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August 14, 1991

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

DOMESTIC NONFINANCIAL DEVELOPMENTS

The economy appears to have bottomed out during the early spring and to have improved somewhat on balance since then. Payroll employment and hours worked, though off last month, have shown small net improvements since April. Rebounds in demand for motor vehicles and for single-family homes have provided much of the impetus for the recovery to date. In contrast, business fixed investment has remained weak, and, as of June, the run-off of inventories had shown only hints of abating. Recent reports on price inflation have continued to be favorable, although the deceleration in labor costs appears to have stalled.

Employment and Unemployment

Labor demand was soft, overall, in July. Private payrolls edged down 41,000, although, with fairly large upward revisions to May and June data, private payroll employment remained 87,000 above the April level. Aggregate hours of production or nonsupervisory workers fell 1.4 percent in July, mostly because the workweek retraced 0.4 hour of its rise during the preceding two months (chart). The decline in average weekly hours in July was concentrated in the service-producing sector for which the data are more volatile.

Changes in payroll employment in July were uneven across sectors. Manufacturing added 13,000 jobs; gains in transportation equipment, textiles, and apparel more than offset further cutbacks in machinery and electrical equipment. In addition, retail trade posted its third consecutive monthly increase in July, and hiring continued in the health services industry. But construction employment moved lower and now stands

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

	1989	1990	1990 Q4	1991 Q1	1991 Q2	1991 May	1991 June	1991 July
	Average monthly changes							
Nonfarm payroll employment[2]	176	36	-164	-240	-12	151	-21	-51
Private	143	3	-172	-258	-18	135	-7	-41
Previous					-40	101	-39	
Manufacturing	-13	-48	-98	-102	-22	30	-50	13
Durable	-16	-39	-74	-81	-17	15	-43	0
Nondurable	3	-9	-24	-21	-5	15	-7	13
Construction	2	-23	-59	-64	-4	27	-6	-22
Trade	31	-10	-52	-87	-24	14	-13	-1
Finance, insurance, real estate	3	1	-6	1	-11	-6	-10	-5
Services	105	72	37	9	50	69	82	-22
Health	27	34	34	27	31	18	43	35
Total government	32	33	8	18	6	16	-14	-10
Private nonfarm production workers	119	-9	-169	-223	-6	138	34	-32
Manufacturing production workers	-14	-41	-83	-83	-3	26	-13	27
Total employment[3]	148	-32	-103	-273	43	-807	293	-172
Nonagricultural	148	-38	-123	-222	-27	-924	257	-102

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; based on seasonally adjusted data)

	1989	1990	1990 Q4	1991 Q1	1991 Q2	1991 May	1991 June	1991 July
Civilian, 16 years and older	5.3	5.5	5.9	6.5	6.8	6.9	7.0	6.8
Teenagers	15.0	15.5	16.4	18.0	18.8	19.1	19.2	20.6
20-24 years old	8.6	8.8	9.2	10.1	10.8	11.2	11.1	11.2
Men, 25 years and older	3.9	4.4	4.8	5.5	5.8	5.8	5.9	5.7
Women, 25 years and older	4.2	4.3	4.6	5.0	5.2	5.1	5.3	4.8
Labor force participation rate	66.4	66.4	66.2	66.1	66.2	66.1	66.2	66.0

little changed, on average, since April. Moreover, the number of jobs at establishments providing various business and personal services apparently dropped almost 60,000 in July after gains in the preceding two months.[1] Employment in finance, insurance, and real estate continued to contract in July; in this sector losses actually have been larger in recent months than over the course of the recession.

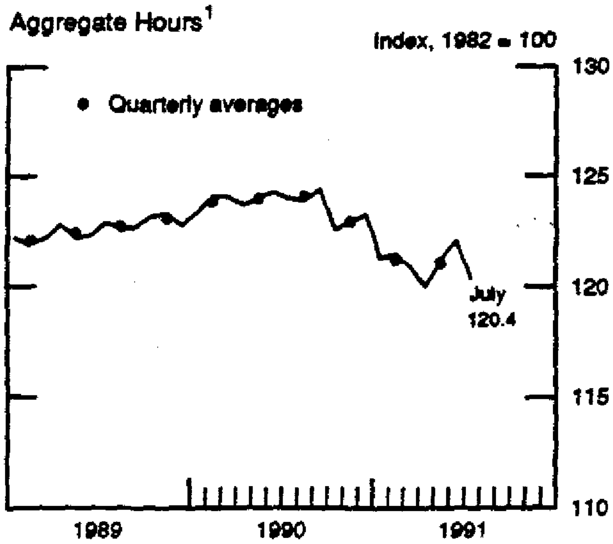
The unemployment rate, which typically lags cyclical troughs, fell 0.2 percentage point in July to 6.8 percent, matching its March level and the second-quarter average. The drop in the unemployment rate apparently reflected the net exit of jobless workers from the labor force rather than into new jobs; household employment fell 172,000.

Following cyclical troughs, movements in key labor market indicators often have been erratic. That said, the performance of those indicators since April--though well within the range of previous experience--suggests a slower-than-usual takeoff in this recovery (table). Specifically, between April and July aggregate hours grew, on net, at about half the pace of the previous four upturns. The relatively small net gain in private payroll employment in the recent period accounts for the smaller increase. The workweek, to date, has made its typical cyclical contribution, although, as in earlier episodes, the monthly pattern has been uneven: In May and June of this year, average weekly hours rose 1/2 hour, and the decline in July erased much of what seemed earlier to be an unusually sharp gain.

1. Health services account for more than one-fourth of the jobs in the heterogeneous services industry; business services constitute slightly less than a fifth. Other relatively large categories (5 to 10 percent of the total) are engineering and management services, social services, membership organizations, education services, and lodging places.

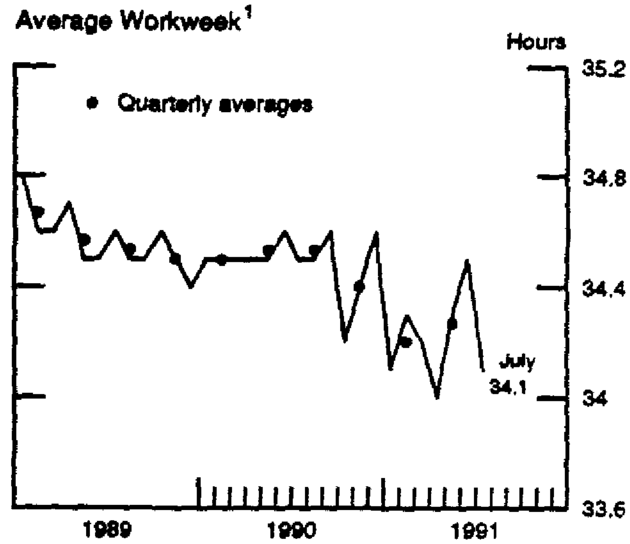
LABOR MARKET INDICATORS

Aggregate Hours[1]



1. Monthly data; seasonally adjusted.

Average Workweek[1]



1. Monthly data; seasonally adjusted.

BEHAVIOR OF KEY LABOR MARKET INDICATORS
AROUND CYCLICAL TROUGHS
(Monthly data; seasonally adjusted)

	Mean change[1] three months from trough	Standard Deviation	Change from April to July 1991
Aggregate hours (percent)	.69	.87	.33
Private payroll employment (percent)	.39	.52	.10
Average weekly hours (hour)	.10	.18	.1
Unemployment rate (percentage point)	-.13	.28	.2

1. The mean change is over the four cyclical troughs since 1970.

Weekly filings for initial claims for unemployment insurance (UI) have edged down, dipping to 418,000 (FRB seasonals) during the week ended July 27. Filings for initial claims peaked at 535,000 in late March and fell off rapidly to a weekly pace of about 450,000 by early May (table). By late June, claims had moved down into the neighborhood of 425,000, where they remained through late July.

UNEMPLOYMENT INSURANCE BENEFITS[1]
(In thousands)

	1991		1991			1991	
	Q1	Q2	May	June	July	July 20	July 27
Initial claims	489	451	449	435	426	425	418
Insured unemployment	3,301	3,534	3,553	3,515	n.a.	3,382	n.a.

1. All regular programs; FRB seasonal adjustment. Data for periods longer than a week are averages of the weekly data.

Output per hour in the nonfarm business sector rebounded 1.9 percent at an annual rate in the second quarter.[2] In manufacturing, productivity rose at a 3.6 percent rate. Strong gains in productivity are typical for the initial stages of a cyclical recovery, as employers are inclined to boost output with their existing labor force before incurring the costs associated with hiring. Despite the increases last quarter, productivity in the nonfarm business sector and in manufacturing stand only 0.4 percent and 1.4 percent, respectively, above their year-earlier levels, which suggests

2. Productivity and cost data released for 1991:Q2 incorporate annual benchmark revisions to employment and revised seasonal adjustment factors for data from 1986 forward. The effects of these revisions were small. Revised data now indicate that productivity in the nonfarm business sector fell 0.1 percent in 1990--an upward revision of 0.2 percentage point. In manufacturing, productivity growth was revised down 0.1 percentage point in 1990, to 2.9 percent.

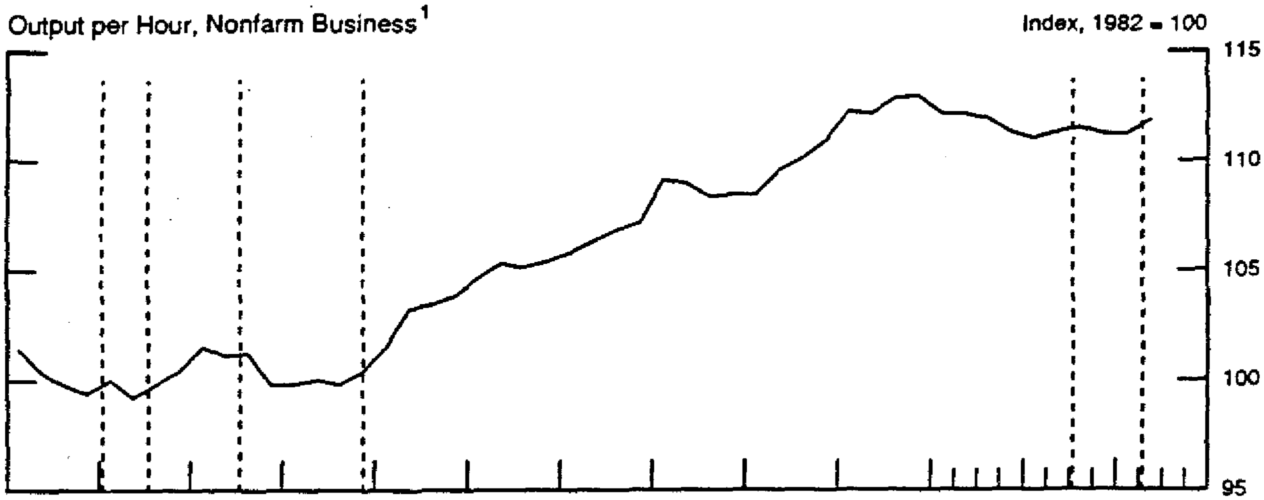
LABOR PRODUCTIVITY

LABOR PRODUCTIVITY
(Percent change from preceding period at compound annual rates; based on seasonally adjusted data)

	1989[1]	1990[1]	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1990:Q2 to 1991:Q2
Output per hour							
Nonfarm business	-1.4	-.1	.6	-.8	.0	1.9	.4
Manufacturing	.1	2.9	6.1	-2.2	-1.8	3.6	1.4

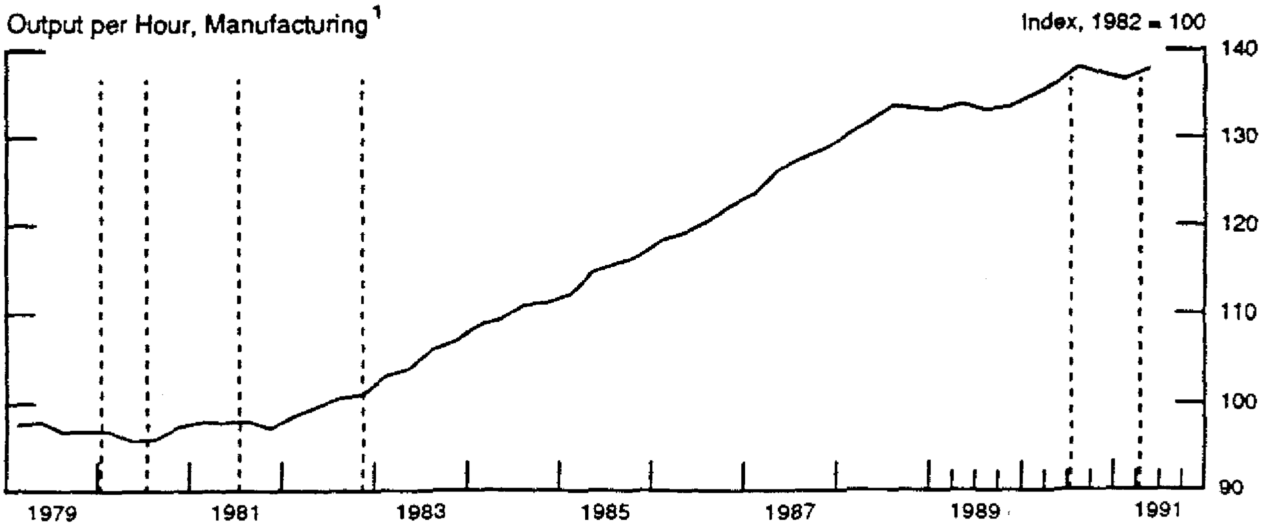
1. Changes are from final quarter of preceding period to final quarter of period indicated.

Output per Hour, Nonfarm Business[1]



1. Quarterly data, 1979:Q1 – 1991:Q2; seasonally adjusted.

Output per Hour, Manufacturing[1]



1. Quarterly data, 1979:Q1 – 1991:Q2; seasonally adjusted.

that employers have room to achieve further sizable increases in output per hour in the second half of the year.

Industrial Production

Industrial production probably rose appreciably in July, although perhaps a bit less than the average pace during the first three months of the upturn in the index. As typically occurs in the initial months of an expansion, an increase in motor vehicle production and a firming in industries that produce construction supplies have accounted for much of the recent gains.

Assemblies of motor vehicles rebounded another 1/2 million units in July to a 9.6 million unit annual rate (FRB seasonals) and now have retraced about half of the steep decline that occurred between September and February. Last month's rise in motor vehicle production added directly 0.15 percentage point to growth of total IP. Current schedules for the remainder of the year call for auto production to come in only a shade above July's 6.0 million unit annual rate. Truck production is scheduled to move up more noticeably from its pace in July of 3.6 million units.

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

	1991				1991		
	Q1	Q2	Q3[1]	Q4[1]	June	July	Aug.[1]
Domestic production:							
Autos	5.1	5.2	6.2	6.0	5.4	6.0	6.3
Trucks	2.6	3.4	3.9	4.1	3.6	3.6	4.1

1. Figures for August through the remainder of the year are based on current manufacturers' schedules.

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

	Proportion in total IP 1990:Q4	1990[1]	1990 Q4	1991 Q1	1991 Q2	1991 April	1991 May	1991 June
			------Annual rate-----					
Total index	100.0	0.3	-7.0	-9.7	1.7	0.5	0.7	0.7
Excluding motor vehicles and parts	96.2	0.8	-4.9	-8.6	0.1	0.2	0.5	0.6
Products, total	61.4	0.6	-5.3	-8.8	1.5	0.4	0.5	0.5
Final products	46.9	1.1	-5.3	-7.3	2.5	0.6	0.4	0.4
Consumer goods	25.7	-0.7	-3.8	-7.0	5.1	0.7	0.9	0.6
Automotive products	2.2	-7.3	-37.6	-24.6	38.0	5.9	2.9	2.1
Other consumer goods	23.5	0.0	0.4	-5.3	2.5	0.3	0.7	0.4
Durables	3.0	-3.9	-16.2	-10.9	10.3	1.7	0.6	2.1
Nondurables	20.5	0.6	3.2	-4.4	1.5	0.1	0.7	0.2
Energy	2.7	-2.3	-2.4	-5.5	4.6	-1.0	3.9	-0.5
Other	17.8	1.0	4.1	-4.3	1.0	0.2	0.2	0.3
Business equipment	15.8	4.2	-7.6	-7.4	2.8	0.9	0.2	0.2
Motor vehicles	1.0	-9.4	-49.8	-42.2	66.6	10.0	4.2	3.3
Other business equipment	14.8	5.3	-3.4	-4.6	-0.3	0.4	-0.0	-0.0
Information processing and related	6.6	5.1	0.4	7.0	1.8	0.2	0.3	-0.4
Industrial	4.3	1.3	-10.2	-14.2	-3.3	0.1	-0.7	0.1
Defense and space equip.	4.8	-0.2	-4.7	-8.6	-10.1	-1.5	-1.0	-0.3
Construction supplies	5.7	-4.6	-12.0	-21.2	-1.3	1.0	0.4	1.8
Materials	38.6	-0.1	-9.7	-11.0	1.9	0.7	0.9	0.9
Durable	19.6	-0.5	-13.9	-16.7	1.9	1.4	1.0	1.0
Nondurable	8.8	0.5	-5.5	-7.0	-0.1	0.3	0.3	1.0
Energy	10.2	0.0	-4.5	-3.0	3.7	-0.3	1.2	0.9
Memorandum:								
Manufacturing	84.9	0.3	-7.4	-10.4	1.5	0.7	0.5	0.7
Excluding motor vehicles and parts	81.0	0.9	-4.9	-9.2	-0.4	0.4	0.3	0.6
Mining	7.5	2.4	-1.4	-4.0	-3.6	-0.7	-0.3	1.5
Utilities	7.6	-2.1	-7.6	-7.6	7.9	-0.6	3.9	-0.5

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

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

	1967-89 Avg.	1988-89 High	1990 June	1991 April	1991 May	1991 June
Total industry	82.2	85.0	83.8	78.6	79.0	79.3
Manufacturing	81.5	85.1	83.1	77.5	77.7	78.1
Primary processing	82.3	89.0	85.6	78.3	78.8	79.8
Advanced processing	81.1	83.6	82.0	77.2	77.2	77.4

Even adjusting for net imports from Canada and Mexico, auto production has recently been below the level of sales. As a result, dealer inventories of cars have continued to decline, reaching an estimated 900,000 units in July, or about 40 days' supply, which compares with a historical average of nearly 60 days' supply. Although dealers likely have been targeting a lower desired level of stocks, current holdings of both autos and light trucks probably are so low that, if sales are sustained, production schedules for the remainder of the year could well be raised.

Excluding motor vehicles, the movements in industrial production in July were mixed. Output of construction supplies probably moved up further after rising briskly in the second quarter. By contrast, output of consumer durables (excluding motor vehicles) likely edged down last month owing mainly to a decline in production of appliances. Production of consumer durables (excluding motor vehicles) had rebounded at a 10.3 percent annual rate during the second quarter; that increase, however, was somewhat less than in the initial months of previous expansions.

Output of business equipment other than motor vehicles appears to have flattened out in recent months after falling sharply in the first quarter. However, no signs of firming have been apparent in most of the major categories in this grouping--which on average continues to decline for five months following the trough in the overall IP index. Indeed, the recent weakness in bookings for capital goods points to further sluggishness in the near term.

The firming in output of final products in recent months appears to have lifted activity at materials producers. Output of steel has retraced part of the steep decline that occurred in the first quarter. Elsewhere,

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

		1991		1991		
	1990	Q1	Q2	Apr.	May	June
Total personal income	20.5	2.4	17.4	4.7	24.9	22.6
Wages and salaries	10.9	-2.7	16.1	4.6	17.2	26.6
Private	8.2	-6.6	14.8	3.8	15.4	25.2
Other labor income	1.3	1.0	1.0	1.0	1.0	1.0
Proprietors' income	2.1	1.9	-.1	-1.6	4.6	-3.2
Farm	.5	1.9	-3.5	-5.2	.7	-6.1
Rent	.7	-1.1	.3	.3	.6	-.1
Dividend	.7	-.6	.1	-.1	.4	.1
Interest	1.6	-3.2	-2.8	-3.2	-2.9	-2.3
Transfer payments	5.2	9.6	3.9	4.1	5.3	2.2
Less: Personal contributions for social insurance	1.1	2.5	1.1	.4	1.2	1.7
Less: Personal tax and nontax payments	4.0	-2.0	3.2	3.0	2.6	4.1
Equals: Disposable personal income	16.5	4.3	14.2	1.7	22.3	18.5
Memo: Real disposable income	-.8	-4.8	3.6	-5.3	4.9	11.1

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

		1991		1991		
	1990	Q1	Q2	Apr.	May	June
		-Annual rate-		----Monthly rate----		
Personal consumption expenditures	.1	-1.5	3.6	-.7	.8	.4
Durable goods	-1.8	-11.7	5.2	-4.3	2.6	1.9
Excluding motor vehicles	-1.1	-.8	3.0	-.4	.8	-.2
Nondurable goods	-2.4	-1.8	1.0	-.6	.5	-.4
Excluding gasoline	-2.3	-1.3	.8	-.6	.8	-.8
Services	2.5	2.1	4.8	.3	.5	.5
Excluding energy	3.1	3.2	4.0	.4	.0	.6
Memo:						
Personal saving rate (percent)	4.6	4.2	3.7	4.1	3.5	3.5

production of consumer durable parts and textile materials have posted noticeable gains since the first quarter; these increases are partly related to the improvement in motor vehicle production.

Capacity utilization in manufacturing, which fell 6 percentage points between July 1990 and April 1991, rose about 1 percentage point from March to June and probably inched up further last month. Operating rates at most primary processing industries have increased since March, especially steel, textiles, lumber, and rubber and plastics. Capacity utilization at advanced processing industries has been little changed during this period: A rise in the operating rate for motor vehicles has been offset by further declines in utilization for nonelectrical machinery and instruments.

Personal Income and Consumption

Nominal disposable personal income grew at about a 6 percent annual rate in May and June, boosted by large increases in private wages and salaries. Relatively small increases in prices helped translate these gains into an increase of 3-1/2 percent (annual rate) in real disposable personal income over the two months. However, the July employment report showed a decline in aggregate hours worked and essentially flat average hourly earnings, suggesting that the level of wage and salary income likely dropped back somewhat last month.

Real personal consumption expenditures (PCE) rose even more rapidly than income in May and June. Expenditures for services posted large increases over the two-month period, boosted, in part, by a high level of spending on energy services. But the greatest stimulus was from purchases of durable goods, especially new cars and trucks. Revised estimates of

RETAIL SALES
(Seasonally adjusted percentage change)

	1990	1991		1991		
	Q4	Q1	Q2	May	June	July
Total sales	.1	-1.0	1.4	1.2	.1	.5
Previous estimate			1.1	.8	-.2	
Retail control[1]	.5	-.3	.9	1.1	.0	.4
Previous estimate			.6	.9	-.5	
Total excl. automotive group	.3	-.3	1.0	1.1	.0	.3
Previous estimate			.8	.9	-.5	
GAF[2]	-2.0	.6	2.2	.9	-1.4	2.0
Previous estimate			2.6	1.1	-.8	
Durable goods stores	-1.3	-2.0	2.5	1.1	.3	.7
Previous estimate			2.2	.8	-.0	
Bldg. material and supply	-2.9	-.6	4.7	-.3	-.3	-.8
Automotive dealers	-.7	-3.4	2.9	1.5	.9	1.1
Furniture and appliances	-2.4	-1.2	1.9	.2	-.8	1.9
Other durable goods	-.6	1.9	-.8	1.8	-.6	-.8
Nondurable goods stores	.8	-.4	.8	1.2	.1	.4
Previous estimate			.5	.8	-.3	
Apparel	-3.0	.0	4.5	.5	-.6	.1
Food	.5	.3	1.1	1.5	.6	-.3
General merchandise[3]	-1.4	1.8	1.4	1.3	-2.0	2.8
Gasoline stations	9.2	-9.8	-3.1	2.4	.4	-1.0
Other nondurables[4]	.3	1.3	.7	.6	.9	.2

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

retail sales in May and June show even higher spending at both auto and non-auto outlets than was incorporated in the earlier PCE estimates. As a result, the staff anticipates that BEA's preliminary estimate of real PCE in the second quarter will come in a few billion dollars above the advance estimate.

Nominal retail sales posted another increase in July; in the retail control category, which excludes spending at automobile dealers and at building material and supply stores, sales rose 0.4 percent. Outlays at automotive dealers continued strong, and sales at general merchandise, apparel, and furniture outlets (the GAF grouping), where expenditures are thought to be largely discretionary, more than offset their sharp June decline. However, declines in outlays at stores selling durable goods other than furniture and automobiles provided some offset to those strong gains. The drop in nominal spending at gasoline stations apparently reflected falling gasoline prices.

Sales of autos and light trucks rose rapidly in May and June, and edged up further in July to 13.3 million units (annual rate), well above the first-quarter pace. The improvement largely has been limited to domestically produced vehicles; imports have risen only slightly since the first quarter.

Although motor vehicle sales have not yet recovered to their pre-recession level, sales have grown rapidly in the past three months relative to income, which is typical of the early stages of a recovery. In the current case, the strong recovery in motor vehicle purchases relative to income probably benefited from a substantial decline in financing costs in May and June, when automakers sweetened their financing incentives

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

	1989	1990	1990 Q4	1991 Q1	1991 Q2	1991 May	1991 June	1991 July
Autos and light trucks	14.51	13.86	12.95	11.80	12.35	12.29	13.07	13.24
Autos	9.90	9.50	8.98	8.22	8.46	8.43	9.02	9.14
Light trucks	4.61	4.36	3.97	3.57	3.89	3.86	4.05	4.10
Domestic total	11.19	10.84	10.18	9.25	9.68	9.64	10.43	10.60
Autos	7.08	6.90	6.59	5.99	6.10	6.09	6.72	6.84
Light trucks	4.11	3.95	3.59	3.26	3.57	3.55	3.71	3.76
Import total	3.33	3.01	2.76	2.54	2.67	2.66	2.64	2.63
Autos	2.82	2.60	2.38	2.23	2.36	2.34	2.30	2.30
Light trucks	.50	.41	.38	.31	.32	.32	.34	.33

Note: Data on sales of trucks and imported autos for the current month are preliminary and subject to revision.

1. Components may not add to totals due to rounding.

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

(including incentives on consumer leases) and market interest rates were declining. (Most of the existing incentive programs will not expire until late September.) At the same time, sticker prices, net of rebates and direct incentives, have been little changed in recent months.

Another factor that may have allowed motor vehicle sales to recover relatively quickly is the increased promotion of automobile leasing as an alternative to direct purchase. A variety of explanations have been proposed for the expanded use of leasing. First, lease companies have certain financial advantages that may enable them to pass savings on to lessees: Firms can depreciate the autos and can deduct interest payments, which individuals no longer can do. Second, consumers are said to perceive that leasing is "easier" than buying in several senses: No down payment need be accumulated; leases can involve less negotiation with car dealers; some lease contracts require the lease company to arrange and pay for maintenance and repairs; and monthly payments on a lease are substantially lower than those on a financed loan.

Housing Markets

An appreciable but uneven recovery in the housing sector continued through June. Real residential investment expenditures rose at an annual rate of 3.7 percent rate in the second quarter, spurred by a 15 percent increase in single-family housing starts. In sharp contrast, multifamily residential expenditures declined 40 percent at an annual rate in the second quarter.

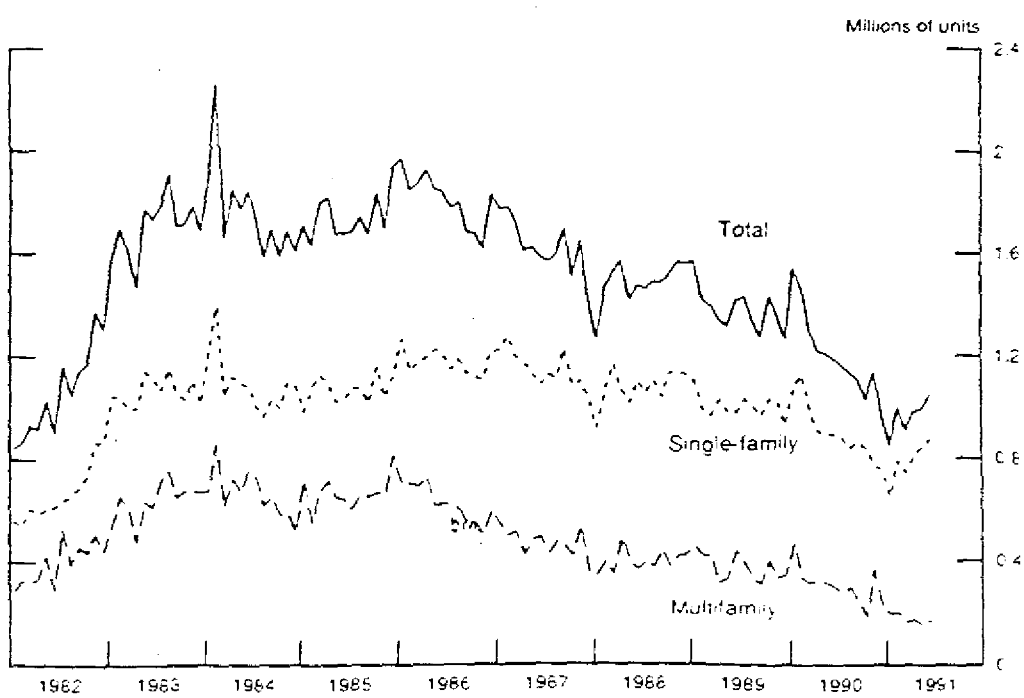
In June, multifamily starts edged up to a 172,000 unit rate, only slightly above the 30-year low recorded in May. Despite the sharply lower level of multifamily building in the past few years, the vacancy rate for

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

	1990	1990	1991		1991		
	Annual	Q4	Q1[r]	Q2[p]	Apr.[r]	May[r]	June[p]
All units							
Permits	1.11	.90	.86	.96	.91	.97	1.00
Starts	1.19	1.04	.92	1.00	.98	.99	1.04
Single-family units							
Permits	.79	.67	.67	.76	.74	.76	.78
Starts	.90	.79	.73	.84	.80	.84	.87
Sales							
New homes	.53	.47	.47	.51	.51	.49	.53
Existing homes	3.30	3.12	3.09	3.48	3.31	3.54	3.59
Multifamily units							
Permits	.32	.23	.19	.20	.17	.21	.23
Starts	.30	.26	.19	.17	.18	.15	.17
Vacancy rate[1]							
Rental units	9.1	9.0	9.4	9.4	n.a.	n.a.	n.a.
Owned units	7.2	6.6	7.6	7.1	n.a.	n.a.	n.a.

1. Percent. Owned units consist mainly of condominiums.
p Preliminary. r Revised estimates. n.a. Not available.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



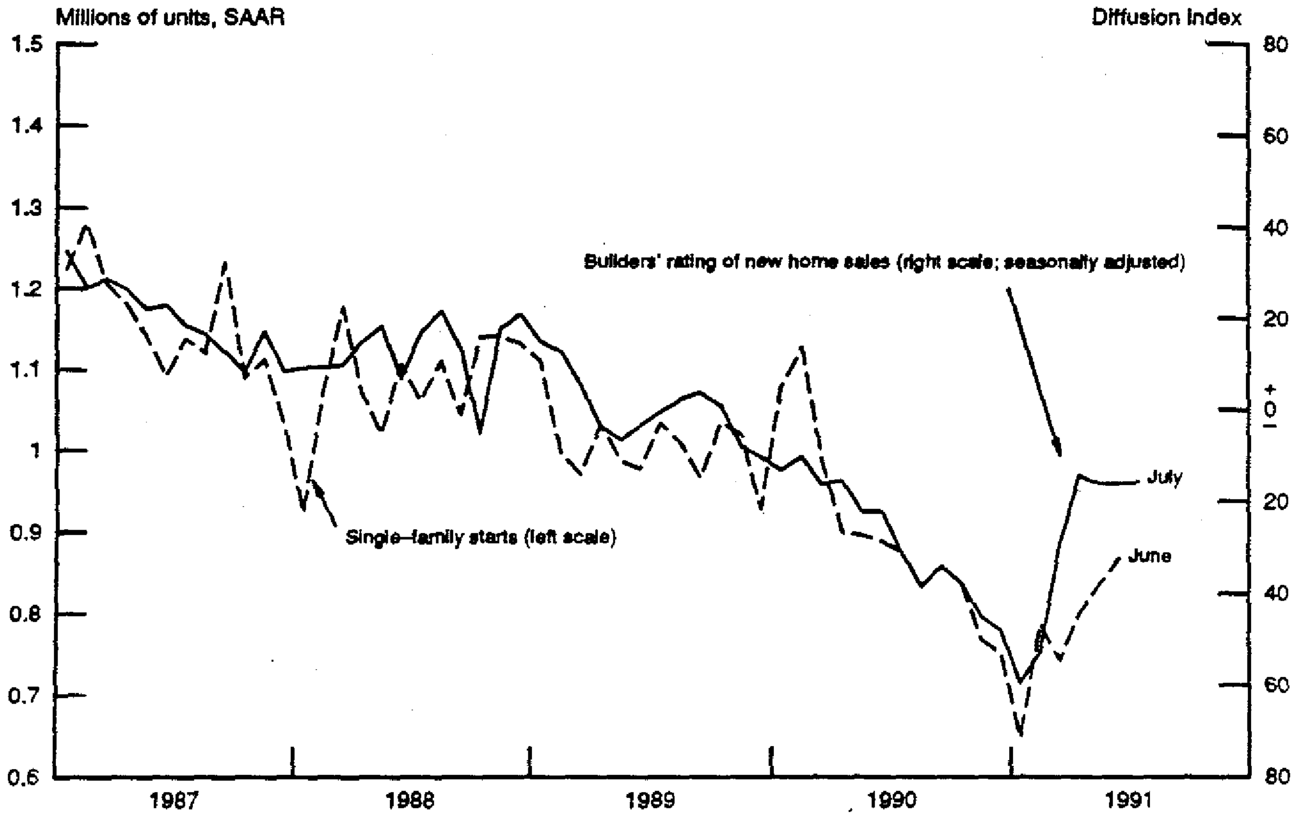
multifamily rental housing units remained at 9.4 percent in the second quarter--not far below the record highs in 1987 and 1988. Given the adverse conditions in the market for multifamily housing in many areas, multifamily starts likely will grow only slowly at best, and will limit the expansion of total residential expenditures.

Most indicators of conditions in the market for single-family homes suggest continued improvement. In June, single-family starts reached 868,000 units (annual rate), the highest figure in nearly a year. Moreover, permit issuance for single-family homes--which is subject to considerably less statistical error than starts--also increased further in that month. The rebound in single-family housing starts between the first and second quarters equaled or exceeded the growth rate during the initial quarter of recovery in all but one of the upturns in single-family starts dating from 1961 (table, column 4).[3] Furthermore, the proportion of the preceding cyclical decline in starts that has been reversed by the increase in starts in the second quarter also equaled or exceeded the relative strength of the rise in starts in all but one of the previous upturns (column 7).

Measures of housing demand also have been encouraging. New home sales rose in June to 525,000 units at an annual rate, the highest monthly reading since last August. Similarly, sales of existing homes moved up to a 3.59 million unit rate in June, the highest level since early 1989. Further, in July, both homebuilders' ratings of new home sales (chart, upper panel), and the University of Michigan's monthly sampling of consumer attitudes toward homebuying (lower panel) remained at the improved levels

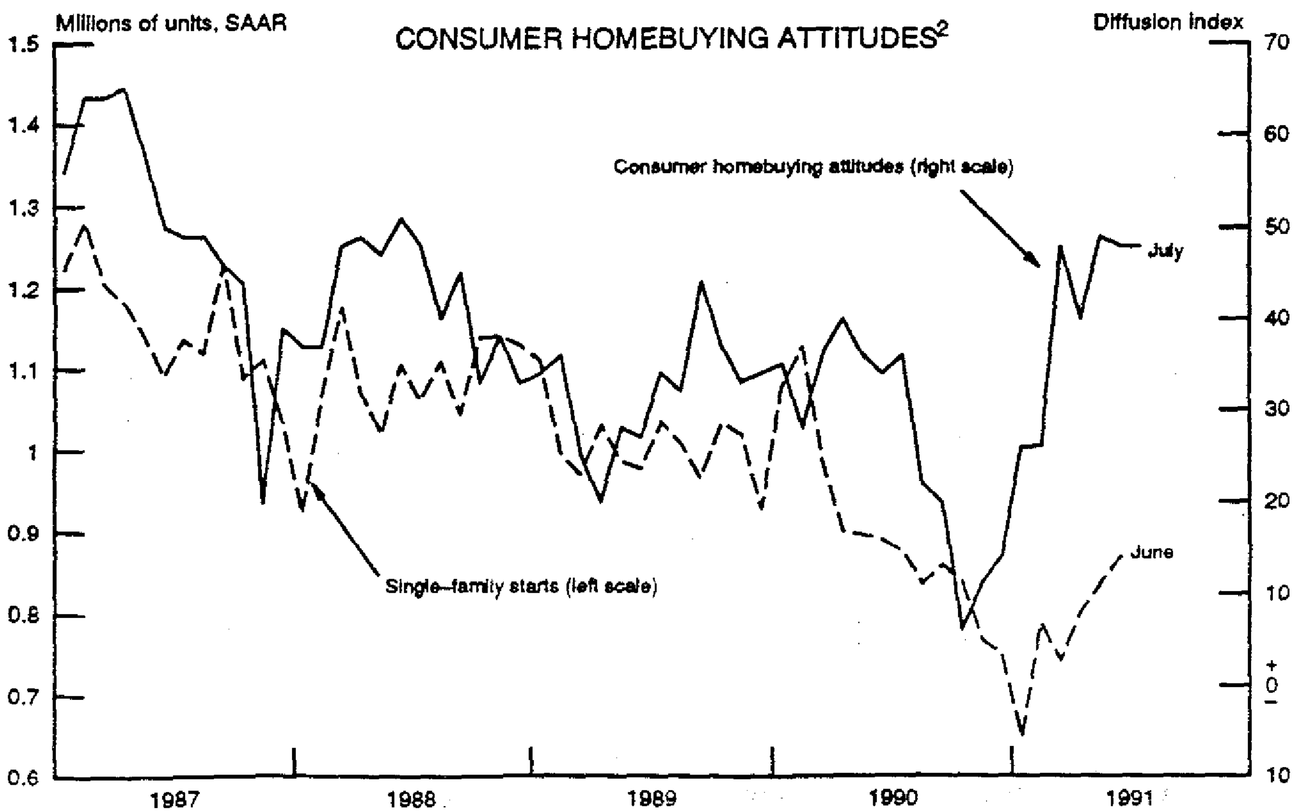
3. This comparison is for the first quarter of recovery in single-family housing starts; those turning points roughly coincide with the beginning of business-cycle expansions.

BUILDERS' RATING OF NEW HOME SALES[1]



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

CONSUMER HOMEBUYING ATTITUDES[2]



2 The homebuying attitudes index is calculated by the Survey Research Center (University of Michigan) as the proportion of respondents rating current conditions as good minus the proportion rating such conditions as bad.

seen in the past few months. The past relationships of these series to single-family housing starts suggest support on the demand side for further increases in home construction.

COMPARISON OF UPTURNS IN SINGLE-FAMILY STARTS, 1960 TO PRESENT

Business cycle trough[1]	Associated low in starts: Period	Number[2]	Percent change in starts in first quarter of upturn	Previous high in starts: Period	Number[2]	Percent of decline offset in first quarter of upturn
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1961:Q1	1960:Q4	904	3	1959:Q1	1,302	8
1970:Q4	1970:Q1	687	10	1963:Q3	1,064	19
1975:Q1	1975:Q1	734	16	1972:Q3	1,345	19
1980:Q3	1980:Q2	691	38	1977:Q4	1,505	33
1982:Q4	1981:Q4	541	5	1980:Q4	979	6
1991:Q2	1991:Q1	726	15	1987:Q1	1,237	21

1. The trough of the 1990-91 recession is assumed to be 1991:Q2.
2. Thousands of units, at a seasonally adjusted annual rate.

House price developments have been mixed. The Census Bureau's constant-quality price index for new homes in the second quarter was 1.7 percent above its level of a year earlier.[4] On the other hand, actual transactions prices for new homes have declined, with the mean and median sales prices in the second quarter down 1.1 and 5.5 percent, respectively, from their year-earlier levels. Part of the reason for the decline is that

4. Unlike transactions prices for new and existing homes, constant-quality new home prices are adjusted for changes in the geographic composition and in the structural characteristics of new homes sold.

MEDIAN PRICE OF EXISTING HOMES SOLD,
U.S. AND SELECTED METROPOLITAN STATISTICAL AREAS
(Percent change from a year earlier)

	1989	1990	1990 Q3	1990 Q4	1991 Q1	1991 Q2
U.S. Total	4.3	2.6	1.8	.5	.4	4.7
South						
Atlanta	n.a.	2.9	2.5	.0	1.1	.1
Dallas	2.9	-4.2	-4.1	-7.4	-4.1	-3.6
Houston	7.9	6.0	1.8	9.7	1.0	5.6
Jacksonsville	2.4	4.5	4.2	.1	-.7	-2.2
Memphis	2.4	.0	.8	-2.1	5.8	5.5
New Orleans	-3.4	-4.0	-5.5	-8.4	2.8	8.4
Oklahoma City	-4.8	-.6	-.9	-3.3	7.3	4.1
Washington, D.C.	9.0	4.0	3.3	.8	.4	3.4
Northeast						
Boston	.4	-4.2	-4.0	-7.9	-9.7	-2.8
Buffalo	10.7	6.5	3.5	-1.7	.8	2.4
Hartford	-1.0	-5.2	-5.4	-7.2	-6.8	-3.5
New York City	-.3	-4.5	-3.8	-6.0	-4.8	-1.9
Philadelphia	1.5	4.6	9.5	-2.1	2.1	1.0
Providence	-.3	-1.8	-1.7	-6.8	-1.4	-2.8
West						
Denver	4.5	1.1	-.8	-1.7	-1.7	3.4
Los Angeles	20.1	-.9	-4.7	-3.1	-3.6	1.2
Phoenix	-1.5	6.6	11.7	7.7	2.1	1.9
Portland	8.9	13.4	14.6	11.0	12.6	8.5
Salt Lake City	2.5	.0	1.0	-1.5	.1	8.1
San Francisco	22.4	-.5	-3.1	-4.9	-6.6	.6
Seattle	22.3	23.5	24.9	10.6	2.2	-2.6
Midwest						
Chicago	20.2	9.2	11.0	3.6	-.2	6.3
Cincinnati	8.8	5.3	5.3	4.9	7.6	4.7
Cleveland	8.7	7.2	7.7	5.7	5.2	6.1
Detroit	.8	4.1	1.7	.1	3.8	2.3
Indianapolis	7.7	5.1	4.1	1.9	4.6	5.5
Kansas City	1.6	3.5	9.4	2.7	-.9	5.1
Minneapolis	2.3	1.7	.5	.1	3.1	2.1
St. Louis	-1.5	-.3	5.4	3.8	2.5	-5.9

n.a.--not available
Source: National Association of Realtors

a smaller proportion of all new home sales have been occurring in the relatively expensive Northeast region this year.

In the market for resales, the median price in the second quarter was 4.7 percent above its level of a year earlier. Data from major metropolitan areas indicate that, in the second quarter, most areas experienced larger year-over-year price increases, or smaller price declines, than was the case in recent quarters. The shift from falling to rising prices was particularly noticeable in the West. In the Northeast, price declines moderated in several metropolitan areas.

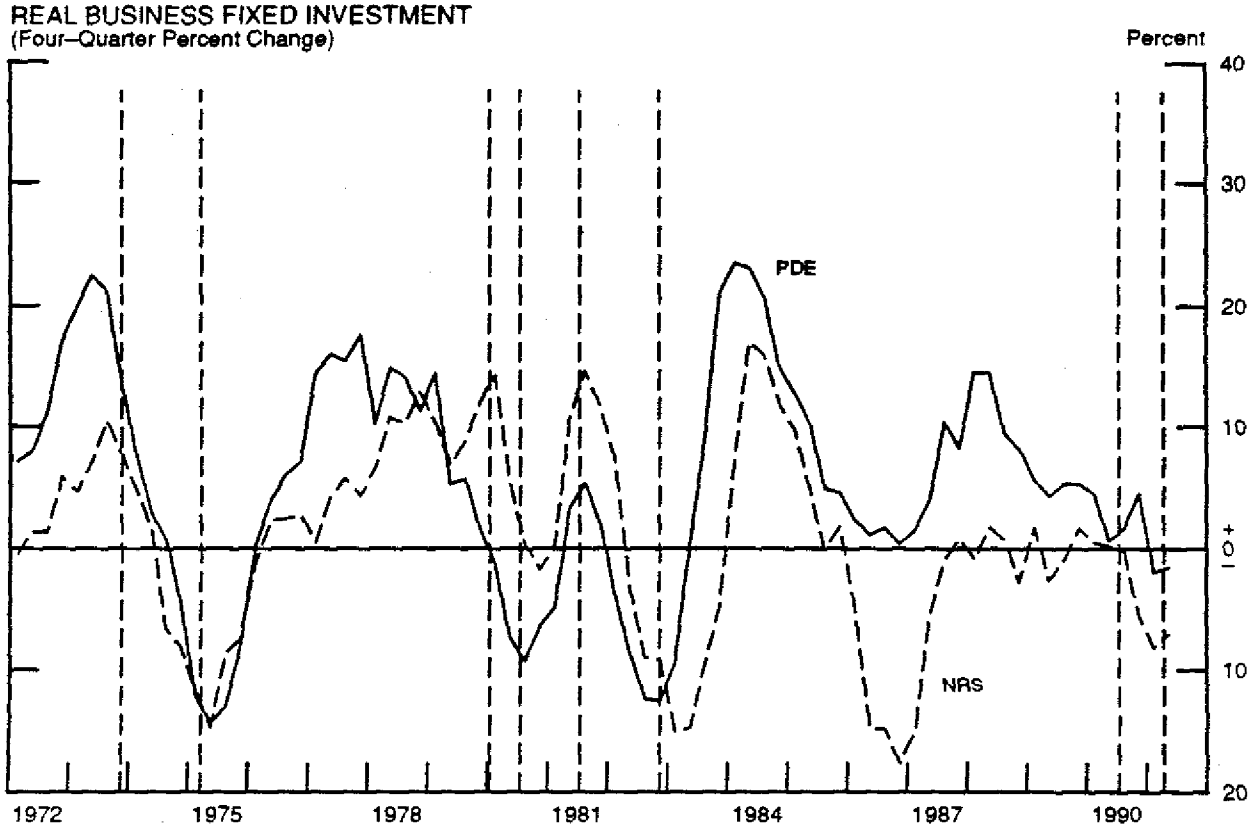
Business Fixed Investment

Real business fixed investment fell in the second quarter. Outlays for equipment fell modestly as reduced purchases of industrial and transportation equipment more than offset a rebound in spending for office and computing equipment.[5] In the nonresidential construction sector, a drop in drilling and mining accounted for the decline in outlays shown in the advance GNP estimates. Data on the value of construction put-in-place--which were not available in time for the advance estimate--fell 3 percent (not annual rate) in the second quarter. These data imply about a $3 billion downward revision to the level of real NRS in the second quarter, producing a decline of about 14 percent at an annual rate compared with the reported drop of 4.5 percent.[6] Among specific categories, large downward

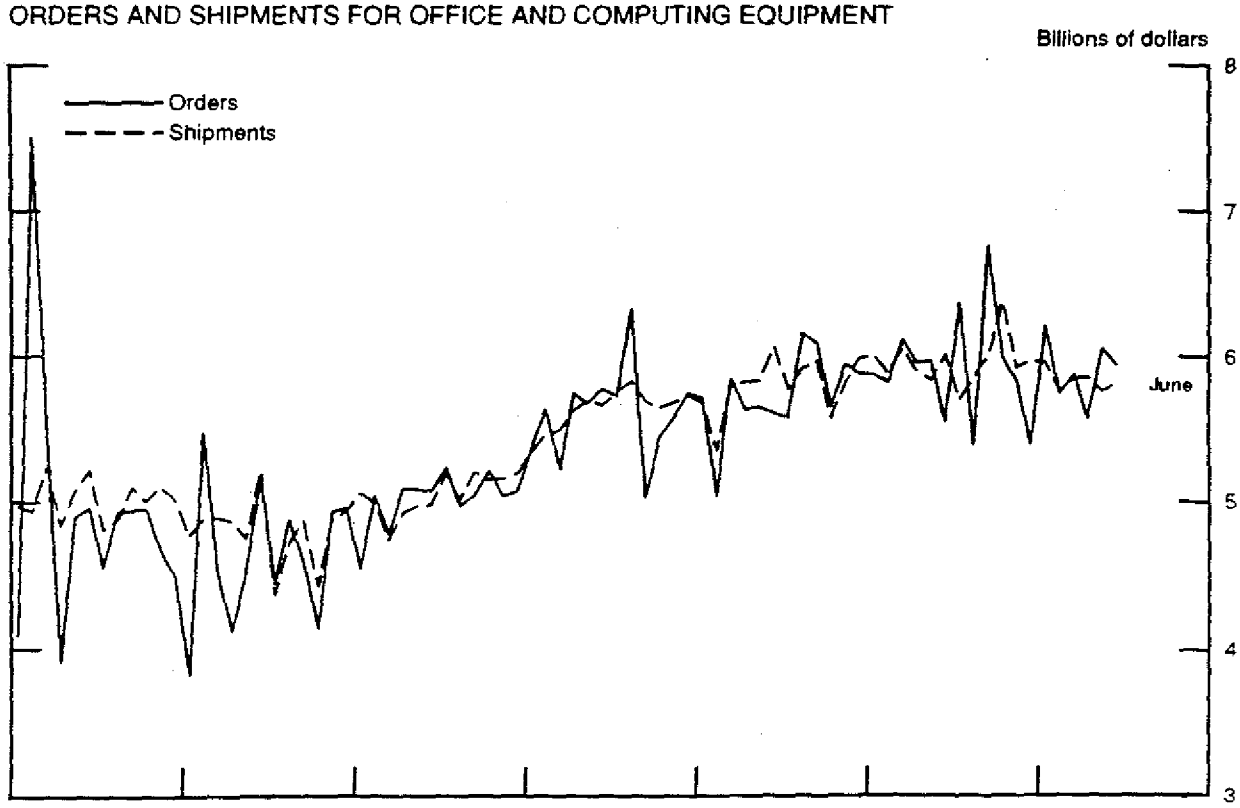
5. The recent revisions to shipments of nondefense capital goods during May and June were small and suggest little change in BEA's estimate of PDE spending in the second quarter.

6. Further, the data for construction put-in-place also were revised down for earlier months. These revisions imply an additional $3 billion downward revision to real NRS in the first quarter. This revision will be incorporated in the NIPA with the November benchmark.

REAL BUSINESS FIXED INVESTMENT
(Four-Quarter Percent Change)



ORDERS AND SHIPMENTS FOR OFFICE AND COMPUTING EQUIPMENT



revisions in the second quarter are likely for construction of hotels, motels, and offices.

Since the middle of last year, investment in nonresidential structures has turned down in a fairly typical fashion, although from a much weaker position at the business-cycle peak. In contrast, the cyclical decline in equipment investment has been moderated by growth in spending on office and computing equipment, which has risen $11 billion in 1982 dollars during the past year. Excluding computers, real equipment spending has fallen 9.9 percent since the cyclical peak in 1990:Q3; this decline is a shade less severe than the postwar average.

Looking ahead, recent indicators suggest that business investment will post little or no growth in the near term. With regard to equipment, the nominal value of orders for nondefense capital goods (excluding aircraft) fell 1-3/4 percent (not an annual rate) in the second quarter, after a drop of 4 percent in the first quarter. These declines reflected reduced orders for virtually every category of machinery and should result in lower current-quarter outlays in these sectors. However, these declines are likely to be offset by increased spending on computers and motor vehicles. Although nominal computer orders and shipments have appeared soft recently, computer prices have been falling rapidly because of competitive pressures and further advances in technology; as a result, real gains in spending are likely in the current quarter.[7] Moreover, with total auto and light truck

7. The "cutthroat" price competition on PCs and mainframes apparently has continued unabated in recent months, as computer manufacturers, notably IBM, attempt to maintain or regain market share. As a result, the July level of the PPI measure of electronic computer prices was 6.8 percent (not at an annual rate) below the second-quarter average.

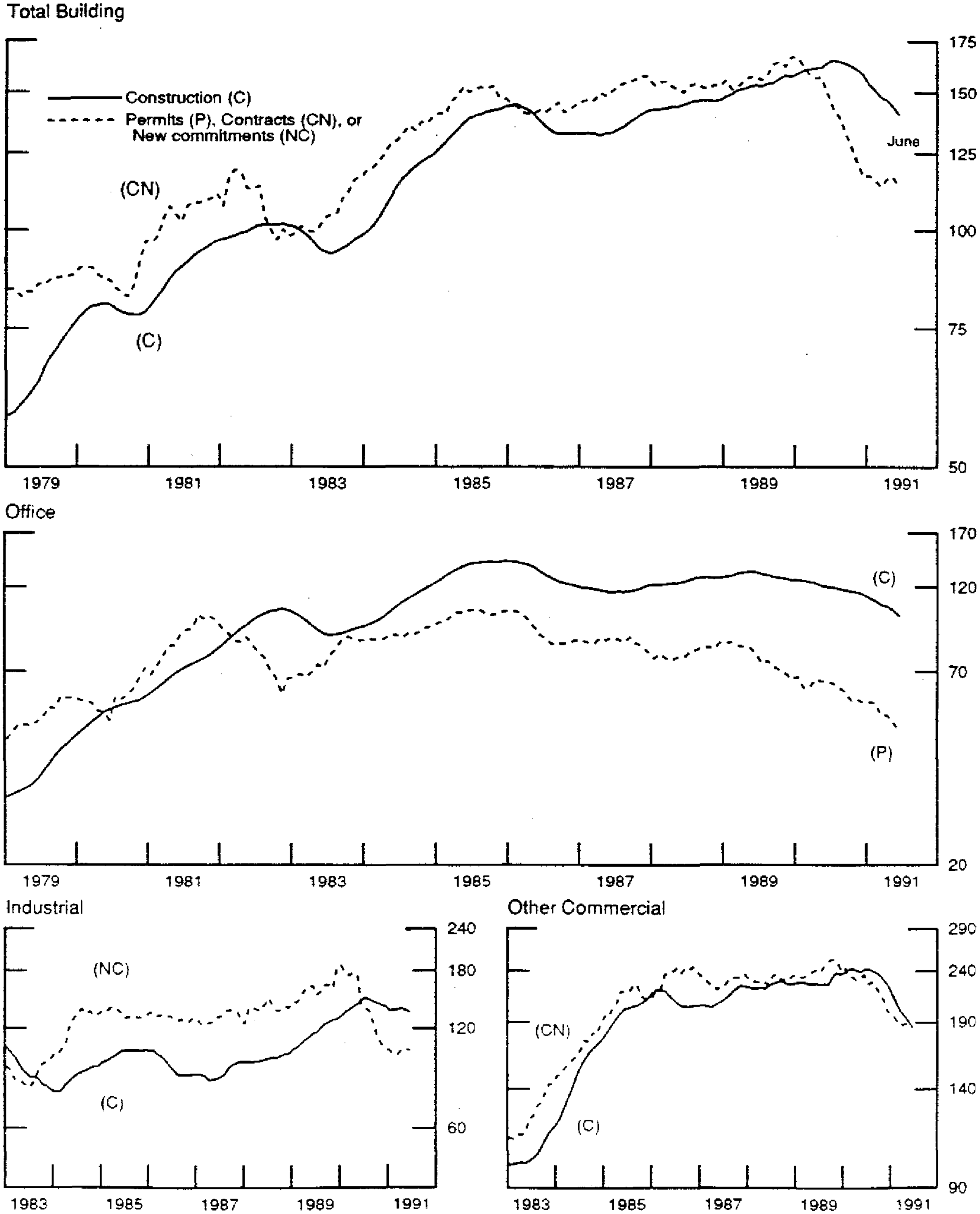
BUSINESS CAPITAL SPENDING INDICATORS
(Percentage change from preceding comparable periods;
based on seasonally adjusted data)

	1990	1991		1991		
	Q4	Q1	Q2	Apr.	May	June
Producers' durable equipment						
Shipments of nondefense capital goods	1.4	-2.2	1.4	1.0	1.3	2.2
Aircraft and parts	-2.2	2.9	5.5	9.3	1.8	7.6
Excluding aircraft and parts	2.2	-3.3	.5	-.7	1.1	.9
Office and computing	4.2	-3.9	-.8	.1	-1.6	.9
All other categories	1.6	-3.1	.9	-1.0	1.9	.9
Shipments of complete aircraft	-3.2	4.4	8.8	17.8	6.8	-.4
Weighted PDE shipments (incl. air)[1]	1.8	-3.6	1.6	3.3	1.3	.4
Sales of heavy-weight trucks	-10.8	-9.1	-7.6	-7.6	-2.8	3.3
Orders of nondefense capital goods	5.3	-6.6	-13.6	-10.0	-2.5	4.7
Excluding aircraft and parts	.8	-4.0	-1.8	3.9	2.9	-4.5
Office and computing	-7.0	3.6	-1.5	-5.3	8.8	-2.0
All other categories	3.3	-6.1	-1.9	6.9	1.2	-5.3
Nonresidential structures						
Construction put-in-place	-5.5	-4.4	-2.9	4.2	-7.4	-2.3
Office	-6.0	-6.6	-6.5	7.2	-12.1	-4.8
Other commercial	-11.0	-10.6	-3.1	4.3	-5.0	-6.2
Public utilities	1.3	-.7	.4	2.1	-2.9	2.3
Industrial	-6.0	.6	-3.2	5.7	-15.7	4.8
All other	-5.7	-4.0	-3.0	3.1	-4.4	-6.5
Rotary drilling rigs in use	-2.8	.9	-8.4	-6.0	-3.0	3.7
Footage drilled[2]	6.0	-7.0	-14.1	-11.1	-6.4	4.7

1. Computed as the weighted sum of 26 individual equipment series from the Census M-3 report, with weight for each type of equipment equal to the ratio of final business spending to shipments.
2. 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.

OFFICE BUILDING CONSTRUCTION

Region	Percent change in contracts[1] from 1990:H1 to 1991:H1	Vacancy rate[2] (percent)
Total	-44	19.4
New England (CT, ME, MA, NH, RI, VT)	-63	18.8
Middle Atlantic (NJ, NY, PA)	-54	17.7
West North Central (IA, KS, MN, MO, NE, ND, SD)	-66	16.7
East North Central (IL, IN, MI, OH, WI)	-64	17.8
South Atlantic (DE, DC, FL, GA, MD, NC, SC, VA, WV)	-26	18.8
East South Central (AL, KY, MS, TN)	11	21.3
West South Central (AR, LA, OK, TX)	-31	24.6
Pacific Northwest (AK, ID, MT, OR, WA, WY	-54	13.8
Pacific Southwest (AZ, CA, CO, NV, NM, HI, UT)	-26	18.8

1. Contracts measured in square footage. Data are from F.W. Dodge Division of McGraw-Hill.
2. Calculated from the March metropolitan vacancy rates in region weighted by existing metropolitan office square footage.

sales having picked up, business purchases of motor vehicles are likely to average higher this quarter as well.

Advance indicators for nonresidential structures paint a much bleaker picture. Construction permits and contracts have trended down during the last year in most sectors (chart). The office sector has been hit especially hard as the recession highlighted and exacerbated the existing abundance of supply. Despite recent cutbacks in office construction, the Coldwell-Banker office vacancy rate for metropolitan areas stood at 19.4 percent in March, little changed from its historic highs of the past few years.[8] Given this persistently high vacancy rate, appraised nominal values of office properties have dropped more than 20 percent since their peak in late 1985, according to the Russell-NCREIF index.[9] In light of high vacancies and falling property values, construction activity is plummeting. Indeed, new contracts for office building in the first six months of this year were 44 percent below the level for the first half of 1990. On a regional basis, the situation is much the same across the country (table). Although the New England and North Central (Great Lakes) states have experienced particularly severe declines in new office construction contracts, almost every major region has faced double-digit declines.

Inventories

Business inventory liquidation continued through the spring. On a current-cost basis, manufacturers and non-auto trade establishments drew

8. The June vacancy data will be available next week.

9. NCREIF is the National Council of Real Estate Investment Fiduciaries. NCREIF also reports indexes on appraised values of retail and warehouse properties. While these indexes have fallen from their peaks in late 1989 and early 1990, the declines are much smaller than in the office sector.

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

	1990	1991		1991		
	Q4	Q1	Q2	Apr.	May	June
Current-cost basis:						
Total	-.8	-29.3	-42.7	-32.7	-62.2	-33.3
Total excluding retail auto	9.1	-14.4	-33.7	-27.4	-56.6	-17.1
Manufacturing	-8.7	-11.3	-22.6	-10.0	-39.2	-18.4
Wholesale	10.5	4.7	-15.7	-20.2	-17.0	-9.9
Retail	-2.6	-22.7	-4.4	-2.4	-5.9	-4.9
Automotive	-9.9	-14.9	-9.0	-5.2	-5.5	-16.1
Excluding auto	7.3	-7.8	4.5	2.8	-.4	11.2
Constant-dollar basis:						
Total	-21.8	-20.0	n.a.	-9.7	-37.5	n.a.
Total excluding retail auto	-11.4	-2.3	n.a.	-9.7	-35.3	n.a.
Manufacturing	-18.3	-1.3	n.a.	2.6	-26.3	n.a.
Wholesale	5.8	6.0	n.a.	-13.0	-5.2	n.a.
Retail	-9.3	-24.7	n.a.	.8	-6.1	n.a.
Automotive	-10.4	-17.6	n.a.	.1	-2.2	n.a.
Excluding auto	1.1	-7.1	n.a.	.7	-3.9	n.a.

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

	Range in preceding 12 months:[2] Low	High	1990 Q4	1991 Q1	1991 Q2	1991 Apr.	1991 May	1991 June
Current-cost basis:								
Total	1.48	1.58	1.52	1.56	1.51	1.54	1.51	1.51
Total excluding retail auto	1.45	1.55	1.49	1.53	1.49	1.52	1.49	1.49
Manufacturing	1.54	1.69	1.59	1.66	1.60	1.64	1.60	1.59
Wholesale	1.26	1.38	1.31	1.37	1.33	1.35	1.34	1.33
Retail	1.55	1.65	1.60	1.58	1.55	1.57	1.55	1.54
Automotive	1.87	2.18	2.01	1.96	1.83	1.91	1.87	1.81
Excluding auto	1.46	1.52	1.49	1.48	1.48	1.48	1.46	1.47
Constant-dollar basis:								
Total	1.42	1.51	1.46	1.49	n.a.	1.47	1.45	n.a.
Total excluding retail auto	1.39	1.49	1.44	1.48	n.a.	1.45	1.43	n.a.
Manufacturing	1.44	1.55	1.48	1.53	n.a.	1.50	1.48	n.a.
Wholesale	1.26	1.40	1.34	1.39	n.a.	1.35	1.34	n.a.
Retail	1.50	1.60	1.55	1.52	n.a.	1.51	1.50	n.a.
Automotive	1.64	1.89	1.77	1.68	n.a.	1.66	1.65	n.a.
Excluding auto	1.46	1.53	1.50	1.48	n.a.	1.48	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 coincidental. Range is for the 12-month period preceding the latest month for which data are available.

down their stocks another $17 billion (annual rate) in June and almost $34 billion for the second quarter as a whole. Although our translation of these figures to constant-dollar changes is imprecise, the staff estimates that they imply a somewhat greater liquidation of real nonfarm inventories in the second quarter than shown in BEA's advance estimate, which was based on monthly data through May.

Manufacturers reported sharp reductions in stocks from March to May. However, the pace of inventory liquidation appears to have slowed in June in a number of industries where market demand had improved and production had started to pick up in recent months--most notably motor vehicles, steel, and fabricated metal products. On the other hand, liquidation continued apace in nonelectrical machinery and several nondurable materials industries (chemicals, paper, and rubber and plastics). Although inventory-to-shipments ratios for the latter group of industries declined in the past few months, their levels in June were still above the recent lows observed last year.

In the trade sector, wholesale inventories were estimated to have been pared substantially, at a $16 billion annual rate in current-cost terms during the second quarter. But the drawdown was notably slower in June than in the preceding three months. The bulk of the recent wholesale inventory reduction occurred in durable goods categories--motor vehicles, machinery, and electrical goods--where inventory-sales ratios late in the spring were near the high end of their ranges over the past year.

At retailers, non-auto stocks rose at an annual rate of $11 billion in current-cost terms in June and $4-1/2 billion over the second quarter as a whole. The June accumulation was largely at stores selling nondurable

FEDERAL GOVERNMENT EXPENDITURES AND RECEIPTS
(NIPA basis, billions of current dollars at annual rates)

	1990 Q2	1990 Q3	1990 Q4	1991 Q1	1991 Q2
Expenditures	1272	1272	1311	1261	1321
Defense purchases	310	313	325	331	325
Nondefense purchases ex SPR and CCC	114	114	115	115	118
Strategic Petroleum Reserve and Commodity Credit Corporation	-2	1	-2	-3	4
Domestic transfer payments	491	496	509	534	542
Transfers to foreigners	19	17	9	-72	-31
Grants to states and localities ex Medicaid	88	85	90	95	96
Medicaid	43	45	46	49	56
Other expenditures	208	203	219	212	212
Receipts	1106	1126	1126	1135	1147[1]
Deficit	166	146	184	127	174[1]

1. The corporate profits tax component of receipts is estimated by the staff.

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS
(Unified basis, billions of dollars, except where otherwise noted)

	Second Quarter 1990	Second Quarter 1991	Second Quarter Percent change	October-June FY1990	October-June FY1991	October-June Percent change
Outlays	331.2	333.1	0.6	940.2	967.4	2.9
Deposit insurance (DI)	28.4	13.9	-51.1	41.8	30.3	-27.4
Outlays Ex DI	302.8	319.2	5.4	898.4	937.1	4.3
National defense	76.4	68.6	-10.2	226.5	198.7	-12.3
ex foreign contributions	76.4	80.6	5.5	226.5	237.6	4.9
Net interest	45.1	48.6	7.8	135.4	144.8	7.0
Social Security	65.7	71.0	8.1	186.0	201.2	8.2
Medicare and health	40.3	46.4	15.1	114.2	128.2	12.2
Income security	36.8	42.2	14.7	112.9	129.3	14.5
Other	38.6	42.4	9.8	123.5	134.9	9.2
Receipts	319.4	307.3	-3.8	776.6	789.9	1.6
Withheld income taxes plus FICA	180.4	183.4	1.7	538.7	559.2	3.8
Individual final payment	58.4	52.4	-10.4	70.6	64.1	-9.2
Individual refunds (-)	-35.8	-40.6	-13.3	-68.0	-74.1	-9.0
Individual declarations	31.0	29.7	-4.4	55.0	53.4	-2.9
Corporate income taxes	33.5	31.9	-4.9	72.5	76.4	5.4
Other	51.9	50.6	-2.5	108.8	110.9	1.9
Deficit	11.8	25.8	118.6	162.6	177.5	9.2
Deficit Ex DI	-16.6	11.9	--	120.8	147.2	21.9

Details may not add to totals due to rounding.

goods--especially apparel outlets and general merchandisers whose sales retreated somewhat; their inventory-sales ratios moved up as a result. Nonetheless, the inventory-sales ratios for most types of retail establishments, including the ratio for stores in the GAF grouping, were considerably lower at the end of the second quarter than at their peaks posted around the turn of the year. With the recovery in sales reported for July, retailers' inventory positions likely improved.

Federal Sector

BEA's advance estimates for the federal sector indicate that fiscal policy remained restrictive in the second quarter, even though several special factors produced a large increase in nominal spending and in the deficit. Much of the restraint is embodied in a 9.2 percent (annual rate) decline in real defense spending; this decline reflects both the downward trend in real spending that has been enacted in recent defense budgets and the tailing off of procurement related to Operation Desert Storm.

The large spending increases occurred in categories that do not have a direct influence on aggregate demand. Smaller foreign contributions for Operation Desert Storm increased transfer payments; these contributions are recorded as negative transfers to foreigners in the national income accounts. Swings in spending by the Strategic Petroleum Reserve and the Commodity Credit Corporation (that represented shifts in inventory between the public and private sector but not current production) increased nondefense purchases. Much of the rise in grants appears to reflect increases in the rate at which the federal government reimburses states for Medicaid programs; this rise in grants ought to be largely offset by smaller state deficits. On the revenue side, the small increase reflected the effects of the recession on income growth.

The federal government's unified deficit was $25.8 billion in the second quarter, $14 billion higher than in the second quarter of 1990; excluding deposit insurance outlays, the increase from a year earlier was $28.5 billion. Recession-related weakness in receipts, particularly a $10.8 billion decline in net final settlements on 1990 individual income tax liability (individual final payments less individual refunds), accounts for much of the increase. The weakness in net final settlements by individuals can be traced to excessive withholding on wages and salaries of individuals during calendar year 1990. This probably occurred because taxpayers had taxes withheld and made estimated tax payments before the extent of their lower income became apparent, either in the form of lost wages or of lower profits, dividends, and capital gains.

The Office of Management and Budget released its Mid-Session Review of the Budget in July showing a $282 billion unified deficit estimate for FY1991 (a downward revision of $36 billion from the February budget estimate), and a $348 billion deficit estimate for FY1992 (an upward revision of $67 billion from the February estimate). Revisions to estimates of outlays both for deposit insurance and for Operation Desert Storm accounted for much of the shift in the deficit projection from FY1991 to FY1992; and technical changes in estimates of receipts increased both the FY1991 and the FY1992 deficit projections. Because current budget rules are based on the economic and technical assumptions made in the Administration's February budget, these deficit estimate revisions place no additional constraints on current budget legislation.

The Congress adjourned on August 2. Of thirteen appropriations bills, the House has passed all thirteen, the Senate has passed seven, and three await the President's signature. Both houses of the Congress have passed "emergency" legislation mandating extended unemployment benefits projected to cost approximately $6 billion. The "emergency" designation allowed the bill to contain no compensating spending reductions or tax increases, as last year's budget agreement otherwise would have required. Press accounts indicate that the President will sign the legislation but will not sign the "emergency" designation, thereby rendering the bill inconsequential.

State and Local Government Sector

Real purchases of goods and services by state and local governments were unchanged in the second quarter, after falling 2 percent in the first quarter. Construction spending declined for the second consecutive quarter to a level 6.5 percent below its high at the end of last year; most of the weakness during the first half was in road and bridge construction. Also, real outlays for employee compensation and other services slowed noticeably in the second quarter. On the receipts side, tax collections have slowed in recent quarters; but, as noted earlier, the pace of federal grants has picked up. On balance, the recent cutbacks in spending, combined with the upward tilt in grants, appear to have helped move state and local budgets part of the way toward balance; the deficit of operating and capital accounts, excluding social insurance funds, is estimated to have shrunk to $32 billion in the second quarter, the lowest level in three quarters.

Budget problems at the state level have been widespread. An unusually large number of states--nine in all--did not have a budget in place at the start of fiscal year 1992, which began July 1 for most states; by early

August, however, all except Connecticut had resolved the difficulties that led to the delays. With revenue shortfalls widely apparent, many states have increased taxes or cut spending. Tax hikes in about 35 states are expected to boost receipts around $20 billion during fiscal year 1992, the largest gain as a percent of revenue in at least two decades. Among the states, the biggest increases are in California ($7-1/2 billion) and in Pennsylvania ($3 billion). On the spending side, states have delayed payments to pension funds and vendors, particularly those providing health care under Medicaid; they also have postponed paychecks to employees or furloughed workers and have cut aid to local governments. However, all states have paid debt service on time.

A recent survey by the National League of Cities also documents substantial budgetary strains among local governments.[10] Indeed, about 60 percent of cities expected their general fund expenditures to exceed revenue, up substantially from recent years. To cope, most cities raised the level of fees and charges, and more than half reduced the growth rate of outlays for day-to-day operations. Other frequently used adjustment techniques included increases in property tax rates and reductions in the actual level of capital spending.

10. The survey was sent to about 500 large cities (with populations over 50,000) and to about 1,000 small-to-medium cities (with populations of 10,000 to 50,000). Five hundred ten usable responses were received.

PERCENTAGE OF CITIES REPORTING EXPENDITURES EXCEEDING REVENUES
IN THEIR GENERAL FUND BUDGETS
(Fiscal Years)

1984	1985	1986	1987	1988	1989	1990	1991[e]
24	30	40	33	37	32	46	61

Source: City Fiscal Conditions in 1991, and earlier issues, National League of Cities.
e Estimate.

Labor Costs

A sharp increase in benefit costs and the April minimum wage adjustment boosted labor costs in the second quarter and stalled the downtrend in hourly compensation that developed last year. Compensation per hour for private industry workers, as measured by the ECI, rose 4.9 percent at an annual rate over the March to June period, up from a 4.6 percent rate in the first quarter. Benefit costs accelerated last quarter to a 7 percent annual rate, the largest increase since the first quarter of 1990. The surge in benefit costs owed not only to further large increases in health care expenses but also to step-ups in contributions by employers for workers' compensation and unemployment insurance.

The wages and salaries component of the ECI increased 4.2 percent at an annual rate in the second quarter, the same as in the first quarter. Wage change apparently was buoyed by a sizable increase in the federal minimum wage from $3.80 to $4.25 an hour in April; the staff estimates that this increase added roughly 0.4 percentage point (annual rate) to wage growth. Wage inflation slowed from its first-quarter pace in a number of industries.

EMPLOYMENT COST INDEX
(Percent change from preceding period at compound annual rates; based on seasonally adjusted data[1])

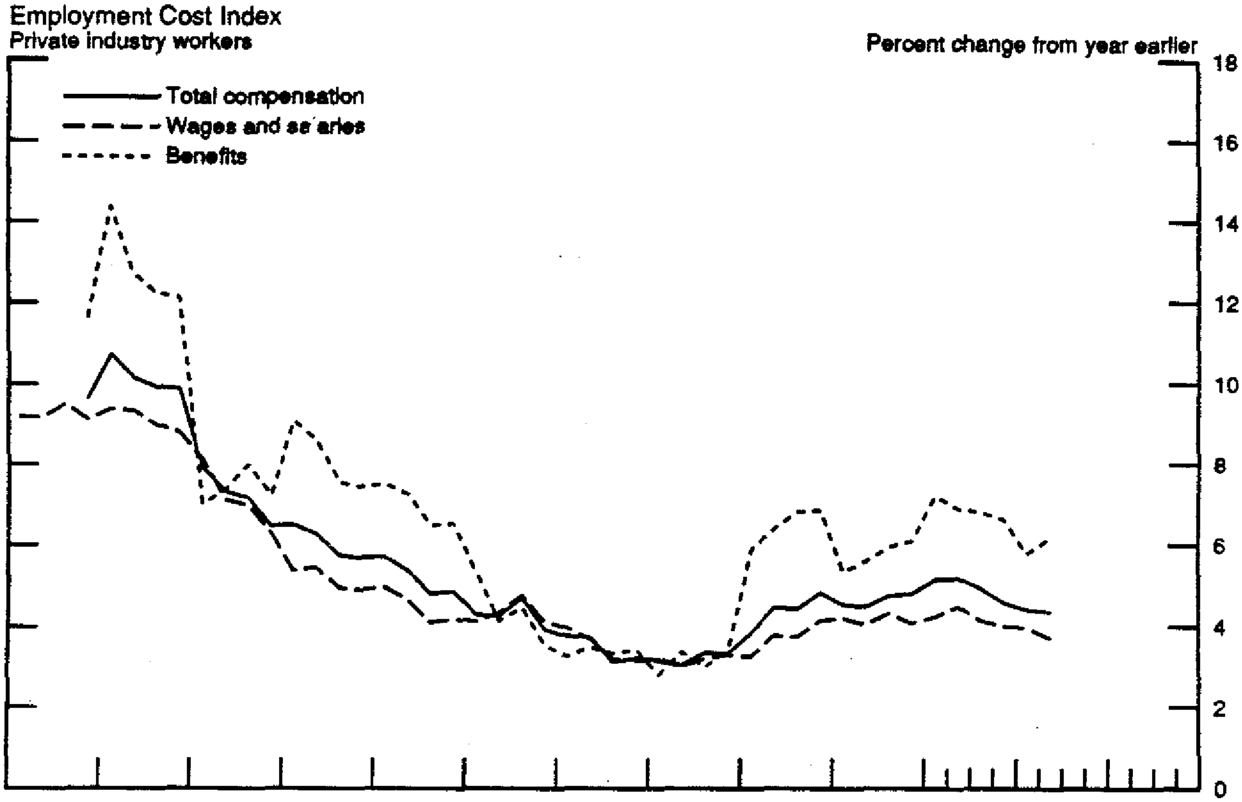
	1990				1991	
	Mar.	June	Sept.	Dec.	Mar.	June
Total compensation costs:						
Private industry workers	5.6	5.1	4.3	3.8	4.6	4.9
By industry:						
Goods-producing	6.0	5.1	4.3	3.8	4.6	4.9
Service-producing	5.2	5.1	4.3	3.8	4.9	4.5
By occupation:						
White-collar	6.8	5.5	4.6	2.7	6.1	4.9
Blue-collar	5.2	4.7	3.9	3.8	4.6	4.1
Service workers	4.8	5.1	3.5	5.0	4.2	6.4
By bargaining status:						
Union	6.0	3.1	3.9	4.3	5.0	4.9
Nonunion	6.8	5.5	4.2	2.7	5.7	4.9
Memo:						
Wages and salaries	4.4	4.3	3.9	3.1	4.2	4.2
Benefits	8.0	6.2	6.5	5.7	5.2	7.0

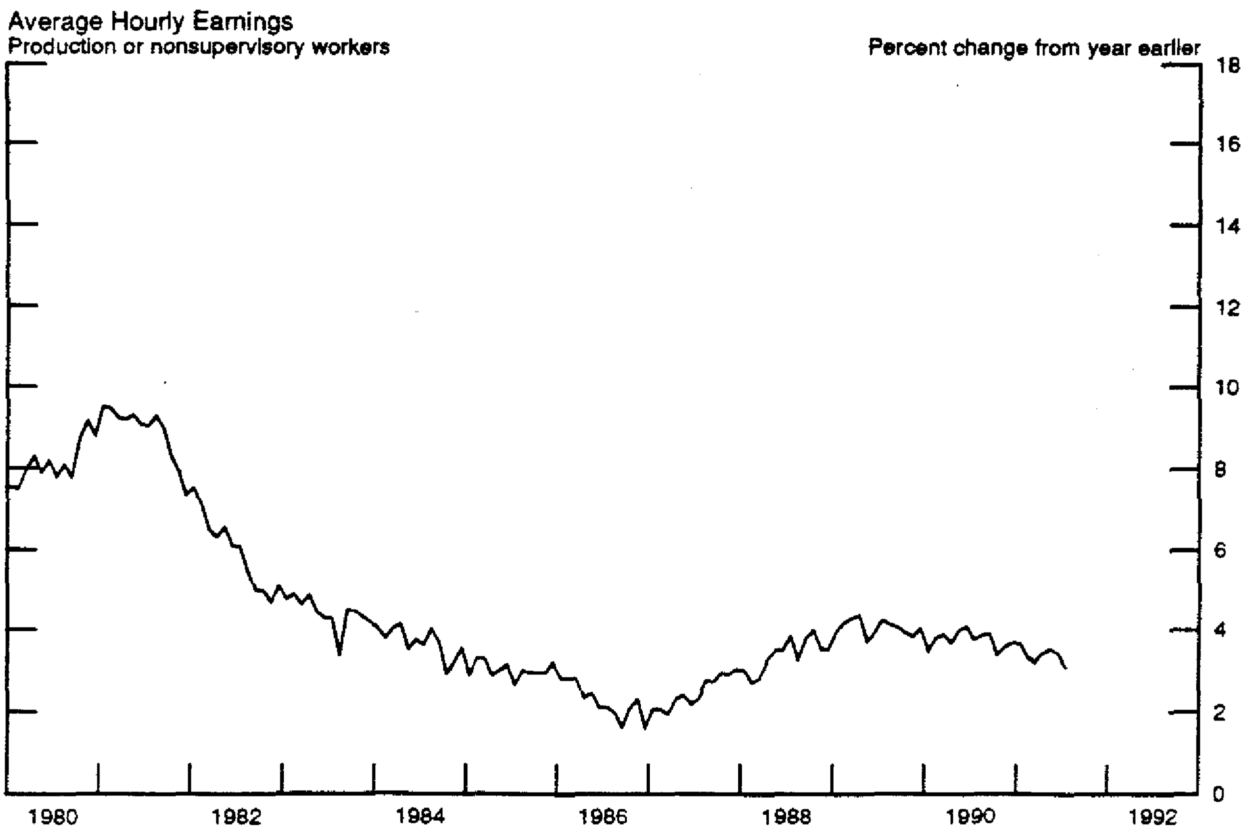
1. Changes are from final month of preceding period to final month of period indicated. Percent changes are seasonally adjusted by the BLS.

EMPLOYMENT COST INDEX
(Private industry workers; 12-month percent changes)

			1990			1991	
	1989	1990	June	Sept.	Dec.	Mar.	June
Total compensation costs:							
Private industry workers	4.8	4.6	5.2	4.9	4.6	4.4	4.4
By industry:							
Goods-producing	4.3	4.8	5.2	5.0	4.8	4.4	4.4
Service-producing	5.1	4.6	5.2	4.8	4.6	4.5	4.4
By occupation:							
White-collar	5.2	4.9	5.5	5.2	4.9	4.7	4.5
Blue-collar	4.1	4.4	4.7	4.5	4.4	4.3	4.1
Service workers	4.4	4.7	4.9	4.5	4.7	4.2	4.8
By bargaining status:							
Union	3.7	4.3	4.1	4.2	4.3	4.1	4.5
Nonunion	5.1	4.8	5.5	5.1	4.8	4.5	4.4
Memo:							
Wages and salaries	4.1	4.0	4.5	4.2	4.0	4.0	3.7
Benefits	6.1	6.6	6.9	6.8	6.6	5.8	6.2

LABOR COST MEASURES





MAJOR COLLECTIVE BARGAINING
(Covering 1,000 or more workers; percent change)

	1989	1990	1991 first six months
All industries			
First-year adjustments	4.0	4.0	3.6
Average over life of contract	3.3	3.2	3.3
Effective wage change	3.2	3.5	3.4[1]

1. Change during the four quarters ending June 30.

NONFARM COMPENSATION PER HOUR
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

	1989[1]	1990[1]	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1990:Q2 to 1991:Q2
Nonfarm business	2.5	4.6	5.0	3.7	4.2	4.5	4.4
Manufacturing	3.1	3.8	4.8	3.7	2.6	6.4	4.4

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.

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

	1989	1990	1990 Q4	1991 Q1	1991 Q2	1991 June	1991 July
			--Annual rate--			Monthly rate	
Total private nonfarm	4.0	3.7	2.8	2.8	5.2	.5	-.1
Finance, insurance and real estate	4.6	5.3	4.0	4.0	6.8	1.4	-.9

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

However, a large pickup occurred in transportation and public utilities, where wage gains were unusually low in the first quarter. In addition, wages accelerated about a percentage point in retail trade, which has a relatively high percentage of minimum wage workers.

Over the twelve months ended in June, the ECI for compensation increased 4.4 percent; a year ago, the twelve-month change stood at 5.2 percent. The wage and salary component also has decelerated 3/4 percentage point from its year-ago reading to 3.7 percent. Benefit cost increases are down as well, but remain at a rapid 6.2 percent.

Data from the ECI indicate that the year-over-year change in compensation per hour was about the same for union and nonunion workers. This contrasts with the pattern over the latter half of the 1980s when nonunion gains consistently outpaced those of union workers. The narrowing in the gap between the increases in union and nonunion wages reflects a marked slowing in wage changes of nonunion workers and a modest pickup in union wage gains. That pickup has not been apparent, however, among workers covered by major collective bargaining settlements. For that group, the average effective wage change for all contracts currently in force was 3.4 percent in the four quarters ending in June--virtually the same as the 1990 average.[11] First-year wage adjustments for the 876,000 workers reaching new contracts averaged 3.6 percent over the first two quarters of 1991, slightly smaller than in recent years.

11. The average effective wage change measures the change in wage rates during the reference period for all workers covered by large contracts, resulting from settlements in the current period, deferred increases, or COLAs.

Compensation per hour in the nonfarm business sector, as measured by the series based on BEA compensation estimates, increased at an annual rate of 4.5 percent in the second quarter.[12] Over the four quarters ending in June, nonfarm hourly compensation rose 4.4 percent--the same as the ECI. In the manufacturing sector, hourly compensation grew at an annual rate of 6.4 percent last quarter, apparently reflecting, in part, increased earnings from overtime.

Moving beyond the second quarter, average hourly earnings of production or nonsupervisory workers fell 0.1 percent in July. The decline follows several months of large increases, which had pushed the change in average hourly earnings from March to June to more than 5 percent. Hourly earnings in July were held down by declines in trade, services, and finance, insurance, and real estate, which had posted large gains in preceding months. Over the 12 months ended in July, hourly earnings increased 3.1 percent.

Prices

Recent inflation reports have been favorable, owing mainly to declines in the prices of energy and food. The CPI rose 0.2 percent in both June and July, while the PPI for finished goods was down in both months. Meanwhile, the core inflation rate appears to be slowing, but only gradually. In July, the CPI less food and energy was 4-3/4 percent above its level of a year

12. Compensation data released for 1991:Q2 reflect annual benchmark revisions to employment as well as revised seasonal factors for data beginning in 1986. The effect of the revisions was small and was concentrated in the most recent years. Revised data indicate that nonfarm compensation per hour increased 4.6 percent in 1990--0.2 percentage point higher than originally reported. In manufacturing, growth in hourly compensation was revised down 0.1 percentage point in 1990 to show an increase of 3.8 percent.

earlier, compared with an increase of 5 percent over the preceding twelve months.

The CPI for energy was down markedly in June and July, after briefly turning up in May. Gasoline prices have retraced their May spurt as inventories were built up rapidly in June, easing concerns about supplies of summer-quality motor fuel.[13] However, private survey data indicate that retail gasoline prices started to move up in early August, and further upward pressures on prices well could emerge in the near term. An unexpectedly strong recovery in demand for gasoline has brought gasoline inventories in recent weeks back nearly to their low May levels, and has pushed up spot prices. Moreover, spot and posted prices of crude oil have held since mid-July at levels about $1 or more per barrel above their average level in June. Crude oil prices have been supported by production problems in the North Sea, as well as by the higher demand for gasoline.

The CPI for food rose 0.5 percent in June but dropped 0.6 percent in July; a big swing in the prices of fresh fruits and vegetables was the main factor in both the June rise and the July decline. Prices of other foods were little changed, on balance, over the two months with declines for livestock products about offsetting increases for other foods. Year-over-year, CPI food inflation moved down to less than 3 percent in July; the increases in food prices had exceeded 5 percent in each year from 1988 through 1990.

Over the near term, food prices seem likely to be held in check by the ample supplies of a number of livestock products. The inventory of cattle

13. Excise taxes on gasoline were up, on average (not seasonally adjusted), about 1/2 cent in July.

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

	Relative importance Dec. 1990	1989	1990	1990 Q4	1991 Q1	1991 Q2	1991 June	1991 July
				------Annual rate-----			-Monthly rate-	
All items[2]	100.0	4.6	6.1	4.9	2.4	3.0	.2	.2
Food	16.2	5.6	5.3	3.9	2.4	5.1	.5	-.6
Energy	8.2	5.1	18.1	18.0	-30.7	-1.2	-1.0	-.4
All items less food and energy	75.6	4.4	5.2	3.8	6.8	3.2	.4	.4
Commodities	24.5	2.7	3.4	2.3	7.9	3.2	.2	.4
Services	51.1	5.3	6.0	4.8	6.4	3.0	.4	.3
Memorandum:								
CPI-W[3]	100.0	4.5	6.1	5.0	1.5	3.3	.2	.1

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

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

	Relative importance Dec. 1990	1989	1990	1990 Q4	1991 Q1	1991 Q2	1991 June	1991 July
				------Annual rate-----			-Monthly rate-	
Finished goods	100.0	4.9	5.7	5.1	-3.5	.7	-.3	-.2
Consumer foods	23.7	5.2	2.6	1.3	1.0	-.3	-.6	-.8
Consumer energy	16.8	9.5	30.7	21.1	-35.5	.0	-1.4	-1.3
Other finished goods	59.5	4.2	3.5	3.5	5.4	1.2	.0	.2
Consumer goods	36.4	4.4	3.7	3.4	5.9	.9	-.2	.4
Capital equipment	23.1	3.8	3.4	3.3	4.6	1.3	.3	.1
Intermediate materials[2]	95.2	2.5	4.6	4.2	-9.8	-1.0	.0	-.3
Excluding food and energy	78.5	.9	1.9	2.3	-2.3	-1.0	.0	-.1
Crude food materials	34.4	2.8	-4.2	-7.3	.0	-12.5	.7	-1.7
Crude energy	50.7	17.9	19.1	-18.8	-54.0	-1.5	-3.5	2.0
Other crude materials	14.9	-3.6	.6	-18.1	-4.7	-13.0	-2.6	-.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.

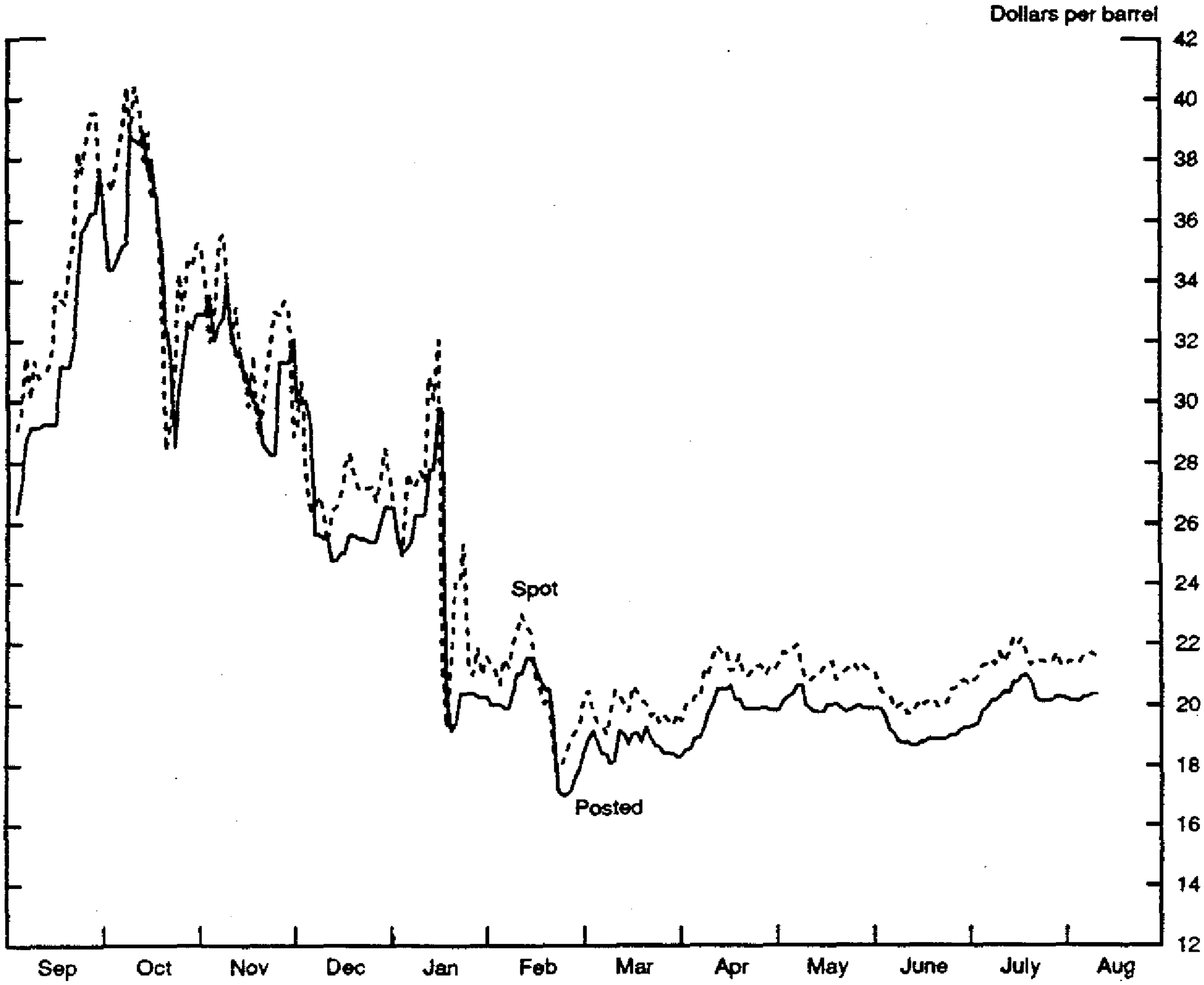
in feedlots at midyear was up 8 percent from a year earlier, and the spot price of cattle recently has dropped to the lowest level in more than three years. Hog producers also have been boosting output, and hog prices, while up seasonally, are well below the levels of a year ago. Broiler production also is moving up, albeit at a somewhat slower pace than in most recent years. Supplies of fresh vegetables, which were repeatedly disrupted by bad weather in the first half of 1991, seem to have recovered around midyear, and the wholesale prices of these products remained at low levels into August.

By contrast, supply conditions have deteriorated for grains and oilseeds since the start of July, owing to a worsening drought in parts of the Midwest. In the USDA's latest crop production report, which was based on conditions as of August 1, the agency marked down sharply its projections of the annual output of corn, soybeans, and a few other minor crops. However, these losses are small relative to those seen during the severe droughts of 1983 and 1988, and they come at a time when export demand for farm crops is sluggish; increases in prices of these crops thus have been fairly subdued.

Excluding food and energy items, the CPI for goods rose 0.4 percent in July, with the largest price increases registered for used cars and apparel.[14] Although average price increases have been modest since February, on a 12-month basis, the inflation rate for goods at the retail level remained in July about at 4.2 percent--3/4 percentage point above the

14. Increases in sales and excise taxes in several states contributed about 0.1 percentage point to the July rise and probably will add a similar amount to the August CPI for commodities less food and energy. These taxes are included in the CPI, but not in the PPI.

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



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

MONTHLY AVERAGE PRICES–WEST TEXAS INTERMEDIATE

Year and Month	Posted	Spot
1990		
September	31.10	33.69
October	34.82	35.92
November	31.32	32.30
December	26.32	27.34
1991		
January	23.74	24.96
February	19.61	20.52
March	18.66	19.86
April	19.56	20.82
May	19.99	21.24
June	19.04	20.20
July	20.15	21.42
August [1]	20.24	21.47

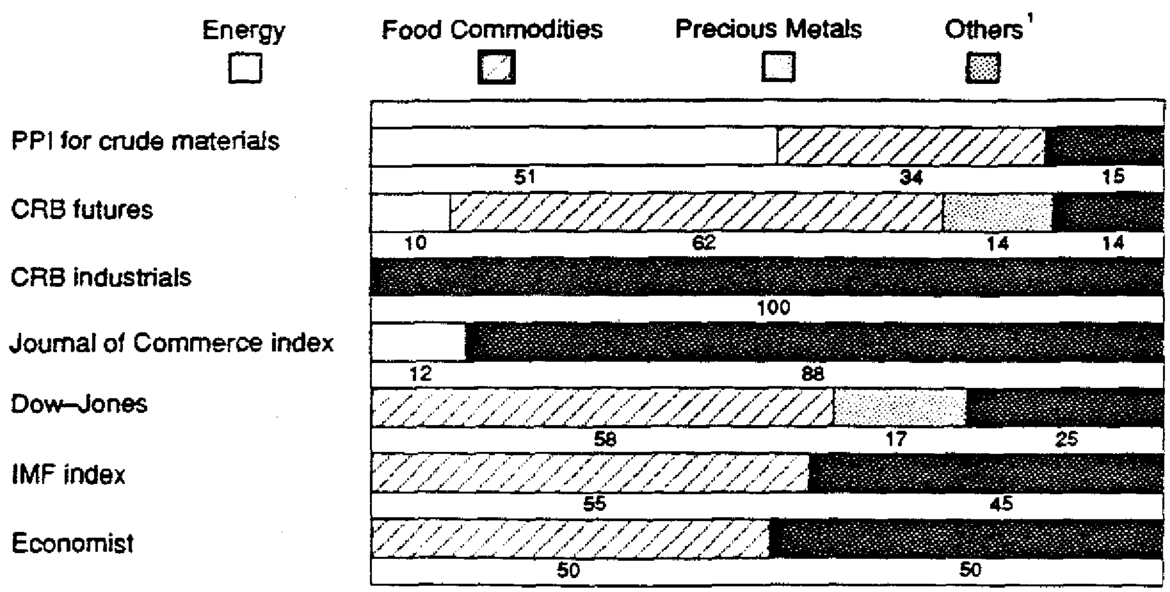
1. Price through August 13.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last observation	1989	1990	1991: To June 25[3]	1991: June 25[3] to date	Memo: Year earlier to date
		Percent change[2]				
1. PPI for crude materials[4]	July	7.1	6.0	-10.0	-.1	-2.0
1a. Foods and feeds	July	2.8	-4.2	-.5	-2.3	-9.1
1b. Energy	July	17.9	19.1	-18.0	2.0	12.2
1c. Excluding food and energy	July	-3.6	.6	-4.5	-.9	-9.1
1d. Excluding food and energy, seasonally adjusted	July	-3.6	.5	-4.6	-.7	-9.1
2. Commodity Research Bureau						
2a. Futures prices	Aug. 13	-9.0	-2.7	-5.3	-1.0	-12.2
2b. Industrial spot prices	Aug. 12	-5.9	.6	-5.9	-1.5	-13.0
3. _Journal of Commerce_ industrials	Aug. 13	1.3	-2.4	-1.6	-2.2	-7.8
3a. Metals	Aug. 13	-7.2	-3.9	-3.9	-.4	-12.4
4. Dow-Jones Spot	Aug. 13	-10.1	-1.7	3.5	-9.7	-12.4
5. IMF commodity index[4]	June	-12.9	-5.6	-1.1	n.a.	-5.3
5a. Metals	June	-23.4	-3.0	-7.4	n.a.	-12.5
5b. Nonfood agric.	June	-4.6	-3.5	2.2	n.a.	-1.1
Economist (U.S. dollar index)	Aug. 6	-22.8	-4.4	-4.5	-.4	-14.2
6a. Industrials	Aug. 6	-23.8	-3.2	-5.7	-3.8	-21.0

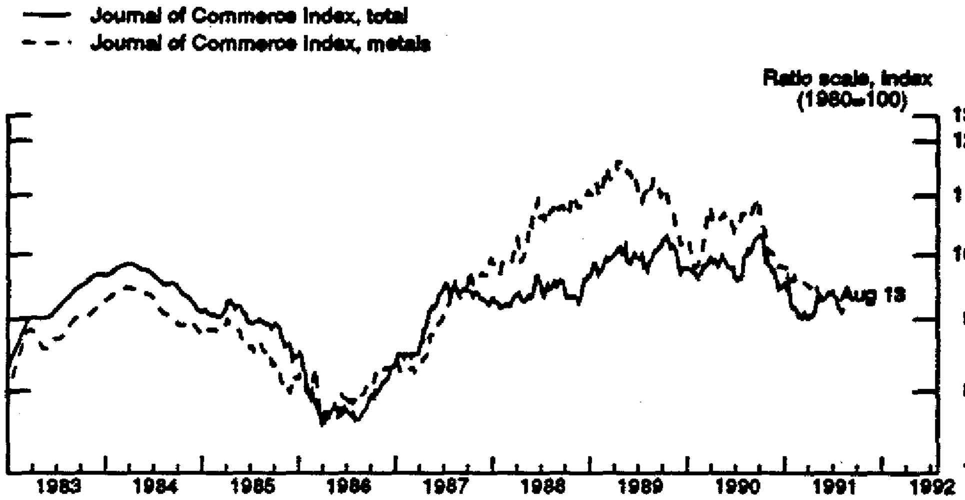
1. Not seasonally adjusted.
2. Change is measured to end of period, from last observation of previous period.
3. Week of the June Greenbook.
4. Monthly observations. IMF index includes items not shown separately.
n.a. Not available.

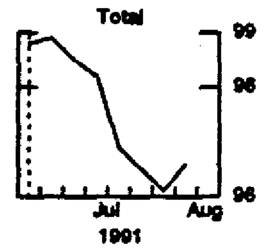
Index Weights

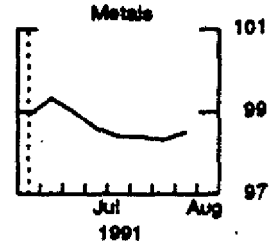


1. Forest products, industrial metals, and other industrial materials.

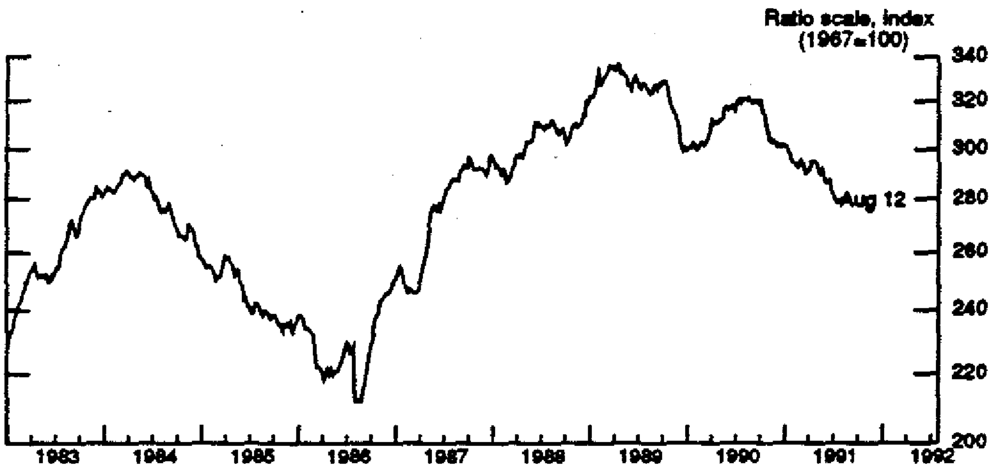
COMMODITY PRICE MEASURES *

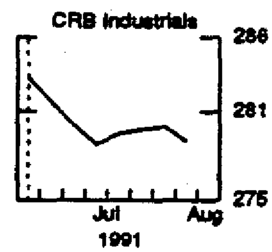




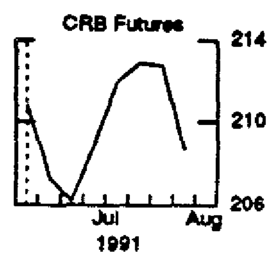


CRB Spot Industrials





CRB Futures



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

Dotted lines indicate week of last Greenbook.

rate over the preceding year--still reflecting the impact of higher federal excise taxes early this year. Nonenergy services prices rose 0.3 percent in July as continued moderation was evident for both tenants' rent and owners' equivalent rent. As a result of the slowdown in these categories, the 12-month change in nonenergy services prices has fallen to 5.1 percent--3/4 percentage point less than the increase in the preceding year.

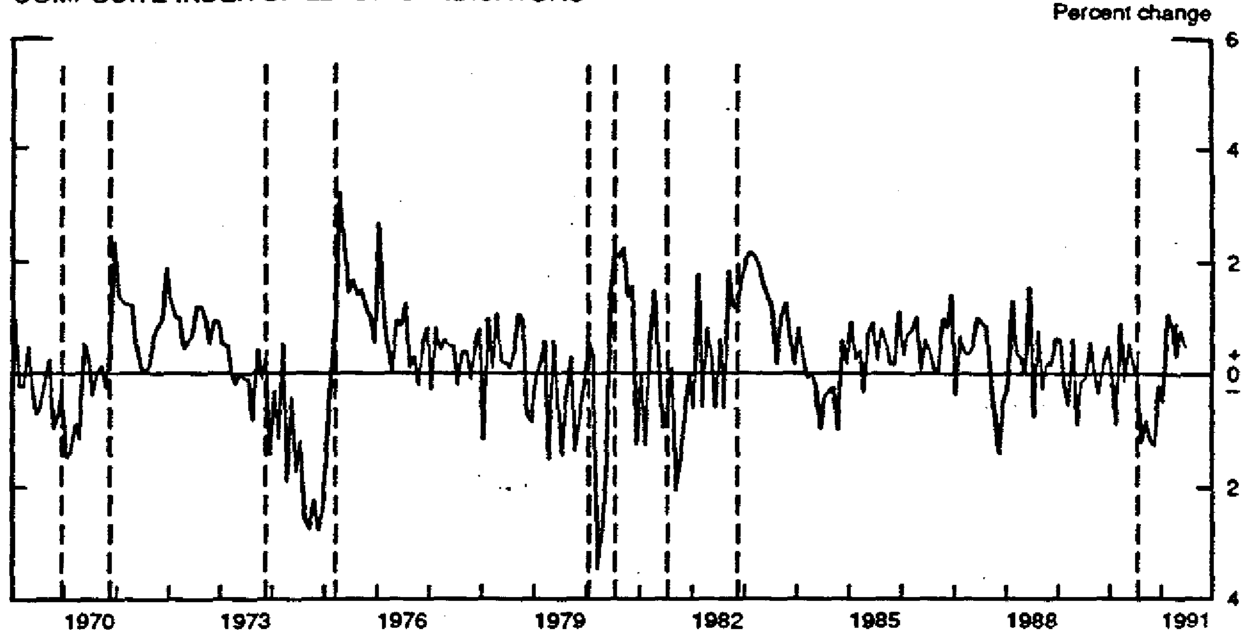
At the producer level, prices of intermediate materials less food and energy were little changed over the last two months and--on net--over the year. Prices of crude nonfood materials less energy declined further and were about 9 percent below their level of a year earlier. More recently, prices on spot commodity markets have retreated markedly for lumber, plywood, and cotton, and in all cases have about retraced the respective climbs seen earlier in the year.[15] By contrast, prices of industrial metals--as indicated by the *Journal of Commerce* index--have posted a small net decline since the week of the last Greenbook despite some firming (in part seasonal) for steel scrap.[16]

Probability of Expansion

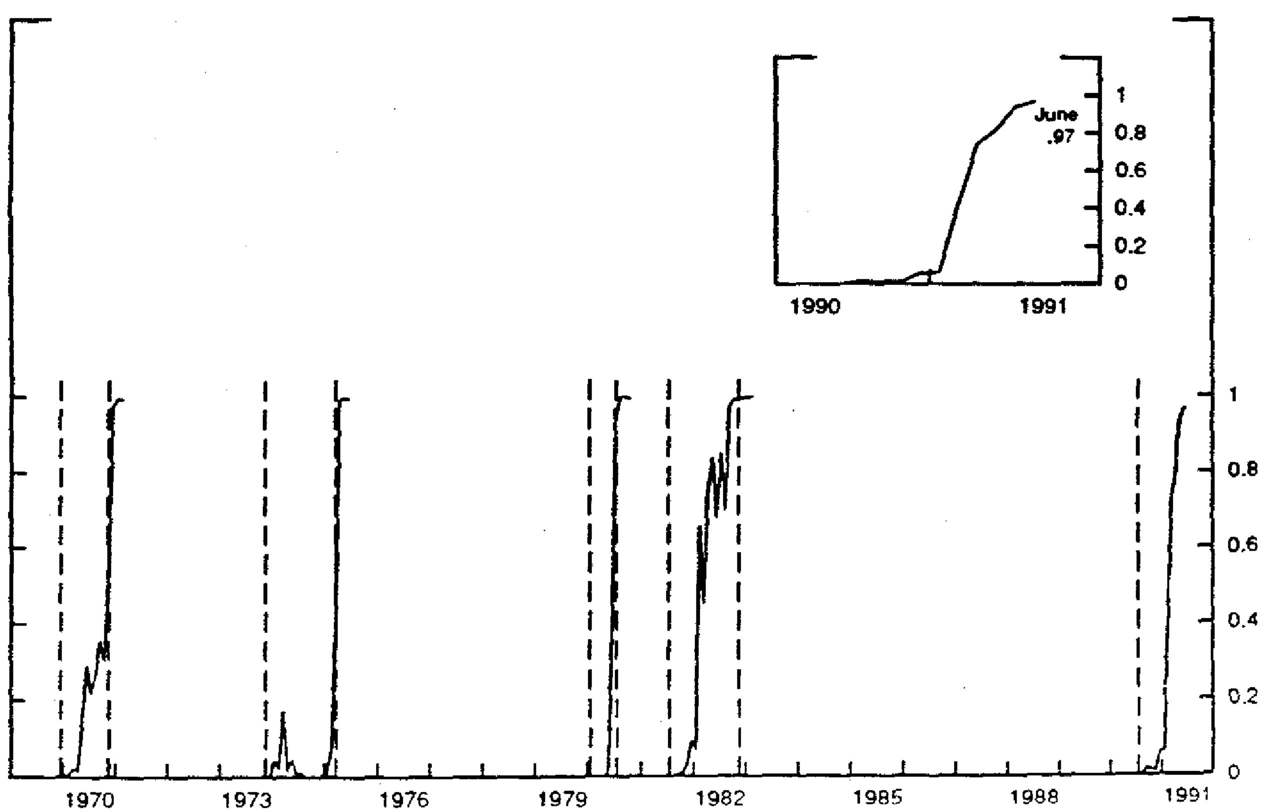
The Commerce Department's composite index of leading economic indicators rose 0.5 percent in June--its fifth consecutive monthly increase. Translated into a probability forecast of the start of an expansion, the June reading implies a 97 percent probability that a cyclical trough has already occurred or is imminent (chart).

15. These runups reflected supply-related concerns--triggered, for lumber and plywood, by logging restrictions in the Pacific Northwest and, for cotton, by heavy rains that delayed planting in the Delta region.
16. The decline in the *Journal of Commerce* index total since late June has mainly reflected the sharply lower prices of cotton and plywood.

COMPOSITE INDEX OF LEADING INDICATORS



PROBABILITY OF EXPANSION *



*Each probability represents the likelihood that an expansion will begin during the next three months

Indeed, recent data on coincident indicators suggest that the economy already has started a recovery phase, with income and retail sales bottoming out in the first two months of the year, followed quite closely in later months by production and employment (table). Both March and April look to be reasonable candidates for the trough month; the designation of a trough quarter is more ambiguous. The advance estimate of real GNP in the second quarter was up only slightly, although real GDP turned up more decidedly.[17]

17. In most countries other than the United States, real GDP is used as a coincident indicator of economic activity rather than real GNP (see, for example, P.A. Klein and G.H. Moore, *Monitoring Growth Cycles in Market-Oriented Countries: Developing and Using International Economic Indicators* (Ballinger, 1985). For the United States, the growth rates of these two aggregates are usually very similar; however, in recent quarters, large fluctuations in oil company profits earned from operations abroad have caused clear differences in the movements of U.S. GNP and GDP.

RECENT DATA ON COINCIDENT INDICATORS

	1991						
	Jan.	Feb.	Mar.	Apr.	May	June	July
Composite coincident index	127.3	126.6	**126.0**	126.2	126.6	127.0	--
Income							
Personal income (billions $82)	3366.9	**3366.5**	3378.7	3372.4	3378.1	3391.7	--
Disposable income (billions $82)	**2857.8**	2858.9	2869.2	2863.9	2868.8	2879.9	--
Personal income less transfer payments (billions $82)[1]	2838.3	**2837.0**	2845.2	2837.5	2841.3	2853.7	--
Sales							
Retail sales (billions $82)	**117.1**	119.7	120.3	119.8	120.7	121.0	--
PCE (billions $82)	**2643.1**	2660.1	2688.0	2669.2	2690.6	2701.8	--
Manufacturing and trade sales (billions $82)[1]	457.1	459.1	**457.0**	465.3	469.5	--	--
Production							
Industrial production (index)[1]	106.6	105.7	**105.0**	105.5	106.2	106.9	--
Capacity utilization (percent)	80.0	79.1	**78.4**	78.6	79.0	79.3	--
Employment							
Total civilian employment (millions)	116.9	116.9	116.8	117.4	**116.6**	116.9	116.7
Nonfarm payroll employment (millions)[1]	109.4	109.2	108.9	**108.7**	108.9	108.9	108.8
Nonfarm payroll hours of production workers (index)	121.3	121.5	120.9	**120.0**	121.2	122.1	120.4
Total nonfarm payroll hours (billions)	200.8	201.2	200.4	**199.4**	200.4	201.2	--

1. Components of composite coincident index.
Note: Low values reached by indicators since July 1990 are in bold.

DOMESTIC FINANCIAL DEVELOPMENTS

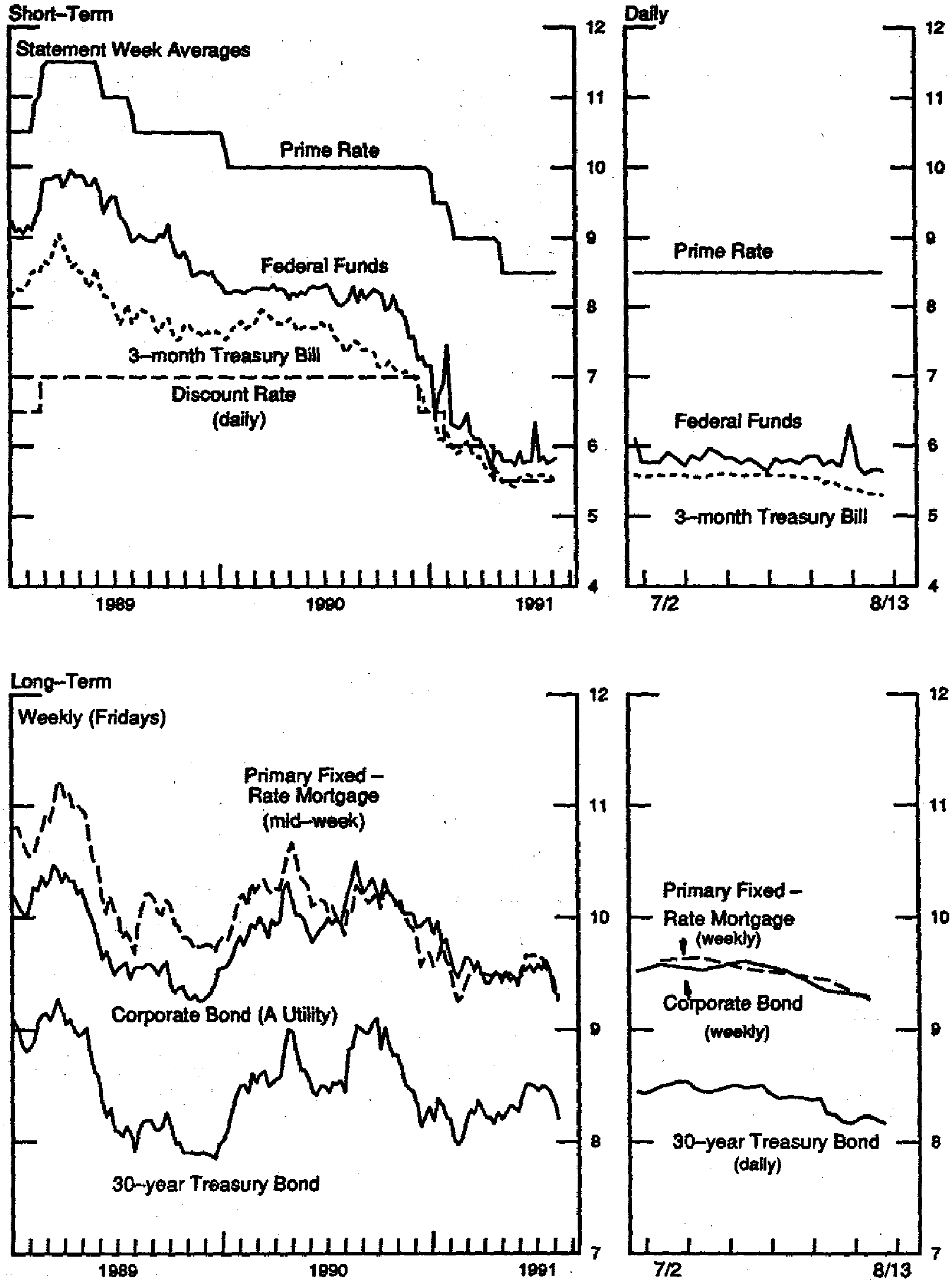
SELECTED FINANCIAL MARKET QUOTATIONS
(percent)

	1989 March highs	1989 Dec lows	1990 Aug highs	1991 FOMC Jul 3	1991 Aug 13	Change from: Aug 90 highs	Change from: FOMC Jul 3
Short-term rates							
Federal funds[2]	9.85	8.45	8.21	5.78	5.63	-2.58	-.15
Treasury bills[3]							
3-month	9.09	7.53	7.59	5.56	5.29	-2.30	-.27
6-month	9.11	7.29	7.51	5.69	5.40	-2.11	-.29
1-year	9.05	7.11	7.45	6.00	5.46	-1.99	-.54
Commercial paper							
1-month	10.05	8.51	8.10	6.05	5.70	-2.40	-.35
3-month	10.15	8.22	8.05	6.13	5.70	-2.35	-.43
Large negotiable CDs[3]							
1-month	10.07	8.52	8.14	5.95	5.66	-2.48	-.29
3-month	10.32	8.22	8.18	6.04	5.67	-2.51	-.37
6-month	10.08	8.01	8.25	6.33	5.83	-2.42	-.50
Eurodollar deposits[4]							
1-month	10.19	8.38	8.13	5.94	5.63	-2.50	-.31
3-month	10.50	8.25	8.19	6.06	5.63	-2.56	-.43
Bank prime rate	11.50	10.50	10.00	8.50	8.50	-1.50	.00
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	9.88	7.69	8.50	7.40	6.84	-1.66	-.56
10-year	9.53	7.77	9.05	8.26	7.91	-1.14	-.35
30-year	9.31	7.83	9.17	8.42	8.17	-1.00	-.25
Municipal revenue[5] (Bond Buyer)	7.95	7.28	7.80	7.30	7.07	-.73	-.23
Corporate--A utility recently offered	10.47	9.29	10.50	9.52	9.24	-1.26	-.28
Home mortgage rates[6]							
S&L fixed-rate	11.22	9.69	10.29	9.67	9.27	-1.02	-.40
S&L ARM, 1-yr.	9.31	8.34	8.39	7.25	7.14	-1.25	-.11

	Record highs	Date	1989 Lows Jan 3	1991 FOMC Jul 3	1991 Aug 13	Percent change from: Record highs	Percent change from: 1989 lows	Percent change from: FOMC Jul 3
Stock prices								
Dow-Jones Industrial	3035.33	6/3/91	2144.64	2934.70	3008.72	-.88	40.29	2.52
NYSE Composite	213.75	8/7/91	154.00	204.47	213.36	-.18	38.55	4.35
AMEX Composite	397.03	10/10/89	305.24	358.41	367.65	-7.40	20.45	2.58
NASDAQ (OTC)	514.40	8/13/91	378.56	474.32	514.40	.00	35.88	8.45
Wilshire	3734.30	8/13/91	2718.59	3563.19	3734.30	.00	37.36	4.80

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 August 21, 1991.
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 August 9, Wednesday weeks through August 7.

In late July and early August, weekly data showing M2 approaching the lower bound of its annual target range and some weaker-than-expected economic statistics contributed to a mild rally in the fixed income markets. On August 6, the Open Market Desk signaled an easing of reserve availability and interest rates across the maturity spectrum fell further. On balance, most short-term rates have declined about 1/4 to 1/2 percentage point since the July FOMC meeting, and benchmark bond yields have fallen roughly a quarter point. A major exception to this pattern is the yield on the debentures of insurance companies, which in many cases were negatively affected by adverse reports about asset quality and earnings performance. With interest rates down, major stock price indexes generally advanced 3 to 5 percent despite heightened concerns that the economic recovery might be faltering. Pacing the advance were bank shares, boosted by merger announcements and the easing of policy.

Continued stress in the depository sector likely has contributed to the lagging growth of money since the July FOMC. After recording a meager 1-1/2 percent rate of growth in June, M2 contracted at a 4 percent annual rate in July. Bank credit stalled last month, with acquisitions of government securities offsetting runoffs of other assets.

Nor has there been any sign of a pickup in credit flows more generally. Borrowing by nonfinancial corporations has remained subdued. Business loans at banks fell for the fourth consecutive month, more than offsetting an increase in outstanding commercial paper; gross public bond offerings slowed in July before picking up in early August with the decline in interest

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

	1990[1]	1991 Q1	1991 Q2	1991 May	1991 Jun	1991 Jul p	Growth Q4 90- Jul 91p
	------------Percent change at annual rates------------						
1. M1	4.2	5.9	7.4	13.5	9.6	2.0	6.7
2. M2	3.8	3.4	4.6	4.3	1.4	-3.8	2.8
3. M3	1.7	4.0	1.7	0.4	-2.3	-4.6	1.4
	------------Percent change at annual rates------------						Levels bil. $ Jul 91p
Selected components							
4. M1-A	4.6	5.7	3.9	7.1	6.4	-1.5	545.6
5. Currency	11.0	15.3	3.9	0.9	3.7	6.1	258.9
6. Demand deposits	-0.6	-2.5	4.4	12.6	9.9	-8.5	278.9
7. Other checkable deposits	3.5	6.1	13.7	25.0	15.2	8.5	314.4
8. M2 minus M1[2]	3.7	2.6	3.7	1.2	-1.4	-5.8	2527.9
9. Overnight RPs and Eurodollars, NSA	3.0	-42.3	-16.5	-34.7	-30.4	-66.1	61.8
10. General purpose and broker/dealer money *market mutual fund shares*	11.0	18.2	6.6	3.0	-2.6	-16.1	359.4
11. Commercial banks	9.9	8.2	7.3	5.7	8.7	5.6	1226.9
12. Savings deposits plus MMDAs[3]	7.5	7.5	16.6	17.1	16.3	11.6	625.5
13. Small time deposits	12.4	8.9	-1.8	-5.8	1.0	-0.8	601.3
14. Thrift institutions	-5.5	-6.3	-1.4	0.1	-11.1	-9.4	882.2
15. Savings deposits plus MMDAs[3]	-2.2	-0.7	18.6	22.9	12.1	10.3	364.7
16. Small time deposits	-7.3	-9.8	-13.6	-14.9	-26.3	-22.7	517.6
17. M3 minus M2[4]	-6.4	6.7	-10.6	-16.3	-17.9	-7.8	760.4
18. Large time deposits	-9.5	1.2	-8.3	-9.5	-12.9	-17.6	490.2
19. At commercial banks, net[5]	-3.5	11.9	-0.6	0.9	-5.1	-12.1	392.7
20. At thrift institutions	-23.9	-32.1	-35.2	-47.4	-42.5	-39.3	97.5
21. Institution-only money market mutual fund shares	20.2	49.9	23.0	4.9	-23.8	-12.6	141.8
22. Term RPs, NSA	-12.0	-32.8	-25.6	-16.1	-34.1	24.4	80.3
23. Term Eurodollars, NSA	-12.1	7.9	-31.2	-47.5	-3.7	16.5	66.2
	-----Average monthly change in billions of dollars----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	-0.1	-1.5	-5.3	-3.1	-11.8	-5.1	694.1
25. Large time deposits, gross	-2.6	6.4	-0.1	1.2	-1.6	-4.5	446.0
26. Nondeposit funds	2.4	-7.9	-5.2	-4.3	-10.2	-0.6	248.1
27. Net due to related foreign institutions	2.2	-1.5	-3.7	-4.8	-6.9	-0.7	18.5
28. Other[7]	0.2	-6.4	-1.5	0.4	-3.3	0.2	229.7
29. U.S. government deposits at commercial banks[8]	0.3	3.1	-3.5	-6.6	8.1	-2.8	20.4

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 June and July at rates of 20.4 percent and 13.9 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during June and July at rates of 11.9 percent and 7.5 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.

p - preliminary

rates. Mortgage credit evidently remained weak in July, and installment credit declined again in June. While private-sector demands for credit receded, the Treasury's borrowing needs were stronger than ever. In contrast, state and local governments reined in offerings of both short- and long-term securities in July relative to June's heavy issuance.

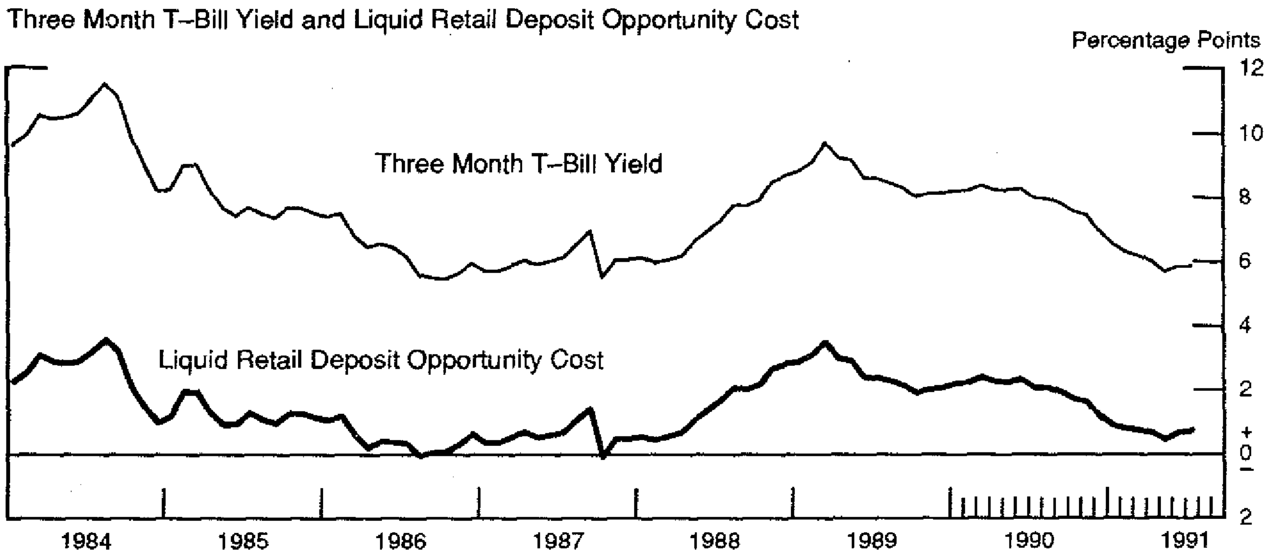
Monetary Aggregates and Bank Credit

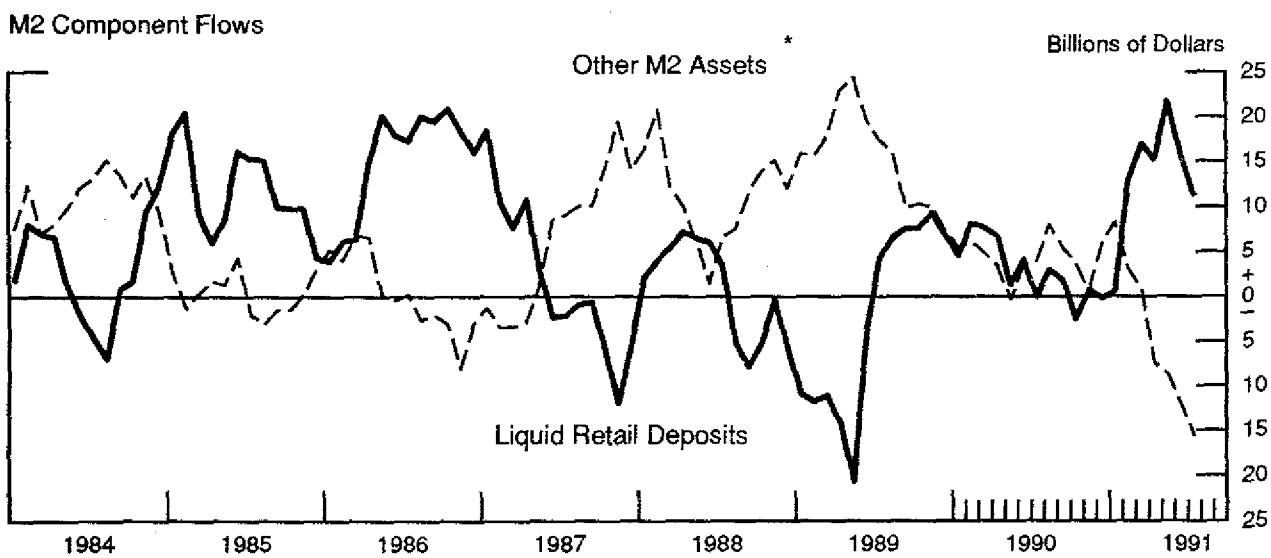
After edging up only slightly in June, M2 fell at a 4 percent pace in July, placing it a shade above the lower bound of its target growth cone. The compositional shift within M2 toward liquid retail deposits (OCDs, savings and MMDAs) and away from money market mutual funds and small time deposits continued. Given the sharp declines in the opportunity cost of holding liquid deposits (chart), it appears many individuals have chosen to transfer maturing CDs into MMDAs and savings accounts. It also is likely, though, that individuals with substantial CD and money market fund holdings are looking outside M2 for higher returns.

Flows into bond and equity funds, for example, have been strong recently and, although they were a bit slower in June than in April and May, anecdotal reports imply a robust July. Given the steep slope in the yield curve, it appears some investors also may have been lured by the relatively high rates prevailing on longer-term Treasury securities. Noncompetitive tenders for Treasury notes were up in July.

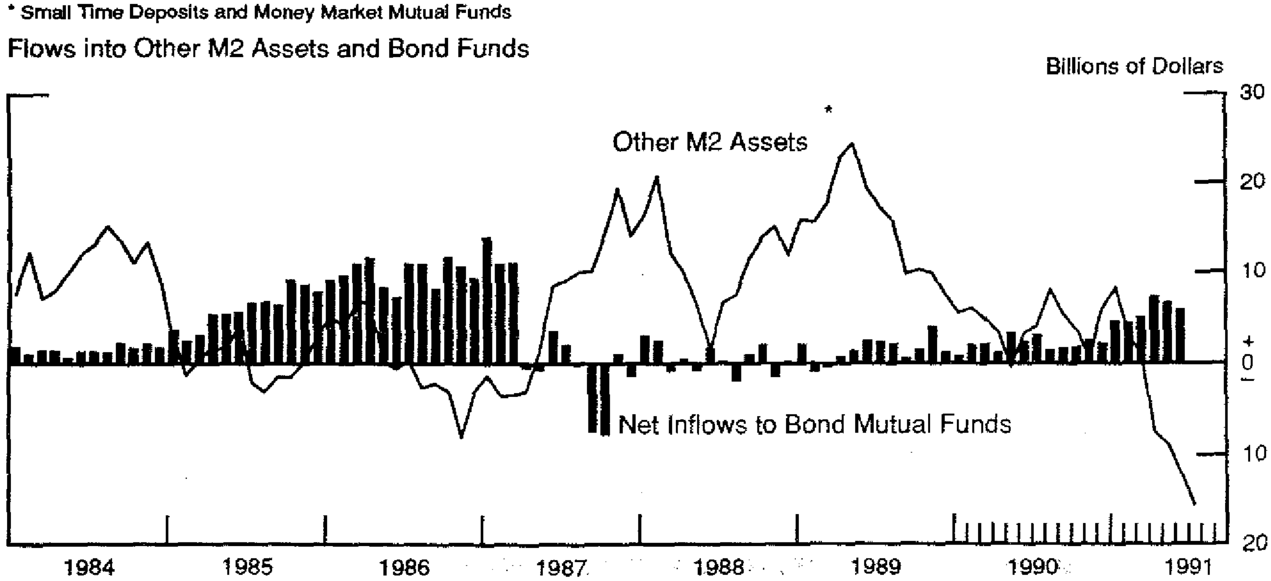
These portfolio effects can account for only a portion of the recent weakness in M2. A host of other factors likely contributed to the slowdown. The combination of low deposit rates and high consumer credit rates may have encouraged some households to finance expenditures out of savings, including M2 balances, rather than accumulate debt. On the supply side, anecdotal

Opportunity Costs and Retail Deposit Flows





* Small Time Deposits and Money Market Mutual Funds



* Small Time Deposits and Money Market Mutual Funds

information gleaned from conversations with advertising executives at several major newspapers suggests banks and thrifts have not been advertising deposits as aggressively over the past year. There also is some evidence that banks have increased the fees on deposits and some have begun 'reserve adjusting' their OCD rates (paying interest on the balance net of reserve requirements).

M3 fell at a 4-1/2 percent rate in July, following its 2-1/4 percent decline in June. Institutional investors also may be responding to the relatively more attractive yields on market instruments, especially on those with longer maturities, as M3 money funds continued to contract in July. Runoffs of large time deposits at commercial banks accelerated, while thrifts continue to shed large time at a rate of $3 to $4 billion a month. Term RPs and Eurodollars showed some strength after several months of steady declines.

Bank credit remained at a standstill in July. After a brief pause in June, loan portfolios shrank again, offsetting additions to holdings of government securities. The failure of the prime rate to fall after the cut in the federal funds rate suggests banks have continued to restrain lending. Preliminary results from the most recent Survey of Bank Lending Practices provides further evidence on this score, indicating that banks on balance have tightened lending standards and terms a little further in the May to August period. However, the number of banks reporting tighter standards dipped a bit compared to earlier surveys, and a handful of respondents reported some easing.

In addition to the continued reluctance of banks to lend, a portion of the weakness in July's bank credit numbers resulted from the FDIC's sale of

COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT

(Percentage changes at annual rates, based on seasonally adjusted data)

		1989:Dec. to 1990:Dec.	1991 Q1	1991 Q2	1991 May	1991 June	1991 July	Levels bil.$ July
		Commercial Bank Credit						
1.	Total loans and securities at banks	5.3	4.0	1.0	-.7	3.5	.1	2758.3
2.	Securities	8.6	12.5	10.5	7.3	12.9	16.2	675.0
3.	U.S. government securities	13.9	15.0	17.9	13.8	19.8	23.9	502.7
4.	Other securities	-3.1	5.7	-9.3	-10.9	-5.5	-5.5	172.3
5.	Total loans	4.3	1.5	-2.0	-3.2	.6	-5.0	2083.4
6.	Business loans	1.9	-.4	-7.2	-7.5	-6.3	-6.3	626.4
7.	Real estate loans	9.5	3.4	4.5	4.9	3.9	-4.1	854.8
8.	Consumer loans	1.2	-2.6	-3.5	-1.6	-5.5	-7.4	369.4
9.	Security loans	4.4	-17.7	-5.2	.0	-45.2	106.5	41.7
10.	Other loans	-2.4	11.6	-9.4	-28.4	29.7	-22.2	191.1
		Short- and Intermediate-Term Business Credit						
11.	Business loans net of bankers acceptances	1.9	.4	-7.2	-8.0	-5.7	-6.5	620.4
12.	Loans at foreign branches[2]	19.3	-3.1	-35.7	-62.7	-5.1	.0	23.5
13.	Sum of lines 11 & 12	2.5	.2	-8.3	-9.9	-5.7	-6.1	644.0
14.	Commercial paper issued by nonfinancial firms	12.2	-5.1	-10.2	-34.4	-9.0	8.3	145.8
15.	Sum of lines 13 & 14	4.2	-.7	-8.7	-14.4	-6.5	-3.3	789.8
16.	Bankers acceptances: U.S. trade related[3,4]	-9.6	-24.3	-22.0	-16.3	8.3	n.a.	29.2[5]
17.	Line 15 plus bankers acceptances: U.S. trade related	3.6	-1.6	-9.2	-14.5	-6.0	n.a.	821.3[5]
18.	Finance company loans to business[3]	13.1	4.7	4.6	6.1	7.3	n.a.	297.7[5]
19.	Total short- and intermediate-term business credit (sum of lines 17 & 18)	5.8	.0	-5.6	-9.1	-2.5	n.a.	1119.0[5]

1. Average of Wednesdays.
2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
3. 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. June data.
p--preliminary.
n.a.--not available

the Bank of New England and the Connecticut Bank and Trust. As part of the resolution, the FDIC took on some loans of the two banks, and the acquiring institutions received government securities as well as $3.3 billion in promissory notes from the FDIC; FDIC notes are not counted in bank credit. Even adjusting for the loans acquired by the FDIC, C&I loans fell at a 4-1/2 percent pace in July. Much of the continuing weakness in C&I loans has been concentrated at large banks, but more recently, growth in C&I loans at small banks also has been unusually sluggish. Continued softening in bank loans may partly reflect business efforts to restructure balance sheets by issuing long-term debt and equity. Real estate loan growth was unusually weak, even after the loans assumed by the FDIC are added back, likely held down in part by heavy charge-offs of commercial loans at the end of June. Adjusted for securitizations, consumer loans increased in July at a 2-1/2 percent pace, down from June but about the same pace as earlier in the year.

Nonfinancial Business Finance

The ongoing weakness in C&I loans is part of a broader picture of subdued business credit growth. Total borrowing by nonfinancial corporations picked up a bit in July from the moribund pace in the second quarter, but still remained sluggish. While bank loans continued to run off in July, outstanding commercial paper increased about 8 percent. Gross public issuance of bonds declined in July, although firms have taken advantage of rate declines in August to step up issuance.

Business credit at finance companies grew about 7 percent in June, about the same as in May. Short-term credit, mostly working capital loans, increased and auto leasing showed continued strength, while financing of business equipment slowed. In recent discussions, finance company officials

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

				1991				
	1988	1989	1990	Q1	Q2[p]	May[p]	June[p]	July[p]
Corporate securities - total[1]	22.41	19.87	19.86	28.34	34.86	38.37	31.26	21.23
Public offerings in U.S.	20.39	17.80	17.73	26.10	31.07	34.72	28.42	19.18
Stocks--total[2]	3.54	2.69	1.95	2.22	6.12	7.42	5.62	2.68
Nonfinancial	1.15	1.08	1.03	1.29	4.01	4.70	3.53	2.32
Utility	0.24	0.29	0.35	0.47	0.70	0.85	0.77	0.21
Industrial	0.91	0.79	0.68	0.82	3.31	3.85	2.76	2.11
Financial	2.39	1.60	0.92	0.93	2.11	2.71	2.09	0.35
Bonds	16.85	15.12	15.77	23.89	24.95	27.30	22.80	16.50
Nonfinancial	6.19	6.30	5.65	9.10	10.20	10.10	8.50	6.50
Utility	1.79	1.78	1.97	2.20	3.69	3.70	3.90	2.70
Industrial	4.41	4.52	3.69	6.90	6.51	6.40	4.60	3.80
Financial	10.66	8.81	10.12	14.79	14.75	17.20	14.30	10.00
By quality[3] >								
Aaa and Aa	2.77	3.17	3.43	4.78	3.80	3.98	3.00	1.30
A and Baa	5.50	5.83	6.41	12.82	12.65	13.22	10.93	8.33
Less than Baa	2.56	2.39	0.15	0.41	1.32	0.83	0.78	0.4[illegible]
No rating (or unknown)	0.05	0.05	0.04	0.03	0.00	0.00	0.00	0.[illegible]
Memo items:								
Equity-based bonds[4]	0.28	0.52	0.38	0.77	0.78	0.71	1.03	0.54
Mortgage-backed bonds	4.72	1.68	2.41	2.04	3.32	2.62	4.22	2.50
Other asset-backed	1.26	2.02	3.35	3.84	3.86	6.65	3.87	3.88
Variable-rate notes	1.19	1.03	0.82	0.75	0.84	1.01	1.19	0.12
Bonds sold abroad - total	1.93	1.90	1.92	2.07	3.00	2.83	2.30	1.50
Nonfinancial	0.73	0.48	0.46	1.04	1.56	1.49	1.20	0.85
Financial	1.20	1.43	1.46	1.03	1.43	1.34	1.10	0.65
Stocks sold abroad - total	0.09	0.16	0.22	0.17	0.80	0.83	0.54	0.54
Nonfinancial	0.08	0.12	0.10	0.05	0.75	0.77	0.54	0.37
Financial	0.02	0.04	0.12	0.11	0.05	0.06	0.00	0.18

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings. Such swaps totaled $9.4 billion in 1990.
3. Bonds categorized according to Moody's bond ratings, or to Standard and Poor's if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.
4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.
p--preliminary.

indicated that business loan demand generally remains weak. They noted, however, that some businesses had turned to finance companies owing to stringent terms at banks, and that some finance companies had purchased lending subsidiaries directly from banking organizations that were attempting to shrink their balance sheets.

Corporate bond spreads are mostly unchanged or up slightly over the intermeeting period. Investment-grade bond spreads are at especially low levels for this stage in the business cycle. In part, this may reflect the effects of insurance companies shifting to acquisitions of higher grade public corporate bonds from riskier and more illiquid investments. However, junk bond spreads have been fairly stable since the first quarter, suggesting little pressure on this market from borrowers turned away by insurance companies.

Stock issuance by nonfinancial firms remained strong in July, although it has slowed a bit from its pace in the second quarter. About 17 percent of gross nonfinancial equity issuance in July was by companies issuing stock for the first time since being taken private in LBOs. Another 25 percent was accounted for by other initial public offerings. Stock issuance should be even stronger in August; this month's volume already has been boosted by Time-Warner's $2.5 billion rights offering.

Recent information on financial stress in the corporate sector is mixed. The number of firms reducing or omitting dividends in May, although high, fell to its lowest level since March 1990, and the pace of debt downgradings was less intense in the second quarter. Moreover, the number of business failures in June, though still high by historical standards, was down from its April peak.

Financial Institutions

Despite mixed second-quarter earnings and recent weak economic data, bank stock indexes have advanced about 19 percent since early July, primarily because of merger announcements by NCNB/C&S-Sovran, Chemical/Manufacturers Hanover, and Bank of America/Security Pacific. These announcements led to speculation that other bank mergers might soon follow. Bank stock prices also benefited from the drop in interest rates following the System easing in August.

In contrast to bank stock indexes, share prices for publicly traded insurance companies dipped in July on concerns about the commercial real estate exposure of many insurers and the potential for liquidity pressures in the industry. The market's concern followed an announcement that Mutual Benefit Life, a $14 billion company, had been taken into conservatorship after suffering large losses on its commercial real estate portfolio. Mutual Benefit will be allowed to continue to pay death, disability, and health benefits, along with all regular annuity payments. However, the payout on other claims against the company, including guarantees, is in doubt. For example, Mutual Benefit guaranteed about $1.4 billion of bonds, of which approximately $650 million are CMOs, primarily consisting of mortgages from the insurance company's own portfolio. The remainder are tax-exempt issues, including about $250 million of bonds issued by local housing authorities on behalf of housing developers. The bonds included options allowing the holder to put the bond back to the beneficiary (the developer in this instance). About $145 million of the put options were exercised, the developers defaulted in most cases, and Mutual Benefit could not make good on its guarantees.

Mutual Benefit's problems, along with the recent downgrades of several other life insurance companies, have caused spreads on insurance company bonds to widen as much as 40 basis points relative to comparable Treasuries. In addition, a few commercial paper investors reportedly were allowing maturing insurance company paper to run off. Commercial paper dealers indicated that they had little difficulty placing insurance company paper with other investors, although spreads have widened a couple of basis points.

Life insurance companies have been taking steps to improve credit quality and liquidity by reducing their exposure to commercial real estate and speculative-grade corporate debt. Data through March indicate a sharp reduction in real estate loan commitments and little willingness to acquire below-investment-grade bonds in the private placement market. Recent conversations with insurance company managers suggest they are still involved in the private placement market but have become even more selective. Fearing heavy withdrawals, many firms evidently are taking measures to build liquidity. Although most companies expressed a desire to shed riskier assets, illiquid markets likely have made this a difficult process.

A sale of Executive Life (California) has been tentatively approved by the California Insurance Commission. Under the terms of the agreement, Executive Life's junk bond portfolio would be sold to a subsidiary of Credit Lyonnais, while outstanding claims on Executive Life would be placed in a new company to be purchased by a group led by a French insurance company. Most policyholders reportedly would receive 81 cents on the dollar; the standing of GIC holders, however, is still a subject of

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

	1991				
	Q2	Q3[p]	July[e]	Aug.[p]	Sept.[p]
Treasury financing					
Total surplus/deficit (-)	-25.7	-92.6	-43.0	-46.5	-3.1
Means of financing deficit:					
Net cash borrowing from the public	43.1	97.8	34.6	33.0	30.2
Marketable borrowings/ repayments (-)	38.6	100.6	39.6	30.8	30.1
Bills	-11.7	42.9	16.5	13.4	13.0
Coupons	50.3	57.7	23.2	17.5	17.1
Nonmarketable[2]	4.5	-2.8	-5.0	2.1	.1
Decrease in the cash balance	-11.6	-5.5	7.3	15.1	-27.9
Memo: Cash balance at end of period	44.2	49.7	36.9	21.8	49.7
Other[3]	-5.8	.3	1.1	-1.6	.8
Federally sponsored credit agencies, net cash borrowing	-7.1	--	--	--	--
FHLBs	-6.5	--	--	--	--
FHLMC	-2.6	--	--	--	--
FNMA	1.7	--	--	--	--
Farm Credit Banks	-.2	--	--	--	--
SLMA	.5	--	--	--	--

1. Data reported on a not seasonally adjusted, payment basis.
2. Includes proceeds from securities issued by federal agencies under special financing authorities (primarily FSLIC) 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.
p--projected.
e--estimated.
Note: Details may not add to totals due to rounding.

negotiation. The transaction awaits approval by the state court overseeing Executive Life's rehabilitation, and the state insurance commissioner is allowing other investors to submit bids. In addition, creditors who stand to receive the least (such as GIC holders) are likely to challenge the rehabilitation plan. Finally, the IRS has filed a claim of $640 million for back taxes that could upset the deal.

Treasury and Sponsored-Agency Financing

While private sector demands for credit apparently stalled in July, the Treasury's borrowing needs were strong and growing. The staff projects a federal deficit of about $93 billion for the third quarter. Over the quarter, Treasury is expected to sell a record $101 billion of securities, comprising $43 billion of bills and $58 billion of coupon securities.

Salomon Brothers Inc. announced on August 9 that it had discovered "irregularities and rule violations" in its bidding at three Treasury note auctions. Treasury auction rules proscribe any bidder from acquiring more than 35 percent of any Treasury issue; the investment firm admitted that its violations had allowed it to circumvent the Treasury's 35 percent rule. Yields on Treasury securities initially rose after the announcement.

In the market for agency debt, spreads generally have remained narrow as overall issuance has continued to decline. The government sponsored enterprises (GSEs) ran off more than $2-1/2 billion of debt in June, the latest month for which complete data are available, bringing the decline for the second quarter to about $7 billion. Most of the decline in agency debt reflects the contraction in FHLB balance sheets as thrifts continue to pay down FHLB advances.

Legislation that would increase the regulation of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation moved through the House Banking Committee. This legislation would establish an independent bureau within the Department of Housing and Urban Development to oversee the financial safety and soundness of the two GSEs. The minimum capital levels required by the bill, however, are somewhat less stringent than proposed by the Treasury.

Municipal Securities

Gross issuance of tax-exempt securities in July fell sharply from June's elevated pace but was about on par with that in the second quarter. Municipal short-term issuance should rebound in August, largely on the strength of an expected $4 billion State of California issue. The New Jersey Turnpike Authority plans to refund a large portion of its outstanding debt later this month, and this action would boost long-term issuance.

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

	1989	1990	1991				
	Year	Year	Q1	Q2	May	June	July[p]
Total offerings[1]	11.90	13.10	11.39	17.51	16.35	23.12	14.56
Total tax-exempt	11.65	12.85	11.25	17.20	15.91	22.79	14.50
Long-term	9.47	10.03	9.81	13.16	14.75	13.81	10.41
Refundings[2]	2.47	1.45	.79	.68	.83	.46	.06
New capital	7.01	8.60	9.02	12.48	13.92	13.35	10.35
Short-term	2.17	2.82	1.44	4.04	1.16	8.98	4.09
Total taxable	.25	.25	.14	.31	.44	.33	.06

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

Yields on most municipal securities decreased over the intermeeting period. However, yields on bonds guaranteed by life and property-casualty insurance companies rose sharply after Moody's downgraded several companies that back municipal debt. Insurance company guarantees account for only a small portion of all guarantees on municipal debt; special purpose insurers account for the bulk of the total. One of the top special purpose insurers is owned, in part, by a downgraded insurance company but the chances of this having a significant effect on the muni market appear remote.

Municipal credit quality continued to deteriorate in the second quarter. Standard & Poor's lowered debt ratings of 74 state and local government units while raising ratings of only 38. In July and August, moreover, Standard & Poor's downgraded New Jersey and Illinois, citing budget problems. The number of governmental unit downgrades in the second quarter was largest in Northeastern states, including Vermont, New Hampshire, Maine, and Rhode Island. The deterioration in the financial condition of state and local governments has been reflected in short-term markets: In 1988, 98 percent of short-term issuance was rated MIG-1(Moody's top rating); in 1991, only 57 percent of short-term issuance has been in the top category.

In a case closely watched in the municipal security market, Bridgeport, Connecticut's petition for relief under Chapter 9 of the bankruptcy code was rejected by the bankruptcy court. The city filed for bankruptcy with the view that it might be insolvent in the current fiscal year and definitely would be insolvent in the next fiscal year. The court ruled that the city was unable to prove insolvency in the current fiscal year. In addition, it

GROSS PUBLIC ISSUANCE OF MUNICIPAL SHORT-TERM DEBT BY CREDIT RATING
(Millions of dollars, annual rates)

Credit Rating*	1988	1989	1990	1991-H1
MIG-1	20,188	23,733	22,677	13,742
MIG-2	356	1,263	7,324	10,317
MIG-3	13	11	2	0
MIG-4	0	0	0	9
Total	20,557	25,007	30,001	24,068

*Moody's Investor Service.

MUNICIPAL LONG-TERM DEBT RATING ACTIONS
(Number of rating revisions by region)

Region	1984	1985	1986	1987	1988	1989	1990	1991 Q1	1991 Q2
West									
Up	20	12	86	31	13	28	39	6	6
Down	8	14	74	41	22	25	48	31	19
Southwest									
Up	4	22	19	19	10	16	11	16	1
Down	8	8	55	76	41	8	48	32	10
Northwest									
Up	0	0	8	11	1	1	16	8	3
Down	4	6	9	11	2	6	8	2	2
Midwest									
Up	8	20	189	20	26	50	27	5	4
Down	45	19	62	30	43	22	92	18	16
Southeast									
Up	15	22	30	27	27	45	29	8	13
Down	8	39	67	73	46	13	101	14	4
Northeast									
Up	16	27	31	47	37	30	18	5	11
Down	15	19	27	37	31	64	168	29	25
Total									
Up	63	103	363	155	114	170	140	49	38
Down	88	105	294	268	185	138	465	126	74
Memo: Ratio of upgrades to downgrades	.72	.98	1.23	.58	.62	1.23	.30	.39	.51

Source: Standard and Poor's Credit Week

ruled that the city could not show insolvency in the next fiscal year without an adopted budget.

News of a small surplus in New York City's 1991 budget led to a favorable reception for its offering of $750 million of long-term general obligation bonds in early August. Yields were down significantly from those on a similar offering in June, although they remain high relative to rates on other Baa-rated municipal bonds.

Philadelphia, another financially troubled city, privately placed about $100 million of tax and revenue anticipation notes this month at a yield of 10.7 percent. A cool reception forced the city to raise the yield more than 100 basis points to attract investors, said to be largely tax-exempt money funds. The notes are the first phase of a bridge loan needed to finance the city's 1992 deficit. The city had expected to receive funds from the Pennsylvania Intergovernmental Cooperation Authority, recently established by the state to provide financial assistance to Philadelphia, but the failure of the city to adopt a five-year fiscal plan has delayed issuance of bonds by the authority.

Mortgage Markets

Available data suggest little pickup in mortgage credit expansion. Real estate loans at commercial banks fell a little in July, but this is probably largely accounted for by continued weakness in lending on commercial properties and by end-of-quarter charge-offs. Judging from the recent increase in sales of new and existing homes, home mortgage debt likely is firming a bit.

Refinancing activity, which increased significantly in the spring, declined in early summer as bond and mortgage yields rose. However,

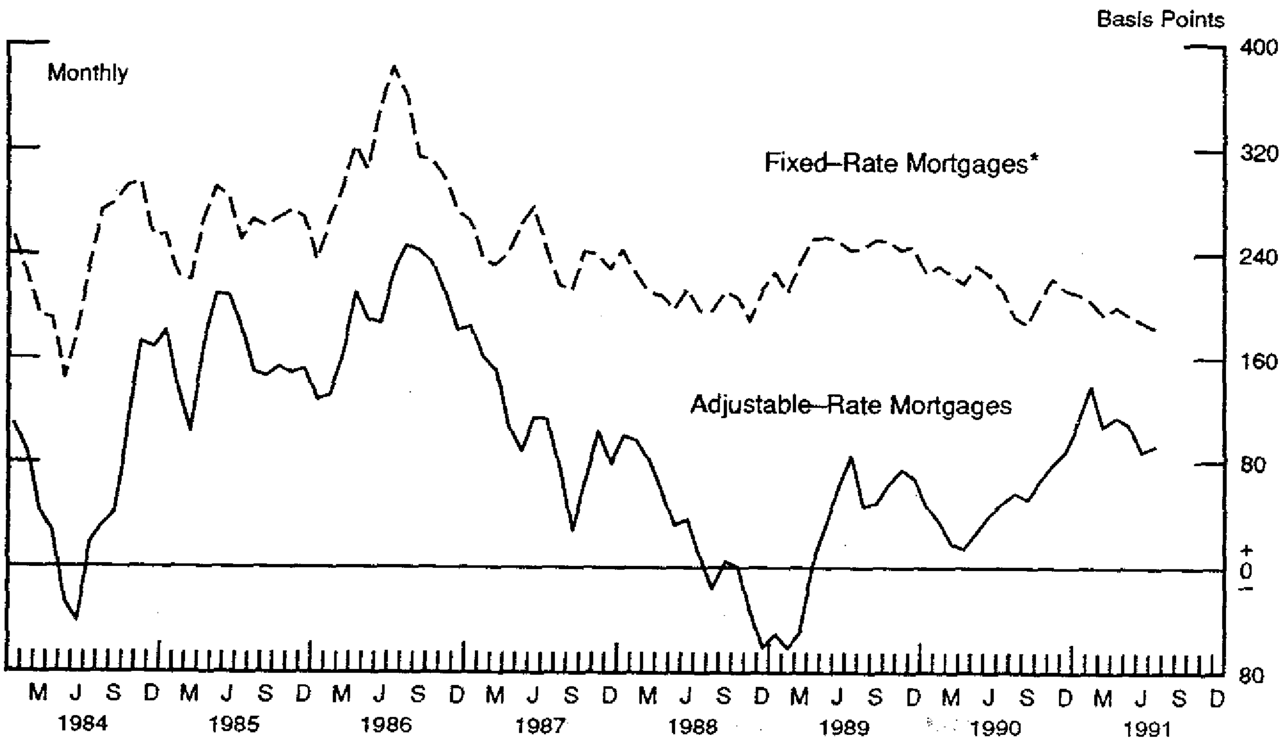
MORTGAGE-BACKED SECURITY ISSUANCE
(Monthly averages, billions of dollars, NSA unless noted)

	Federally related pass-through securities			Multiclass securities				
	Total (SA)	Fixed-Rate	ARM-backed	Total	Private issues[1]	FNMA REMICs	FHLMC REMICS	Agency strips
1989	16.5	14.1	2.6	8.1	1.4	3.1	3.2	.3
1990	19.7	17.3	2.3	11.3	2.4	5.0	3.4	.5
1990-Q1	21.5	18.4	1.4	11.3	1.6	5.0	3.8	.9
Q2	19.9	16.3	2.2	11.1	2.9	4.7	3.0	.4
Q3	18.2	17.5	1.6	12.1	2.7	6.6	2.3	.6
Q4	19.1	16.8	4.1	10.9	2.3	3.9	4.5	.3
1991-Q1 r	16.8	14.1	1.5	8.9	2.0	4.0	2.8	.1
Q2 p	24.7	21.6	1.6	18.5	2.9	8.2	6.8	.6
1991-Jan.	15.7	13.0	0.7	5.3	1.5	2.4	1.2	.2
Feb.	16.2	14.1	1.1	8.3	1.4	3.2	3.6	.2
Mar. r	18.5	15.2	2.8	13.2	3.2	6.3	3.7	.0
Apr. r	19.3	16.8	1.1	15.0	3.1	5.9	6.0	.0
May r	26.7	21.7	1.0	17.6	2.6	8.1	6.9	.0
June p	28.2	26.2	2.6	22.6	2.9	10.6	7.6	1.6

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

Mortgage Pricing

Spreads over Comparable Maturity Treasuries



*30yr FRM is bond-yield equivalent.

contract rates on fixed-rate mortgages (FRMs) have fallen about 40 basis points in recent weeks to 9-1/4 percent, the lowest level since March. This may prompt a resumption in FRM refinancing activity. Initial rates on ARMs also have declined, but not by as much as FRM rates; the FRM-ARM spread has narrowed about 20 basis points. Although the initial FRM-ARM rate spread is still about 2-1/4 percentage points, the Federal Housing Finance Board's most recent survey of major institutional lenders reports that the proportion of loans closed with adjustable-rate features remains below 25 percent. Apparently, many home buyers fear that rates could go higher in the future and are opting to lock in the relatively attractive long-term rates available now.

Although conventional mortgage rates have fallen in recent months, the fixed costs of obtaining an FHA mortgage have increased. New and higher FHA mortgage insurance premiums, as well as a 57 percent cap on the share of closing costs that can be financed, became effective July 1. The new fees, set by the National Affordable Housing Act of 1990, are designed to reinforce the financial strength of FHA. Lenders are required to begin charging the higher mortgage insurance premiums for all loans closed on or after July 1, even if HUD had issued commitments prior to that date. In addition to the new annual premium of 0.5 percent on FHA loans, lenders must continue charging the up-front mortgage insurance premium payment of 3.8 percent.[1] The new FHA rule implies a borrower with a $100,000 FHA loan will pay an additional $1,000 at closing. Moreover, about 15 percent of

1. The new 0.5 percent annual premium applies for five years for mortgages with loan-to-value ratios of 90 percent or lower; eight years for loans with LTV ratios between 90 and 95 percent; and 10 years for loans with LTV ratios of 95 percent or higher.

CONSUMER CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)								Memo: Outstandings (billions of dollars)
				1990	1991		1991		1991
	1988	1989[1]	1990	Q4	Q1	Q2	May[r]	June[p]	June[p]
Installment	8.8	5.9	2.3	-.2	-1.4	-1.1	-2.2	-3.0	730.5
Auto	6.9	1.3	-2.1	-1.5	-5.5	-9.3	-13.9	-10.2	274.1
Excluding auto	10.2	9.2	5.2	.5	1.1	4.0	5.1	1.4	456.3
Revolving	13.7	15.2	10.6	1.9	8.6	5.2	6.9	2.2	227.7
All other	7.4	4.5	.6	-.7	-6.0	2.9	3.2	.5	228.6
Noninstallment	6.0	2.6	-4.9	-6.0	-14.2	-1.1	15.8	-19.0	57.0
Total	7.2	5.8	1.7	-.7	-2.4	-1.1	-0.9	-4.2	787.5

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

CONSUMER INTEREST RATES
(Annual percentage rate)

			1991				
	1989	1990	Feb.	Mar.	Apr.	May	June
At commercial banks[1]							
New cars (48 mo.)	12.07	11.81	11.60	...	...	11.28	...
Personal (24 mo.)	15.44	15.46	15.42	...	...	15.16	...
Credit cards	18.02	18.17	18.28	...	...	18.22	...
At auto finance cos.[2]							
New cars	12.62	12.54	13.16	13.14	13.14	...	12.77
Used cars	16.18	15.99	15.90	15.82	15.82	...	15.74

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.

banks in the August survey of Senior Loan Officers indicated some modest further tightening in their standards for making conventional fixed-rate mortgages.

In the secondary mortgage market, issuance of federally related pass-through securities was slightly more than $28 billion in June, just under the record pace of about $30 billion set in September 1986. A large volume of new agency pass-throughs continues to be repackaged as REMICs, with June issuance of mortgage-backed derivatives increasing for the fifth consecutive month to an estimated record volume of about $22-1/2 billion. Trade reports indicate that investor demand for derivative securities remained strong in July. As a consequence, mortgage-to-Treasury yield spreads in the primary market narrowed still further over the intermeeting period.

The RTC recently made its debut in the pass-through security market in the form of two REMIC issues totalling about $1 billion. The RTC issued the REMICs directly, rather than through FNMA or FHLMC, because the underlying loans lacked primary mortgage insurance, had high loan-to-value ratios, or were too large to conform to the agencies' purchase limits. The RTC securities were well-collateralized and, despite the non-conforming features of the underlying loans, the two issues earned a triple-A rating and sold well in the market.

Consumer Credit

Consumer installment credit outstanding fell at a 3 percent rate in June, following a downward-revised 2-1/4 percent rate of decline in May. Once again, auto credit was the weakest component, following its 14 percent decline in May with a 10 percent drop in June. For the second quarter as a

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

	1985-1987	1988	1989	1990	1991 (mid-July)	Cumulative total
Total	**19.39**	**15.40**	**22.51**	**34.48**	**18.50**	**100.28**
Commercial banks	4.38	8.07	11.03	21.92	9.69	55.04
Finance companies	13.32	3.04	7.70	9.62	6.29	39.97
Savings institutions	1.74	2.14	1.11	.40	.67	6.06
Retail firms	--	2.15	2.67	2.55	1.85	9.22
Auto loans	**16.57**	**5.50**	**7.84**	**10.47**	**7.18**	**47.56**
Commercial bank	2.33	1.91	1.77	2.37	.87	9.25
Finance companies	13.14	2.04	5.51	7.70	5.64	34.03
Savings institutions	1.10	1.55	.56	.40	.67	4.28
Credit cards	**2.21**	**7.93**	**12.02**	**22.01**	**10.67**	**55.04**
Commercial banks	2.00	5.78	8.90	19.47	8.82	44.97
Savings institutions	.21	--	.45	--	--	.66
Retail firms	--	2.15	2.67	2.55	1.85	9.22
Other loans	**.61**	**1.97**	**2.65**	**2.00**	**.65**	**7.88**
Commercial banks	--	.38	.36	.08	--	.82
Finance companies	.18	1.00	2.19	1.92	.65	5.94
Savings institutions	.43	.59	.10	--	--	1.12
Memo:						
Home Equity[1]			2.70	5.54	5.11	13.35

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

whole, installment credit outstanding decreased at a 1 percent annual rate--the third consecutive quarterly decline. Total consumer credit (installment plus noninstallment) fell 1-1/4 percent in the second quarter. Credit appears readily available to consumers judging from, among other things, competition in the credit card segment and responses of senior loan officers at banks.

A portion of the continuing weakness in auto credit may stem from wider use of alternative financing arrangements, especially auto leasing. Leases are relatively more attractive in the absence of deductibility of consumer interest payments. Moreover, favorable assumptions about residual values seem to have become a popular way for auto manufacturers to cut prices indirectly.

Banks, thrifts, and finance companies continued to securitize loans at a rapid pace in the first half of 1991. Public issuance in the first six months of 1991 was $18.5 billion, about the same pace of issuance as last year. Most of this year's activity has been in securities backed by credit cards, although auto-backed issues also have been fairly strong.

Spreads on asset-backed securities narrowed considerably relative to Treasuries from January to early July of this year. Moreover, since the July FOMC, spreads have been fairly steady despite heavy issuance, suggesting the market is comfortable with the degree of protection the securities provide against charge-offs and unscheduled amortizations, even though charge-offs have been trending up.

INTERNATIONAL DEVELOPMENTS

U.S. Merchandise Trade

In May, the preliminary U.S. merchandise trade deficit was $4.6 billion (seasonally adjusted, Census basis), about the same as the revised April deficit of $4.5 billion. Both exports and imports declined slightly in May. Most of the decline in exports was in commercial aircraft, which eased somewhat from a very strong level in April; the decrease in imports was spread across most major trade categories (except oil). Preliminary data for June will be released August 16 and will be included in the Greenbook supplement.

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

	Exports			Imports			
	Total	Ag.	NonAg.	Total	Oil	NonOil	Balance
1990-Jul	32.2	3.2	29.0	41.4	4.2	37.2	-9.2
Aug	32.5	3.3	29.2	41.8	5.3	36.5	-9.3
Sep	32.2	3.1	29.1	41.3	5.9	35.4	-9.0
Oct	34.6	3.1	31.5	44.5	6.3	38.2	-9.9
Nov	33.6	3.3	30.3	43.1	6.5	36.6	-9.5
Dec	33.6	3.1	30.5	39.9	5.3	34.6	-6.3
1991-Jan	34.2	3.1	31.1	41.5	5.2	36.3	-7.4
Feb	33.6	3.4	30.2	39.1	4.1	35.0	-5.5
Mar	34.0	3.3	30.6	38.1	3.8	34.3	-4.1
Apr	35.6	3.2	32.5	40.1	4.1	36.1	-4.5
May	35.3	3.3	32.0	39.9	4.6	35.3	-4.6

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

For April and May combined, the deficit improved moderately from the first-quarter average. The improvement reflects strong growth in the value of exports (about 4 percent), and only a small increase in the value of imports (about 1 percent). The increase of exports was primarily in machinery, automotive products, and aircraft.

The jump in exports of machinery in April/May was primarily in quantity and was larger than in any quarter for the past two years. The rise was broad-based; there were strong increases recorded in oil drilling, telecommunications, and scientific equipment, and a broad range of industrial machines. The value of exported computers increased only slightly from the high level reached in the first quarter.

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

	Years		Seasonally Adjusted AR				Memo: Percent Change	
			1990		1991		1991: Q2-e from	
	1989	1990	Q3	Q4	Q1	Q2-e	Year Ago	Prev. Qtr.
Exports	361	390	387	402	403	419	7.8	3.8
Imports	477	498	502	513	477	483	-0.3	1.3
Oil	51	62	62	72	53	52	1.8	-0.8
Non-oil	426	436	440	441	424	431	-0.6	1.6
Balance	-116	-108	-115	-111	-73	-65		
Ex Oil	-65	-46	-53	-39	-21	-12		

e--Average of first 2 months of quarter at an annual rate.
Source: U.S. Department of Commerce, Bureau of Economic Analysis, Balance-of-Payments Accounts.

The increase in automotive exports in April/May reversed almost all of the declines recorded since the second quarter of last year and reflected events in the United States as well as in other countries. Increased shipments to Canada were primarily automotive parts that are used largely in producing vehicles shipped back to the United States; exports of parts had declined sharply in the fourth and first quarters as automotive sales in the United States sagged. Exports of automotive products to countries other than Canada also rose significantly, accounting for about 60 percent of the increase. Exports of trucks increased sharply as record numbers were shipped to Saudi Arabia and Kuwait.

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

	Year	1990			1991		$ Change	
	1990	Q2	Q3	Q4	Q1	Q2-e	Q2-Q2	Q2-Q1
Total U.S. Exports	389.6	388.4	386.6	402.3	403.4	419	30.2	15.1
Agricultural Export	40.2	40.8	39.3	37.8	39.7	39	-1.9	-0.8
Nonagric. Exports	349.3	347.5	347.3	364.5	363.7	380	32.2	16.0
Industrial Suppl.	96.7	92.8	95.4	106.0	105.2	104	11.3	-1.0
Gold	3.0	2.8	3.0	4.4	4.1	4	0.8	-0.4
Fuels	14.0	11.7	13.9	18.1	16.8	13	1.8	-3.3
Other Ind. Suppl.	79.6	78.3	78.6	83.5	84.3	87	8.8	2.8
Capital Goods	153.8	155.3	153.1	156.0	155.9	169	13.4	12.8
Aircraft & Parts	32.3	34.6	31.6	30.9	30.8	37	2.1	5.9
Computers & Parts	25.9	25.1	26.5	26.4	27.3	28	2.4	0.2
Other Machinery	95.6	95.5	95.0	98.7	97.7	104	8.8	6.7
Automotive Products	37.4	38.7	38.4	37.1	34.1	40	1.3	5.8
To Canada	22.6	23.8	23.5	21.5	19.5	22	-2.0	2.3
To Other	14.8	14.8	14.9	15.6	14.7	18	3.3	3.5
Consumer Goods	43.3	43.8	42.8	45.8	45.9	45	1.3	-0.9
Other Nonagric.	18.2	17.0	17.6	19.6	22.6	22	4.8	-0.8
Total U.S. Imports	497.7	484.7	501.6	513.2	476.9	483	-1.5	6.3
Oil Imports	62.1	51.3	61.8	72.1	52.6	52	0.9	-0.4
Non-Oil Imports	435.6	433.4	439.8	441.1	424.3	431	-2.4	6.7
Industrial Suppl.	82.5	82.0	83.3	83.9	80.2	83	1.3	3.1
Gold	2.5	2.1	2.8	3.3	3.3	3	1.2	0.0
Other Fuels	3.6	3.2	3.5	4.3	3.9	5	1.5	0.8
Other Ind. Suppl.	76.4	76.7	77.0	76.4	73.0	75	-1.4	2.2
Capital Goods	116.4	115.6	116.2	120.2	119.0	122	6.6	3.2
Aircraft & Parts	10.6	10.7	9.9	12.8	11.1	12	1.3	0.9
Computers & Parts	23.0	22.9	23.0	23.3	24.2	26	2.8	1.5
Other Machinery	82.8	82.0	83.3	84.1	83.7	84	2.5	0.8
Automotive Products	87.3	87.3	90.3	86.1	82.5	78	-9.1	-4.3
From Canada	29.7	31.0	32.2	27.3	23.5	29	-2.4	5.1
From Other	56.5	56.4	58.1	58.8	58.9	50	-6.8	-9.4
Consumer Goods	106.2	104.7	106.6	106.9	100.5	102	-3.2	1.0
Foods	26.6	27.1	25.8	26.0	25.6	28	1.0	2.6
All Other	16.4	16.7	17.5	18.1	16.5	18	0.9	1.1

e--Average of first 2 months of quarter at an annual rate.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Deliveries of large jet aircraft in April/May continued at the stronger rate begun in March. McDonnell-Douglas began to deliver its new MD-11 aircraft and foreign carriers accounted for a slightly higher proportion of Boeing deliveries. Most of the increase in exports of large jets was to industrial countries, but there have also been increased deliveries of the largest aircraft to developing countries, especially in Asia.

Exports of consumer goods remained little changed in April/May. Agricultural exports in April/May also declined slightly from the first-quarter average; decreases in wheat and cotton were not fully offset by increases in tobacco, soybeans, and other foods.

The value of imports turned up in April/May following a drop in the first quarter. While oil imports were about the same as in the first quarter, non-oil imports rose slightly, with increases spread over most major trade categories. All of the increase in non-oil imports was in quantity as prices (fixed-weight) declined at an annual rate of 3 percent in the second quarter.

Some of the sharpest changes in imports occurred in various categories of automotive imports, which fell by about 2 percent on balance. A sharp rise in deliveries from Canada in April/May was more than offset by an even greater drop in imports from other countries (particularly Japan). A 20 percent increase in the value of automotive imports from Canada moved these imports about two-thirds of the way back to levels recorded in the second and third quarters of last year.

The value of imported automotive products from countries other than Canada dropped sharply in April/May after having changed very little from the third quarter of last year through the first quarter of this year. Most of the drop in April/May was in passenger cars, primarily from Japan.

Japanese companies had continued to increase shipments of cars to the United States through February despite sagging sales; only at the beginning of the new "agreement" year on April 1 were shipments cut noticeably. In April/May, shipments from Japan were 12 percent less than for the same period a year ago and 35 percent less than two years ago. Passenger car imports from Sweden, Korea, and Mexico declined much less over the same period.

Imports of computers were another exception to the general pattern of decline in the first quarter and moderate recovery in April/May evidenced for non-oil imports; computer imports increased steadily in every quarter of 1990 and accelerated in the first quarter and into the second quarter of 1991. In April/May the value of computer imports was 10 percent higher than in the fourth quarter of last year; the deflator for computers dropped 6 percent over the same period, implying a nearly 18 percent increase in imported computers in constant dollars. This increase in the quantity of imports of computers was large enough to push the level of total real non-oil imports slightly above levels recorded in the second half of 1990.

Oil Imports: Quantities and Prices.

The value of oil imports in April/May was about the same as in the first quarter; a decline in prices in April/May was offset by an increase in the quantity imported.

Relative to the first quarter, the price of imported oil in April/May fell almost $3 per barrel. Spot prices fluctuated in a narrow band during April and May after falling throughout the first quarter, leaving the import price around $17.50 per barrel for both months. Spot prices have generally firmed through July and early August as the market has focused on a potentially tight winter supply situation (the result of the slow return of exports from Iraq and Kuwait). For example, from the middle of June through the middle of August the price of the January crude oil futures contract rose by $1.20 per barrel. These movements in spot and futures prices suggest that import prices could increase by perhaps $1.40 per barrel from June through August.

OIL IMPORTS
(BOP basis, value at annual rates)

	1990	1991		Months				
	Q4	Q1	Q2-e	Jan	Feb	Mar	Apr	May
Value (Bil. $)	72.08	52.63	52.21	62.84	49.72	45.32	49.03	55.39
Price ($/BBL)	28.77	20.29	17.47	23.54	19.35	17.85	17.34	17.59
Quantity (mb/d)	6.86	7.10	8.18	7.31	7.04	6.95	7.74	8.62

e--Average of first 2 months of quarter at an annual rate.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

U.S. oil imports increased by more than 1 mb/d in April/May from rates recorded in the first quarter. Although domestic oil consumption declined slightly in April/May, stocks were built (at a very rapid rate) for the first time since July 1990. Preliminary Department of Energy data for June and July suggest that oil consumption rebounded with the pick-up in economic activity and that stocks continued to be built. By the end of July, stocks were above historical average levels.

Prices of Non-oil Imports and Exports

In June, according to the Bureau of Labor Statistics (BLS), the price index for non-oil imports declined 0.5 percent. A large decline in prices of industrial supplies excluding oil, coupled with declines in prices of capital goods and automotive products, swamped a three percent increase in the price of consumer goods. The price index for exports fell 0.1 percent in June, as large declines in the prices of exports of consumer goods and industrial supplies offset increases in prices of exports of capital goods

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

	Year	Quarters			Months	
	1991-Q2	1990	1991		1991	
	1990-Q2	Q4	Q1	Q2	May	Jun
		(Quarterly Average, AR)			(Monthly Rates)	
	--------------------BLS Prices--------------------					
Imports, Total	2.9	24.9	-11.9	-7.4	-0.2	-0.9
Foods, Feeds, Bev.	5.8	5.2	7.8	3.0	0.1	-0.4
Industrial Supplies	3.0	77.1	-40.4	-19.1	-0.3	-1.9
Ind Supp Ex Oil*	-0.9	2.7	-0.2	-4.4	-0.1	-1.0
Capital Goods	2.8	8.2	4.9	-5.4	-0.6	-0.8
Automotive Products	5.3	10.3	6.6	1.2	0.2	-0.6
Consumer Goods	0.5	4.5	2.5	-4.3	-0.4	0.3
Memo:						
Oil	10.6	307.2	-73.1	-41.7	-0.7	-4.1
Non-oil	2.2	6.3	3.7	-2.7	-0.2	-0.5
Exports, Total	1.4	4.4	0.6	-1.2	-0.3	-0.1
Foods, Feeds, Bev.	-4.0	-16.5	8.3	8.1	0.1	0.1
Industrial Supplies	-0.8	15.9	-9.6	-12.0	-1.2	-0.6
Capital Goods	3.6	2.1	5.6	3.5	0.3	0.4
Automotive Products	2.7	3.5	3.5	2.0	0.2	0.4
Consumer Goods	4.4	3.7	6.0	6.3	0.2	-1.4
Memo:						
Agricultural	-3.7	-14.2	6.7	6.7	0.3	-0.1
Nonagricultural	2.1	7.9	-0.6	-2.7	-0.3	-0.1
	------------Prices in the GNP Accounts------------					
Fixed-Weight						
Imports, Total	3.3	34.4	-18.3	-10.3	--	--
Oil	9.0	346.2	-75.0	-46.3	--	--
Non-oil	2.6	5.3	4.0	-2.7	--	--
Exports, Total	1.6	5.7	0.4	-0.4	--	--
Ag	-2.1	-11.8	7.8	7.7	--	--
Nonag	2.3	9.5	-1.0	-1.8	--	--
Deflators						
Imports, Total	-1.7	27.1	-20.8	-16.7	--	--
Oil	8.8	345.0	-75.0	-46.3	--	--
Non-oil	-2.7	0.6	-4.7	-8.7	--	--
Exports, Total	-1.2	3.6	-5.2	0.8	--	--
Ag	-2.1	-11.8	7.8	7.7	--	--
Nonag	-1.0	5.6	-6.6	0.6	--	--

*/ Months not for publication.

and automotive products. BLS price indexes for July will be released on August 22.

The fixed-weight price index for non-oil imports, reported in the GNP accounts, declined 2.7 percent at an annual rate in the second quarter, following increases of 4 to 5 percent annual rate during the previous three quarters. The price declines, which occurred in most major trade categories, reflected the appreciation of the dollar since March.

Prices of agricultural exports in the second quarter moved up 7-3/4 percent at an annual rate for the second quarter in a row, with prices of exported wheat leading the increase. In contrast, the average price of nonagricultural exports declined in the second quarter following a smaller decrease in the first quarter, as price increases for exported capital goods and consumer goods were more than offset by declines in the prices of exported industrial supplies.

U.S. International Financial Transactions

Banks continued to report substantial net capital outflows in June, bringing the total for the second quarter to almost $30 billion (line 1 of the Summary of International Transactions table). Weak growth in bank credit in the United States was probably a major factor behind the direction of flow. In addition, shifts in the funding pattern of U.S. offices of foreign banks contributed to the net outflow; capital inflows from foreign parents to their U.S. offices fell, as these U.S. offices sharply increased their issuance of large CDs in the U.S. market. The net outflow for the second quarter in line 1 of the Summary table is consistent in direction, although not in size, with the outflow to own foreign offices and IBFs reported to the Federal Reserve by foreign-chartered banks (line 1b of the International Banking Data table). These data suggest a continuing, but small, outflow in July from U.S.-chartered banks (line 1a).

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

	1989	1990	1990		1991		1991		
	Year	Year	Q3	Q4	Q1	Q2	Apr.	May	Jun.
Private Capital									
Banks									
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	27.2	31.5	21.7	-1.4	1.6	-29.6	-19.6	-3.3	-6.7
Securities									
2. Private securities transactions, net[1]	15.4	-28.4	-4.0	-7.3	-4.4	1.9	1.5	0.6	-0.3
a) foreign net purchases (+) of U.S. corporate bonds[2]	32.0	16.5	-0.1	6.2	3.8	7.8	1.6	2.7	3.6
b) foreign net purchases (+) of U.S. corporate stocks	7.9	-13.7	-2.3	-5.0	1.8	7.7	3.1	3.2	1.4
c) U.S. net purchases (-) of foreign securities	-24.5	-31.3	-1.7	-8.5	-10.0	-13.6	-3.1	-5.3	-5.2
3. Foreign net purchases (+) of U.S. Treasury obligations	30.1	-0.2	0.2	-2.5	3.5	14.0	0.2	13.8	0.1
Official Capital									
4. Changes in foreign official reserves assets in U.S. (+ = increase)	8.3	31.9	14.3	18.8	5.6	-3.9	-5.4	6.3	-4.8
a) By area									
G-10 countries	-5.2	10.0	8.6	8.6	-11.7	-4.3	-6.3	2.1	*
OPEC	10.1	1.1	-1.4	-0.6	0.3	-2.8	-1.9	-0.3	-0.7
All other countries	3.4	20.8	7.1	10.8	17.0	3.2	2.8	4.5	-4.1
b) By type									
U.S. Treasury securities	0.1	29.6	12.3	19.7	2.4	-1.9	-2.0	3.4	-3.3
Other[3]	8.2	2.3	2.0	-0.9	3.2	-2.0	-3.4	2.9	-1.5
5. Changes in U.S. official reserve assets (+ = decrease)	-25.3	-2.2	1.7	-1.1	-0.4	1.4	-0.2	-0.2	1.8
Other transactions (Quarterly data)[4]									
6. U.S. direct investment (-) abroad	-33.4	-33.4	-17.8	-3.8	-8.5	n.a.	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	70.6	37.2	7.1	4.5	2.0	n.a.	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[5]	-5.0	-7.8	-0.8	-2.9	5.9	n.a.	n.a.	n.a.	n.a.
9. U.S. current account balance	-106.3	-92.1	-23.9	-23.4	10.2	n.a.	n.a.	n.a.	n.a.
10. Statistical discrepancy	18.4	63.5	1.5	19.1	-15.5	n.a.	n.a.	n.a.	n.a.
MEMO:									
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-115.9	-108.1	-28.8	-27.7	-18.4	n.a.	n.a.	n.a.	n.a.

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

	1989				1990				1991		
	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	July*
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	-2.9	-3.9	-6.4	-5.5	-11.7	-11.0	-15.6	-31.3	-23.8	-13.7	-10.3
(a) U.S.-chartered banks	20.4	19.2	14.9	19.2	12.2	7.2	5.7	5.5	7.6	5.4	9.3
(b) Foreign-chartered banks	-23.3	-23.1	-21.3	-24.7	-23.9	-18.2	-21.3	-36.9	-31.3	-19.2	-19.6
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	24.0	26.0	21.6	20.7	21.8	22.2	24.0	24.7	26.0	23.9	23.3
3. Eurodollar Holdings of U.S. Nonbank Residents 1/	144.8	131.5	130.3	123.5	110.6	106.5	109.1	115.9	114.8	105.4	102.6

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.

* Data through July 29.

Foreign purchases of U.S. securities of all kinds were very strong in the second quarter, resulting in a capital inflow totaling $29.5 billion (lines 2a, 2b, and 3 of the Summary table). The increased foreign net holdings of U.S. stocks that started in March continued at a robust rate through June (line 2b). Foreign purchases of U.S. corporate bonds increased steadily throughout the quarter, reflecting high bond issuance both in the United States and in the Euromarket; recent data indicate a slowing of new issues of Eurobonds by U.S. corporations in July. The large increase in foreign holdings of Treasury obligations of $14.0 billion in the second quarter (line 3) largely reflected net purchases from the Netherlands Antilles and Bermuda; investment funds located in these jurisdictions were participants in the squeeze in the May auction of 2-year Treasury notes. Activity in the U.S. Treasury market originating in these countries has increased markedly in the last year.

At $13.6 billion for the second quarter, U.S. purchases of foreign stocks and bonds proceeded at a pace even faster than in the first quarter (line 2c). This total reflected $2.5 billion net purchases of Japanese stocks, $4.5 billion net purchases of Canadian bonds, and over $2 billion net purchases of Mexican stocks and bonds; the latter was related to the privatization of the Mexican telephone system and other former state-owned firms.

Foreign official reserve assets held in the United States declined $4 billion in the second quarter (line 4). Among the G-10 countries, Germany, Italy and the United Kingdom reduced their reserve assets in the United States moderately. Spain and, especially, Mexico increased their reserves held in the United States.

The cumulative total of the presently known capital flows for the second quarter appearing in the Summary table (lines 1 through 5) represents an outflow of about $16 billion. Our present forecast for other net capital flows (lines 6 through 9 on the table) suggests that the statistical discrepancy for 1991:2 will be positive, but moderate -- reversing the negative statistical discrepancy in the first quarter. An important contributing factor to this expected positive statistical discrepancy is the shift, noted above, in the funding pattern of the U.S. offices of foreign banks. The reduction in the net capital flow from foreign parent banks to their U.S. offices, registered in line 1 of the Summary table, was largely matched by a $9 billion decline in commercial paper issued by the foreign parents in the United States. In principle, this reduced capital outflow would appear in line 8 of the Summary table; however, it will probably go largely unreported. Responsibility for reporting U.S. holdings of foreign commercial paper is divided between custodians and investors; available evidence indicates that reporting in these categories is inadequate.

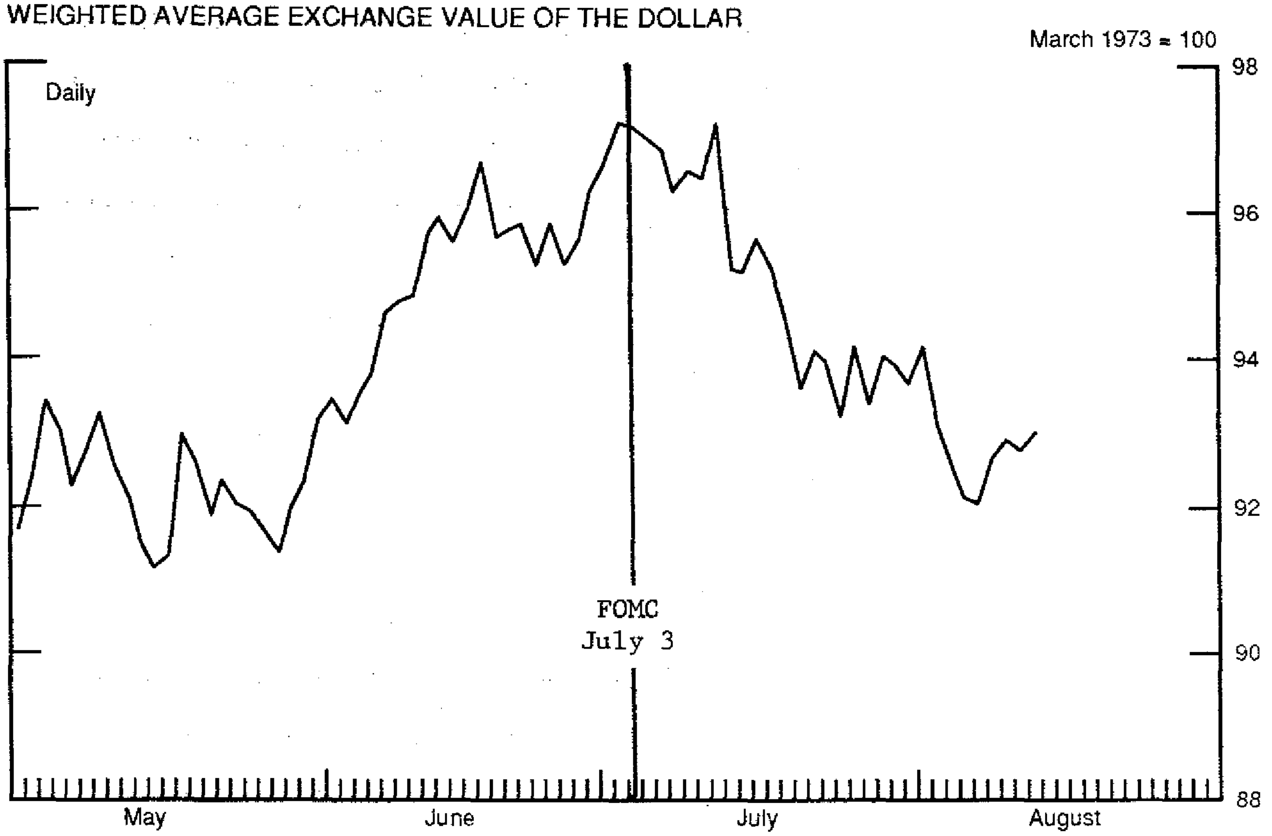
Foreign Exchange Markets

The weighted-average foreign-exchange value of the dollar, in terms of the other G-10 currencies, has declined about 4 percent, on balance, since the July FOMC meeting, as shown in the accompanying chart. The dollar rose to a high near DM 1.84 early in the intermeeting period, before moving down sharply on Friday July 12

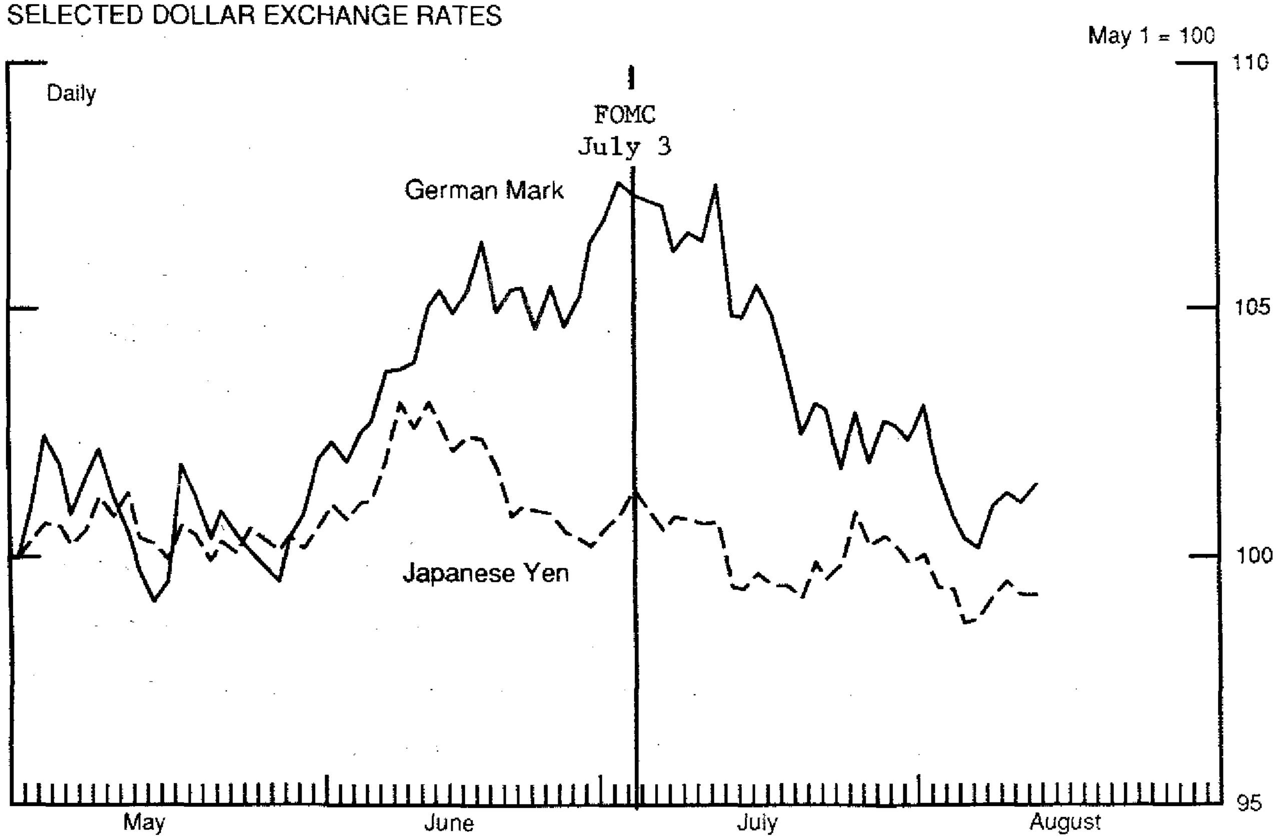
. The dollar continued to decline throughout most of the period as news of sluggish U.S. money growth, lower-than-expected second-quarter real GNP growth, and a decline in U.S. employment in July built expectations of U.S. monetary easing that were later realized.

The dollar has declined about 5 percent against the mark. The mark was supported by the expectation that the Bundesbank would tighten German monetary policy in response to a surprisingly sharp rise in German consumer price inflation to nearly 4-1/2 percent in July. New Bundesbank President

WEIGHTED AVERAGE EXCHANGE VALUE OF THE DOLLAR



SELECTED DOLLAR EXCHANGE RATES



Schlesinger made several statements indicating that a further rise in German interest rates was necessary to correct for the inflationary impact of past fiscal policy mistakes. German three-month interest rates rose 30 basis points during the period, and rates on the Bundesbank's one-month RPs rose 25 basis points, with the Bundesbank widely expected to make some upward adjustment in its official rates at its Council meeting on August 15. Market expectations are for an increase in the discount rate of a half to a full percentage point and, probably, also a half point increase in the Lombard rate.

The dollar has declined less against the Japanese yen (about 2 percent), as expectations formed that the Bank of Japan, which cut the discount rate just before the last FOMC meeting, might ease again in the next few months. Japanese three-month interest rates declined more than 25 basis points during the period, and Japanese call money fell 50 basis points. Scandals within the Japanese financial system also weakened the yen. The scandal over the compensation of stock losses widened somewhat, and another scandal surfaced over the issuance of false certificates of deposits by some bankers to serve as collateral for real estate loans.

Within the EMS, sterling has changed little overall against the mark. The political ramifications of the BCCI closure depressed sterling only temporarily. The Bank of England cut its base rate by 1/2 percentage point during the period, but sterling was little affected by that widely anticipated move.

The Canadian dollar has risen slightly, on balance, against the U.S. dollar over the period. Reports that kickbacks had been paid to government officials led to a sharp decline of more than 1 percent in the Canadian dollar, but the Canadian dollar rebounded after a temporary rise in Canadian interest rates and little subsequent news about the scandal.

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Desk's only intervention was sales of $100 million .

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Developments in Foreign Industrial Countries

Recent data present a mixed picture of economic activity in the industrial countries. In the second quarter, economic activity appears to have rebounded in Canada, while France and Italy showed tentative signs of more rapid growth. The pace of economic activity eased in Japan and Germany, although there were indications of a return to stronger German growth toward the end of the quarter. Recession continued in the United Kingdom, although June data contain signs of positive growth.

With the exception of Germany, inflation in the industrial countries was nearly unchanged. Wage inflation moderated in Canada and France, although recorded consumer price inflation rose slightly in both countries. Producer prices fell slightly in Japan and Italy. Both consumer and wholesale price inflation in Germany in July rose significantly, in part because of tax increases.

Trade balances improved in the second quarter in most of the industrial countries, except for in Germany, which posted a quarterly trade deficit for the first time in a decade. Japan's trade surplus widened, and for the first seven months of the year was running at an annual rate about $15 billion higher than in 1990. The U.K. trade deficit was nearly halved in the first six months to an annual rate nearly $13 billion below 1990.

Individual Country Notes. In Japan, the pace of activity appears to have slowed somewhat from the rapid pace of the first quarter. Industrial production (s.a.) declined 0.6 percent in the second quarter, the second consecutive quarterly decline. Retail sales (s.a.a.r.) in the April-May period showed no increase compared with their first-quarter level. New passenger car registrations (s.a.) were 0.9 percent lower in the second quarter than in the first, the third consecutive quarterly reduction. Housing starts (s.a.a.r.) showed a 7.2 percent reduction between the first quarter and the April-May period. Corporate bankruptcies (s.a.a.r.) jumped 22.2 percent over the same period. The unemployment rate (s.a.), although remaining near historical low levels, edged up to 2.1 percent in June, while the ratio of job offers to applicants (s.a.) declined slightly.

Inflation rates have changed little recently. Consumer prices (n.s.a.) increased 0.2 percent in July, and their 12-month rate of increase rose to 3.7 percent. Excluding perishable foods, the 12-month increase was only 3.1 percent. The 12-month change in wholesale prices (n.s.a.) remained at a low 0.6 percent in June.

The trade balance (s.a.) strengthened in June and declined slightly in July. For the first seven months of this year, the trade surplus (s.a.a.r.) was $72.2 billion, well above the $57.5 billion surplus rate for the same period last year.

Despite volatility in the data, monthly indicators for the second quarter in western Germany indicate a softening of economic activity from the robust rate in the first quarter. Although industrial production in western Germany (s.a.) recovered in June, the second quarter average was

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

	Q4/Q4 1989	Q4/Q4 1990	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1991 Feb.	1991 Mar.	1991 Apr.	1991 May	1991 June	Latest 3 months from year ago 2
Canada												
GDP	2.9	-1.1	-.3	-1.2	-1.7	n.a.	*	*	*	*	*	-3.4
IP	-.4	-5.5	-.8	-3.1	-1.9	n.a.	-.8	-.6	1.4	1.1	n.a.	-5.0
France												
GDP	3.9	1.9	.9	-.1	.2	n.a.	*	*	*	*	*	1.2
IP	2.8	-.3	1.4	-2.7	.3	n.a.	-.9	-2.8	3.6	-.5	n.a.	-.5
West Germany												
GNP	3.2	5.3	1.8	.6	2.3	n.a.	*	*	*	*	*	5.2
IP	4.8	5.4	3.0	.4	2.0	-.5	-2.0	1.4	-.9	-1.0	2.5	5.0
Italy												
GDP	2.9	1.0	.5	-.1	.3	n.a.	*	*	*	*	*	.5
IP	3.3	-3.8	1.4	-1.9	.3	n.a.	-.2	-.2	-2.1	1.1	n.a.	-2.5
Japan												
GNP	4.8	4.8	1.1	.6	2.7	n.a.	*	*	*	*	*	5.9
IP	4.2	6.9	2.2	1.7	-.1	-.6	-.4	-2.1	.5	2.0	-2.8	3.1
United Kingdom												
GDP	1.3	-1.3	-1.5	-.8	-.6	n.a.	*	*	*	*	*	-2.4
IP	.2	-3.4	-3.2	-1.7	-.3	-1.2	1.8	.1	-2.6	-.3	3.0	-6.2
United States												
GNP	1.8	.5	.4	-.4	-.7	.1	*	*	*	*	*	-.6
IP	1.1	.3	1.0	-1.8	-2.5	.4	-.9	-.7	.5	.7	.7	-3.0

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 1989	Q4/Q4 1990	1990 Q1	1990 Q2	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1991 Apr.	1991 May	1991 June	1991 July	Latest 3 months from year ago
Canada													
CPI	5.2	4.9	1.4	.9	1.1	1.4	2.9	.7	.0	.5	.5	n.a.	6.3
WPI	.2	1.6	.4	.3	-.1	1.0	.1	-1.6	-.7	-.4	-.2	n.a.	-.5
France													
CPI	3.6	3.6	.7	.9	1.0	1.0	.5	.7	.3	.3	.2	n.a.	3.2
WPI	.9	.7	-.3	-.3	.2	1.1	-.5	n.a.	*	*	*	*	.6
West Germany													
CPI	3.0	3.0	1.1	.5	.4	.9	.8	.9	.5	.4	.5	1.0	3.7
WPI	4.3	.9	-.3	.6	.2	.4	.5	.3	.2	.6	.3	.8	2.1
Italy													
CPI	6.6	6.3	1.6	1.2	1.4	2.0	1.9	1.4	.4	.4	.5	.2	6.8
WPI	n.a.	9.9	1.4	-.0	3.9	4.3	.2	n.a.	-.6	.2	n.a.	n.a.	7.8
Japan													
CPI	2.9	3.5	.4	1.2	.2	1.6	.8	.6	.4	.4	-.2	.2	3.5
WPI	3.7	1.9	.4	.8	.0	.7	.1	-.4	-.3	.1	-.1	n.a.	.4
United Kingdom													
CPI	7.6	10.0	1.8	4.7	1.6	1.6	.6	2.0	1.1	.3	.4	n.a.	6.0
WPI	5.2	5.9	1.6	2.1	.9	1.1	2.0	1.8	1.1	.3	.1	.3	5.9
United States													
CPI (SA)	4.6	6.3	1.8	1.0	1.7	1.7	.9	.5	.2	.3	.2	n.a.	4.8
WPI (SA)	4.9	6.5	2.1	.1	1.6	2.6	-.6	-.2	-.1	.6	-.3	-.2	3.1

1. Asterisk indicates that monthly data are not available.

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

	1989	1990	1990				1991		1991			
			Q1	Q2	Q3	Q4	Q1	Q2	Apr.	May	June	July
Canada												
Trade	5.8	9.3	1.4	2.6	2.8	2.4	1.8	n.a.	.7	1.0	n.a.	n.a.
Current account	-14.1	-14.0	-4.4	-3.6	-2.9	-3.1	-4.6	n.a.	*	*	*	*
France												
Trade	-6.9	-9.0	-.6	-1.7	-3.6	-3.1	-2.6	-1.3	-.4	-.3	-.6	n.a.
Current account	-3.1	-7.3	-.1	-2.3	-3.4	-1.6	-2.6	-2.2	*	*	*	*
Germany 2												
Trade (NSA)	71.6	65.2	22.4	16.7	16.0	10.1	4.4	-1.1	-.8	-.5	.2	n.a.
Current account	57.3	47.3	18.5	10.9	9.4	8.5	-6.0	-6.2	-1.5	-2.6	-2.1	n.a.
Italy												
Trade	-12.6	-12.1	-3.5	-1.9	-2.9	-3.8	-1.2	-4.2	-1.9	-2.0	-.3	n.a.
Current account (NSA)	-10.7	-14.2	-9.1	-2.2	.7	-3.7	n.a.	n.a.	*	*	*	*
Japan												
Trade	64.5	51.9	15.6	13.2	14.7	8.5	17.4	18.8	6.0	5.8	7.0	5.9
Current account	57.6	36.7	15.3	8.5	7.0	5.9	17.8	18.8	7.8	5.9	5.1	n.a.
United Kingdom												
Trade	-39.2	-31.4	-9.8	-8.8	-7.2	-5.7	-5.4	-3.7	-1.5	-1.6	-.6	n.a.
Current account	-32.1	-23.8	-8.6	-8.5	-3.6	-3.2	-4.9	-1.6	-.8	-.9	.0	n.a.
United States												
Trade	-115.9	-108.1	-27.5	-24.1	-28.8	-27.7	-18.4	n.a.	*	*	*	*
Current account	-106.3	-92.1	-22.7	-22.2	-23.9	-23.4	10.2	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.

2 percent (a.r.) below the average for the first quarter. The volume of new orders for west German manufactured goods (s.a.) increased in June, but the average level of total orders for the second quarter still was 10.6 percent (a.r.) below that in the first quarter. Domestic orders, which declined more than 12 percent (a.r.) in the second quarter were especially weak. The volume of retail sales (s.a.) in western Germany fell in both April and May with the average for the two months 8.4 percent (a.r.) lower than the first quarter.

The west German unemployment rate (s.a.) moved up 0.1 percentage point in July. Official east German unemployment (n.s.a.) was unchanged in both May and June at 9.5 percent but jumped to 12.1 percent in July as one-year job guarantees given at the time of the economic merger one year ago expired. The share of workers engaged in government-subsidized "short-time" work (n.s.a.) also declined more than 2-1/4 percentage points to 18.3 percent of the labor force.

West German consumer prices (n.s.a.) increased 1 percent in July after rising 0.5 percent in June. On a year-over-year basis, consumer price inflation increased from 2.7 percent in the first quarter to 4.5 percent in July. New excise taxes on energy products are estimated to have contributed 0.6 to 0.8 percentage point to the July increase in consumer price inflation, but earlier weakness of the DM also was a factor in higher DM prices in recent months.

West German wholesale prices (n.s.a.) increased 0.8 percent in July after increasing 0.3 percent in June. On a year-over-year basis, wholesale prices rose 3.1 percent in July.

The average level of exports and imports (n.s.a.) in the second quarter fell from first-quarter levels. In June, imports fell more rapidly, resulting in an improvement of the German trade position to a surplus of about $200 million. For the second quarter as a whole, German trade was in deficit at about a $3-1/2 billion annual rate, compared to an $18 billion annual rate in the first quarter.

The combined German current account deficit (n.s.a.) was about unchanged in the second quarter at $25 billion (a.r.). Excluding payments related to the Gulf war, however (most of which were in the first quarter), the German current account was in surplus by about $5 billion (a.r.) in the first quarter. The surplus for 1990 as a whole was $47 billion.

In its annual mid-year review of its monetary target, the Bundesbank lowered its 1991 target range (set last December) for growth of M3 in eastern and western Germany one percentage point to 3 to 5 percent. The Bundesbank said that the reduction in the target range was in response to both slow monetary growth and large holding of M3 in eastern Germany.

The recently approved draft 1992 budget includes a 1 percentage point increase in the VAT rate that will take effect at the beginning of 1993 and cuts in west German subsidies that will save DM 30 billion over three years. Under the new medium-term financial plan, growth of federal expenditures is to be no greater than 2.3 percent per year in nominal terms.

Recent data on activity in France are mixed, but provide tentative evidence of the beginning of a pick up in growth. Industrial production (s.a.) fell 0.5 percent in May, after rising 3.6 percent in April. May data were clouded by an unusually large number of public holidays, but industrial production was still 3.1 percent above its December trough. Household consumption of manufactured products (s.a.) fell 0.4 percent between the first and second quarters; however, this early indicator of total household consumption rose 2.0 percent in June, after decreasing in both April and May. Business confidence (s.a.), measured by near-term industrial production plans, fell slightly in July after three consecutive monthly increases.

French inflation remained moderate. The CPI was up 3.3 percent on a twelve-month basis in June, after a 3.2 percent rise in May. For the first time since 1973, French inflation, in June, was lower than west German inflation (by 0.2 percentage point). Wage growth has moderated, with average hourly wages growing 4.4 percent (Q2/Q2) in the second quarter, down from 5.1 percent in the first quarter.

The merchandise trade deficit (s.a.a.r.) narrowed to $5.2 billion in the second quarter from $10.4 billion in the first quarter, as imports fell more than exports.

In Italy, first-quarter GDP increased 1.2 percent (s.a.a.r.), following a 0.4 percent decline in the previous quarter, largely due to a 2.8 percent rise in private consumption. Investment spending increased slightly, after falling in the previous two quarters. Industrial production increased 1.1 percent (s.a.) in May and recently released non-seasonally adjusted data for June indicate that industrial production rose slightly from its level a year earlier (after an adjustment for working days).

Consumer prices rose 6.7 percent (s.a.) in July from their level a year earlier, down from the 6.9 percent increase registered in the previous month. Producer price inflation continued to slow in May, rising 3.8 percent above the price level a year earlier, down from 4.0 in the previous month.

Italy's trade deficit narrowed to $0.3 billion (s.a.) in June, from $2 billion in May, due to a surge in exports. The cumulative trade deficit (s.a.) through June roughly equals last year's rate.

In the United Kingdom, activity appears to have declined further in the second quarter, although some June data suggest some strength. The volume of retail sales (s.a.) fell by 0.9 percent in the second quarter, the third consecutive quarterly decline, but June data were revised upward to show a 1.5 percent increase. Industrial production (s.a.) in the second quarter was 1.2 percent lower than in the first quarter, but rose a surprising 3.0 percent in June, due mainly to higher oil output. The unemployment rate (s.a.) increased to 8.1 percent in June, its twelfth consecutive monthly rise.

Inflation rates were little changed. Retail prices (n.s.a.) rose 0.4 percent in June while the 12-month increase remained unchanged at 5.8 percent. Producer prices (n.s.a.) were nearly unchanged in June, but rose 0.3 percent in July. The year-over-year increase rose to 5.9 percent in July from 5.7 percent in June.

The trade deficit (s.a.) was reduced further in June. For the first half of this year, the trade deficit was $18.1 billion (a.r.), compared to $31 billion last year.

In Canada, economic activity rebounded in the second quarter, possibly the first quarter of positive growth since the first quarter of 1990. Retail sales (s.a.) rose 1.5 percent in May, up from 0.4 percent in April. Industrial production (s.a.) increased 1.1 percent in May following a 1.4 percent April jump. Nearly all other monthly indicators from the second quarter show evidence of a recovery in economic activity. Unemployment (s.a.) remained at 10.5 percent in July.

Recent data on inflation present mixed signals. Private sector wage settlements (s.a.a.r.) decelerated to their lowest rate in four years, increasing only 3.1 percent in May. Industrial product prices (n.s.a.) fell 0.2 percent in June, the fifth consecutive monthly decline. Consumer price inflation, however, edged up slightly in June to 6.3 percent on a 12-month basis.

Canada's merchandise trade surplus widened in May to $1.0 billion as both exports and imports fell off.

Developments in East European Countries

Trade data indicate that in the first half of 1991, trade between the countries of Eastern Europe and the Soviet Union was only one-half the level of the same period last year. This dramatic decline in trade has exacerbated employment problems brought on by the reform programs. Unemployment rates jumped from 3.2 percent in May to 3.8 percent in June in the CSFR, from 3.9 percent in June to 4.6 percent in July in Hungary, and from 8.4 percent in June to 9.4 percent in July in Poland.

In Poland, industrial sales rose in June by 0.8 percent, responding to the 14.4 percent devaluation of the zloty in May. For the first half of 1991, industrial sales were off 9.4 percent compared with the first half of 1990. Private sector sales increased 3.5 percent.

Exports responded strongly to the devaluation, increasing 30 percent in May over April, and imports responded in June, dropping 8.8 percent over May. Trade surpluses recorded in May and June reduced the trade deficit for the half-year to $140 million.

Monthly inflation jumped in June to 4.9 percent following five months of declining monthly rates, mainly on account of the zloty devaluation and a 10 percent increase in the officially set price of gasoline.

The budget deficit climbed to 13 trillion zlotys (around 1 percent of GDP) through the first six months of 1991 in part because of reduced tax revenues from troubled Polish enterprises. This figure exceeds the IMF target, and Polish officials have requested a renegotiation of the three-year IMF plan. October parliamentary elections are likely to test the Polish government's reform program, particularly tight monetary and wage indexing policies.

The World Bank granted a $200 million loan to modernize the banking sector; $150 million will be available immediately.

Hungary has been hard hit by the collapse of trade with the Soviet Union and other Eastern European countries, and has renegotiated some barter arrangements with the Soviet Union. Industrial production fell 20 percent over the first half of 1991, although this figure does not include output by small companies, the most dynamic component of the Hungarian economy.

The return to some barter and an inflow of goods to joint-ventures with no offsetting cash payment complicate the trade picture. On a customs basis, Hungary's trade deficit totalled more than $825 million for the first half year. On a cash flow basis, the trade deficit through June totaled only about $150 million. The European Community has extended an ECU 100 million (about $110 million equivalent) loan that is part of the G-24 balance of payments loan to Hungary.

Inflation continued to moderate on account of tight fiscal and monetary policies as well as fewer changes in administered prices. Prices rose only 2.1 percent in June continuing the decline in monthly rates begun in January.

Industrial production in the Czech and Slovak Federal Republic was down 17.6 percent for the first six months of 1991 compared with the same period in 1990. Monthly inflation continued to decline and was only 1.8 percent for June; following price liberalization in January, prices have increased 49 percent in the first six months of 1991.

The current account deficit totalled $330 million in May, much better than expected, although the level of both imports and exports has fallen about 20 percent. The CSFR government and the World Bank signed a $450 million structural adjustment loan on July 31, with the first tranche of $250 million available immediately.

Economic situation in other countries

Mexico registered a trade deficit in the first five months of 1991. The Mexican government converted nearly $1.2 billion of frozen interbank credits owed to foreign banks into 10-year bonds. Brazil paid $900 million in July to commercial banks pursuant to an agreement on arrears. In August, banks holding a critical mass of Brazil's external debt granted waivers allowing the agreement to move forward. Argentina's macroeconomic situation continued to improve, which facilitated IMF approval of a new stand-by arrangement on June 29. Fiscal pressures pushed monthly inflation in Venezuela to its highest level this year in July, but new measures are being taken to reduce the public-sector deficit. Preliminary data indicate that the Philippines may be out of compliance with its IMF program. Korea's current account deficit rose substantially to a record $5.8 billion in the first half of 1991. In Taiwan, the cumulative trade surplus for January through July showed a modest increase compared with 1990.

Individual Country Notes. Mexico had a trade deficit of $1.5 billion in the first five months of 1991, compared with a surplus of $1 billion in the same period of 1990. Imports were 42 percent higher, with large increases in all categories. Exports were 16 percent higher, with oil exports up 13 percent and non-oil exports up 17 percent. Large capital inflows are continuing, and reserves are reported to be growing further, although no recent data are available.

Last month, the government auctioned $1.15 billion of 10-year bonds at a 1.6 percent average discount in exchange for $1.17 billion in interbank credit lines owed to foreign banks, which have been frozen since 1982. The bonds will be convertible into shares of Mexican banks that are being privatized. The frozen interbank lines amounted to about $5.2 billion in 1982. They were repeatedly rolled over, but the amount held by creditor banks was reduced by various means, including secondary market sales, to about $3.8 billion immediately before the auction. The secondary market discount on these lines ranged from 10 to 15 percent in early June, depending on the market evaluation of individual debtor banks, but the discount fell steadily after the auction was announced as bidders positioned themselves to take advantage of the conversion option. Most primary holders of the claims expect to be paid in full by the privatized banks when the current rollover expires in December 1992.

Three Mexican banks were privatized in June and July. Winning bids were announced for two other banks in early August and are to be announced for two more on August 19 and August 26. The announcement expected August 26 will deal with the National Bank of Mexico (BANAMEX), the country's largest bank.

Interest rates rose slightly in late June and early July, but fell back after mid-July. At the auction of August 6, the 28-day Treasury bill rate was 16.8 percent, compared with the previous low of 17.3 percent on June 4. The CPI rose by 1 percent in June and by 0.9 percent in July.

Mid-term congressional elections are being held in Mexico on August 18.

On July 1, Brazil paid $900 million to commercial banks pursuant to an agreement on arrears that was signed in April and ratified by the Brazilian Senate in mid-June. In mid-August, banks holding a 95 percent critical mass of Brazil's external debt granted waivers that will allow the agreement to move forward; Brazil will settle the remaining arrears with $1.1 billion in cash and $6 billion in bonds. Economy Minister Moreira recently stated that negotiations on restructuring Brazil's $60 billion of medium- and long-term bank debt are expected to begin in late August.

Inflation continues to rise in response to the removal of price controls and to the prospect of an increased fiscal deficit that the central bank is expected to accommodate. Official inflation data for June and July are not yet available; however, one unofficial index indicates that prices increased 10 percent in July, compared with 9.4 percent in June.

A principal source of impending fiscal and monetary pressure is the need to issue money to finance the return of financial assets that the government froze in March 1990. Roughly $25 billion remains frozen. In late July, the government announced that it would return a small amount of these assets in mid-August, a few weeks ahead of schedule. The government has pledged to return the rest in 12 equal monthly installments, beginning in September 1991. In addition, the federal government is continuing to fund state government fiscal deficits, which have been a major source of fiscal pressure. Finally, legal problems that have recently come up in the context of an attempt to privatize the USIMINAS steel mill have raised doubts about the government's ability to divest itself of money-losing public firms.

On June 29, an SDR 780 million ($1.04 billion) 12-month stand-by arrangement for Argentina was approved by the IMF's Executive Board. The program replaces the stand-by arrangement that became inoperative at the beginning of the year, when Argentina failed to meet its 1990 fourth-quarter performance criteria. Under the program, Argentina must achieve a primary (non-interest) surplus of 3.5 percent of GDP, approximately sufficient to finance the interest obligations on its non-bank external debt and continued partial interest payments of $60 million monthly on its foreign commercial bank debt. The improvement in fiscal performance compared with 1990, when the primary surplus registered only 2.2 percent of GDP, is to be achieved through a combination of asset sales, tax rate increases, and intensified tax collections. The fiscal adjustment effort will be supported by a $325 million World Bank Public Sector Reform Loan, which was approved July 30.

The macroeconomic situation has continued to improve following the legal fixing of the exchange rate to the dollar in late March. Consumer inflation (monthly basis) rose to 3.1 percent in June from 2.8 percent in May, but then declined to 2.6 percent in July and is projected at only about 1 percent in August.

. Monthly short-term call money rates of interest have fluctuated between 2 percent and 3 percent, quite low relative to the experience of recent decades in Argentina. Financial markets remain calm in the face of congressional and provincial gubernatorial elections being held in August and September. Even though the majority Peronist Party is expected to lose some of these elections, no change in the government's overall economic strategy is anticipated.

Consumer price inflation in Venezuela rose to 3.1 percent in July, its highest level so far this year. This increase is mainly due to rapid economic growth spurred by a fiscal expansion in excess of that provided for under Venezuela's IMF Extended Fund Facility. Preliminary reports indicate that real GDP may have expanded at an annual rate of as much as 10 percent in the first half of 1991. Agreement was recently reached with the IMF on a revised program to curtail the excessive fiscal stimulus and reduce inflation. The revised program, expected to be approved by the IMF Board next month, calls for achieving a 1991 fiscal surplus of 0.5 percent of GDP by specific spending reductions and tax increases.

In light of a 1991 current account surplus that is expected to exceed 5 percent of GDP, the revised IMF program is expected to reduce the size of the drawings permitted to Venezuela. As a consequence, burden-sharing provisions in last year's commercial bank financing package will require Venezuela to seek waivers from the banks supplying new money under the package in order for the third and last new money tranche ($300 million) to be released by the banks.

In mid-August, Venezuela's privatization program took a major step forward with the sale of a controlling interest in the state-owned VIASA airline to Iberia Airlines and a Venezuelan partner for $145 million.

The Philippines exceeded the ceiling for the growth of base money under its IMF program at the end of June, according to preliminary data. If this is eventually confirmed, the Philippines will be out of compliance with the program and, unless granted a waiver, will not be eligible to make further drawings on the IMF. In addition, a large emergency credit extended to the National Power Corporation has increased sharply the size of the government's budget deficit and has further threatened observance of the IMF program. An IMF mission will visit Manila later this month, and a review by the IMF Board of the Philippines program is expected in September.

Korea's current account deficit rose to a record $5.8 billion in the first half of 1991 from $1.5 billion in the first half last year, as a steep rise in imports of oil and capital goods more than offset a recovery in exports. Industrial production was 9 percent higher in the first four months of this year than in the same period a year earlier. In July, a number of foreign currency regulations were loosened, including an increase in the ceiling on corporate foreign-currency bank deposits to $100 million from $10 million. North and South Korea applied separately for membership in the United Nations on July 8 and August 5, respectively.

In Taiwan, economic activity has picked up moderately this year as a strengthening in exports has helped to compensate for continued weakness in domestic demand. GNP rose 6.7 percent in the first half of 1991, compared with 5.9 percent in the first half of last year. In the first seven months of 1991, the cumulative trade surplus (on a customs basis) rose to $6.9 billion from $6.4 billion in the same period last year. On July 15, Taiwan's central bank cut its rediscount rate by 3/8 of a percentage point to 7-3/8 percent, the first cut since October 1986, in an effort to stimulate domestic investment. Taiwan granted licenses to 15 new private commercial banks on June 26, the first approvals for new domestic banks since 1975. Nearly all of Taiwan's existing 16 domestic commercial banks are owned by the government.