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December 12, 1990

RECENT DEVELOPMENTS

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

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DOMESTIC NONFINANCIAL DEVELOPMENTS

Incoming data suggest that economic activity has fallen appreciably in the past couple of months. The motor vehicle and construction sectors have been especially weak, and the downturn appears to have affected a broad range of other industries to some degree. Consumer and business confidence evidently has been at a low ebb, owing in part to concerns about the consequences of the Gulf situation; consumer spending apparently has been weak, and businesses have been moving aggressively to avoid an inventory buildup.

On the price front, the inflationary effects of the oil price shock have continued to dominate the incoming data. Consumer energy prices jumped further in October, and higher fuel and feedstock costs have begun to spill over into the prices of other goods and services. Prices of non-oil imports also have risen noticeably, owing to the depreciation of the dollar. Despite the substantial increases in living costs this year, wage gains seem to have moderated a bit in recent months, under the influence of deteriorating business and labor market conditions.

Labor Markets

After a progressive weakening during the first three quarters of this year, labor market conditions deteriorated sharply in October and November. Private payrolls declined 270,000 in November after a downward-revised drop of 206,000 in October. The civilian unemployment rate rose to 5.9 percent last month. Aggregate hours of production or nonsupervisory workers in private industry edged up in November following a precipitous October decline (chart); still, the October-November average was 1-1/4 percent below

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

	1988	1989	1990 Q1	1990 Q2	1990 Q3	1990 Sep.	1990 Oct.	1990 Nov.
	Average Monthly Changes							
Nonfarm payroll employment[2]	272	193	246	236	-72	-1	-178	-267
Excluding census workers			207	153	41	39	-175	-256
Private	242	162	169	106	8	-14	-206	-270
Manufacturing	20	-16	-22	-23	-43	-65	-70	-200
Durable	16	-16	-12	-20	-44	-61	-41	-159
Nondurable	4	-0	-11	-3	1	-4	-29	-41
Construction	8	5	32	-14	-31	-18	-81	-62
Trade	66	47	24	27	4	-8	-77	-80
Finance, insurance, real estate	5	9	12	8	2	-1	-4	-11
Services	134	100	109	92	72	53	23	80
Total government	30	30	77	129	-80	13	28	3
Private nonfarm production workers	197	134	143	94	-25	-26	-160	-259
Manufacturing production workers	14	-17	-21	-18	-36	-69	-50	-158
Total nonagricultural employment[3]	193	145	147	-31	-108	196	-173	-473

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

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

	1988	1989	1990 Q1	1990 Q2	1990 Q3	1990 Sep.	1990 Oct.	1990 Nov.
Civilian unemployment rate	5.5	5.3	5.2	5.3	5.6	5.7	5.7	5.9
Teenagers	15.3	15.0	14.5	14.8	16.2	15.5	16.2	16.5
20-24 years old	8.7	8.6	8.4	8.9	8.9	9.6	9.6	9.1
Men, 25 years and older	4.2	3.9	4.1	4.1	4.5	4.6	4.5	4.8
Women, 25 years and older	4.3	4.2	4.2	4.1	4.3	4.3	4.3	4.7
Labor force participation rate	65.9	66.5	66.5	66.5	66.3	66.3	66.2	66.0
Teenagers	55.3	55.9	54.6	54.3	52.1	53.1	53.0	52.3
20-24 years old	78.7	78.7	77.8	78.0	77.5	77.7	77.7	77.5
Men, 25 years and older	77.0	77.2	77.1	77.0	77.1	77.2	77.1	77.0
Women, 25 years and older	54.9	56.0	56.3	56.6	56.6	56.4	56.1	55.9
Memo:								
Total national unemployment rate[1]	5.4	5.2	5.2	5.2	5.5	5.6	5.6	5.8

1. Includes resident armed forces as employed.

the level in the third quarter (not at an annual rate). Since the November survey week, initial claims for unemployment insurance have fluctuated around 450,000.

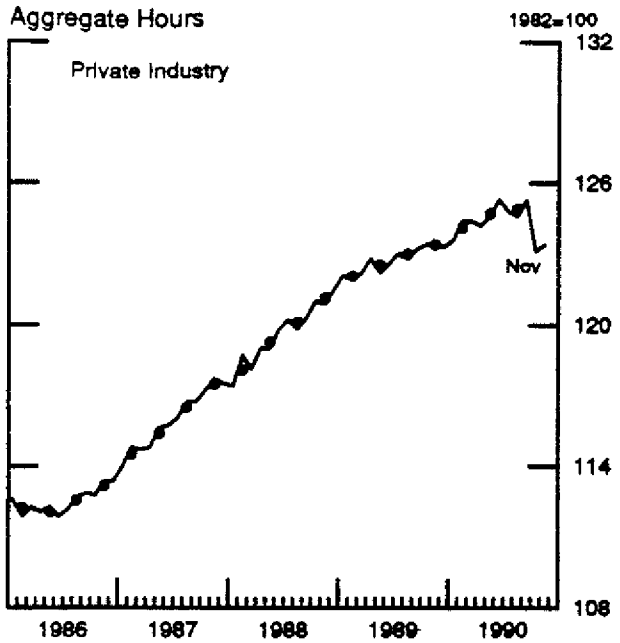
The employment decline in November was widespread across industries. The diffusion index of employment change over a three-month span in 356 private industries declined to 36.5 percent, its third month below the 50 percent mark and its lowest reading since 1982. The largest job losses occurred in the goods-producing sector. Construction and manufacturing shed 60,000 and 200,000 jobs, respectively. Manufacturing as a whole has eliminated about 535,000 jobs since last December; about one-half of this decline (270,000 jobs) has occurred in the past two months. In the motor vehicles industry--where employment moved down about 20,000 jobs in the first three quarters of 1990--some 55,000 layoffs occurred in November. The service-producing sector, which earlier in the year had generated most of the employment gains in the economy, registered a small employment loss in November. Retail trade lost 70,000 jobs on a seasonally adjusted basis, with hiring lower than usual at the start of the holiday season. Health services was one of the few industries to post significant employment gains.

In the household survey, nonagricultural employment fell 470,000 in November. The number of unemployed persons rose nearly 300,000, and with the weakness in labor demand, the labor force participation rate continued to decline.[1] Most of the newly unemployed appear to have been job losers, not entrants into the labor force; as a result, job losers as a percent of

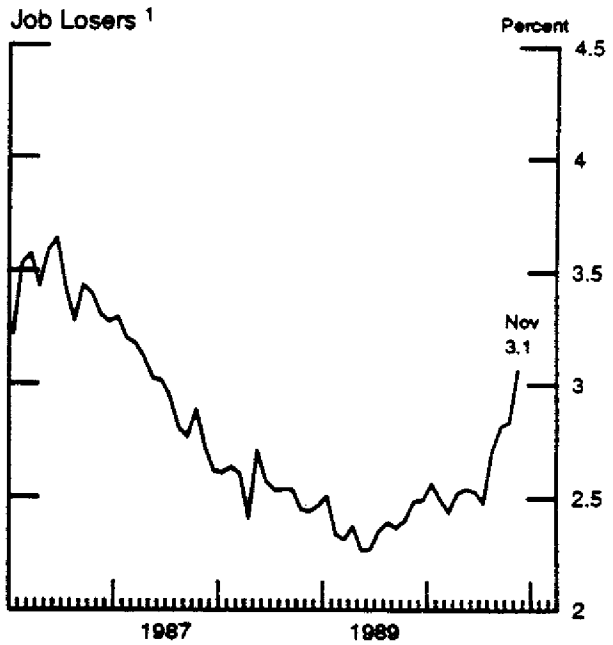
1. Potential labor force entrants have been more discouraged recently. According to the Conference Board's November consumer confidence survey, only 14 percent of respondents believe jobs to be plentiful, down from about 25 percent this summer and 35 percent in early 1989.

SELECTED LABOR MARKET INDICATORS

Monthly Data



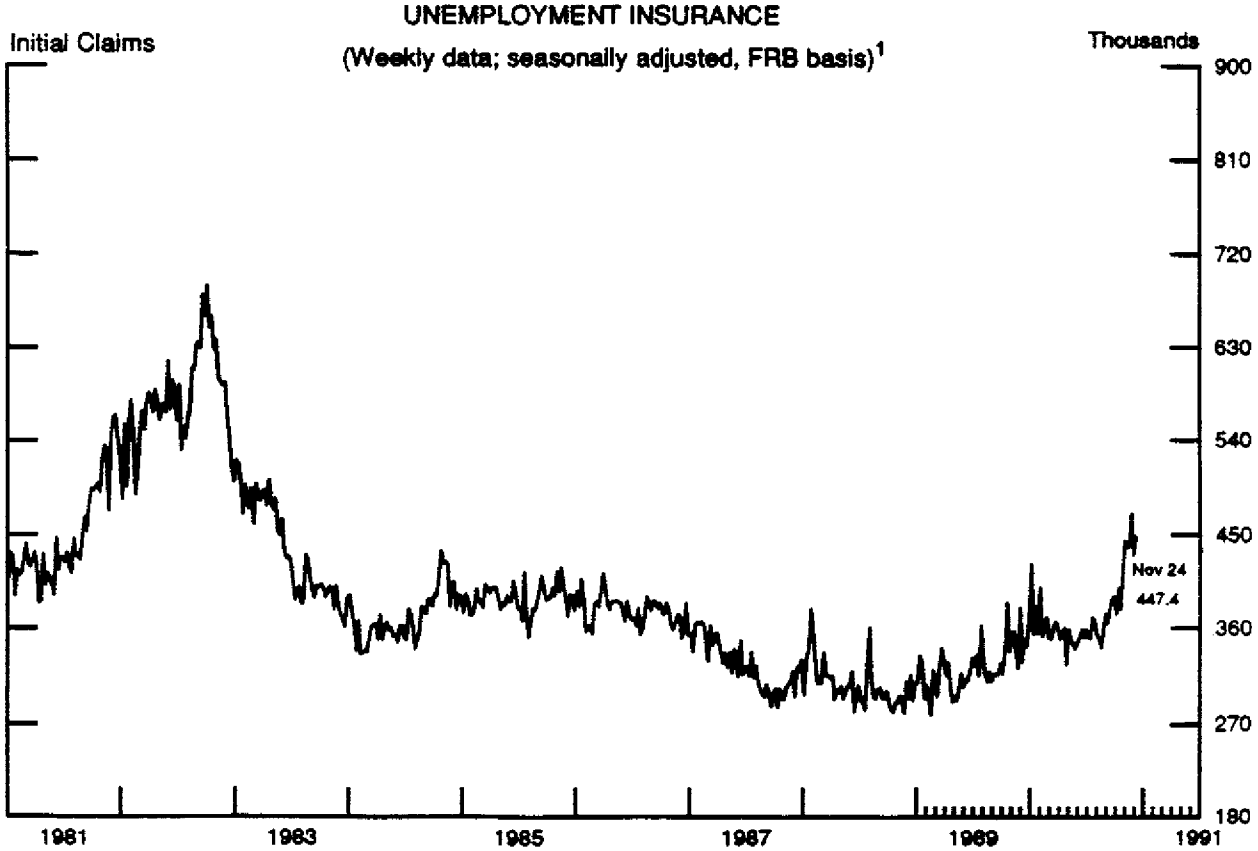
1. Dots denote quarterly averages.



1. Job losers as a percentage of civilian labor force.

UNEMPLOYMENT INSURANCE

(Weekly data; seasonally adjusted, FRB basis)[1]



1. Only the state program components of these series are seasonally adjusted.

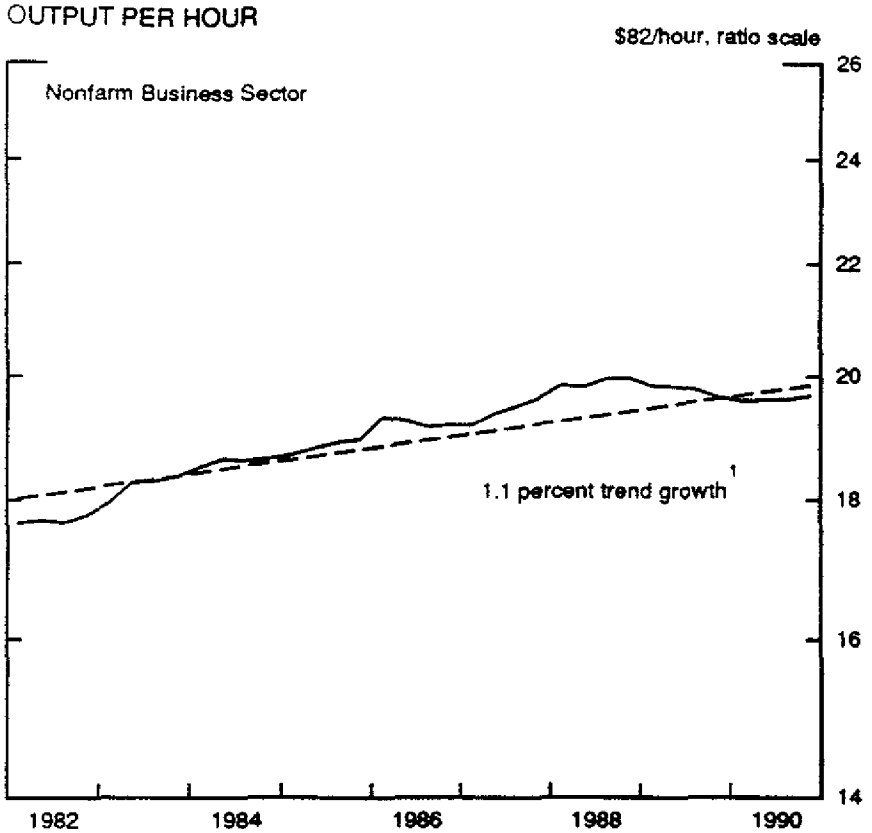
household employment moved up to 3.1 percent in November, the highest since mid-1987 (chart). Demographically, the increase in the unemployment rate largely reflected increased joblessness among people 25 years and older; in contrast, in September and October the unemployment rate for this group had remained about flat. In addition, the number of persons working part-time for economic reasons rose in November.

Other labor market indicators also displayed significant weakness in recent months. The Conference Board's index of help-wanted advertising, which had been declining steadily since the turn of the year, began a sharper decline in July. In addition, according to the Manpower, Inc., Employment Outlook Survey of plans to hire in the first quarter of 1991, the number of firms intending to reduce their workforces exceeds the number of firms intending to increase their workforces. This is the first time since 1983 that the net number of hiring firms was negative.

Productivity in the nonfarm business sector as a whole grew only 0.2 percent in the third quarter (a large downward revision from the preliminary estimate of 1.6 percent) reflecting flat output and a small decline in hours worked. In contrast, output per hour in the manufacturing sector increased at a 5.1 percent annual pace, as firms moved aggressively to cut costs. In both the broader measure and in manufacturing separately, the levels of productivity are below their estimated, cyclically adjusted trends (chart); historically, this relation has been associated with efforts to trim workforces, which certainly has been the pattern this fall.

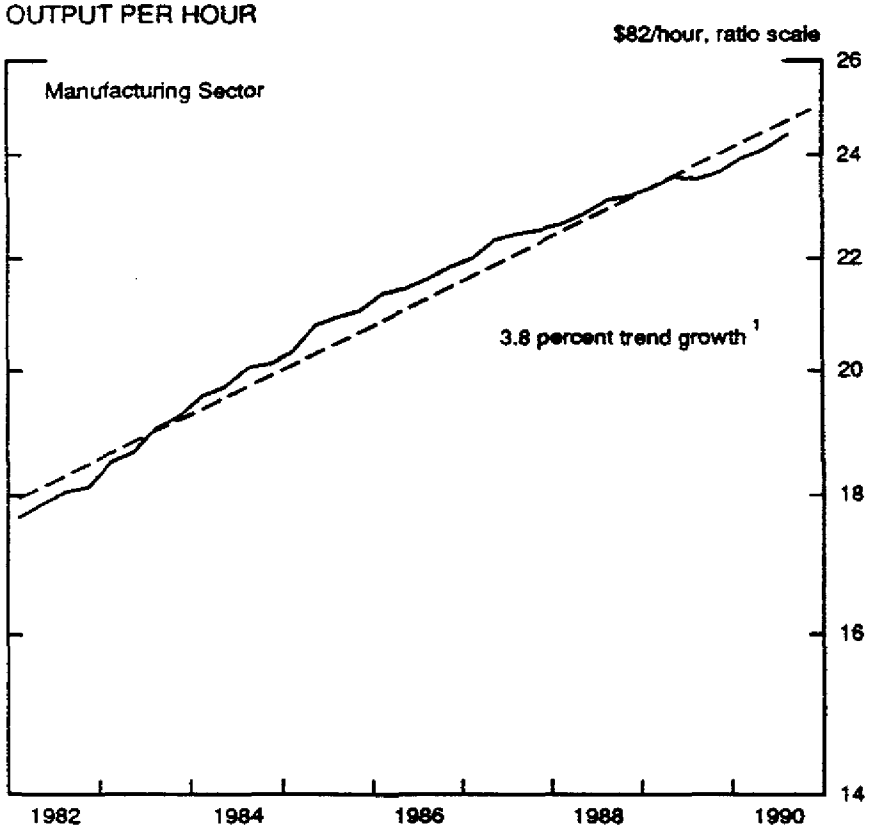
Scattered reports of salary plans for 1991 do not suggest a major downshift from what firms budgeted in 1990. However, announcements of pay freezes and other efforts to restrain compensation costs at companies facing

OUTPUT PER HOUR



Percent change (annual rate)	
1988 [2]	1.8
1989 [2]	–1.6
1990	
Q1	–1.3
Q2	.3
Q3	.2
1989:Q3 to 1990:Q3	–.9

OUTPUT PER HOUR



Percent change (annual rate)	
1988 [2]	2.9
1989 [2]	2.0
1990	
Q1	4.9
Q2	3.1
Q3	5.1
1989:Q3 to 1990:Q3	3.9

1. Productivity trends are staff estimates.
2. Changes are from fourth quarter of preceding year to fourth quarter of year shown.

difficulty suggest that the weakness in the economy is having some effect. The November reading on average hourly earnings of production or nonsupervisory workers points in that direction. Because this series has limited coverage and does not adjust for industry or occupational shifts, it must be read cautiously as an indicator of general patterns. That said, it is noteworthy that average hourly earnings were flat on average in October and November, and that for the three months ending in November, they increased 1.6 percent at an annual rate, a slowdown of about 2-1/2 percentage points from the pace earlier in the year.

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

		1990			1990			Memo:
	1989	Q1	Q2	Q3	Sep.	Oct.	Nov.	Nov. 1989 to Nov. 1990
		--Annual rate--			--Monthly rate--			
Total private nonfarm	4.1	4.1	4.1	4.0	.4	-.1	.1	3.6
Manufacturing	2.8	4.2	5.0	3.6	.3	.4	-.1	3.6

1. Annual changes are measured from fourth quarter to fourth quarter.

Industrial Production and Capacity Utilization

Industrial activity has declined sharply in the current quarter. The available indicators suggest that total industrial production in November contracted more severely last month than the 0.8 percent drop in October. In November, motor vehicle assemblies fell 2-1/4 million units to 8.4 million units (annual rate; FRB seasonals)--an 18 percent underbuild from the plans that were announced at the beginning of the month. The drop in assemblies, together with its effect on supplier industries such as

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

	Proportion in total IP 1989:Q4	1989	1990			1990		
		H2[1]	H1[1]	Q2	Q3	Aug.	Sep.	Oct.
		--------Annual rate-------				---Monthly rate----		
Total index	100.0	-0.5	2.4	4.2	3.7	-0.0	0.2	-0.8
Excluding motor vehicles and parts	95.7	0.1	2.2	2.3	3.6	0.0	-0.2	-0.6
Products, total	61.2	-0.1	2.8	4.2	2.0	-0.0	0.2	-0.9
Final products	46.6	-0.4	3.2	5.6	3.1	0.1	0.5	-0.9
Consumer goods	25.9	1.7	-0.3	2.5	1.6	0.3	0.5	-1.1
Automotive products	2.4	-9.8	7.8	43.4	2.9	-1.9	7.6	-4.6
Other consumer goods	23.5	3.0	-1.1	-0.9	1.5	0.5	-0.2	-0.7
Durables	3.1	-1.4	4.6	0.2	-8.0	-0.0	-1.0	-2.1
Nondurables	20.4	3.6	-2.0	-1.0	3.0	0.5	-0.0	-0.5
Business equipment	15.2	-3.6	8.7	10.7	7.7	0.	0.8	-1.0
Motor vehicles	1.1	-13.9	14.1	92.7	5.7	-1.5	11.3	-5.8
Other business equipment	14.1	-2.8	8.2	6.1	7.9	0.4	-0.1	-0.6
Computers	2.5	2.8	16.1	14.1	9.0	-0.3	0.9	-0.7
Other	11.6	-3.9	6.6	4.4	7.7	0.5	-0.3	-0.6
Construction supplies	6.0	1.4	-1.7	-6.8	-2.8	-1.4	-1.4	-1.4
Materials	38.8	-1.2	1.8	4.2	6.6	-0.0	0.1	-0.8
Durable	19.8	-2.3	3.2	7.7	6.9	0.5	-0.4	-1.2
Metals	2.8	-4.5	2.5	9.0	18.3	0.3	0.2	-2.6
Nondurable	8.8	-0.9	1.4	1.4	4.9	-1.0	-0.1	0.1
Energy	10.2	1.2	-0.6	0.1	7.3	-0.3	1.0	-0.6
Memorandum:								
Manufacturing	84.9	-1.1	2.9	3.8	3.1	-0.0	0.0	-0.8
Excluding motor vehicles	80.6	-0.4	2.6	1.6	3.0	0.1	-0.4	-0.6

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

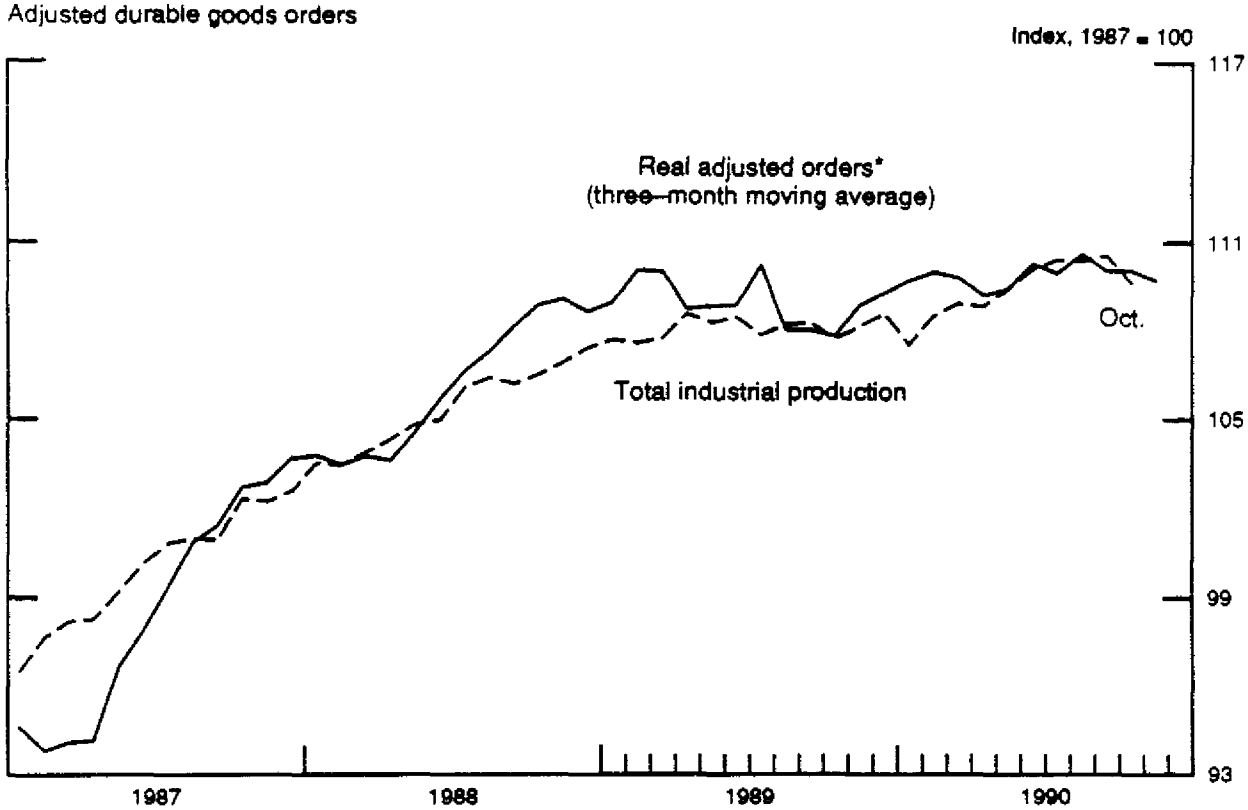
CAPACITY UTILIZATION IN SELECTED INDUSTRIES
(Percent of capacity; seasonally adjusted)

	1967-89	1988-89	1989	1990		
	Avg.	High	Oct.	Aug.	Sep.	Oct.
Total industry	82.2	85.0	83.3	83.5	83.5	82.6
Manufacturing	81.5	85.1	82.9	82.7	82.5	81.7
Primary processing	82.3	89.0	86.6	85.8	85.0	84.2
Textile mill products	86.0	91.2	88.4	85.4	84.0	82.8
Lumber and products	82.7	91.2	84.6	80.4	79.0	77.7
Primary processing chemicals[1]	82.9	91.7	90.2	86.3	84.4	86.0
Petroleum products	85.1	90.3	88.4	91.0	91.6	90.3
Iron and steel	79.4	92.0	83.2	88.0	89.3	86.4
Advanced processing	81.1	83.6	81.4	81.4	81.5	80.6
Advanced processing chemicals[2]	77.2	83.2	78.7	78.3	78.6	78.1
Nonelectrical machinery	81.3	83.5	79.5	83.1	82.1	80.9
Electrical machinery	80.4	83.1	81.2	80.3	80.0	79.1
Motor vehicles and parts	76.7	85.5	75.5	75.1	80.7	76.9

1. Primary processing chemicals includes industrial organic and inorganic chemicals, synthetic materials, plastics resins and fertilizers.
2. Advanced processing chemicals includes drugs and toiletries, soaps and detergents, paints and allied products, pesticides, and other miscellaneous chemical products.

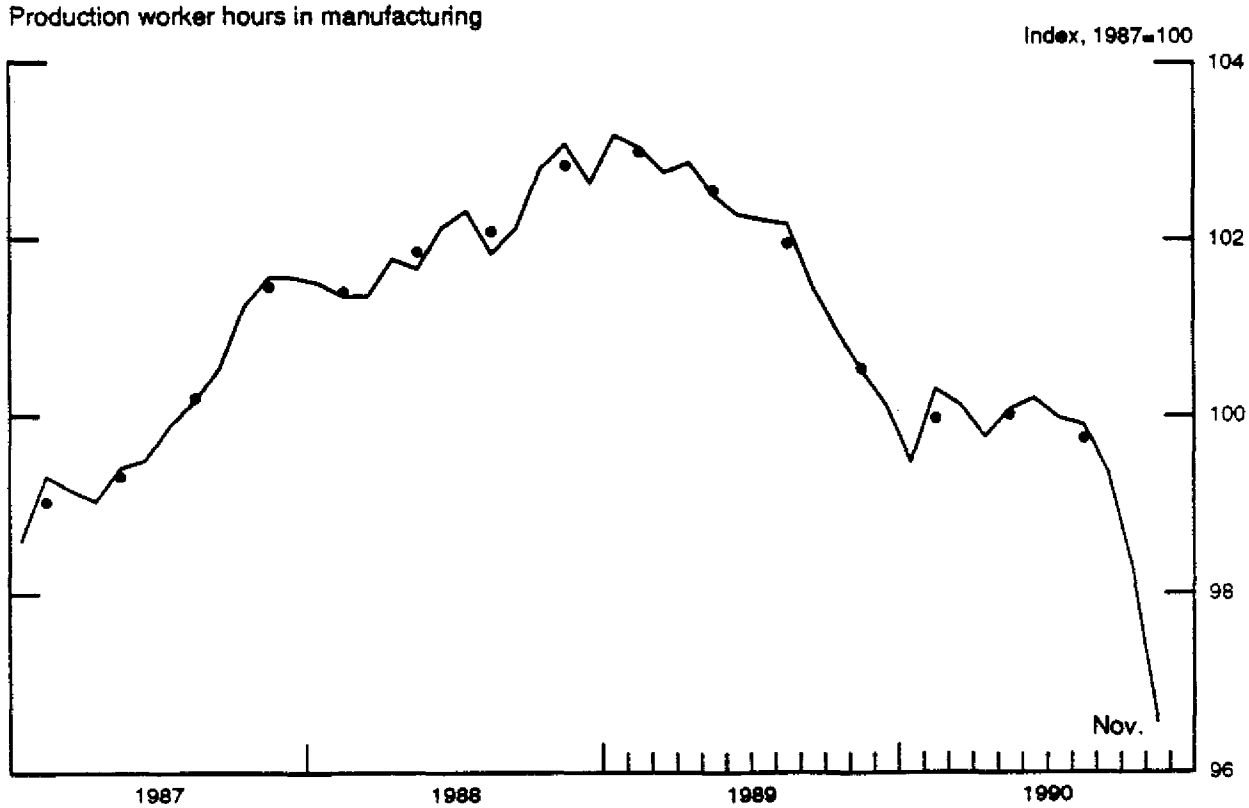
INDICATORS OF INDUSTRIAL ACTIVITY

Adjusted durable goods orders



*Adjusted goods orders equal bookings for durable goods industries that report unfilled orders, excluding orders for defense capital goods, nondefense aircraft, and motor vehicle parts. Value shown at time t is a moving average of data from t–1, t–2, and t–3. Nominal orders are deflated using the PPI for durable goods.

Production worker hours in manufacturing



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

	1989	1990 Q1	1990 Q2	1990 Q3	1990 Aug.	1990 Sept.	1990 Oct.
Total personal income	24.5	32.7	15.3	19.6	14.0	21.6	5.7
Wages and salaries	9.7	15.4	14.0	11.3	1.2	16.7	-9.3
Private	7.2	11.8	11.0	9.7	-.5	14.2	-11.7
Other labor income	1.2	1.7	1.2	1.2	1.2	1.2	1.2
Proprietors' income	2.4	10.0	-5.7	-.6	.9	-3.7	1.5
Farm	1.1	6.4	-6.5	-2.6	-2.8	-4.5	2.5
Rent	-1.3	1.4	.2	1.7	3.0	1.3	2.0
Dividend	.9	.8	.7	.6	.7	.3	.8
Interest	7.1	1.0	3.4	3.0	3.0	2.4	1.7
Transfer payments	5.0	8.3	2.7	3.1	3.9	4.8	7.2
Less: Personal contributions for social insurance	1.4	2.5	1.1	.8	.0	1.3	-.6
Less: Personal tax and nontax payments	5.1	2.0	6.4	5.6	3.6	6.2	.5
Equals: Disposable personal income	19.4	30.7	8.9	14.0	10.4	15.4	5.2
Memo: Real disposable income	5.0	5.0	-.5	-6.2	-11.5	-10.6	-14.6

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

	1989	1990 Q1	1990 Q2	1990 Q3	1990 Aug.	1990 Sept.	1990 Oct.
		----Annual rate--			---Monthly rate----		
Personal consumption expenditures	1.2	1.1	.2	3.2	.2	.2	-.7
Durable goods	-1.4	14.4	-9.5	2.3	-1.4	1.5	-2.0
Excluding motor vehicles	2.3	7.8	-7.2	1.3	-.4	.3	-.7
Nondurable goods	.6	-3.2	-1.9	3.2	.4	-.4	-1.2
Excluding gasoline	.8	-2.9	-1.0	2.8	.5	-.5	-.7
Services	2.4	.1	5.1	3.5	.5	.2	.2
Excluding energy	2.2	3.4	3.8	3.6	.3	.1	.3
Memo:							
Personal saving rate (percent)	4.6	4.9	5.0	4.1	4.1	3.6	3.8

rubber and plastics, may have reduced November IP growth by around 1 percentage point.

The widespread declines in production worker hours and in the available physical product data suggest that production outside of the motor vehicle sector contracted in November for the third consecutive month. As in October, factory labor input was especially weak in industries related to construction and household durables. Production of business equipment excluding motor vehicles also appears to have declined a bit further in November. The available physical product data indicate a large drop in electricity generation, owing mainly to unseasonably warm weather, but also to declines in the production of lumber, plywood, gasoline, and coal.

Capacity utilization in manufacturing has plunged, and operating rates at most advanced processing industries are moving below their averages over the 1967-89 period. The utilization rate for primary processing industries likely fell again in November, reflecting widespread production curtailments among these basic industries.

Personal Income and Consumption

Nominal income growth has slowed substantially, and real income has been falling. In October (the most recent data available), nominal personal income rose $5-3/4 billion at an annual rate, well below the average monthly change of $22-1/2 billion observed through the first three quarters of this year. The growth in overall personal income would have been even weaker in October but for a large increase ($7-1/4 billion at an annual rate) in

transfer income.[2] The wage and hours figures for November imply another month of very slow income growth.

Real PCE fell 0.7 percent in October, owing in part to a large drop in expenditures on new cars and trucks. Spending on goods other than motor vehicles fell 0.7 percent, reflecting a sharp reduction in real outlays for gasoline and fuel oil and a further decline in expenditures for furniture, which were at their lowest level this year. Outlays for energy-related services (electricity and natural gas) declined a bit in October, while PCE for other services increased 0.3 percent, about the average monthly pace in the first three quarters of 1990.

The personal saving rate edged up in October, but remained at a low level--3.8 percent. Prior to the invasion of Kuwait, the personal saving rate had averaged 4.9 percent in 1990. Thus, as of October, consumers had not cut back their spending as sharply as their income had fallen. Such behavior could be consistent either with a sluggish adjustment of spending to changes in income, or with an expectation that the runup in energy prices will be reversed shortly and real income growth restored; sentiment indexes suggest that consumers are pessimistic about the future, and thus would tend to support the former explanation of the low saving rate.

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2. The October increase in transfer income reflected three special factors: First, payments to Japanese-Americans in compensation for their internment during World War II accounted for about $3-1/2 billion at an annual rate. Another $200 million is scheduled to be spent during the rest of the current fiscal year; according to an analyst at BEA, about half of this--or $1-1/4 billion at an annual rate--was scheduled to be disbursed in November, and the rest is scheduled to be paid between now and March. Second, the State of Alaska made a large payment to citizens of the state under its program of remitting earnings from a fund of accumulated oil tax revenues; this factor accounted for about $1-1/2 billion of the October increase. Third, disbursements under the food stamp program increased about $1 billion at an annual rate, reflecting the annual adjustment of the program's benefit schedule.

Consumer sentiment remained at depressed levels in November. After registering sizable declines in each of the preceding three months, the University of Michigan's Index of Consumer Sentiment ticked up slightly. But, at 66, the level of the index remained about 25 points below the average seen during 1989 and early 1990 and was comparable to the readings taken during the 1980 and 1981-82 recessions. The Conference Board's Consumer Confidence Index slipped a bit lower in November and also was at recession levels.

Pending receipt later this week of the November retail sales release, there is little hard information on which to base an assessment of recent consumer spending. Chain store reports for last month, Beige Book stories, and the Board staff's conversations with major retailing concerns all suggest, however, a distinctly soft picture. Although retailers evidently were cautious when they placed their orders prior to the holiday season, sales have been sluggish enough to force heavier discounting than had been planned.

Autos and Light Trucks

Total unit sales of new cars and light trucks moved down notably in November from the October pace, to about a 12-3/4 million unit rate. Sales of domestically built cars were at a 6-1/4 million unit annual pace, down about 3/4 million units from October, while sales of imported cars fell to a 2-1/4 million unit annual rate. Sales of light trucks were flat in November, with a further decline in sales of domestically produced models offset by a pickup in imports.

Auto sales at the beginning of the 1991 model year would have been even weaker had there not been an increase in fleet sales. Fleet purchases often

are made under an agreement that the manufacturer will buy back some of the cars at a contracted price.[3] This year, manufacturers broadened buy-back programs to cover all vehicles in the fleet purchase, up from the 25 percent or 50 percent coverage ratio of previous programs. After the cars are repurchased, they are sold at auction. Under a relatively recent arrangement, the automakers' own dealers have the right of first access in these auctions. When fleet cars are purchased by the auto dealers at auction, they go into the dealers' inventories as used cars. Nonetheless, these "nearly new" cars are seen by customers as close substitutes for new cars, in part because they have low mileage and still carry the manufacturer's warranty. Given the lower prices and close substitutability, these "nearly new" cars probably reduce household demand for new cars.

While retail demand for new motor vehicles has weakened this year, the auto companies reportedly have used fleet sales as a short-term strategy for maintaining production at a faster pace than would otherwise have been possible. Eventually, the increased volume of fleet sales (and the reported move of auto rental companies to "cycle" their fleets back to the manufacturers more frequently) will result in more "nearly new" cars on dealers' lots. This factor apparently has combined with reduced credit availability and concerns about the economy to cause dealers to trim their orders for new cars. As a result, manufacturers are cutting their production schedules sharply even though inventories of new cars are well in line with conventional rules of thumb.

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3. The repurchase price is calculated as a function of depreciation, which is figured at 40 cents per mile. At Ford and General Motors, the minimum purchase to qualify for the buyback program is 10 vehicles; at Chrysler, the minimum is 250 vehicles.

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

	1989	1990 Q1	1990 Q2	1990 Q3	1990 Sep.	1990 Oct.	1990 Nov.
Autos and light trucks	14.51	14.40	13.97	14.18	14.47	13.51	12.73
Autos	9.90	9.81	9.54	9.72	10.06	9.35	8.51
Light trucks	4.61	4.59	4.43	4.47	4.41	4.16	4.22
Domestic total[2]	11.19	11.17	10.77	11.30	11.67	10.67	9.94
Autos	7.08	7.02	6.80	7.21	7.60	6.91	6.24
Light trucks	4.11	4.14	3.98	4.09	4.07	3.76	3.69
Import total	3.33	3.23	3.19	2.88	2.80	2.84	2.79
Autos	2.82	2.78	2.74	2.51	2.46	2.43	2.27
Light trucks	.50	.45	.45	.38	.34	.40	.52

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 because of rounding.
2. Includes vehicles produced in Canada and Mexico and vehicles made in U.S. plants of foreign manufacturers.

Inventories of domestically built cars were at about 1.35 million units--65 days' supply--at the end of November. Production of domestically built cars dropped 1 million units at an annual rate in November to a 5-1/2 million unit pace (BEA seasonals). Since the beginning of November, the domestic automakers have slashed their assembly schedules for the five-month period from November through March by 1/2 million units at an annual rate. Moreover, schedules in the first quarter of 1991 may be pared back still further, with manufacturers extending the traditional holiday shutdowns.

Housing Markets

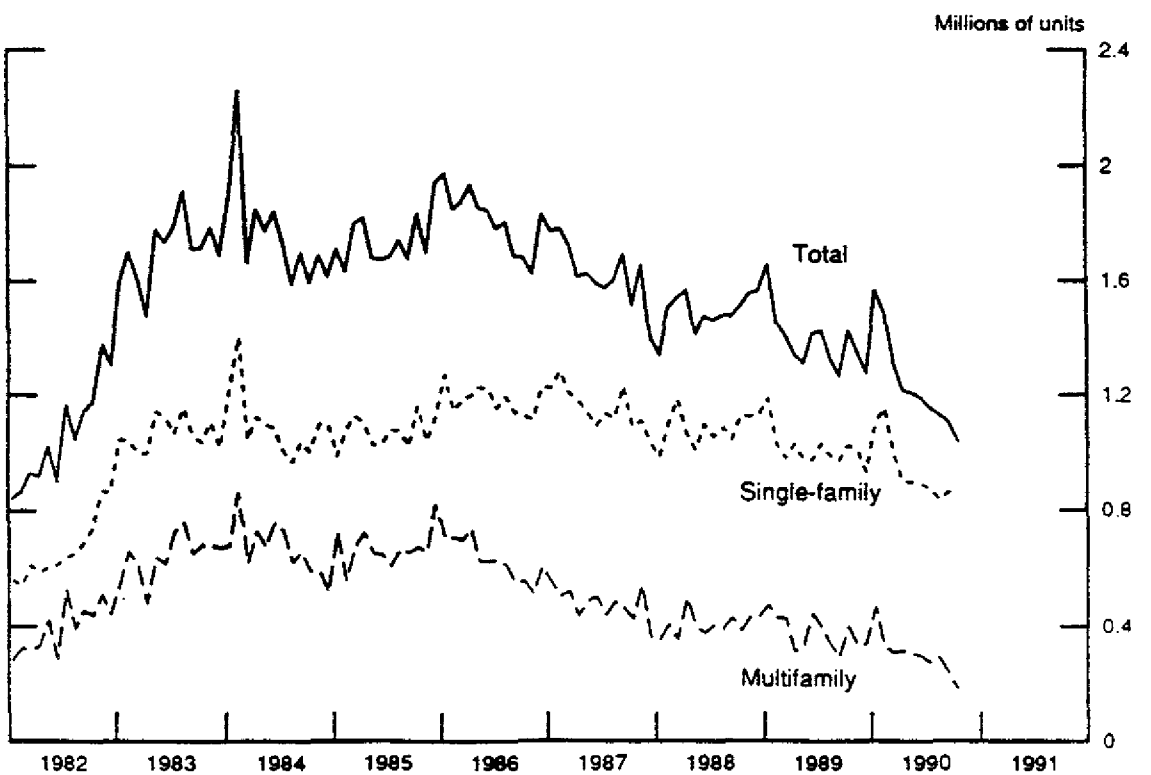
Housing activity continued on a downward path through October. Total housing starts fell to an annual rate of 1.04 million units, while building permit issuance also was down sharply. The multifamily sector accounted for

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

	1989	1990			1990		
	Annual	Q1	Q2	Q3[p]	Aug.[r]	Sep.[r]	Oct.[p]
All units							
Permits	1.34	1.42	1.09	1.04	1.05	.99	.93
Starts	1.38	1.45	1.20	1.13	1.13	1.11	1.04
Single-family units							
Permits	.93	.96	.80	.76	.76	.74	.71
Starts	1.00	1.08	.90	.86	.84	.86	.85
Sales							
New homes	.65	.59	.54	.53	.53	.51	.49
Existing homes	3.44	3.44	3.32	3.33	3.50	3.17	3.02
Multifamily units							
Permits	.41	.47	.29	.28	.29	.26	.22
Starts	.37	.37	.31	.27	.30	.24	.19
Vacancy rate[1]							
Rental units	9.3	9.4	8.5	9.5	n.a.	n.a.	n.a.
Owned units	7.1	7.6	7.9	6.6	n.a.	n.a.	n.a.

1. Percent. Owned units consist mainly of condominiums. All vacancy rate data are revised.
p Preliminary. r Revised estimates. n.a. Not available.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)

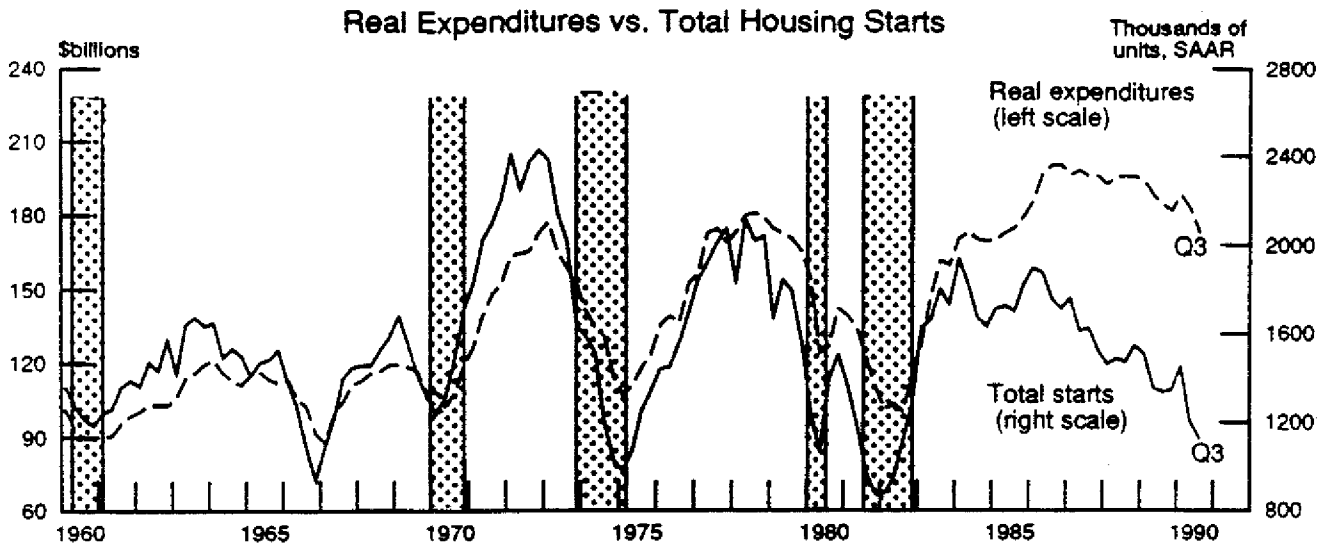


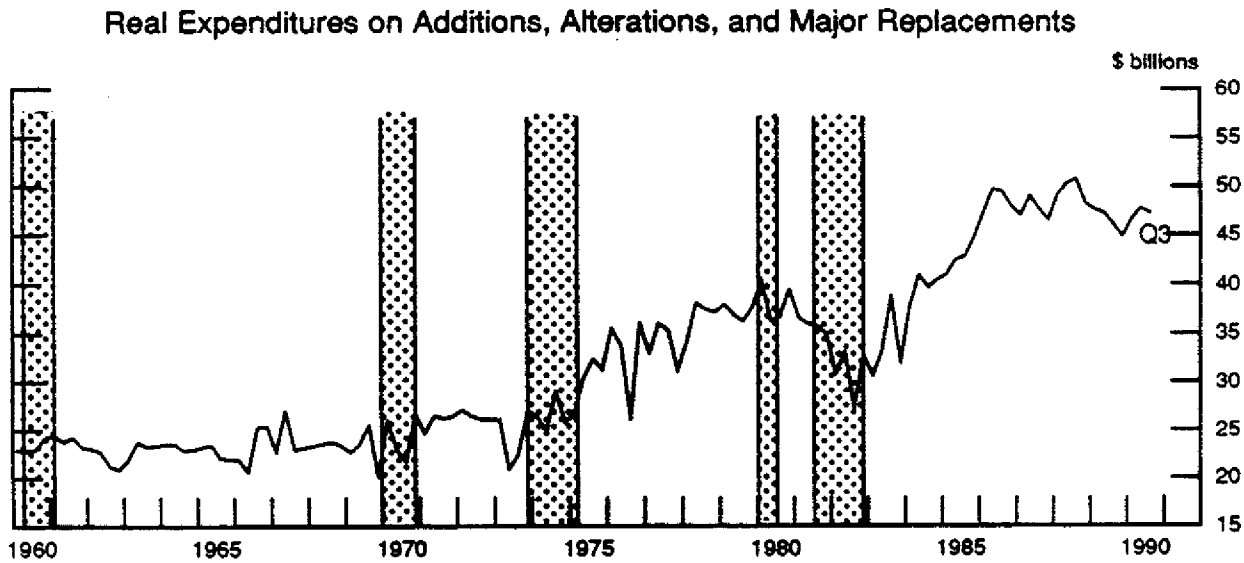
almost all of the October decline. Starts of multifamily units in October were at the lowest level in the 31 years for which data are available; in addition to high rental vacancy rates and declining real rents, regulatory restrictions on construction lending and uncertainty about federal requirements for handicapped access have been depressing influences on apartment construction this year.[4]

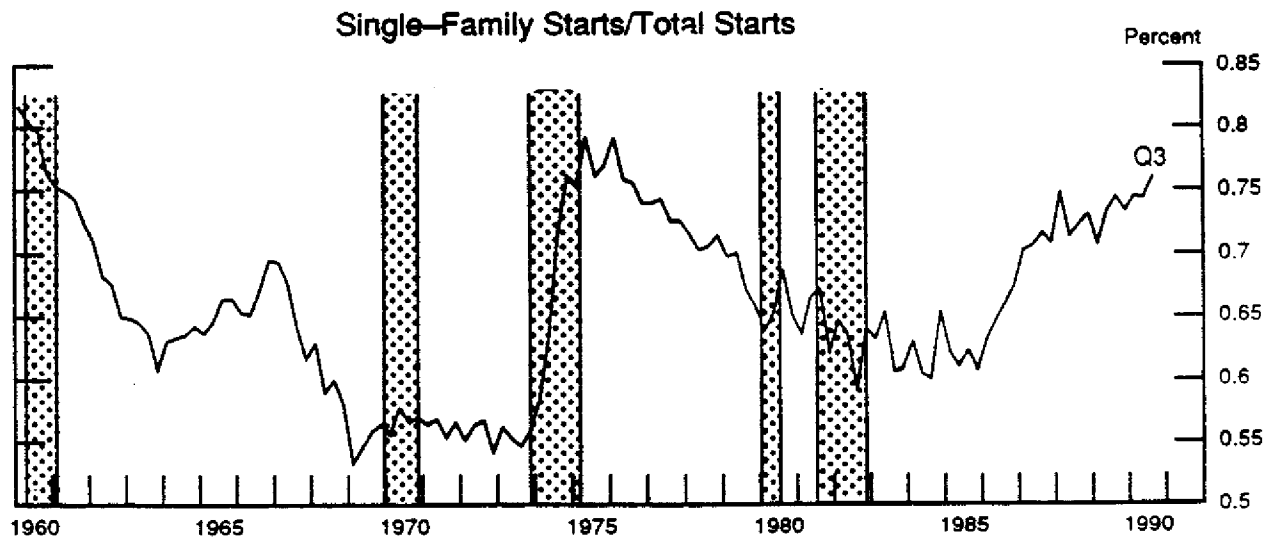
In the single-family sector, starts have been reasonably stable since early summer. However, permits, which are statistically more reliable, have drifted lower, suggesting that there has been further erosion of building activity. Demand for new single-family homes has declined noticeably this year; both the volume of new home sales and quality-adjusted prices have been weak, a pattern that points to soft demand rather than to shortages of construction credit as the primary cause of the slow pace of production. Reduced demand is evident in the market for existing homes as well: Existing home sales fell in both September and October. This pattern would be consistent with an unwillingness of sellers to cut prices as much as bid prices have fallen. The increased caution on the part of prospective buyers of both new and existing homes likely reflects declining real incomes, general economic uncertainty, and reduced expectations of investment returns from home ownership. Both the University of Michigan and the Conference Board found less positive attitudes toward homebuying in October and November; the Michigan survey found attitudes less favorable than at any time in the last six years.

4. Most multifamily developers starting projects this fall will be subject to new federal regulations regarding handicapped access. However, the final regulations have yet to be issued, and the uncertainty about the requirements is causing some builders to delay starts.

INDICATORS OF RESIDENTIAL INVESTMENT EXPENDITURES







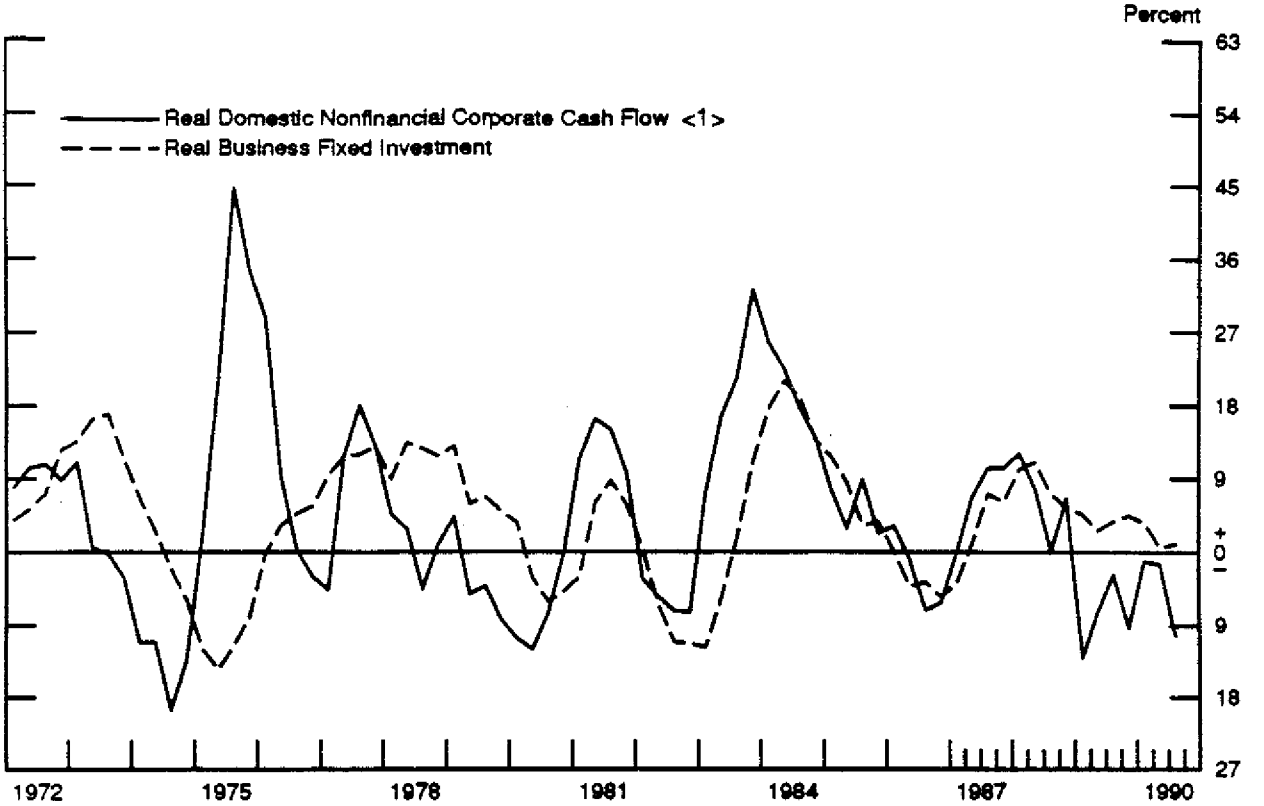
Residential investment expenditures have held up unusually well relative to housing starts in recent years (chart). Expenditures are down only 13 percent from their peak in 1986, although starts have fallen more than 40 percent. During past downturns, home improvements fell less rapidly than other residential expenditures or did not fall at all, cushioning cyclical downturns in new construction (middle panel). Since starts began trending down in 1986, home improvements have contributed to the relative stability in total residential expenditures, but expenditures have declined less rapidly than housing starts largely because the falloff in starts has been concentrated in multifamily units (bottom panel). Multifamily starts involve less than half as much construction spending per unit as single-family homes.

Business Fixed Investment

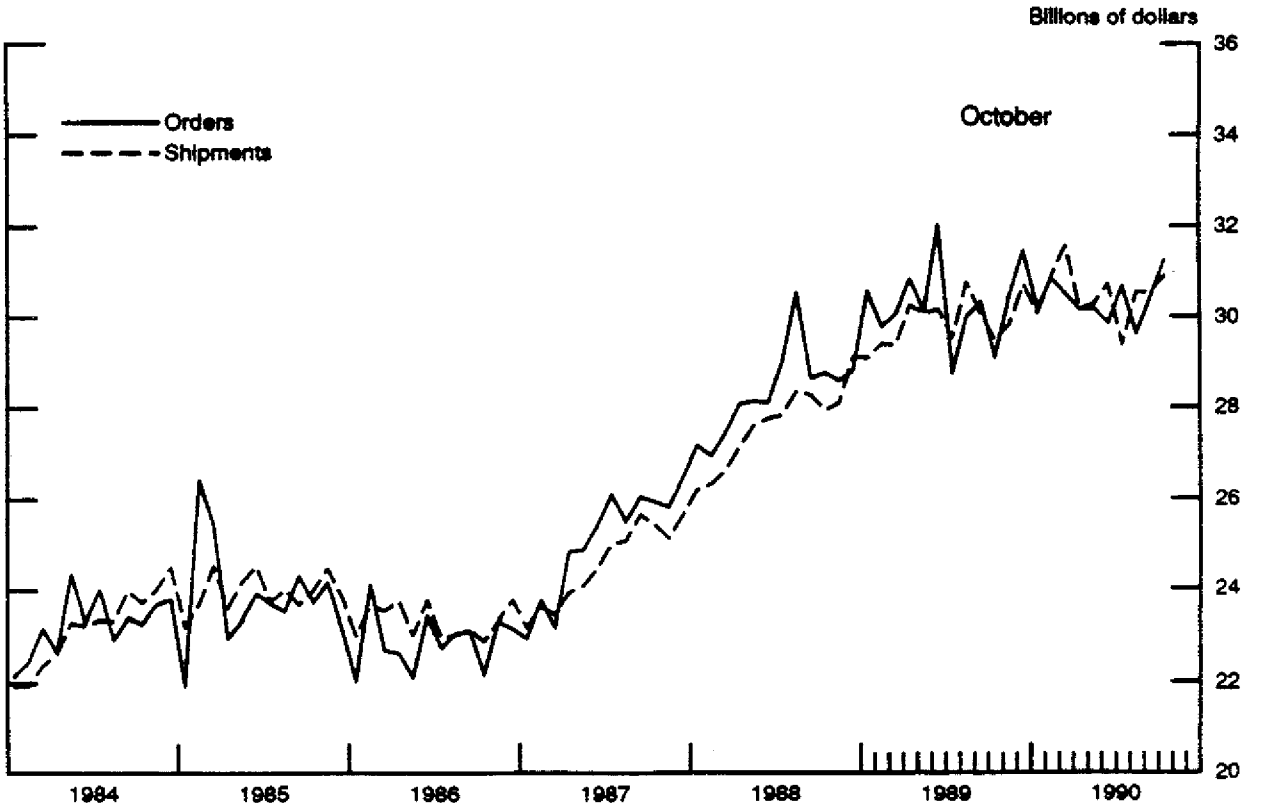
Outlays for both business equipment and structures posted gains in the third quarter. Equipment purchases jumped 10 percent (annual rate), led by surges in outlays for aircraft and motor vehicles, which likely reflected transitory factors and may be partly reversed in the current quarter.[5] The declines in cash flow in recent quarters (chart), along with the slowdown in sales, underscore the weakness in underlying determinants of business fixed investment. Given the tightening of credit availability, the reduced volume of internally generated funds may be particularly important for capital spending at this juncture.

5. Aircraft purchases rose because aircraft shipments were bunched in the third quarter and a larger-than-usual share of these shipments went to domestic--rather than foreign--airlines. The gain in motor vehicle purchases reflects, in part, strong fleet sales.

INVESTMENT AND CASH FLOW
(Four–Quarter Percent Change)



ORDERS AND SHIPMENTS OF NONDEFENSE CAPITAL GOODS
(excluding aircraft and motor vehicles and parts)



1. Depreciation plus retained earnings, with inventory valuation and capital consumption adjustments.

The most recent orders and shipments data for nontransportation equipment point to a continuation of this year's lackluster trend (chart). These data remain on the essentially flat path that has persisted since the end of last year. Shipments excluding aircraft and weighted to reflect only final business purchases rose 2.5 percent in October but remained below the levels reached earlier this year (table).

Computers have been a notable area of strength recently. Nominal shipments of computers rose nearly 3-1/4 percent (monthly rate) in October to a level 7-1/2 percent above the third-quarter average. However, the surge may be short-lived: Orders for computers, after averaging through a recent swing induced by IBM's announcement of a new line of mainframe computers, have been relatively flat.

Real outlays for nonresidential structures, which advanced 2-1/2 percent at an annual rate for the third quarter as a whole, now appear to have turned down. After falling sharply in August, nominal construction put in place decreased about 1 percent in both September and October to a level 2-3/4 percent below the third-quarter average. The October decline was led by drops in office and other commercial construction.

Commitments for future building have continued the steep downward trend that began at the end of last year (chart). Permits for office construction dropped further, pushed down by high vacancy rates, falling rents, and tight lending standards. Contracts for other commercial construction also have trended down recently; anecdotal reports suggest that financing constraints have tightened in this sector, particularly for strip shopping centers. Although industrial building continued to post gains through the third quarter, the recent decrease in new commitments for industrial construction

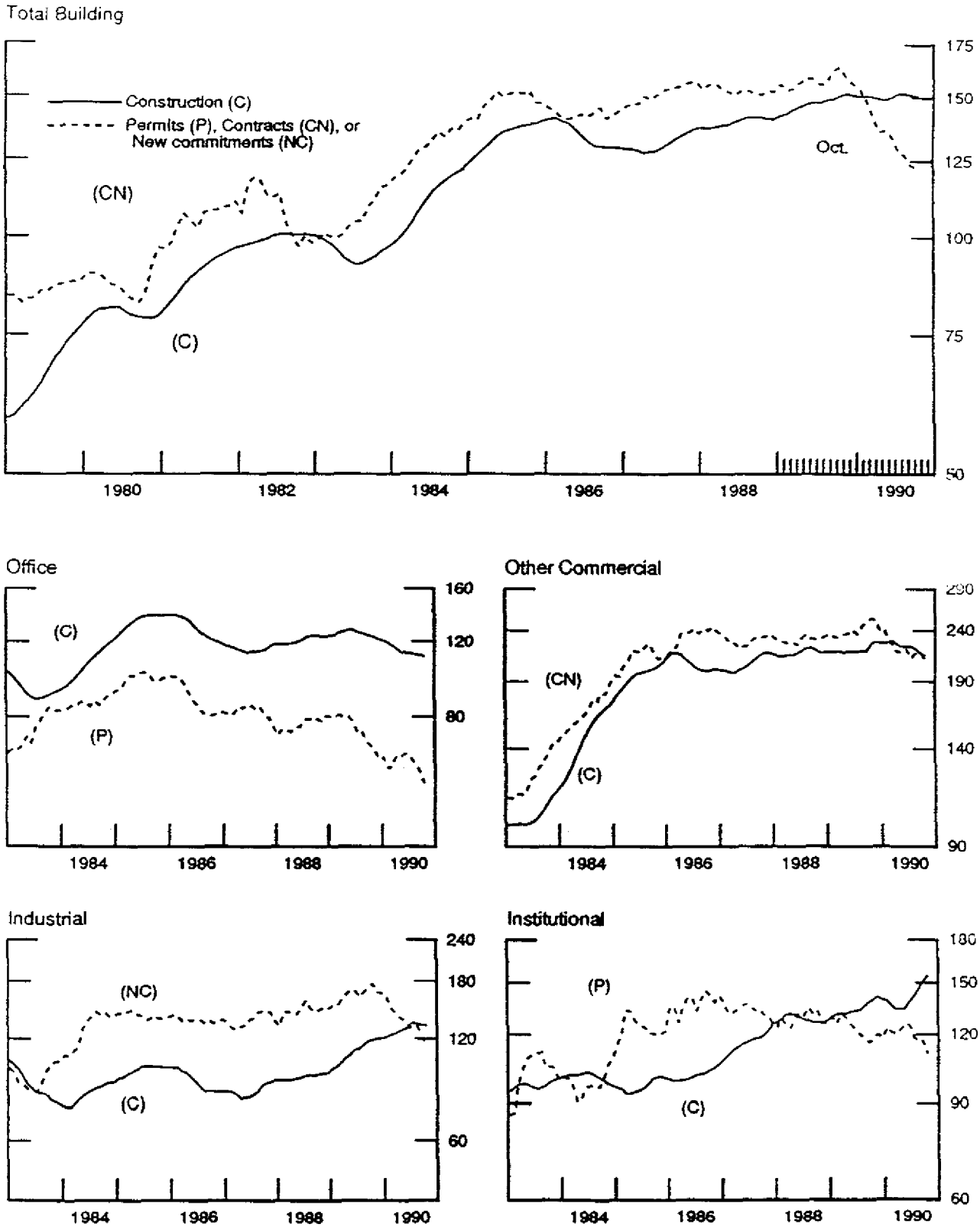
BUSINESS CAPITAL SPENDING INDICATORS
(Percentage change from preceding comparable periods;
based on seasonally adjusted data)

	1990			1990		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Producers' durable equipment						
Shipments of nondefense capital goods	4.8	-.9	1.1	4.6	-.3	-.2
Excluding aircraft and parts	2.8	-1.5	-.8	4.0	-.1	1.2
Office and computing	4.0	-1.0	-1.4	3.7	4.6	3.2
All other categories	2.5	-1.6	-.7	4.1	-1.1	.7
Weighted PDE shipments[1]	2.4	-1.4	-.1	2.9	-.2	2.5
Shipments of complete aircraft[2]	124.8	-14.3	25.7	23.0	7.9	n.a.
Sales of heavy-weight trucks	-.1	-5.9	6.4	-8.1	-1.9	-4.5
Orders of nondefense capital goods	-3.3	-5.8	4.9	-10.0	6.8	8.7
Excluding aircraft and parts	.5	-1.4	.6	-3.4	2.7	2.7
Office and computing	1.8	-1.2	5.2	-15.4	26.9	-12.6
All other categories	.3	-1.5	-.6	-.3	-2.6	7.0
Weighted PDE orders[1]	.1	-.7	.1	-2.1	1.5	4.3
Nonresidential structures						
Construction put-in-place	1.0	-.5	1.5	-3.5	-.9	-.9
Office	-4.0	-3.8	1.7	-3.3	-.1	-3.8
Other commercial	-1.5	-3.5	-1.9	-2.1	-5.3	-.7
Public utilities	2.2	-.5	.2	.1	1.4	-1.2
Industrial	8.2	.7	2.7	-14.2	-1.6	3.4
All other	2.5	4.9	5.0	-.4	.6	-1.2
Rotary drilling rigs in use	2.2	21.6	-6.0	-8.5	.9	-2.5
Footage drilled[3]	-8.2	3.8	1.9	-1.8	-2.1	7.2

1. Computed as the 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.
3. From Department of Energy. Not seasonally adjusted.
n.a. Not available.

NONRESIDENTIAL CONSTRUCTION AND SELECTED INDICATORS*

(Index, Dec. 1982 = 100, ratio scale)



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

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

	1990			1990		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Current-cost basis:						
Total	-7.0	11.2	60.0	64.1	47.9	n.a.
Total excluding retail auto	9.1	9.8	36.7	19.1	40.5	n.a.
Manufacturing	2.7	-4.2	25.2	12.2	32.2	3.3
Wholesale	2.2	7.6	8.2	6.4	3.7	5.4
Retail	-11.8	7.8	26.7	45.5	11.9	n.a.
Automotive	-16.1	1.4	23.3	45.0	7.4	n.a.
Excluding auto	4.3	6.5	3.3	.5	4.5	n.a.
Constant-dollar basis:						
Total	-25.0	6.2	4.1	-15.0	-14.9	n.a.
Total excluding retail auto	-2.4	3.3	1.6	-19.1	-11.5	n.a.
Manufacturing	1.7	-2.6	1.5	-12.8	-4.9	n.a.
Wholesale	-1.1	1.2	2.3	.1	-4.0	n.a.
Retail	-25.6	7.6	.3	-2.4	-6.0	n.a.
Automotive	-22.6	2.8	2.5	4.1	-3.5	n.a.
Excluding auto	-3.0	4.8	-2.2	-6.5	-2.5	n.a.

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

	Range in preceding 12 months:[2]		1990			1990		
	Low	High	Q1	Q2	Q3	Aug.	Sept.	Oct.
Current-cost basis:								
Total	1.46	1.51	1.48	1.48	1.48	1.46	1.48	n.a.
Total excluding retail auto	1.43	1.49	1.46	1.45	1.45	1.43	1.45	n.a.
Manufacturing	1.52	1.65	1.60	1.56	1.56	1.52	1.55	1.52
Wholesale	1.24	1.27	1.25	1.25	1.26	1.24	1.27	1.27
Retail	1.55	1.62	1.55	1.58	1.60	1.60	1.59	n.a.
Automotive	1.81	2.12	1.84	1.92	2.10	2.12	2.08	n.a.
Excluding auto	1.46	1.50	1.48	1.49	1.47	1.47	1.46	n.a.
Constant-dollar basis:								
Total	1.42	1.46	1.44	1.43	1.43	1.42	1.44	n.a.
Total excluding retail auto	1.39	1.45	1.42	1.41	1.41	1.39	1.42	n.a.
Manufacturing	1.44	1.54	1.50	1.47	1.46	1.44	1.46	n.a.
Wholesale	1.26	1.30	1.28	1.27	1.28	1.26	1.30	n.a.
Retail	1.51	1.58	1.51	1.55	1.54	1.55	1.54	n.a.
Automotive	1.72	2.04	1.73	1.82	1.84	1.89	1.83	n.a.
Excluding auto	1.44	1.49	1.46	1.48	1.46	1.46	1.47	n.a.

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

as well as the decline in capacity utilization rates suggests future weakness.

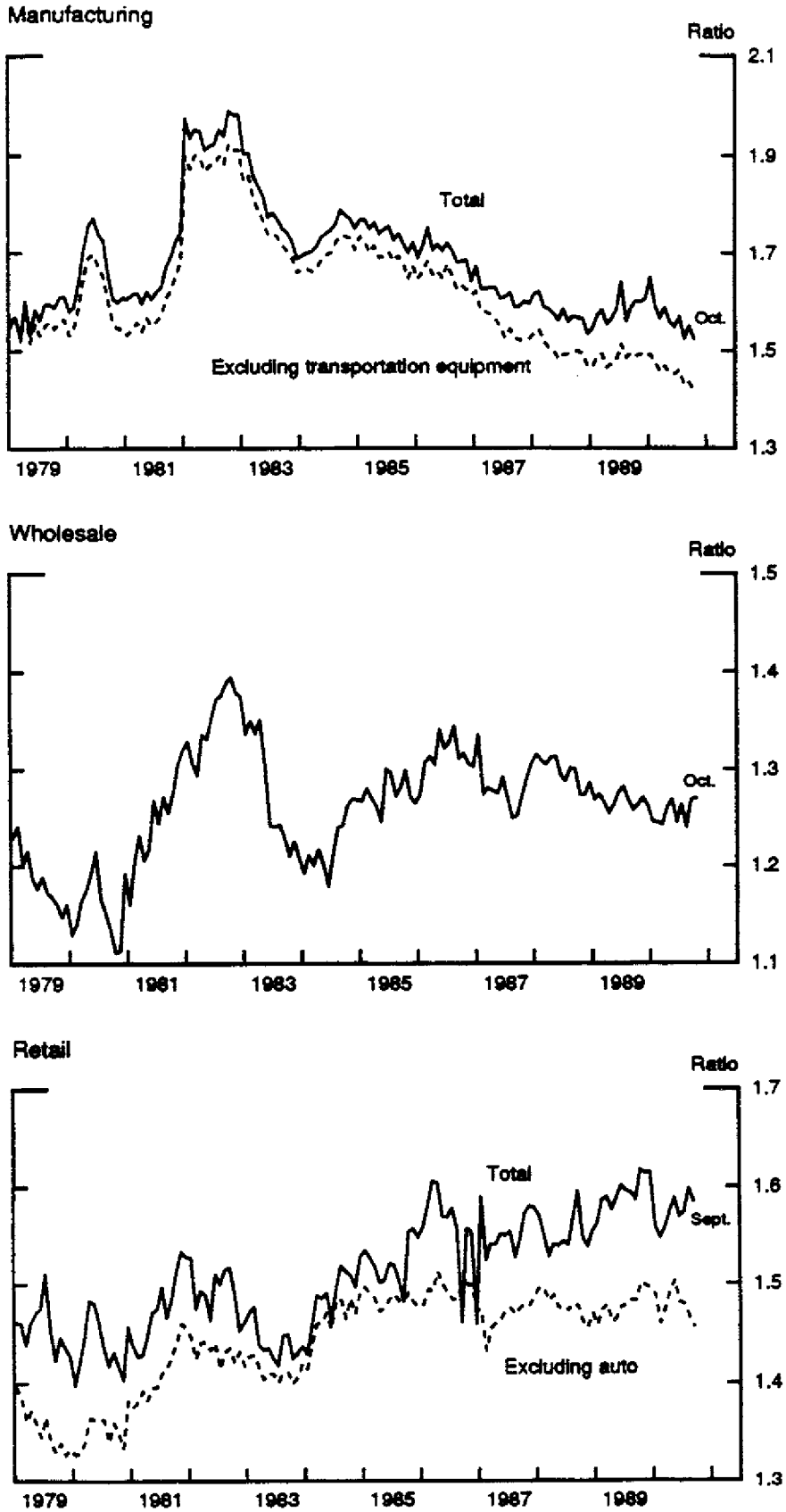
Business Inventories

Businesses remain cautious in the management of inventories. In all manufacturing and trade, stocks rose at an annual rate of $4.1 billion (1982 prices) in the third quarter, not much different from the moderate second-quarter pace of $6.2 billion. By major sector, the inventory-sales ratio in manufacturing continued to edge down and in retail and wholesale trade remained within a relatively narrow band (chart).

Within manufacturing, the Persian Gulf crisis has directly influenced inventories in the petroleum refining industry, and production adjustments in most industries outside of petroleum refining are being accompanied by reduced inventory investment. From August through October, inventories held by oil refineries were drawn down substantially.

The change in inventories in manufacturing outside of petroleum refining was only $2 billion (annual rate) in current-cost terms in October, following an average accumulation of $4-1/2 billion over the first nine months of this year. As a result of the conservative inventory stance, the inventory-to-shipments ratio for all manufacturing has trended down since the beginning of this year (chart, upper panel). Moreover, stage-of-processing data have shown little net buildup of materials stocks since

RATIO OF INVENTORIES TO SALES
(Current-cost data)



July, suggesting that production in manufacturing will remain restrained in coming months.[6]

In the wholesale trade sector, inventories rose at an annual rate of $2.3 billion in constant-dollar terms over the third quarter--only slightly above the second-quarter pace. In October, wholesale inventories excluding petroleum rose at just a $2.3 billion annual rate in current dollars, about the same as in September and less than half of the average pace in the preceding six months. Wholesale stocks of machinery and capital equipment--which accounted for a sizable part of the accumulation in wholesale inventories through the third quarter--were reduced at a $5-1/2 billion annual rate in October.

In retail trade, non-auto establishments were able to trim their stocks in August and September despite weak sales. In particular, at stores that carry nondurable goods other than food (largely apparel and general merchandise), inventories were reduced at an annual rate of $6 billion in August and September. Indeed, stocks held by stores in this category showed a net decline over the first nine months of this year--in line with the anecdotal information that general merchandisers and apparel stores have been extremely cautious in placing their orders this year, in an attempt to keep their inventories at acceptable levels.

6. In constant-dollar terms, manufacturers' materials and supplies inventories declined at a $4.2 billion annual rate during the third quarter of this year. Although, in current-cost terms, Census data showed a $7.7 billion accumulation of materials stocks in October, more than one-third of the increase was in petroleum and petrochemical industries and probably reflects higher prices.

CBO BUDGET ESTIMATES[1]
(Billions of dollars)

	Fiscal years					
	1990	1991	1992	1993	1994	1995
Outlays	1252	1363	1447	1428	1400	1458
Receipts	1031	1110	1185	1258	1344	1429
Deficit	220	253	262	170	56	29
Memo:						
Deposit insurance outlays	58	91	107	28	-44	-29
Deficit ex. deposit insurance	162	162	155	143	100	58

CBO ECONOMIC ASSUMPTIONS

	Calendar years					
	1990	1991	1992	1993	1994	1995
	--------Percent change, year-to-year------					
Real GNP	1.0	0.6	3.0	3.0	3.0	3.0
Implicit GNP deflator	4.3	4.6	3.8	3.8	3.8	3.8
CPI-U	5.4	5.3	3.8	3.8	3.8	3.8
	----------Percent, annual average---------					
Civilian unemployment rate	5.5	6.4	6.4	6.1	5.7	5.5
Interest rates						
Treasury bills	7.5	6.8	6.6	6.2	5.6	5.2
Treasury notes	8.6	8.0	7.6	7.2	6.8	6.5

1. The projections assume that revenues and outlays for major benefit programs evolve according to laws in effect at the time the projections are made, and that appropriations for other programs are consistent with the new discretionary spending caps. The projections include Social Security and the Postal Service, which are off-budget.

Federal Government Sector

In October the federal government recorded a $31 billion budget deficit, about the same as a year earlier after accounting for last year's $6 billion shift in payments from October to September.[7] Receipts totaled $78.7 billion in October, including $1.6 billion for the Defense Cooperation Account in which foreign contributions to Operation Desert Shield are recorded.[8] Excluding these contributions, receipts were about the same as the average for the third quarter, allowing for the payments of estimated personal and corporate income taxes that were due in September.

Outlays totaled $110 billion in October, boosted, in part, by higher expenditures for deposit insurance. Net deposit insurance outlays were $7 billion, including $6 billion in net outlays by the RTC and about $1 billion by the FDIC.[9] RTC outlays have surged in the first month of recent quarters, owing to the completion of end-of-quarter deals that flow over into the following month.

Hard, up-to-date information on the cost of Operation Desert Shield still is limited. Press reports vary, and the Pentagon does not give troop strengths, but it appears that force levels will grow from more than 200,000 to more than 400,000 by mid-January. The Pentagon has not yet released a revised estimate for Desert Shield outlays, but the Congressional Budget

7. When the first of the month falls on a weekend, as it did in October 1989, about $3-1/2 billion in military pay, $1 billion in supplemental security income payments, and $1-1/2 billion in veteran's benefits payments are shifted into the preceding month.

8. In November, the Defense Cooperation Account received $2.3 billion of contributions.

9. In deriving net outlays of the RTC from gross outlays, $5 billion of receipts from REFCORP were subtracted. The net outlays of the FDIC include transactions in both the Bank Insurance Fund and the FSLIC Resolution Fund.

Office's estimates now show budget authority of $12 billion and outlays of $9 billion.[10]

The CBO has released an interim assessment of the outlook for the federal budget that takes into account the recent laws enacted by Congress, including the new budget rules included in the reconciliation bill. The new estimates also incorporate an informal--and rather dated--economic forecast prepared by the CBO in October (table). The CBO now projects a $253 billion budget deficit in FY1991, excluding Operation Desert Shield, and an FY1992 deficit of $262 billion, assuming that Congress abides by the new discretiona spending caps. Excluding deposit insurance, the deficit is projected at $162 billion in FY1991 and $155 billion in FY1992. The CBO estimates that the new budget agreement reduces the deficit (relative to CBO's July baseline) by $35 billion in FY1991 and $496 billion over five years.

On an NIPA basis, real federal government purchases of goods and services (excluding CCC) fell at a 2 percent annual rate in the third quarter. Real defense purchases were unchanged in the third quarter, held down by sales of defense inventories to Saudi Arabia.[11] To date, Operation Desert Shield has had little net effect on real federal purchases, as the

10. The CBO estimate assumes no hostilities and full deployment for the rest of the fiscal year. In September, under the smaller force level assumption the Pentagon estimated $15 billion in budget authority and $11-1/2 billion in outlays. This included $2 billion (of both budget authority and outlays) for the effects on its normal fuel expenditures of a $10 per barrel increase in the price of oil. Press reports indicate that the $15 billion figure may be increased by $10 billion to reflect the further buildup in the Gulf.

11. These sales did not affect real GNP in the third quarter because they came out of inventories rather than current production. In the national income and product accounts, the offsetting entry was an increase in exports.

increased spending for this operation has been accompanied by reductions in defense spending in less critical areas. Real nondefense purchases (excluding CCC) fell at an 8 percent annual rate in the third quarter, reflecting the termination of temporary Census workers.

State and Local Government Sector

Lower-than-expected revenues appear to be restraining the spending of state and local governments, especially in states along the East Coast. A recent informal survey taken by the National Conference of State Legislatures indicates that so far in FY1991 revenues have been coming in below expectations in twelve of the twenty-one states for which data are available. Among major programs, states dealing with fiscal constraints are likely to reduce spending on education, grants to local governments, and medicaid. However, because much of medicaid is mandated by the federal government, only those states offering optional services will be able to cut medicaid outlays.

The October surge in state and local construction spending--to a level nearly 6 percent (not at an annual rate) above its third-quarter average--likely reflects noise in the data, rather than a higher underlying path for these outlays. Indeed, spending is expected to slow as governments respond to budgetary shortfalls. The results of November bond referenda seem to indicate that taxpayers prefer spending restraint. The percentage of bonds approved--at 40 percent of the total on state and local ballots--was the lowest for any general election since 1975, a clear signal of taxpayer reluctance to fund new projects. Even in California, where general obligation issues typically fare relatively well, only 24 percent were

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

	Relative importance Dec. 1989	1988	1989	1990 Q1	1990 Q2	1990 Q3	1990 Sept.	1990 Oct.
				------Annual rate-----			-Monthly rate-	
All items[2]	100.0	4.4	4.6	8.5	3.5	7.9	.8	.6
Food	16.3	5.2	5.6	11.4	2.1	3.7	.2	.4
Energy	7.4	.5	5.1	14.8	-2.0	42.7	5.6	4.5
All items less food and energy	76.3	4.7	4.4	7.5	3.9	5.7	.3	.3
Commodities	25.2	4.0	2.7	7.8	.7	2.9	.4	.2
Services	51.1	5.0	5.3	7.2	5.5	7.2	.3	.3
Memorandum:								
CPI-W[3]	100.0	4.4	4.5	8.3	3.2	8.0	.8	.7

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. 1989	1988	1989	1990 Q1	1990 Q2	1990 Q3	1990 Sept.	1990 Oct.
				------Annual rate-----			-Monthly rate-	
Finished goods	100.0	4.0	4.9	7.1	.3	11.7	1.6	1.1
Consumer foods	25.9	5.7	5.2	10.6	-3.8	.6	-.9	.9
Consumer energy	9.2	-3.6	9.5	24.7	-14.3	137.4	13.8	8.0
Other finished goods	64.9	4.3	4.2	3.6	4.2	3.2	.6	.0
Consumer goods	39.5	4.8	4.4	3.5	5.4	2.2	.6	.0
Capital equipment	25.4	3.6	3.8	4.0	2.3	5.3	.8	-.2
Intermediate materials[2]	94.9	5.3	2.5	2.5	-.4	13.4	1.9	1.6
Excluding food and energy	82.5	7.2	.9	1.0	.7	4.0	.6	.4
Crude food materials	41.9	14.2	2.8	9.1	-10.2	-7.9	-1.8	1.1
Crude energy	40.5	-9.5	17.9	.5	-39.2	296.0	12.4	18.7
Other crude materials	17.5	7.5	-3.6	4.0	13.2	8.7	-.1	-1.7

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

approved; among those rejected were bonds for higher education facilities and water projects.

Prices

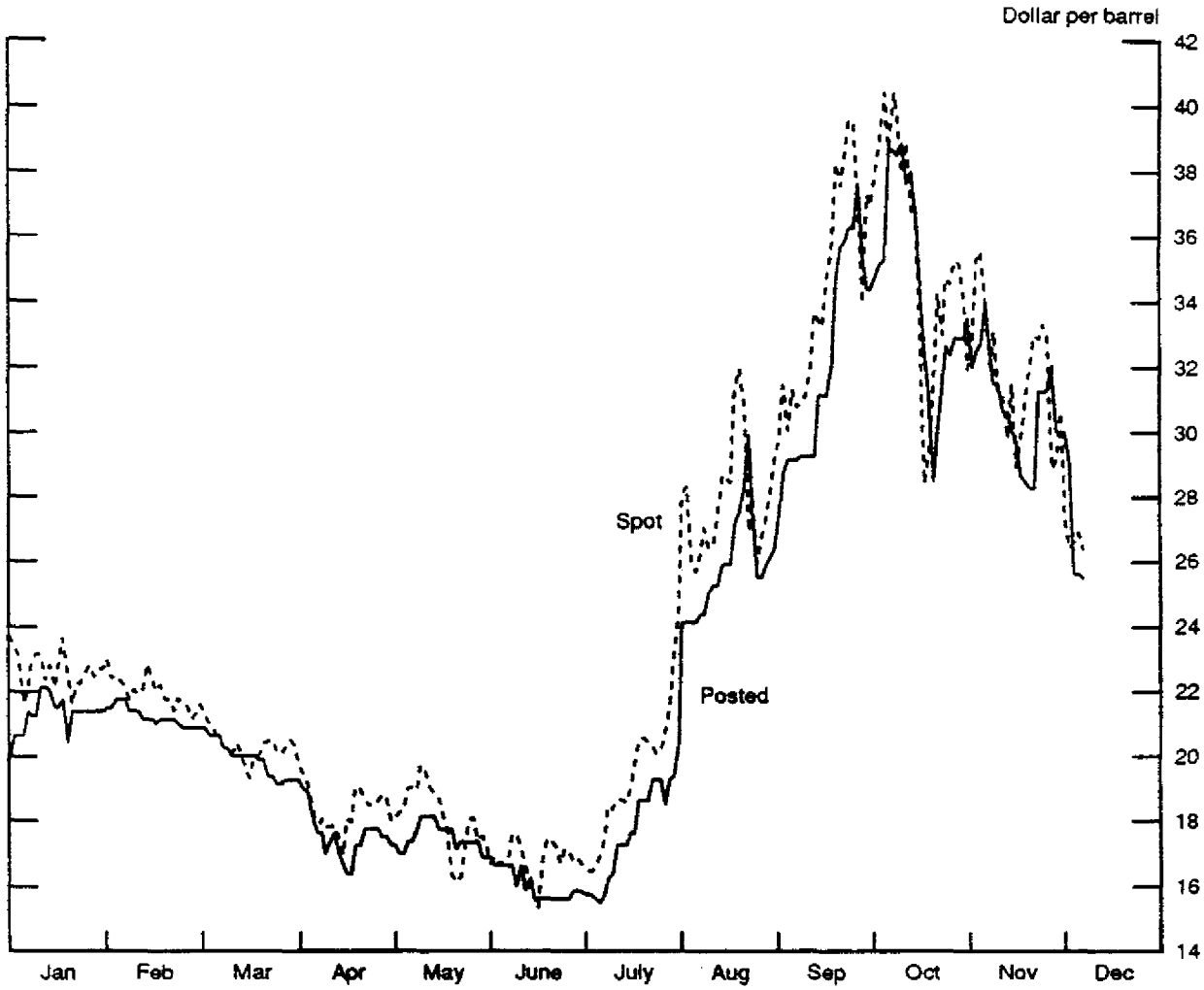
Higher crude oil prices continued to boost inflation in October, both directly through their influence on the prices of refined petroleum products and indirectly as a number of energy-intensive industries raised prices. The CPI rose 0.6 percent in October, and the PPI for finished goods was up 1.1 percent further, somewhat less than in the previous two months.

Retail energy prices rose 4-1/2 percent in October, as prices of gasoline and fuel oil climbed 7-3/4 and nearly 13 percent, respectively. Gasoline prices were 27 percent--and fuel oil 51 percent--above their July levels. Private survey data suggest that retail gasoline prices rose a bit further in November, about completing the passthrough of the surge in crude oil prices into the prices of refined petroleum products.

Spot and posted prices of crude oil have continued to fluctuate widely, as political developments have altered the market's perception of the risk of war. Posted prices of West Texas Intermediate crude averaged $31.32 per barrel--and spot prices $32.30--in November, both about $3.50 below their average levels in October (chart). Spot prices have dropped sharply since late November, to $26.40 per barrel as of December 11; however, survey data suggest that retail gasoline prices held up through early December (on a seasonally adjusted basis), as the federal excise tax was increased by 5 cents per gallon.

The CPI for food rose 0.4 percent in October. Meat prices were up markedly, reflecting higher livestock prices, but prices of fruits and vegetables edged down. More recently, hog prices have declined in spot

DAILY SPOT AND POSTED PRICES OF WEST TEXAS INTERMEDIATE



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

MONTHLY AVERAGE PRICES—WEST TEXAS INTERMEDIATE

Month	Posted	Spot
January	21.21	22.64
February	21.27	22.12
March	20.08	20.42
April	17.77	18.58
May	17.55	18.24
June	16.15	16.87
July	17.23	18.64
August	24.99	27.17
September	31.10	33.69
October	34.82	35.92
November	31.32	32.30
December *	27.98	27.63

* Price through December 11, 1990.

markets, while steer prices have remained high. Wholesale prices of some fresh vegetables also spurted temporarily in November. As of October, the year-over-year increase in the CPI for food continued at about 5-1/2 percent. Nevertheless, both current supply conditions and futures prices for agricultural commodities point to a slowing of retail food price increases in the coming year.

Excluding food and energy items, the CPI advanced 0.3 percent in October, the same as in September. Prices of nonfood, nonenergy commodities rose only 0.2 percent as apparel prices declined, reversing part of the large increase recorded in September. However, the index for new cars was up 0.5 percent, reflecting higher prices for the 1991 models included in the sample.

The CPI for nonenergy services rose 0.3 percent for the second month after three months of increases of 0.6 to 0.8 percent. In large part this recent monthly pattern reflects the index for owners' equivalent rent, which rose sharply from May to August but then about leveled off.[12] Over the twelve months ending in October, owners' equivalent rent has registered an increase of 5-1/2 percent, about 1/2 percentage point less than its annual pace during the summer. Nevertheless, in October the CPI for services less energy remained 6-1/4 percent above its level of a year earlier, owing to sharply higher prices for a variety of services, including medical care, airfares, cable television, and automobile fees.

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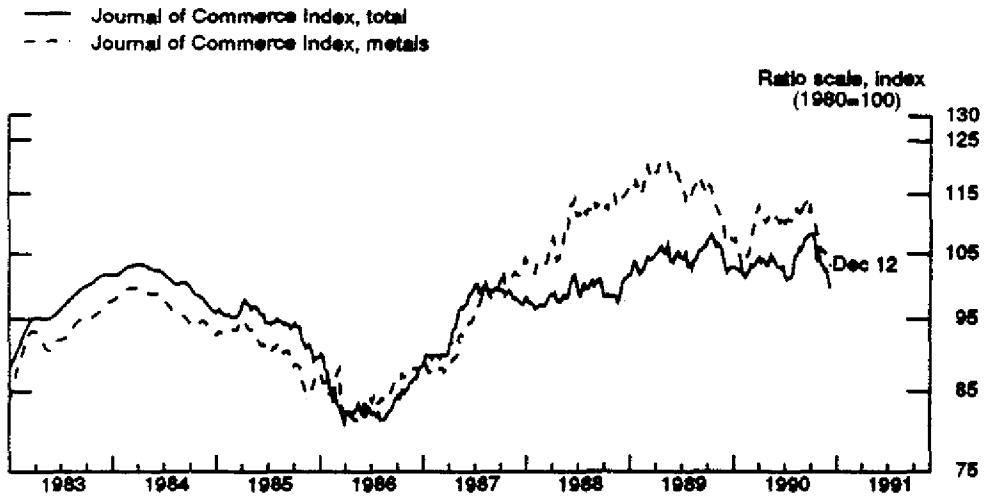
12. To compute owners' equivalent rent, the BLS adjusts contract rents--the amount tenants actually agree to pay landlords--to exclude the value of utilities provided by landlords. CPI indexes for utility charges, rather than the actual utility charges to tenants from landlords, are used in the adjustment; this procedure (together with the relative fixity of rents on a monthly basis) might explain part of the recent deceleration in the index for owners' equivalent rent.

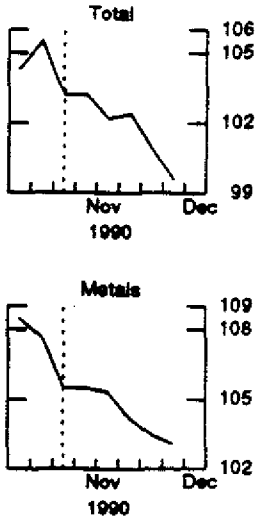
SPILLOVER EFFECTS OF HIGHER ENERGY PRICES
(Percent change; based on seasonally adjusted)

	Relative importance[1] Dec. 1989	Dec. 1989 to July 1990	Aug.	Sep.	Oct.
	----------Average monthly change----------				
CPI					
Airfares[2]	.9	1.2	.1	1.9	2.7
Other intercity transportation[2]	.2	.4	.3	1.9	-.3
Housekeeping services[2]	1.5	.3	-.1	.6	.6
Home maintenance and repair services[2]	.1	.2	-1.2	4.7	-.8
PPI finished goods					
Cosmetics and other	1.3	-.2	.2	.5	.7
Tires, tubes, etc.	.4	-.1	-.5	.7	.5
PPI intermediate materials					
Industrial chemicals	4.6	-.2	.1	4.3	3.0
Plastic products[2]	3.6	.0	.1	.3	.5
Plastic resins and materials	1.7	-.4	.7	1.2	1.3
Synthetic rubber	.3	.2	.0	.3	2.1
Paving mixtures and blocks	.3	-.1	.1	1.2	1.8
Asphalt felt and coatings	.2	-.3	-.4	1.9	2.4

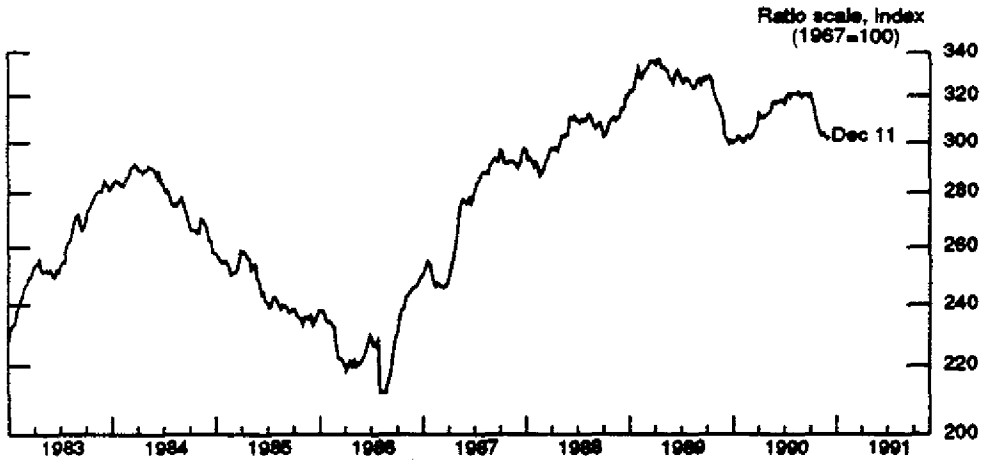
1. Weights refer to the respective totals for the CPI, PPI finished goods, and PPI intermediate materials.
2. Not seasonally adjusted.

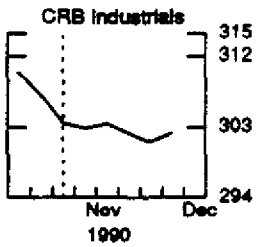
COMMODITY PRICE MEASURES *



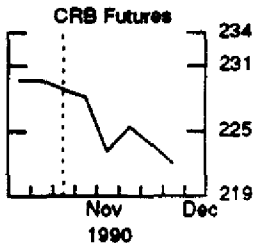


CRB Spot Industrials





CRB Futures



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

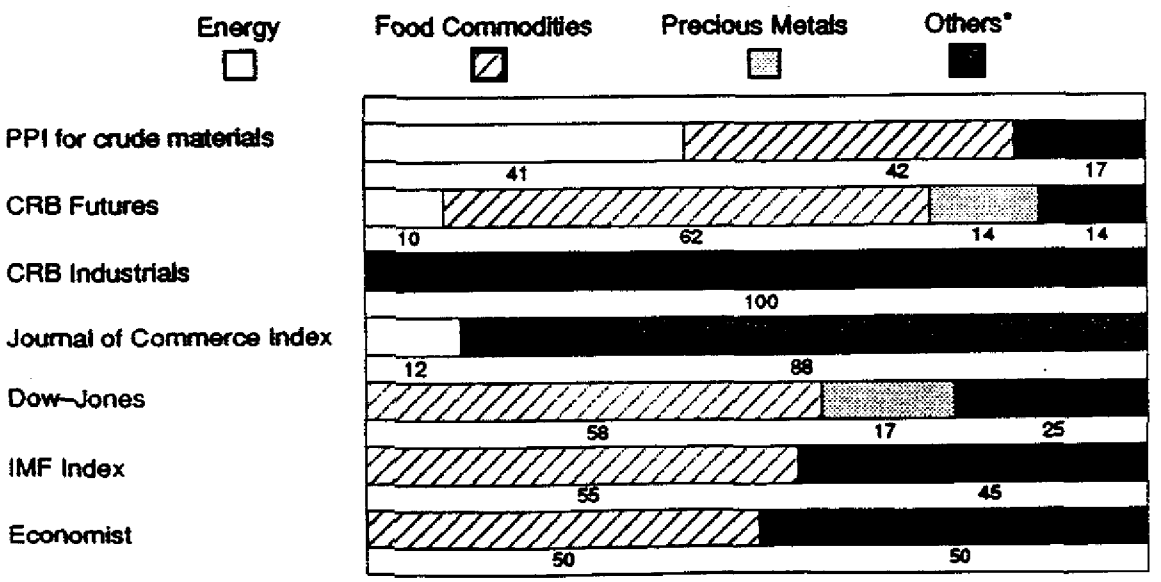
Dotted lines indicate week of last Greenbook.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last observation	Percent change[2] 1988	1989	1990 To Nov. 6[3]	1990 Nov. 6[3] to date	Memo: Year earlier to date
1. PPI for crude materials[4]	Oct.	3.1	7.1	19.6[5]	n.a.	22.0[5]
1a. Foods and feeds	Oct.	14.2	2.8	-1.5[5]	n.a.	2.8[5]
1b. Energy	Oct.	-9.5	17.9	48.0[5]	n.a.	51.7[5]
1c. Excluding food and energy	Oct.	7.5	-3.6	4.5[5]	n.a.	.2[5]
1d. Excluding food and energy, seasonally adjusted	Oct.	7.6	-3.6	4.5[5]	n.a.	.2[5]
2. Commodity Research Bureau						
2a. Futures prices	Dec. 11	8.5	-9.0	-.4	-2.9	-2.4
2b. Industrial spot prices	Dec. 10	7.3	-5.9	1.0	-.4	.4
3. Journal of Commerce industrials	Dec. 11	3.8	1.3	.3	-3.5	-2.4
3a. Metals	Dec. 11	11.0	-7.2	-1.9	-2.3	-3.4
4. Dow-Jones Spot	Dec. 11	6.9	-10.1	-4.1	.2	-3.4
5. IMF commodity index[4]	Oct.	12.6	-12.9	-2.2[5]	n.a.	-5.2[5]
5a. Metals	Oct.	33.7	-23.4	4.4[5]	n.a.	-5.4[5]
5b. Nonfood agric.	Oct.	-9.4	-4.6	1.7[5]	n.a.	-1.1[5]
6. Economist (U.S. dollar index)	Dec. 4	17.7	-22.8	-2.5	-2.3	-4.8
6a. Industrials	Dec. 4	18.9	-23.8	-2.0	-4.8	-6.5

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

Index Weights



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

Higher energy prices are beginning to spill over into the prices of other goods and services (table). The effect is most visible at the intermediate goods level where the prices of a variety of petrochemicals and derivatives have risen sharply over the past three months. Among producer prices of finished goods and consumer prices, some pickup is evident for cosmetics and tires. However, the spillover to date at the consumer level has been mainly in the prices of transportation services.

Spot prices for industrial metals have continued to weaken since early November, though not as rapidly as in the preceding weeks. The Journal of Commerce sub-index for metals has fallen about 2-1/4 percent since the November FOMC meeting, and the CRB spot index for industrials has declined 1/4 percent.

DOMESTIC FINANCIAL DEVELOPMENTS

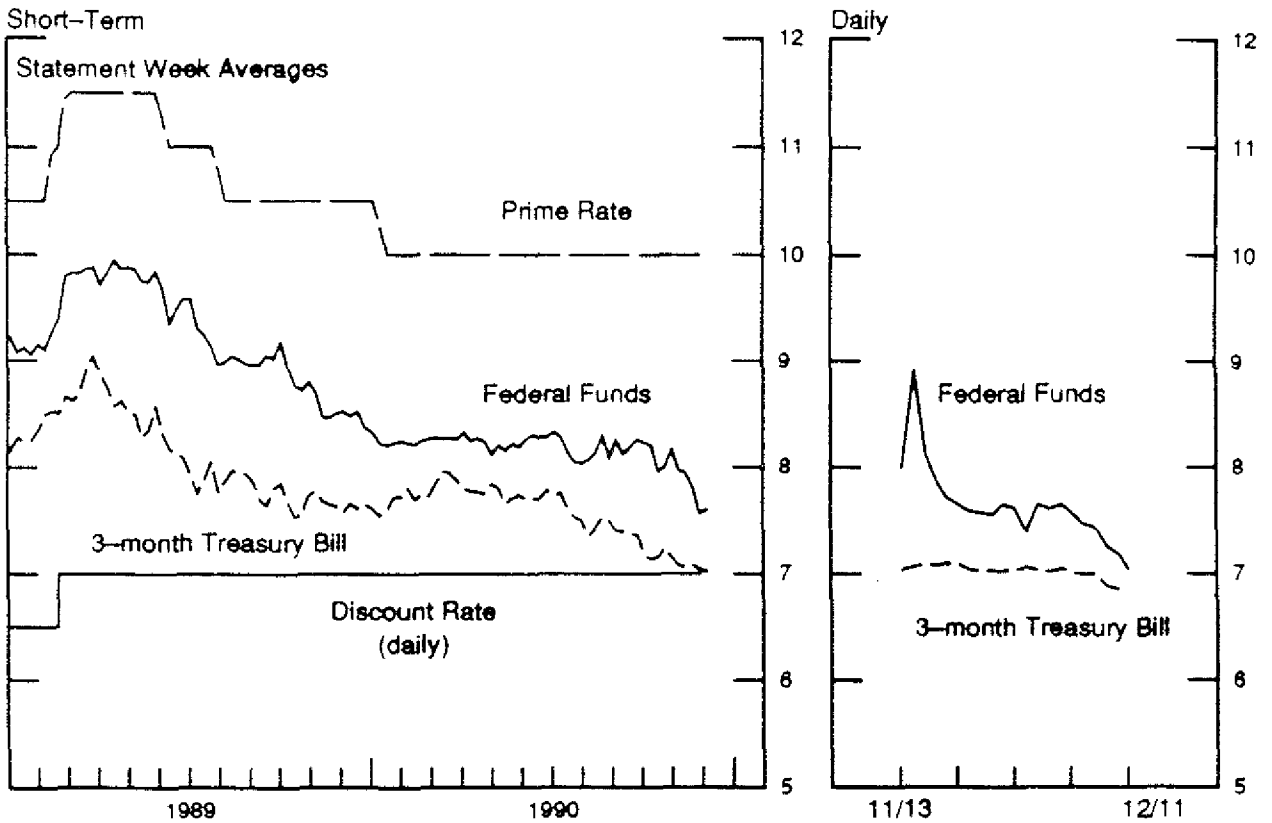
SELECTED FINANCIAL MARKET QUOTATIONS
(percent)

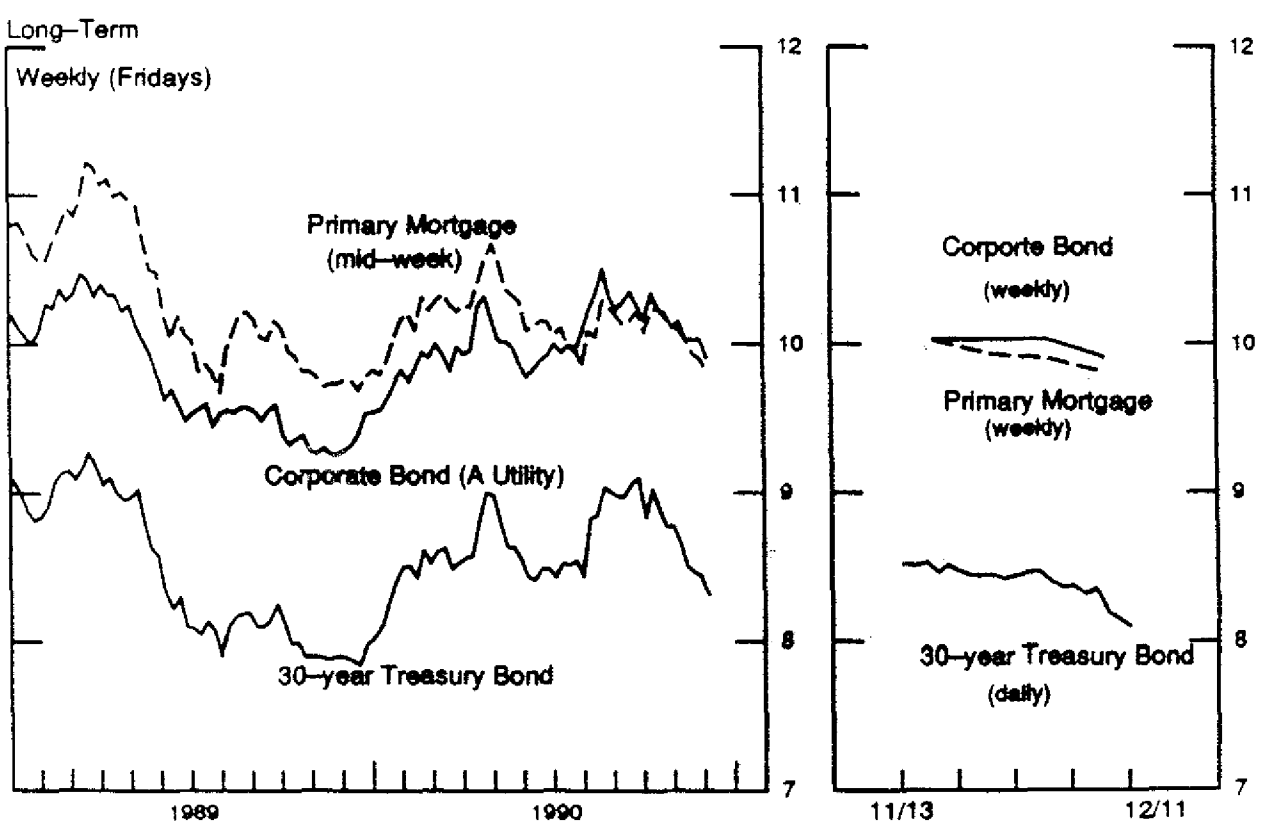
	1989		1990			Change from:		
	March highs	Dec lows	Aug highs	FOMC Nov 13	Dec 11	Dec 89 lows	Aug 90 highs	FOMC Nov 13
Short-term rates								
Federal funds[2]	9.85	8.45	8.21	7.88	7.43	-1.02	-.78	-.45
Treasury bills[3]								
3-month	9.09	7.53	7.59	7.04	6.84	-.69	-.75	-.20
6-month	9.11	7.29	7.51	7.04	6.73	-.56	-.78	-.31
1-year	9.05	7.11	7.45	6.84	6.64	-.47	-.81	-.20
Commercial paper								
1-month	10.05	8.51	8.10	7.86	7.74	-.77	-.36	-.12
3-month	10.15	8.22	8.05	7.87	7.44	-.78	-.61	-.43
Large negotiable CDs[3]								
1-month	10.07	8.52	8.14	7.86	7.76	-.76	-.38	-.10
3-month	10.32	8.22	8.18	7.96	7.53	-.69	-.65	-.43
6-month	10.08	8.01	8.25	7.89	7.46	-.55	-.79	-.43
Eurodollar deposits[4]								
1-month	10.19	8.38	8.13	7.81	7.81	-.57	-.32	.00
3-month	10.50	8.25	8.19	7.94	7.56	-.69	-.63	-.38
Bank prime rate	11.50	10.50	10.00	10.00	10.00	-.50	.00	.00
Intermediate- and long-term rates								
U.S. Treasury (constant maturity)								
3-year	9.88	7.69	8.50	7.70	7.38	-.31	-1.12	-.32
10-year	9.53	7.77	9.05	8.37	7.94	.17	-1.11	-.43
30-year	9.31	7.83	9.17	8.52	8.10	.27	-1.07	-.42
Municipal revenue[5] (Bond Buyer)	7.95	7.28	7.80	7.53	7.33	.05	-.47	-.20
Corporate--A utility recently offered	10.47	9.29	10.50	10.10	9.85	.56	-.65	-.25
Home mortgage rates[6]								
S&L fixed-rate	11.22	9.69	10.29	10.09	9.81	.12	-.48	-.28
S&L ARM, 1-yr.	9.31	8.34	8.39	8.09	8.04	-.30	-.35	-.05

	Record highs	Date	1989 Lows Jan 3	1990 FOMC Nov 13	1990 Dec 11	Percent change from: Record highs	1989 lows	FOMC Nov 13
Stock prices								
Dow-Jones Industrial	2999.75	7/16/90	2144.64	2535.40	2586.14	-13.79	20.59	2.00
NYSE Composite	201.13	7/16/90	154.98	173.31	178.42	-11.29	15.12	2.95
AMEX Composite	397.03	10/10/89	305.24	295.56	306.11	-22.90	.29	3.57
NASDAQ (OTC)	485.73	10/9/89	378.56	352.87	367.99	-24.24	-2.79	4.28
Wilshire	3523.47	10/9/89	2718.59	2968.18	3063.74	-13.05	12.70	3.22

1/ One-day quotes except as noted.
2/ Average for two-week reserve maintenance period closest to date shown. Last observation is average to date for the maintenance period ending December 12, 1990.
3/ Secondary market.
4/ Bid rates for Eurodollar deposits at 11 a.m. London time.
5/ Based on one-day Thursday quotes and futures market index changes.
6/ Quotes for week ending Friday closest to date shown.

Selected Interest Rates*
(percent)





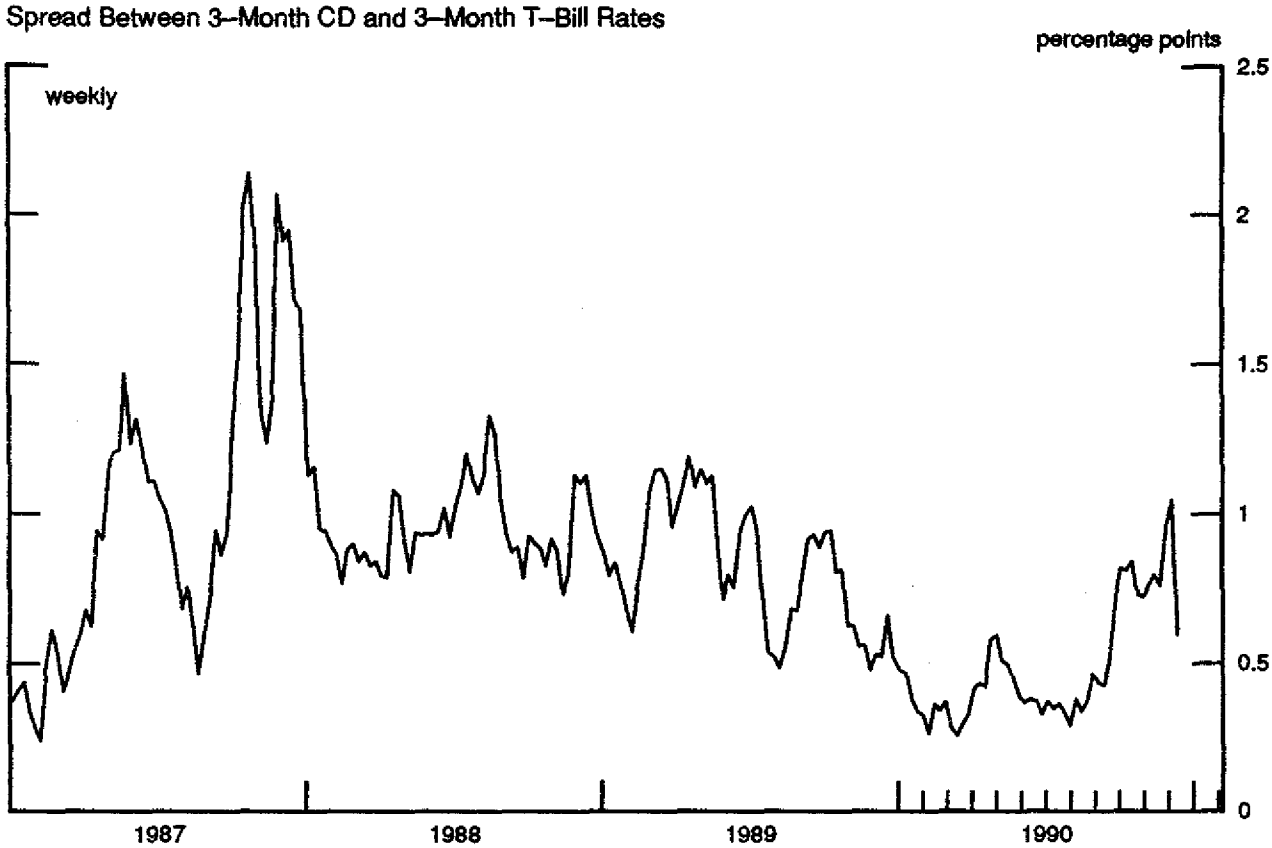
*—Friday weeks through December 7, Wednesday weeks through December 5.

Signs of a weakening economy, hopes of avoiding a disruption of oil supplies, and an easing of monetary policy have caused market interest rates to fall since the November FOMC meeting. The federal funds rate has dropped to 7-1/4 percent, for a decline of roughly 1/2 percentage point since mid-November, and most other market interest rates are down 20 to 45 basis points.

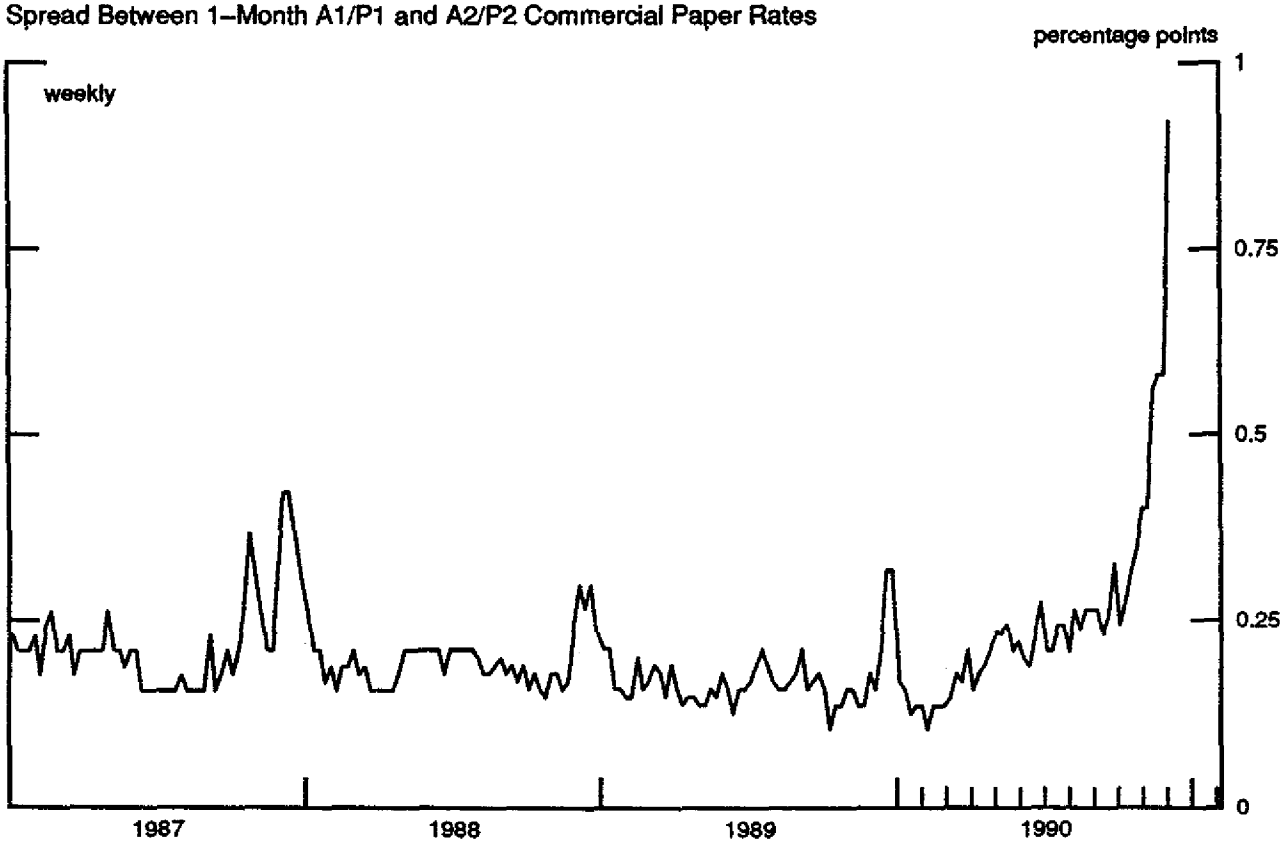
For a time late last month, concerns about potential year-end pressures and bank funding needs intensified dramatically, pushing yields on bank-related securities sharply higher relative to those on Treasury obligations. Partly in reaction to the Board's decision to reduce reserve requirements, however, these spreads narrowed, and bank stock prices rose. This action apparently was interpreted by market participants as possibly signalling a more accommodative monetary policy stance, the Federal Reserve's willingness to take steps to prevent a funding crunch at year-end, and the Federal Reserve's sensitivity to stresses in the banking sector.

Although quality spreads in bank funding markets are now below the levels of the previous FOMC meeting, many remain higher than a few months ago (chart). Further deterioration in the credit quality of bank loan portfolios, along with capital considerations, has induced banks to widen interest rate margins on some loans; in addition, the prime rate has remained unchanged despite further easing of the federal funds rate. In the commercial paper market, risk premiums have increased, on balance, since mid-November. A2/P2 issuers have faced strong investor resistance, causing

Spread Between 3-Month CD and 3-Month T-Bill Rates



Spread Between 1-Month A1/P1 and A2/P2 Commercial Paper Rates



quality spreads to widen (chart) and inducing some issuers to tap their backup lines of credit at banks.

Drawdowns of these lines may be one factor behind the turnaround in C&I loans last month, at a time when nonfinancial commercial paper was declining. The fall-off in commercial paper also may reflect some substitution with public bond issuance, which has picked up substantially in response to the drop in long-term rates. Overall, business credit demand appears to have firmed of late, while for households available data suggest that mortgage borrowing has remained subdued and consumer credit has weakened further.

M2 edged down in November, despite a further reduction in opportunity costs of holding monetary assets. The continued weak expansion in bank credit, along with the ongoing retrenchment in the thrift industry, contributed to a second straight monthly decline in M3.

Monetary Aggregates and Bank Credit

After falling in October, M1 grew at a 4 percent rate in November, reflecting a bounceback in transactions accounts. Currency growth, which had been running at a 12-1/2 percent rate through October, came in at about one-third the rate in November. In previous months, shipments abroad had fueled much of the rapid expansion in currency.

M2 edged down last month after barely increasing in October. Nearly all of its nontransactions components were weak. Money market mutual funds, which had grown rapidly in the three preceding months, fell in November, perhaps reflecting the rebound in stock prices. Monthly flows into M2 money funds have been inversely correlated with changes in stock prices during

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

	1989[1]	1990 Q2	1990 Q3	1990 Sep	1990 Oct	1990 Nov pe	Growth Q4 89- Nov 90pe
	----------Percent change at annual rates----------						
1. M1	0.6	3.5	4.1	9.3	-3.1	4	4
2. M2	4.6	3.2	3.1	5.2	0.5	-1	3¾
3. M3	3.3	1.1	1.5	0.4	-1.1	-1	1¾
	----------Percent change at annual rates----------						Levels bil. $ Oct 90
Selected components							
4. M1-A	0.4	1.6	6.8	12.1	-0.7	3	529.2
5. Currency	4.8	9.2	11.6	15.6	12.4	4	244.0
6. Demand deposits	-2.8	-4.7	2.6	7.8	-12.4	1	276.8
7. Other checkable deposits	1.0	7.1	-0.8	4.1	-7.0	6	290.9
8. M2 minus M1[2]	5.9	3.1	2.8	3.9	1.6	-2	2501.0
9. Overnight RPs and Eurodollars, NSA	-8.6	-2.0	5.9	-17.4	39.8	-73	84.2
10. General purpose and broker/dealer money market mutual fund shares	29.7	1.2	13.2	21.4	9.8	-5	344.7
11. Commercial banks	7.5	10.3	11.3	6.4	12.7	2	1159.7
12. Savings deposits plus MMDAs[3]	-1.7	8.6	7.5	4.4	3.8	1	574.3
13. Small time deposits	19.0	12.1	15.3	8.2	21.5	4	585.4
14. Thrift institutions	-0.2	-4.0	-10.0	-6.2	-16.1	-4	914.6
15. Savings deposits plus MMDAs[3]	-9.3	1.4	-5.3	-3.8	-12.3	-3	346.9
16. Small time deposits	5.8	-7.1	-12.8	-7.7	-18.3	-5	567.7
17. M3 minus M2[4]	-1.3	-7.3	-5.2	-20.0	-7.9	-3	768.0
18. Large time deposits	4.2	-10.3	-8.8	-17.4	-15.1	-10	510.0
19. At commercial banks, net[5]	9.9	-2.8	-0.8	-14.2	-8.0	-1	389.0
20. At thrift institutions	-7.8	-30.1	-31.4	-27.2	-37.5	-40	121.0
21. Institution-only money market mutual fund shares	17.1	11.5	22.0	22.1	38.2	3	119.8
22. Term RPs, NSA	-14.7	5.0	0.8	-46.4	-40.6	-3	91.3
23. Term Eurodollars, NSA	-21.9	-22.4	1.2	-3.6	-9.0	24	65.9
	-----Average monthly change in billions of dollars----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	6.0	-1.7	1.0	-7.3	5.4	-2	732.1
25. Large time deposits, gross	2.6	-1.5	-2.4	-5.2	-4.0	-2	441.5
26. Nondeposit funds	3.5	-0.1	3.4	-2.1	9.4	0	290.6
27. Net due to related foreign institutions	0.2	-0.9	1.5	2.5	9.0	-1	28.2
28. Other[7]	3.3	0.7	2.0	-4.5	0.3	1	262.4
29. U.S. government deposits at commercial banks[8]	-0.3	0.4	2.6	-5.0	-6.3	5	21.9

1. Amounts shown are from fourth quarter to fourth quarter.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Commercial bank savings deposits excluding MMDAs grew during October and November at rates of 7.9 percent and -2 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during October and November at rates of -13.7 percent and -5 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
6. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
7. Consists of borrowing from other than commercial banks in the form of federal funds purchased, 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.

pe - preliminary estimate

1990, suggesting that individual investors tend to tilt the composition of their portfolios away from safer assets during a market upturn (chart).

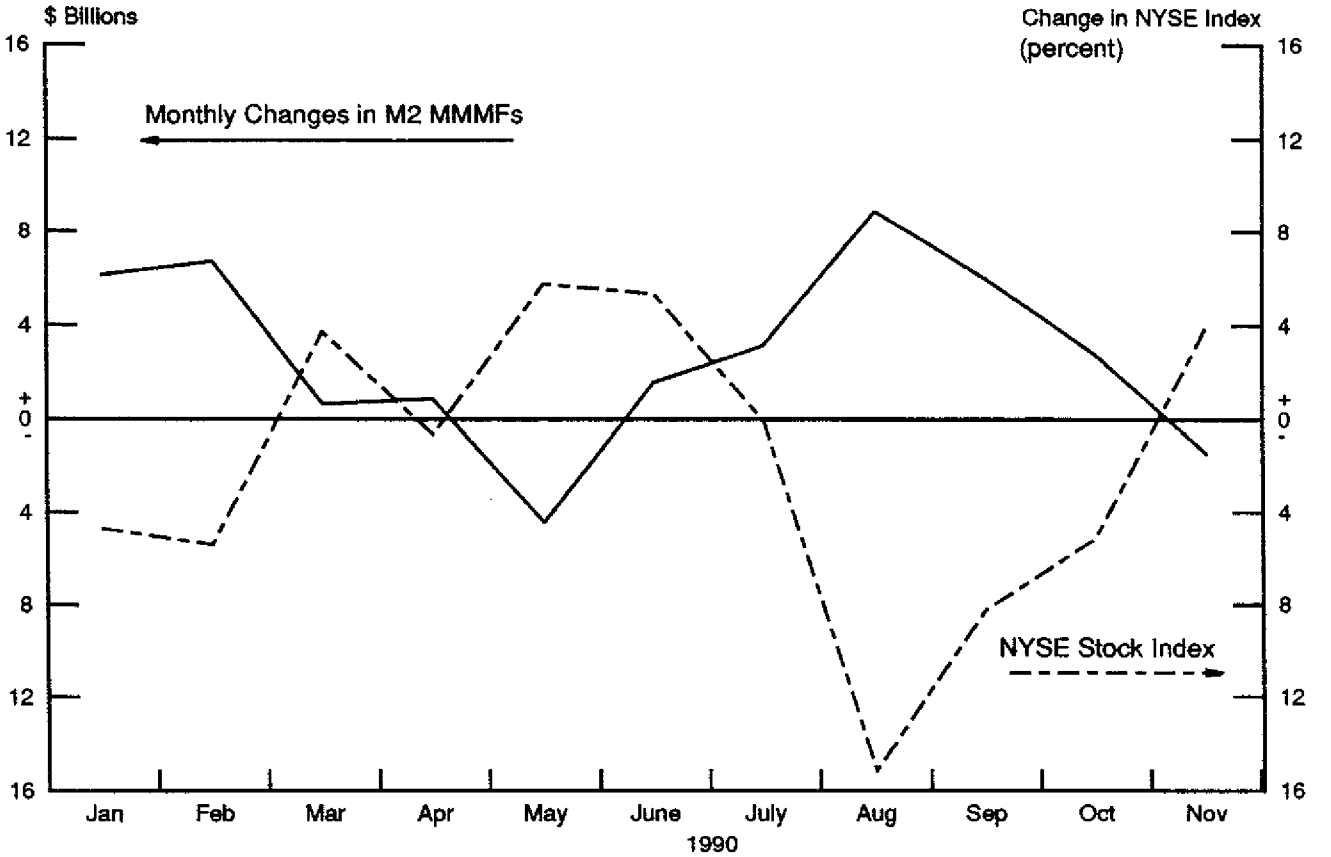
More important, however, slow M2 growth in the fourth quarter reflects a weak underlying trend in nontransactions deposits--savings, small time, and money market deposit accounts--which make up almost two-thirds of this aggregate. These deposits decelerated in September from an already sluggish August pace and have declined in the two most recent months. At commercial banks, which previously benefited from the exodus from thrifts, nontransactions deposits grew at only a 2-1/4 percent rate in November--the slowest pace in nearly two years.

Even after allowing for weak income growth, the deceleration in retail deposit growth since August is puzzling because opportunity costs have been declining since earlier in the year. Money demand models suggest that the decline in opportunity costs should have raised nontransactions deposit growth more than a percentage point in the third quarter and by a comparable amount in the fourth quarter. Instead, deposit growth has slowed, perhaps reflecting a shift in asset preferences toward other instruments, as suggested by the strong pace of noncompetitive tenders for Treasury securities and by a pickup in inflows to stock and bond funds.

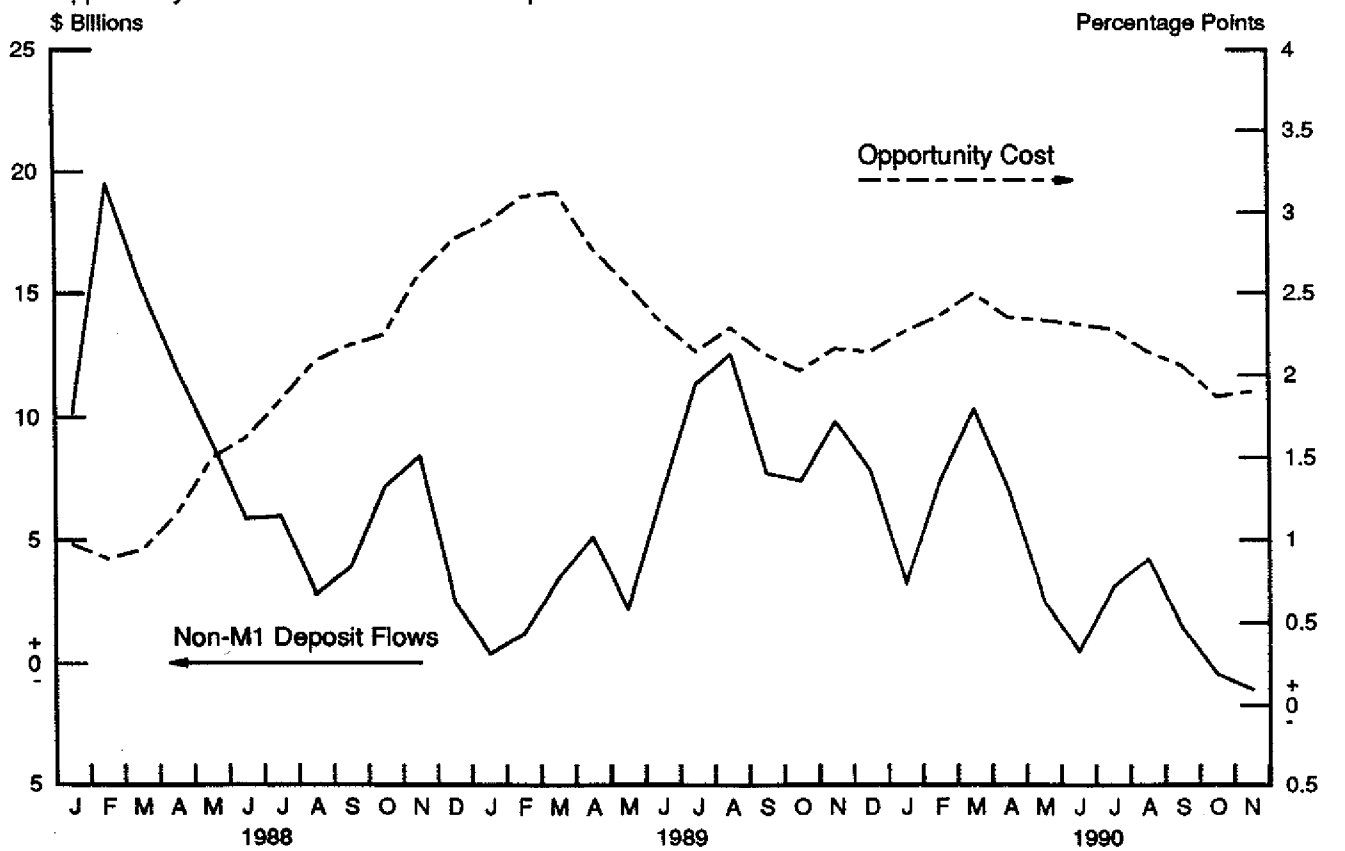
In November, M3 declined at a 1 percent rate for a second consecutive month. Large time deposits continued to fall, owing to weak credit demand and the desire of many depositories to shrink their balance sheets ahead of year-end statement dates.

Consistent with this pattern of M3 growth, thrift credit likely contracted at a good clip last month, while bank credit remained anemic. Although business loan growth at banks turned positive, other major

M2 Money Fund Flows and Stock Prices



Opportunity Costs and Non-M1 Retail Deposit Flows



components were weak. As part of their downsizing efforts, banks ran off securities and securitized large amounts of consumer and home equity loans in November.

Reflecting the cautious attitudes of borrowers and lenders, real estate loans grew at a 5 percent rate in November, down from 8 percent in October. Although about $1 billion of home equity loans and other second mortgages were securitized in November, this occurred late in the month and consequently had little effect on the overall growth rate of real estate loans. Excluding home equity lines, real estate lending was even weaker at about 2 percent.

Consumer loans fell at a 3 percent annual rate in November, marking their second straight monthly decline. Adjusted for securitizations, consumer loans grew at only a 2 percent rate, down sharply from the rates prevailing throughout much of the year. Survey results suggest that this deceleration may reflect an increased reluctance on the part of consumers to take on new debt, as income growth becomes both slower and more uncertain, rather than a recent tightening in lending standards. Surveys of bank loan officers taken during 1990 indicate that the change in banks' willingness to make consumer installment loans has only turned from slightly positive, on balance, a year ago to about unchanged recently.

Business loans rose at a 5-3/4 percent annual rate last month after declining in both September and October. The November gains partly reflect a drop in commercial paper outstanding of nonfinancial businesses, as some medium- and lower-rated firms turned to bank backup lines to avoid higher costs of issuing paper relative to borrowing from banks. In addition, some issuers reportedly tapped their backup lines to test their availability.

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

		1988:Q4 to 1989:Q4	1990 Q2	Q3	Sep.	Oct.	Nov. p	Levels bil.$ Nov. p
		Commercial Bank Credit						
1.	Total loans and securities at banks	7.5	5.2	5.8	.1	.9	1.8	2715.0
2.	Securities	4.1	9.4	6.5	11.6	3.3	-2.1	627.4
3.	U.S. government securities	10.0	15.4	7.8	16.0	11.8	.5	452.1
4.	Other securities	-6.7	-4.4	3.1	.7	-18.1	-8.8	175.3
5.	Total loans	8.5	3.9	5.6	-3.3	.3	3.0	2087.6
6.	Business loans	6.9	4.9	.9	-2.4	-2.6	5.4	652.3
7.	Real estate loans	13.3	9.3	6.4	3.4	8.1	5.0	824.0
8.	Consumer loans	6.3	-.8	3.1	3.2	-.3	-3.1	380.2
9.	Security loans	3.8	-20.4	88.4	-75.7	-47.3	-43.5	39.9
10.	Other loans	1.5	-6.5	8.3	-28.7	-6.3	9.7	191.2
		Short- and Intermediate-Term Business Credit						
11.	Business loans net of bankers acceptances	7.0	4.7	1.1	-3.0	-2.6	5.0	644.6
12.	Loans at foreign branches[2]	-5.0	9.2	28.8	80.7	25.2	24.7	24.8
13.	Sum of lines 11 & 12	6.5	4.8	2.0	-.2	-1.6	5.8	669.4
14.	Commercial paper issued by nonfinancial firms	31.2	9.3	16.8	50.3	19.0	-24.9	150.9
15.	Sum of lines 13 & 14	10.0	5.6	4.6	8.7	2.2	.0	820.3
16.	Bankers acceptances: U.S. trade related[3,4]	6.1	-9.8	-27.6	-19.9	12.1	n.a.	30.0[5]
17.	Line 15 plus bankers acceptances: U.S. trade related	9.8	5.0	3.5	7.8	2.5	n.a.	850.5[5]
18.	Finance company loans to business[3]	10.6	15.4	20.7	17.1	10.6	n.a.	286.8[5]
19.	Total short- and intermediate-term business credit (sum of lines 17 & 18)	10.0	7.5	7.6	10.1	4.6	n.a.	1137.3[5]

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

All of the increase in business loans occurred at foreign-related institutions, principally Japanese branches and agencies, where loan commitments had grown rapidly in the past few years.

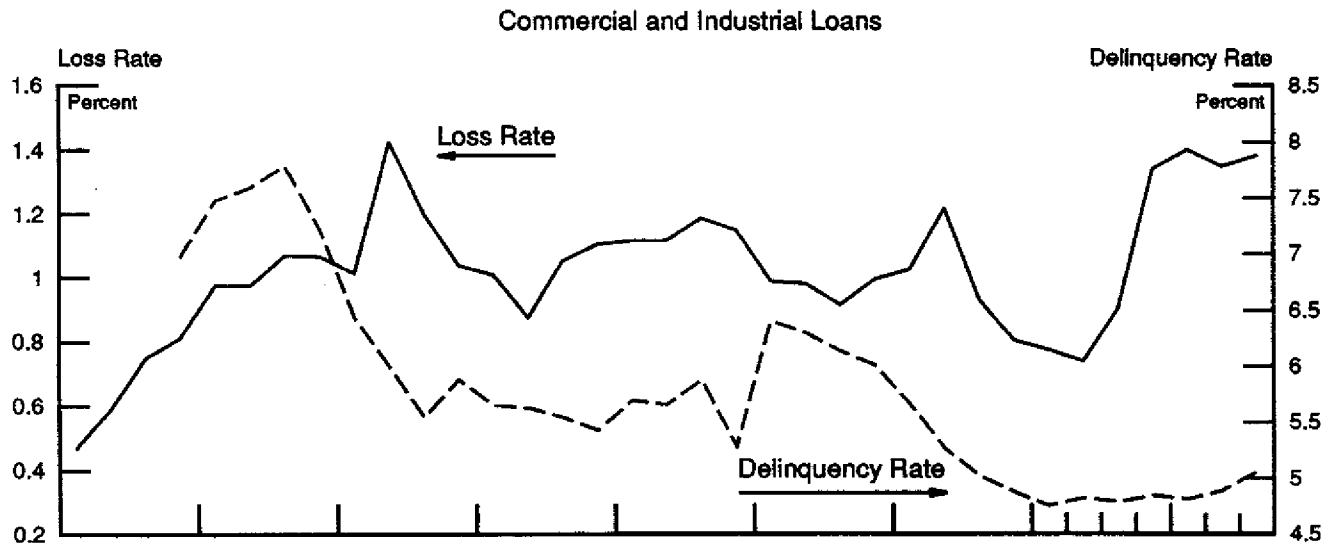
Adding to pressures on bank capital positions and a reluctance to lend have been growing asset quality problems. Preliminary data from the third quarter Call Reports show that loan chargeoffs and delinquencies continued to mount, especially for real estate and consumer loans (chart). The deterioration in the performance of real estate loans was concentrated in the east coast districts.

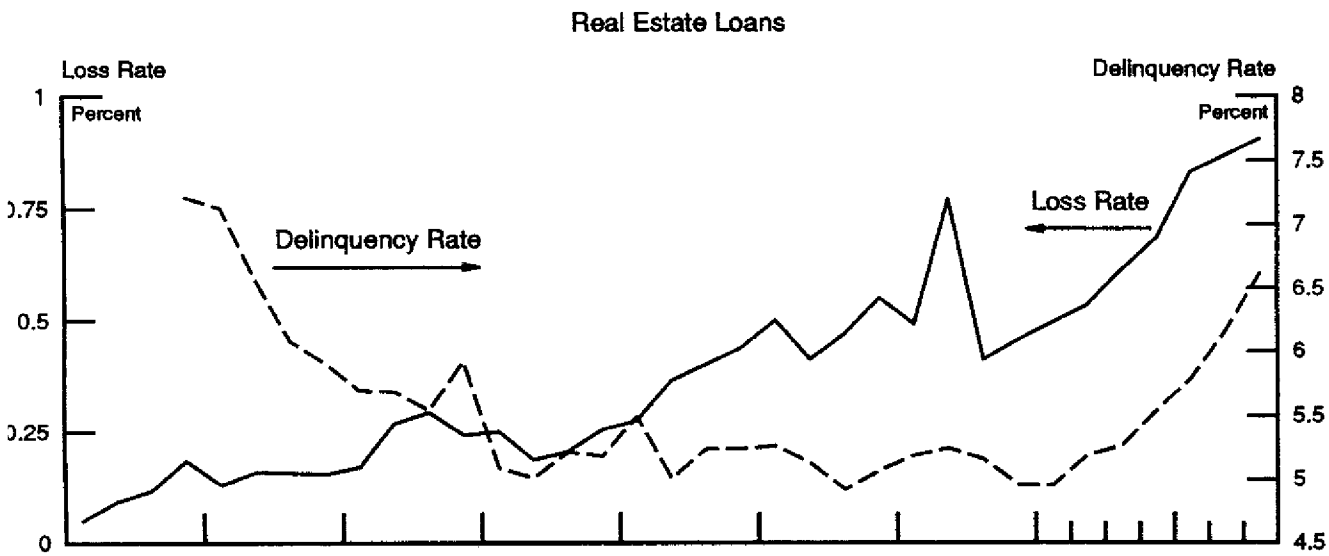
Nonfinancial Business Finance

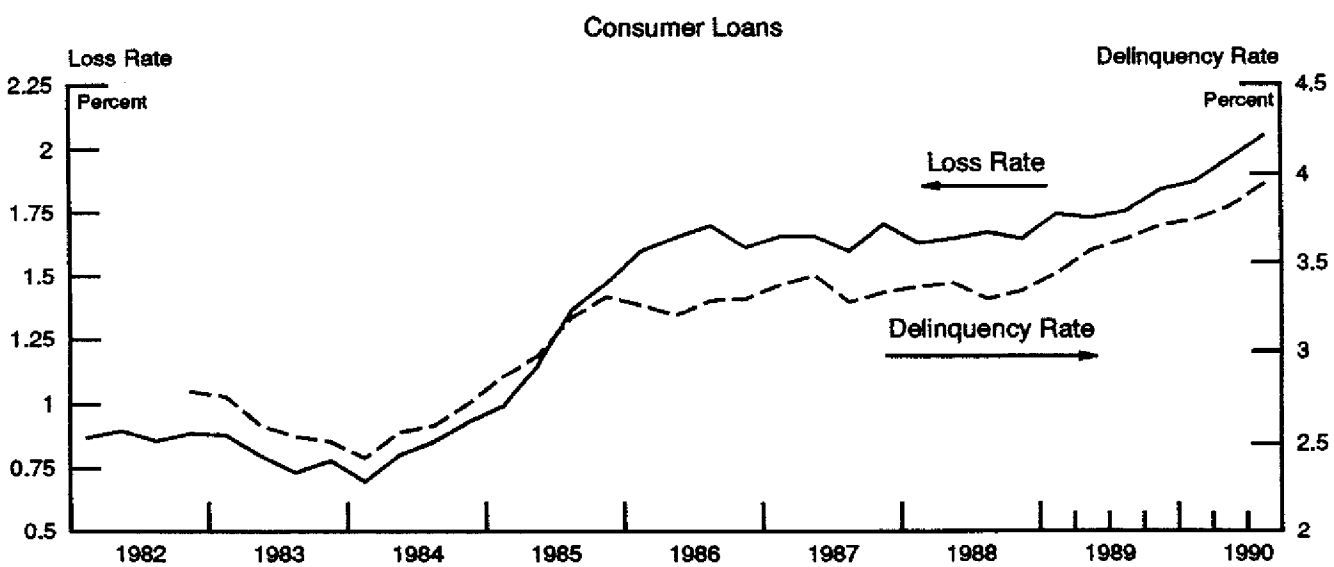
Total borrowing by nonfinancial corporations appears to have firmed a bit in November. After growing in previous months, the sum of commercial paper and C&I loans was flat last month. Gross public bond issuance was up significantly in November and has been robust thus far in December, as corporations have taken advantage of the decline in interest rates. Some of the funds have been used to pay down commercial paper or to refund outstanding long-term debt. The pickup was concentrated in investment-grade issues, while junk issuance has been nil. Business credit at finance companies rose about 10 percent at an annual rate in October, down significantly from September's pace. Virtually all October's slowdown reflected a large decline in the growth of wholesale auto financing, which had previously been growing rapidly.

Participants in the commercial paper market have feared that normal year-end pressures will be exacerbated by increased bank reluctance to lend and by money funds' efforts to reduce holdings of medium-grade paper. The anticipation of these pressures was especially evident during the last week

Loan Loss (Chargeoff) and Delinquency Rates at Large Domestic Banks, SA [1]







1. Loss rates are based on chargeoffs net of recoveries. Delinquent loans include those past due 30 days or more and still accruing interest, as well as those on nonaccural status. Data are reported on the Quarterly Report of Condition by banks with at least $300 million in assets. Data are consolidated (foreign and domestic offices). Percent at annual rate of average amount outstanding, seasonally adjusted. Loss rate series begin in 1982 Q1, delinquency rate series begin in 1982 Q4.

of November when Japanese banks moved aggressively to lock in funding over the statement date, causing the forward rate on turn-of-the-year federal funds to soar to 25 percent or more. These pressures subsided somewhat with the lowering of reserve requirements, but rates on such funding still have been around 14 percent in recent days. In the commercial paper market, the rate on 30-day, top-rated paper rose about 1/2 percentage point as the maturity date moved into the new year. In addition, some A2/P2 issuers of commercial paper are paying as much as 90 basis points more than A1/P1 firms to fund into early January, in contrast to a spread of 55 basis points for paper maturing in the last week of December. Tiering has occurred even in the top-rated A1/P1 category, as investors have become less willing to purchase bank-related, asset-backed issues and paper relying on bank letters of credit.

The availability of credit to small businesses, as indicated by the National Federation of Independent Business' monthly survey, was little changed in November, although credit conditions remain tighter than those prevailing earlier in the year. In the private placement market, life insurance companies apparently have been shifting bond purchases toward investment-grade issues and away from private placements by small and medium-sized borrowers. This shift has been reinforced by the new rating categories established by the National Association of Insurance Commissioners, which become effective at year-end and may result in a substantial portion of insurers' current bond holdings being reclassified from investment grade to speculative grade. Market reports also suggest a movement by pension funds away from corporate bonds toward government securities. On the other hand, some large finance companies are reportedly

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

	1987	1988	1989	1990 Q1	Q2	Q3[p]	Oct[p]	Nov[p]
Corporate securities - total[1]	24.08	22.40	19.82	16.99	23.57	16.31	19.31	21.43
Public offerings in U.S.	21.89	20.37	17.76	15.10	20.72	14.02	17.56	19.93
Stocks--total[2]	4.45	3.54	2.69	3.00	2.33	1.16	0.96	1.23
Nonfinancial	2.32	1.15	1.08	1.55	1.29	0.73	0.56	0.66
Utility	0.57	0.24	0.29	0.41	0.38	0.26	0.31	0.46
Industrial	1.75	0.91	0.79	1.14	0.91	0.47	0.25	0.20
Financial	2.12	2.39	1.60	1.45	1.03	0.43	0.40	0.57
Bonds	17.45	16.84	15.08	12.10	18.40	12.86	16.60	18.70
Nonfinancial	6.56	6.17	6.26	3.83	6.82	3.33	4.50	8.40
Utility	2.01	1.80	1.78	1.22	2.37	1.42	1.30	2.90
Industrial	4.54	4.37	4.48	2.61	4.46	1.91	3.20	5.50
Financial	10.89	10.67	8.81	8.27	11.57	9.53	12.10	10.30
By quality[3]								
Aaa and Aa	3.29	2.72	3.29	2.68	3.78	2.64	3.35	5.71
A and Baa	5.20	5.54	5.67	4.31	8.38	4.92	5.50	7.19
Less than Baa	2.77	2.56	2.39	0.17	0.24	0.08	0.15	0.00
No rating (or unknown)	0.06	0.05	0.06	0.01	0.08	0.00	0.00	0.00
Memo items:								
Equity-based bonds[4]	0.87	0.28	0.52	0.05	0.88	0.34	0.15	0.00
Mortgage-backed bonds	5.19	4.72	1.67	1.64	2.95	2.68	2.60	1.90
Other asset-backed	0.94	1.26	2.02	3.28	2.97	2.53	5.00	3.90
Variable-rate notes	1.90	1.19	1.03	1.45	0.29	0.47	1.03	0.60
Bonds sold abroad - total	2.03	1.93	1.90	1.62	2.43	2.13	1.70	1.50
Nonfinancial	0.94	0.73	0.48	0.39	0.58	0.53	0.25	0.35
Financial	1.09	1.20	1.42	1.24	1.84	1.61	1.45	1.15
Stocks sold abroad - total	0.16	0.09	0.16	0.27	0.42	0.15	0.05	0.00
Nonfinancial	0.13	0.08	0.12	0.10	0.16	0.10	0.03	0.00
Financial	0.04	0.02	0.04	0.17	0.26	0.05	0.02	0.00

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings. Such swaps totaled $20.4 billion in 1989.
3. Bonds categorized according to Moody's bond ratings, or to Standard and Poor's if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.
4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.
p--preliminary.

looking to increase their lending to those firms that might face trouble placing their debt with other lenders.

According to preliminary NIPA data, before-tax economic profits from domestic operations of the nonfinancial corporate sector are estimated to have fallen $21.5 billion in the third quarter or 36.5 percent at an annual rate, extending the slump begun in early 1989. Declines apparently were registered throughout the nonfinancial sector. As a share of gross domestic nonfinancial corporate product, before-tax economic profits declined from 8 to 7.2 percent, largely owing to increases in the share to labor and to indirect taxes. Taxes rose, as book profits were boosted by inventory gains, and dividends increased. As a consequence, undistributed profits--after IVA and CCA--turned negative last quarter and cash flow fell more than $25 billion.

In equity markets, major stock indexes have risen 2 to 4-1/4 percent over the intermeeting period, buoyed by lower interest rates and improved prospects for a peaceful resolution in the Middle East. Nevertheless, offerings of new shares by nonfinancial firms remained scarce in November and initial public offerings all but dried up. Completions of mergers and acquisitions continue to be light, with small and middle-level deals constituting the bulk of the activity. With the MCA and NCR acquisitions not likely to be completed until next year, net equity retirements in the fourth quarter are estimated to be lower than their third-quarter pace.

Financial Firms

The Dow Jones index of financial stock prices was up about 4-3/4 percent over the intermeeting period. After matching the overall stock market's advance in the last half of November, bank stock prices soared

following the reduction in reserve requirements--and by more than estimates of the direct impact of lowering requirements on profits would imply--suggesting the policy change was seen as a sign of a more favorable attitude on the part of federal regulators. Prices of insurance companies, which had been battered of late, also improved. Equitable Life's announcement on December 11 to convert from a mutual to a stock company, along with the downgrading of its claims paying ability, reportedly had little immediate effect on stock and bond prices of publicly traded stock insurance companies. In contrast to the upward movement in stock prices of most financial firms, thrift stock prices fell nearly 5 percent over the intermeeting period.

Several major bank holding companies chose to redeem portions of their outstanding auction-rate preferred stock rather than pay sharply higher rates. Dividends on some of these issues were recently reset at rates exceeding 100 percent of the benchmark commercial paper index, and market participants reportedly expected rates to move still higher at year-end. Asset-backed issuance continued at a healthy pace in November, as banks attempted to improve their capital ratios. After widening significantly in October, spreads on asset-backed securities have since increased another 10 basis points. Spreads on the unsecured debt of finance companies have followed a similar pattern.

Treasury and Sponsored Agency Financing

Seasonal influences are expected to increase the deficit to about $96 billion in the fourth quarter from $58 billion last quarter. The Treasury is expected, as usual, to finance the bulk of the deficit by borrowing. Gross sizes of bill and coupon auctions have been increased progressively

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

	1990					
	Q2	Q3	Q4[p]	Oct.	Nov.[e]	Dec.[p]
Treasury financing						
Total surplus/deficit (-)	-12.0	-57.8	-96.3	-31.5	-44.9	-20.0
Means of financing deficit:						
Net cash borrowing from the public	41.0	69.0	90.6	32.3	46.5	11.8
Marketable borrowings/ repayments (-)	32.7	64.5	84.4	27.8	44.2	12.4
Bills	.5	29.0	45.7	18.2	28.1	-0.6
Coupons	32.2	35.6	38.7	9.6	16.1	13.1
Nonmarketable[2]	8.3	4.5	6.2	4.5	2.3	-.6
Decrease in the cash balance	-16.2	-5.5	20.5	4.7	12.6	3.2
Memo: Cash balance at end of period	34.6	40.2	19.6	35.4	22.9	19.6
Other[3]	-12.8	-5.6	-14.8	-5.5	-14.2	4.9
Federally sponsored credit agencies, net cash borrowing[4]	2.5	-1.9	--	--	--	--
FHLBs	-8.5	-6.7	--	.8	--	--
FHLMC	4.9	-3.1	--	--	--	--
FNMA	1.1	.9	--	.9	--	--
Farm Credit Banks	-.3	.9	--	2.4	--	--
FAC	.3	.1	--	.0	.0	--
SLMA	1.4	1.0	--	--	--	--
FICO	.0	.0	--	.0	.0	--
REFCORP	3.5	5.0	--	5.0	.0	--

1. Data reported on a not seasonally adjusted, payment basis.
2. Includes proceeds from securities issued by federal agencies under special financing authorities and the face value of zero-coupon bonds issued to REFCORP (the discount from face value is offset in other means of finance).
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.
p--projected.
Note: Details may not add to totals due to rounding.

over the past year to finance the widening federal deficit. Coupon issues have provided $30 billion to $40 billion in new cash each quarter, while net bill issuance has been more variable to meet seasonal and other special funding needs.

In the market for government sponsored enterprise debt, changes in spreads on securities have been mixed and erratic since the last FOMC meeting. Overall borrowing by the federal agencies appears to have picked up in October. The outstanding debt of the Federal Home Loan Banks (FHLBs) showed a small increase in October, breaking with a trend of sixteen successive monthly declines. The FHLBs' borrowing has been concentrated in short-term securities, reflecting the shortening of maturities on advances to member institutions caused partly by the tendency of new commercial bank and credit union members to borrow for very short periods.[1] An additional factor that has shortened the maturity of advances is the thrift industry's greater use of so-called pipeline funding, whereby mortgages need to be funded for only 90 days or so until they can be sold into the secondary market. The Resolution Trust Corporation's practice of repaying advances with little or no notice also has pushed the FHLBs toward shorter-term debt.

Municipal Securities

Issuance of long-term state and local government securities remained sluggish in November, running at an estimated $8.7 billion pace. Refunding issuance slowed to a trickle, because few eligible outstanding issues are attractive for refunding at current yields. Reflecting the paucity of refunding offerings over recent months, very few SLGS have been issued. As

1. Forty-five banks, two credit unions, and one thrift and loan association have joined the Federal Home Loan Bank System since August 1989.

a result, the outstanding volume of SLGS has declined significantly as bonds that were advance refunded earlier have reached their call dates.

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

	1988	1989	1990				
	Year	Year	Q1	Q2	Q3	Oct	Nov[p]
Total offerings[1]	11.73	11.90	8.86	15.67	15.47	9.82	10.91
Total tax-exempt	11.41	11.65	8.74	15.44	15.22	9.48	10.60
Long-term	9.54	9.48	7.64	11.31	10.90	8.53	8.66
Refundings[2]	2.90	2.47	1.45	1.58	1.07	.49	.36
New capital	6.64	7.01	6.19	9.73	9.83	8.04	8.30
Short-term	1.87	2.17	1.10	4.13	4.32	.95	1.94
Total taxable	.32	.25	.12	.23	.25	.34	.31

p--preliminary.
1. Includes issues for public and private purposes; also includes taxable issues.
2. Includes all refunding bonds, not just advance refundings.

Budget problems in the Northeast have continued to worsen. New York City announced revisions to its 1991 fiscal plan, including budget cuts and a hiring freeze. The rating agencies criticized the revised plan, however, suggesting that the savings would only cover half of the $600 million prospective 1991 deficit, with the remainder being pushed into fiscal year 1992. Despite having imposed large budget cuts and tax increases last fiscal year, New Jersey faces a $600 million projected deficit in the current fiscal year stemming from a decline in tax revenues. The projected 1991 budget deficit for Connecticut is nearly as large as New Jersey's, and its fiscal 1992 deficit is estimated to be $2.1 billion. The District of Columbia faces a budget deficit of $200 million this year that could rise to $700 million by 1996, according to a report by an independent commission.

Philadelphia's budget problems remain the most severe in the Northeast. According to the city controller, funds in a special escrow account established to ensure debt service on the city's revenue bonds will suffice only through February, although from March onward, operating fees will be sufficient to cover debt service in the current fiscal year. To avoid failing to make scheduled debt service payments on both revenue and general obligation debt, the city is negotiating with local banks, the state treasurer, and the city pension fund for a $300 million loan, which also would be used to cover normal operating expenses. If these negotiations break down, the city finance director has promised to limit spending only to debt service when the city's cash reserves fall to $52 million, which is expected to occur in late December. As a result of these developments, Moody's downgraded the city's revenue bonds, with airport bonds dropping to speculative levels.

The municipal sector also has been affected by the downgrading of commercial banks. In late November, Standard & Poor's dropped the credit rating of $4.5 billion in municipal revenue bonds backed by Citicorp letters of credit, and it placed another $2.3 billion of state housing agency debt associated with Citicorp on CreditWatch. In addition, $14 billion of municipal debt was downgraded when the ratings of four Japanese banks were reduced by Moody's.

Mortgage Markets

Rates in the residential mortgage market have declined in recent weeks, to the lowest levels since the beginning of the year. Yields on both fixed- and adjustable-rate mortgages generally have moved with yields on Treasury

securities of comparable maturity, and spreads remain about 20 to 30 basis points above their late summer levels (chart).

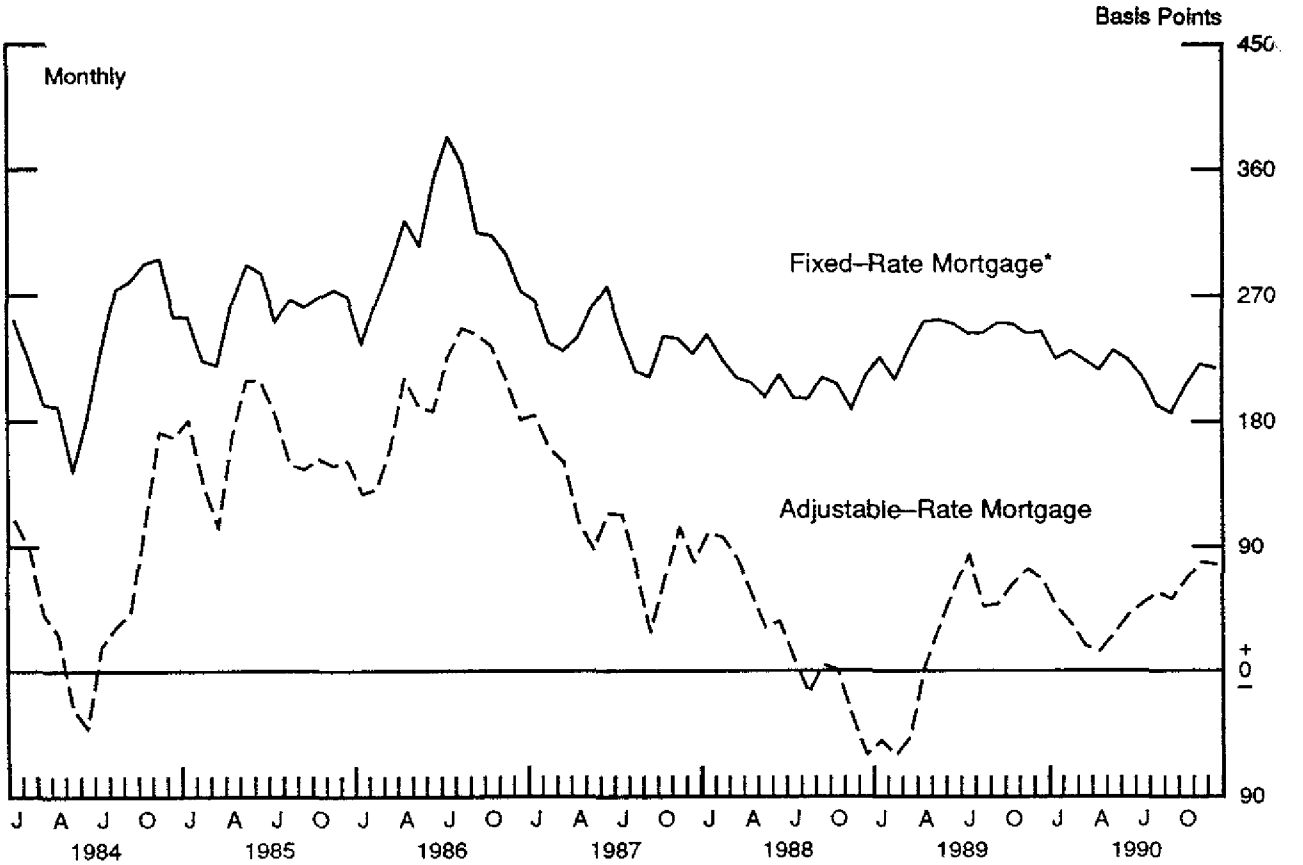
Reports suggest that real estate loan quality continued to deteriorate in the third quarter, especially in the Northeast. Preliminary data from the Mortgage Bankers Association indicate that the average delinquency rate on all mortgages past due for at least 60 days increased in the third quarter to 1.53 percent from 1.39 percent in the second quarter. Problem commercial loans were cited as major factors underlying the third quarter losses reported by several large thrift institutions in the Northeast, while charges to reserves for residential mortgage losses led to reduced earnings or losses at other thrifts and commercial banks. At life insurance companies, the delinquency rate on all mortgages increased slightly in the third quarter to 3.35 percent, the highest level since March 1988; at 3.36 percent, the delinquency rate on their commercial real estate loans is at the highest level in the past decade.

Problem loans have been rising at the government sponsored institutions, as well. Freddie Mac, which suspended purchases of multifamily loans in October to stem continued losses, reported a significant increase in delinquencies among the single-family ARMs held either in its investment portfolio or as collateral for its securities.[2] Freddie Mac attributed the pickup in ARM delinquencies to weakening economic conditions and normal seasoning effects, as loans acquired in 1986 and 1987 approach the peak period of delinquency. Fannie Mae reported that a

2. The delinquency rate on ARMs past due 60 days or more increased to 1.16 percent as of September 30, up from 0.95 percent in June and 0.84 percent a year ago. By contrast, delinquencies on fixed-rate mortgages were 0.62 percent in September, up slightly from 0.57 percent in June and 0.60 percent a year earlier.

Mortgage Pricing

Spreads over comparable maturity Treasuries



*30yr FRM is bond–yield equivalent.

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

	Federally related pass-through securities			Multiclass securities				
	Total (SA)	Fixed-Rate	ARM-backed	Total	Private issues[1]	FNMA REMICs	FHLMC REMICS	Agency strips
1988	12.4	10.1	2.4	6.9	4.2	.9	1.2	.6
1989	16.8	14.1	2.6	8.1	1.4	3.1	3.2	.3
1989-Q3	15.9	15.1	2.5	9.8	1.2	3.6	4.4	.5
Q4	21.6	19.4	2.2	10.7	1.2	5.2	4.0	.4
1990-Q1	23.3	18.5	1.4	11.3	1.6	5.0	3.8	.9
Q2	17.9	16.4	2.2	11.1	2.9	4.7	3.0	.4
Q3 r	17.3	17.5	1.6	11.8	2.4	6.6	2.3	.6
1990-May	18.4	15.6	2.5	12.6	4.6	5.0	3.0	.0
June r	17.0	17.3	2.2	11.5	1.8	4.7	3.8	1.3
July r	14.7	16.2	0.5	11.0	1.5	6.7	2.8	.0
Aug. r	19.3	19.1	1.6	11.6	3.4	4.4	2.4	1.4
Sep. r	18.0	17.3	2.8	12.9	2.4	8.6	1.6	.3
Oct. p	19.0	16.6	2.5	14.4	2.4	5.6	5.7	.6

1. Excludes pass-through securities with senior/subordinated structures.
r--revised p--preliminary n.a.--not available.

weakening regional economy and instances of declining property values led to a doubling in its acquisitions of foreclosed property in the Northeast during the first three quarters of 1990, although its foreclosures nationwide were down about 20 percent from a year earlier.

Lenders' concerns about credit quality and regulatory scrutiny are frequently mentioned in trade reports as contributing to the slowing in overall mortgage lending in recent months. Real estate loan growth at banks averaged less than a 7 percent annual rate in October and November, little changed from the subdued third quarter pace, while SAIF-insured institutions likely continued to reduce their asset holdings, judging from monthly changes in liabilities at these institutions. The runoff of mortgage assets at thrifts had occurred disproportionately in holdings of mortgage-backed securities late last year and early this year. More recent information, however, suggests that these institutions have been running off holdings of whole mortgage loans, reflecting efforts by capital-deficient institutions to meet the interim risk-based capital requirement that becomes effective at year-end. The drop in multifamily and commercial mortgage loans on the books of thrifts has been the largest factor (in dollar terms) underlying the sluggish aggregate growth rates of these two types of loans in recent quarters. Despite their own pullback, commercial banks and life insurance companies have accounted for the bulk of the net increase in these mortgage debt categories in recent quarters.

In home loan markets, the proportion of loans being securitized has continued to expand, as reflected in the secondary market activities of Fannie and Freddie. Despite generally weak mortgage lending, issuance of federally related pass-through securities has been running well ahead of

CONSUMER CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)						Net change (billions of dollars)		Memo: Outstandings (billions of dollars)
			1990		1990		1990		1990
	1988	1989[1]	Q2	Q3[r]	Sept.[r]	Oct.[p]	Sept.[r]	Oct.[p]	Oct.[p]
Total installment	8.9	5.5	2.3	5.9	4.6	2.4	2.84	1.47	736.7
Installment, excluding auto	10.3	8.6	7.4	11.5	7.7	6.0	2.86	2.25	452.2
Selected types									
Auto	7.0	1.3	-5.2	-2.7	-.1	-3.3	-.02	-.79	284.5
Revolving	13.7	14.2	12.1	16.2	12.9	8.6	2.31	1.56	218.4
All other	7.6	4.2	3.2	7.1	2.8	3.6	.55	.69	233.8
Memorandum:									
Total[2]	7.3	5.0	1.5	3.1	1.4	1.1	.89	.74	792.3

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

CONSUMER INTEREST RATES
(Annual percentage rate)

			1990				
	1988	1989	May	Aug.	Sept.	Oct.	Nov.
At commercial banks[1]							
New cars (48 mo.)	10.86	12.07	11.82	11.89	...	...	11.72
Personal (24 mo.)	14.68	15.44	15.41	15.46	...	...	15.69
Credit cards	17.79	18.02	18.14	18.18	...	...	18.23
At auto finance cos.[2]							
New cars	12.60	12.62	12.23	12.62	12.34	...	...
Used cars	15.11	16.18	16.03	15.98	16.03	...	...

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.

last year's pace, and issuance of multiclass securities by the agencies is on a record-setting pace (table). Fannie and Freddie recently completed arrangements to streamline their application process, making it easier for credit unions to sell them mortgages. The RTC, meanwhile, has announced plans to begin securitizing loans from its portfolio.

Consumer Installment Credit

Consumer credit growth in October weakened further. Installment credit outstanding grew at a 2-1/2 percent annual rate--down from the 4-1/2 percent increase in September. The gain in October was in revolving credit, which advanced at a slower pace than in September, and in the "other" category, which expanded at a slightly more rapid pace. Auto loans outstanding declined in the month, as they have throughout most of the past year, consistent with the reduced volume of auto purchases. Total consumer credit (installment plus noninstallment) rose at about a 1 percent annual rate, close to the September pace of 1-1/2 percent.

Over the six months ending in October, consumer borrowing for automobiles declined at a 3 percent annual rate; to some extent this reduction may be due to alternative financing, such as home equity loans or leasing. At finance companies the drop in auto lending was an even sharper 9-1/2 percent.[3] In large measure, the steeper decline in consumer borrowing at finance companies may reflect the continued reliance by automakers on rebates, rather than reduced loan rates, as their major form of incentive. Although there are some reports of banks tightening their standards on auto loans, this type of credit appears to be generally

3. The data underlying these growth rates have auto-backed securitizations added back in with the outstandings currently on the books. Finance companies have issued a larger volume of these securities than banks.

available at normal pricing at most banks, and so the captive auto finance companies have not had to step up their lending.

Movements in consumer loan rates at commercial banks were mixed between August and November. The most common rate on a 48-month new car loan declined 17 basis points to 11.72 percent, while rates on credit cards and 24-month personal loans moved up.

Available measures of consumer loan quality suggest some deterioration, on net, during the third quarter. The American Bankers Association (ABA) series on delinquencies on all closed-end consumer loans edged down 6 basis points in the third quarter--mainly on the strength of a large drop in delinquencies on personal loans.[4] Delinquencies on credit cards inched up 8 basis points to 2.54 percent--about in the middle of their range over the past 15 years. Call Report data for large commercial banks indicated a continued upward movement in the overall consumer loan delinquency rate. Personal bankruptcy filings increased slightly in the third quarter and continue to run about 15 percent above the 1989 pace.

Recently, concerns have arisen that large defaults on credit cards could trigger an early call on some credit card-backed securities, thus exposing buyers of these securities to possible prepayment risk.[5] The likelihood of such prepayments, however, appears quite remote because defaults would have to rise very sharply to trigger an early call. Spreads

4. The ABA each quarter surveys approximately 800 commercial banks--a sample panel which may not be consistent over time--to find the number and percentage of loans delinquent. The delinquency rates are simple averages of those reported by the sampled institutions.

5. The triggering of such a call is designed to protect holders of asset-backed securities from credit risk.

on these securities have widened since the summer, but this primarily reflects heavy issuance of asset-backed securities in recent months.

APPENDIX

GROWTH OF MONEY AND CREDIT IN 1990

After a reasonable first-quarter showing, growth of the broader monetary aggregates weakened markedly over the balance of the year. M2 has grown at barely a 2-1/4 percent annual rate since March, bringing its increase from the fourth quarter of 1989 through November to 3-3/4 percent, and leaving this aggregate in the lower quartile of its annual target range. The growth of M2 so far this year is well below both what the staff had been expecting earlier in the year and what money demand models suggest would be implied by historical relationships with income and interest rates. The slowdown in M3 growth from last year to a 1-1/4 rate this year is more pronounced than that for M2, but it is more explicable: Pressures on bank capital positions and last year's thrift legislation, which set in motion a rapid contraction of the thrift industry, have cut into depository credit expansion, and thus reduced these institutions' needs for funds--a reduction that shows through in lower M3 growth. By contrast, M1 growth picked up from near zero in 1989 to 4 percent this year.

The debt of domestic nonfinancial sectors decelerated further in 1990 despite a pickup in its federal component associated with RTC resolutions. At a 7 percent rate through October, growth in the debt aggregate appears poised to come in at its lowest level in two decades.

M1

Despite the slower growth in nominal income, M1 grew somewhat faster this year than last, responding in part to the effects of lower market interest rates on incentives to hold transactions balances. In addition, about half of the pickup in M1 growth for the year reflected stronger growth of currency. Currency growth more than doubled from last year and, at 11 percent, was the most rapid of the postwar period. Perhaps a third of the pickup in currency growth reflected a lagged response to the drop in market interest rates from the peak in early 1989, but the bulk of the acceleration appears attributable to increased demands for U.S. currency outside our borders. Information on shipments overseas suggests that demands for U.S. currency were particularly heavy in areas experiencing economic and political turmoil, especially Eastern Europe, Latin America, and, after the Iraqi invasion of Kuwait in August, the Middle East. In November, currency expanded at just a 5 percent rate, probably reflecting a dropoff of demands from abroad.

Besides foreign demands for currency, several other special factors influenced the growth of M1 at various times through the year, some of which showed through to the broader aggregates. For example, restructuring of accounts and new practices by individual large banks sometimes had significant effects. OCDs dropped by about $2.5 billion at the beginning of July after the subsidiary banks began to sweep OCD accounts into a trust account, with the funds then returned to the banks as a series of large time deposits. (At least one such CD matures daily to fund checks drawn on the OCD accounts.) This action by a single entity

THE GROWTH AND FLOW OF MONETARY AND CREDIT AGGREGATES
(Q4 to Q4 averages, seasonally adjusted unless otherwise noted)

Growth rates or flows	1986	1987	1988	1989	1990[1]	Memo: 1990 levels (billions of dollars)[1]
Growth rates (percent)						
M1	15.5	6.3	4.3	0.6	4.0	822.8
M2	9.3	4.3	5.2	4.6	3.7	3319.0
M3	9.1	5.8	6.3	3.3	1.3	4085.2
Domestic nonfinancial debt	13.2	9.7	9.2	7.7	6.9	10357.6
Bank credit	9.8	8.0	7.8	7.2	5.2	2717.3
Thrift credit	10.3	8.2	7.4	-2.5	-7.9	1648.0
Flows (billions of dollars)						
M1						
Currency	12.4	15.6	15.7	10.0	24.0	244.8
Demand deposits	30.6	-2.7	-3.8	-8.1	-2.4	277.1
Other checkable deposits	51.8	31.5	19.9	2.7	9.3	292.4
M2						
Nontransaction M2	142.0	74.4	118.1	135.3	85.4	2496.2
MMDAs	58.7	-40.2	-24.4	-24.9	27.3	507.2
Savings deposits	61.9	54.7	12.1	-20.6	5.8	413.5
Small time deposits	-20.3	42.1	118.0	117.3	13.7	1152.6
General purpose and broker/dealer money market mutual fund assets	30.8	12.2	17.0	70.6	35.3	343.3
Overnight RPs, net (NSA)	7.5	6.9	0.1	-7.5	-0.8	61.5
Overnight Eurodollars, net (NSA)	4.0	-1.1	-4.5	0.4	3.8	17.7
M3						
Non-M2 component	50.8	81.6	80.3	-10.6	-63.3	766.2
Institution-only money market mutual fund assets	20.7	2.5	-0.5	14.8	18.6	120.1
Large time deposits	7.7	41.1	55.8	22.6	-55.1	505.6
Term RPs, net (NSA)	19.1	28.8	15.8	-18.1	-14.0	91.1
Term Eurodollars, net (NSA)	3.3	11.4	10.3	22.5	-13.0	67.2

1. For monetary aggregates and bank credit, through November; for domestic nonfinancial debt, through October; for thrift credit, through July.

pared 1/4 percent off the annual growth of M1 and a negligible amount off M2, while leaving M3 unaffected. A few weeks later, Security Pacific scaled back its securities clearing operation in order to boost its capital-asset ratio. This action increased demand deposits, and the monetary aggregates, by about $3 billion because Security Pacific's accounting for certain securities clearing activities had been reducing its reported demand deposits.

Overall, despite the boost from Security Pacific, demand deposits contracted again this year. For several years, demand deposits have exhibited a weak underlying trend, probably reflecting the movement by firms away from compensating balance arrangements and toward fee-based payments for bank services. This has left more firms holding their marginal balances for pure transactions needs, so that innovations that allow firms to economize on their cash balances are showing through to overall demand deposits. Moreover, transactions balances would be much less sensitive to changes in interest rates than compensating balances, in part explaining why the drop in interest rates since early 1989 has had less effect on demand balances than would be implied by historical relationships.

OCDs increased 3-1/4 percent through November--higher than the 1989 growth rate. Nevertheless, the pace of OCD growth this year reflected the restraining influence of slow income growth and still-wide opportunity costs. One puzzle about the behavior of this component, however, was the slow growth evident late in the year--even accounting for the dropoff in nominal income growth--at a time when opportunity costs had narrowed appreciably.

M2

M2 expanded along the 7 percent upper bound of its target cone in the first quarter, but slowed notably thereafter. Currently, there is no fully satisfactory explanation for the anemic pace of recent quarters. While the weaker income growth this year is, no doubt, one of the factors pulling M2 growth down to its lowest level in several decades, money demand models indicate that something else must be at work as well. One force possibly involved in the slowdown could be the shifting of intermediation flows associated with the contraction of the thrift industry and the increased reluctance of commercial banks to expand their balance sheets. These trends, which have their primary effect on the M3 aggregate, also may have damped M2 by lessening commercial banks' and thrifts' need to bid for retail funds. As a result, opportunity costs were somewhat higher than might have been expected from the pattern of market rates for part of the year. However, money demand models using actual opportunity costs badly overpredict M2 growth since the first quarter, with the largest error in the current quarter, when the recent decline in opportunity costs has failed to revive M2 growth. Some of the changes in effective opportunity costs may not be well measured by the indexes used in the models; for example, advertising may have been cut back, and the RTC has allowed high-rate contracts to be abrogated as deposits at failed thrifts were assumed by banks and other thrifts. The slump of M2 growth--and shortfall relative to traditional demand models--began around the time that RTC activity picked

up, suggesting some disturbance related to the shift of deposits and the overall decline in depository institution funding needs.

Nevertheless, even taking account of possible misspecification of opportunity costs, M2 growth remains much slower than seems explainable, indicating a downward shift in demand as well. To some extent damped M2 may have reflected weak saving, as households sought to maintain spending in the face of higher prices for energy products and the softening of real income growth. The slack pace of consumer credit--even relative to spending--suggests households may have turned in favor of drawing down liquid assets rather than accumulating debt to support spending. But the strength of noncompetitive tenders at Treasury auctions--a rough index of retail demand for Treasury securities--may indicate some decline in demand for depository obligations in particular. Perhaps the publicity about the demise of the S&L industry and about credit quality problems at banks have caused some investors to shy away from deposits.

M3

M3 growth through November was only 1-1/4 percent, slightly above the lower edge of its target range. That range itself had been lowered in midyear by 1-1/2 percentage points amid evidence that the drop in thrift assets was proceeding more rapidly than had been expected and that credit flows were being redirected away from depository institutions. On top of the shrinkage in thrift assets--as marginal institutions retrenched and the RTC transferred large amounts of assets onto its own books in the course of closing failed institutions--commercial banks became less willing to expand their balance sheets. With asset quality problems mounting, new capital standards phasing in at year-end, and capital markets giving a poor reception to bank offerings, commercial banks generally increased their efforts to securitize loans, raised price and nonprice costs of credit, and tightened lending standards. As a result, banks' needs for funds were limited.

In dollar terms, the entire increase in M3 so far this year can be more than accounted for by growth in currency and money fund obligations; overall depository liabilities in M3 registered a small decline. M2 inflows into depositories were more than sufficient to fund their credit growth. As a result, they ran off managed liabilities rapidly, including large time deposits, which fell nearly 10 percent.

Domestic Nonfinancial Sector Debt

Through October, the debt of the domestic nonfinancial sectors grew at a 7 percent annual rate, marking a fourth straight year of deceleration. This pace still exceeded the growth of nominal GNP, but only because of the strong increase in U.S. government debt that largely reflected financial intermediation associated with RTC resolution activity. RTC's net outlays contributed about 2-1/4 percentage points to the growth of federal sector debt and about 1/2 percentage point to the growth of total domestic nonfinancial debt.

Nonfederal debt growth slowed to about a 5-3/4 percent rate, and data suggest that, for the year, all major components will grow more slowly than

in any year since 1983. Consumer credit was sluggish, especially auto loans; home mortgage borrowing also ebbed over the course of the year as real estate markets deteriorated and housing activity slumped. State and local governments cut back on the amount of new borrowing they undertook, and there evidently were sizable retirements of debt that had been advance-refunded earlier. Also, late in the year, certain municipalities were losing access to the credit markets amid financial distress.

Business borrowing slackened further in 1990 as needs to finance corporate restructuring diminished. Even so, the corporate financing gap increased in the second half of the year in the face of declining profits. A tightening of credit availability for all but the top-rated firms became increasingly evident as the year progressed: Banks reported raising lending standards at the same time that downgradings increased and the new issuance market for junk bonds evaporated.

INTERNATIONAL DEVELOPMENTS

U.S. Merchandise Trade

Preliminary data for September indicate that the deficit in U.S. merchandise trade was little changed at $9.4 billion (seasonally adjusted, Census basis) from an upward revised deficit in August of $9.7 billion. The small reduction of the deficit in September reflected a sharp decline in non-oil imports that was nearly offset by an increase in the value of oil imports and an easing in exports. For the third quarter, the deficit increased to a level unmatched since the third quarter of last year.

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil	Non-oil	Balance
					(nsa)		
1990-Jan	31.4	3.6	27.8	41.6	5.9	35.7	-10.2
Feb	31.6	3.4	28.2	38.7	4.7	34.0	-7.1
Mar	33.3	3.7	29.6	41.6	4.7	36.9	-8.4
Apr	32.1	3.3	28.8	39.4	3.8	35.6	-7.3
May	32.8	3.3	29.5	40.5	4.3	36.2	-7.8
Jun	34.2	3.6	30.6	39.6	3.7	35.9	-5.3
Jul	32.1	3.1	29.0	41.2	4.0	37.2	-9.1
Aug[r]	32.5	3.4	29.2	42.3	4.8	37.5	-9.7
Sep[p]	31.8	3.1	28.7	41.3	6.2	35.1	-9.4

r--revised p--preliminary
Source: U.S. Department of Commerce, Bureau of the Census.

Several elements contributed to the large deficit in recent months. The value of oil imports rose nearly 30 percent in September following an equally large increase in August; for the third quarter oil imports were 30 percent higher than in the second quarter with nearly all of the increase attributable to higher prices. Between July and September the average price of imported oil rose $10 per barrel to just under $25 per barrel. The rise in import prices lagged the sharp increases in posted and spot prices,

following the same pattern as in previous oil market disruptions. Allowing for shipping lags, posted and spot prices suggest that the price of imported oil will have approached $30 per barrel in October. The quantity of oil

OIL IMPORTS
(BOP basis, value at annual rates)

	1990			Months				
	Q1	Q2-r	Q3-p	May	Jun	Jul	Aug	Sep
Value (Bil. $)	62.37	48.66	62.78	52.32	46.71	49.08	63.70	75.57
Price ($/BBL)	19.47	15.81	19.58	15.76	14.94	14.77	19.95	24.37
Quantity (mb/d)	8.90	8.45	8.71	8.93	8.68	8.93	8.58	8.61

r--revised. p--preliminary.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

imported increased about 3 percent in the third quarter, reflecting small recorded increases in both oil consumption and inventories (with the former including secondary and tertiary inventories as well). Recent weekly data on oil imports reported by the Department of Energy indicate a sharp drop in imports in both October and November, likely the result of a slowdown in refinery runs to undertake necessary maintenance.

For the third quarter non-oil imports were 2 percent higher than in the second quarter (see the table below), despite a sharp drop in September. Much of the third quarter increase was in quantity, largely in consumer

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

	Years		1990			Percent Change 1990-Q3 from	
	1989	1990 (9 mo.)	Q1	Q2-r	Q3-p	Prev. Qtr.	Year Ago
Exports	360	386	385	387	385	-0.6	7.6
Imports	475	491	490	479	504	5.0	5.7
Non-oil	424	432	428	431	441	2.3	4.0
Balance	-115	-105	-105	-92	-119		

r--revised. p--preliminary.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

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

	Year	1989		1990		
	1989	Q3	Q4	Q1	Q2-r	Q3-p
Agricultural Exports	41.5	39.7	40.9	43.8	41.3	38.9
Nonagricultural Exports	319.0	317.7	326.1	341.2	345.7	345.7
Industrial Supplies	90.6	90.5	89.0	94.2	92.9	95.2
Gold	2.5	2.6	2.1	2.6	3.6	3.7
Fuels	12.1	11.0	12.2	12.8	11.2	13.9
Other Ind. Supp.	76.0	76.9	74.7	78.8	78.1	77.6
Capital Goods	138.0	141.1	140.8	152.9	154.6	152.2
Aircraft & Parts	26.5	29.7	25.6	32.3	34.5	31.4
Computers & Parts	24.2	24.6	24.7	26.4	24.9	26.2
Other Machinery	87.3	86.8	90.5	94.2	95.2	94.6
Automotive Products	34.7	33.0	35.6	34.7	38.5	36.1
Canada	22.5	21.5	22.8	20.8	23.5	21.7
Other	12.2	11.5	12.9	13.9	15.0	14.4
Consumer Goods	35.4	35.0	38.0	40.7	42.0	43.7
Other Nonagric.	20.3	18.1	22.7	18.7	17.7	18.5
Oil Imports	50.9	52.7	53.3	62.4	48.7	62.8
Non-Oil Imports	424.4	423.9	428.6	427.8	430.8	440.9
Industrial Supplies	84.1	82.5	83.2	80.4	82.2	83.3
Gold	3.6	3.4	4.3	1.7	2.1	2.7
Other Fuels	3.2	3.1	3.7	3.1	3.1	3.4
Other Ind. Supp.	77.3	76.0	75.2	75.6	77.0	77.2
Capital Goods	113.1	113.1	116.5	115.7	115.6	116.7
Aircraft & Parts	9.5	9.2	9.0	9.2	10.5	9.8
Computers & Parts	21.5	22.5	23.4	23.1	22.8	23.1
Other Machinery	82.1	81.4	84.1	83.4	82.3	83.8
Automotive Products	86.0	85.4	83.0	83.9	84.9	90.4
Canada	22.5	29.1	29.6	27.6	30.7	33.0
Other	56.5	56.3	53.4	56.3	54.2	57.5
Consumer Goods	102.8	104.9	106.4	103.4	104.3	107.1
Foods	25.1	24.7	25.0	27.8	26.8	25.5
Other Non-oil	13.4	13.3	14.5	16.6	17.0	17.9

r--revised. p--preliminary.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

goods and automotive products, with smaller increases recorded for industrial supplies and computers; the growth in non-oil imports was roughly in line with the increase in domestic demand. Part of the higher value of non-oil imports was from an increase in prices that was associated, in part, with the recent decline in the foreign exchange value of the dollar. Most of the increase in non-oil imports in the third quarter came from countries in Asia (the NIEs, China, other developing countries, and Japan).

The value of nonagricultural exports in the third quarter was about the same as in the second quarter. Increased exports to Latin America and Japan were offset by declines in shipments to Canada and Western Europe. The quantity of nonagricultural exports increased slightly in the third quarter led by expanding exports of consumer goods and computers; exports of automotive products and aircraft declined. Nonetheless, the quantity of nonagricultural exports in the third quarter was 8-1/2 percent higher than a year earlier. Agricultural exports declined for the second quarter in a row in both quantity and value; most of the decrease was in corn and soybeans.

Prices of Imports and Exports

Prices of imported oil jumped again in October, more than doubling since July, according to data released by the BLS. Prices of non-oil imports rose 0.4 percent in October, following a stronger increase in September; the rise in October was led by higher prices for passenger cars. (See the table below.) For the third quarter, prices of non-oil imports rose 5.4 percent (annual rate) over the second quarter, the largest quarterly increase in two years. The rise was spread among most major trade categories, reflecting the effects of the depreciation of the dollar.

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

	Year	Quarters			Months	
	1990-Q3	1990			1990	
	1989-Q3	Q1	Q2	Q3	Sep	Oct
		(annual rates)			(monthly rates)	
	BLS Prices					
Imports, Total	7.0	3.7	-6.8	28.9	3.6	3.2
Foods, Feeds, Bev.	6.7	11.5	2.2	6.2	0.9	0.1
Industrial Supplies	16.7	-0.4	-20.1	114.6	11.2	9.0
Ind Supp Ex Oil	-0.4	-2.2	-3.5	6.6	1.9*	0.3*
Capital Goods	4.5	9.1	-0.9	7.4	1.0	0.3
Automotive Products	1.0	-0.3	-5.1	4.1	0.1	0.9
Consumer Goods	3.7	6.9	0.9	3.0	0.6	0.1
Memo:						
Oil	54.3	3.3	-47.2	664.9	28.1	21.8
Non-oil	2.5	3.8	-1.8	5.4	0.9	0.4
Exports, Total	1.7	1.8	1.4	3.6	0.6	0.6
Foods, Feeds, Bev.	-5.3	-3.3	5.7	-14.9	-0.2	-2.7
Industrial Supplies	2.3	0.0	-2.0	14.6	2.1	2.5
Capital Goods	2.8	4.1	2.6	2.2	-0.1	0.3
Automotive Products	2.7	1.8	1.8	2.2	0.4	0.0
Consumer Goods	3.1	6.3	2.0	2.0	0.3	0.4
Memo:						
Agricultural	-3.8	-1.1	7.1	-14.9	-0.1	-2.1
Nonagricultural	2.6	2.1	0.4	7.6	0.9	1.0
	Prices in the GNP Accounts					
Fixed-Weight						
Imports, Total	3.6	10.1	-12.3	15.8	--	--
Oil	16.3	48.2	-56.7	135.7	--	--
Non-oil	1.8	4.9	-2.3	3.9	--	--
Exports, Total	0.9	3.8	1.5	0.8	--	--
Ag.	-3.5	2.7	10.7	-10.1	--	--
Nonag.	1.9	4.1	-0.2	3.1	--	--
Deflators						
Imports, Total	1.8	5.4	-8.7	11.3	--	--
Oil	16.3	48.2	-56.6	135.2	--	--
Non-oil	-0.1	2.8	-1.1	2.0	--	--
Exports, Total	-0.7	-0.6	4.7	-4.1	--	--
Ag.	-3.5	2.7	10.7	-10.1	--	--
Nonag.	-0.3	-1.2	4.4	-3.2	--	--

*Not for publication.

Export prices rose slightly in October following a 3.6 percent (annual rate) increase in the third quarter. For the third quarter, gains in prices of exported industrial supplies (especially fuel and petroleum-based chemicals) were partly offset by a drop in prices for agricultural exports.

U.S. Current Account in 1990-Q3

The U.S. current account deficit was $102.3 billion (seasonally adjusted annual rate) in the third quarter, $12.4 billion larger than in the revised second quarter (see table below). An increase in the merchandise

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

	1989	1990		Changes
	Year	Q2-r	Q3-p	Q3-Q2
1. Trade Balance	-114.9	-92.4	-119.0	-26.6
2. Exports	360.5	387.0	384.6	-2.4
3. Imports	475.3	479.4	503.6	24.2
4. Investment Income, net*	-0.9	-4.0	9.8	13.8
5. Direct Investment, net*	39.6	41.7	53.3	11.6
6. Portfolio Income, net	-40.5	-45.7	-43.5	2.2
7. Service Transactions				
8. Military, net	-6.3	-5.5	-6.6	-1.1
9. Other Services, net	26.8	29.5	29.9	0.4
10. Unilateral Transfers	-14.7	-17.5	-16.4	1.1
11. Current Account Balance*	-110.0	-89.9	-102.3	-12.4
Memo:				
12. Capital Gains or Losses[1]	-0.6	2.6	5.6	3.0

* Includes capital gains and losses.
1. Gains or losses on net financial assets include only realized capital gains (or losses) resulting from the sale of assets for more (or less) than book value. Plus = gain; minus = loss.
r--revised p--preliminary

trade deficit in the third quarter was partially offset by increased net investment income (both portfolio and direct). The gain in net direct investment income reflected an increase in receipts from foreign petroleum

affiliates. The decline in net service transactions was accounted for by a boost to direct defense expenditures resulting from the stationing of U.S. troops in the Middle East that was larger than an increase in deliveries to the Middle East under military agency sales contracts.

U.S. International Financial Transactions

Net recorded capital inflows reached $26 billion in the third quarter, an amount roughly equal to the recorded current account deficit. Large inflows through private bank transactions and increased holdings in the United States by official foreigners were offset by a sharp increase in U.S. direct investment abroad. Private securities transactions registered small net outflows in the quarter. In October official holdings in the United States continued to rise. Bank transactions switched to net outflows in the month and outflows through private security transactions continued.

Recorded capital inflows through the banking system totaled more than $26 billion in the third quarter (line 1 of the Summary Table). About two thirds of the inflow reflected increased liabilities to related foreign offices; foreign-based banks in general, and Japanese-based banks in particular, accounted for a large share of the inflow. The inflow from abroad tended to offset weak growth in demand deposits and a decline in large time deposits at all banks. Data for October, measured on a month-end basis, show an outflow of about $6 billion. However, data reported to the Federal Reserve on banks' net claims on their own foreign offices and IBFs indicate a continued reliance on related foreign offices as a source of funds in during October and November on a monthly average basis (see line 1 of the International Banking Table).

In addition to the interbank inflows, loans to U.S. nonbanks booked offshore also increased during the third quarter. On a month-end basis foreign banks increased their loans to U.S. nonbanks by over $4 billion and

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

	1988 Year	1989 Year	1989 Q4	1990 Q1	1990 Q2	1990 Q3	1990 Aug.	1990 Sept.	1990 Oct.
Private Capital									
Banks									
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	22.2	27.5	10.6	17.0	-1.3	26.4	8.4	7.8	-5.8
Securities									
2. Private securities transactions, net[1]	17.8	16.1	6.2	-7.6	-8.7	-3.1	-2.2	-4.1	-5.5
a) foreign net purchases (+) of U.S. corporate bonds[2]	26.8	32.8	12.5	5.1	6.6	0.9	-0.8	-1.7	0.9
b) foreign net purchases (+) of U.S. corporate stocks	0.4	7.6	-1.3	-3.2	-3.5	-2.3	-1.4	-2.3	-3.5
c) U.S. net purchases (-) of foreign securities	-9.4	-24.3	-5.0	-9.5	-11.8	-1.8	-0.1	0.2	-3.0
3. Foreign net purchases (+) of U.S. Treasury obligations	20.6	30.4	5.2	-0.9	3.7	0.4	-1.1	-4.1	1.7
Official Capital									
4. Changes in foreign official reserves assets in U.S. (+ = increase)	40.2	8.3	-7.6	-7.4	4.5	14.3	9.1	2.4	3.9
a) By area									
G-10 countries	15.8	-5.2	-2.2	-6.2	-1.1	9.1	5.0	4.2	2.2
OPEC	-3.4	10.1	-1.5	3.1	*	-1.3	1.3	0.4	0.1
All other countries	27.9	3.4	-3.9	-4.3	5.6	6.5	2.9	-2.2	1.6
b) By type									
U.S. Treasury securities	41.7	0.1	-7.5	-5.8	2.4	12.1	6.9	3.5	1.2
Other[3]	-1.6	8.2	-0.1	-1.6	2.0	2.0	2.2	-1.1	2.6
5. Changes in U.S. official reserve assets (+ = decrease)	-3.9	-25.3	-3.2	-3.2	0.4	1.7	-0.2	-0.2	-0.1
Other transactions (Quarterly data)[4]									
6. U.S. direct investment (-) abroad	-16.2	-31.7	-8.8	-9.3	-4.8	-19.3	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	58.4	72.2	21.5	5.5	7.2	7.6	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[5]	-1.8	-9.9	-3.3	5.8	-7.2	-2.0	n.a.	n.a.	n.a.
9. U.S. current account balance	-128.9	-110.0	-26.7	-21.7	-22.5	-25.6	n.a.	n.a.	n.a.
10. Statistical discrepancy	-8.4	22.4	6.1	21.8	28.7	-0.4	n.a.	n.a.	n.a.
MEMO:									
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-127.2	-114.9	-28.7	-26.3	-23.1	-29.8	n.a.	n.a.	n.a.

1. These data have not been adjusted to exclude commissions on securities transactions and, therefore, do not match exactly the data on U.S. international transactions as published by the Department of Commerce.
2. Includes all U.S. bonds other than Treasury obligations.
3. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
4. Seasonally adjusted.
5. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking and official transactions not shown elsewhere. In addition, it includes amounts resulting from adjustments to the data made by the Department of Commerce and revisions to the data in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

*--Less than $50 million.

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

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1988	1989				1990				
	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Oct.	Nov.
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	-4.9	-2.9	-3.9	-6.4	-5.5	-11.7	-11.0	-15.6	-23.4	-23.7
(a) U.S.-chartered banks	21.6	20.4	19.2	14.9	19.2	12.2	7.2	5.7	2.4	.8
(b) Foreign-chartered banks	-26.5	-23.3	-23.1	-21.3	-24.7	-23.9	-18.2	-21.3	-25.8	-24.5
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	21.2	24.0	26.0	21.6	20.7	21.8	22.2	24.0	25.0	25.2
3. Eurodollar Holdings of U.S. Nonbank Residents 1/	145.3	144.8	131.5	130.3	123.5	110.6	106.5	109.1	109.9	110.0

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 offshore offices of U.S.-based banks increased their loans to U.S. nonbanks by almost $2 billion. As shown in line 2 of the Banking table, on a monthly average basis loans from foreign offices of U.S.-based banks increased further in October and November.

In contrast to the banking flows, private security transactions registered outflows of $3 billion in the quarter (line 2 of the Summary Table). Foreigners on net sold U.S. corporate and agency bonds in August and September (line 2.a). Foreigners also sold U.S. stocks in August and September as share prices were generally declining (line 2b). U.S. residents purchased net $1.8 billion of foreign securities in the quarter.

Foreign transactions in Treasury obligations (line 3) mirrored the activity in corporate and agency bonds; large net purchases in July were mostly offset by sales that began in August and accelerated in September (line 3).

In October foreign transactions in both Treasury bonds and corporate and agency bonds swung to net purchases. However, foreign net sales of stocks accelerated in the month to $3.5 billion.

Foreign official holdings in the United States increased further in September, bringing the increase during the third quarter to $14.3 billion (line 4). Two thirds of the increase was attributable to G-10 countries,

In October foreign official holdings in the United States increased $3.9 billion further. Partial data from FRB New York indicate official holdings in the U.S. increased $4 billion in November.

U.S. direct investment abroad increased by more than $19 billion in the third quarter (line 6). This large outflow reflected the financing of several takeovers, including the purchase of Jacobs Suchard by Philip Morris and the purchase of the New Zealand Telephone Company by the Bell Atlantic

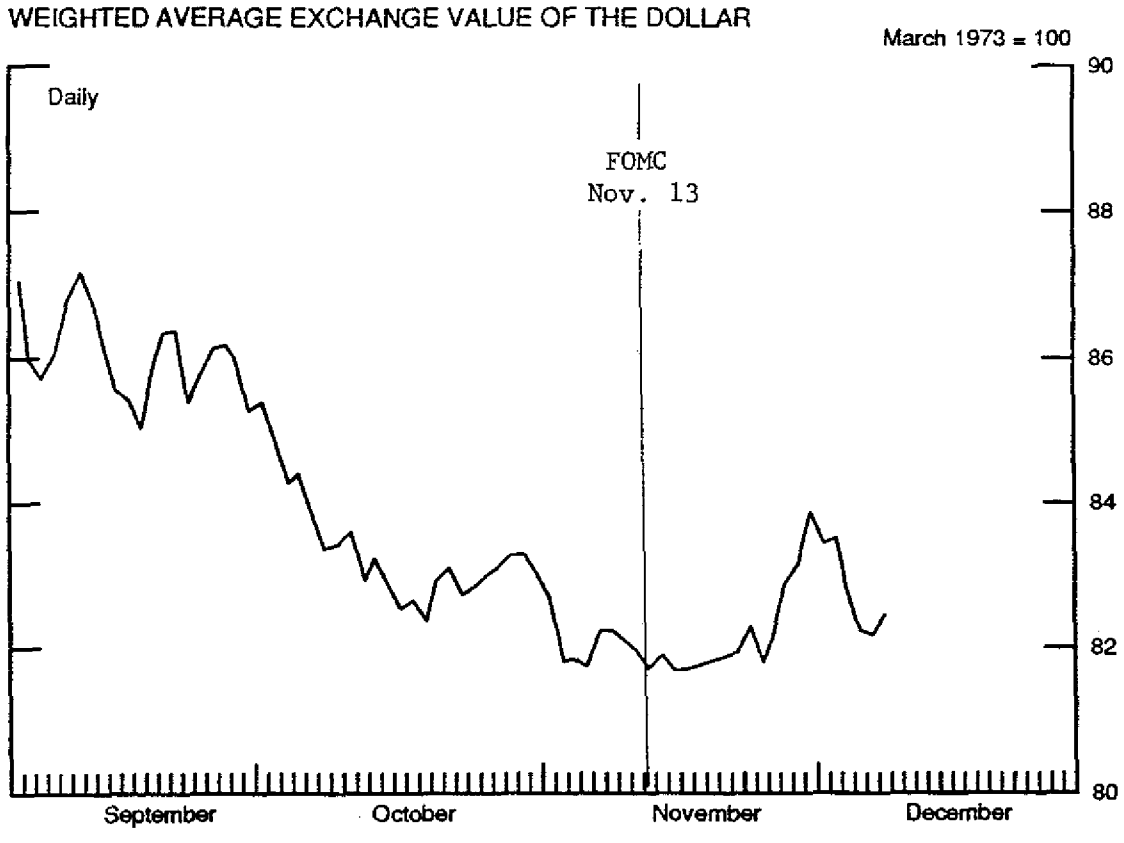
Corporation. In addition to the takeovers, plant and equipment expenditure by the foreign affiliates of U.S. corporations have remained strong. By contrast, foreign direct investment in the United States was $7.6 billion in the third quarter, only slightly above its second quarter level and far below its 1989 pace.

Foreign Exchange Markets

The weighted-average foreign-exchange value of the dollar in terms of the other G-10 currencies differs little from its level at the November 13 FOMC meeting, as shown in the accompanying chart. The dollar fluctuated during the period as perceptions changed regarding Middle East tensions. Around the time of the U.N. Security Council's vote authorizing the use of force against Iraq, the dollar rose sharply, but it retreated somewhat when Saddam Hussein announced that he intended to allow foreigners held in Iraq and Kuwait to leave. The dollar retreated further when the weaker-than-expected U.S. employment figures for November were released and the federal funds rate declined. The dollar changed little, overall, against the mark over the intermeeting period, while it appreciated about 1-3/4 percent against the yen.

German short-term interest rates increased about 30 basis points from their levels at the time of the last FOMC meeting. Indications of continued strong economic growth in Western Germany heightened perceptions that the Bundesbank was adopting a tighter monetary policy. Late in the intermeeting period, the Bundesbank returned to the use of variable rate tenders in its one-month RP allocations, which were made at or above the Lombard rate of 8-1/2 percent and well above the prior fixed rate tender of 8 percent. The yield on the German bellwether bond declined slightly, though not as much as long-term yields in Japan and the United States, and German stock prices increased more than 5 percent.

In late November, the yen depreciated and Japanese stock prices declined amid rumors of financial difficulties at Japanese real estate firms; however, stock prices recovered to their previous levels after oil prices declined sharply. The yield on the Japanese bellwether bond declined about 75 basis points, and Japanese short-term interest rates changed little.



Amid heightened expectations of monetary tightening in Germany, spreads among the EMS currencies widened. The French franc became the weakest of the EMS currencies within the narrow band, and its spread against the mark exceeded 1 percent.

. Official interest rates in the Netherlands and in Belgium were increased about 40 basis points in response to the rise in short-term German interest rates.

Developments in Foreign Industrial Countries

Real GNP growth slowed somewhat in Japan in the third quarter from its rapid second-quarter pace, but it was negative in the United Kingdom and Canada. More recent indicators such as industrial production, orders and sales, point to a continued general slowing in the fourth quarter in these countries. Economic activity continues to be weak in Eastern Europe. In contrast, real GNP in Western Germany grew almost 7 percent (s.a.a.r.) in the third quarter and French growth appears to have rebounded as well.

Inflation appears to be moderating in most foreign industrial countries, as the increases in oil prices have now been largely passed through. However, inflation has continued to rise in most Eastern European countries. Gradual progress towards the reduction of external imbalances has continued, although some countries, notably France, have recently recorded larger external deficits. Eastern European nations continue to run surpluses in hard-currency trade, but the higher cost of oil imports and the decline in CMEA trade have begun to have a negative impact.

On December 9, Lech Walesa won the second round of the Polish elections. On December 2, Chancellor Helmut Kohl won a clear victory in the

first election for a democratic United German parliament since 1932. After failing to win a large enough majority in the Conservative party leadership contest, Margaret Thatcher announced her resignation as U.K. Prime Minister on November 22. The new Prime Minister is John Major, former Chancellor of the Exchequer.

Individual Country Notes. There is increasing evidence that the pace of Japanese economic activity may be slowing. Real GNP grew 4.1 percent (s.a.a.r.) in the third quarter after growing more than 6 percent in the first half of the year. Slower growth in the third quarter was mainly due to weak consumption (up 1.4 percent) and less buoyant plant and equipment investment (up 7.2 percent, the first single-digit rise in over a year). Most recent monthly indicators of activity also suggest some slowing of growth. Retail sales (s.a.) declined 3 percent in October, and new machinery orders (s.a.) fell 10.6 percent in September. New passenger car registrations (s.a.) were down 1.7 percent in October, their second consecutive monthly decline. The rate of capacity utilization (s.a.) declined 2.5 percent in September. Business bankruptcies (n.s.a.) jumped 21.4 percent in October, registering their first increase from year-earlier levels in nearly six years. Housing starts (s.a.) declined 3.2 percent in October, the fourth decline in five months. In contrast to these weaker indicators, industrial production (s.a.) rose 2.5 percent in October.

Recent evidence on inflation trends has been somewhat ambiguous. Although the consumer price index in the Tokyo area (n.s.a.) fell 0.1 percent in November, the 12-month increase jumped to 3.9 percent, the highest since August 1982. However, seasonally-adjusted consumer prices excluding perishable food products registered a 12-month increase of only 2.9 percent in October. Wholesale prices (n.s.a.) were unchanged in October and were only 1.5 percent above year-earlier levels. The yen's appreciation

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

	Q4/Q4 1988	Q4/Q4 1989	1989 Q4	1990 Q1	1990 Q2	1990 Q3	1990 June	1990 July	1990 Aug.	1990 Sept.	1990 Oct.	Latest 3 months from year ago 2
Canada												
GDP	3.1	2.9	.6	.5	-.3	-.3	*	*	*	*	*	.5
IP	1.5	-.4	-.8	-1.8	.1	-.4	.1	.5	-.9	-1.6	n.a.	-2.8
France												
GDP	3.5	3.4	.7	.6	.2	n.a.	*	*	*	*	*	2.1
IP	4.0	2.8	-.2	-.5	1.6	1.4	.2	1.8	.0	-1.1	n.a.	2.2
West Germany												
GNP	3.4	3.2	1.0	3.6	-.9	1.7	*	*	*	*	*	5.5
IP	4.0	4.8	.7	2.4	-.7	3.2	.0	1.5	.7	.8	-1.1	5.8
Italy												
GDP	3.7	3.0	.7	.6	-.2	n.a.	*	*	*	*	*	1.9
IP	7.5	3.3	2.1	-2.3	-1.2	n.a.	1.0	1.2	n.a.	n.a.	n.a.	.3
Japan												
GNP	5.0	5.3	1.3	1.6	1.4	1.0	*	*	*	*	*	5.4
IP	7.6	4.2	.7	.9	1.9	2.4	-.2	1.8	.3	-.9	2.5	6.2
United Kingdom												
GDP	3.8	1.5	.4	.9	.3	n.a.	*	*	*	*	*	2.3
IP	2.5	.3	-.0	-.2	1.9	-3.0	1.9	-3.4	-.7	-.4	n.a.	-1.4
United States												
GNP	3.5	1.8	.1	.4	.1	.4	*	*	*	*	*	1.1
IP	4.5	1.1	.0	.2	1.0	.9	.6	.3	-.0	.2	-.8	2.0

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

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

	Q4/Q4 1988	Q4/Q4 1989	1989 Q2	1989 Q3	1989 Q4	1990 Q1	1990 Q2	1990 Q3	1990 Aug.	1990 Sept.	1990 Oct.	1990 Nov.	Latest 3 months from year ago
Canada													
CPI	4.1	5.2	1.7	1.4	.7	1.4	.9	1.1	.1	.3	.8	n.a.	4.4
WPI	3.8	.2	.2	-.3	-.6	.4	.3	-.1	.1	.6	.3	n.a.	.5
France													
CPI	3.0	3.6	1.2	.7	.8	.7	.9	1.0	.6	.5	.5	n.a.	3.7
WPI	7.2	.9	.4	-.7	-1.0	-.3	-.2	n.a.	*	*	*	*	-2.2
West Germany													
CPI	1.6	3.1	.9	.0	.6	1.1	.5	.4	.3	.4	.7	-.1	3.1
WPI	2.2	4.3	1.5	-.6	.3	-.3	.6	.2	.8	.3	.6	n.a.	1.3
Italy													
CPI	5.2	6.6	1.7	1.0	1.8	1.6	1.2	1.4	.7	.6	.8	.6	6.3
WPI	n.a.	n.a.	1.7	.0	2.5	2.1	-.1	3.9	4.0	1.7	n.a.	n.a.	8.6
Japan													
CPI	1.5	2.9	2.2	.1	.9	.4	1.2	.2	.2	.8	1.1	-.1	3.3
WPI	-1.4	3.7	2.7	.8	-.3	.4	.8	.0	.3	.2	.0	n.a.	1.2
United Kingdom													
CPI	6.5	7.6	2.9	.9	2.0	1.8	4.7	1.6	1.0	.9	.8	n.a.	10.8
WPI	4.9	5.2	1.2	1.2	1.2	1.6	2.1	.9	.3	.4	.5	.2	5.9
United States													
CPI (SA)	4.3	4.6	1.5	.7	1.0	2.0	.9	1.6	.8	.8	.6	n.a.	6.0
WPI (SA)	3.4	4.9	1.6	.0	1.2	2.3	-.2	1.4	1.3	1.6	1.1	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)

	1988	1989	1989			1990			1990			
			Q2	Q3	Q4	Q1	Q2	Q3	July	Aug.	Sept.	Oct.
Canada												
Trade	8.3	6.4	1.2	1.6	1.1	1.5	2.6	3.2	1.1	.8	1.3	n.a.
Current account	-8.4	-14.1	-4.0	-3.5	-4.0	-4.4	-3.6	-3.0	*	*	*	*
France												
Trade	-5.4	-6.6	-2.1	-1.6	-2.2	-.4	-1.9	-3.6	-.6	-1.0	-2.0	-1.2
Current account	-3.4	-4.0	-1.2	-1.2	-3.0	.3	-2.0	-3.2	*	*	*	*
West Germany												
Trade (NSA)	72.9	71.6	17.7	17.8	16.6	22.4	16.7	13.7	4.9	3.6	5.1	5.5
Current account (NSA)	50.5	55.5	14.0	11.1	13.5	17.0	10.8	8.7	3.0	2.3	3.4	4.4
Italy												
Trade	-10.5	-12.4	-3.5	-2.6	-1.9	-4.1	-2.1	-2.3	-.5	-1.0	-.7	-1.8
Current account (NSA)	-6.3	-10.6	-1.1	.1	-1.5	-6.0	-6.1	n.a.	*	*	*	*
Japan												
Trade	77.3	64.5	16.2	15.5	12.2	15.6	13.5	16.3	5.4	5.7	5.2	2.5
Current account 2	79.6	57.2	14.0	14.2	9.2	15.3	8.3	7.1	1.8	3.0	2.3	2.5
United Kingdom												
Trade	-37.0	-38.2	-10.3	-10.5	-6.9	-9.0	-8.2	-6.8	-3.0	-2.3	-1.5	-2.1
Current account	-26.6	-31.0	-7.6	-9.6	-6.4	-7.8	-7.2	-6.3	-2.5	-2.3	-1.5	-2.1
United States												
Trade 2	-127.0	-114.9	-28.2	-29.8	-28.7	-26.3	-23.1	-29.8	*	*	*	*
Current account	-128.9	-110.0	-28.6	-27.6	-26.7	-21.7	-21.8	n.a.	*	*	*	*

1. The current account includes goods, services, and private and official transfers. Asterisk indicates that monthly data are not available.
2. Before July 1990, West Germany only.
3. Annual data are subject to revisions and therefore may not be consistent with quarterly and/or monthly data.

and higher oil prices have had a varied impact on wholesale prices of different goods. In October, the wholesale price of exported goods fell 2.8 percent while the price of imported goods rose 2 percent and the wholesale price of domestically produced goods increased 0.3 percent.

The current account surplus (s.a.) continued to decline in the third quarter and in October was only slightly above its third-quarter rate. Through the first 10 months of this year, the current account surplus was $39.5 billion (s.a.a.r.), $23 billion below the surplus rate in the same period last year.

West German real GNP increased 6.8 percent (s.a.a.r.) in the third quarter, after falling 3.5 percent in the second quarter. The strongest component of final demand was exports, which rose almost 30 percent due to an acceleration of shipments to Eastern Germany. Equipment investment rose 11 percent, but this was the only category of domestic demand that showed significant strength. Total domestic demand was up only 1.8 percent. Industrial production in Western Germany (s.a.) fell 1.1 percent in October to a level 5.2 percent above the same period in 1989. However, the Economics Ministry stated that an upward revision of the October figure was very likely. The volume of new orders for manufactured goods (s.a.) increased 0.2 percent in October. Most of the recent strength in orders came from domestic orders (including orders from Eastern Germany) which were 16 percent above year-earlier levels in October, while foreign orders were up only 1.9 on the same basis. The unemployment rate (s.a.) fell in November to 6.7 percent.

Unofficial estimates suggest that East German real GNP (n.s.a.) fell 24 percent in the third quarter to a level 31 percent below that of a year ago. All categories of domestic demand declined except public consumption. The bulk of the decline in real GNP was accounted for by a sell-off of

inventories and a sharp increase in imports. After collapsing in July and August, industrial production in Eastern Germany (n.s.a.) actually increased 2.2 percent in September. Nevertheless it remained 51 percent below its year-earlier level. Official East German unemployment (n.s.a.) was 6.7 percent in November, up from 6.1 percent in October. The number of workers engaged in government subsidized "short-time" work (n.s.a.) increased only 0.8 percent in October to 20 percent of the labor force.

West German consumer prices (n.s.a.) fell 0.1 percent in November to a level 3.1 percent above a year ago. In October, wholesale and producer prices were only 1.6 and 2 percent above year-earlier levels, respectively. West German import prices (n.s.a.) increased 2.4 percent and 1.3 percent in September and October, respectively, due almost exclusively to increases in oil prices. They are up only 1.1 percent above year-earlier levels partly as a result of the strong appreciation of the mark over the last year.

The combined German trade balance (n.s.a.) was $66 billion (a.r.) in October, compared with $55 billion in the third quarter. This compares with a West German trade balance of $75 billion for the third quarter of 1989. The combined German current account (n.s.a.) was $41 billion (a.r.) in October compared with $35 billion in the third quarter.

Initial data for the third quarter indicate that activity in France picked up somewhat after a very slow second quarter. Marketable real GDP (a preliminary indicator of total GDP) grew 5.3 percent (s.a.a.r.), after a 0.4 percent rise in the second quarter. Third-quarter activity was boosted by investment and exports, which rebounded from poor second-quarter figures, and stockbuilding, which surged. French consumer prices (n.s.a.) rose 0.5 percent in October, to a level 3.9 percent above a year ago. Non-energy prices rose 0.3 percent. Wage growth (n.s.a.) slowed to a 0.9 percent pace in the third quarter after a 1.7 percent rise in the second quarter. On a

twelve-month basis, wages in the third quarter were up 4.8 percent, while consumer prices were up 3.4 percent.

French trade and current account data remain erratic, but point to a deterioration in recent months. The trade deficit (s.a.a.r.) deepened to $15.2 billion in the third quarter from a $4.7 billion annual rate in the first half of the year, although the deficit moderated in October. Imports have surged, partly due to appreciation of the franc against the dollar.

In Italy, monthly indicators suggest that the pace of economic activity slowed in September and October. Industrial production (n.s.a.) was roughly constant (after an adjustment for working days) in September and for the third quarter as a whole, relative to a year earlier. Capacity utilization in September was 78.1 percent (n.s.a.), down from 80.8 percent in June. Other indicators for October, such as orders and retail sales, are down from year-earlier levels. Consumer prices (n.s.a.) were up 6.5 percent in November from their level a year earlier.

As a result of rising oil prices, Italy's trade deficit was $1.8 billion (s.a.) in October, compared with an average monthly deficit of $750 million in the third quarter. The trade deficit for the first 10 months of 1990 was down 8 percent from the same period last year. Despite this improvement in the trade balance, a doubling of the deficit in services caused Italy's current account deficit to increase to $12 billion (n.s.a.) in the first half of 1990, from $9 billion a year earlier.

The United Kingdom appears to be in recession. The output measure of real GDP fell 4 percent (s.a.a.r.) in the third quarter after growing 2 percent in the previous quarter. Manufacturing production fell 1.1 percent in September, the fifth successive monthly decline. In the third quarter, manufacturing output was 1.8 percent lower than in the previous quarter. Total industrial production declined somewhat less as oil production

recovered. The unemployment rate edged up to 6 percent in October while retail sales volume fell 1.1 percent to a level slightly below a year ago.

The year-over-year rate of consumer price inflation remained at 10.9 percent in October, but the underlying rate of inflation (excluding the effects of the poll tax and mortgage interest payments) rose to 8.3 percent. Producer price inflation has been more moderate and stood at a 12-month rate of 5.8 percent in November. Wages have continued to rise rapidly; the underlying rate of increase was 10.2 percent in the year to October.

Canadian real GDP declined 1 percent (s.a.a.r.) in the third quarter, about equal to its fall in the second quarter. Final domestic demand fell 1.7 percent (s.a.a.r.), although consumption expenditures rose 1.1 percent. Investment spending was particularly weak, declining 20 percent (s.a.a.r.) in the third quarter. Signs of fourth-quarter weakness are abundant. Unemployment (s.a.) rose again in October to a rate of 9.1 percent, up 2 percentage points from April. In October, housing starts (s.a.a.r.) fell 35 percent and bankruptcies were up 61 percent from a year ago.

The external sector did not contribute to growth in the third quarter, as the fall in real imports was matched by a decline in real exports. Canada's current account deficit (s.a.), however, stood at $3 billion in the third quarter, down from $3.6 billion in the second quarter. The deficit is likely to narrow further this quarter as higher oil prices boost export earnings and weak demand reduces import growth.

Led by higher gasoline prices, the consumer price index (n.s.a.) rose 0.8 percent in October to a level 4.8 percent above its year earlier level, up from 4.2 percent in the three previous months. Excluding food and energy, the CPI rose 0.5 percent in October, and inflation remained at 4.0 percent on a year-over-year basis. Major wage settlements (n.s.a.)

accelerated to 6.5 percent (a.r.) in the third quarter, compared with a pace of 5.4 percent in the second quarter.

Developments in East European Economies

Poland's first presidential elections have left the economic reform program in limbo. The pattern of voting in the first round of elections on November 25 demonstrated dissatisfaction with current economic policies, but Walesa, who won the runoff on December 9, has indicated that he will continue the general thrust of the current program.

In October industrial sales by state-owned firms advanced 10 percent over September, but remain 21 percent below October last year. Monthly inflation continued to rise; prices were up 5.7 percent in October, in part due to wage acceleration and the pass-through of higher world oil prices. The National Bank of Poland raised interest rates again in November to 55 percent to combat inflation; this is the second increase since August.

Poland's hard-currency trade surplus improved to $3.7 billion through October. Following declines earlier this year, imports posted positive growth in September and October. The oil bill was the primary cause, but imports of capital goods have also been strong.

Faced with a rapidly deteriorating situation caused by the Gulf crisis, dissolution of CMEA trade, and drought, Hungarian authorities proposed completing the transformation to a market economy with a shock program of further liberalization of prices and foreign trade and accelerated transfer of state-owned enterprises. The plan was rejected by the Cabinet, however, and Finance Minister Rabar threatened to resign because of policy differences with the administration's top economic adviser Matolcsy.

Industrial production contracted about 10 percent in the first eight months of 1990. However, production at smaller enterprises increased 21

percent over the same period. Inflation will likely exceed 30 percent at an annual rate by the end of this year as subsidies are eliminated and energy prices are passed through. The National Bank of Hungary tried to keep the underlying rate of inflation low by restricting domestic credit growth through September to about 5 percent, about half that for last year.

Hungary achieved a hard currency trade surplus of $890 million in the first ten months of 1990. Export performance was strong despite poor agricultural performance due to drought. Imports increased only 2 percent. Exports to Germany were particularly robust, up 41 percent.

In the Czech and Slovak Federal Republic, gross industrial output by the state-owned sector fell 3.7 percent in the first eight months of 1990 compared with a year earlier. The decline was concentrated in the mining, heating and power, and arms-producing sectors. Consumer prices have increased markedly in recent months as subsidies have been removed. The average level of the CPI in the third quarter was 14.1 percent above a year earlier. In contrast, production prices were flat measured on that basis. To combat inflation, the State Bank increased the discount rate from 5 to 7 percent in September after increasing it from 4 percent in August.

Negotiations on a letter of intent for a stand-by arrangement of 90 percent of quota (about $844 million) and drawings under the newly created oil element of the compensatory and contingency financing facility (CCFF) have been completed. The program is expected to be approved by the IMF Executive Board on January 7. The World Bank is preparing three types of loans: a Structural Adjustment Loan of $450 million, a Financial Sector Rehabilitation project loan of $150 million, and technical assistance loan of about $50 million to be focussed on energy, the environment, and telecommunications.

The CSFR has normalized trade relations with the United States; a trade agreement that provides for most-favored-nation treatment including GSP was signed, a bilateral investment treaty is being negotiated, and OPIC coverage is available. President Bush, on his recent visit to the CSFR, indicated that he would ask Congress to authorize a $60 million investment fund for the CSFR, similar to the Hungarian-American and Polish-American Enterprise Funds.

Economic Situation in Major Developing Countries

After failing to meet third-quarter performance criteria, Argentina obtained IMF approval of a second modification to its stand-by arrangement and resumed drawing on a reduced arrangement. Negotiations between the Brazilian government and the commercial banks are held up by a disagreement over payment of a portion of the interest arrears. Economic and political conditions there are deteriorating. The Mexican anti-inflation pact has been extended to the end of 1991 with a reduced rate of peso crawl and increases in minimum wages and energy prices. Real appreciation of the peso and a resumption of moderate growth this year have helped to fuel a surge in imports. The bank financing and debt reduction package for Venezuela is scheduled to close on December 18. Agreement in principle has been reached on a bank financing package for Colombia. The Philippines and the IMF have tentatively agreed on a stand-by arrangement to replace the discontinued Extended Fund Facility. In Korea, real GDP is continuing to grow rapidly, while inflation and the current account deficit are worsening due to the rise in oil prices. In Taiwan, industrial production turned up in October. Narrower trade surpluses in October and November, due to the rising value of oil imports, portend a lower fourth-quarter current account surplus.

Individual Country Notes. In late November, Argentina obtained IMF approval of a second modification to its stand-by arrangement, after failing

to meet third-quarter performance criteria, owing to large shortfalls in revenue collection. A waiver for a small deviation from the second-quarter performance criteria was also obtained, allowing the drawing for that quarter to take place. However, the SDR 184 million drawing contingent on third-quarter performance was eliminated.

The authorities have continued to implement their program of economic reform. On November 21, the state airline, Aerolineas Argentinas, was sold to a consortium led by the Spanish airline Iberia for $2 billion in debt paper and $250 million in cash. A decree approved November 26 is intended to eliminate roughly 120,000 state jobs over the next few years; progress to date in cutting public payrolls has been slow, but the authorities are believed to be more serious about implementing this latest measure.

Since September, Argentina's economic performance has improved to some extent. Monthly inflation declined from 15.7 percent in September to 7.7 percent in October, and to 6.2 percent in November. The fiscal operating balance, which was in deficit by about $8 million in September, is believed to have been in surplus by roughly $80 million in October. The November fiscal accounts are expected to benefit from the cash payments associated with the privatization of Aerolineas Argentinas and of ENTEL, the state telephone company, which was sold in early November. The December 3 revolt by a dissident military faction, which was suppressed quickly, is not expected to have adverse consequences for economic performance or policy.

Negotiations between the Brazilian government and the commercial banks are held up by a disagreement over payment of a portion of the interest arrears. The government maintains that no agreement on the interest arrears is possible until an overall debt restructuring package has been drawn up. The banks are pressing for a Brazilian commitment to pay a part of the arrears before discussions continue. Lack of progress in the negotiations

has held up IMF Executive Board consideration of a stand-by arrangement of SDR 1,449 million (about $2 billion). However, inflation has not fallen to levels expected when the nominal targets were set under the arrangement, and it is likely that new targets will have to be negotiated. Lack of progress also held up consideration of IBRD and IDB loans totaling $700 million. These loans were approved in late November, but no further loans are expected to be considered until the bank negotiations show progress.

Economic and political conditions in Brazil are deteriorating. Real GDP is estimated to have been 4.5 percent lower in the third quarter of 1990 than a year earlier. In September, industrial output was 7.5 percent less than a year earlier. Monthly inflation was 16.7 percent in November, up from 14.2 percent in October. The trade surplus for the first ten months of this year was $9.7 billion, down from $14.1 billion in the same period of 1989. Anecdotal evidence suggests that a large number of firms continue to seek protection from creditors because of the high real interest rates and low product demand. Real interest rates have fallen as a result of the central bank's easing of monetary policy. However, they continue to reflect expectations that the government will attempt another confiscation of financial assets in lieu of a fiscal reform. Indications are that the government lacks the support needed to carry out the needed reforms. The president's standing in opinion polls is down, and his supporters lost key governorships in the November elections.

On November 11, the Mexican anti-inflation pact among government, business, and labor, which was scheduled to expire at the end of January, was extended to the end of 1991 with a reduced rate of peso crawl, an 18 percent increase in minimum wages, and increases in energy prices of from 10 to 30 percent. The new rate of crawl is 40 centavos per dollar per day, half as high as it had been since late May.

The pact extension was followed by a sharp drop in interest rates. At the November 13 auction, the rate for 28-day Treasury bills fell by 2.95 percentage points to 23.9 percent (about 2 percent per month). However, the market soon judged that this was likely to yield a negative real return, given the prospect of higher monthly inflation rates in the near term following the wage and price increases. As a result, upward pressure on interest rates developed. At the December 4 auction, the 28-day rate was 25.5 percent, and the authorities kept the rate from rising further by issuing only half of the 28-day bills they had offered. In fact, the CPI rose by 2.7 percent in November, and is now 30 percent above a year earlier.

The peso price of the dollar was only about 12.2 percent higher at the end of November than a year earlier, resulting in a real appreciation of the peso in 1990, which, together with a resumption of moderate growth, helped to fuel a surge in imports. Imports were 30 percent higher in August and September than a year earlier. As recently as January-April, they were only 14 percent higher. For January-September, imports were 22 percent higher than in the same period of 1989, whereas non-oil exports were only 9 percent higher. With the recovery of oil prices, oil exports were 10 percent higher in January-September than a year earlier, but the nine-month trade surplus was only $1.1 billion, half as large as in the same period of 1989.

The surge in imports reflects a rise in demand that has helped real GDP growth to recover from its first quarter low of 1.8 percent. Compared with a year earlier, growth was 2.3 percent in the second quarter and an estimated 3 percent in July-August. For January-August, it was 2.3 percent.

The 1991 public sector budget calls for an overall deficit of 1.9 percent of GDP, down from an estimated 4.3 percent in 1990. The entire reduction reflects an expected decline in public sector interest payments to 7.9 percent of GDP from 10.4 percent in 1989.

The bank financing and debt-reduction package for Venezuela is scheduled to close on December 18. As of December 5, banks holding about 99 percent of the public sector medium- and long-term debt have subscribed to one of the five options. They have committed $1.4 billion for a buyback at a 55 percent discount (completed on October 18), $1.8 billion for principal reduction, $7.5 billion for permanent interest reduction, $3 billion for temporary interest reduction, and $6 billion for the new money option.

In November, pressure for appreciation of the bolivar stemming from the Gulf crisis eased. This enabled the central bank to reverse its decision of last August to resist this pressure by allowing the annual yield on three-month bills to fall below the rate of inflation. The annual yield on these bills rose to 28 percent last month from 17 percent in early October. However, the real yield remains negative, since the CPI rose by 2.9 percent in November, or by nearly 41 percent at an annual rate.

On November 9, Colombia and its bank advisory committee reached agreement in principle on a commercial bank financing package providing up to $1,775 million to help refinance the $1.9 billion in maturities coming due during 1991-1994. The loan will consist of a $200 million bearer bond issue and a syndicated loan for as much as $1,575 million. Subscriptions to the loan are expected to be completed by February 1991.

The Philippines and the IMF have reached tentative agreement on a new stand-by arrangement to replace the discontinued Extended Fund Facility. Final IMF approval of the new arrangement, which is expected to free about $700 million in funds for the Philippines from various sources, is to occur after the government has fulfilled preconditions of the proposed program by enacting new tax measures, raising domestic fuel prices, and taking other specified actions. Congressional leaders, who had blocked earlier tax proposals, have agreed to enact new tax measures.

Korea's real GDP was 9.6 percent higher in the third quarter than in the same period of 1989. In November, consumer prices were 9 percent higher than a year earlier, down from 10 percent at the peak in July. However, wholesale prices have increased fairly rapidly since July, partly reflecting higher oil prices. Retail oil prices were raised by about 28 percent on November 25, the first increase in nine years, signaling higher consumer-price inflation rates ahead. There was a record current account deficit in October, due to deliveries of oil contracted for after the Gulf crisis began. The January-October current account was in deficit by nearly $1.3 billion, in contrast with a $3.8 billion surplus in the same period of 1989.

In Taiwan, industrial production was 1.7 percent higher in October than a year earlier, after falling below year-earlier levels for most of the year. The 12-month inflation rate was 3.9 percent in November. The current account surplus for January-September was $8.4 billion, nearly unchanged from the same period of 1989. However, the trade surplus narrowed in October and November, as the value of crude oil imports surged, suggesting a smaller current account surplus in the fourth quarter.