply in the fourth quarter, and in industrial supplies. Most of the decrease in consumer goods was in manufactured nondurables, notably apparel and household goods from Hong Kong, Korea, and Taiwan. The number of passenger cars imported from both Japan and Germany decreased more than 20 percent, while those from Korea rose slightly. Imports of capital goods increased somewhat, almost entirely because of an increase in imports of computers and peripherals.

Import and Export Prices

During the first five months of 1989, the cumulative rise in prices of non-oil imports was 1.2 percent at an annual rate, according to the monthly indexes constructed by the Bureau of Labor Statistics. This relatively flat picture for non-oil import prices during 1989 follows a nearly 10 percent rate of increase in the fourth quarter of last year. During the first five months of this year, the trade category showing the largest increase was consumer goods (3.6 percent AR), only prices of automotive imports declined (1.3 percent AR). A small increase in prices in May followed a small decline in April; for the first quarter, non-oil import prices rose 1.6 percent at an annual rate.

The increase in the price of exports during the first five months of 1989 was 4.1 percent at an annual rate. The rise in export prices in May was due entirely to a sharp rise in agricultural prices (reversing a drop in the price of agricultural exports that had caused a decline in total export prices in April). The price of total exports resumed its upward trend in the first quarter following a slight decline in the preceding quarter, largely due to a turnaround in the indices for food, fuels, and crude materials.

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

	1989-Q1 / 1988-Q1	Quarters (AR) 1988 Q3	1988 Q4	1989 Q1	Months 1989 Apr	1989 May
					(monthly rates)	
	BLS Prices					
Imports, Total	5.1	-5.0	8.2	7.0	0.9	0.7
Foods, Feeds, Bev.	0.2	-3.5	5.4	-1.0	-0.7	1.9
Industrial Supplies	9.3	-10.2	5.1	24.9	3.1	1.8
Capital Goods	2.9	-6.0	10.6	0	0.4	-0.2
Automotive Products	4.4	0.6	10.6	-0.3	-0.4	-0.1
Consumer Goods	3.5	-4.1	7.9	3.5	0.3	0.3
Memo:						
Oil	11.2	-32.8	-8.7	103.2	13.7	3.9
Non-oil	4.5	-2.5	9.6	1.6	-0.2	0.3
Exports, Total	6.3	9.1	-1.1	5.9	0.1	0.4
Foods, Feeds, Bev.	22.4	63.5	-20.9	11.4	-3.3	3.5
Industrial Supplies	5.5	1.4	-0.3	6.6	0.9	-0.4
Capital Goods	3.3	2.3	3.1	3.8	0.2	0.0
Automotive Products	3.6	6.6	4.6	1.5	0.0	-0.1
Consumer Goods	4.8	2.6	5.9	9.2	0.0	0.2
Memo:						
Agricultural	16.1	39.9	-20.2	12.5	-2.3	3.1
Nonagricultural	4.8	4.1	2.9	4.7	0.4	-0.2
	Prices in the GNP Accounts					
Fixed-Weighted						
Imports, Total	4.6	-0.8	2.0	11.3	--	--
Oil	2.3	-21.9	-32.4	113.0	--	--
Non-oil	4.9	2.4	7.1	2.8	--	--
Exports, Total	5.2	13.8	0.8	-1.1	--	--
Ag.	16.8	65.8	-5.8	-2.9	--	--
Nonag.	3.0	5.4	2.2	-0.7	--	--
Deflators						
Imports, Total	2.7	-1.8	5.3	6.2	--	--
Oil	2.3	-21.9	-32.4	113.0	--	--
Non-oil	3.2	0.1	10.1	-1.2	--	--
Exports, Total	6.2	9.9	1.0	4.9	--	--
Ag.	16.9	65.8	-5.8	-2.9	--	--
Nonag.	4.9	4.1	2.4	5.6	--	--

U.S. Current Account: 1989-Q1

The U.S. current account deficit in 1989-Q1 widened $8.0 billion (SAAR) from the fourth-quarter level. The increase occurred because of a large negative swing from capital gains to capital losses on assets denominated in foreign currencies, as the dollar's appreciation in 1989-Q1 lowered the dollar value of foreign-currency denominated assets, liabilities, depreciation, and inventory charges on the books of the foreign affiliates of U.S. firms. Excluding the volatile capital gains and losses, the current account improved by $22.4 billion in the first quarter.

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

	1988 Year-r	1988 Q4-r	1989 Q1-p	$ Change Q1-Q4
Trade balance	-127.2	-128.1	-110.6	17.5
Exports	319.3	334.9	354.0	19.1
Imports	446.5	463.0	464.5	1.5
Investment income, net	2.2	18.0	-14.0	-32.0
Direct investment, net	31.5	50.1	19.5	-30.7
Capital gains or losses[1]	-1.0	15.8	-14.6	-30.5
Other direct investment	32.5	34.3	34.1	-0.2
Portfolio income, net	-29.3	-32.2	-33.5	-1.3
Military, net	-4.6	-6.4	-5.9	0.5
Other services, net	17.7	21.9	21.4	-0.5
Unilateral transfers	-14.7	-20.1	-13.7	6.4
Current account balance:				
Published	-126.5	-114.7	-122.7	-8.0
Excluding capital gains and losses	-125.4	-130.5	-108.1	22.4

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

Nearly all of the $22.4 billion improvement in the adjusted current account deficit resulted from an improvement in the trade balance; the remainder was primarily a reduction in unilateral transfer payments from a high level in the fourth quarter when Israel once again drew in the first quarter of fiscal year 1989 nearly all of the grant funds provided by the U.S. government. Net income on private portfolio investment was little changed, though the gross flows were boosted by higher U.S. interest rates.

Receipts from foreigners for both travel and passenger-fare services declined a bit in the first quarter, following nine consecutive quarters of increases, while payments to foreigners for travel services increased about 2 percent; these figures included new estimates for travel and passenger fare receipts and payments based on an ongoing in-flight survey by the U.S. Travel and Tourism Administration. In addition, the levels of other private service receipts and payments were revised upward substantially (based on new surveys of selected service transactions with unaffiliated foreigners, and estimates for U.S. students' expenditures abroad and foreign students' expenditures in the United States). All these revisions added $10 billion in net receipts to service transactions in 1988; the adjustments were carried back to 1981.

U.S. International Financial Transactions

Private securities transactions continued to produce net capital inflows in April (line 2 of the U.S. International Transactions table) as foreign demand for U.S. corporate and government agency bonds

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

	1987 Year	1988 Year	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Feb.	1989 Mar.	1989 Apr.
Private Capital										
Banks										
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	47.5	23.0	-1.8	16.5	-1.1	9.4	-4.9	6.2	4.6	*
Securities										
2. Private securities transactions, net[1]	36.4	15.3	-2.2	10.9	5.7	0.9	6.0	3.2	2.3	2.6
a) foreign net purchases (+) of U.S. corporate bonds	26.4	26.9	2.6	8.9	6.4	9.0	8.9	4.6	2.9	3.7
b) foreign net purchases (+) of U.S. corporate stocks	16.8	0.4	*	1.1	1.3	2.0	0.1	-0.3	0.2	*
c) U.S. net purchases (-) of foreign securities	-6.9	-12.0	-4.9	1.0	-2.0	6.1	-3.0	-1.1	-0.8	-1.2
3. Foreign net purchases (+) of U.S. Treasury obligations	-7.3	20.5	6.0	5.6	3.5	5.4	8.8	4.7	1.8	-1.6
Official Capital										
4. Changes in foreign official reserves assets in U.S. (+ = increase)	47.7	40.1	25.0	6.4	-2.0	10.8	7.8	2.5	3.3	5.4
a) By area										
G-10 countries (incl. Switz.)	38.8	15.5	17.7	-0.8	-6.8	5.3	*	0.3	1.5	2.7
OPEC	-8.9	-3.4	-1.5	-1.7	-0.8	0.7	6.8	3.9	2.6	-0.7
All other countries	17.8	28.0	8.8	8.9	5.6	4.8	1.0	-1.7	-0.7	3.3
b) By type										
U.S. Treasury securities	43.2	41.7	27.7	5.9	-3.8	11.9	4.6	4.0	3.8	-0.2
Other[2]	4.5	-1.6	-2.8	0.6	1.8	-1.1	3.2	-1.5	-0.5	5.5
5. Changes in U.S. official reserve assets (+ = decrease)	9.1	-3.6	1.5	*	-7.4	2.3	-4.0	-0.5	-1.7	-0.3
Other transactions (Quarterly data)										
6. U.S. direct investment (-) abroad[4]	-44.2	-17.5	-6.1	2.4	-4.9	-8.9	-3.7	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.[4]	46.9	58.4	9.6	13.9	11.9	23.0	14.4	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[3,4]	5.7	0.9	-0.5	-6.5	2.6	5.2	-7.1	n.a.	n.a.	n.a.
9. U.S. current account balance[4]	-143.7	-126.5	-32.0	-33.5	-32.3	-28.7	-30.7	n.a.	n.a.	n.a.
10. Statistical discrepancy[4]	1.9	-10.6	0.5	-15.7	24.0	-19.4	13.4	n.a.	n.a.	n.a.
MEMO:										
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-159.5	-127.2	-33.4	-31.4	30.3	-32.0	-27.6	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. Line 2a includes all U.S. bonds other than Treasury obligations.
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 to 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.

remained strong (line 2a). The downward trend in long-term dollar interest rates since March together with the upward trend in the foreign exchange value of the dollar since December have made U.S. dollar bonds attractive with prospects for capital gains on both the price of the bond and the currency translation -- motivations that intensified in May and early June. During the first four months of 1989, net foreign purchases of U.S. corporate and government agency bonds totaled $12-1/2 billion, well above the average rate during 1988. Private foreigners also purchased net U.S. Treasury bonds in April. They sold bills, however, producing net overall sales of Treasury securities in April of $1-1/2 billion (line 3). For the year through April, private net purchases of Treasury securities totaled $7 billion, a rate similar to last year's.

Foreign net purchases of U.S. corporate stocks were negligible in April and totaled only $0.1 billion for 1989 through April (line 2b). This rate is similar to that of 1988, but is down significantly from 1987 when foreign transactions in U.S. stocks produced an inflow of $17 billion. U.S. residents bought net $1 billion in foreign securities in April, bringing the net outflow for the first four months to $4-1/4 billion.

Foreign official net capital inflows in April were $5-1/2 billion (line 4), bringing the total official inflow for the first four months of 1989 to $13 billion. Increases in OPEC reserves account for about one-half of this total; inflows from G-10 countries account for one-fifth, despite sizable intervention sales of dollars during the period.

The remainder is a mix of outflows by Latin American countries and inflows by Taiwan, Korea, and Spain. Partial data from FRBNY indicate that official reserves in the United States declined almost $4 billion in May, reflecting very large intervention sales of dollars in the month.

Net capital inflows through the banking system were negligible in April after posting large inflows in February and March (line 1 of the Summary table). In April, strong growth in time deposits and slower growth in business and securities loans allowed U.S. banks to reduce net Eurodollar borrowing. Through the first four months of 1989, there has been a net outflow through the banking system of almost $5 billion. Credit extended to U.S. nonbanks from banks outside of the United States rose slightly in April and by $1 billion in May (line 2 of the International Banking table, below) as the prime-LIBOR spread widened 70 basis points during the two months.

Recently released U.S. balance-of-payments data report large foreign direct investment in the United States in the first quarter of 1989 (line 7 of the Summary table). The total for the fourth quarter of 1988 was also revised up substantially because of late reports. U.S. direct investment abroad (line 6) was depressed in both the first quarter of 1989 and the year 1988, in part by the sale of assets by Texaco. However, plant and equipment expenditures by the foreign affiliates of U.S. companies increased sharply in 1988 and are expected to remain high in 1989, indicating continued expansion of the activities of U.S. firms abroad.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1986	1987	1988				1989				
	Dec.	Dec.	Mar.	June	Sept.	Dec.	Jan.	Feb.	Mar.	Apr.	May
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	22.3	-10.9	8.7	-4.8	-4.9	-4.9	-3.4	-6.1	-2.9	3.4	1.6
(a) U.S.-chartered banks	31.7	15.2	27.8	17.0	16.6	21.6	21.1	18.6	20.4	23.7	22.7
(b) Foreign-chartered banks	-9.4	-26.1	19.0	-21.8	21.5	-26.5	-24.5	-24.7	-23.3	-20.3	-21.1
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	16.8	15.8	19.1	19.7	21.4	21.2	19.8	21.0	24.0	24.2	25.4
3. Eurodollar Holdings of U.S. Nonbank Residents	124.5	132.6	128.9	138.1	141.1	145.3	143.9	143.1	144.2	143.5	142.0

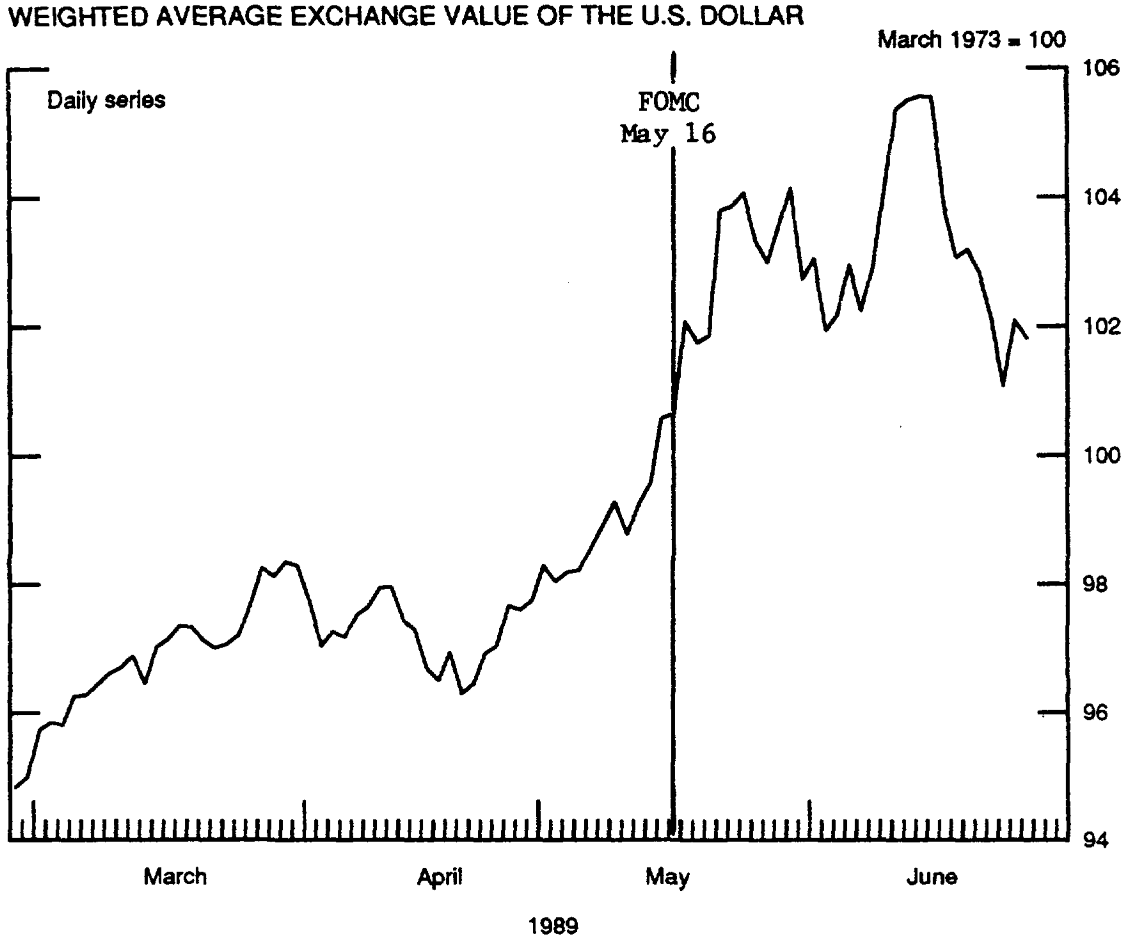
1. Includes term and overnight Eurodollars held by money market mutual funds. Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices.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

The statistical discrepancy in the U.S. international transactions accounts (line 10) for past years has been reduced substantially by revisions to recorded capital flows and by revised estimates of U.S. service receipts and payments -- discussed above in the section on the U.S. current account. For 1987 the discrepancy was reduced from an inflow of $18-1/2 billion to an inflow of $2 billion. For 1988 the discrepancy was revised from an inflow of $16-1/2 billion to an outflow of $10-1/2 billion, owing mostly to a $20 billion revision to the preliminary figure for the fourth quarter. The preliminary figure for the first quarter of 1989 is an inflow of $13-1/2 billion.

Foreign Exchange Markets

Between the May FOMC meeting and June 14, the dollar rose 5 percent to a 2-1/2 year high against the mark, DM 2.0470, and a 1-1/2 year high against the yen, Y 151.90. Since reaching those highs, however, the dollar has retraced much of its gains in the past two weeks. On balance, the weighted-average exchange value of the dollar in terms of the other G-10 currencies has risen about 2 percent since the May 16 FOMC meeting, as shown in the accompanying chart. The dollar has risen 1-1/2 percent against the mark, 4-1/2 percent against the yen, and 5-1/4 percent against sterling. Better-than-expected news on the U.S. trade deficit initially underpinned the dollar's rise. In addition, political events in China and Japan, and expectations of capital gains in the U.S. bond market, temporarily generated increased demand for U.S. assets, even as interest differentials narrowed. The dollar's sharp decline in the last two weeks of the inter-meeting period did not appear to be

WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



based on any new economic data nor even on a re-assessment of economic fundamentals.

Intervention during the inter-meeting period was extremely large, with total U.S. sales of $9 billion substantially exceeding U.S. sales during the episode of dollar strength last summer.

Interest rate differentials between U.S. and foreign assets narrowed during the inter-meeting period as U.S. interest rates eased, especially U.S. long-term rates which declined about 70 basis points. Japanese call money rose 85 basis points and Japanese three-month CD rates increased 45 basis points as the Bank of Japan raised its discount rate 3/4 percentage point to 3-1/4 percent. Japanese long-term rates were little changed. In Germany, call money firmed 15 basis points while the three-month interbank rate and the average of bond yields each eased 15 basis points. In England, the three-month interbank rate rose 130 basis points, as the Bank of England raised its money-market dealing rate 1 percentage point to 13-7/8 percent. On May 24, the Swiss National Bank announced a new variable-rate Lombard facility, with the Lombard rate to be set 100 basis points above the average call-money rate of the preceding two days. The Swiss Lombard rate jumped within three days to a peak of 9-1/2 percent, from 7 percent just prior to the new policy, but more recently it has stabilized at around 8 percent.

The Spanish peseta joined the exchange rate mechanism of the EMS on June 19 with a wide band of 6 percent.

. While the peseta is relatively strong now, the wide band allows room for depreciation if that is necessary, given Spain's relatively high inflation rate and large trade deficit.

U.S. bank lending to foreigners

The dollar value of U.S.-chartered banks' claims (all currencies) on all foreigners increased by more than $4 billion (1 percent) in the first quarter of 1989. During this period, the foreign exchange value of the dollar in terms of other G-10 currencies rose by 6 percent. Excluding estimated valuation effects due to changes in the value of the dollar, total claims on foreigners increased by an estimated $10 billion in the first quarter.

U.S. bank claims on non-OPEC developing countries rose by $1 billion in the first quarter. In Latin America, an increase in claims on Brazil of $600 million (3 percent) was more than offset by declines of $500 million each in Argentina and Mexico. Claims of U.S.-chartered banks on other non-OPEC borrowers rose $1.7 billion; in particular, claims on Taiwan rose by $1.3 billion to $4.9 billion.

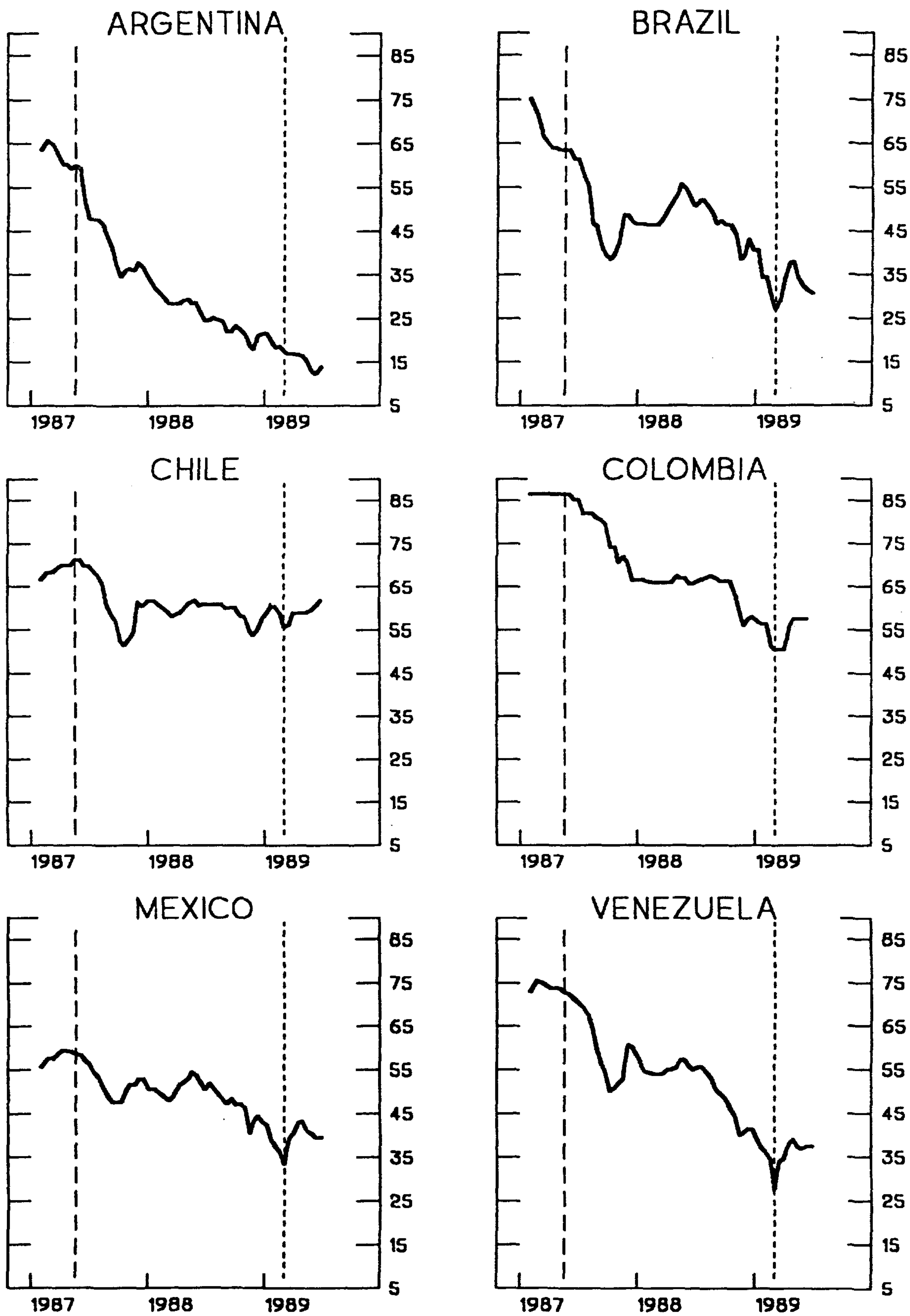
As indicated in the chart with data through June 27, the secondary market prices of bank loans to the heavily indebted countries in general

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

	Changes (no sign = increase)								Out-
	1985	1986	1987	1988	1988			1989	standing
	Year	Year	Year	Year	Q2	Q3	Q4	Q1	3/31/89
Total, all countries	-20.3	-0.3	-3.7	-32.6	-19.5	3.2	-4.9	4.4	353.2
Non-OPEC developing countries	-7.6	-5.1	-1.5	-12.1	-3.0	-4.3	-1.5	1.0	86.5
of which:									
(Latin America)	-3.9	-0.6	-1.7	-9.0	-2.1	-2.4	-2.3	-0.3	61.2
(Asia and Africa)	-3.5	-4.4	0.1	-3.3	-0.7	-2.5	0.8	1.7	25.5
OPEC countries	-3.6	-2.0	-2.2	-0.6	-0.8	1.2	-1.1	0.8	17.3
Eastern Europe	-0.3	-0.9	-0.2	0.7	0.2	-0.1	0.7	-0.2	3.5
Smaller developed countries	-3.7	-4.2	0.5	-5.3	-2.5	-1.0	-1.8	-0.1	20.8
G-10 countries	-2.1	10.6	3.4	-5.5	-6.0	-1.7	5.0	-4.8	149.7
Offshore banking centers	-2.7	-1.6	-7.0	-8.8	-8.4	4.1	-1.0	4.8	50.3
Miscellaneous	-0.4	2.9	3.4	-1.4	0.8	4.7	-5.2	2.7	24.5
Memorandum:									
Total, adjusted for exchange rate changes (staff estimate)	-29	-11	-25	-26	-16	4	-10	10	

Indicative Secondary Market Prices of Bank Loans for Six of the Baker Initiative Countries

(as a percent of face value)



— — — Citibank announcement of $3 billion reserve action, May 18, 1987.

------- Announcement of the Brady Initiative, March 10, 1989.

have been relatively stable during the second quarter of 1989, after rising in the aftermath of the announcement of the Brady initiative on March 10. Nevertheless, there has been more day-to-day price volatility as the market has reacted to the ebb and flow of news about the possible outcome of Mexico's negotiations with its creditor banks.

In mid-June, Mexico returned to the international bond market for the first time since 1982 with a $100 million issue. The five-year Eurobond carried a 10-1/4 percent coupon and an issue price of slightly less than 90, generating an average yield of about 17 percent. This is below the roughly 28 percent yield implicit in the current secondary market price of Mexican debt of about 40 percent of face value. The difference in yields presumably reflects Mexico's good payment record on bonds, a record that is likely to be maintained as long as amounts outstanding remain small. Mexico's total public sector bonds outstanding total less than $4 billion, including about $2.5 billion in bonds exchanged for public sector debt at a discount in March 1988. Mexico's total medium- and long-term public sector bank debt totals approximately $54 billion.

Developments in Foreign Industrial Countries

Real economic activity accelerated in Japan, Germany, France, and Canada in the first quarter, but slowed in the United Kingdom. Capacity utilization also rose, on average, in the first quarter for the major foreign industrial economies while unemployment rates were stable or lower in most countries. Preliminary data from several countries point to somewhat slower growth in the second quarter. Industrial production

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

	Q4/Q4 1987	Q4/Q4 1988	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Jan.	1989 Feb.	1989 Mar.	1989 Apr.	1989 May	Latest 3 months from year ago 2
Canada												
GDP	6.1	3.4	1.1	.8	.6	n.a.	*	*	*	*	*	3.4
IP	8.5	2.5	1.1	.9	-.6	-.2	-.4	.0	.0	n.a.	n.a.	1.1
France												
GDP	2.7	2.9	.4	1.1	.4	n.a.	*	*	*	*	*	2.9
IP	3.2	4.2	.9	2.6	-.2	1.1	.9	-.7	-.6	3.4	n.a.	5.1
Germany												
GNP	2.4	2.6	-.1	1.1	.3	2.9	*	*	*	*	*	4.2
IP	1.5	4.0	.6	1.8	.6	2.4	1.3	.0	-.1	.8	n.a.	5.9
Italy												
GDP	2.7	n.a.	.8	1.5	0.9	n.a.	*	*	*	*	*	3.9
IP	5.7	6.7	-.7	.2	4.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6.7
Japan												
GNP	5.7	4.8	-.8	2.3	.8	2.2	*	*	*	*	*	4.5
IP	8.1	7.6	-.2	2.4	2.0	3.1	1.4	-1.8	5.4	-3.8	.9	8.5
United Kingdom												
GDP	4.2	3.0	.3	.3	.5	.4	*	*	*	*	*	1.4
IP	4.1	2.6	2.0	1.2	.2	-2.0	-1.2	-.7	.4	.5	n.a.	1.4
United States												
GNP	5.0	2.8	.7	.6	.6	1.1	*	*	*	*	*	3.1
IP	5.8	5.0	1.1	1.7	1.1	.5	.3	-.2	.1	.6	-.0	4.2

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

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

	Q4/Q4 1987	Q4/Q4 1988	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 Mar.	1989 Apr.	1989 May	1989 June	Latest 3 months from year ago
Canada													
CPI	4.2	4.1	.8	1.3	1.1	.8	1.2	n.a.	.5	.3	1.0	n.a.	4.7
WPI	4.3	3.5	1.1	.9	1.0	.5	1.0	n.a.	.3	n.a.	n.a.	n.a.	3.4
France													
CPI	3.2	3.0	.5	1.0	.9	.6	.8	n.a.	.3	.6	.3	n.a.	3.6
WPI	2.6	7.2	1.0	1.0	2.7	2.3	n.a.	n.a.	*	*	*	*	7.2
Germany													
CPI	1.0	1.5	.5	.5	.1	.4	1.6	.9	.2	.6	.2	.0	3.0
WPI	-.7	2.7	.1	1.1	.4	1.2	2.7	n.a.	.6	1.1	.3	n.a.	6.3
Italy													
CPI	5.2	5.2	1.1	1.0	1.0	1.9	2.0	n.a.	.5	.7	.4	n.a.	6.6
WPI	4.6	5.4	1.1	1.3	1.2	1.7	2.3	n.a.	.5	n.a.	n.a.	n.a.	6.7
Japan													
CPI	1.1	1.5	-.2	.6	.1	1.0	-.1	n.a.	.7	1.4	.6	n.a.	2.6
WPI	-.6	-1.4	-1.2	-.3	.9	-.8	.5	n.a.	.2	1.7	.7	n.a.	2.1
United Kingdom													
CPI	4.1	6.5	.5	2.4	1.4	2.1	1.6	n.a.	.4	1.8	.6	n.a.	8.1
WPI	4.1	4.9	1.1	1.4	1.2	1.1	1.4	n.a.	.3	.5	.3	n.a.	5.0
United States													
CPI (SA)	4.4	4.3	.9	1.1	1.2	1.1	1.3	n.a.	.5	.7	.6	n.a.	5.2
WPI (SA)	2.5	3.4	.6	.8	1.1	.9	2.2	n.a.	.4	.4	.9	n.a.	5.8

1. Asterisk indicates that monthly data are not available.

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

	1987	1988	1987 Q4	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Feb.	1989 Mar.	1989 Apr.	1989 May
Canada												
Trade	8.3	7.8	1.6	1.6	2.1	2.6	1.5	1.4	.4	.3	n.a.	n.a.
Current account	-8.0	-9.2	-2.6	-1.6	-2.3	-1.8	-3.5	n.a.	*	*	*	*
France												
Trade	-5.2	-5.9	-1.0	-.8	-1.0	-1.9	-2.1	-.5	-.1	-.0	-.6	n.a.
Current account	-4.1	-4.0	-2.3	1.5	-.7	-1.1	-3.7	n.a.	*	*	*	*
Germany												
Trade (NSA)	65.9	72.8	20.1	15.0	19.9	17.0	21.0	19.5	6.1	6.9	5.3	n.a.
Current account (NSA)	45.6	48.7	15.2	9.7	14.4	8.7	15.9	15.8	4.6	5.1	4.2	n.a.
Italy												
Trade	-9.0	-10.0	-2.9	-2.8	-1.9	-2.4	-2.9	-4.2	-1.0	-1.7	-1.4	n.a.
Current account (NSA)	-1.1	-4.4	-1.6	-5.1	1.1	.4	-.8	n.a.	*	*	*	*
Japan												
Trade	79.5	78.1	18.3	20.9	16.9	18.4	21.9	21.9	8.8	5.4	6.7	3.6
Current account 2	87.0	79.6	20.7	22.3	17.1	18.1	21.2	21.2	8.7	6.1	6.2	n.a.
United Kingdom												
Trade	-15.9	-36.2	-5.3	-7.1	-8.2	-9.4	-11.5	-10.4	-3.9	-2.9	-3.7	-2.8
Current account	-4.7	-26.3	-3.5	-5.1	-4.9	-6.3	-10.0	-8.4	-3.2	-2.2	-3.0	-2.2
United States												
Trade 2	-160.3	-126.5	-40.4	-33.4	-31.4	-30.3	-32.0	-27.6	*	*	*	*
Current account	-154.0	-135.3	-33.5	-37.0	-33.8	-32.6	-31.9	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.

expanded weakly in April in the United Kingdom, and fell in Canada in March. In Japan production declined in April, but then partially rebounded in May.

Inflation rates have moved up recently in nearly all major foreign industrial economies. Higher oil prices and weakness of the other G-10 currencies against the dollar account for part of the increased price pressure. Increases in indirect taxes in several countries, including Japan, Germany, and Canada, also have contributed to rising prices.

Movements in external balances have shown a varied pattern. Germany's cumulative current account surplus through April is more than a third higher than last year's corresponding period. A sharp drop in Japan's trade surplus in May brought its cumulative surplus so far this year in line with the corresponding surplus of last year. Trade and current account deficits have widened recently in France and Italy, but have narrowed in Canada and the United Kingdom.

Individual Country Notes. In Japan, the pace of economic activity was very strong in the first quarter as real GNP rose 9.1 percent (s.a.a.r.), up sharply from the 3.3 percent growth rate of the previous quarter. Domestic demand grew 9.9 percent (s.a.a.r.) in the first quarter, as consumption increased 7.7 percent after being flat in the previous quarter, and plant and equipment jumped 20.3 percent. In contrast, housing investment declined by 7.5 percent. Exports jumped 34.0 percent (s.a.a.r.) while imports grew by an even more rapid 39.1 percent, resulting in a 0.8 percent negative contribution to growth from net exports.

Strong domestic demand growth in the first quarter appears to have been due, at least in part, to purchases made in anticipation of the introduction in April of a 3-percent consumption tax. As shown in the table below, monthly data tend to confirm this shift in the pattern of economic activity. Industrial production jumped by 5.4 percent (s.a.) in March in advance of the tax, fell by 3.8 percent in April, then rebounded by 0.9 percent in May. Retail sales rose 17 percent (s.a.) in March, then dropped 18 percent in April. Reflecting the March surge in activity, the capacity utilization rate rose by more than 5 percent (s.a.) in March to its highest level in nearly a decade. The unemployment rate remained unchanged for the fourth consecutive month at 2.3 percent (s.a.) in April.

JAPANESE ECONOMIC INDICATORS
(percent change from previous period, s.a., except were noted)

	1988		1989			
	Q3	Q4	Q1	Mar.	Apr.	May.
Real GNP	2.3	0.7	2.2	--	--	--
Industrial Production	2.4	2.0	3.1	5.4	-3.8	0.9
Retail Sales	0.3	2.7	6.4	17.0	-18.0	--
Capacity Utilization	2.8	1.6	0.0	5.3	--	--
Unemployment Rate (percent)	2.5	2.4	2.3	2.3	2.3	--

Inflation rates have moved higher in recent months. Consumer prices in Tokyo rose by 0.6 percent (n.s.a.) in May, following a 1.4 percent jump in April when the consumption tax was introduced. The 12-month increase in Tokyo consumer prices rose to 3.3 percent in May, up more than 2 percentage points from the rate at the end of last year. In the 12 months to May, wholesale prices were 3.4 percent above the level a year earlier, compared with a 12-month decrease of 1.1 percent at the end of last year.

The trade surplus rate for Japan dropped sharply in May to $43.2 billion (s.a.a.r.), about half the average surplus rate in the first four months of the year. The lower surplus in May was due in part to lower auto exports, possibly reflecting a changing seasonal pattern of auto exports to the United States. So far this year, the trade surplus has been $77.3 billion (s.a.a.r.), about unchanged from the trade surplus last year.

On June 2, Sosuke Uno became the new Japanese Prime Minister. Mr. Uno had been serving as Foreign Minister in the cabinet of outgoing Prime Minister Takeshita, who was forced to resign because of the Recruit scandal. Elections for one-half of the seats in the Upper House of the Diet have been scheduled for July 23. Opinion polls continue to show very low support for the ruling Liberal Democratic Party and Prime Minister Uno.

Economic activity also accelerated in Germany in the first quarter to 12 percent (s.a.a.r.), putting real GNP 4.2 percent above its year-earlier level. Mild winter weather fostered a strong boom in construction activity which accounted for two-thirds of the total increase in first-quarter GNP. While this contribution is expected to be transitory, net exports expanded even more rapidly than construction in the first quarter, and investment in machinery and equipment also advanced strongly. Other components, such as private and public consumption, which contributed little, and inventories, which subtracted substantially from first-quarter growth, held real domestic demand growth to a moderate 2.5 percent (s.a.a.r.) in the first quarter.

Other data shown in the accompanying table also indicate economic strength in recent months. Industrial production moved up sharply in April and stood 6.5 percent above its year-earlier level. Although manufacturers' new orders were flat in April, they were still up 10.6 percent above year-earlier levels. In contrast, the unemployment rate and the capacity utilization rate in manufacturing appear to have stabilized recently.

GERMAN ECONOMIC INDICATORS
(percent change from previous period, s.a. except where noted)

	1988		1989				
	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
Industrial Production	0.6	2.4	1.3	0.0	-0.1	0.8	--
Ex Construction	2.0	0.7	0.9	-0.5	0.6	2.3	--
Volume of Manufacturing Orders	4.1	-2.0	3.4	2.6	4.2	0.0	--
Domestic	4.1	-2.4	4.4	1.9	4.5	-1.7	--
Foreign	3.2	0.2	1.2	5.1	2.8	3.4	--
Unemployment Rate (level)	8.8	8.5	7.9	7.9	7.8	7.9	8.0
Manufacturing Capacity Utilization Rate (level)	87.4	88.7	87.9	--	--	--	--

Inflation remains a key policy concern in Germany. As shown in the table on the next page, measures of inflation have accelerated this year. Higher excise taxes in January, recent weakness in the deutsche mark, and rising oil prices all have contributed to higher inflation.

A factor behind weakness in the mark has been the political problems of Chancellor's Kohl's Christian Democratic Union, the largest party in the ruling government coalition. The CDU has sustained a series of electoral losses recently in both local elections and the

European parliamentary elections, and is trailing a potential liberal opposition coalition in the polls.

GERMAN INFLATION INDICATORS
(percent change from year earlier)

	1988		1989				
	Q3	Q4	Q1	Mar	Apr	May	Jun
Consumer Prices	1.2	1.5	2.6	2.7	3.0	3.1	2.9
GNP Deflator	1.5	1.9	3.9	--	--	--	--
Industrial Producer Prices	1.5	1.7	3.1	3.4	3.5	3.4	--
Wholesale Prices	1.4	2.7	5.4	5.8	6.5	6.5	--
Import Prices	1.2	2.2	6.1	6.8	7.3	7.1	--

Germany's monthly external surpluses fell in April from year-earlier levels--the first such drop in 1989. The trade surplus was $5.3 billion (n.s.a.) in April, versus $5.7 billion in April 1988. However, the cumulative trade and current account surpluses for the first four months of 1989 remained substantially above last year's rate. The widening of Germany's trade surplus so far in 1989 reflects largely a further increase in its trade surplus within the EC; its surplus with the United States has continued to decline.

In France, recent data indicate that activity has remained moderately strong while inflationary pressure has picked up in recent months. Preliminary figures for French GNP showed that first-quarter real growth rebounded to a rate of nearly 5 percent (s.a.a.r.), well above the 1.6 percent rate of growth recorded in the fourth quarter. Industrial production more than recovered from a nearly 1 percent drop in March with a sharp 3-1/4 percent (s.a.) gain in April to a level almost 7-1/2 percent above the level in April 1988. Capacity utilization continued to edge upward in the first quarter, and the unemployment rate eased slightly to 9.9 percent (s.a.) in May.

Consumer prices moved up 0.4 percent (s.a.) in May to a level 3.7 percent above the May 1988 level. Recent increases were led by a particularly strong upward movement in the price of manufactured goods and by a sharp increase in the price of petroleum products. Concerns about inflationary pressure were heightened by preliminary reports that wages rose about 1-1/4 percent in the first quarter to a level almost 4 percent above their year-earlier level. New monetary data for March show, however, that French M-2 was still growing at an annual rate below the official target range of 4-5 percent.

After narrowing steadily in the first three months of the year to less than $50 million (s.a.) in March, the French trade deficit widened sharply in April to more than $600 million. The deterioration of French trade is attributable almost entirely to a nearly 3-1/2 percent decline in manufactured exports.

In the United Kingdom, activity appears to have weakened somewhat. The average measure of real GDP increased by 1.4 percent (s.a.a.r.) in the first quarter. The output measure, which authorities consider the most reliable measure of short-run movements in activity, increased by only 0.4 percent. Industrial production rose by 0.5 percent in April but was only 1.1 percent above its year-earlier level. The volume of retail sales fell 1.4 percent (s.a.) in April, lowering the 12-month increase to 2.6 percent. The unemployment rate continued to decline in May, moving down to 6.4 percent (s.a.).

Consumer price inflation has continued to accelerate with the 12-month increase moving up to 8.3 percent in May. Excluding mortgage interest payments, the rate edged up to 6 percent. The increase in average earnings remained at 9-1/4 percent in the year to April.

The U.K. trade deficit decreased in May to $2.8 billion (s.a.). Through the first five months of this year, the trade deficit rate was $40.6 billion (s.a.a.r.), somewhat greater than the deficit rate of last year.

Real GDP in Canada increased 3.8 percent (s.a.a.r.) in the first quarter, up from the 2-1/2 percent annual rate of the two previous quarters. Domestic demand rose by 5.0 percent (s.a.a.r.) while net exports subtracted slightly from growth. Other indicators present mixed signals of current strength in the economy. Unemployment fell to 7.7 percent (s.a.) in May, and retail sales surged 2.3 percent (s.a.) in April after three consecutive monthly declines. However, housing starts fell 9 percent (s.a.a.r.) in May following an 8.4 percent drop in April.

A 1.0 percent increase in the consumer price index in May (the largest monthly increase since 1983) brought Canada's 12-month inflation rate to 5.0 percent. About half of the increase has been attributed to new sales and excise taxes, and half to higher food and energy prices.

Preliminary data in Italy indicate that real GDP grew 3.6 percent (s.a.a.r.) in the first quarter, slightly less than the growth rates seen during the second half of last year. Measures of inflation appear to have stabilized after absorbing the effects of the implementation of higher indirect taxes late last year. The consumer price index in May stood 6.8 percent above its level a year ago.

Economic Situation in Major Developing Countries

Argentina remains in a severe economic crisis; although the economic and financial markets reacted positively at first to the news that President Alfonsin will transfer power on July 8 to President-elect Menem, they again became volatile when Menem disclosed the low level of foreign exchange reserves. Mexico has extended its anti-inflation social pact through March 1990, as it continues to negotiate with banks for a package of new money, debt reduction, and debt-service reduction. Mexico, Venezuela, and the Philippines have obtained substantial financial assistance from the IMF and the World Bank. Mexico and the Philippines have also obtained multi-year Paris Club debt reschedulings. Venezuela has launched a comprehensive trade liberalization program. Brazil's worsening internal financial situation led the government to reintroduce indexed government debt and to resume daily devaluations. There was also a major stock market crisis there in June. Nigeria has cleared its outstanding interest arrears to banks, and its debt restructuring has become effective.

Individual country notes. Argentina remains in a severe economic crisis. The economic and financial markets reacted positively at first to the news that President Alfonsin will transfer power to President-elect Carlos Menem on July 8, rather than in December 1989, as originally scheduled. However, they again became volatile when Menem disclosed the low level of foreign exchange reserves.

In the run-up to and the aftermath of the May 14 presidential election, which Peronist Party candidate Carlos Menem won more decisively than expected, Argentina approached economic chaos. The monthly rate of increase of the CPI more than doubled in May to 79 percent, and is likely to exceed 100 percent in June. In the face of accelerating price increases, a severe cash shortage developed and economic activity became deeply depressed. In this period, interest rates fluctuated widely, and the black market exchange rate depreciated sharply.

Menem reportedly plans to implement an economic package soon after he takes office that would include deep cuts in public expenditures, tax reform, a significant devaluation of the currency, and wage increases. His economic team seems to be orthodox, and the fact that he has political support encourages belief that his proposals may have a chance of being put into effect.

In June, Argentina cleared a substantial part of its arrears to the IMF and World Bank, which had been accumulating for a few months. This was accomplished in part with the help of a $150 million bridge loan from Brazil, Mexico, and Venezuela.

Mexico has extended its anti-inflation social pact to March 31, 1990, as it continues to negotiate with commercial banks for a package of new money, debt reduction, and debt-service reduction. In recent weeks, Mexico has obtained a three-year SDR 2.8 billion Extended Fund Facility (EFF) arrangement and an SDR 453.5 million Compensatory and Contingency Financing Facility drawing from the IMF, three World Bank loans totalling $1.5 billion to support structural reforms, and a Paris Club rescheduling covering $2.5 billion in payments due through May 1992. The equivalent of 30 percent of the EFF and 25 percent of the three World Bank loans will be set aside for debt reduction operations. Additional resources from the IMF, the World Bank, and the Government of Japan are expected to be available to Mexico for debt reduction and debt-service reduction operations, bringing the probable total for these operations to about $5-1/2 billion. Mexico may use some of its own financial resources for this purpose as well.

The social pact, which governs exchange rate, price, and wage policies, was to have expired July 31. At the signing ceremony formally extending it, President Salinas said that removal of the July deadline relieved the pressure to accept any agreement with the banks and gave Mexico time to reach a satisfactory external debt arrangement.

The Mexico City stock market index, which has risen by more than 70 percent since March 1, rose strongly further after the pact extension was announced. On June 26, it was only 4 percent below its October 1987 pre-crash all-time high. The 28-day Treasury bill rate has risen 10 percentage points since March 14 as fears of a maxi-devaluation increased, and was 57 percent at the June 20 auction.

On June 23, several days after the pact extension was signed, the authorities announced a 6 percent increase in minimum wages, effective July 1.

The Brazilian authorities, responding to rising prices and interest rates over the first two weeks of June, devalued the cruzado by 5.5

percent on June 13 and announced on June 15 that they would reintroduce indexed government debt and resume daily devaluations. Since then, prices and interest rates have risen further. Monthly inflation is likely to be around 25 percent in June, compared with 9.9 percent in May. The overnight money market rate rose from 27 percent per month June 12 to 44.5 percent on June 27. However, the spread between the parallel and official exchange rates has fallen from the 200 percent high it reached in April to about 110 percent June 26. Some of the fall is attributed to dollar sales by brokerage houses that experienced losses in the stock exchanges in June.

The stock exchange losses stemmed from a major crisis that erupted June 9 when a large investor, who had been speculating in options and futures contracts, stopped payment on checks totalling 39 million cruzados ($29 million at the official exchange rate). Five brokerage houses were closed by the Central Bank June 21. Losses, which are expected to be covered by members of the exchange, are estimated at 200 million cruzados ($148 million). In the aftermath, Central Bank president Elmo Camoes resigned June 22, principally because of his family involvement in a major brokerage house. Wadico Waldir Bucchi, director of the banking department of the Central Bank, has been appointed interim president. Early this week, stock prices in the Rio and Sao Paulo exchanges were 30-40 percent lower than before the crisis.

Brazil continued to register sizable trade surpluses in April ($1.3 billion) and May ($1.4 billion). Exports in May were higher than expected, given the considerable dollar premium in the parallel market.

The cumulative surplus in January-May totaled $7 billion, about the same as in the same period of 1988. The April and May surpluses, however, were lower than in the same months last year.

Since mid-June, Venezuela has obtained a three-year SDR 3.7 billion Extended Fund Facility arrangement from the IMF and World Bank loans of $402 million for Structural Adjustment and $353 million for Trade Policy reforms. Up to 25 percent of this assistance will be set aside for debt reduction operations. Negotiations with commercial banks on a public sector debt restructuring combined with new money and debt reduction are essentially on hold pending the results of the Mexican negotiations. Meanwhile, a group of banks is attempting to raise $600 million in interim financing. Some public sector interest arrears to banks of more than 90 days have accumulated over the past several months.

The government has announced an overhaul of the country's complex and distortionary system of tariff and trade restrictions. With the assistance of the World Bank under the Trade Policy loan, the authorities have begun to remove quantitative restrictions on 2,000 tariff items produced by domestic industry and to lower the maximum tariff from 135 percent to 80 percent. Over the next four years, the tariff system is to be further simplified and maximum rates are to be cut to 20 percent.

In mid-June, the Central Bank raised minimum deposit and maximum loan interest rates by a further five percentage points each; however, these rates remain below the expected rate of inflation. Since the economic reform program was launched in February, growth of the money supply has been negative in real terms and the fiscal deficit has been cut substantially. The monthly inflation rate, which surged to 21.3 percent in March in the wake of exchange rate devaluation, the freeing of many controlled prices, and wage increases, was down to 6.4 percent in May.

In May, the Philippines obtained a three-year SDR 660.6 million Extended Fund Facility arrangement (EFF) and a SDR 286.3 million Compensatory and Contingency Financing Facility drawing from the IMF, a $300 million financial sector adjustment loan from the World Bank, and a Paris Club rescheduling of about $2.2 billion representing arrears and payments of principal and interest falling due through June 1991. The equivalent of 25 percent of each purchase under the EFF will be set aside for debt reduction operations. However, the World Bank loan was approved before the World Bank had adopted a policy in support of debt reduction operations. As a result, no part of this loan is earmarked for this purpose.

Nigeria's $5.7 billion commercial bank debt restructuring agreed to in March became effective on June 7 upon clearance of about $40 million in outstanding interest arrears.