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Confidential (FR) Class III FOMC

September 25, 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

The news on the economy continues to be mixed. Business establishments reported a rebound in the aggregate hours of production workers in August, and manufacturing output rose further despite what seems to have been a temporary drop in motor vehicle assemblies. However, non-auto retail sales in August retraced part of a large July gain, recent data on residential construction have been lackluster, and businesses remain cautious about investing in either inventories or fixed capital. Wages and prices appear to be on a path of gradual deceleration.

Employment and Unemployment

Payroll employment rose 34,000 in August; and, with a rebound in the workweek, aggregate hours of production or nonsupervisory workers increased 0.7 percent, after a drop of 1.1 percent in July.[1] However, signs of weakness in labor demand also continued to be evident: The payroll survey showed further declines in construction, trade, and state and local government in August; and, in the household survey, employment fell almost 300,000 to a new cyclical low. The unemployment rate was unchanged at 6.8 percent. Since mid-August, when the employment surveys were taken, weekly filings of initial claims for unemployment insurance have held steady at about 420,000 per week (on FR seasonals), suggesting that the growth of payrolls probably has remained sluggish into September.

1. The initial reading on aggregate hours in July showed a deeper decline of 1.4 percent.

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

	1990	1990 Q4	1991 Q1	1991 Q2	1991 June	1991 July	1991 Aug.
	-----------------	Average	Monthly	Changes	---------		
Nonfarm payroll employment[2]	36	-164	-240	-6	-2	-73	34
Private	3	-172	-258	-22	-18	-4	65
Manufacturing	-48	-98	-102	-22	-48	25	42
Durable	-39	-74	-81	-17	-41	11	13
Nondurable	-9	-24	-21	-5	-7	14	29
Construction	-23	-59	-64	-3	-5	-21	-12
Transportation, public utilities	9	4	-14	-5	-10	-4	12
Wholesale trade	-5	-13	-20	-12	-17	-3	-18
Retail trade	-5	-40	-67	-11	6	-2	-15
Finance, insurance, real estate	1	-6	1	-11	-9	-12	5
Services	72	37	9	45	67	17	57
Total government	33	8	18	16	16	-69	-31
State and local	36	24	17	10	-3	-61	-40
Private nonfarm production workers	-9	-169	-223	-8	26	34	10
Manufacturing production workers	-41	-83	-83	-5	-19	39	37
Total employment[3]	-32	-103	-273	43	293	-172	-296
Nonagricultural	-38	-123	-222	-27	257	-102	-324

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

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

	1990	1990 Q4	1991 Q1	1991 Q2	1991 June	1991 July	1991 Aug.
Civilian unemployment rate (16 years and older)	5.5	5.9	6.5	6.8	7.0	6.8	6.8
Teenagers	15.5	16.4	18.0	18.8	19.2	20.6	19.0
20-24 years old	8.8	9.2	10.1	10.8	11.1	11.2	10.7
Men, 25 years and older	4.4	4.8	5.5	5.8	5.9	5.7	5.8
Women, 25 years and older	4.3	4.6	5.0	5.2	5.3	4.8	5.1
Labor force participation rate	66.4	66.2	66.1	66.2	66.2	66.0	65.7

Private payrolls rose 65,000 in August and now are estimated to have been little changed in July instead of down 40,000. The manufacturing sector added 42,000 jobs, with gains in a large number of industries. Manufacturers also boosted the factory workweek to 40.9 hours, the highest it has been in nearly a year. In the private service-producing sector, employment rose 41,000 in August, owing mostly to employment increases in health and business services. The rest of the service-producing sector, especially wholesale and retail trade, remained weak.

GROWTH IN PAYROLL EMPLOYMENT DURING THE FIRST
FOUR MONTHS OF ECONOMIC RECOVERY
(Percentage change, based on seasonally adjusted data)

	Average of seven postwar cycles[1]		Memo:
	Mean	Standard deviation	April 1991 to Aug. 1991
Private payroll employment	.5	.6	.2
Goods-producing	.2	1.3	.1
Manufacturing	.4	1.0	.3
Service-producing	.7	.2	.2
Trade	.7	.4	-.1

1. Seven postwar cycles since 1954.

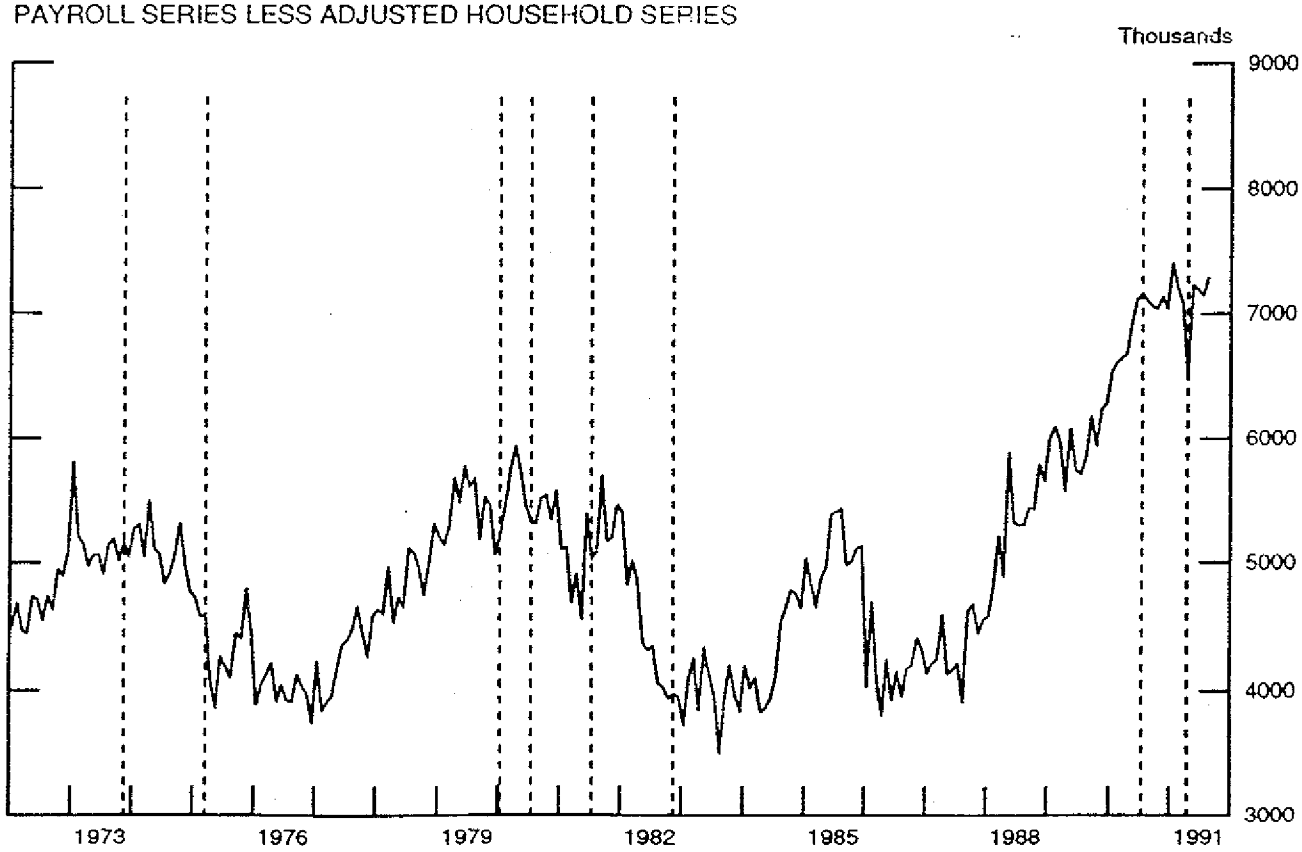
The cumulative rise in private payroll employment from April to August amounted to only 0.2 percent (table). This showing is within the range of results seen in previous postwar recoveries, but it is well to the low side of the average. While employment in manufacturing has been following a path fairly close to that of the average recovery, gains in the service-producing sector since April have been exceptionally low relative to earlier postwar recoveries.

NET CHANGES IN EMPLOYMENT
(Thousands; seasonally adjusted)

	May 1985 to May 1989	May 1989 to July 1990	July 1990 to May 1991[1]	May 1991 to Aug. 1991
Nonagricultural payroll	10,846	2,140	-1,382	-41
Total household	10,133	817	-1,291	-175
Nonagricultural	10,289	833	-1,455	-169
Minus:				
Self-employed	816	164	8	85
Unpaid family workers	-1	-32	-52	6
Private household workers	-82	-140	-69	124
Unpaid absences	467	-163	31	-173
Plus:				
Agricultural service workers	114	52	-76	113
Household series adjusted to the payroll concept	9,203	1,056	-1,449	-98

1. The NBER Dating Committee designated July 1990 as the cyclical peak. April was the specific trough for nonagricultural payroll employment; prior to its downturn in August, May was the low for the adjusted household series.

PAYROLL SERIES LESS ADJUSTED HOUSEHOLD SERIES



The weakness has been concentrated in the trade sector, especially among retailers of general merchandise and wholesalers of durable goods; firms carrying industrial machinery and farm machinery have been particularly hard hit.

In August, the payroll and household measures of employment diverged sharply, as they often do on a monthly basis. But the two series seem to be tracing out fairly similar pictures of the changes in labor demand if viewed in a somewhat longer time frame, particularly if adjustment is made for the differences in coverage between the two measures (table). For example, the household and payroll surveys show quite similar declines in employment between July 1990 and May 1991, and they are in agreement in showing labor demand to have been essentially flat since May.[2]

The labor force participation rate fell further in August to 65.7 percent, down about 3/4 percentage point from its highs of 1989 and early 1990. Much of the drop in participation appears to reflect increases in the number of individuals reporting themselves as retired and in the number of persons who have postponed employment in order to attend school. Although it is difficult to

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2. During the expansion of the 1980s, growth in payroll jobs outpaced the household count of persons employed by a wide margin. Much of that gap, adjusted for differences in coverage, was attributable to increases in multiple jobholding. Between May 1985 and May 1989, the dates of the last two BLS surveys of dual jobholding, the number of persons with more than one nonagricultural job rose 1.1 million; this rise was equal to about two-thirds of the gap between gains in the payroll survey and gains in the adjusted household survey over that period. Between May 1989 and July 1990, the gap between the two series widened at an even faster pace, with the payroll series up about twice as much as the adjusted household measure. The similarity in the size of the changes in the two series since last July likely owes to an ebbing of multiple jobholding, which tends to level off or decline during periods of weak labor demand.

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

	Proportion in total IP 1990:Q4	1990[1]	1991 Q1	1991 Q2	1991 June	1991 July	1991 Aug.
			-----Annual rate-----				
Total index	100.0	0.3	-9.7	2.6	0.8	0.6	0.3
Excluding motor vehicles and parts	96.2	0.8	-8.6	1.1	0.8	0.4	0.5
Products, total	61.4	0.6	-8.8	2.5	0.9	0.2	0.1
Final products	46.9	1.1	-7.3	3.2	0.8	-0.0	0.0
Consumer goods	25.7	-0.7	-7.0	6.4	1.3	0.0	0.5
Automotive products	2.2	-7.3	-24.6	41.9	3.3	2.9	-3.6
Other consumer goods	23.5	0.0	-5.3	3.7	1.1	-0.3	0.9
Durables	3.0	-3.9	-10.9	12.6	2.8	1.3	1.1
Nondurables	20.5	0.6	-4.4	2.5	0.8	-0.5	0.8
Energy	2.7	-2.3	-5.5	8.5	1.2	-1.7	1.0
Other	17.8	1.0	-4.3	1.6	0.8	-0.3	0.8
Business equipment	15.8	4.2	-7.4	2.9	0.3	0.5	-0.3
Motor vehicles	1.0	-9.4	-42.2	66.6	3.3	6.4	-10.8
Other business equipment	14.8	5.3	-4.6	-0.2	0.1	0.1	0.5
Information processing and related	6.6	5.1	7.0	1.3	-0.7	0.2	0.1
Industrial	4.3	1.3	-14.2	-2.8	-0.2	0.1	0.4
Defense and space equip.	4.8	-0.2	-8.6	-10.7	-0.5	-1.2	-0.1
Construction supplies	5.7	-4.6	-21.2	-0.1	1.7	0.4	0.6
Materials	38.6	-0.1	-11.0	2.7	0.8	1.2	0.5
Durable	19.6	-0.5	-16.7	2.6	0.5	1.3	0.9
Nondurable	8.8	0.5	-7.0	0.6	1.1	1.4	0.2
Energy	10.2	0.0	-3.0	4.7	1.1	1.0	-0.1
Memorandum:							
Major industry groups:							
Manufacturing	84.9	0.3	-10.4	2.1	0.8	0.7	0.3
Excluding motor vehicles and parts	81.0	0.9	-9.2	0.3	0.7	0.5	0.6
Mining	7.5	2.4	-4.0	-3.8	2.0	1.0	-1.1
Utilities	7.6	-2.1	-7.6	13.5	0.1	-0.9	0.8

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 Aug.	1991 Apr.	1991 June	1991 July	1991 Aug.
Total industry	82.2	85.0	83.7	78.6	79.6	79.9	80.0
Manufacturing	81.5	85.1	82.9	77.5	78.3	78.6	78.7
Primary processing	82.3	89.0	86.1	78.2	79.9	80.9	81.2
Advanced processing	81.1	83.6	81.6	77.3	77.6	77.7	77.6

determine how much of the recent drop is cyclical, econometric research by the staff suggests that the softness in the participation rate has been somewhat greater than can be explained by cyclical factors alone.

Wage rates, as measured by average hourly earnings, increased 0.4 percent in August (table). In the manufacturing sector, hourly earnings rose 0.5 percent, partly reflecting an increase in the number of hours worked at premium overtime rates. Over the twelve months ended in August, average hourly earnings increased 3.2 percent--almost 3/4 percentage point below the pace of a year ago.

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

	1989[2]	1990[2]	1991 Q1	1991 Q2	1991 July	1991 Aug.	Aug. 1990 to Aug. 1991[2]
			Annual rate		Monthly rate		12-month change
Total private nonfarm	4.0	3.7	2.8	5.2	-.1	.4	3.2
Manufacturing	2.7	3.6	2.2	5.2	.3	.5	3.6
Excluding overtime	3.0	3.7	2.7	3.8	.3	.4	3.6

1. Changes over periods longer than one month are measured from final month of preceding period to final month of period indicated.
2. Change based on not seasonally adjusted data.

Industrial Production

Industrial production rose 0.3 percent in August; in addition, production data for June and July were revised up and now show gains of 0.8 percent and 0.6 percent, respectively. Since its most recent trough in March 1991, total industrial production has grown at an average monthly pace of 0.6 percent, compared with an average of

0.9 percent over the first five months of the previous seven recoveries. The somewhat less vigorous behavior of the total index relative to previous cyclical episodes has reflected slower than usual growth in consumer durable goods, construction supplies, and materials.

Last month, growth in the total index was held down about 1/4 percentage point by a sharp drop in assemblies of motor vehicles, which fell to an annual rate of 8.7 million units (FRB seasonals). Industry sources attributed this drop to difficulties in modifying assembly plants for model changeover as well as to weakness in orders both from dealers and from rental fleets. Domestic auto and truck manufacturers have scheduled a substantial rise in motor vehicle assemblies in September, to an annual rate of 10.4 million units. In the first three weeks of the month, auto production proceeded about on schedule, but truck production fell about 10 percent short of the scheduled assembly rate. Even so, if the pace of the first three weeks were to continue for the remainder of the month, the September rise in domestic motor vehicle production would directly boost the total IP index about 0.4 percentage point.

PRODUCTION OF DOMESTIC AUTOS AND TRUCKS
(Millions of units at an annual rate; FRB seasonal basis)[1]

	1991				1991		
	Q1	Q2	Q3[1]	Q4[1]	July	Aug.	Sep.[1]
Domestic production:							
Autos	5.1	5.2	5.8	6.2	6.0	5.3	6.1
Trucks	2.6	3.4	3.7	4.3	3.6	3.4	4.2

1. Figures for September through the end of the year are based on current manufacturers' schedules.

Dealers' inventories of cars inched up in August, but this rise reversed only a tiny portion of the liquidation of the previous nine months, and stocks remain historically low relative to sales. The August level of inventories amounted to 47 days' supply, well below the traditional norm of nearly 60 days' supply. Inventories of light trucks have risen slightly over the past two months; the latest reading amounts to 87 days' supply (FRB seasonals).[3]

Production of consumer durables other than motor vehicles continued to post noticeable gains in July and August, mainly because of gains in output of carpeting, furniture, appliances, and other household goods. In addition, production of most types of nondurable consumer goods was up in August. By contrast, business equipment, which dropped sharply late last year and in early 1991, remains weak; overall, production of equipment has changed little since the spring, as gains in output of aircraft and equipment primarily used outside of the industrial sector, such as farm and service industry equipment, have been offset by continued sluggishness in the production of industrial equipment and computers.

Capacity utilization in manufacturing edged up in August but has retraced only one-fourth of the decline of 6 percentage points that occurred between July 1990 and March 1991. Since the spring, operating rates have increased in most primary processing industries, especially textiles, lumber, steel, and nonferrous metals. By contrast, utilization at advanced processing industries has risen only slightly; increases in operating rates at industries

3. Seasonally adjusted data for truck inventories are not available from BEA.

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

		1991		1991		
	1990	Q1	Q2	May	June	July
Total personal income	20.5	2.4	21.0	32.4	24.3	-5.6
Wages and salaries	10.9	-2.7	17.8	22.4	26.5	-7.6
Private	8.2	-6.6	16.5	20.6	25.0	-10.7
Other labor income	1.3	1.0	1.0	1.0	1.0	1.0
Proprietors' income	2.1	1.9	.2	5.6	-3.5	-1.6
Farm	.5	1.9	-3.7	.7	-6.5	-4.2
Rent	.7	-1.1	.6	.8	.3	.6
Dividend	.7	-.6	.1	.4	.1	.6
Interest	1.6	-3.2	-1.8	-1.9	-1.3	-1.0
Transfer payments	5.2	9.6	4.2	5.4	2.9	1.8
Less: Personal contributions for social insurance	1.1	2.5	1.1	1.2	1.7	-.6
Less: Personal tax and nontax payments	4.0	-2.0	.9	.6	1.3	-4.3
Equals: Disposable personal income	16.5	4.3	20.1	31.7	23.2	-1.4
Memo: Real disposable income	-.8	-4.8	7.8	12.0	14.1	-3.2

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

		1991		1991		
	1990	Q1	Q2	May	June	July
		-Annual rate-		----Monthly rate----		
Personal consumption expenditures	.1	-1.5	2.8	.4	.7	.4
Durable goods	-1.8	-11.7	-1.3	-.4	3.0	1.1
Excluding motor vehicles	-1.1	-.8	2.6	.5	.1	.6
Nondurable goods	-2.4	-1.8	2.7	1.1	-.2	.7
Excluding gasoline	-2.3	-1.3	2.1	1.0	-.2	.8
Services	2.5	2.1	4.1	.1	.5	-.1
Excluding energy	3.1	3.2	3.6	-.2	.6	.2
Memo:						
Personal saving rate (percent)	4.6	4.2	4.2	4.2	4.1	3.7

that produce motor vehicles, electrical machinery, and apparel products have been offset by further declines in nonelectrical machinery and instruments.

Personal Income and Consumption

The monthly changes in income and consumption have been erratic as of late.[4] Nominal personal income weakened in July, because of a deterioration in labor income brought on by a substantial drop in aggregate hours worked; real disposable income, which had registered strong gains in May and June, was down 0.1 percent. However, with the August employment report showing sizable increases in both hours worked and hourly wages, labor income probably more than recovered from the July drop. Given the small rise in consumer prices last month, much of this nominal increase should translate into real gains.

In real terms, spending on durable and nondurable goods lifted personal consumption expenditures 0.4 percent in July (not an annual rate); spending on services declined slightly as energy usage fell from the abnormal levels reached during the hot weather in May and June. In August, nominal retail sales declined 0.7 percent. Most of the drop reflected a 2.7 percent decline in the sales of

4. Some fairly sizable revisions have been made to the second-quarter data since the last Greenbook. The personal saving rate for the second quarter, which is now estimated to have been 4.2 percent, was revised up an unusually large 0.5 percentage point from the initial estimate of 3.7 percent. Of the total revision, roughly 0.3 point reflected a higher estimate of disposable personal income and 0.2 percentage point reflected a lower estimate of personal consumption expenditures.

Most of the downward revision in growth of PCE in the second quarter, from 3.6 percent to 2.8 percent, resulted from a reduced estimate of consumer outlays for motor vehicles. Incoming vehicle registration data showed that businesses had purchased many of the automobiles originally attributed to household purchases. The strength of sales to the business sector reportedly was the result of a surge of auto purchases by the daily rental fleets in June.

RETAIL SALES
(Seasonally adjusted percentage change)

	1990	1991		1991		
	Q4	Q1	Q2	June	July	Aug.
Total sales	.1	-1.0	1.3	.0	.5	-.7
Previous estimate			1.4	.1	.5	
Retail control[1]	.6	-.3	.8	-.2	.7	-.1
Previous estimate			.9	.0	.4	
Total excl. automotive group	.4	-.3	.9	-.3	.8	-.2
Previous estimate			1.0	.0	.3	
GAF[2]	-1.8	.6	2.2	-1.5	2.8	-1.1
Previous estimate			2.2	-1.4	2.0	
Durable goods stores	-1.2	-2.0	2.5	.3	.0	-2.2
Previous estimate			2.5	.3	.7	
Bldg. material and supply	-2.8	-.6	4.6	-.7	2.1	-2.6
Automotive dealers	-.8	-3.4	2.9	.8	-.7	-2.7
Furniture and appliances	-2.3	-1.2	1.9	-.7	2.3	-3.1
Other durable goods	-.5	1.9	-.6	-.2	-1.5	1.0
Nondurable goods stores	.9	-.4	.7	-.2	.8	.1
Previous estimate			.8	.1	.4	
Apparel	-2.7	.0	4.4	-.9	1.6	-.1
Food	.6	.3	1.0	.4	-.5	-.3
General merchandise[3]	-1.3	1.8	1.3	-2.2	3.5	-.7
Gasoline stations	9.2	-9.8	-3.4	-.8	-.5	1.0
Other nondurables[4]	.4	1.3	.6	.7	.6	.7
Memo:						
Motor vehicle sales[5]	12.9	11.8	12.3	13.1	13.2	12.4
Autos	9.0	8.2	8.5	9.0	9.1	8.4
Light trucks	4.0	3.6	3.9	4.1	4.1	4.0

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.
5. Millions of units at an annual rate; BEA seasonals.

automobile dealers. In the retail control category, which excludes spending at automotive dealers and at building material and supply stores, sales edged down 0.1 percent last month after a nominal rise of 0.7 percent in July. Altogether, the data for the retail control category suggest that the August level of real personal consumption expenditures for items other than autos was close to 1 percent above the second-quarter average (not an annual rate).

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

		1991		1991			
	1990	Q1	Q2	June	July	Aug.	Sep.[3]
Total	13.86	11.80	12.35	13.07	13.24	12.35	n.a.
Autos	9.50	8.22	8.46	9.02	9.14	8.35	n.a.
Light trucks	4.36	3.57	3.89	4.05	4.10	4.00	n.a.
Domestic total[2]	10.84	9.25	9.68	10.43	10.60	9.79	10.47
Autos	6.90	5.99	6.10	6.72	6.84	6.12	6.35
Light trucks	3.95	3.26	3.57	3.71	3.76	3.67	4.12
Import total	3.01	2.54	2.67	2.64	2.63	2.56	n.a.
Autos	2.60	2.23	2.36	2.30	2.30	2.23	n.a.
Light trucks	.41	.31	.32	.34	.33	.33	n.a.

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

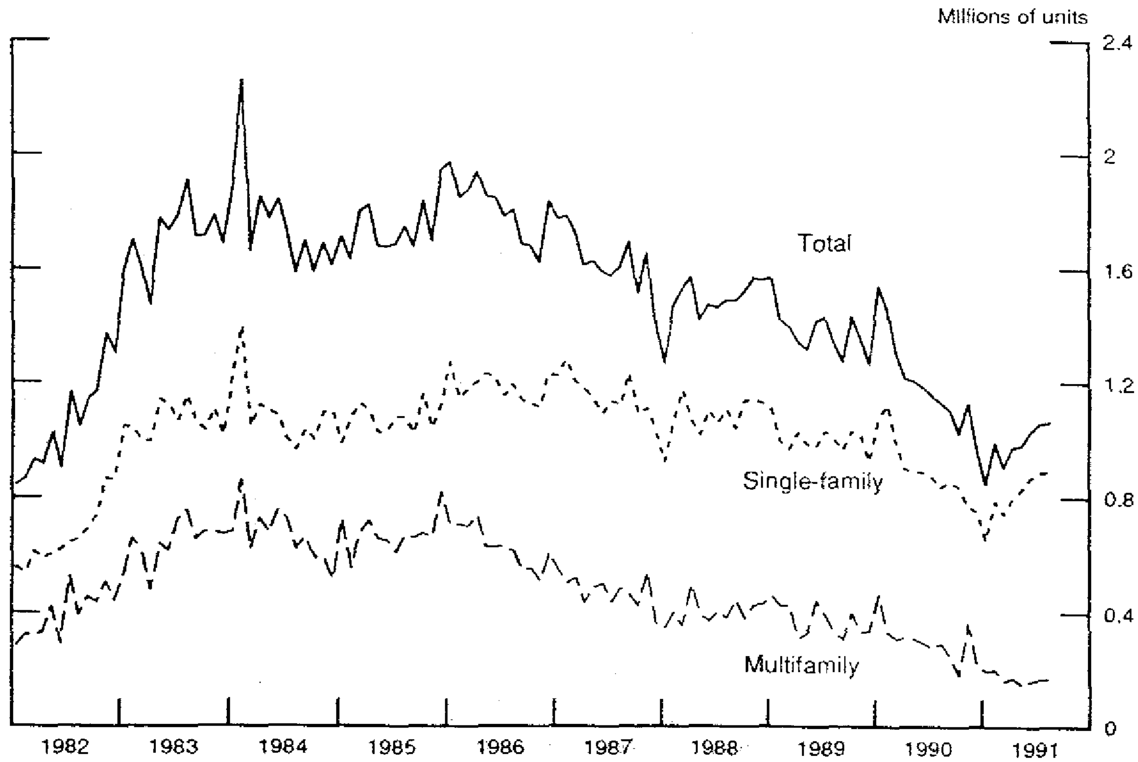
Unit sales of cars and light trucks fell from a June-July average of 13.2 million units at an annual rate to 12.4 million units in August, but they apparently have rebounded this month. Reduced sales of domestically produced autos accounted for almost all of the August decline; sales of imported vehicles and domestic light trucks held steady. To some extent, the August weakness in

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

	1990 Annual	1990 Q4	1991 Q1	1991 Q2[r]	1991 June[r]	1991 July[r]	1991 Aug.[p]
All units							
Permits	1.11	.90	.86	.96	1.00	1.01	.96
Starts	1.19	1.04	.92	1.00	1.03	1.06	1.07
Single-family units							
Permits	.79	.67	.67	.76	.78	.79	.77
Starts	.90	.79	.73	.83	.87	.89	.89
Sales							
New homes	.53	.47	.47	.51	.52	.47	n.a.
Existing homes	3.30	3.12	3.09	3.48	3.59	3.32	3.25
Multifamily units							
Permits	.32	.23	.19	.20	.22	.21	.19
Starts	.30	.26	.19	.16	.17	.17	.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)



sales of domestic autos evidently was a reflection of a bunching of purchases around mid-year by the daily rental fleets, in response to impending changes in automakers' fleet repurchase programs. In the first twenty days of September, sales of domestic cars retraced part of their August decline, and sales of domestically produced light trucks strengthened considerably.

Housing Markets

The recovery in housing activity showed signs of stalling this summer. In the single-family market, starts edged up 0.6 percent in August, while permits--a more reliable indicator of the onset of construction--declined 2.9 percent. The flattening of production appears to be a response to some softening in demand for single-family housing. New home sales declined 8 percent in July; sales of existing homes fell 7 percent in July and then declined another 2 percent in August. The falloff in sales is consistent with trade association reports from home builders.

Sales have been weak despite relatively favorable cash-flow housing affordability as gauged by the customary measures of mortgage payments relative to income. However, the impetus from this positive factor has been damped, perhaps by diminished expectations of capital gains from homeownership, an oversupply of apartments that keeps downward pressure on rents, and uncertainties about the economic outlook and job security.

In the multifamily sector, construction has remained near its thirty-year low. Multifamily starts were at 173,000 units in August; activity has been close to this level all year. Permit issuance for multifamily construction fell 12.3 percent in August, to a level about in line with starts. The low level of construction

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

	1990	1991		1991		
	Q4	Q1	Q2	June	July	Aug.
Producers' durable equipment						
Shipments of nondefense capital goods	1.4	-2.2	1.4	2.2	-3.3	1.3
Aircraft and parts	-2.2	2.9	5.4	7.3	-7.0	5.1
Excluding aircraft and parts	2.2	-3.3	.5	1.0	-2.3	.4
Office and computing	4.2	-3.9	-.8	1.0	.4	-.4
All other categories	1.6	-3.1	.9	1.0	-3.1	.6
Shipments of complete aircraft	-3.2	4.4	8.6	-1.1	.4	5.0
Weighted PDE shipments (incl. air)[1]	1.8	-3.6	1.6	.3	-1.6	.4
Sales of heavy-weight trucks	-10.8	-9.1	-7.4	3.8	5.2	-5.6
Orders of nondefense capital goods	5.3	-6.6	-13.6	4.4	25.5	-16.0
Excluding aircraft and parts	.8	-4.0	-1.8	-4.6	5.0	-2.7
Office and computing	-7.0	3.6	-1.6	-2.4	-2.5	1.4
All other categories	3.3	-6.1	-1.9	-5.2	7.4	-3.9
Nonresidential structures						
Construction put-in-place	-5.5	-4.4	-2.9	-2.8	.5	n.a.
Office	-6.0	-6.6	-5.3	-3.7	1.7	n.a.
Other commercial	-11.0	-10.6	-3.6	-7.5	-2.1	n.a.
Public utilities	1.3	-.7	.4	2.5	-.3	n.a.
Industrial	-6.0	.6	-3.8	2.0	4.8	n.a.
All other	-5.7	-4.0	-3.1	-6.8	-.5	n.a.
Rotary drilling rigs in use	-2.8	.9	-8.4	3.7	-4.6	-9.3
Footage drilled[2]	5.6	-9.7	-15.3	8.8	-6.8	n.a.

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.

has diminished the importance of multifamily housing in total residential investment. Only 8 percent of residential investment expenditures (and 0.3 percent of GNP) now is attributable to multifamily construction.[5] These percentages were about twice as large in 1986, before multifamily construction began its decline.

Business Fixed Investment

A hint of firming is evident in the indicators of business equipment spending. Recent data suggest that growth in real outlays for equipment probably has been slightly positive again in the quarter now ending; these outlays grew at a 2 percent annual pace in the second quarter, after plunging in the first quarter of 1991.

The composition of growth this quarter has remained much the same as in the second quarter: Declines in spending on industrial equipment have been more than offset by increased investment in computers and, to a lesser extent, transportation equipment. In nominal terms, average shipments in July and August of nondefense capital goods excluding aircraft and computing equipment were 1-1/2 percent below the second-quarter level, suggesting a significant decline in real outlays for these items. However, the nominal value of computer shipments during the past two months have averaged slightly above the second-quarter level. With continuing declines in computer prices, the gains in real spending on computers this quarter probably have been fairly robust.[6] Furthermore,

5. By comparison, new single-family construction accounts for 46 percent of residential investment and 1.7 percent of GNP. The remaining 46 percent of residential construction mainly reflects spending for residential improvements and commissions paid to real estate agents.

6. The average level of the PPI for electronic computers in July and August was 30 percent below the second-quarter level (annual rate).

during July and August, average shipments of complete aircraft and average sales of heavy trucks were both above their second-quarter levels, suggesting that spending on transportation equipment continued to increase this quarter as well.

Looking ahead, the prospects for a near-term improvement in the growth of equipment investment appear to be favorable. New orders in August for nondefense capital goods other than aircraft and computers fell 4 percent but, on the basis of earlier increases, remained about 2 percent above the second-quarter level. In addition, the persistence of a large backlog of unfilled orders for aircraft should ensure increases in future production of planes.[7] Indeed, with many start-up problems resolved and a new system of production management in place, McDonnell-Douglas is doubling the pace of production--to a rate of one aircraft per week--of the new MD-11 tri-jet, thus facilitating a speed-up of deliveries. In addition, Boeing continues to make small, steady increases in aircraft production.

Significant increases in real spending on computers are likely during the rest of this year. In the past two weeks, IBM has begun to ship the two most powerful models of the new generation of mainframes that the company unveiled a year ago.[8] Analysts expect IBM to ship about 250 to 300 of these machines this year at an average (current-dollar) cost of about $15 million apiece.

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7. American Airlines recently announced that it would cancel some of its options to buy aircraft, but this cancellation applies to deliveries in 1993 and beyond. Also, this action will have no immediate effect on the reported backlog of orders (which is reported net of cancellations) because options are not entered in manufacturers' official order books.
8. The new computers are water-cooled models in the ES/9000 line.

Although many of these shipments undoubtedly will displace sales of other mainframes, total investment in computers still seems likely to rise.

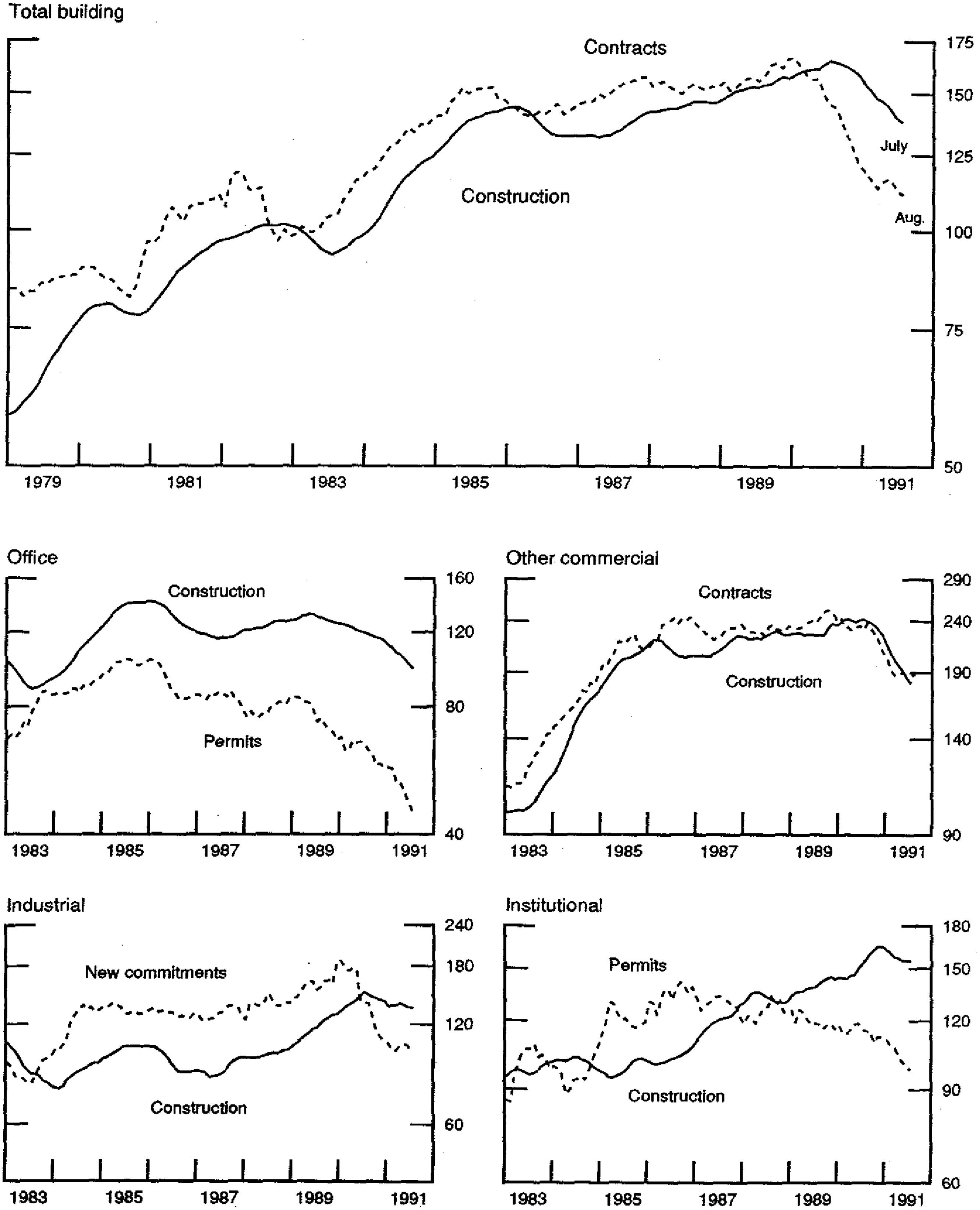
Real outlays for nonresidential structures appear likely to continue to plunge in the near term. The nominal value of construction put in place in July was almost 4 percent below the second-quarter level (not an annual rate). Although industrial construction appears to have stabilized, the overwhelming influence on construction is the ongoing reduction in office, other commercial, and hotel building. The prospects for construction put in place over the long term also remain bleak, as the value of new construction contracts has been trending down since 1989.

Drilling and mining, which declined 12-1/2 percent during the first half of this year, is likely to fall even further in the current quarter. Indeed, the number of drilling rigs in use during July and August was 7-3/4 percent below the second-quarter level. This decline largely reflects the spectacular drop in natural gas spot prices this year; if these prices remain close to their current levels, drilling appears likely to suffer further declines in the near term.

The latest Commerce Department survey of business plans for plant and equipment indicates a 0.5 percent rise in nominal outlays this year (in terms of annual averages). These plans, which were collected in July and August, are 2-1/4 percentage points lower than those reported in the spring. By now, of course, these annual figures are reflecting the weight of past quarters to a substantial degree; their usefulness in gauging future trends in outlays is quite limited. For example, when used to forecast the increase in

Nonresidential Construction and Selected Indicators[1]

(Dec. 1982 = 100, ratio scale)



1. 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. Contracts extend through August.

plant and equipment spending between the second and fourth quarters over the past three decades, the July-August survey has a mean absolute error of more than four percentage points (annual rate). Thus, while the latest survey is pointing to a rise in nominal P&E spending of 6 percent at an annual rate over the last two quarters of 1991, the confidence interval around that figure is very wide.[9]

<u>Inventories</u>

Business inventories continued to decline rapidly early in the third quarter. In July, stocks in manufacturing and trade fell at an annual rate of $31.8 billion in current-cost terms, after drawdowns averaging $50 billion at an annual rate during the second quarter. Excluding the stocks of retail auto dealers, the July reduction amounted to almost $40 billion, about the same as the second-quarter pace. The inventory-sales ratio for manufacturing and trade excluding retail autos was about the same in July as that observed last year before the beginning of the downturn; it thus would appear that the intensive liquidation efforts of recent months have eliminated most of the imbalance that developed last winter.

Manufacturing stocks were liquidated in July at about the same rapid pace as in the second quarter. The decline in July was accompanied by sizable gains in shipments, and the sector's inventory-to-shipments ratio moved down another step, into the lower portion of the range seen over the past year (chart). At the

9. The July-August P&E survey may overstate investment plans because of its low sample coverage in several crucial industries that likely have posted large declines. In particular, a large component of commercial construction activity is excluded from this survey because spending plans for the real estate industry are reported only annually, in the January-March survey.

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

	1990	1991		1991		
	Q4	Q1	Q2	May	June	July
Current-cost basis:						
Total	-.8	-29.3	-50.0	-62.2	-55.3	-32.7
Total excluding retail auto	9.1	-14.4	-42.2	-56.6	-42.4	-40.8
Manufacturing	-8.7	-11.3	-24.1	-39.2	-22.9	-27.4
Wholesale	10.5	4.7	-18.8	-17.0	-19.1	-14.9
Retail	-2.6	-22.7	-7.2	-5.9	-13.3	9.6
Automotive	-9.9	-14.9	-7.9	-5.5	-12.9	8.1
Excluding auto	7.3	-7.8	.7	-.4	-.4	1.5
Constant-dollar basis:						
Total	-21.8	-20.0	-22.7	-45.0	-14.8	n.a.
Total excluding retail auto	-11.4	-2.3	-21.4	-43.4	-12.3	n.a.
Manufacturing	-18.3	-1.3	-11.3	-25.5	-11.8	n.a.
Wholesale	5.8	6.0	-11.5	-13.5	-8.2	n.a.
Retail	-9.3	-24.7	.0	-6.1	5.2	n.a.
Automotive	-10.4	-17.6	-1.3	-1.6	-2.5	n.a.
Excluding auto	1.1	-7.1	1.3	-4.5	7.7	n.a.

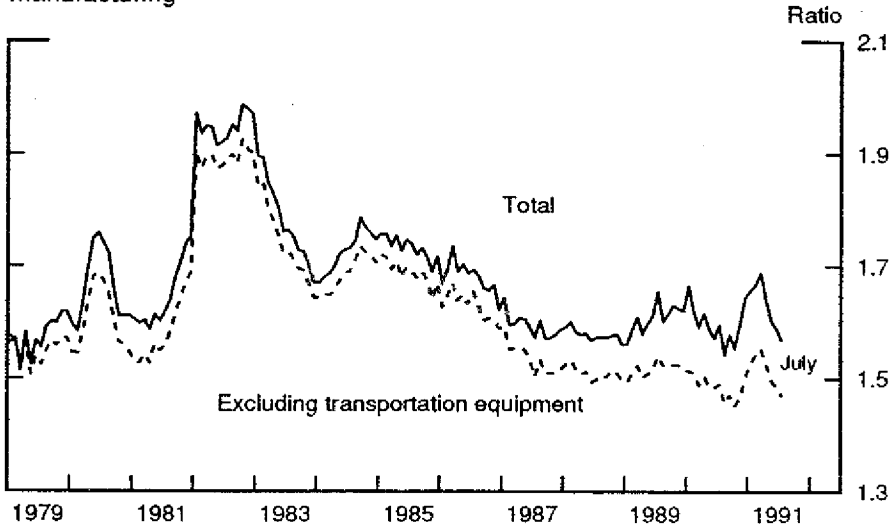
INVENTORIES RELATIVE TO SALES[1]
(Months supply; based on seasonally adjusted data)

	Range in preceding 12 months:[2] Low	High	1990 Q4	1991 Q1	1991 Q2	1991 May	1991 June	1991 July
Current-cost basis:								
Total	1.48	1.58	1.52	1.56	1.51	1.51	1.50	1.49
Total excluding retail auto	1.45	1.55	1.49	1.53	1.49	1.49	1.48	1.47
Manufacturing	1.54	1.69	1.59	1.66	1.60	1.60	1.59	1.57
Wholesale	1.26	1.38	1.31	1.37	1.32	1.34	1.32	1.30
Retail	1.54	1.65	1.60	1.58	1.55	1.55	1.54	1.54
Automotive	1.82	2.18	2.01	1.96	1.84	1.87	1.82	1.85
Excluding auto	1.46	1.52	1.49	1.48	1.47	1.46	1.47	1.46
Constant-dollar basis:								
Total	1.42	1.51	1.46	1.49	1.45	1.45	1.44	n.a.
Total excluding retail auto	1.39	1.49	1.44	1.48	1.44	1.43	1.43	n.a.
Manufacturing	1.44	1.55	1.48	1.53	1.48	1.48	1.47	n.a.
Wholesale	1.26	1.40	1.34	1.39	1.34	1.34	1.33	n.a.
Retail	1.50	1.60	1.55	1.52	1.51	1.50	1.50	n.a.
Automotive	1.61	1.89	1.77	1.68	1.63	1.63	1.61	n.a.
Excluding auto	1.46	1.53	1.50	1.48	1.47	1.46	1.47	n.a.

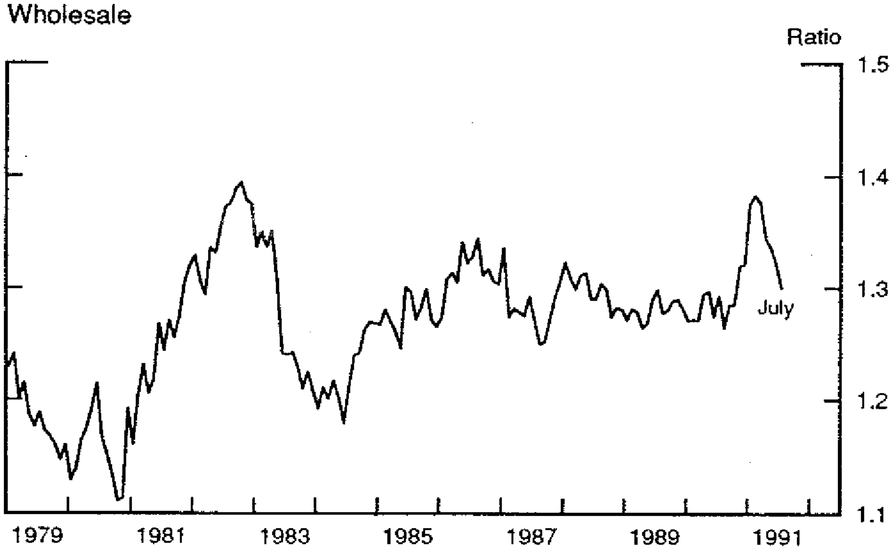
1. Ratio of end of period inventories to average monthly sales for the period.
2. Highs and lows are specific to each series and are not necessarily coincidental. Range is for the 12-month period preceding the latest month for which data are available.

Ratio of Inventories to Sales
(Current-cost data)

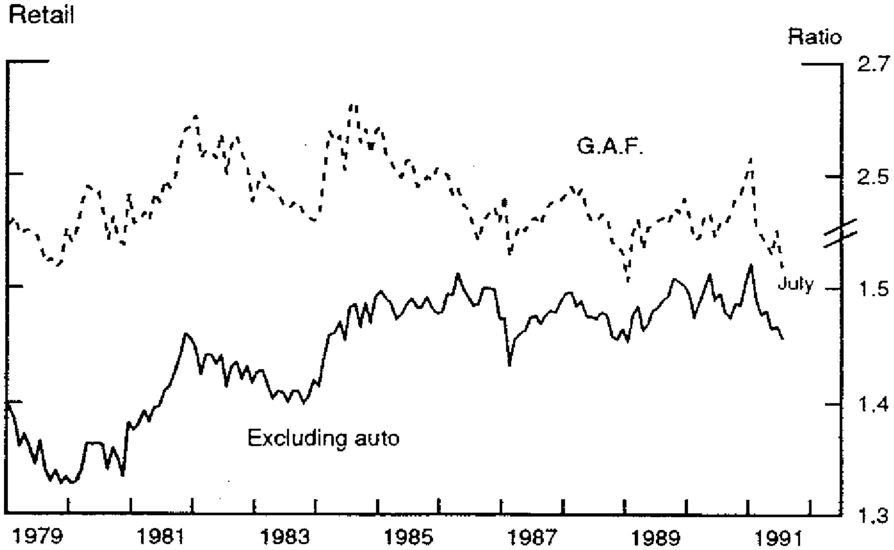
Manufacturing



Wholesale



Retail



industry level, nearly one-third of the July inventory runoff was in stocks of transportation equipment, in part reflecting a sharp (7.3 percent) rise in shipments of motor vehicles and automotive accessories in that month. Inventories in major materials-producing industries (primary metals, chemicals, paper and paper products, and rubber and plastics), where shipments were unusually brisk in July, also were reduced substantially. As a result of continued corrections since early spring, the inventory positions of these materials industries have shown marked improvement; nevertheless, except for rubber and plastics, their inventories remain above prerecession levels.

Wholesale inventories were trimmed further in July after sizable drawdowns in the preceding several months. The July liquidation was concentrated in a few categories of durable goods, particularly in stocks of machinery and business equipment. Before the second quarter of this year, wholesale machinery inventories had been rising persistently while shipments weakened. The sharp declines in machinery stocks in July, as well as drawdowns during the second quarter, helped to lower the inventory-sales ratio for this group of wholesale distributors; the July ratio was the lowest of the past year.

In retail trade, non-auto inventories expanded only slightly from April to July as sales advanced moderately. The inventory-sales ratio for retail establishments outside of auto dealers moved down to 1.46 months in July, quite a bit below the recession high of 1.52 months registered in January. For most types of retail establishments, especially the broad range of stores in the GAF grouping that sell largely discretionary consumption goods, inventory-sales ratios have fallen below their pre-recession levels.

Federal Sector

The federal unified budget deficit for July and August totaled nearly $85 billion, bringing the deficit for the first eleven months of the fiscal year to $261 billion; it was $241 billion for the first eleven months of the last fiscal year. In September, the final month of the fiscal year, the budget frequently shows a surplus--or a very small deficit--because receipts bulge with the filing of quarterly estimated personal and corporate income tax payments. This year, however, daily Treasury data indicate that a pickup in RTC outlays and continued weakness in tax collections will result in a moderate budget deficit for September. (Last year, September's social security benefits were paid in August, creating a record August deficit and a record September surplus.)

Receipts for July and August were 3 percent above a year earlier. Withholdings of income and social insurance taxes also increased about 3 percent, boosted, in part, by the legislated increase, from $51,000 last year to $125,000 this year, in the annual wages that are subject to Medicare taxes. The growth in these receipts, relative to a year earlier, will pick up in the second half, as workers whose earnings exceeded the old cap by this time last year now will be paying the tax through year-end. An extension of social insurance tax coverage to additional state and local workers also began adding to withholdings as of July 1. Federal receipts from excise taxes in July and August were 54 percent higher than a year earlier, partly reflecting the increases in the gasoline tax and other excise taxes enacted last

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS
(Billions of dollars, except where otherwise noted)

	July and August			October-August		
	1990	1991	Percent change	FY1990	FY1991	Percent change
Outlays	229.4	238.5	3.9	1169.6	1205.8	3.1
Social security advance[1]	20.2	.0	n.a.	20.2	.0	n.a.
Outlays excluding social security advance	207.2	238.5	14.0	1149.4	1205.8	5.0
Deposit insurance	6.5	19.2	197.3	48.2	49.9	3.4
National defense	51.4	51.9	1.0	277.8	250.6	-9.8
excluding DCA[2]	51.4	55.3	7.7	277.8	293.0	5.4
Net interest	32.7	33.6	2.8	168.5	179.2	6.3
Social security	41.8	45.2	8.3	227.7	246.4	8.2
Medicare and health	28.8	32.2	11.5	143.1	160.4	12.1
Income security	25.3	30.2	19.9	138.0	159.4	15.5
Other	22.8	26.2	14.9	146.0	160.0	9.6
Receipts	150.8	155.0	2.8	928.4	944.9	1.8
Withheld income taxes plus FICA	121.5	125.2	3.1	660.2	684.4	3.7
Nonwithheld income taxes	2.9	2.9	-3.1	60.5	46.3	-23.6
Other social ins. taxes	7.0	6.7	-3.2	48.5	51.0	5.1
Corporate income taxes	3.7	3.1	-16.1	76.2	79.5	4.4
Excise taxes	5.8	8.9	53.7	32.6	38.6	18.4
Other	10.1	8.2	-18.8	50.6	45.2	-10.6
Deficit	78.6	83.4	6.1	241.2	260.9	8.2
Deficit excluding social security advance	56.4	83.5	48.0	221.0	260.9	18.1

Details may not add to totals due to rounding.

1. The August 1990 figure includes the advance payment of September social security benefits because the first three days of September 1990 were nonbusiness days.

2. The Defense Cooperation Account, DCA, includes foreign contributions for Operation Desert Storm and interest payments on these contributions.

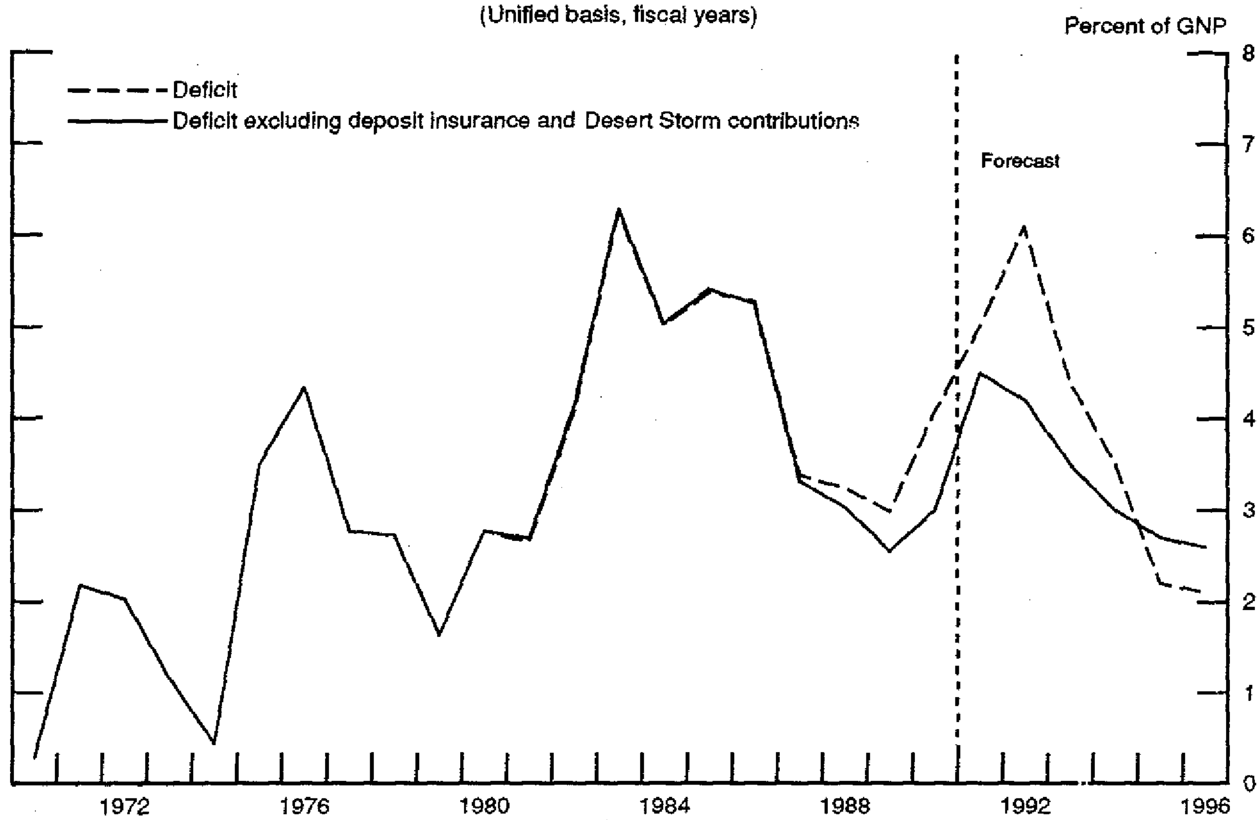
fall. Nonwithheld personal and corporate income taxes in September are running about 4 percent above a year earlier, according to the daily data.

Outlays in July and August were 14 percent above a year earlier, after adjusting for last year's shift in the timing of social security benefit payments. Deposit insurance outlays account for much of the increase. Outlays by the RTC, the FSLIC Resolution Fund, and the Bank Insurance Fund totaled $19 billion in July and August compared with $7 billion a year earlier. Daily data indicate that approximately another $16 billion have been spent by these entities in September. Elsewhere, the incoming data show continued increases in defense outlays (excluding foreign contributions for Desert Storm), rapid growth for Medicaid and income security, and increased outlays for some discretionary spending areas, such as administration of justice, education, and international affairs.

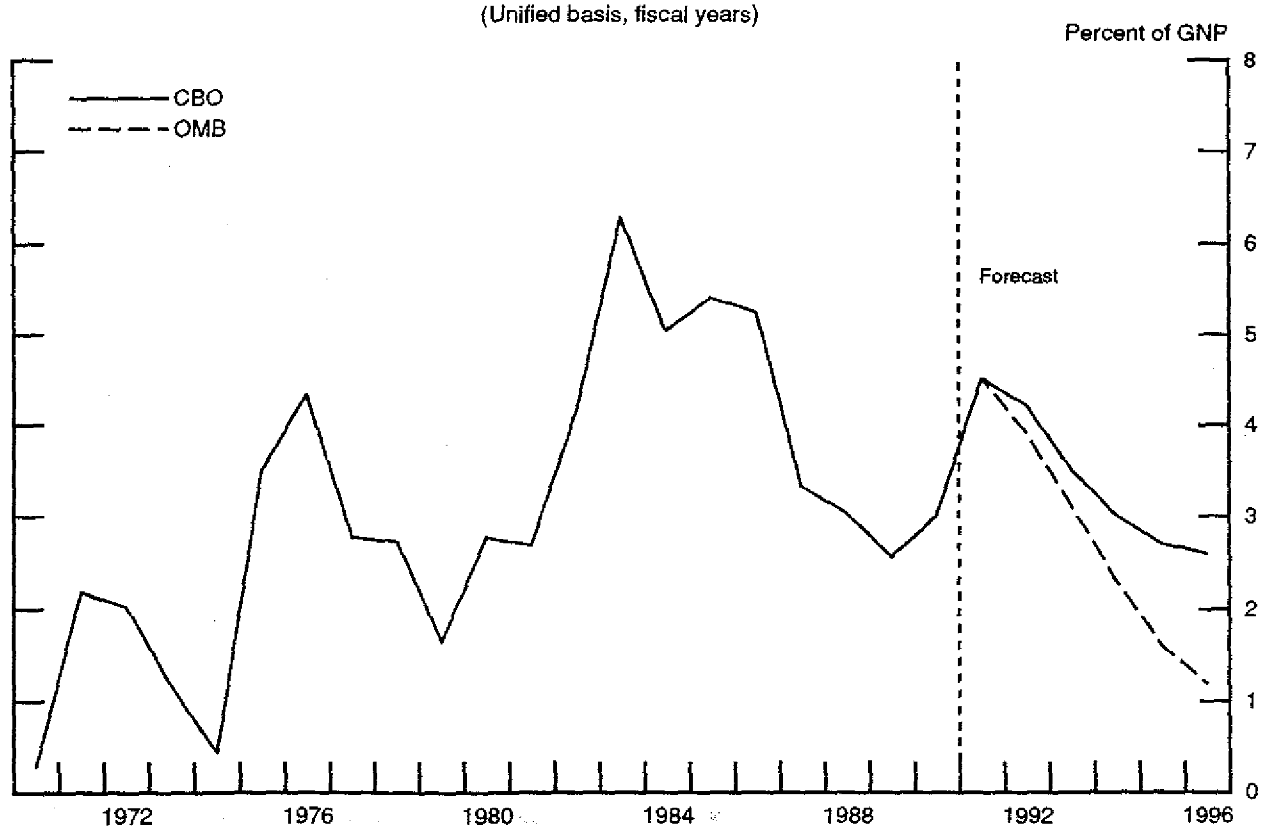
The Congress has passed only 3 of the 13 regular appropriations bills. Although most money issues have been resolved, many of the remaining bills have been delayed by disagreements over provisions concerning abortion. If these bills are not completed and signed by the President by October 1, a continuing resolution will be required to fund the government until the regular appropriations bills are passed. The bills, as they stand, appear to conform to last year's budget act. The Congress also is considering a five-year reauthorization of transportation programs and an extension of unemployment benefits.[10]

10. An appendix to this section focuses on the recent proposals to extend unemployment benefits.

CBO BASELINE DEFICIT
(Unified basis, fiscal years)



DEFICIT EXCLUDING DEPOSIT INSURANCE AND DESERT STORM CONTRIBUTIONS
(Unified basis, fiscal years)



The CBO issued its summer update of the budget outlook in mid-August. The near-term deficit estimates are similar to OMB's July projections. Specifically, the CBO projects a $279 billion deficit (5.0 percent of GNP) for the 1991 fiscal year, including $77 billion of deposit insurance outlays (chart). Data received since mid-August indicate that deposit insurance outlays and the deficit may be lower, however. The 1992 fiscal year deficit is projected to rise to $362 billion, even if the new budget law is adhered to, largely because of increases in net outlays for deposit insurance and the end of foreign contributions for Operation Desert Storm. The CBO has become more pessimistic about the longer-term outlook for the budget; it now expects the deficit, excluding deposit insurance, to fall only to $200 billion (2.6 percent of GNP) by 1996. In contrast, the Administration projects that this measure of the deficit will decline continuously and fall below $100 billion (1.2 percent of GNP) by 1996 (chart). The lower deficit forecast reflects the Administration's more optimistic assumptions for real GNP growth.

State and Local Government Sector

Real purchases of goods and services by state and local governments apparently have continued to contract in the third quarter. Employment in the sector fell sharply in both July and August; the total decline amounted to about 100,000, according to preliminary data. Although cuts in hiring appear to have been widespread, the largest declines, purely in terms of the number of workers, seem to be in education employment at the local level, a category that makes up about 40 percent of state and local employment. Real outlays for construction, which account for

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 July	1991 Aug.
				-----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	-.6	-.3
Energy	8.2	5.1	18.1	18.0	-30.7	-1.2	-.4	-.2
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	.4	.5
Services	51.1	5.3	6.0	4.8	6.4	3.0	.3	.3
Memorandum:								
CPI-W[3]	100.0	4.5	6.1	5.0	1.5	3.3	.1	.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 July	1991 Aug.
				-----Annual rate------			-Monthly rate-	
Finished goods	100.0	4.9	5.7	5.1	-3.5	.7	-.2	.2
Consumer foods	23.7	5.2	2.6	1.3	1.0	-.3	-.8	-.4
Consumer energy	16.8	9.5	30.7	21.1	-35.5	.0	-1.3	1.8
Other finished goods	59.5	4.2	3.5	3.5	5.4	1.2	.2	.2
Consumer goods	36.4	4.4	3.7	3.4	5.9	.9	.4	.3
Capital equipment	23.1	3.8	3.4	3.3	4.6	1.3	.1	.1
Intermediate materials[2]	95.2	2.5	4.6	4.2	-9.8	-1.0	-.3	.4
Excluding food and energy	78.5	.9	1.9	2.3	-2.3	-1.0	-.1	.0
Crude food materials	34.4	2.8	-4.2	-7.3	.0	-12.5	-1.7	-1.8
Crude energy	50.7	17.9	19.1	-18.8	-54.0	-1.5	2.0	1.3
Other crude materials	14.9	-3.6	.6	-18.1	-4.7	-13.0	-.7	.5

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

13 percent of state and local purchases, fell again in July to a level about 1 percent below the second-quarter average. Further large reductions in spending for highways and sewer systems were reported. Apparently, many governments have postponed expenditures on construction projects and have laid off workers to cope with recent fiscal difficulties.

According to a recent survey by the National Association of Counties, about 40 percent of all large counties--those with populations of 100,000 or more--are facing deficits in fiscal year 1991.[11] About half are trying to close their budget gaps through expenditure reductions alone; another 40 percent are cutting spending and raising revenue; and only 8 percent are attempting to balance their budgets solely through revenue-raising measures. The current budget problems have resulted from a "structural fiscal gap" and from the effects of the recession. The counties blame the underlying problems on a period of declining federal assistance, an escalation in the number and costs of services, and a wave of unfunded federal and state mandates.

Prices

Inflation appears to be slowing gradually. Both the CPI and the PPI for finished goods rose 0.2 percent in August, held down in part by declines in food prices. Although the CPI excluding food and energy has risen faster in recent months than it did in the spring, the twelve-month change in this indicator of core inflation has continued to edge down; the slowing over the past year amounts

11. Around half of all counties begin their fiscal year on January 1, another 25 percent begin the year on July 1, and the remainder start the year on September 1 or November 1. Spending at the county level accounts for 13 percent of total state and local outlays.

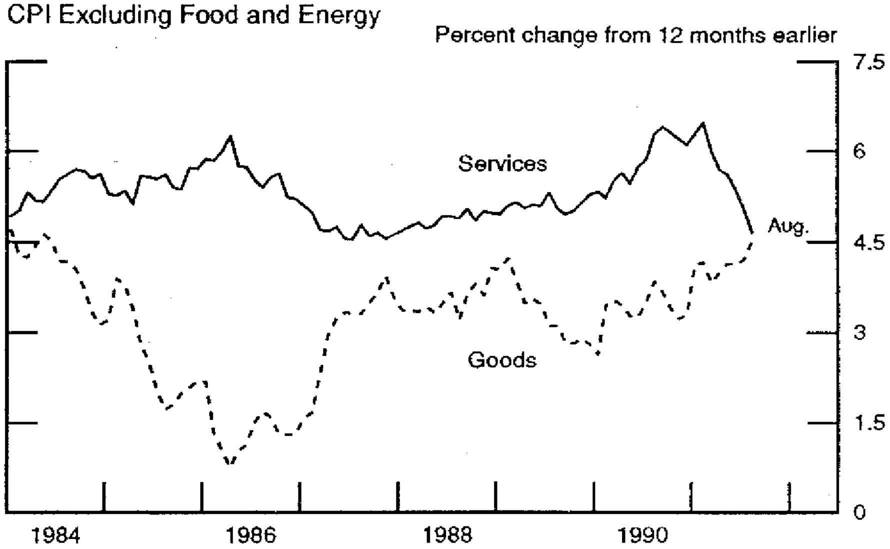
to nearly 1 percentage point. Moreover, the elements of a gradual deceleration of inflation still seem to be in place: The unemployment rate is well above the estimated "natural" rate; the trend of wage increases has slowed; expectations of inflation are easing; and upward pressures from import prices, energy prices, and commodity prices have been virtually absent.

Food prices fell in August for a second month. As in July, a steep drop in the prices of fruits and vegetables more than accounted for the August decline. Excluding the prices of fruits and vegetables, which have been enormously volatile from month to month, the CPI for food has risen 0.1 to 0.2 percent in almost every month since the start of the year. Overall, food prices have slowed sharply this year after rising 5 percent or more in each year from 1988 to 1990; in August the index for food was only 2.3 percent above the level of a year earlier. Increases in supplies in some areas--notably, of meats and poultry--have helped to shape this deceleration. However, the slowdown also has extended to most other food groups, including many for which prices typically are affected much more by the costs of nonfarm inputs than by supply conditions in agriculture. Thus, much of the deceleration in food prices this past year probably is, in fact, a reflection of many of the same forces that are contributing to a gradual deceleration of prices in the general economy. In the farm sector, futures prices for grain have been firming of late; production prospects diminished a bit further in August, and traders are speculating that farm exports, which have been weak, will be boosted by increased aid to the states emerging from the break-up of the Soviet Union.

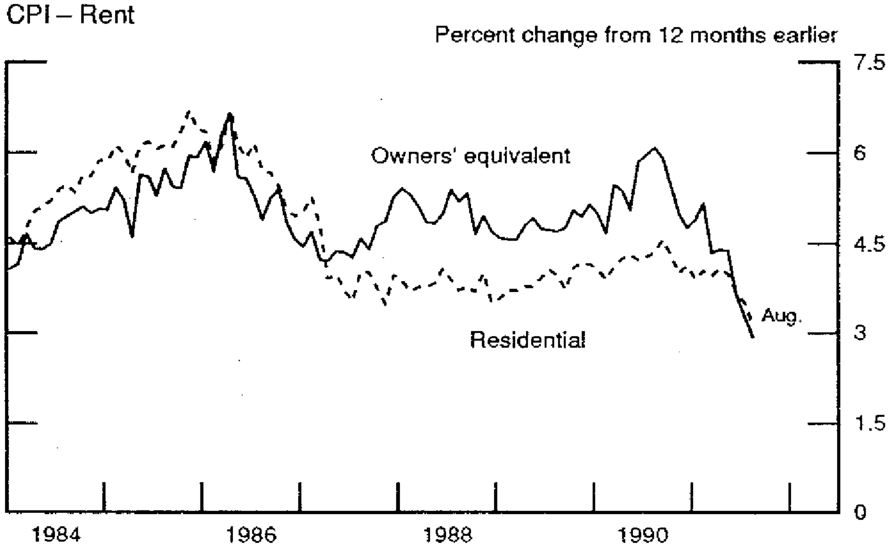
Energy prices edged down 0.2 percent further in the August CPI, as declines in natural gas and electricity rates more than offset a pickup for motor fuels and fuel oil. Gasoline prices posted a small increase (after seasonal adjustment) at retail and were up sharply at the refinery level. The recent upward pressures on gasoline prices mainly have reflected a tight inventory situation owing to reduced imports and some domestic refinery problems. Now, according to private surveys, the inventory tightness appears to be easing and retail prices in September were little changed, before seasonal adjustment, although the CPI for gasoline may post a small increase on a seasonally adjusted basis.

August was the third consecutive month in which the CPI excluding food and energy items rose 0.4 percent; increases in the three preceding months were 0.1 percent or 0.2 percent. The recent increases reflect, in part, problems with seasonal adjustment and some recent bunching of increases in prices and in state and local sales and excise taxes. The apparel index was raised in both July and August by the early introduction of higher-priced fall and winter clothing into the CPI sample; these increases accounted for about half or more of the advances in the CPI for goods other than food or energy in those two months. Large increases also were registered in August for some other goods, notably for prescription drugs. Prices of new motor vehicles were up 0.2 percent, reflecting somewhat less discounting than usually occurs near the end of the model year. In the services component, tuition and other school fees rose more than 1 percent, as higher charges for the new academic year were introduced into the sample earlier than "expected" by the CPI seasonal factors. Medical service costs also

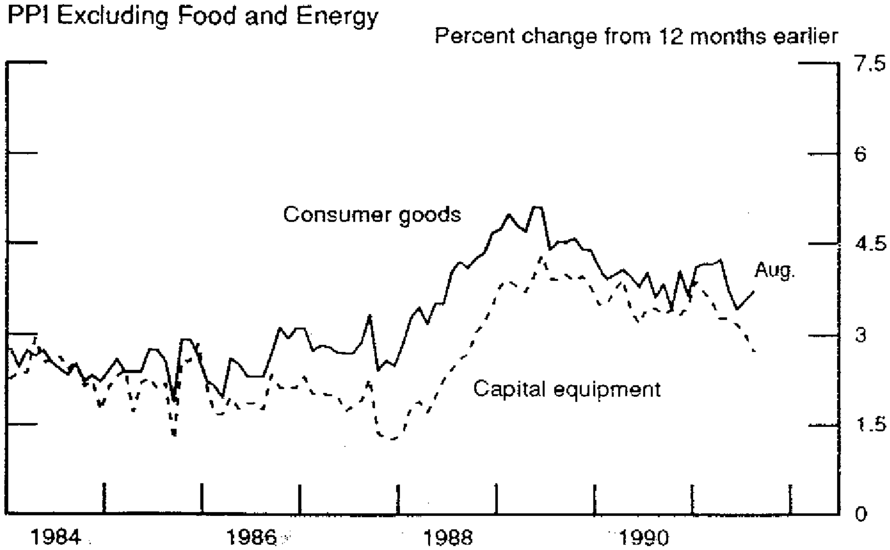
CPI Excluding Food and Energy



CPI – Rent



PPI Excluding Food and Energy



posted a large increase, and airfares turned up. Nevertheless, the index for nonenergy services rose a moderate 0.3 percent, held down by the rent components.

This past year has brought a marked deceleration in the CPI for nonenergy services. The twelve-month change in this index (chart) has eased, as of August, to less than 5 percent; from the summer of 1990 into the early months of 1991, the pace had been 6 percent or more. A sharp slowing in rent increases, reflecting weak rental markets, accounts for most of this deceleration.[12] The CPI for both residential (tenants') rent and owners' equivalent rent rose only about 3 percent over the twelve months ended in August, compared with increases of about 4-1/2 percent and 6-1/4 percent, respectively, over the preceding twelve-month period. There has been much less deceleration, on average, in price increases for other services.

In contrast to services, the CPI for nonfood, nonenergy commodities has risen faster over the past twelve months than it did during the preceding year--about 4-1/2 percent compared with 3-3/4 percent. A portion of this acceleration can be attributed to the higher federal excise taxes on alcoholic beverages and tobacco products effective in January as well as to the recent increases in excise and sales taxes at the state and local levels. However, prices of new motor vehicles have risen 4-1/4 percent over the year--more than 2 percentage points above the increase during the preceding year--contributing about 0.4 percentage point to the

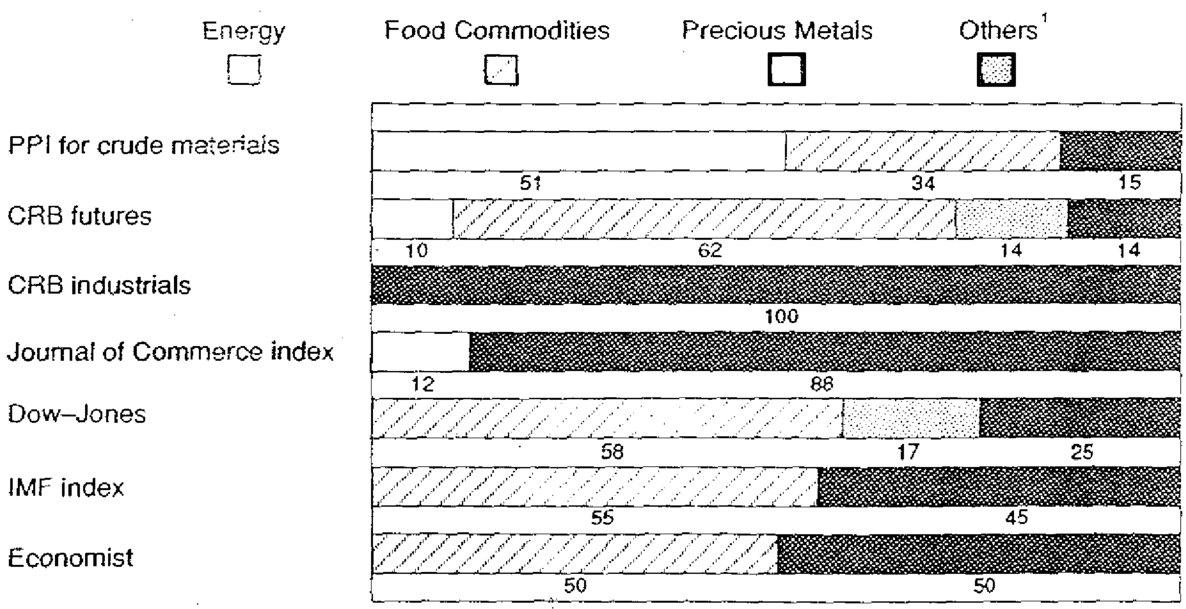
12. As of December 1990, rents had a relative importance weight in the CPI for nonenergy services of almost one-half.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last observation	Percent change[2] 1989	1990	1991 To Aug. 13[3]	1991 Aug. 13[3] to date	Memo: Year earlier to date
1. PPI for crude materials[4]	Aug.	7.1	6.0	-10.2	n.a.	-10.0
1a. Foods and feeds	Aug.	2.8	-4.2	-5.0	n.a.	-9.5
1b. Energy	Aug.	17.9	19.1	-15.3	n.a.	-9.2
1c. Excluding food and energy	Aug.	-3.6	.6	-5.1	n.a.	-10.3
1d. Excluding food and energy, seasonally adjusted	Aug.	-3.6	.5	-4.8	n.a.	-10.3
2. Commodity Research Bureau						
2a. Futures prices	Sept. 24	-9.0	-2.7	-6.3	4.3	-9.1
2b. Industrial spot prices	Sept. 23	-5.9	.6	-7.6	-2.7	-15.2
3. *Journal of Commerce* industrials	Sept. 24	1.3	-2.4	-3.8	.4	-10.2
3a. Metals	Sept. 24	-7.2	-3.9	-4.3	-.7	-12.4
4. Dow-Jones Spot	Sept. 24	-10.1	-1.7	-6.5	.9	-9.5
5. IMF commodity index[4]	Aug.	-12.9	-5.6	-1.2	n.a.	-6.5
5a. Metals	Aug.	-23.4	-3.0	-7.9	n.a.	-20.2
5b. Nonfood agric.	Aug.	-4.6	-3.5	3.0	n.a.	-1.1
6. *Economist* (U.S. dollar index)	Sept. 17	-22.8	-4.4	-7.7	.5	-20.2
6a. Industrials	Sept. 17	-23.8	-3.2	-10.3	-2.5	-27.9

1. Not seasonally adjusted.
2. Change is measured to end of period, from last observation of previous period.
3. Week of the August 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.

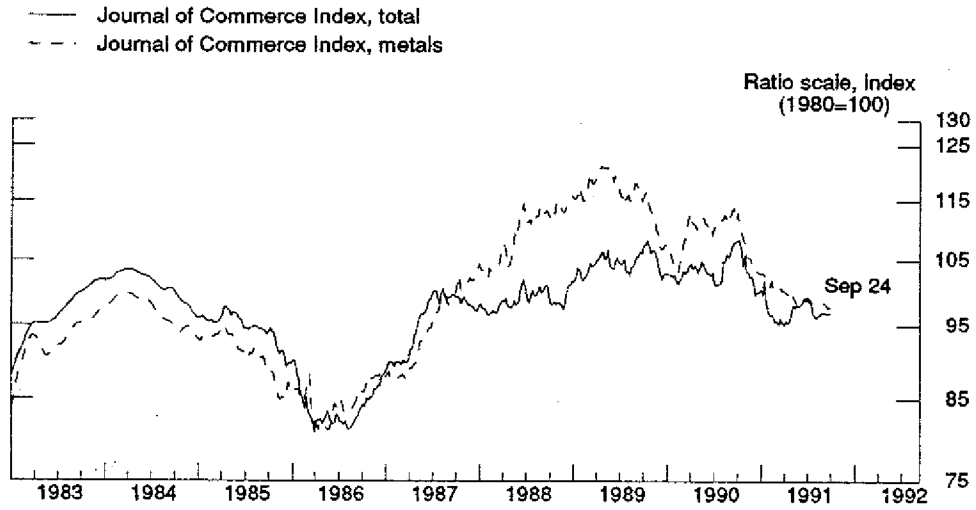
acceleration in this CPI goods component. Slowing in some other goods categories, notably apparel, was partially offsetting.

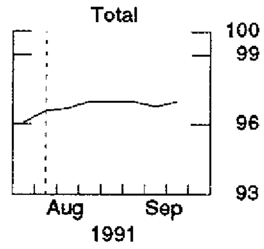
At the producer level, the twelve-month rise in the PPI for finished consumer goods (nonfood, nonenergy), although down from the first-quarter pace, does not appear markedly different from that posted over the year ended in August 1990. However, capital equipment prices were up less than 3 percent over the past year, compared with an increase of about 3-1/2 percent over the preceding year. This deceleration reflects smaller price increases for agricultural machinery, construction machinery and equipment, machine tools, commercial furniture, and some other capital equipment items.

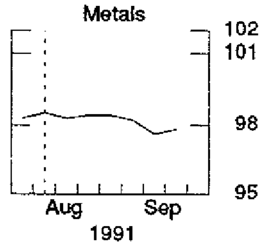
At earlier stages of processing, prices of intermediate materials less food and energy were unchanged, on average, in August and appear to be flattening out after retreating earlier in the year. The PPI for crude nonfood materials less energy posted its first increase since January, mainly owing to higher prices for some nonferrous metal scrap and ores. The index remained about 10 percent below its level of a year earlier. More recently, price movements in spot commodity markets, have been mixed, with the changes relatively small, on balance. The *Journal of Commerce* index of industrial prices, has changed little, on net, since the August FOMC meeting; the sub-index for metals, while remaining in a narrow range, has edged down somewhat further, on net.[13]

13. The CRB futures index has been boosted since mid-August by increases in the prices of some foodstuffs.

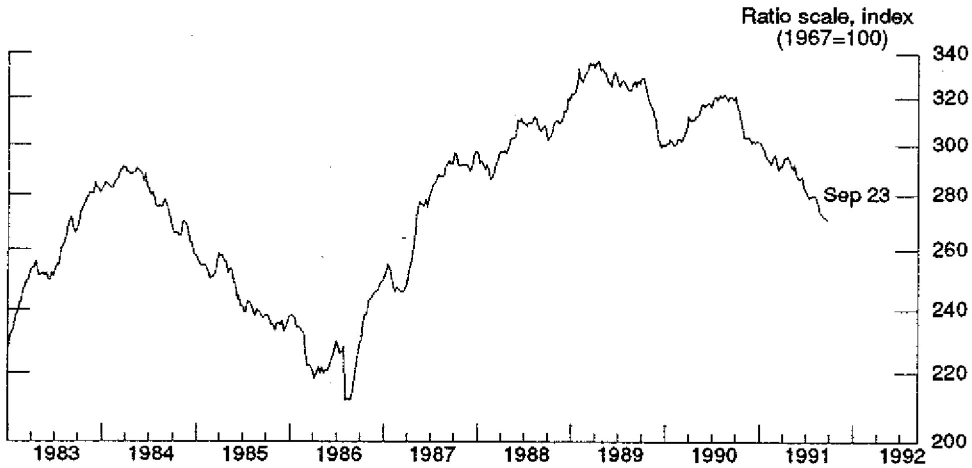
COMMODITY PRICE MEASURES *

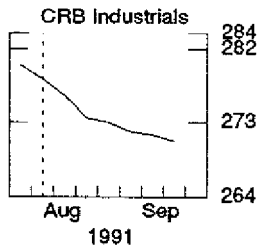




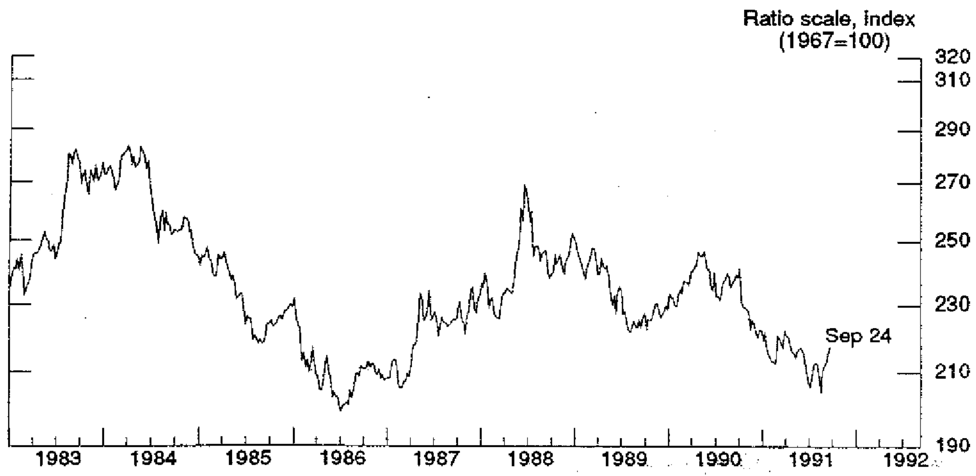


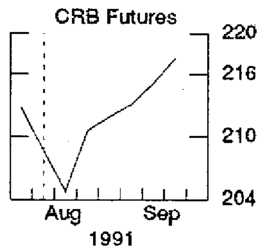
CRB Spot Industrials





CRB Futures

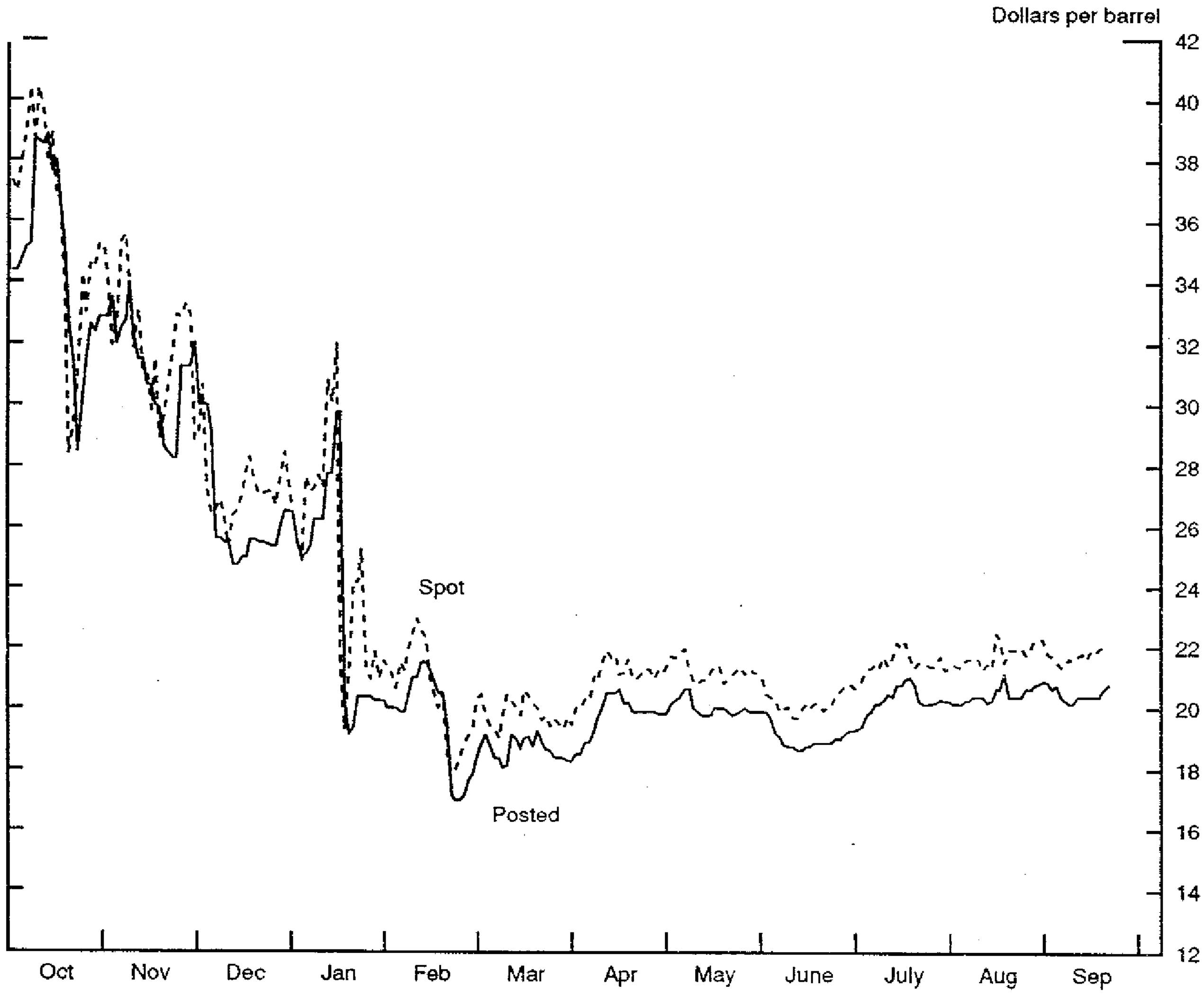




* Weekly data, Tuesdays; Journal of Commerce data monthly before 1985

Dotted lines indicate week of last Greenbook.

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		
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	20.40	21.69
September [1]	20.48	21.76

1. Price through September 24.

APPENDIX

THE DEBATE OVER EXTENDED UNEMPLOYMENT BENEFITS

The Congress is considering legislation that would extend additional unemployment insurance (UI) benefits to long-term unemployed workers who have exhausted their regular UI benefits. The current proposals follow passage of similar legislation in August. The President signed the earlier legislation but negated its effectiveness by failing to declare the budget emergency necessary to provide funding for an extended benefits program. This appendix describes the existing laws covering extended UI benefits, discusses the issues surrounding the current debate, and summarizes the changes proposed in the legislation now under consideration.

Background

The extended benefits program for unemployment insurance was first established in the 1970 amendments to the Social Security Act. The program offered an additional thirteen weeks of unemployment compensation to unemployed workers who had exhausted their regular UI benefits (usually lasting twenty-six weeks), with the additional benefits jointly funded by the state and federal governments.[1] In the original program, extended benefits were triggered nationally when the insured unemployment rate (IUR) for the United States rose above 4.5 percent. In addition, extended benefits were triggered for an individual state if the state's IUR exceeded 4 percent for a thirteen-week period and the state IUR was 120 percent of its average in the same period in the preceding year or, at the state's option, if the state IUR exceeded 5 percent regardless of its level in the preceding year.

In 1981, the Omnibus Budget Reconciliation Act revised the criteria used to trigger the extended benefits program.[2] The national trigger was eliminated, and the basic state IUR trigger was raised to 5 percent with the provision that the state IUR was at least 120 percent of its average in the corresponding weeks in the preceding <u>two</u> years.[3] In addition, the optional trigger was raised from 5 percent to 6 percent. Currently, extended benefits

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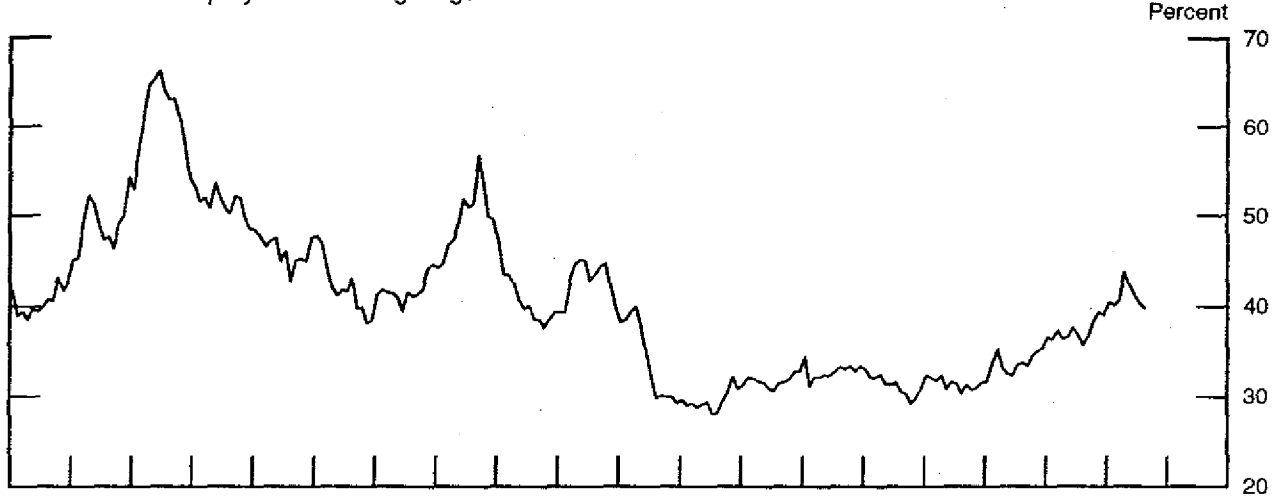
1. The strict rule is that no claimant may receive more than 39 times their regular weekly benefit from the regular and extended benefits programs. In most states, the weekly extended benefit payments are the same as under the regular state program and last for one-half the number of weeks that the regular payments were received.

2. The revisions to the extended benefits program did not take effect until October 1, 1982. At the same time, the Congress enacted the Federal Supplemental Compensation program, which was in effect from September 1982 through March 1983. This program paid additional benefits of up to six weeks in all states, up to eight weeks in states with an IUR at or above 3.5 percent, and up to ten weeks in states that had offered extended benefits after June 1, 1982.

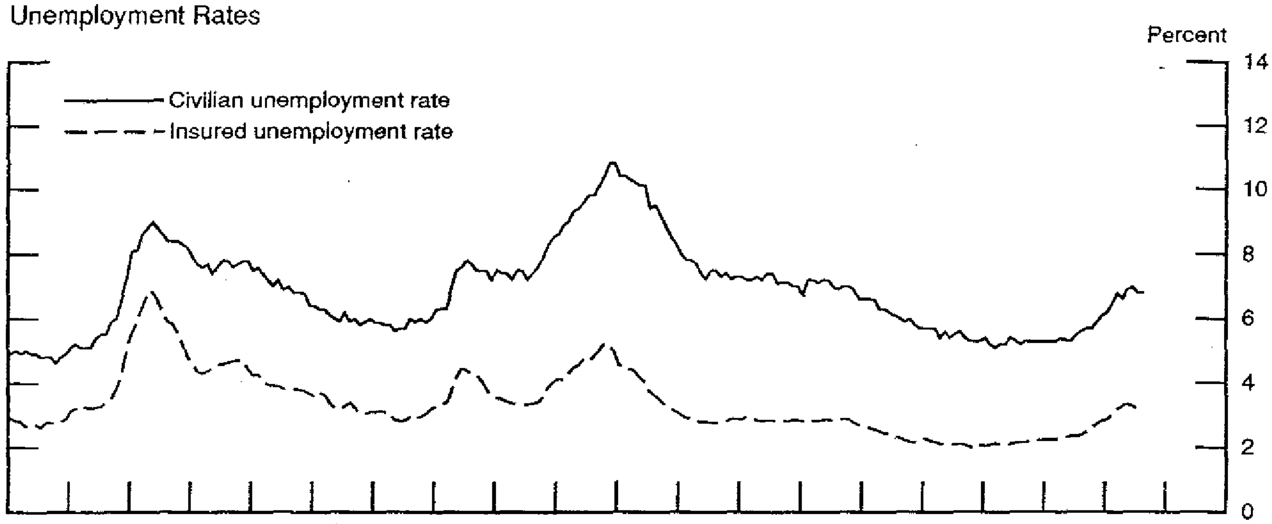
3. Once the trigger has deactivated extended benefits in a state, the state must remain in that status for at least thirteen weeks.

UNEMPLOYMENT INSURANCE BENEFITS

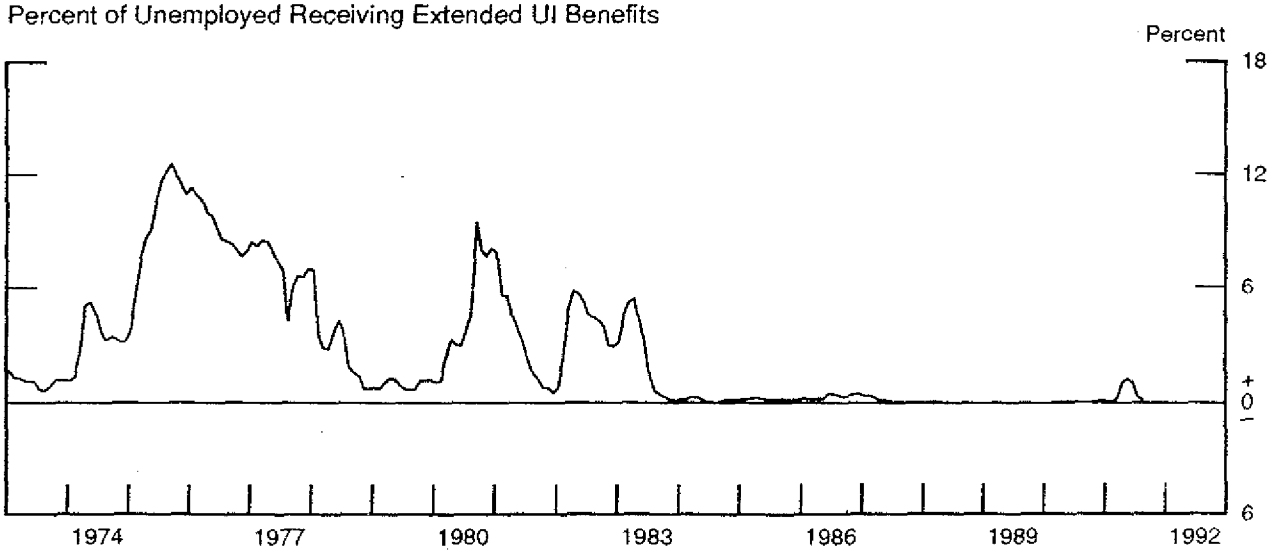
Percent of Unemployed Receiving Regular UI Benefits



Unemployment Rates



Percent of Unemployed Receiving Extended UI Benefits



are available only in Rhode Island and Puerto Rico, although the program was activated at some point this year in seven other states.[4]

Issues Underlying the Current Debate

The impetus for the recent proposals to expand the extended benefits program appears to stem from three developments. First and most obvious, the economic recession and the resulting rise in unemployment have led to real and clearly visible hardships for many individuals. The new proposals represent a straightforward way to aid the unemployed population.

Second, there is clear evidence that the unemployment insurance system over the past decade has been less effective than it was in the 1970s as an income support program for the unemployed. Although the fraction of employed workers covered by the UI system has risen to more than 90 percent, the percentage of the unemployed receiving unemployment insurance benefits trended down through the mid-1980s; in the latest recession about 45 percent of the unemployed received UI benefits, compared with nearly 70 percent in 1975 (chart, top panel). Similarly, whereas the insured unemployment rate stood at nearly 80 percent of the civilian jobless rate in the mid-1970s, it was less than half the level of the civilian unemployment rate in the recent recession (middle panel).

Researchers have identified several likely causes of the decline in the ratio of UI recipients to total unemployment, although no study has been able to account completely for the decline.[5] Among the reported causes are changes in state and federal laws in the late 1970s and early 1980s--most notably, tighter state eligibility requirements, partial taxation of UI benefits, and the incorporation of compulsory pension-offset provisions. However, other factors also have been linked to the decline in the use of the UI system. Most notable among these are the shrinkage of the manufacturing sector (where laid-off workers apparently are more likely to file UI claims), shifts in the geographic distribution of unemployment away from high-coverage regions such as the Northeast toward low-coverage regions such as the South-Central, and a puzzling decline in the proportion of the UI-eligible unemployed who file for UI benefits (the so-called takeup rate).[6]

4. Alaska, Maine, Massachusetts, Michigan, Oregon, Vermont, and West Virginia.

5. The three most comprehensive studies available are Gary Burtless, "Why is Insured Unemployment So Low?," Brookings Papers on Economic Activity, 1983:1, pp. 225-49; Walter Corson and Walter Nicholson, An Examination of Declining UI Claims During the 1980s (U.S. Department of Labor, 1988); and Rebecca Blank and David Card, "Recent Trends in Insured and Uninsured Employment: Is There an Explanation?" Working Paper 2871 (National Bureau of Economic Research, March 1989).

6. Indeed, Blank and Card argue that the decline in the takeup rate is the major factor behind the lower percentage of unemployed receiving UI benefits. In part, this decline can be traced to a (Footnote continues on next page)

A third source of concern among members of the Congress has been the limited availability of extended benefits during the recession. As noted above, only eight states and Puerto Rico activated the extended benefits program in 1991, and the share of unemployed workers receiving extended benefits was much lower than in previous recessions (chart, bottom panel). In part, this reflects a smaller rise in the unemployment rate in the recent downturn than is typical in a recession. However, the 1981 changes to the trigger mechanism and the relative decline in the insured unemployment rate (the trigger variable) also helped to limit the number of states offering extended benefits. For example, if the insured unemployment rate had remained at 80 percent of the civilian unemployment rate in each state, twenty-nine states would have offered extended benefits during the recession. Had the trigger levels not been raised in 1981 as well, the number of states offering extended benefits at some point this year would have risen to forty.

The Current House and Senate Bills

The legislation currently before the Congress generally is intended to increase the availability of additional UI benefits to long-term jobless workers by altering (either temporarily or permanently) the criteria used to trigger the offering of extended benefits in each state. In the House version of the bill, which was passed on September 17, five weeks of extended benefits would be provided in all states through 1992, so long as the national total unemployment rate remains at or above 6 percent. In addition, the bill would permanently change the extended benefits program to allow for an additional ten, fifteen, or twenty weeks of benefits if a state's total unemployment rate is 6, 7, or 8 percent respectively and if a state's total unemployment rate is equal to or exceeds 120 percent of its average for the corresponding three-month period in each of the preceding two calendar years. The House bill, which is estimated to cost $6-1/2 billion over five years, would waive the pay-as-you-go requirements of the budget law and would automatically trigger an emergency designation if the President signs the legislation or if the Congress overrides a veto.[7]

(Footnote continued from previous page)
shift in the distribution of unemployment from states with higher average takeup rates to states with lower takeup rates. The remainder is unexplained by the existing studies, although it may, to some extent, reflect reduced incentives to collect UI benefits in the 1980s because of the changes in the tax and pension provisions of the federal law, described above.

7. In contrast to the existing extended benefits program, the costs of the legislation now being considered would be borne by the federal government. Democrats argue that the $7.7 billion surplus currently in the extended unemployment benefit trust fund is more than enough to fund the proposed additional UI benefits and should be used for that purpose. However, the trust fund is included in the pay-as-you-go requirements of last year's budget agreement, and an emergency declaration would still be needed to authorize additional benefits unless budgetary offsets were made elsewhere.

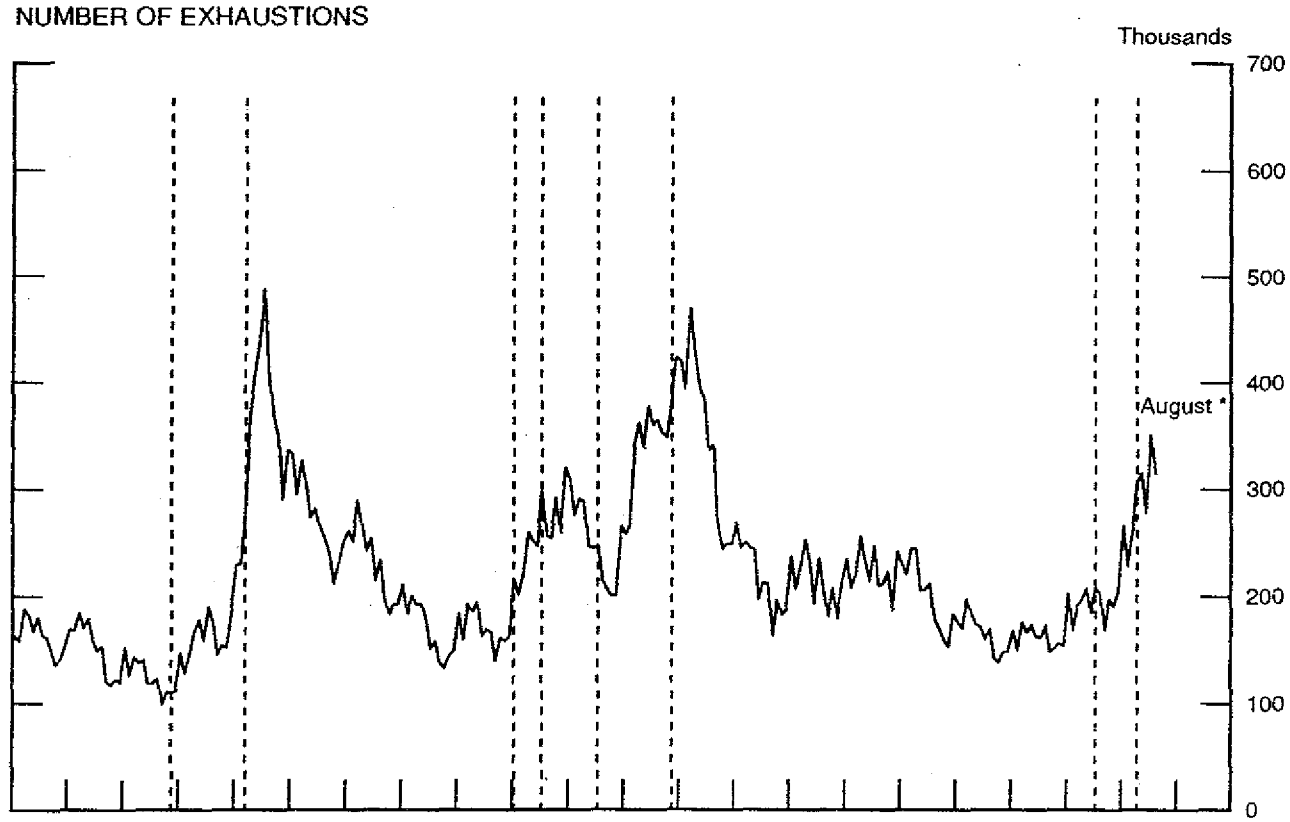
The Senate version, which was passed on September 24, would establish a temporary nine-month program of additional benefits. Seven weeks of extended benefits would be made available in all states under the Senate plan; extended benefits of thirteen or twenty weeks would be available in states with an unemployment rate of 7 or 8 percent respectively. In contrast to the House version, the Senate plan does not automatically waive the pay-as-you-go requirement of the budget law, and hence an emergency declaration by the President would be needed to fund the program; the cost of the Senate plan is estimated at about $6 billion. The House and Senate versions will now go to a joint conference committee for reconciliation. The President has expressed support for a more modest self-financed plan proposed by Senator Dole but is likely to veto any bill that violates last year's budget agreement.[8]

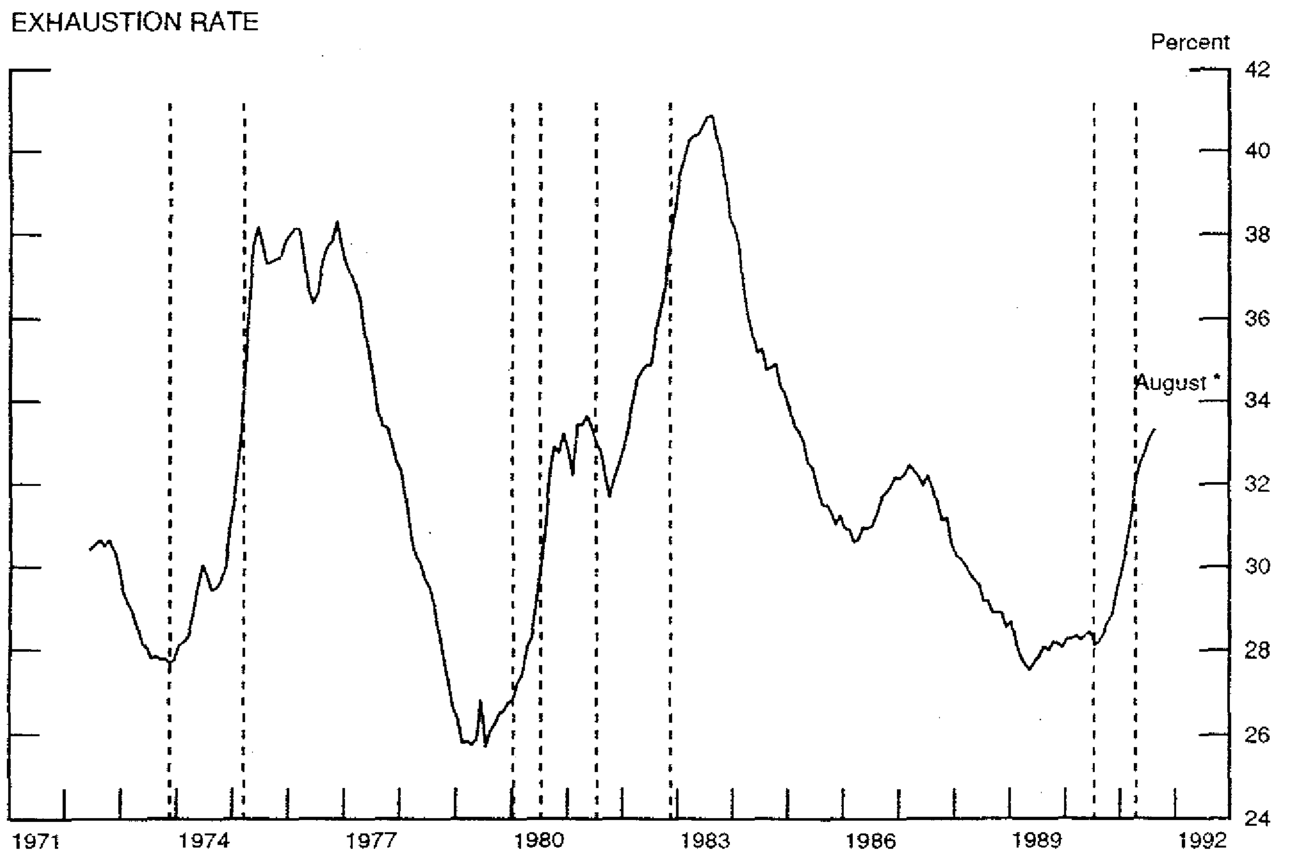
Estimates of the number of unemployed who would receive additional benefits vary by proposal and by assumptions about the employment status of persons who have exhausted their regular UI benefits. About 2-1/4 million individuals exhausted their regular UI benefits between January and August, according to the Department of Labor, and some observers argue that the cumulative total could reach 3-1/2 million by the end of the year. However, neither the number of exhaustions nor the corresponding exhaustion rate (exhaustions as a percentage of first payments) is especially high by historical standards (chart). Moreover, many of these potential claimants are likely to have taken jobs since that time; indeed, the number of persons unemployed for twenty-seven weeks or longer was only 1.2 million according to the August employment report. In addition, the House and Senate bills differ as to who would be eligible for the new program. Both bills would make additional benefits available to those who exhaust their regular benefits after October 1991, and both contain a reachback provision to cover individuals in states with an unemployment rate above 6 percent. However, the reachback provision of the House plan is somewhat more generous than in the Senate bill, and the length of time extended benefits would be available in all states is somewhat greater; in addition, the House plan would permanently ease the trigger for the extended benefits program.

8. Dole's proposal would offer between six and ten weeks of additional UI benefits and would be funded by permanently extending the IRS tax refund offset program (which is used primarily to collect unpaid student loans) and by auctioning unused radio frequencies owned by the federal government.

EXHAUSTIONS OF UI BENEFITS

(Monthly data; not seasonally adjusted)





* August data are preliminary and subject to revision.

DOMESTIC FINANCIAL DEVELOPMENTS

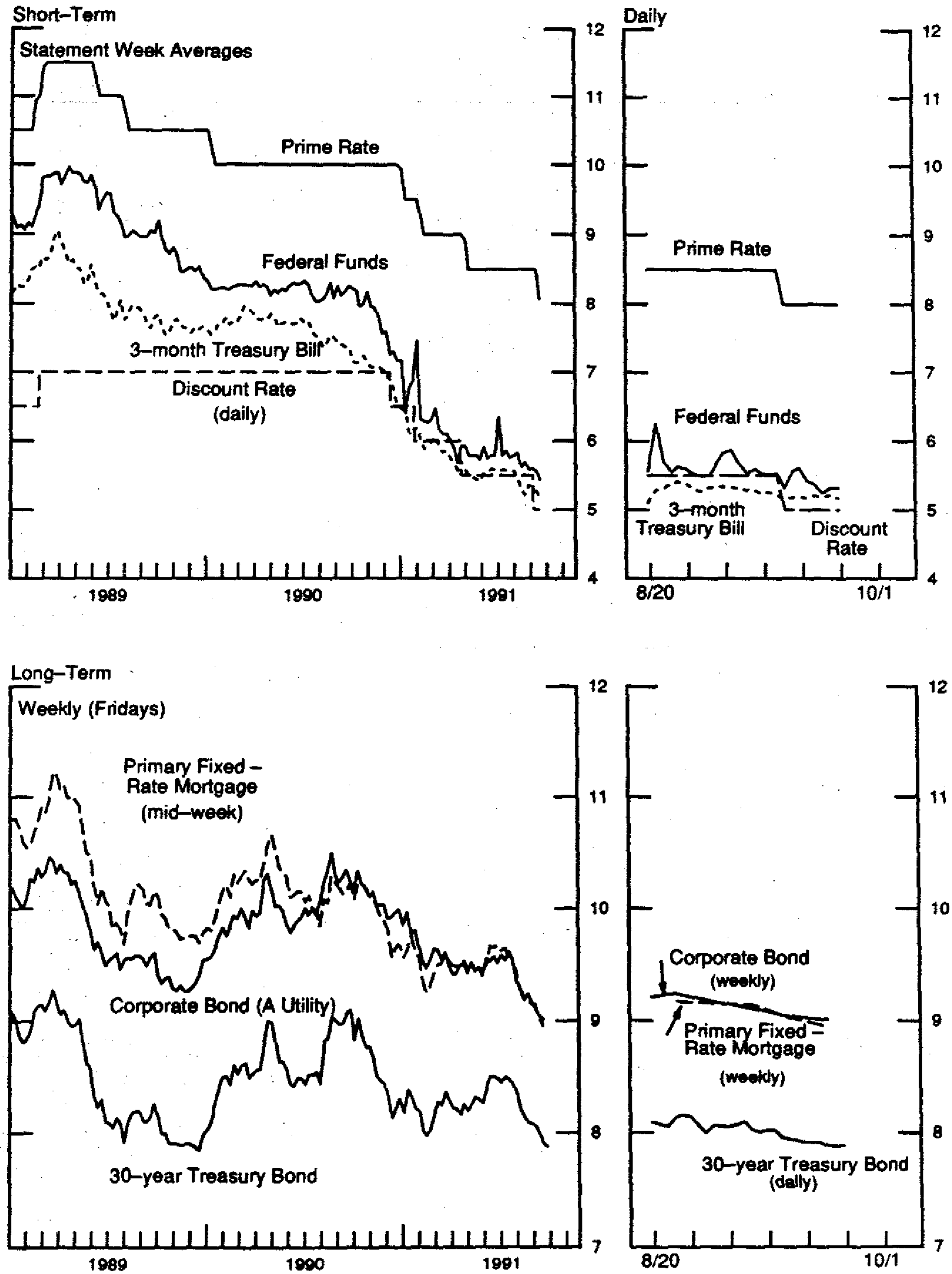
SELECTED FINANCIAL MARKET QUOTATIONS [1]
(percent)

	1989		1990	1991		Change from:	
	March highs	Dec lows	Aug highs	FOMC Aug 20	Sept 24	Aug 90 highs	FOMC Aug 20
Short-term rates							
Federal funds [2]	9.85	8.45	8.21	5.61	5.29	-2.92	-.32
Treasury bills [3]							
3-month	9.09	7.53	7.59	5.11	5.17	-2.42	.06
6-month	9.11	7.29	7.51	5.13	5.23	-2.28	.10
1-year	9.05	7.11	7.45	5.17	5.23	-2.22	.06
Commercial paper							
1-month	10.05	8.51	8.10	5.62	5.51	-2.59	-.11
3-month	10.15	8.22	8.05	5.62	5.52	-2.53	-.10
Large negotiable CDs [3]							
1-month	10.07	8.52	8.14	5.55	5.40	-2.74	-.15
3-month	10.32	8.22	8.18	5.55	5.39	-2.79	-.16
6-month	10.08	8.01	8.25	5.63	5.58	-2.67	-.05
Eurodollar deposits [4]							
1-month	10.19	8.38	8.13	5.56	5.44	-2.69	-.12
3-month	10.50	8.25	8.19	5.56	5.44	-2.75	-.12
Bank prime rate	11.50	10.50	10.00	8.50	8.00	-2.00	-.50
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	9.88	7.69	8.50	6.58	6.42	-2.08	-.16
10-year	9.53	7.77	9.05	7.81	7.56	-1.49	-.25
30-year	9.31	7.83	9.17	8.09	7.89	-1.28	-.20
Municipal revenue [5] (Bond Buyer)	7.95	7.28	7.80	7.03	6.95	-.85	-.08
Corporate--A utility recently offered	10.47	9.29	10.50	9.21	9.02	-1.48	-.19
Home mortgage rates [6]							
S&L fixed-rate	11.22	9.69	10.29	9.19	8.95	-1.34	-.24
S&L ARM, 1-yr.	9.31	8.34	8.39	7.05	6.83	-1.56	-.22

			1989	1991		Percent change from:		
	Record highs	Date	Lows Jan 3	FOMC Aug 20	Sept 24	Record highs	1989 lows	FOMC Aug 20
Stock prices								
Dow-Jones Industrial	3055.23	8/28/91	2144.64	2913.69	3029.07	-.86	41.24	3.96
NYSE Composite	217.17	8/28/91	154.00	208.27	212.90	-1.97	38.25	2.22
AMEX Composite	397.03	10/10/89	305.24	360.30	372.16	-6.26	21.92	3.29
NASDAQ (OTC)	527.19	9/20/91	378.56	502.05	526.47	-.14	39.07	4.86
Wilshire	3803.35	8/28/91	2718.59	3646.43	3736.60	-1.76	37.45	2.47

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 October 2, 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 September 20, Wednesday weeks through September 18.

Weak monetary growth and mixed economic indicators have provided the backdrop for a broad rally in fixed income markets. Supported by a reduction of the discount rate to 5 percent on September 13, and an associated 1/4 point drop in the federal funds rate, most interest rates have declined by 10 to 20 basis points since the August FOMC meeting. Treasury bill rates have been an exception, posting small increases, but they had been depressed at the time of the August meeting by uncertainties surrounding events in the Soviet Union. Immediately after the discount rate announcement major banks cut their prime lending rate 50 basis points to 8 percent. Nevertheless, the prime remains unusually high in relation to funding costs. Major stock indexes set record highs in the week following the August meeting but have given back some gains as the near-term outlook for earnings has dimmed. Still, most major indexes are up 2 to 4 percent.

Weakness in M2 and M3 persisted in August and appears to have carried over into early September, dropping these aggregates down to the bottom of their annual ranges. M2 was about unchanged last month, and for the third quarter as a whole its velocity appears likely to decline at around a 4 percent rate, despite the decline in market interest rates over the past several quarters. Some of the weakness in M2 can be attributed to shifts to higher yielding non-M2 assets, such as bond funds. In addition, households may be drawing down M2 balances to pay off outstanding debt or to avoid building up additional debt at a time when yields on M2 assets have fallen relative to borrowing costs. The contraction in M3 moderated in

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

	1990[1]	1991 Q1	1991 Q2	1991 Jun	1991 Jul	1991 Aug p	Growth Q4 90- Aug 91p
	------------Percent change at annual rates-------------------						
1. M1	4.2	5.9	7.3	9.6	1.8	9.1	6.9
2. M2	3.8	3.5	4.8	1.7	-3.9	0.0	2.6
3. M3	1.7	4.0	1.9	-2.0	-5.4	-1.4	1.1
	------------Percent change at annual rates------------						Levels bil. $ Aug 91p
Selected components							
4. M1-A	4.6	5.7	3.9	6.4	-2.0	6.2	548.3
5. Currency	11.0	15.3	3.9	3.7	6.1	8.3	260.7
6. Demand deposits	-0.6	-2.5	4.5	9.9	-8.5	3.9	279.9
7. Other checkable deposits	3.5	6.1	13.5	15.2	8.1	14.5	317.9
8. M2 minus M1[2]	3.7	2.7	4.0	-0.8	-5.8	-3.1	2524.9
9. Overnight RPs and Eurodollars, NSA	3.8	-40.5	-6.2	-6.9	-60.6	47.4	68.4
10. General purpose and broker/dealer money market mutual fund shares	11.0	18.2	6.6	-2.6	-16.1	-22.0	352.8
11. Commercial banks	9.9	8.2	7.3	8.7	5.1	9.0	1235.7
12. Savings deposits plus MMDAs[3]	7.5	7.5	16.7	16.3	11.6	10.4	631.0
13. Small time deposits	12.4	8.9	-1.8	1.0	-1.6	7.8	604.8
14. Thrift institutions	-5.5	-6.3	-1.5	-11.2	-9.0	-15.5	870.7
15. Savings deposits plus MMDAs[3]	-2.2	-0.7	18.4	11.7	10.0	2.3	365.1
16. Small time deposits	-7.3	-9.8	-13.7	-26.5	-22.1	-28.3	505.5
17. M3 minus M2[4]	-6.4	6.5	-10.5	-18.1	-12.4	-7.9	752.1
18. Large time deposits	-9.5	1.2	-7.6	-11.9	-18.5	-16.6	484.4
19. At commercial banks, net[5]	-3.5	11.9	0.3	-3.9	-13.6	-9.1	390.5
20. At thrift institutions	-23.9	-32.1	-34.8	-42.4	-38.1	-47.9	93.8
21. Institution-only money market mutual fund shares	20.2	49.9	23.0	-23.8	-12.6	25.4	144.8
22. Term RPs, NSA	-12.5	-34.3	-27.7	-37.6	18.6	-3.1	78.3
23. Term Eurodollars, NSA	-12.1	7.9	-31.7	-7.3	-9.2	-16.7	63.6
	-----Average monthly change in billions of dollars----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	0.0	-1.3	-3.4	-9.9	-3.8	-5.8	697.3
25. Large time deposits, gross	-2.6	6.4	0.3	-1.1	-4.4	-0.5	447.0
26. Nondeposit funds	2.6	-7.7	-3.7	-8.8	0.6	-5.3	250.3
27. Net due to related foreign institutions	2.2	-1.5	-3.7	-6.9	0.0	-2.6	16.6
28. Other[7]	0.3	-6.2	0.0	-1.9	0.6	-2.7	233.7
29. U.S. government deposits at commercial banks[8]	0.3	3.1	-3.5	8.1	-2.7	3.3	23.8

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 July and August at rates of 13.9 percent and 17.1 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during July and August at rates of 7.5 percent and 9.6 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

August; with depository credit still shrinking, runoffs of large time deposits continued but were partly offset by sizable inflows to institution-only money funds.

Borrowing by the private sector evidently has remained sluggish recently. In the business sector, heavy public bond issuance since the beginning of August has been offset by declines in bank loans and commercial paper. The proceeds of equity offerings, which have been near record levels, also have been used by many firms to reduce short-term indebtedness. Incoming information suggests a continued subdued pace of household mortgage borrowing this quarter, while consumer credit posted a decline in July and remained weak at banks in August. Borrowing by the Treasury, in contrast, is expected to reach a record in the third quarter, and borrowing by state and local governments appears to have picked up recently.

Monetary Aggregates and Bank Credit

M2 was unchanged in August, placing the aggregate around the lower bound of its target growth cone. Data through mid-September suggest little recovery in this aggregate, implying a small decline in the third quarter. M2 velocity will register a sizable advance this quarter, perhaps at more than a 4 percent pace, despite the decline in market rates and opportunity costs over the past several quarters. The shortfall in M2 growth in the third quarter relative to that forecast by the Board's models of money demand is likely to be on the order of 6 percentage points at an annual rate.

The weakness in M2 growth appears in part to reflect shifts by households into higher-yielding non-M2 instruments. Bond funds,

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 June	1991 July	1991 Aug p	Levels bil.$ Aug p
	Commercial Bank Credit						
1. Total loans and securities at banks	5.3	4.0	1.7	5.5	.0	-.7	2761.6
2. Securities	8.6	12.5	11.9	16.9	16.2	9.0	682.4
3. U.S. government securities	13.9	15.0	19.8	25.0	24.5	17.3	512.6
4. Other securities	-3.1	5.7	-9.3	-5.5	-7.6	-14.7	169.9
5. Total loans	4.3	1.5	-1.5	1.9	-5.0	-3.9	2079.2
6. Business loans	1.9	-.4	-6.7	-5.1	-7.0	-11.9	620.5
7. Real estate loans	9.5	3.4	5.3	6.0	-3.5	-4.3	853.9
8. Consumer loans	1.2	-2.6	-3.2	-4.8	-7.7	-2.3	368.9
9. Security loans	4.4	-17.7	-5.2	-45.2	103.4	28.8	42.6
10. Other loans	-2.4	11.6	-9.4	30.3	-22.2	13.8	193.3
	Short- and Intermediate-Term Business Credit						
11. Business loans net of bankers acceptances	1.9	.3	-6.7	-4.6	-7.1	-12.8	614.1
12. Loans at foreign branches[2]	19.3	-3.1	-35.7	-5.1	5.1	-35.6	22.9
13. Sum of lines 11 & 12	2.5	.2	-7.9	-4.6	-6.7	-13.6	637.0
14. Commercial paper issued by nonfinancial firms	12.2	-5.1	-10.2	-9.0	8.3	-32.1	141.9
15. Sum of lines 13 & 14	4.2	-.7	-8.4	-5.6	-3.8	-17.0	778.9
16. Bankers acceptances: U.S. trade related[3,4]	-9.6	-24.3	-22.0	8.3	-24.7	-29.4	27.9
17. Line 15 plus bankers acceptances: U.S. trade related	3.6	-1.6	-8.8	-4.9	-4.7	-17.4	806.8
18. Finance company loans to business[3]	13.1	4.7	4.6	7.3	6.0	n.a.	299.2[5]
19. Total short- and intermediate-term business credit (sum of lines 17 & 18)	5.8	.0	-5.3	-1.7	-1.8	n.a.	1117.9[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. July data.
p--preliminary.
n.a.--not available

in particular, registered sizable inflows in July, and inflows to such funds reportedly were again brisk in August. Shifts into non-M2 assets have become increasingly attractive as depository institutions, facing weak loan demand and regulatory and capital market pressures to strengthen capital positions, have been reluctant to bid aggressively for retail deposits. In addition, low yields on M2 assets relative to the cost of consumer credit may be inducing households to pay down debt or to finance spending by drawing down their M2 balances.

M3 ran off further in August, at a 1-1/2 percent rate, and data for early September provide scant evidence of a rebound. Institution-only money fund shares surged in both months as institutional investors sought to exploit the funds' yield advantage during episodes of falling short-term market yields. This increase was more than offset, however, by continued shrinkage in the stock of large time deposits, particularly those issued by thrift institutions. Like M2, M3 remains near the lower bound of its target cone for September.

Bank credit declined at about a 3/4 percent annual rate in August, reflecting continued weakness in loans. As in July, loans in the three major categories--business, real estate, and consumer--continued to fall.[1] Loan runoffs at domestic banks continued at about their July pace and were widespread, both geographically and among size classes of banks; in addition, business loans at foreign banks contracted after rising earlier this year. These declines appear to reflect an overall weak demand for short-term business

1. After adjustment for securitization (not shown), consumer loans posted a slight increase August, though smaller than the meager increases observed in most previous months this year.

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

	1988	1989	1990	1991 Q1	1991 Q2p	1991 Julyp	1991 Aug.p	1991 Sept.e
Corporate securities - total[1]	22.41	19.87	19.86	28.34	35.05	22.23	31.75	24.50
Public offerings in U.S.	20.39	17.80	17.73	26.10	31.22	20.18	29.73	23.00
Stocks--total[2]	3.54	2.69	1.95	2.22	6.12	2.68	6.73	4.00
Nonfinancial	1.15	1.08	1.03	1.29	4.01	2.32	5.43	2.00
Utility	0.24	0.29	0.35	0.47	0.70	0.21	0.21	0.00
Industrial	0.91	0.79	0.68	0.82	3.31	2.11	5.22	2.00
Financial	2.39	1.60	0.92	0.93	2.11	0.35	1.30	2.00
Bonds	16.85	15.12	15.77	23.89	25.10	17.50	23.00	19.00
Nonfinancial	6.19	6.30	5.65	9.10	10.18	6.50	9.70	8.50
Utility	1.79	1.78	1.97	2.20	3.68	2.60	2.80	2.00
Industrial	4.41	4.52	3.69	6.90	6.50	3.90	6.90	6.50
Financial	10.66	8.81	10.12	14.79	14.92	11.00	13.30	10.50
By quality[3] >								
Aaa and Aa	2.77	3.17	3.43	4.78	3.76	1.21	3.90	3.29
A and Baa	5.50	5.83	6.41	12.82	12.84	9.20	10.25	4.06
Less than Baa	2.56	2.39	0.15	0.41	1.33	0.49	0.48	0.[illegible]
No rating (or unknown)	0.05	0.05	0.04	0.03	0.00	0.00	0.02	0[illegible]
Memo items:								
Equity-based bonds[4]	0.28	0.52	0.38	0.77	0.78	0.54	0.38	0.31
Mortgage-backed bonds	4.72	1.68	2.41	2.04	3.31	2.72	4.71	2.50
Other asset-backed	1.26	2.02	3.35	3.84	3.86	3.88	3.65	8.50
Variable-rate notes	1.19	1.03	0.82	0.75	0.82	0.33	1.37	0.10
Bonds sold abroad - total	1.93	1.90	1.92	2.07	3.04	1.50	1.50	1.50
Nonfinancial	0.73	0.48	0.46	1.04	1.60	0.85	0.65	0.35
Financial	1.20	1.43	1.46	1.03	1.44	0.65	0.85	1.15
Stocks sold abroad - total	0.09	0.16	0.22	0.17	0.80	0.54	0.52	0.00
Nonfinancial	0.08	0.12	0.10	0.05	0.75	0.37	0.47	0.00
Financial	0.02	0.04	0.12	0.11	0.05	0.18	0.04	0.00

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings. Such swaps totaled $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. e--staff estimate.

credit arising in part from the liquidation of inventories and from heavy issuance in capital markets.

The contraction of real estate loans quickened in August, even after adjustments for observed loan sales, securitizations, and charge-offs. The weakness was widespread across the country, although apparently somewhat less severe in the Midwest. Bank holdings of U.S. government securities continued to increase in August, a common pattern during the first quarter of an economic recovery. Securities holdings may also have been boosted by the substitution of mortgage-backed securities for mortgage loans. In particular, call report data for the second-quarter (the most recent data available) show that purchases of agency CMOs accounted for nearly one-half of the total increase in U.S. government securities during that period.

Business Finance

Borrowing by nonfinancial firms has remained weak over the intermeeting period, as strong bond issuance offset declines in bank loans and commercial paper. Throughout most of 1991, firms have been shifting financing from the shorter-term markets to the equity and long-term bond markets. Business loans at banks have declined in each month since April; at the same time, commercial paper outstanding has fallen nearly 10 percent, whereas the public bond and equity markets have posted near-record volumes of gross issuance.

The shift toward longer maturities apparently reflects efforts by many corporations to lock in current long-term rates, which have dropped to their lowest level since early 1987. In addition, some issuers reportedly are lengthening debt maturities to lessen liquidity risks. Indeed, the lengthening of debt maturities also has been noticeable within each broad category. The average maturity of outstanding commercial paper, for example, has increased to forty days from thirty-five days in February. In the bond market, offerings with maturities of thirty years or longer have accounted for 34 percent of nonfinancial issuance during the third quarter, compared with 21 percent over the previous year. Firms rated Aaa and Aa, which have the greatest flexibility to time market borrowings and change the maturity structure of their liabilities, have since April accounted for an unusually large share of nonfinancial borrowing in the bond market. Despite the heavy issuance, yield spreads on investment-grade bonds have remained relatively narrow.

The spread between yields on junk bonds and 10-year Treasuries has remained at about 625 basis points since June, as a combination of sizable corporate buybacks and cash inflows at high-yield mutual funds have offset the potential impact of efforts by insurance companies to reduce holdings of junk bonds. With the narrowing of yield spreads in the first half of 1991, the junk bond market has absorbed a small but steady supply of new offerings. For example, in August, American Medical International sold a twenty-year note with a yield spread of 569 basis points, and Dr. Pepper Company issued a five-year secured note with a yield spread of 425 basis points. These were the first offerings of straight debt by B-rated companies since February 1990. However, the high-yield market remains open primarily to issuers of generally higher quality and to those that have deleveraged.

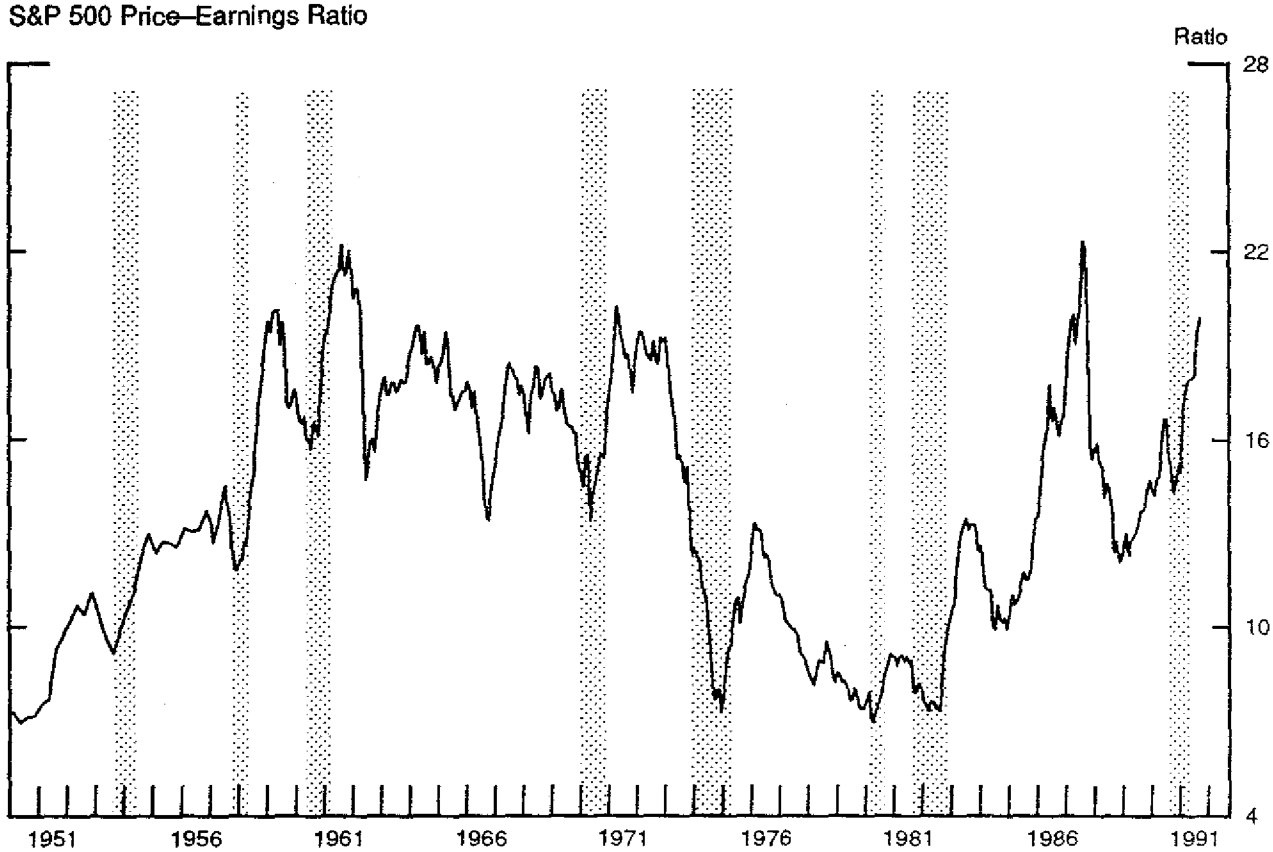
In the market for privately placed bonds, below-investment-grade firms are facing serious difficulties in placing bonds, largely because of the withdrawal of life insurance companies from the market. The withdrawal started last year with the implementation of regulatory changes by the National Association of Insurance Commissioners that broadened the definition of junk bonds and increased reserves for lower-rated bonds. In addition to regulatory changes, liquidity concerns have added to the pressure on insurance companies to shift to investment-grade bonds, which generally are more readily marketable than lower-grade securities. Other investors, such as pension funds and finance companies, play only a minor role in the private placement market, and issuers apparently have had limited success in tapping other sources of funds, including the equity market.

On balance, stock prices are up about 2 to 4 percent since the August FOMC meeting, and some indexes set record highs during the intermeeting period. With the strength in the market, the ratio of prices to four-quarter trailing earnings for the S&P 500 has moved to around 20 since mid-August, while the dividend-price ratio has fallen to about 3.1 percent (chart). While the price-earnings ratio is somewhat high compared to levels attained on the heels of the three most recent recessions, similar levels have been recorded during earlier recoveries (chart).

Reflecting strong share prices, public issuance of equity by nonfinancial firms amounted to $5.4 billion in August--the second highest month ever recorded--and continued to be heavy in September. Favorable equity valuations and the rewards associated with deleveraging have continued to draw a large, steady flow of IPOs and

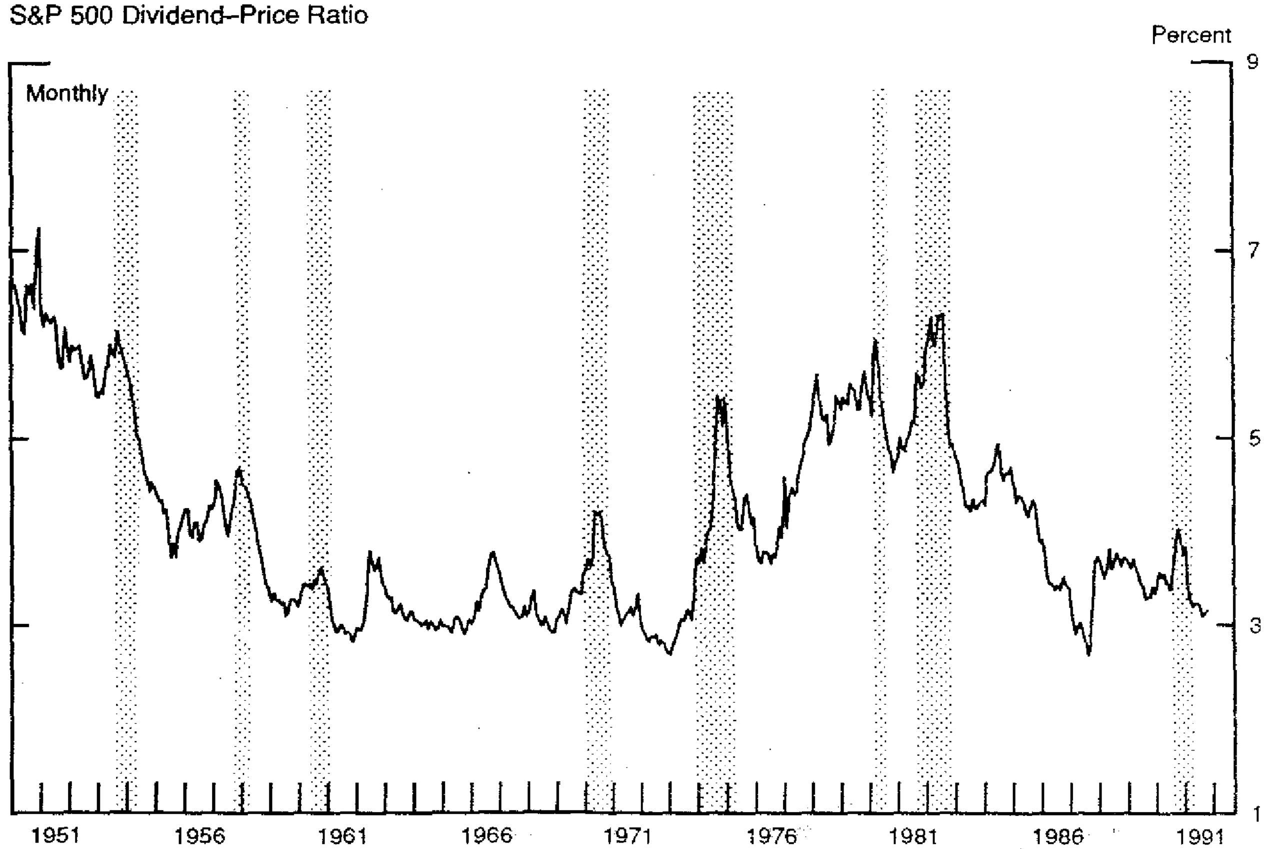
Indicators of Equity Valuation

S&P 500 Price–Earnings Ratio



Note: Quarterly values through 1956:4, monthly thereafter.

S&P 500 Dividend–Price Ratio



reverse LBOs to the equity market. However, the exceptionally heavy volume in August and September can be traced mainly to a few large offerings by Fortune 500 corporations. For example, the August total includes a $2.5 billion rights offering by Time-Warner, the proceeds of which were used to reduce bank debt. September's equity volume includes a $650 million offering by NCR, which was related to its $7.5 billion merger with AT&T. In recent months, several companies have issued Preferred Equity Redemption Cumulative Stock (Percs), which are hybrid convertible securities that offer investors a dividend yield above that on the underlying common stock in return for a cap on appreciation potential. Together, General Motors, K Mart, and Texas Instruments have raised just over $2 billion from Percs offerings. Given the large volume of new equity securities and the continued cool climate for leveraged restructurings, net equity issuance is expected to be positive in the third quarter for the second straight quarter.

Treasury and Sponsored Agency Financing

Borrowing in marketable securities by the Treasury is expected to run at a record $102 billion pace in the third quarter, with about $43 billion in bills and the remainder in notes and bonds. To accommodate this borrowing, the sizes both of weekly bill auctions and of coupon auctions have been increased: Gross bill auctions have been boosted $800 million, and gross sizes of some coupon auctions have been increased as much as $500 million.

Fallout in the Treasury auctions from the investigation of Salomon Brothers' bidding violations appears limited. Recent auctions generally have gone smoothly, with active bidding and strong investor interest. The Treasury recently announced several

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	-98.6	-40.8	-42.7	-15.1
Means of financing deficit:					
Net cash borrowing from the public	43.1	98.6	34.4	32.6	31.6
Marketable borrowings/ repayments (-)	38.6	102.3	40.7	31.0	30.7
Bills	-11.7	43.1	16.7	13.4	12.9
Coupons	50.3	59.2	24.0	17.6	17.8
Nonmarketable	4.5	-3.7	-6.2	1.6	.9
Decrease in the cash balance	-11.6	3.1	6.7	18.5	-22.1
Memo: Cash balance at end of period	43.6	40.5	36.9	18.4	40.5
Other[2]	-5.8	-3.1	-.4	-8.4	5.7
Federally sponsored credit agencies, net cash borrowing[3]	-7.1	--	3.1[4]	--	--
FHLBs	-6.5	--	.6	--	--
FHLMC	-2.6	--	.7	--	--
FNMA	1.7	--	2.2	--	--
Farm Credit Banks	-.2	--	-.4	--	--
SLMA	.5	--	--	--	--

1. Data reported on a not seasonally adjusted, payment basis.
2. Includes checks issued less checks paid, accrued items and other transactions.
3. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
4. Total does not include SLMA.
p--projected.
e--staff estimate.
Note: Details may not add to totals due to rounding.

steps that should make violations of its auction rules easier to detect. Written confirmation of large bids by customers of primary dealers and banks will be required before securities awarded in an auction are delivered. Projects under way to automate the auction process are being accelerated, and a permanent surveillance group, consisting of representatives from the Board, the Federal Reserve Bank of New York, the Treasury, and the SEC, has been established.

Partly motivated by the need to extend the Government Securities Act (GSA), which expires on October 1, hearings in both the House and the Senate have examined Salomon Brothers' violations and the regulation of the Treasury market. Rep. Edward J. Markey, Chairman of the House Subcommittee on Telecommunications and Finance, has indicated a desire to require new internal control systems by dealers and new reporting by holders of large positions in Treasury securities, in addition to the sales practices and information dissemination provisions previously proposed for the renewal of the GSA. Sen. Christopher J. Dodd and others have introduced a bill that would make the submission of false written statements in connection with the issue of government securities explicitly illegal.

Salomon Brothers also admitted overstating the size of its customer orders in conjunction with new issues of agency securities and acknowledged purchasing agency securities on its own account that it had reported were for its customers. Similar abuses related to the allotment of agency securities involve several firms, according to the SEC.

Municipal Securities

Gross issuance of long-term municipal securities rose sharply in August to more than $15 billion, the highest level in four years. Municipal issuance of short-term debt also was brisk, totaling $5.6 billion. Issuance of both short- and long-term securities has remained strong in September. Market participants suggest that some of the surge in borrowing is attributable to relatively attractive yields, which stand at their lowest point since February. While refunding announcements did pick up in mid-September, the drop in rates has yet to boost refunding volume to an appreciable extent. Because of the relative stability of municipal bond yields over the past several years, most of the bonds suitable for refinancing at current yields have already been refunded. The

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

	1989	1990	1991				
	Year	Year	Q1	Q2	July	Aug.[p]	Sept.[f]
Total offerings[1]	11.90	13.10	11.39	17.51	14.56	21.77	--
Total tax-exempt	11.65	12.85	11.25	17.20	14.50	20.94	16.00
Long-term	9.47	10.03	9.81	13.16	10.41	15.31	12.00
Refundings[2]	2.47	1.45	.79	.68	.06	.56	--
New capital	7.01	8.60	9.02	12.48	10.35	14.75	--
Short-term	2.17	2.82	1.44	4.04	4.09	5.63	4.00
Total taxable	.25	.25	.14	.31	.06	.83	--

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

modest pickup in refunding in August owed largely to an offering from the New Jersey Turnpike Authority.[2]

Connecticut has announced its intention to refinance short-term obligations, issued to fund last year's deficit, with a $1 billion bond issue that likely will come in September. This action prompted Standard & Poor's to lower the state's credit rating to AA- from AA. The credit quality of many other states also continues to decline. Moody's recently downgraded the general obligation debt of Illinois to Aa1 from Aaa, the rating it had held since 1941; S&P had taken similar action earlier in August. Both rating agencies suggested that the state's accumulated deficit from fiscal years 1990 and 1991, amounting to more than $1 billion, left it more vulnerable to negative developments. Other states downgraded recently include Maine and New Jersey.

The mayor of Bridgeport, Connecticut, announced that she would not raise taxes to close the city's fiscal-year 1992 budget deficit of $16 million. To finance the deficit, the city plans to draw on a $27 million cash reserve. At the same time, the city announced that it plans to appeal the dismissal of its bankruptcy filing, suggesting to market participants that the city may be depleting the reserve in order to strengthen its case for bankruptcy. The availability of reserve funds was the primary factor cited by the bankruptcy judge in dismissing Bridgeport's petition. The city's financial control board contends that the cash reserves, formed in part by a 1988 $58 million bond issue backed the

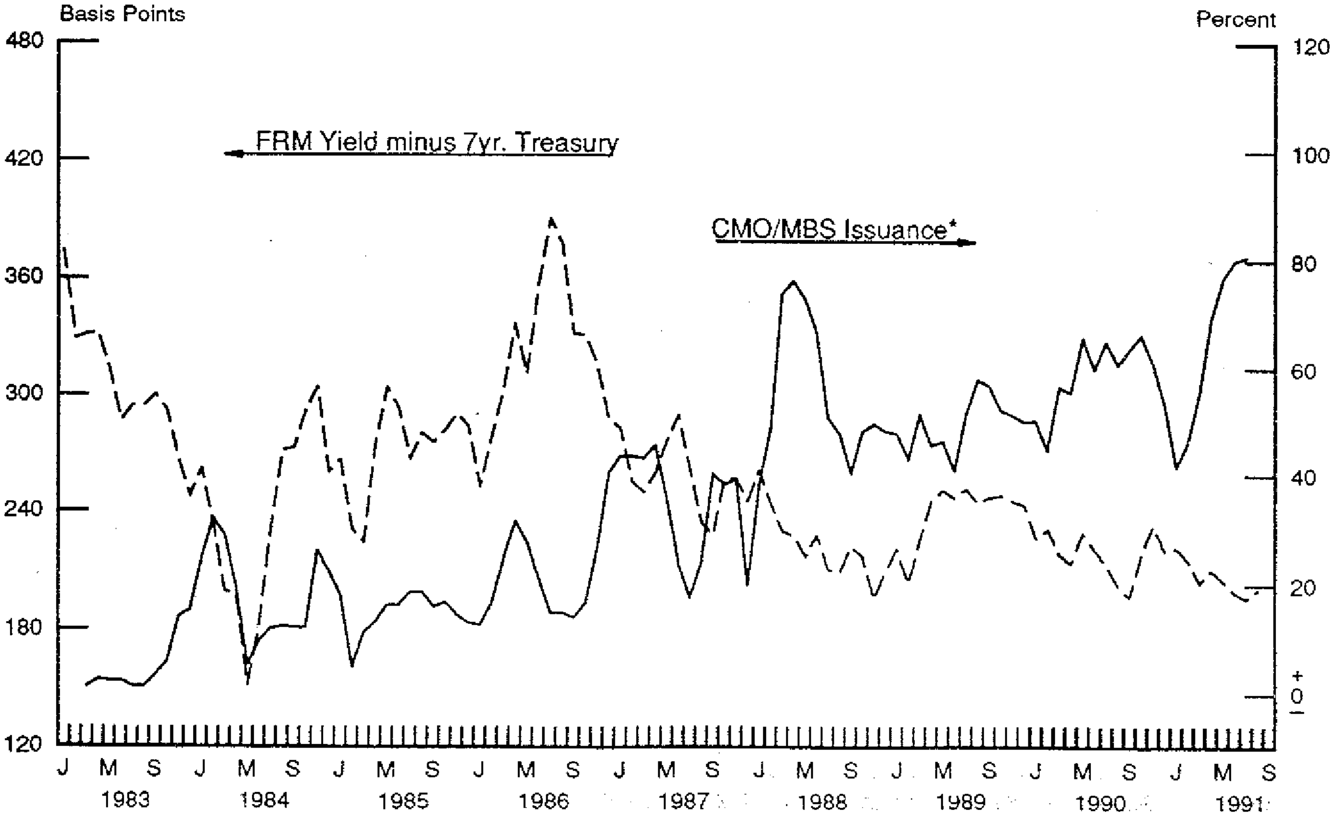
2. The Authority will purchase a portion of I-95 from the state, helping the state balance its fiscal 1992 budget. The purchase violates the covenants on much of the Authority's outstanding debt, forcing a full refunding on all outstanding debt.

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	16.8	14.1	1.5	8.9	2.0	4.0	2.8	.1
Q2 r	24.7	21.5	1.6	18.8	3.3	8.2	6.8	.5
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.	18.5	15.2	2.8	13.2	3.2	6.3	3.7	.0
Apr.	19.3	16.8	1.1	15.0	3.1	5.9	6.0	.0
May	26.7	21.7	1.0	17.6	2.6	8.1	6.9	.0
June r	28.1	26.1	2.6	23.9	4.2	10.6	7.6	1.6
July p	23.5	22.7	1.0	19.3	2.6	8.9	6.3	1.6
Aug. p	n.a.	n.a.	1.6	24.4	3.3	12.2	7.5	1.5

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

Mortgage–Treasury Yield Spreads and CMO Activity



*CMO/MBS Issuance is the 3-month moving average of the monthly ratio of CMO issuance to pass-through issuance.

state, can be used only to provide short-term liquidity, not to finance budget deficits.

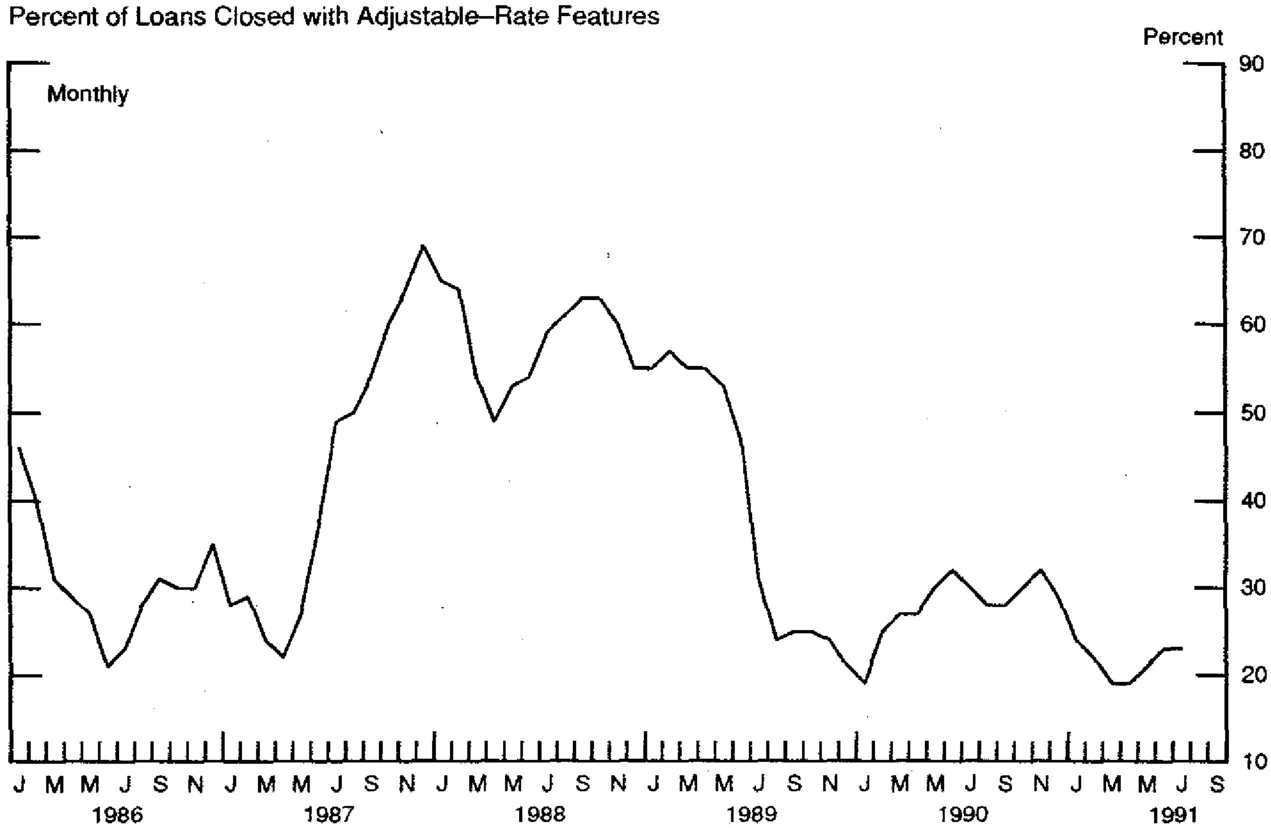
Mortgage Markets

Available data on mortgage lending thus far in the third quarter suggest that the pace of borrowing remains fairly slow. Mortgage credit outstanding for all property types grew at an estimated 4-1/4 percent in the second quarter, reflecting a 6-1/2 percent growth in loans on single-family properties and a 1 percent decline in outstanding commercial mortgage credit. More recently, however, the volume of FHA loans has declined, and home-purchase applications at mortgage banking companies have been flat. Meanwhile, real estate loans at commercial banks declined at a 4 percent annual rate over July and August, and initial reports for early September indicate continued weakness.

In secondary mortgage markets, issuance of federally related mortgage-backed securities so far in the third quarter continues at a record pace, despite recent declines in home sales (table). Issuance in August likely exceeded $1 billion. The higher level of agency pass-through issuance may be attributable to continued sales of mortgages by thrifts, the swapping of real estate loans for CMOs by banks, the growing market shares of Fannie Mae and Freddie Mac, and a rising rate of mortgage refinancings. Moreover, in June and July combined, the RTC issued $1 billion of securities backed by single- and multi-family mortgages from the RTC's portfolio.

In the multiclass sector, issuance declined in July for the first time since January but subsequently rebounded to another record level in August. For the year as a whole, CMO issuance is

Adjustable-Rate Mortgages



expected to be at a record high. As banks and other investors have increased their demand for CMOs and other multiclass securities, such issues have absorbed a growing proportion of agency pass-throughs and increased the demand for pass-through collateral. Consequently, fixed-rate mortgages have commanded higher prices when sold into the secondary market, enabling lenders to extend fixed-rate mortgage credit at narrower spreads to Treasuries (chart).

Mortgage refinancing activity, which declined in early summer as mortgage interest rates rose, apparently has revived in recent weeks. The weekly survey of the Mortgage Bankers Association indicates that refinancing rates have nearly doubled since the end of June. Various industry reports also suggest that mortgage refinancing currently accounts for one-quarter or more of total loan applications at some lenders, with a substantial number of borrowers switching from adjustable-rate mortgages to conventional fixed-rate loans. Indeed, at 8.95 percent, the average commitment rate on conforming conventional FRMs is at its lowest level since January 1978. In addition, the Department of Veterans Affairs' latest cut in its ceiling rate on VA-guaranteed loans to 8.50 percent puts that benchmark at its lowest point since April 1987. Moreover, despite an initial rate advantage on ARMs of more than 2 percentage points the reduced costs of fixed-rate financing continue to be reflected in a large FRM share of conventional home loan originations, as shown by the survey of major institutional lenders conducted by the Federal Housing Finance Board (chart).

Consumer Installment Credit

Consumer installment credit outstanding contracted further in July, declining at an annual rate of 1-1/2 percent, about the

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[r]	June[r]	July[p]	July[p]
Installment	8.8	5.9	2.3	-.2	-1.4	-1.0	-2.8	-1.4	729.8
Auto	6.9	1.3	-2.1	-1.5	-5.5	-8.8	-8.7	-3.8	273.6
Excluding auto	10.2	9.2	5.2	.5	1.1	3.8	.8	.1	456.1
Revolving	13.7	15.2	10.6	1.9	8.6	5.2	2.3	2.5	228.2
All other	7.4	4.5	.6	-.7	-6.0	2.5	-.7	-2.3	227.9
Noninstallment	6.0	2.6	-4.9	-6.0	-14.2	-3.3	-25.6	-19.5	55.8
Total	7.2	5.8	1.7	-.7	-2.4	-1.2	-4.5	-2.7	785.6

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)

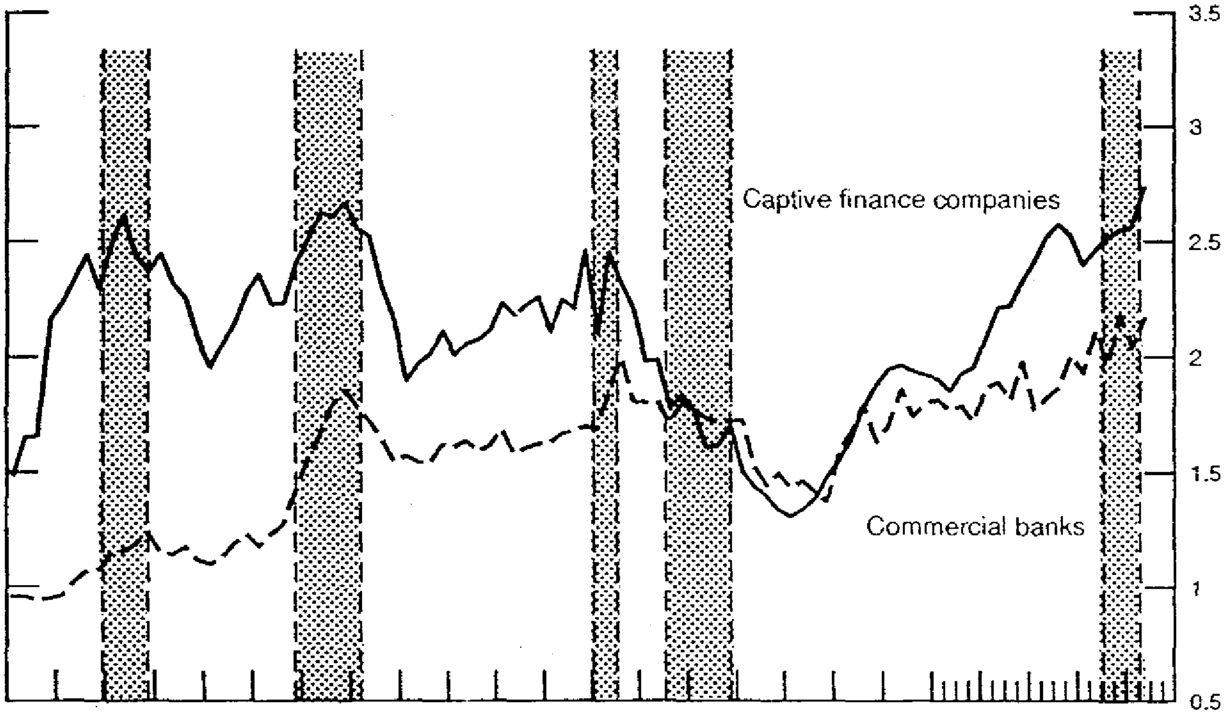
			1991				
	1989	1990	Apr.	May	June	July	Aug.
At commercial banks[1]							
New cars (48 mo.)	12.07	11.81	...	11.28	...	...	11.06
Personal (24 mo.)	15.44	15.46	...	15.16	...	...	15.24
Credit cards	18.02	18.17	...	18.22	...	...	18.24
At auto finance cos.[2]							
New cars	12.62	12.54	13.14	12.95	12.77	12.55	...
Used cars	16.18	15.99	15.82	15.85	15.74	15.66	...

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.

September 9, 1991
Mortgage and Consumer Finance

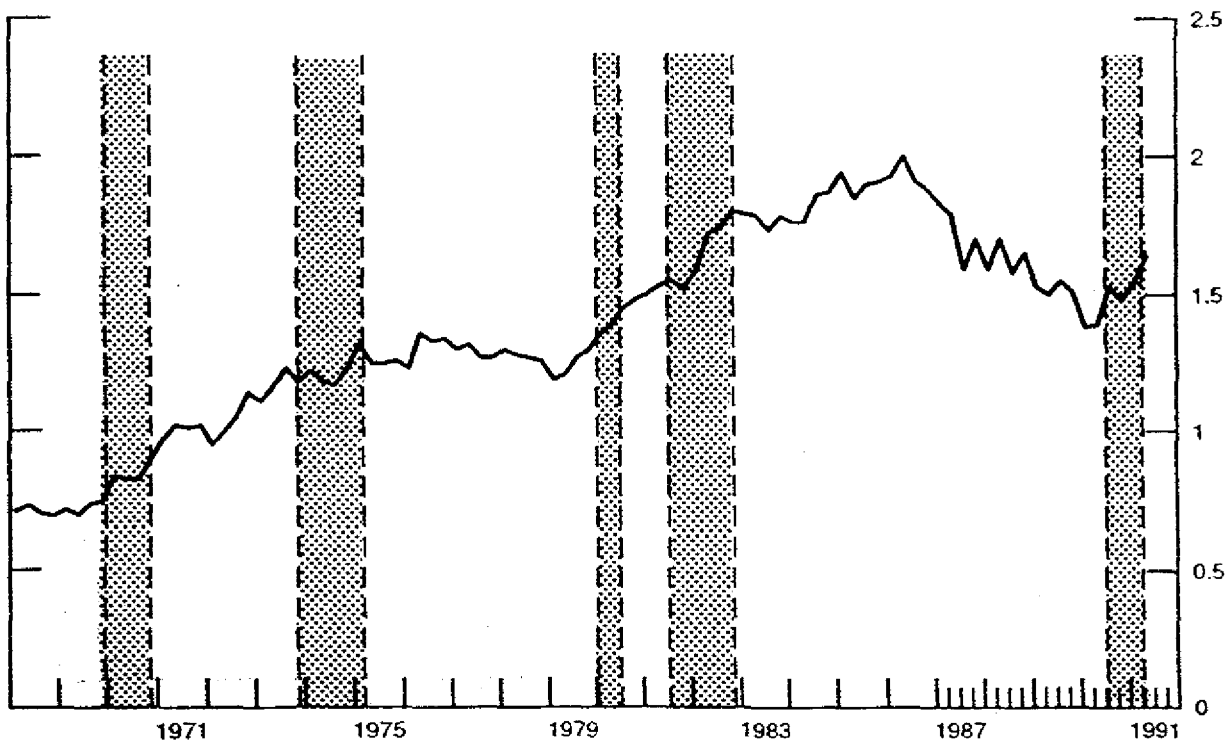
Delinquency Rates On Household Debt
(Seasonally adjusted, quarterly averages)

Auto Loans (30–days or more)



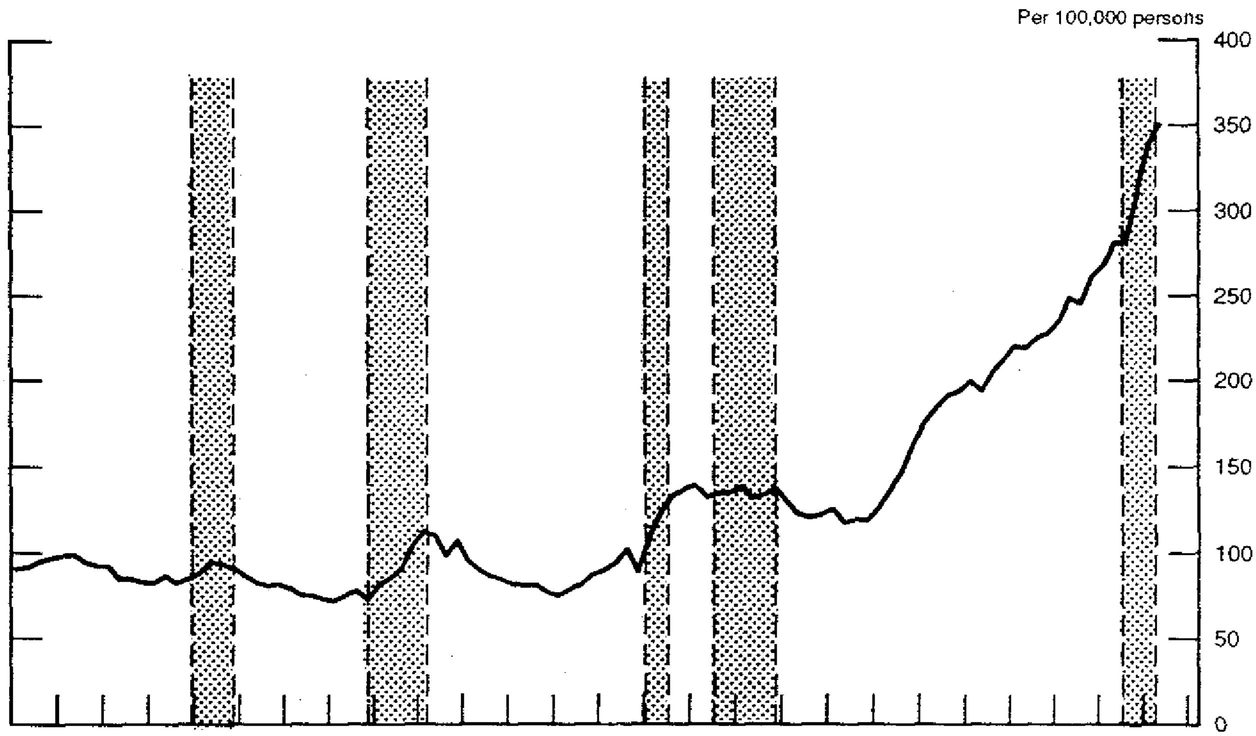
Source: American Bankers Association.

Home Mortgages (60–days or more)

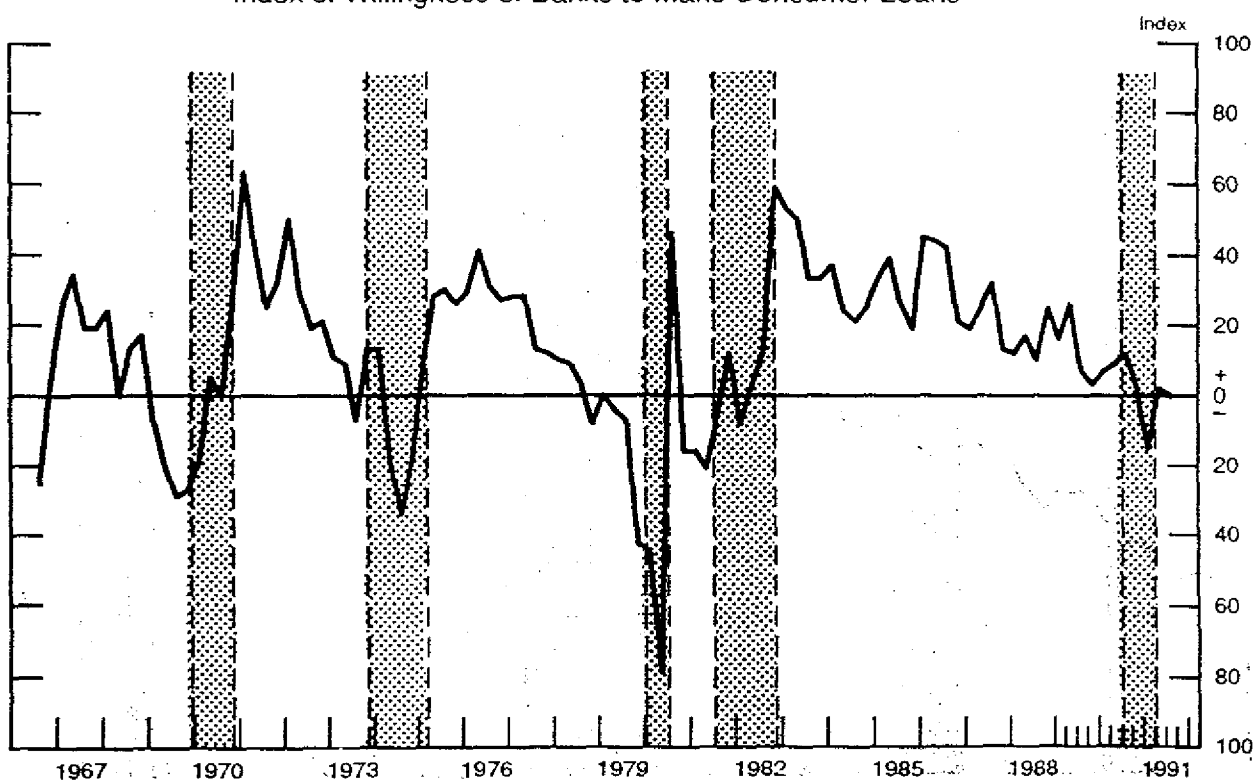


Source: Mortgage Bankers Association.

Nonbusiness Bankruptcy Filings



Index of Willingness of Banks to Make Consumer Loans [1]



Source: Senior Loan Officer Survey.

1. Weighted responses of banks more willing to make consumer loans minus responses of banks that are less willing.

average rate of decline since the stock of debt peaked in November. The deceleration in consumer debt last year and the contraction this year largely reflect the general weakness in consumer durables purchases. Auto credit has been the weakest component of installment credit for several quarters; it declined at a 3-3/4 percent rate in July, following an 8-3/4 percent drop in the second quarter. New-car sales in August declined from their July rate, pointing to further runoffs in auto loans, and other indications suggest that installment credit may have continued to decline in August. Loans to consumers by commercial banks (adjusted to include securitizations) rose at less than a 1 percent annual rate last month, the weakest performance since March.

Households are showing signs of increased difficulty in making mortgage and consumer loan payments. Delinquency rates on consumer loans have climbed to levels higher than those in the more severe recessions of the early 1980s; the mortgage delinquency rate also has risen sharply but remains below the highs reached in the mid-1980s (chart). Furthermore, personal bankruptcies have surged far above historical rates (chart), partly in reflection of changes in bankruptcy law and court interpretations. By establishing larger asset exemptions, revisions to federal law in 1978, and subsequent revisions to state law, have increased the relative attraction of formal bankruptcy proceedings for households having trouble meeting debt repayments.

Despite rising delinquencies, providers of consumer credit do not appear to have altered credit availability in the past several months. Indeed, the August reading on an index of willingness to lend, based upon responses to the Senior Loan Officer

Opinion Survey, is little changed from the May level (chart). The index did not decline as much during the recent recession as it did during previous recessions, and it bounced back in February, suggesting that credit conditions for consumers have not been unusually restrictive. Recent movements in consumer loan rates are mixed; since May, auto loan rates have declined along with Treasuries of comparable maturities, while personal loan rates have moved up a few basis points. The resultant spreads remain wide relative to much of the previous decade but are in line with such measures after previous recessions.

INTERNATIONAL DEVELOPMENTS

Merchandise Trade

In July, the preliminary U.S merchandise trade deficit increased to $5.9 billion from the revised June deficit of $3.8 billion. The deterioration in July was driven by growth in imports, which increased 4 percent over the low second quarter average. Exports in July were about the same as the second quarter average, which itself was high by recent historical standards.

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

	Exports			Imports			
	Total	Ag.	NonAg.	Total	Oil (nsa)	NonOil	Balance
1991-Jan	34.1	3.1	31.0	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	30.7	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	31.9	40.1	4.6	35.4	-4.8
Jun	35.0	3.1	31.8	38.8	4.2	34.5	-3.8
Jul	35.3	3.5	31.8	41.2	4.0	37.2	-5.9

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

In the second quarter the merchandise trade deficit continued to improve. This improvement was driven by strong growth in the value of exports (about 3 percent) from the first to second quarters and only a small increase in the value of imports (less than 1/2 percent).

Merchandise Exports. The most significant development in exports in recent months has been the strong performance of exports of capital goods, which rose 9-1/2 percent (not at an annual rate) in the second quarter whereas other exports fell slightly on average.

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

	Years		Seasonally Adjusted AR				Memo: Percent Change 1991: Q2 from	
			1990		1991			
	1989	1990	Q3	Q4	Q1	Q2	Year Ago	Prev. Qtr.
Exports	361	390	387	402	404	416	7.2	3.2
Imports	477	498	502	513	477	479	-1.2	0.4
Oil	51	62	62	72	53	52	0.6	-2.4
Non-oil	426	436	440	441	424	427	-1.4	0.7
Balance	-116	-108	-115	-111	-74	-62		
Ex Oil	-65	-46	-53	-39	-21	-11		

Source: U.S. Department of Commerce, Bureau of Economic Analysis, Balance-of-Payments Accounts.

The rise in capital goods exports reflected both a transitory bunching in exports of aircraft and stronger investment demand in a number of markets abroad. Deliveries to Germany and other developed countries accounted for most of the increase in aircraft exports. However, various developing countries, particularly Mexico, and Canada accounted for most of the increase in exports of capital goods other than aircraft. Investment growth has been strong in Mexico and clear signs of economic recovery emerged in Canada in the second quarter. Computer exports did not play a major role in the second quarter increase in capital goods exports when measured in current dollars. In real terms however, computer exports increased 3 percent, and accounted for about one-fifth of the real increase in exports of capital goods.

In July, aircraft exports fell 10 percent from the average rate in the second quarter, but exports of other capital goods remained at about their high second quarter rate.

Another strong component of exports in the second quarter was automotive products, which increased 18 percent from an abnormally low rate in the first quarter. Much of the second quarter increase was in intermediate trade with Canada, and reflected an anticipated rise in U.S. domestic auto sales. Part of the increase was also in exports of trucks to replenish stocks in Kuwait and Saudi Arabia.

Merchandise Imports. The quantity of non-oil imports increased more than 3-1/2 percent between the first and the second quarters and substantially further between the second quarter average and July. The second quarter increase was mostly attributable to computers (including accessories and parts), which rose by 11 percent. The further increases in July were concentrated in consumer goods, autos and computers.

In July, the value of oil imports fell 5 percent from the June rate, the result of declines in both the price and quantity of imported oil. In the second quarter, the value of oil imports fell 2 percent from the first quarter, as declining prices more than offset a large increase in the quantity of oil imported. The increase in quantity in the second quarter was the result of a rapid runup in stocks, as market participants rebuilt inventories in the wake of lower prices. Prior to the second quarter, stocks had been drawn down for 8 consecutive months. Preliminary Department of Energy data show further stockbuilding in August, suggesting that imports remained above the 8 mb/d pace during the third quarter.

Since April, oil import prices have moved in a very narrow band. The general firming in the spot and posted markets in June and early July should add the same amount to the price of oil imports over the next two months.

Prices of Non-oil Imports and Exports

In July, the price of non-oil imports fell 0.5 percent (at a monthly rate), the fourth consecutive month of decline. The decline was widespread

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

	Year	1990			1991		$ Change	
	1990	Q2	Q3	Q4	Q1	Q2	Q2-Q2	Q2-Q1
Total U.S. Exports	389.6	388.4	386.6	402.3	403.6	416.4	28.1	12.8
Agricultural Export	40.2	40.8	39.3	37.8	39.8	38.0	-2.8	-1.8
Nonagric. Exports	349.3	347.5	347.3	364.5	363.8	378.4	30.9	14.6
Industrial Suppl.	96.7	92.8	95.4	106.0	105.1	101.6	8.8	-3.4
Gold	3.0	2.8	3.0	4.4	4.1	3.3	0.4	-0.8
Fuels	14.0	11.7	13.9	18.1	16.8	13.0	1.3	-3.8
Other Ind. Suppl.	79.6	78.3	78.6	83.5	84.2	85.4	7.1	1.2
Capital Goods	153.8	155.3	153.1	156.0	155.8	170.5	15.3	14.7
Aircraft & Parts	32.3	34.6	31.6	30.9	30.8	38.9	4.2	8.0
Computers & Parts	25.9	25.1	26.5	26.4	27.3	27.3	2.2	0.0
Other Machinery	95.6	95.5	95.0	98.7	97.7	104.4	8.8	6.7
Automotive Product	37.4	38.7	38.4	37.1	34.2	40.3	1.6	6.2
To Canada	22.6	23.8	23.5	21.5	19.5	22.3	-1.6	2.8
To Other	14.8	14.8	14.9	15.6	14.7	18.0	3.2	3.4
Consumer Goods	43.3	43.8	42.8	45.8	45.9	44.5	0.7	-1.4
Other Nonagric.	18.2	17.0	17.6	19.6	22.9	21.5	4.5	-1.4
Total U.S. Imports	497.7	484.7	501.6	513.2	477.2	478.9	-5.8	1.7
Oil Imports	62.1	51.3	61.8	72.1	52.9	51.6	0.3	-1.3
Non-Oil Imports	435.6	433.4	439.8	441.1	424.3	427.3	-6.1	3.0
Industrial Suppl.	82.5	82.0	83.3	83.9	80.4	80.8	-1.2	0.4
Gold	2.5	2.1	2.8	3.3	3.3	3.0	0.8	-0.3
Other Fuels	3.6	3.2	3.5	4.3	3.9	4.3	1.1	0.4
Other Ind. Suppl.	76.4	76.7	77.0	76.4	73.2	73.5	-3.1	0.4
Capital Goods	116.4	115.6	116.2	120.2	119.3	121.1	5.5	1.9
Aircraft & Parts	10.6	10.7	9.9	12.8	11.2	12.4	1.7	1.2
Computers & Parts	23.0	22.9	23.0	23.3	24.2	26.0	3.1	1.8
Other Machinery	82.8	82.0	83.3	84.1	83.9	82.7	0.7	-1.2
Automotive Product	87.3	87.3	90.3	86.1	82.1	78.9	-8.4	-3.1
From Canada	29.7	31.0	32.2	27.3	23.5	28.5	-2.5	4.9
From Other	56.5	56.4	58.1	58.8	58.5	50.5	-5.9	-8.1
Consumer Goods	106.2	104.7	106.6	106.9	100.5	100.3	-4.4	-0.2
Foods	26.6	27.1	25.8	26.0	25.6	28.0	0.9	2.4
All Other	16.4	16.7	17.5	18.1	16.6	18.2	1.5	1.6

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

OIL IMPORTS
(BOP basis, value at annual rates)

	1990	1991		Months				
	Q4	Q1	Q2	Mar	Apr	May	Jun	Jul
Value (Bil. $)	72.08	52.88	51.62	46.07	49.03	55.35	50.47	48.07
Price ($/BBL)	28.75	20.33	17.32	17.90	17.34	17.58	17.00	16.63
Quantity (mb/d)	6.86	7.13	8.16	7.05	7.74	8.62	8.13	8.57

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

through all major trade categories. Export prices fell 0.7 percent in July, following smaller decreases in the previous two months. Most of the decline was in agricultural products. Data for August will be released September 26, and will be included in the Greenbook supplement.

In the second quarter, non-oil import prices (fixed-weight basis reported in the GNP accounts) declined 3.7 percent at an annual rate. Price declines occurred in all major trade categories except foods. The declines are attributable to the combined effects of dollar appreciation and sluggish U.S. demand during this period.

Prices of agricultural exports in the second quarter moved up 15 percent at an annual rate for the second quarter in a row. 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, automotive products, and consumer goods were more than offset by declines in the prices of exported industrial supplies (especially fuels, chemicals, and paper).

U.S. Current Account through 1991-Q2

The U.S. current account balance was in surplus by $12 billion at an annual rate in the second quarter, compared with a surplus of $42 billion in the first quarter. Unilateral transfers from coalition partners in Operation Desert Storm were considerably smaller in the second quarter

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

	Year 1991-Q2 / 1990-Q2	Quarters 1990 Q4	1991 Q1	1991 Q2	Months 1991 Jun	Jul
		(Quarterly Average, AR)			(Monthly Rates)	
	BLS Prices					
<u>Imports, Total</u>	2.9	24.9	-11.9	-7.4	-0.9	-0.4
Foods, Feeds, Bev.	5.8	5.2	7.8	3.0	-0.4	-0.5
Industrial Supplies	3.0	77.1	-40.4	-19.1	-1.9	-0.1
Ind Supp Ex Oil*	-0.9	2.7	-0.2	-4.4	-1.0	-0.5
Capital Goods	2.8	8.2	4.9	-5.4	-0.8	-0.9
Automotive Products	5.3	10.3	6.6	1.2	-0.6	-0.1
Consumer Goods	0.5	4.5	2.5	-4.3	0.3	-0.6
Memo:						
Oil	10.6	307.2	-73.1	-41.7	-4.1	0.8
Non-oil	2.2	6.3	3.7	-2.7	-0.5	-0.5
<u>Exports, Total</u>	1.4	4.4	0.6	-1.2	-0.1	-0.7
Foods, Feeds, Bev.	-4.0	-16.5	8.3	8.1	0.1	-4.4
Industrial Supplies	-0.8	15.9	-9.6	-12.0	-0.6	-0.6
Capital Goods	3.6	2.1	5.6	3.5	0.4	-0.1
Automotive Products	2.7	3.5	3.5	2.0	0.4	0.2
Consumer Goods	4.4	3.7	6.0	6.3	-1.4	0.2
Memo:						
Agricultural	-3.7	-14.2	6.7	6.7	-0.1	-3.9
Nonagricultural	2.1	7.9	-0.6	-2.7	-0.1	-0.2
	Prices in the GNP Accounts					
<u>Fixed-Weight</u>						
Imports, Total	3.0	34.4	-18.3	-11.3	--	--
Oil	8.4	346.2	-75.0	-47.5	--	--
Non-oil	2.3	5.3	4.0	-3.7	--	--
Exports, Total	1.6	5.7	0.4	-0.4	--	--
Ag	-0.5	-11.8	7.8	14.9	--	--
Nonag	2.0	9.5	-1.0	-3.1	--	--
<u>Deflators</u>						
Imports, Total	-2.2	27.1	-20.8	-18.3	--	--
Oil	8.2	345.0	-75.0	-47.6	--	--
Non-oil	-3.3	0.6	-4.7	-10.7	--	--
Exports, Total	-1.3	3.6	-5.2	0.7	--	--
Ag	-0.5	-11.8	7.8	14.9	--	--
Nonag	-1.2	5.6	-6.6	-0.1	--	--

*/ Months not for publication.

than in the first, and more than accounted for the decrease in the surplus. Excluding unilateral transfers, the deficit of all other current account transactions (goods, services and investment income) narrowed by $5 billion.

Improvements in the balances for merchandise trade, military transactions, and other services, were nearly offset by a weakening in net investment income receipts. There was a substantial reduction in receipts on U.S. direct investments abroad, both from petroleum and nonpetroleum affiliates.

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

	1990 Year	1991 Q1	1991 Q2	Changes Q2-Q1
1. Trade Balance	-108.1	-73.6	-62.5	11.1
2. Exports	389.6	403.6	416.4	12.8
3. Imports	497.7	477.2	478.9	1.8
4. Investment Income, net	11.9	19.5	9.9	-9.7
5. Direct Investment, net	52.7	61.3	52.6	-8.7
6. Portfolio Income, net	-40.7	-41.8	-42.8	-1.0
7. Service Transactions	26.4	28.3	31.9	3.6
8. Military, net	-7.2	-9.3	-6.7	2.6
9. Other Services, net	33.6	37.6	38.6	1.0
10. Unilateral Transfers	-22.3	67.8	32.6	-35.1
11. Current Account Balance	-92.1	42.0	11.9	-30.1

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

U.S. International Financial Transactions

Banks reported a small net capital inflow in July (see line 1 of the Summary of U.S. International Transactions table). The inflow was more than accounted for by a reduction in bank claims on foreign public borrowers and other nonbanks. Brazil accounted for almost $3 billion of the inflow, in part as a result of the outcome of the negotiations with banks on interest arrears. Repurchase agreements (RPs) with the World Bank accounted for

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

	1989 Year	1990 Year	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1991 May.	1991 Jun.	1991 Jul.
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	-31.1	-3.8	-7.7	3.4
Securities									
2. Private securities transactions, net[1]	15.4	-28.4	-4.0	-7.3	-4.4	2.1	0.5	-0.2	-0.9
a) foreign net purchases (+) of U.S. corporate bonds[2]	32.0	16.5	-0.1	6.2	3.8	7.7	2.6	3.6	1.9
b) foreign net purchases (+) of U.S. corporate stocks	7.9	-13.7	-2.3	-5.0	1.8	7.7	3.2	1.4	1.0
c) U.S. net purchases (-) of foreign securities	-24.5	-31.3	-1.7	-8.5	-10.0	-13.2	-5.3	-5.1	-3.9
3. Foreign net purchases (+) of U.S. Treasury obligations	30.1	-0.2	0.2	-2.5	3.5	14.2	13.8	0.3	1.1
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	6.3	-4.7	3.2
a) By area									
G-10 countries	-5.2	10.0	8.6	8.6	-11.7	-5.0	2.1	-0.8	-0.[illegible]
OPEC	10.1	1.1	-1.4	-0.6	0.3	-2.8	-0.2	-0.7	
All other countries	3.4	20.8	7.1	10.8	17.0	4.0	4.4	-3.3	4.[illegible]
b) By type									
U.S. Treasury securities	0.1	29.6	12.3	19.7	2.4	-2.2	3.4	-3.6	0.9
Other[3]	8.2	2.3	2.0	-0.9	3.2	-1.7	2.9	-1.2	2.4
5. Changes in U.S. official reserve assets (+ = decrease)	-25.3	-2.2	1.7	-1.1	-0.4	1.4	-0.2	1.8	1.5
Other transactions (Quarterly data)[4]									
6. U.S. direct investment (-) abroad	-33.4	-33.4	-17.8	-3.8	-11.9	-2.6	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	70.6	37.2	7.1	4.5	4.3	3.3	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[5]	-5.0	-7.8	-0.8	-2.9	0.0	-8.0	n.a.	n.a.	n.a.
9. U.S. current account balance	-106.3	-92.1	-23.9	-23.4	10.5	3.0	n.a.	n.a.	n.a.
10. Statistical discrepancy	18.4	63.5	1.5	19.1	-8.8	21.6	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	-15.6	n.a.	n.a.	n.a.

1. These data have not been adjusted to exclude commissions on securities transactions and, therefore, do not match exactly the data on U.S. international transactions as published by the Department of Commerce.
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 official transactions not shown elsewhere. In addition, it includes amounts resulting from adjustments to the data ma the Department of Commerce and revisions to the data in lines 1 through 5 since publication of the quarterly data in t: Survey of Current Business.

*--Less than $50 million.

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

another $2 billion inflow (RPs are treated as loans and not purchases and sales of securities).

Net U.S. purchases of foreign securities were very strong in July, although below the levels of May and June (line 2c). U.S. residents purchased net $1.8 billion of stocks in the United Kingdom and another $.6 billion of stocks in Japan. Foreigners also continued to add to their holdings of U.S. stocks and corporate bonds in July (lines 2a and 2b). However, more recent data indicate that new issues of Eurobonds by U.S. corporations have fallen below the levels reached in the first half of 1991. Net private foreign purchases of U.S. Treasury securities were modest in July (line 3).

Foreign official reserve assets in the United States increased somewhat in July (line 4). Spain, Taiwan, and Mexico continued to increase their holdings here. In contrast, OPEC and G-10 holdings were virtually unchanged.

Data recently released by the Department of Commerce indicate only small direct investment capital flows in the second quarter. Foreign direct investment in the United States was depressed in the second quarter, as it had been in the first quarter, by lower takeover activity as well as by negative reinvested earnings (losses) reported by U.S. affiliates in a variety of industries including nonbank finance, insurance, real estate, and wholesale trade (line 7). U.S. direct investment abroad dropped sharply in the second quarter. The value of acquisitions abroad by U.S. companies has been lower in 1991 than in 1990. The shift from large capital outflows in the first quarter to a small outflow in the second in part reflected a shift in the pattern of intercompany debt with European affiliates.

The adjustment of foreign-based banks to the earlier Federal Reserve Board decision to eliminate reserve requirements on large time deposits had

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1989				1990				1991			
	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	July	Aug.
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	-11.0	-10.2
(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	9.2	9.4
(b) Foreign-chartered banks	-23.3	-23.1	-21.3	-24.7	-23.9	-18.2	-21.3	-36.9	-31.3	-19.2	-20.2	-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	23.4
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	105.8	101.7	98.8

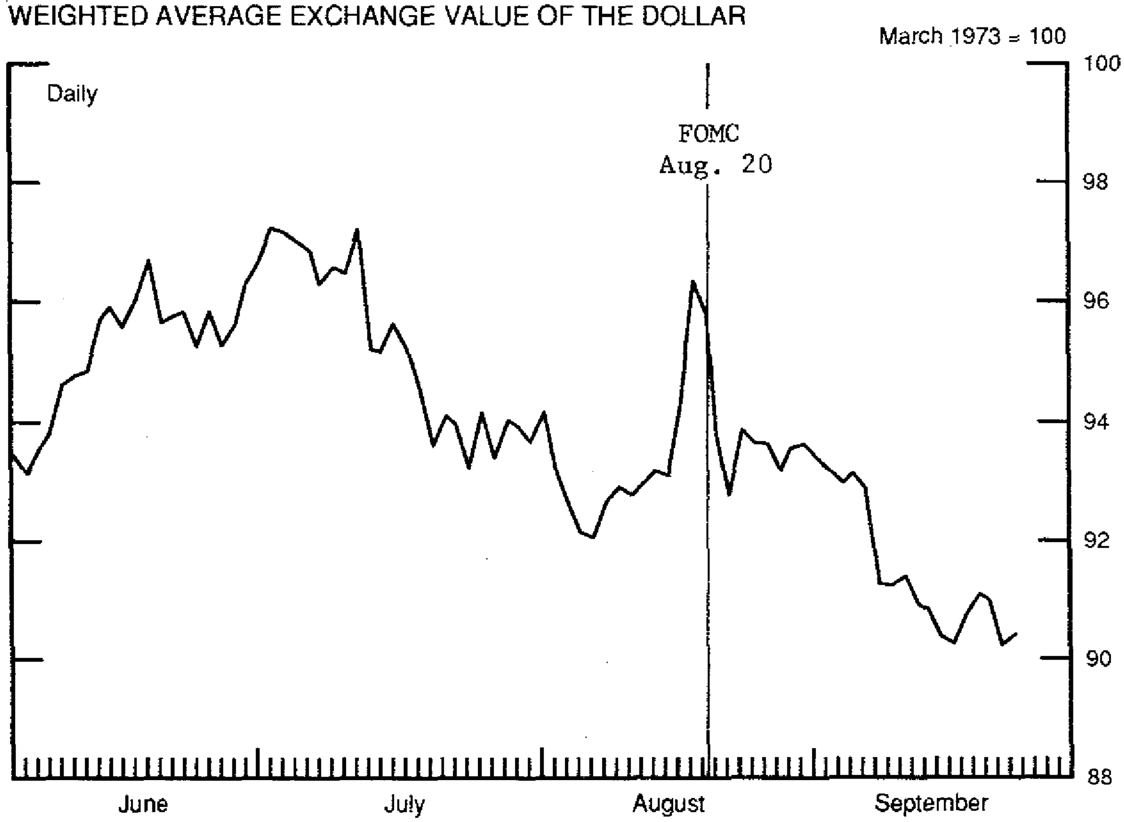
1. Includes term and overnight Eurodollars held by money market mutual funds. Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices.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

a noticeable impact on several components of the U.S. international transactions accounts in the second quarter. First, foreign-based banks continued to expand their large time deposits outstanding in the United States while sharply reducing their net borrowings from their own foreign offices and from the Euro-interbank market. These adjustments resulted in a large net capital outflow reported by banks (part of line 1 of the Summary of U.S. International Transactions table). Second, commercial paper outstanding in the United States issued by foreign parent banks or by their U.S. finance affiliates declined sharply (by $9 billion and $3.5 billion respectively during the second quarter). Without the inflow to foreign bank finance affiliates (reported in the direct investment accounts) to pay down commercial paper, foreign direct investment in the United States would have been virtually zero in the second quarter (see line 7). Third, some U.S. investors in large time deposits issued by foreign banks in the United States appear to have shifted out of Eurodollar deposits; Federal Reserve data show a $9 billion average decline in U.S. nonbanks' Eurodollar holdings between March and June (see line 3 of the International Banking Data table on previous page). Since BEA's U.S. international transactions data do not adequately cover changes in U.S. nonbanks' holdings of foreign commercial paper and deposits, the decline in these holdings in the second quarter contributed significantly to the large positive statistical discrepancy in the U.S. international transactions accounts (line 10).

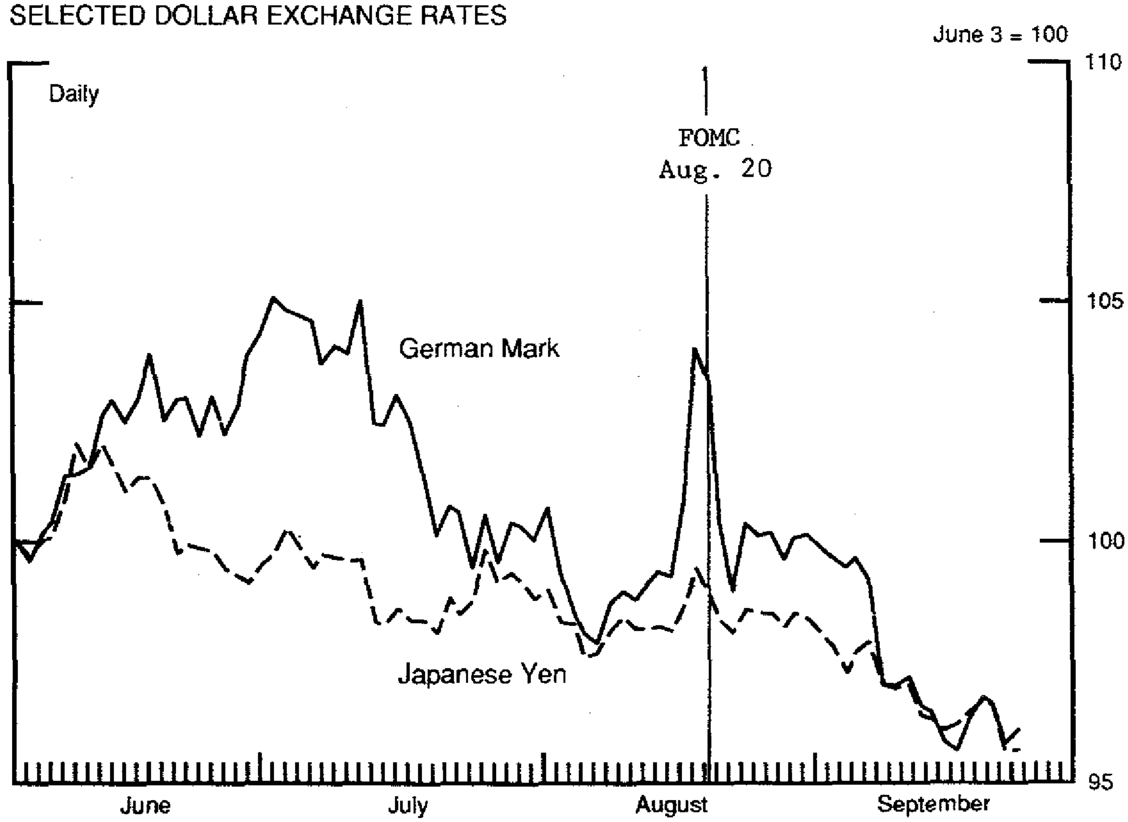
Foreign Exchange Markets

The weighted average value of the dollar declined about 5-1/2 percent since the August 20 FOMC meeting. A large part of that decline occurred in the first two days of the intermeeting period, as the sharp runup of the dollar in response to the ouster of Soviet President Gorbachev was reversed when it became clear that the coup attempt had failed. The dollar moved

WEIGHTED AVERAGE EXCHANGE VALUE OF THE DOLLAR



SELECTED DOLLAR EXCHANGE RATES



lower later in the period amid disappointment with the pace of the U.S. recovery and expectations that continued weakness in U.S. money growth would prompt the Federal Reserve to ease. These expectations were realized on September 13, but, because they had been so widespread, there was little further rate movement in reaction to the discount rate cut itself or the decline in the federal funds rate. In the days following, however, the dollar drifted somewhat lower amid commentary that the Fed may ease further.

The dollar's decline was more pronounced against the mark--7 percent--than against the yen--3-1/4 percent. Because of Germany's ties with Eastern Europe and the Soviet Union, the mark was particularly volatile during the days of the coup, and part of the mark's stronger performance can be explained by the coup's failure and perhaps also the resulting improvement in the outlook for political reform and trade in the region. Changes in interest rate differentials during the intermeeting period also contributed to the mark's relative strength. The interest rate on three-month CDs in Japan declined 70 basis points in the period since the August FOMC meeting, while the comparable rate in Germany declined only 10 basis points. The movement in the Japanese interest rate reflects some actual easing of monetary policy there as well as market expectations that further easing is on the way, while further monetary tightening in Germany appears to be on hold. The yield on the bellwether bond in Japan moved down nearly 45 basis points during the intermeeting period to 6.05 percent, while the bellwether yield in Germany declined only 15 basis points to 8.43 percent.

Sterling declined about 1-1/4 percent against the mark during the intermeeting period. Sterling had been buoyed early in the period by polls that showed the Conservative Party pulling ahead of Labour and by favorable press reports on Prime Minister Major's trips to Moscow, Beijing, and Hong Kong. The pound remained firm against the mark despite a sooner-than-expected 1/2-point cut in the Bank of England's money-market dealing rate on September 4. However, the bullish sentiment was overturned subsequently as market participants began to focus on the possibility that Prime Minister Major might call an early election and push U.K. interest rates down further prematurely. The likelihood of this scenario diminished late in the period, however, as the most recent polls show Labour once again ahead of the Conservatives by a small margin. Both the three-month interbank interest rate in the United Kingdom and the bellwether yield declined 45 basis points during the intermeeting period to about 10.30 percent and 9.55 percent, respectively.

. The Desk did not intervene during the period.

Developments in Foreign Industrial Countries

Recent monthly data suggest that economic activity grew slowly in foreign industrial countries during the third quarter, following positive surprises in recently released national accounts data for the second quarter. After double-digit growth in the first quarter, GNP growth in Japan and western Germany fell sharply in the second quarter, although the decline in Japanese growth was less than expected. Monthly indicators suggest that economic activity in these two countries continued to grow slowly in the third quarter. Canadian GNP and French marketable GDP grew strongly in the second quarter, but other indicators do not confirm a robust recovery. The recession in the United Kingdom continued into the second quarter, but other recent data show suggest the start of recovery.

Recent data on prices show some gains in reducing inflation abroad. Inflation in both Canada and the United Kingdom has declined in recent months partially in response to the lagged impact of their recessions.

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 Apr.	1991 May	1991 June	1991 July	1991 Aug.	Latest 3 months from year ago 2
Canada												
GDP	2.1	-1.1	-.3	-1.2	-1.2	1.2	*	*	*	*	*	-1.5
IP	-1.1	-6.3	-.9	-3.3	-2.2	1.3	1.3	.8	.4	n.a.	n.a.	-5.0
France												
GDP	3.9	1.9	.9	-.1	.1	n.a.	*	*	*	*	*	1.0
IP	2.8	-.3	1.4	-2.7	.3	1.1	3.5	-.2	.0	n.a.	n.a.	.1
West Germany												
GNP	3.2	5.3	1.8	.6	2.4	-.6	*	*	*	*	*	4.3
IP	4.8	5.4	3.0	.4	2.0	-.1	-.9	-1.0	3.8	-1.2	n.a.	4.5
Italy												
GDP	2.9	1.0	.5	-.1	.3	n.a.	*	*	*	*	*	.5
IP	3.3	-3.8	1.4	-1.9	.3	n.a.	-2.1	1.1	n.a.	n.a.	n.a.	-2.5
Japan												
GNP	4.8	4.8	1.1	.6	2.7	.5	*	*	*	*	*	5.0
IP	4.2	6.9	2.2	1.7	-.1	-.7	.5	2.0	-2.8	3.2	n.a.	2.6
United Kingdom												
GDP	1.3	-.7	-2.2	-.2	-.8	-.6	*	*	*	*	*	-3.7
IP	.3	-3.4	-3.0	-1.8	-.1	-1.3	-2.7	-.5	3.6	.1	n.a.	-4.4
United States												
GNP	1.8	.5	.4	-.4	-.7	-.0	*	*	*	*	*	-.8
IP	1.1	.3	1.0	-1.8	-2.5	.6	.5	.9	.8	.6	.3	-2.2

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

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

	Q4/Q4 1989	Q4/Q4 1990	1990 Q1	1990 Q2	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1991 May	1991 June	1991 July	1991 Aug.	Latest 3 months from year ago
Canada													
CPI	5.2	4.9	1.4	.9	1.1	1.4	2.9	.7	.5	.5	.1	.1	6.0
WPI	.2	1.6	.4	.3	-.1	1.0	.1	-1.6	-.4	-.3	-.3	n.a.	-.9
France													
CPI	3.6	3.6	.7	.9	1.0	1.0	.5	.7	.3	.2	.4	.2	3.2
WPI	.9	.7	-.3	-.3	.2	1.1	-.5	-1.3	*	*	*	*	-.5
West Germany													
CPI	3.0	3.0	1.1	.5	.4	.9	.8	.9	.4	.5	.9	.0	4.0
WPI	4.3	.9	-.3	.6	.2	.4	.5	.3	.6	.3	.8	-.9	2.1
Italy													
CPI	6.6	6.3	1.6	1.2	1.4	2.0	1.9	1.4	.4	.5	.2	.3	6.6
WPI	n.a.	9.9	1.4	-.0	3.9	4.3	.2	-1.0	.2	.4	-.3	n.a.	7.3
Japan													
CPI	2.9	3.5	.4	1.2	.3	1.5	.8	.6	.4	-.2	.1	.4	3.5
WPI	3.7	1.9	.4	.8	.0	.7	.1	-.4	.1	-.1	-.2	.0	.4
United Kingdom													
CPI	7.6	10.0	1.8	4.7	1.6	1.6	.6	2.0	.3	.4	-.2	.2	5.3
WPI	5.2	5.9	1.6	2.1	.9	1.1	2.0	1.8	.3	.1	.4	.1	5.8
United States													
CPI (SA)	4.6	6.3	1.8	1.0	1.7	1.7	.9	.5	.3	.2	.2	.2	4.3
WPI (SA)	4.9	6.5	2.1	.1	1.6	2.6	-.6	-.2	.4	-.3	-.2	.2	2.5

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	May	June	July	Aug.
Canada												
Trade	6.0	9.4	1.6	2.7	2.8	2.3	2.3	2.6	1.0	.7	.1	n.a.
Current account	-14.1	-14.0	-4.4	-3.6	-2.9	-3.1	-4.8	-4.8	*	*	*	*
France												
Trade	-6.9	-9.3	-.6	-2.0	-3.6	-3.1	-2.6	-1.4	-.3	-.7	-.7	-.6
Current account	-3.1	-8.0	-.1	-2.9	-3.5	-1.4	-2.9	n.a.	*	*	*	*
Germany 2												
Trade (NSA)	71.6	65.2	22.4	16.7	16.0	10.1	4.4	-1.1	-.5	.2	-1.1	n.a.
Current Account (NSA)	57.3	47.3	18.8	10.7	9.4	8.5	-5.9	-6.2	-2.6	-2.1	-3.2	n.a.
Italy												
Trade	-12.6	-12.1	-3.5	-1.9	-2.9	-3.9	-1.2	-4.1	-2.2	-.1	-2.2	n.a.
Current account (NSA)	-10.7	-14.2	-9.1	-2.2	.7	-3.7	n.a.	n.a.	*	*	*	*
Japan												
Trade	64.6	51.8	14.8	14.2	14.2	8.5	17.4	18.8	5.8	7.0	5.9	7.0
Current account	57.7	35.8	14.4	7.9	7.0	6.4	17.8	18.8	5.9	5.1	4.7	n.a.
United Kingdom												
Trade	-39.4	-31.6	-9.8	-8.7	-7.4	-5.7	-5.4	-3.7	-1.6	-.6	-1.0	-1.3
Current account	-32.5	-26.7	-8.6	-8.3	-5.9	-3.9	-4.9	-1.6	-.9	.0	-.7	-.9
United States												
Trade	-115.9	-108.1	-27.5	-24.1	-28.8	-27.7	-18.4	-15.6	*	*	*	*
Current account	-106.3	-92.1	-22.7	-22.2	-23.9	-23.4	10.5	3.0	*	*	*	*

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.

After a sharp increase in July, due in part to increases in excise taxes, west German inflation moderated in August.

The pan-German current account deficit did not decline significantly in the second quarter despite the ending of payments connected with the Gulf War. Japanese trade and current account surpluses continue to increase.

Individual Country Notes. Recent indicators of economic activity in Japan have been mixed. Real GNP (s.a.) increased 2 percent (a.r.) in the second quarter, following very rapid 11 percent growth in the first quarter. Domestic demand growth eased to 4 percent in the second quarter from 5.2 percent in the first quarter. Consumption grew strongly (7.2 percent), while plant and equipment investment was weak (down 0.2 percent) and housing investment dropped further (down 24.3 percent). Inventory investment made only a small contribution to second-quarter growth (0.3 percent). The main reason for the slowing of overall growth between the first and second quarters was a swing in the contribution of net exports from positive 5.6 percent to negative 2.1 percent. Exports declined 10.6 percent in the second quarter, while imports were down 1.1 percent.

Other recent indicators of activity, on balance, have been suggested some weakening. Industrial production (s.a.) increased 3.2 percent in July, but this followed a 2.8 percent drop in June. The unemployment rate (s.a.) rose 0.1 percentage point in July to 2.2 percent. The capacity utilization rate (s.a.) fell 3.9 percent in June and was 5.6 percent below its peak level of last October. The Bank of Japan's latest short-term ("Tankan") corporate survey indicated that perceptions of future business conditions declined further in August. The index of leading indicators (s.a.) was below the level designated as indicating weakness for the eleventh consecutive month in July. New manufacturing orders (s.a.) dropped sharply in June, falling 13.5 percent below their level of last December. Housing starts (s.a.) declined in July for the fifth month out of the last six and were 15.7 percent lower than in December last year. New passenger car registrations (s.a.) increased slightly in August, but were below their year-earlier level for the sixth consecutive month. The strongest recent indicator has been retail sales (s.a.), which jumped 4.8 percent in June to 6.9 percent above their level at the end of last year.

Inflationary pressures appear generally to have remained moderate in recent months. The consumer price index for the Tokyo area increased 0.4 percent in August, and its 12-month increase rose to 3.6 percent. However, over the first eight months of this year, Tokyo consumer prices, seasonally adjusted and excluding perishable food items, increased at only a 2.5 percent annual rate. Wholesale prices were unchanged in August, and their 12-month rise was only 0.1 percent.

The trade surplus (s.a.) increased further in August. Over the first eight months of the year, the trade surplus was $74 billion (a.r.), well above the $57 billion surplus in the same period last year. The volume of imports and exports increased 3 percent over this period, while the unit value of imports fell 6 percent, due in large part to lower oil prices, and the unit value of exports declined only 2 percent.

Real GNP in western Germany (adjusted for seasonal and calendar variations) fell at an annual rate of 2.4 percent in the second quarter, after increasing 10.1 percent in the first quarter. Final domestic demand fell sharply. After increasing 87 percent (a.r.) in the first quarter because of mild weather, seasonally adjusted construction investment fell 32 percent in the second quarter. Private consumption was also weak due, in part, to an increase in payroll taxes. West German exports (including shipments to eastern Germany) fell 7.7 percent in the second quarter, while imports increase 2.6 percent. These declines in final demand were partially offset by an increase in inventory investment.

Other data are mixed, but they suggest that growth remained depressed in the third quarter. Although industrial production in western Germany (s.a.) fell 1.2 percent in July, it had increased 3.8 percent in June, and the average level of industrial production for June and July was 2.8 percent above the average level for April and May. The volume of new orders for west German manufactured goods (s.a.) fell slightly in July after increasing strongly in May and June; foreign orders have out performed domestic orders over the past four months. In July, the volume of retail sales (s.a.) in western Germany fell 0.2 percent, after increasing 1.8 percent in the previous month. The west German unemployment rate (s.a.) was unchanged in August after increasing 0.1 percent in July to 6.4 percent.

Official east German unemployment was unchanged in August at 12.1 percent, after increasing 2.6 percentage points in July. The July increase was expected as a number of important employment guarantees expired at the end of June. Labor-market conditions appear to have improved over the past two months as the number of workers engaged in government subsidized "short-time" work has fallen by more than the increase in unemployment. It now appears that recovery in the construction sector is well underway. New construction orders in eastern Germany have increased steadily since February, and May's level was 27.5 percent above the average level for the second half of 1990.

West German consumer prices were unchanged in August, after increasing 0.5 and 0.9 percent in June and July respectively. On a year-over-year basis, consumer-price inflation fell from 4.4 percent in July to 4.1 percent in August. Excluding energy products, west German consumer prices (s.a.) increased 0.4 percent in August, after monthly increases of 0.6 percent in both June and July. West German wholesale prices fell 0.9 percent in August after increasing 0.8 percent in July. On a year-over-year basis WPI inflation was 1.3 percent in August compared with 3.1 percent in July.

Unit labor costs in western Germany continue to accelerate. Average hourly earnings in western Germany (s.a.) increased 3.2 percent in the second quarter, up from a quarterly increase of 2.7 percent in the first quarter. In contrast, output per hour in west German industry (s.a.) was essentially unchanged in the second quarter, after increasing 1.5 percent in the first quarter.

The combined German trade balance (s.a.) deteriorated slightly in July, falling to a deficit of \$2.7 billion (a.r.). For the second quarter as a whole, the trade deficit was \$1.8 billion, compared with a trade surplus of \$18.2 billion in the first quarter. (The last time western Germany had a quarterly trade deficit (s.a.) was in 1965.) The combined German current account (s.a.) improved slightly in the second quarter. The current account deficit fell from \$27.6 billion (a.r.) in the first quarter to \$23.1 billion in the second quarter. The current account showed a small surplus in the first quarter, however, when payments related to the Gulf war, most of which occurred in the first quarter, are excluded. On a non-seasonally adjusted basis the current account deteriorated further in July.

Marketable GDP (s.a.) in France rose 3.2 percent (a.r.) in the second quarter. (This preliminary measure excludes most government services.) The second-quarter increase was largely due to strong net exports. Consumption and investment made small positive contributions, while a decline in inventories made a significant negative contribution. Industrial production (s.a.) remained constant in June, and the unemployment rate (s.a.) increased 0.1 percentage point in July to 9.5 percent.

French consumer prices in August were 3 percent above their level a year earlier. This decrease in inflation from 3.4 percent in July is largely due to the fact that last August's energy price increase is no longer reflected in the 12-month change of the CPI.

France's 1992 draft budget, adopted on September 18, maintains the restrictive fiscal stance of previous years. Expenditures are budgeted to rise 3.1 percent, only slightly more than the projected 1992 inflation rate. The target budget deficit has been set at FF89 billion, about 1.3 percent of GDP and well below the current estimate for the 1991 deficit of FF100 billion. The budget offsets significant increases in expenditures on education and research with a cut in real defense expenditures. Associated with the budget is a reform of corporate income taxation, in which a single tax rate of 34 percent is applied to retained earnings, dividend payments, and capital gains. President Mitterrand announced on September 11 that private-sector firms would be permitted to acquire a stake in public enterprises of up to 49.9 percent. This partial renunciation of his "Ni-Ni" policy (neither privatization, nor nationalization) reflects the need to increase capitalization of public enterprises without resorting to government transfers.

In Italy, preliminary data indicate that industrial production (s.a.) rose about 2 percent in June, after rising 1.1 percent in May. Consumer demand appears to have increased recently; auto sales were up 7.2 percent in August and 5.6 percent in July on a year-over-year basis.

Consumer prices in August were 6.3 percent above their level a year earlier, down considerably from the 6.7 percent rise of July and the 6.9 percent rise of June. This slowing of inflation reflects the fact that higher energy prices arising from the August 1990 Gulf crisis and higher indirect taxes introduced a year ago are no longer captured in the 12-month change in the CPI. Wholesale price inflation continued to slow in July, rising 6.9 percent above the level a year earlier, down from 7.2 percent in the previous month.

Italy's 1991 cumulative trade deficit (s.a.) was $13 billion (a.r.) through July, up from $10.5 billion during the same period of 1990.

Italy's fiscal deficit is running well above the government's target, in part because of the slowing economy. During the first eight months of 1991, the deficit was reportedly 82 trillion lire ($66 billion), about 25 percent above its level during the same period last year. Most observers expect the actual 1991 deficit to be 140 to 150 trillion lire, or roughly 10 to 10-1/2 percent of GDP, well above the deficit target of 9.1 percent of GDP.

The United Kingdom has been in a recession since the third quarter of 1990. Real GDP (s.a.) fell 2.4 percent (a.r.) in the second quarter and is 3.7 percent below its level at the onset of the recession. Private consumption was down slightly in the second quarter, and gross fixed capital formation fell 11.4 percent. Significant destocking of inventories occurred for the third consecutive quarter. Exports grew strongly (13 percent) and imports were up (3.4 percent) for the first time in a year.

Recent data provide some support for the view that the United Kingdom is emerging from its recession, but the recovery is still tentative. Housing starts rose 12 percent in May-July compared with the previous three months. Retail sales were up strongly in June and July, but fell back in August. Industrial output of manufactured products rose gradually between May and July, but remained 5.2 percent below its pre-recession level of July 1990.

The inflation rate has dropped considerably during the past year. After peaking at a year-over-year rate of 10.9 percent in October 1990, consumer-price inflation fell to 4.7 percent this August. Almost half of the decline in measured inflation has stemmed from cuts in mortgage rates. Producers' output prices inched up in August to a level 5.6 percent above a year ago. This year-on-year increase is the lowest since March 1990. As unemployment swelled (to a rate of 8.5 percent in August), the rate of wage inflation fell to 7-1/2 percent (year/year) in July compared with a peak rate of 10-1/4 percent a year earlier.

The recession has led to a narrowing of Britain's current account deficit. The cumulative current account deficit (s.a.) for the first eight months of 1991 was $12.2 billion (a.r.) compared with a $31.2 deficit for the same period in 1990.

In Canada, real GDP (s.a.) rose 4.9 percent (a.r.) in the second quarter, ending four consecutive quarters of decline; the level of GNP was still 1.7 percent below its peak in the first quarter of 1990, however. The stronger-than-expected rebound in output was led by a 20.6 percent increase in exports, a 7.8 percent increase in real consumption expenditures, and a 6.4 percent increase in investment. Final domestic demand grew 6 percent but inventories dropped sharply.

Recent monthly data, however, suggest that the recovery is fragile. Housing starts (s.a.) fell 3.2 percent in August, manufacturer's shipments fell 0.3 percent (s.a.) in July, and retail sales (s.a.) were virtually unchanged in June. Unemployment (s.a.) increased from 10.5 percent to 10.6 percent in August, a figure exceeding any recorded during the recession. Industrial production (s.a.) increased 0.4 percent in June, however, and new car sales (s.a.) were up 0.8 percent in July.

Recent price data suggest that the government's anti-inflation efforts are beginning to bear fruit. The consumer price index posted consecutive increases of only 0.1 percent in July and August, but twelve-month inflation fell 0.5 percentage points in July to 5.8 percent due to the surge in oil prices in August 1990. Industrial product prices fell 0.3 percent in July, the sixth straight monthly decline. Private sector wage settlements (s.a.) increased 0.4 percent in June and 0.2 percent in July.

The current account deficit (s.a.) was virtually unchanged in the second quarter at $19.3 billion (a.r.). A slight increase in the merchandise trade surplus (s.a.) to $11.2 billion (a.r.) was offset by an increasing deficit in non-merchandise transactions.

Developments in East European Countries

Economic adjustment in Eastern Europe is progressing. In recent months inflation rates in Poland, Hungary, and the Czech and Slovak Federal Republic have declined to their lowest levels since reform programs were put in place, and trade with the west continues to expand. However, data for July and August provide little evidence of a turnaround in economic activity in the region. On September 6, EC Ministers tabled a proposed package of trade liberalization measures that would have sharply expanded Eastern European access to EC markets, particularly for agriculture and textiles.

In Poland, industrial sales were stable in August following a sharp drop in July. For the first eight months of the year, industrial sales were off 22 percent compared with the same period a year earlier. The August unemployment rate rose 0.4 percentage points to 9.8 percent. One positive development was that monthly inflation was 0.1 percent in July and 0.6 percent in August. These inflation rates are the lowest since the start of the adjustment effort 1-1/2 years ago. Also, the trade balance registered a small surplus in August, the fourth consecutive monthly surplus following the May devaluation.

A weakening economy, coupled with the poor financial condition of state enterprises, contributed to a shortfall in government revenues and caused Poland to miss its end-June IMF budget targets. Measures proposed by the government that would put the economic program on track have run into heavy opposition in the Parliament (SEJM), which has also stalled government-sponsored legislation on privatization and central banking reform. It is unlikely that these measures will be approved before the SEJM elections on October 27.

In Hungary, industrial production contracted 21 percent in the first seven months of 1991 compared with the same period a year ago. The decline was concentrated in large state firms, while output of small firms (mostly private) increased. The unemployment rate rose to 5.2 percent in August from 4.6 percent in July. Inflation was 0.9 percent in July and has declined steadily since the beginning of the year.

In the Czech and Slovak Federal Republic, industrial production was essentially stable in July, but it was 22 below year-earlier levels. The unemployment rate rose to 4.6 percent in July from 3.8 percent in June. One bright spot was that prices fell 0.1 percent in July. Prices appear to have stabilized after a 25 percent increase since January when a broad liberalization was implemented. With the decline in inflation, the Central Bank announced a lowering of the discount rate by 1/2 percentage point to 9-1/2 percent.

The dramatic events in the Soviet Union in late August have further complicated an already fragile economic situation. Industrial production has fallen 6.4 percent in the first eight months of 1991 compared with the same period in 1990, and GNP is expected to fall 15 percent in 1991. Soviet trade with the West has fallen from already low levels, and there are fears of a collapse of inter-republic trade in coming months. Despite severe import compression, recent events have raised concerns about whether the

Soviet Union's $60-$65 billion external debt will continue to be serviced. (Germany remains the largest single creditor of the Soviet Union.)

Economic situation in other countries

The rise in Mexico's real GDP in the first half of this year exceeded expectations, but the rate of inflation continued to decline. An improvement in Mexico's public finances allowed the Bank of Mexico to ease banks' liquidity reserve requirements in September. Brazil paid $470 million in mid-September to commercial banks pursuant to an arrears agreement that was signed last April. The IMF staff are now exploring the possibilities for negotiating a program. However, it remains to be seen whether Brazil can present a policy package that will meet IMF requirements. The macroeconomic situation in Argentina has continued to improve, with the inflation rate declining, industrial activity recovering, and money market rates dropping. Peru made substantial progress in repairing its relations with the international financial community. In mid-September the IMF approved a "rights accumulation" program for Peru, and the Paris Club rescheduled $6.6 billion of Peru's foreign debt. The Philippines missed some end-June IMF program targets, and an IMF Board review has been postponed to November. Real GDP increased rapidly in Korea in the first half of the year, but the current account deficit rose to a record level. Taiwan's authorities eased monetary policy in September to stimulate private domestic investment and to decrease pressure on the appreciating NT dollar.

Individual Country Notes. Mexico's real GDP was 4.8 percent higher in the first half of this year than in the same period in 1990. This rate of increase exceeded expectations. However, the monthly CPI increase has continued to decline. In August, the CPI was 0.7 percent higher than in July and 20.7 percent higher than a year earlier. The merchandise trade deficit for the first half was $2 billion, compared with a $0.7 million surplus in the same period in 1990. The current account deficit was $4.6 billion.

Interest rates eased further in August, but turned up late in the month and the first half of September. At the September 17 auction of treasury securities, the rate for 28-day bills was 17.25 percent, 150 basis points higher than at the low point on August 27. In part, the recent upturn in rates--which occurred in spite of heavy open market purchases by the Bank of Mexico--was associated with a scramble by commercial banks to cover end-of-month liquidity reserve requirements, when the first payment on the privatization of the National Bank of Mexico (BANAMEX), equal to 20 percent of the purchase price, fell due on September 2. A large brokerage house, Acciones y Valores, won the bidding for BANAMEX, with a bid equivalent to almost $3.2 billion for about 70 percent of the stock. The rest of the stock is held by the private sector.

On September 12, the Bank of Mexico eased the banks' liquidity reserve requirement by instituting an absolute ceiling in terms of peso amounts on their required holdings of government securities. The Bank explained that the improvement in the country's public finances made it unnecessary to require banks to continue buying government securities. This is expected to result in a stimulation of additional bank credit to the private sector, which may prove to be inconsistent with the need to avoid overheating of the economy.

In the mid-term congressional elections held August 18, the PRI (the government party) increased its majority in the lower house of the Mexican Congress from 52 percent to approximately 64 percent, mainly at the expense of the leftist opposition parties.

In late August, <u>Brazil</u> opened negotiations to restructure its $60 billion medium- and long-term external debt to commercial banks. Creditor banks responded very favorably to the proposal and Brazilian debt in the secondary market rose from 35 cents to 39.5 cents on the dollar. Several options in the proposal envision enhancements on the principal, which are likely to require that Brazil agree to an IMF program. Brazil also paid $470 million in mid-September pursuant to the interest arrears agreement that was signed last April. The amount includes 30 percent of interest due plus a cash payment. The remaining payments on the $2 billion cash settlement will be spread out through the end of the year.

Discussions with IMF staff on a possible program are in progress, but it remains to be seen whether Brazil can assemble a policy package acceptable to the IMF. Due to continuing budget deficits and the public's reluctance to hold government debt, Brazil is currently in a severe budgetary crisis. In August and September, the government returned about $1 billion in funds it had frozen in March 1990, but imposed high commercial bank reserve requirements in order to force the domestic banks to hold public debt. The government's expected return of an estimated $24 billion (equivalent) in frozen savings over the next twelve months is putting strong pressures on government spending.

Reflecting the budget deficits, the rate of inflation has been rising and is expected to increase further. Consumer prices rose 15.5 percent in August, and are expected to rise by 18-19 percent in September. Economic activity appears to have risen in recent months, although it is below levels attained in 1989. The Sao Paulo index of industrial activity rose 5.4 percent in July compared with June, and was 6 percent above its level in July 1990. Brazil's cumulative trade surplus through July was $7.9 billion, compared with $7.5 for the same period in 1990.

The status of budgetary reforms proposed by the Brazilian economic team is uncertain. Many of the proposed reforms require changes in Brazil's constitution, which need a three-fifths majority vote in congress. President Collor rejected congress' proposal to reindex wages, and a new law with partial wage controls was passed earlier this month. Over the past few weeks, there have been rumors that the present economic team that has been in power since mid-May would be replaced and that price controls would be imposed once again.

In Argentina, the macroeconomic situation has continued to improve. Consumer price inflation on a monthly basis declined from 2.6 percent in July to 1.3 percent in August, the smallest monthly increase since 1974. Monthly short-term call money rates have declined to close to 1 percent per month, also very low by historical standards. In recent months industrial activity has begun to recover from its low in 1990, although it has yet to regain the levels reached in the mid-1980s.

Based on increased optimism concerning the prospects for the stabilization program, the secondary market price of the government's BONEX (10-year dollar-denominated bonds) has increased from 65 percent of face value in April to 80 percent in recent days. During the same period, the secondary market price of commercial bank debt increased from 20 percent to almost 40 percent of face value, while the Buenos Aires' stock exchange index increased by more than 80 percent. On September 10, the Argentine government successfully issued a two-year Eurobond offering underwritten by J.P. Morgan. On the basis of strong initial demand, the size of the offering was increased from $100 million to $300 million. The bonds will pay 11 percent annually, or about 500 basis points above LIBOR. On September 18 the Paris Club rescheduled $1.6 billion in Argentine bilateral debt, covering most interest and all principal coming due through June 1992, over 10 years with six years grace. As part of the agreement, Argentina must clear by the end of 1991 about $267 million in arrears to the Paris Club creditors.

The key to sustaining the stabilization program is balancing the budget. Under the IMF stand-by arrangement approved at the end of July, Argentina is projected to achieve a fiscal surplus, excluding interest payments and capital revenues, of 1 percent of GDP, or about $350 million, during the third quarter of 1991. A $30 million deficit was registered in July, although, in part, this reflected the payment of about $200 million in traditional mid-year bonuses to government employees. While the July shortfall was offset by receipts of $240 million from the sale of oil concessions, it is clear that various fiscal problems must still be addressed. These include the financial problems of the provincial governments and the social security system, as well as continued, widespread tax evasion.

On September 13, Peru cleared its arrears with the Inter-American Development Bank (IDB) with the help of a four-year loan from the Latin American Reserve Fund, which is funded by regional central banks, and is scheduled to receive the first $100 million disbursement of an IDB foreign trade sector loan in October. On September 12, the International Monetary Fund approved a "rights accumulation" program for Peru for up to a maximum of SDR 623.7 million (about $825 million). Under such a program, an IMF member with protracted arrears can earn "rights," based on sustained performance over a certain period monitored by the IMF, toward future financing once its arrears to the IMF have been cleared. In addition, on September 17, the Paris Club rescheduled $6.6 billion of Peru's foreign debt, allowing repayment over 20 years, among other terms.

The Philippines was unable to draw in August the $50 million third tranche of its 18-month stand-by arrangement with the IMF because it exceeded the base money target at the end of June. Accordingly, a review of the program by the IMF Board was postponed to November. On August 30 a tentative agreement was reached with the foreign commercial banks on a restructuring of part of the $5.3 billion in public sector commercial bank debt. The agreement includes four options: new loans through the purchase of 17-year bonds and the conversion of existing Philippine debt into bonds; new loans through cofinancing with the Asian Development Bank; and swaps of outstanding loans either into 15-year interest-reduction bonds, or 25-year collateralized interest-reduction bonds.

Korea's real GDP rose 9.2 percent in the first half of 1991, led by an investment boom. The current account deficit rose to a record $7 billion in the first seven months of 1991 from $1 billion in the year-earlier period, as a steep rise in imports of oil and capital goods more than offset a recovery in exports. In order to slow import growth, the government has reduced the private sector's access to foreign currency loans. Rapid growth of economic activity in excess of potential has continued to put pressure on consumer prices, which were up 9.5 percent in August over a year earlier.

In Taiwan, economic activity has picked up moderately this year due to stronger exports and rising public investment. In the first eight months of 1991, exports increased 12.7 percent, with large increases in exports to Europe and to Asia, particularly China (through Hong Kong). The cumulative trade surplus was $7.9 billion over that period, essentially unchanged from the same period last year. Inflation has decelerated this year and consumer prices were only 3.3 percent higher in August than a year earlier. On September 9 and September 20, Taiwan's central bank cut its rediscount rate by a total of 3/4 of a percentage point to 6.6 percent and reduced reserve requirements.