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[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

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Confidential (FR) Class III FOMC

December 11, 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 recovery in economic activity has stalled. Payroll employment fell substantially in November, and industrial production likely turned down. Consumer spending has softened, commercial construction still is in free-fall, and the federal and state and local sectors continue to be mired in budgetary imbalances. Elsewhere, spending for housing and business equipment has been rising, but the current momentum is uncertain. The incoming data on wages and prices have continued to suggest that inflation is trending down.

Employment and Unemployment

Labor market conditions weakened in November. Private payroll employment, which had edged down 30,000 in October, fell an additional 230,000 last month.[1] And, despite a slight lengthening of the workweek, which came mainly in retail trade, the aggregate hours of production or nonsupervisory workers slipped another 0.1 percent last month, after a drop of 0.7 percent in October; these declines left the average level of hours worked in October and November about equal to that for the third quarter.

Job losses were widespread in November. In manufacturing, a third month of decline brought the cumulative reduction of factory jobs since August to 100,000. Employment in retail trade also was down again last month--and at a much faster pace than in the previous month. In construction, underlying weakness was compounded during the November survey week by shutdowns due to bad weather; the

1. The Bureau of Labor Statistics points out that introduction of new seasonal factors affected the size of the November payroll decline. The BLS used updated seasonal factors on the November data, but reported October employment based on the old factors. If the new factors also had been used to adjust the October data, the November reduction in total payroll employment would have been about 170,000 rather than 240,000. A consistent set of seasonal factors will be introduced with the benchmark employment revision in the spring.

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

	1991 Q1	1991 Q2	1991 Q3	1991 Sep.	1991 Oct.	1991 Nov.
	------Average monthly changes--------					
Nonfarm payroll employment[2]	-240	-6	60	95	4	-241
Private	-258	-22	71	85	-32	-232
Manufacturing	-102	-22	12	-28	-40	-33
Durable	-81	-17	-1	-22	-37	-32
Nondurable	-21	-5	13	-6	-3	-1
Construction	-64	-3	-4	8	-28	-95
Transportation, public utilities	-14	-5	7	9	0	-3
Wholesale trade	-20	-12	-6	-1	-6	-11
Retail trade	-67	-11	-2	-5	-44	-111
Finance, insurance, real estate	1	-11	-4	5	6	4
Services	9	45	75	106	86	19
Total government	18	16	-11	10	36	-9
State and local	17	10	-13	-2	29	-11
Private nonfarm production workers	-223	-8	64	73	-17	-215
Manufacturing production workers	-83	-5	15	-32	-19	-25
Total employment[3]	-273	43	94	749	-198	-209
Nonagricultural	-222	-27	94	709	-87	-315
Memo:						
Aggregate hours of production or nonsupervisory workers (percent)	-1.4	-.1	.3	.7	-.7	-.1
Average weekly hours of production or nonsupervisory workers (hours)	34.5	34.2	34.3	34.5	34.3	34.4
Manufacturing (hours)	40.3	40.5	40.9	41.0	40.9	40.9

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	1991 Q1	1991 Q2	1991 Q3	1991 Sep.	1991 Oct.	1991 Nov.
Civilian unemployment rate (16 years and older)	5.5	6.5	6.8	6.8	6.7	6.8	6.8
Teenagers	15.5	18.0	18.8	19.2	18.0	18.8	18.5
20-24 years old	8.8	10.1	10.8	10.9	10.8	11.3	11.0
Men, 25 years and older	4.4	5.5	5.8	5.8	5.8	5.7	5.6
Women, 25 years and older	4.3	5.0	5.2	5.0	5.0	5.1	5.2
Labor force participation rate	66.4	66.2	66.1	65.9	66.1	66.0	65.8

result was an unusually large employment decline of 95,000. Employment in wholesale trade continued to trend lower in November, and employment in business services turned down after three months of increase. The number of jobs in health services continued to grow, however.

The monthly survey of households also showed a weakening of labor market conditions in November. Total employment fell 200,000. In addition, the size of the labor force shrank 300,000 last month and was only fractionally above its year-earlier level. The absence of growth in the labor force has reduced the upward pressure on the unemployment rate, which held steady in November at 6.8 percent.

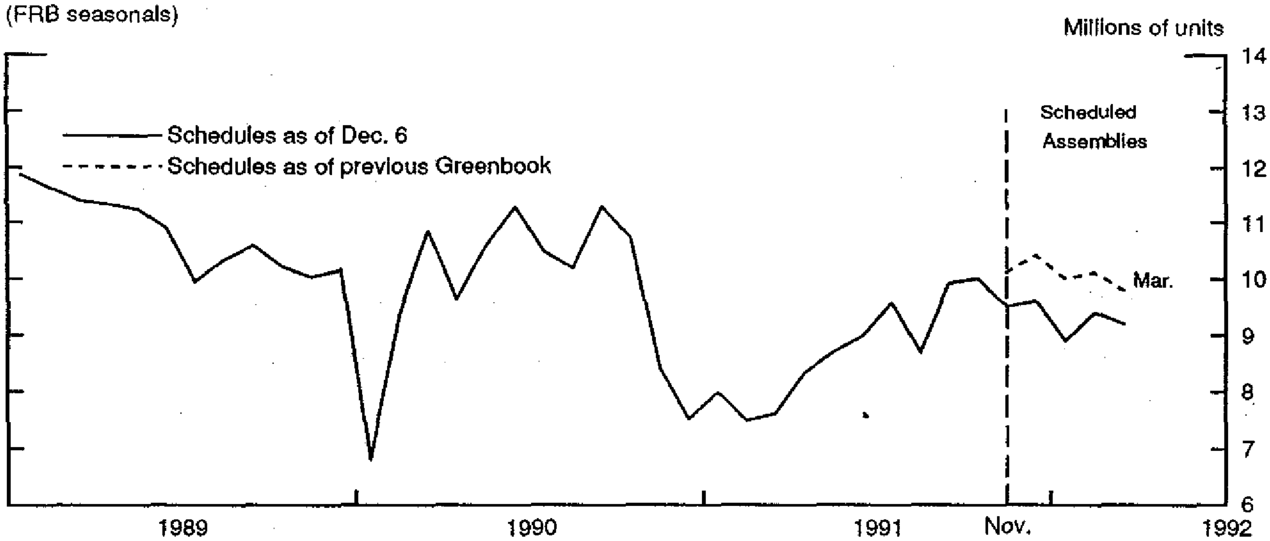
Industrial Production and Capacity Utilization

After remaining essentially unchanged from July to October, the index of industrial production likely fell appreciably in November. Motor vehicle assemblies dropped about 5 percent last month to an annual rate of 9.5 million units, and weekly data for selected other industrial products and materials were flat, on balance. In addition, many other manufacturers, particularly those in durable goods industries, trimmed their labor input further.[2] New orders for industrial products also have been sluggish, with the staff's measure of real adjusted durable goods orders edging down a bit, on net, over the past few months (chart). With production declining in November, capacity utilization likely fell to its lowest level since last spring.

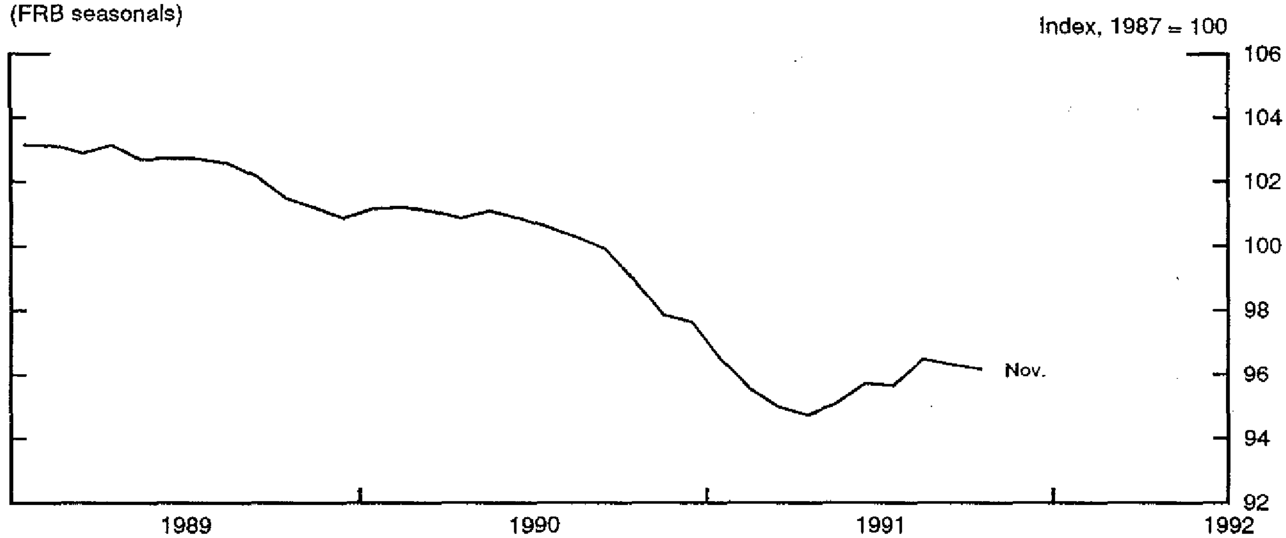
2. Data from the November establishment survey, adjusted using FRB seasonal factors, show a decline of 0.2 percent in total hours worked by production workers in manufacturing excluding motor vehicles (chart). However, when industry detail on hours are aggregated using value added weights--consistent with the construction of the industrial production index--hours worked in manufacturing excluding motor vehicles were down 0.7 percent in November.

MANUFACTURING SECTOR INDICATORS

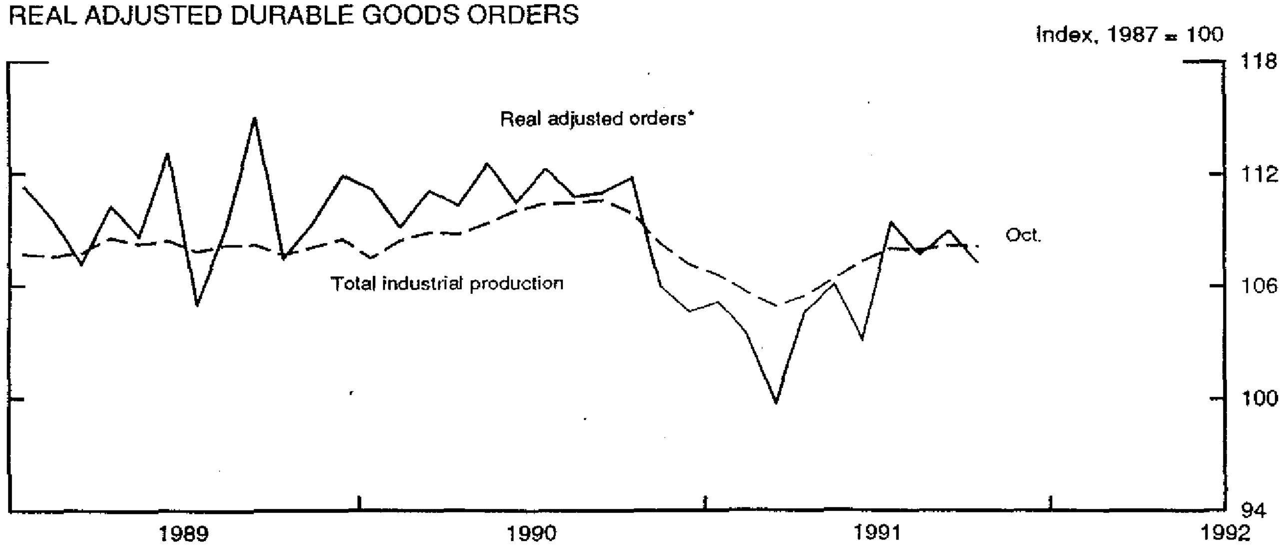
MOTOR VEHICLE ASSEMBLIES
(FRB seasonals)



PRODUCTION WORKER HOURS – excl. Motor Vehicles
(FRB seasonals)



REAL ADJUSTED DURABLE GOODS ORDERS



*Adjusted durable goods orders equal bookings for durable goods industries that report unfilled orders, excluding orders for defense, nondefense aircraft and motor vehicle parts. Nominal orders were deflated using the PPI for durable goods and the BEA deflator for office, computing, and accounting machinery.

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

	1991			1992	1991		
	Q2	Q3	Q4	Q1[1]	Oct.	Nov.	Dec.[1]
Domestic production	8.7	9.4	9.7	9.2	10.0	9.5	9.6
Autos	5.2	5.8	5.7	5.6	5.9	5.7	5.7
Trucks	3.4	3.6	3.9	3.6	4.1	3.8	3.9

1. Figures beyond November are based on current manufacturers' schedules.

Production restraint in the auto sector now appears likely to persist into the early months of 1992. In late November, motor vehicle manufacturers slashed the output of domestic cars and trucks planned for December and the first quarter of next year; the cuts likely were a response to the weak pace of sales, the plunge in consumer confidence, and slow ordering by dealers. The level of car and truck assemblies now planned for December is just a touch above the November level; assembly plans for the first quarter of next year are, on average, a little below the November pace.

Production has slackened in other industries as well, especially those for durable goods. In October, production of consumer durable goods other than autos and light trucks dropped for the first time since February, and production of durable materials contracted. Output of construction supplies has been falling since mid-year, after strong growth during the spring. Cutbacks in defense and space production have proceeded almost without interruption for more than a year now.

The production of business equipment other than motor vehicles has shown little improvement since its low in March as production of office and computing machinery and industrial equipment has remained weak. The early indicators for November provide no hint of a significant upturn. The strike at Caterpillar reduced output of

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

	Proportion in total IP 1990:Q4	1990[1]	Sep. 90- Mar. 91	1991 Mar. - July	1991 July - Oct.	1991 Sep.	1991 Oct.
			--------Average--------- ------Monthly Rate------			-Monthly Rate-	
Total index	100.0	.3	-.9	.7	.0	.2	.0
Motor vehicles and parts	3.8	-9.9	-4.6	4.9	1.5	8.5	1.1
EXCLUDING MOTOR VEHICLES AND PARTS:							
Total Index	96.2	.8	-.7	.6	.0	-.1	-.1
Products, total	57.5	1.4	-.5	.2	-.1	-.2	-.1
Final products	43.1	2.2	-.3	.1	.0	-.2	.0
Consumer goods	24.4	-.1	-.3	.6	.3	.1	.2
Durables	4.0	-3.5	-1.0	1.3	.1	.2	-.5
Nondurables	20.5	.6	-.2	.4	.3	.1	.3
Business equipment	14.8	5.3	-.5	.1	-.1	.1	-.2
Office and computing	2.7	9.0	.2	.2	-.6	.2	-.2
Industrial	4.3	1.3	-1.2	-.1	-.1	.1	.0
Other	7.8	6.3	-.3	.2	.1	.0	-.2
Defense and space equip.	4.8	-.2	-.6	-1.1	-.5	-1.1	-.4
Intermediate products	14.5	-.9	-1.0	.7	-.1	-.3	-.3
Construction supplies	5.7	-4.6	-1.6	.8	-.1	.2	-.2
Materials	38.6	-.1	-1.1	1.1	.0	.0	-.1
Durables	18.5	.4	-1.5	.9	.2	.0	-.4
Nondurables	8.8	.5	-.7	1.3	.2	.6	.2
Energy	10.2	.0	-.3	.7	-.5	-.6	.0

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

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1967-90 Avg.	1988-89 High	1990 Oct.	1991 Apr.	1991 Aug.	1991 Sep.	1991 Oct.
Total industry	82.2	85.0	83.0	78.6	79.8	79.8	79.6
Manufacturing	81.5	85.1	82.2	77.5	78.6	78.8	78.6
Primary processing	82.4	89.0	84.3	78.2	81.2	81.2	81.1
Advanced processing	81.1	83.6	81.3	77.3	77.5	77.8	77.5

business equipment by about 0.5 percent last month, and production-worker hours remain sluggish, on balance, in other equipment-producing industries.

Personal Income and Consumption

Assessment of recent trends in real income and consumption is hampered this month by the absence of rebenchmarked monthly data; those data are not scheduled to be available until December 23. Assuming, however, that the patterns of change in the existing monthly data are accurate to at least a first order of approximation, the picture in recent months is basically one of sluggish consumption and the virtual absence of real income growth.[3] Taking the data as they stand, real personal consumption expenditures measured in 1982 dollars fell 0.4 percent in October, putting its level in that month slightly below the average level for the third quarter, which itself has been revised down since the last Greenbook. The October drop was concentrated in expenditures on motor vehicles.

The weakness of consumption has been paralleled by virtually nonexistent income growth. Between June and October, real disposable personal income rose at an average monthly rate of less than 0.1 percent. Although the October data did show a rise in nominal disposable income of almost $10 billion at an annual rate, more than all of this increase was attributable to a temporary bulge in farm subsidy payments and a $10 billion rise in transfer income. Total wages and salaries fell by about $5 billion in October, the first drop since July, and interest income continued to contract.

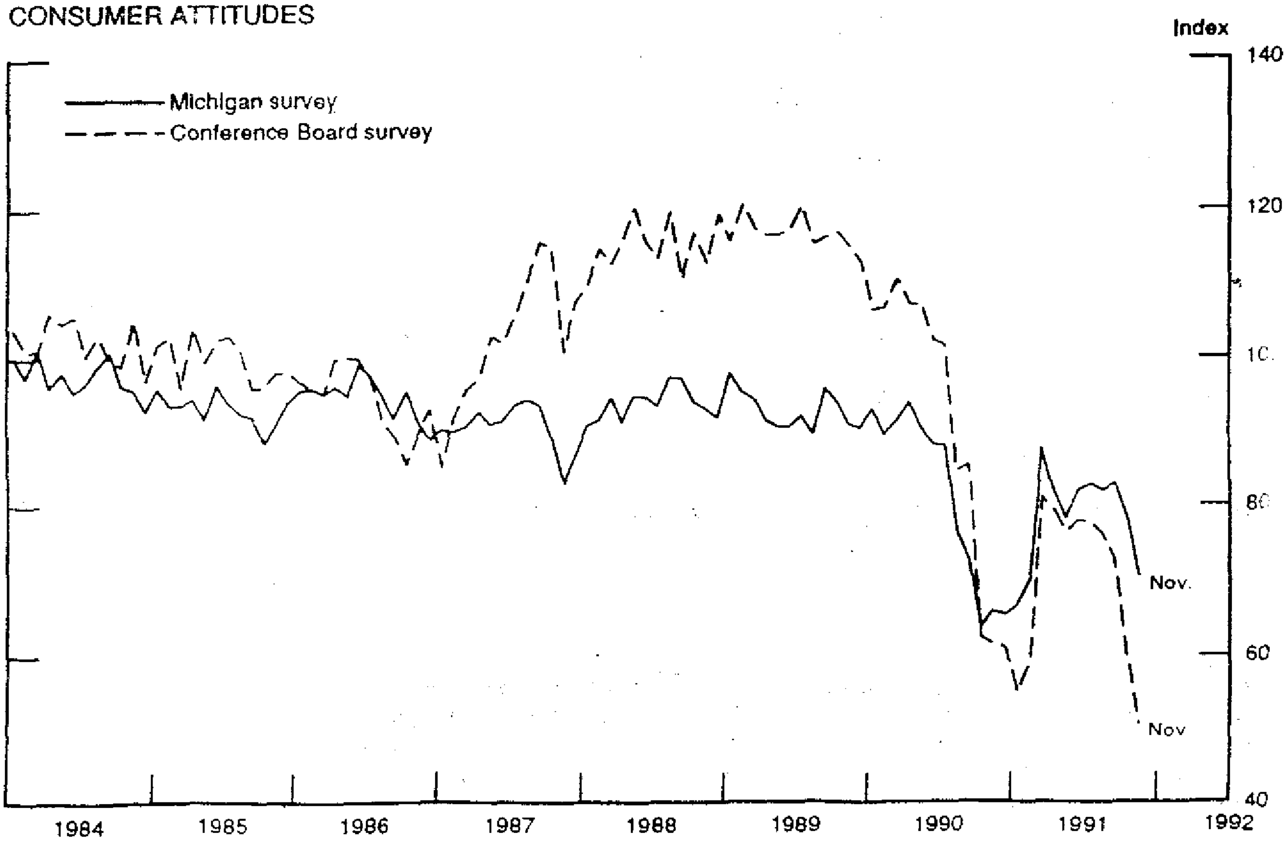
3. Nominal retail sales, which were not affected by the NIPA revisions, declined in October, and the estimates for the two previous months were revised down. Retail control, a category that excludes autos and other nonconsumption items, declined in August, September, and October.

SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, BEA seasonal basis)

	1991			1991		
	Q1	Q2	Q3	Sep.	Oct.	Nov.
1. Total autos and light trucks	12.0	12.3	12.7	12.9	12.1	12.3
2. Domestically produced[1]	9.4	9.7	10.1	10.3	9.6	9.8
3. Autos	6.1	6.1	6.3	6.2	6.1	6.2
4. Light trucks	3.3	3.6	3.8	4.1	3.5	3.7
5. Imports	2.6	2.7	2.7	2.7	2.5	2.4
6. Autos	2.3	2.3	2.3	2.3	2.2	2.1
7. Light trucks	.3	.3	.3	.3	.3	.3

1. Includes vehicles produced in Canada and Mexico for General Motors, Ford, and Chrysler as well as foreign makes produced in the United States.
Note: Components may not add to totals due to rounding.

CONSUMER ATTITUDES



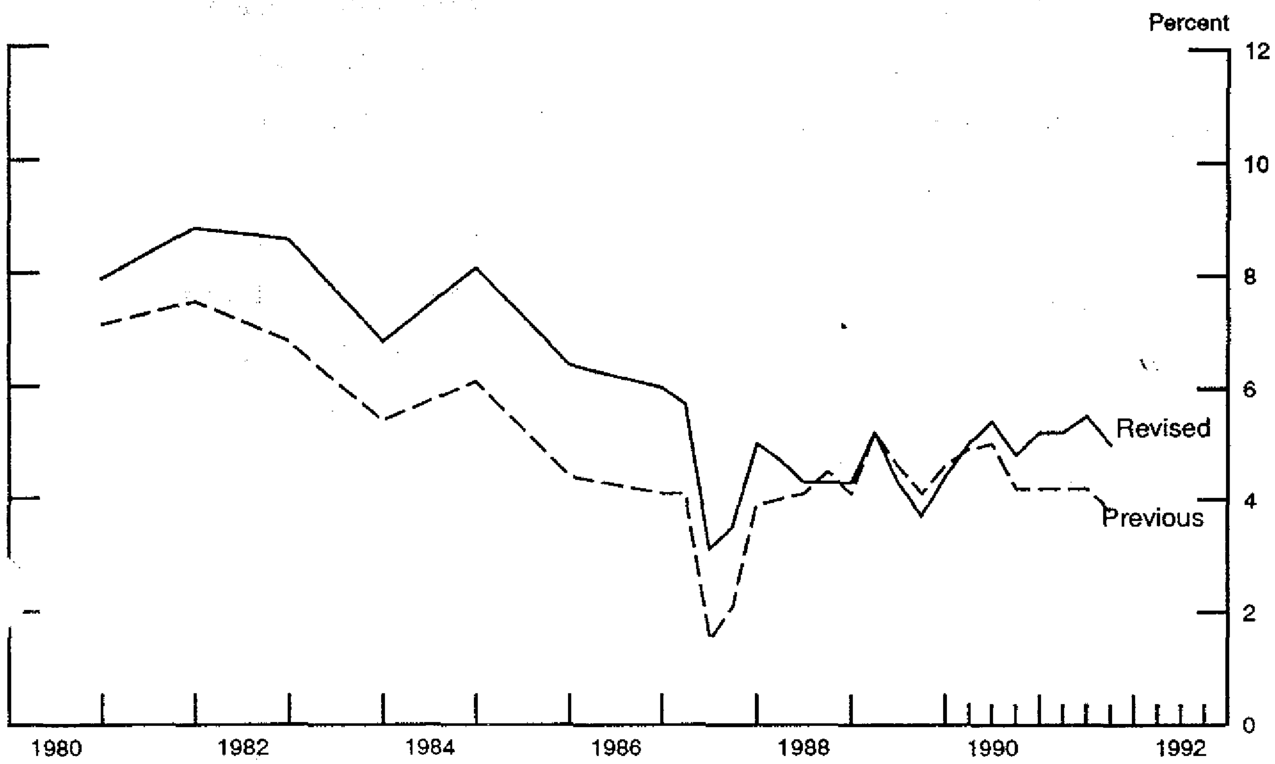
In November, wages and salaries appear to have increased moderately in nominal terms.

The weakness in spending on motor vehicles extended into November. Unit sales of autos and light trucks, which had dropped from a 12.9 million unit annual rate in September to a 12.1 million unit rate in October, retraced only a little of that decline in November (chart). September sales of domestic models had been boosted by temporary purchasing incentives on light trucks, and probably by temporary increases in sales to the daily rental fleets. However, even allowing for these special factors, sales of domestic models have been soft recently. Sales of imported autos and trucks also have been sluggish; sales of imported cars declined further in November to the lowest level since January, while sales of imported light trucks were flat.

Consumer confidence took another sharp step downward in November according to both the Conference Board and the Michigan Survey Research Center (SRC) indexes. The Conference Board index fell below its low point of the 1981-82 recession, and the SRC index retreated to the levels of last winter. Consumers' assessments of their current financial situation, employment opportunities, and business conditions soured further last month, as did their views about the future. Also, consumers again expressed reluctance to use savings or credit for major purchases.

The comprehensive revision of the NIPA has altered the recent pattern of consumption growth a little. Real personal consumption expenditures now are estimated to have grown at annual rates of 1.4 percent in the second quarter and 2.3 percent in the third quarter of this year, in each case more than 1 percentage point below the previously estimated growth rates. The downward revisions were mainly in nondurables and services. Revisions to the consumption

REVISIONS TO THE PERSONAL SAVING RATE



Note: Chart shows annual data through 1986, and quarterly data thereafter.

data for previous years generally were small. In particular, the data still show a huge rise in household spending on durable goods over the course of the 1980s. Although this buildup apparently left households well-stocked with these goods coming into the 1990s, during the past year purchases of durables have dropped well below the earlier trend.

The level of the personal saving rate was revised up over most of the last decade, but it continues to exhibit a sharp drop from 1981 through 1987 and a moderate rebound thereafter (chart). For the period from mid-1990 to the third quarter of 1991, the revised saving rate shows little net change, in contrast to the previously estimated decline of 1 percentage point. The revised pattern since early 1990 is more in line with movements in the fundamental determinants of the saving rate over the period--such as the limited increase in the ratio of wealth to income and flagging consumer confidence--than was the case prior to the revisions. As before the revision, however, the recent saving rate is low by historical standards, suggesting that there is little room for increased consumption from a downward adjustment of saving.

Business Fixed Investment

With the revision to the NIPA, the reported magnitude of the recovery in real outlays for producers' durable equipment since the first quarter has been muted considerably, while spending for nonresidential construction is still estimated to have been on a steep downtrend over the past year.[4] Recent indicators suggest

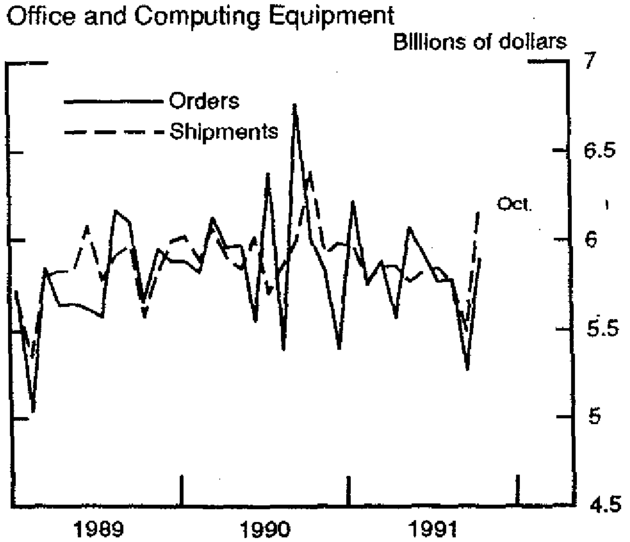
4. However, the level of nonresidential construction outlays was adjusted up markedly in the new estimates; in current dollars, the average level of outlays now reported for 1990 is 35 percent above that previously estimated, with the largest upward revision in industrial construction. BEA made this adjustment because the 1982 Census of Construction indicated that payments to contractors were much higher than the nominal value of construction put-in-place, which had been used in previous benchmarks to tie down the level of nonresidential construction.

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

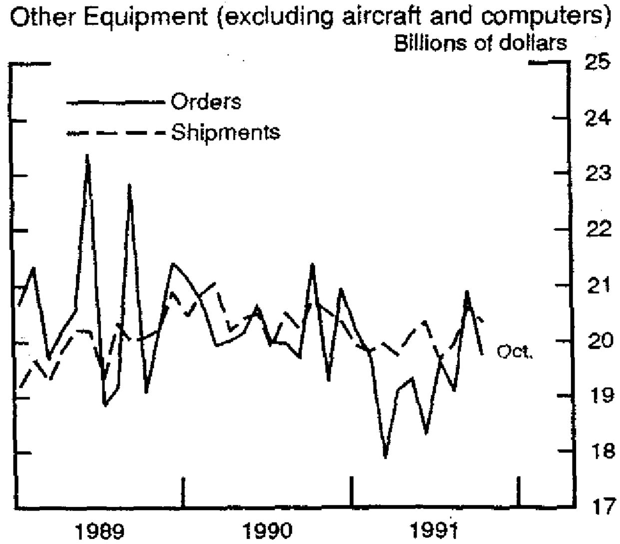
	1991			1991		
	Q1	Q2	Q3	Aug.	Sep.	Oct.
Producers' durable equipment						
Shipments of nondefense capital goods	-2.2	1.4	-.2	1.7	.9	2.4
Excluding aircraft and parts	-3.3	.5	-.5	.7	1.5	1.7
Office and computing	-3.9	-.8	-2.0	-1.3	-4.7	12.7
All other categories	-3.1	.9	.0	1.4	3.3	-1.2
Shipments of CIR complete aircraft[1]	71.7	.0	5.0	18.9	.0	n.a.
Sales of heavy-weight trucks	-9.1	-7.4	3.9	-5.6	3.3	-8.5
Orders of nondefense capital goods	-6.6	-13.6	13.6	-15.5	-2.8	3.2
Excluding aircraft and parts	-4.0	-1.8	2.9	-2.0	5.1	-1.9
Office and computing	3.6	-1.6	-4.2	.2	-8.8	11.7
All other categories	-6.1	-1.9	5.0	-2.7	9.3	-5.3
Nonresidential structures						
Construction put-in-place	-4.4	-2.7	-6.3	-.8	-.1	-1.3
Office	-6.6	-5.4	-9.1	-2.6	.5	-3.0
Other commercial	-10.6	-3.5	-8.9	-.3	-3.1	-5.8
Industrial	.6	-4.2	-6.4	-2.5	-.6	5.0
Public utilities	-.7	1.4	-.3	1.0	-1.0	.7
All other	-4.0	-3.1	-8.4	-.9	3.4	-2.9
Rotary drilling rigs in use	.9	-8.4	-11.3	-9.3	-7.2	-1.8
Footage drilled[2]	-9.4	-4.9	-10.2	-1.9	-10.2	18.0

1. From the Current Industrial Report "Civil Aircraft and Aircraft Engines". Seasonally adjusted with BEA seasonal factors.
2. From Department of Energy. Not seasonally adjusted.
n.a. Not available.

Office and Computing Equipment



Other Equipment (excluding aircraft and computers)



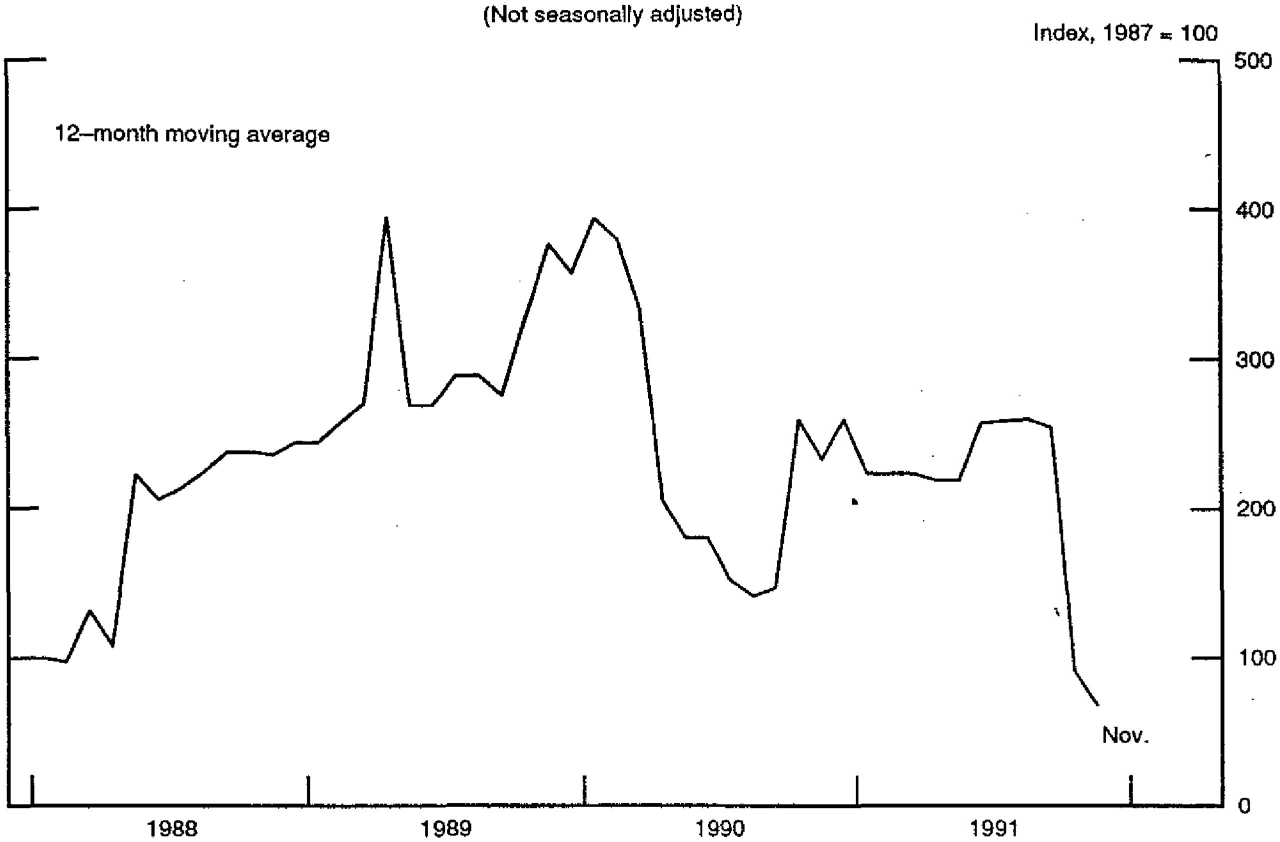
that aggregate real outlays for equipment have flattened out during the current quarter and that nonresidential construction has weakened further.

In 1987 dollars, equipment spending is estimated to have risen at an annual rate of 3-1/4 percent between the first and third quarters of 1991, well below the 11-1/2 percent increase published before the benchmark revision. The weaker recovery mainly reflects the shift in the base year for real outlays from 1982 to 1987, which reduced the weight attached to the sizable rise in purchases of computing equipment since the first quarter. Apart from this weight shift, the benchmark revision conveys roughly the same picture of equipment spending as did the earlier data. Business spending for motor vehicles still is estimated to have risen from the depressed first-quarter level, while outlays for most other types of equipment (except computers) remained sluggish through the third quarter.

Recent indicators of equipment spending have been mixed and point to little change in total real outlays in the current quarter. Shipments of office and computing equipment jumped 12.7 percent in October, the largest monthly increase in nearly eleven years. This rise meshes with reports that IBM began large-scale shipments of its new generation of mainframe computers in late September. These units were ordered as much as a year ago. More recently, though, bookings for computing equipment have been lackluster: the level of nominal orders in October, while up sharply from that of September, differed little from the average over the preceding six months. For nondefense capital goods excluding computing equipment (and aircraft and parts), orders have trended up in a choppy fashion since March. Shipments of this broad aggregate of equipment have risen somewhat on net since July, leaving the October level of shipments about 1-1/3 percent above the third-quarter average. In contrast, purchases

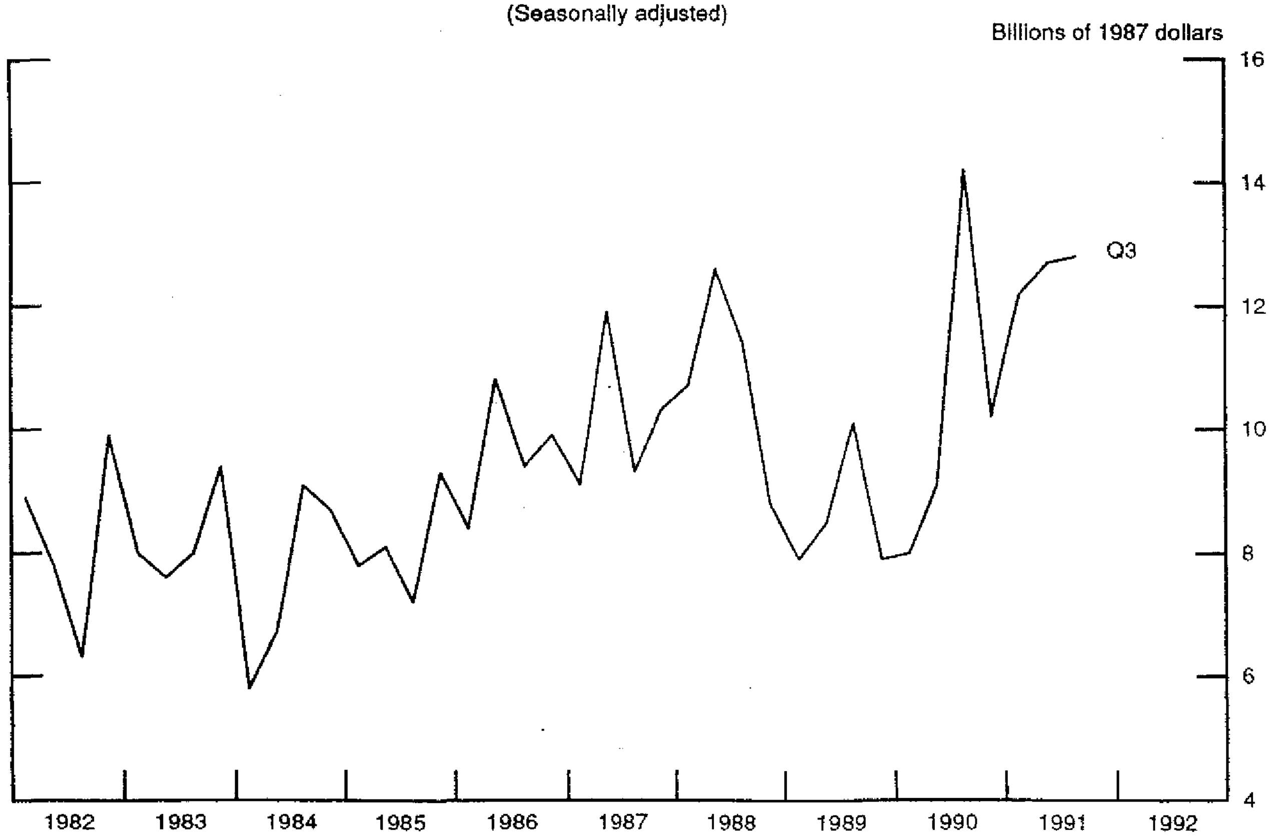
ORDERS OF BOEING COMMERCIAL AIRCRAFT BY DOMESTIC AIRLINES

(Not seasonally adjusted)



REAL OUTLAYS FOR PDE AIRCRAFT

(Seasonally adjusted)

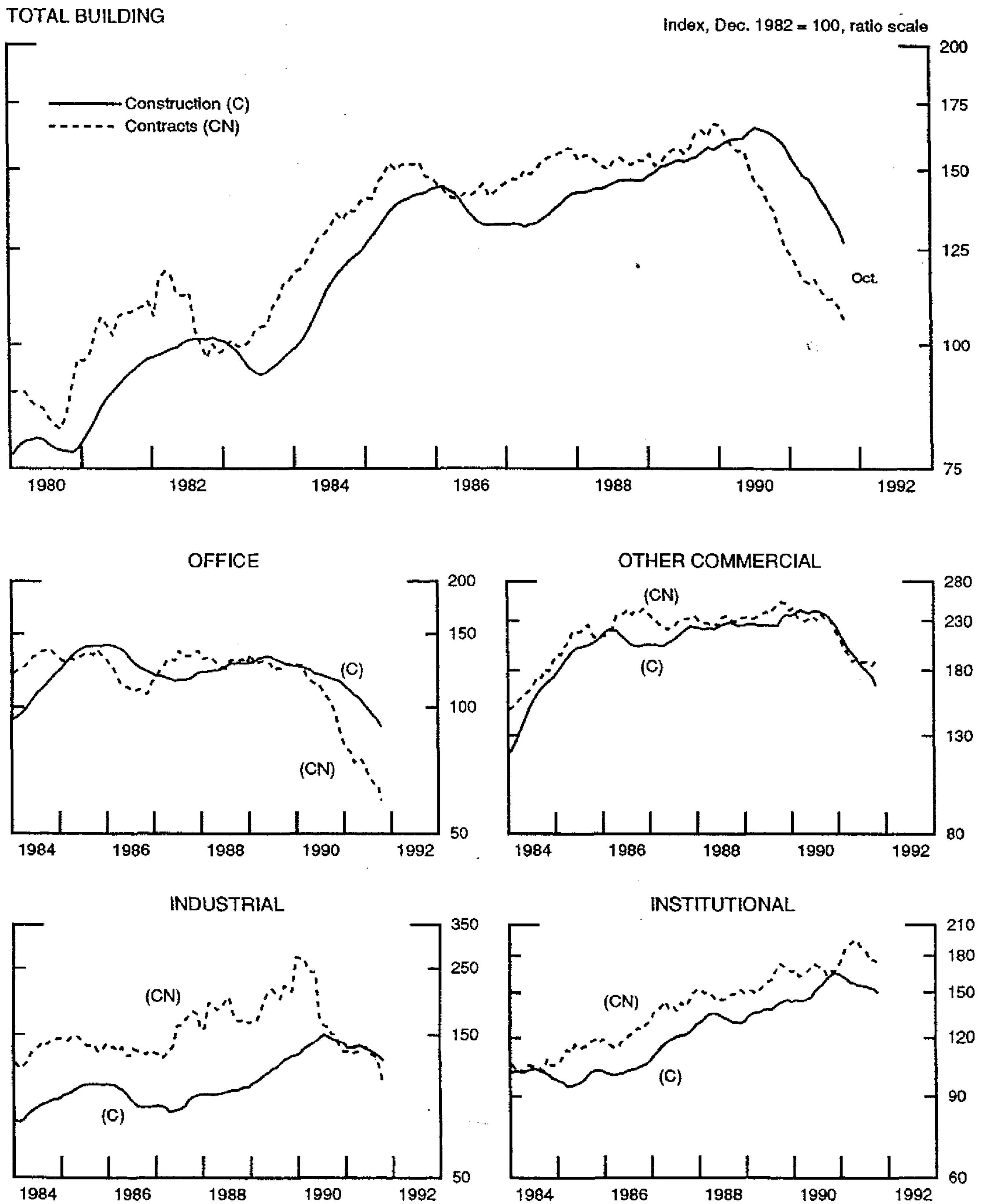


of heavy trucks fell 8-1/2 percent in October, and business spending on cars and light trucks likely has declined as well since the third quarter.

Signs of weakness also have emerged in domestic demand for aircraft. Orders from domestic carriers for Boeing commercial aircraft have plummeted since mid-year, and American Airlines announced last month that it was scaling back capital expansion plans through 1995. Although Boeing's backlog of domestic aircraft orders has begun to contract, domestic deliveries could rise somewhat during the first half of next year, because of the increase in monthly production of 757s scheduled to begin in January. However, the longer-term outlook for aircraft deliveries is decidedly more negative. Boeing already has announced its intention to cut the monthly production of 737s by 20 percent next September, and recent comments by company officials suggest that further cutbacks could be forthcoming if orders do not rebound.

Turning to nonresidential construction, recent indicators suggest that activity in this sector has continued to shrink. Nonresidential construction put-in-place fell another 1.3 percent in October, with further sharp declines for office and "other commercial" buildings. Even though real outlays for office construction dropped 25 percent over the year ended in the third quarter, the vacancy rate for office buildings nationwide was still 19-1/2 percent at the end of September, indicating that the sector remains badly overbuilt. Real outlays for "other commercial" buildings, primarily stores and warehouses, declined more than 30 percent over the year ended in the third quarter; however, in contrast to the office market, forward-looking indicators of other commercial construction--such as newly signed contracts--suggest that the steepest declines may be behind us. In the manufacturing

Nonresidential Construction and Contracts <1>



<1> Six-month moving average for all series shown. For contracts, total only includes private, while individual sectors include private and public.

sector, the rate of capacity utilization continues to be relatively low by historical standards and limits the need for new factory construction. Overall, the outlook for total nonresidential construction during the next several quarters remains bleak, with the value of contracts signed for all nonresidential buildings still on a sharp downtrend through October.

Business Inventories [5]

After many months of decline, business inventories turned up sharply in September, with sizable increases in both manufacturing and retail trade. In manufacturing, the September increase in stocks was followed by a month of virtually no change in October, and serious overhangs of factory stocks are not apparent. However, the buildup of retail stocks has gone on longer and has been more pronounced than in manufacturing; the inventory-sales ratio moved up in the retail sector in early autumn, perhaps into a range that is undesirably high in light of the sluggishness of final sales.

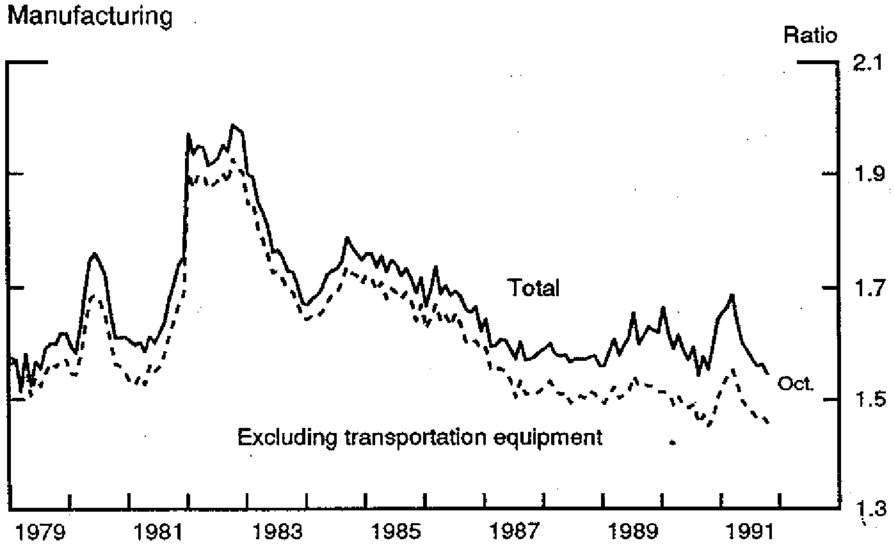
CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Billions of dollars at annual rates;
based on seasonally adjusted data)

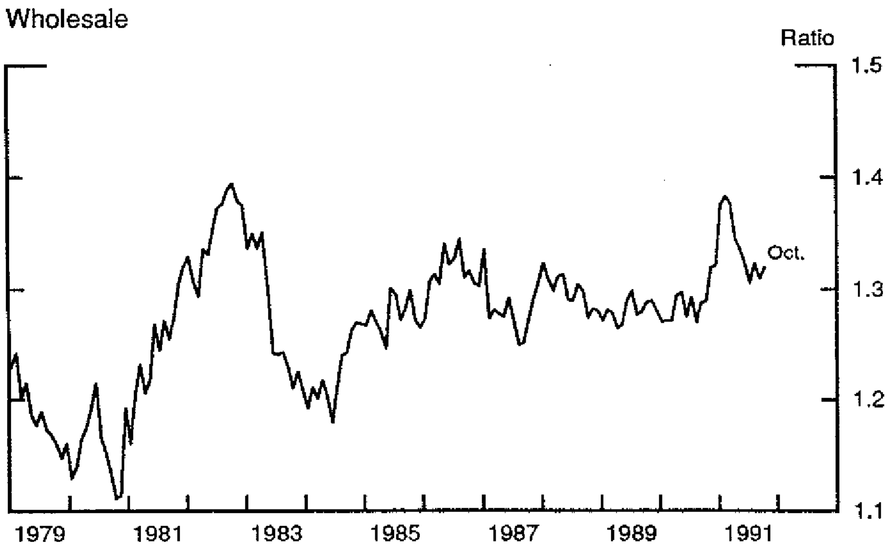
	1991			1991		
	Q1	Q2	Q3	Aug.	Sep.	Oct.
Current-cost basis:						
Total	-29.3	-50.0	13.1	-1.8	44.8	n.a.
Total excluding retail auto	-14.4	-42.2	3.9	-9.5	28.5	n.a.
Manufacturing	-11.3	-24.1	-4.5	-7.4	17.4	.5
Wholesale	4.7	-18.8	-3.3	-3.6	-15.5	2.0
Retail	-22.7	-7.2	20.9	9.2	42.9	n.a.
Automotive	-14.9	-7.9	9.2	7.7	16.3	n.a.
Excluding auto	-7.8	.7	11.8	1.5	26.7	n.a.

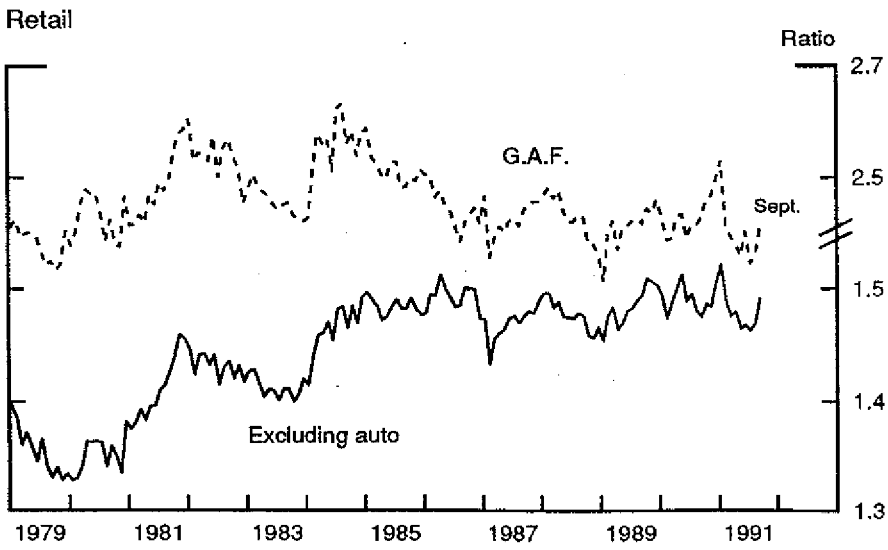
The September accumulation of non-auto stocks at the retail level was $26.7 billion (annual rate) in current-cost terms, after

5. This discussion is based largely on current-cost data from Census; data on 1987 constant-dollar shipments and sales in manufacturing and trade are not expected to be available for some time.

Ratio of Inventories to Sales
(Current-cost data)







much smaller increases in July and August. Rough staff estimates indicate that something on the order of 40 percent of the substantial pickup in the rate of retail inventory investment resulted from increased supplies from overseas. Merchandise trade data show that, in nominal terms, imports of consumer goods rose sharply in September; the rise was especially large in apparel and toys. As a result, foreign producers may bear much of any subsequent adjustment.

In the auto sector, retail dealers' stocks of passenger cars at the end of November amounted to about a 47-day supply relative to the sluggish sales pace for that month. Although this ratio is well below the 55- to 60-day standard once considered generally acceptable by the industry, it is up a little from the very low levels of early last summer. Given the uncertain outlook for sales, the industry may have viewed even this small uptick in stocks as cause for concern. Meanwhile, the inventories of foreign cars have been backing up on dealers' lots; these stocks amounted to an 80-day supply at the end of November. Inventories of light trucks also have become burdensome of late, as sales have dropped off considerably after the promotion-induced surge in September; this rise in stocks no doubt was a factor in the assembly cutbacks announced for light trucks in late November.

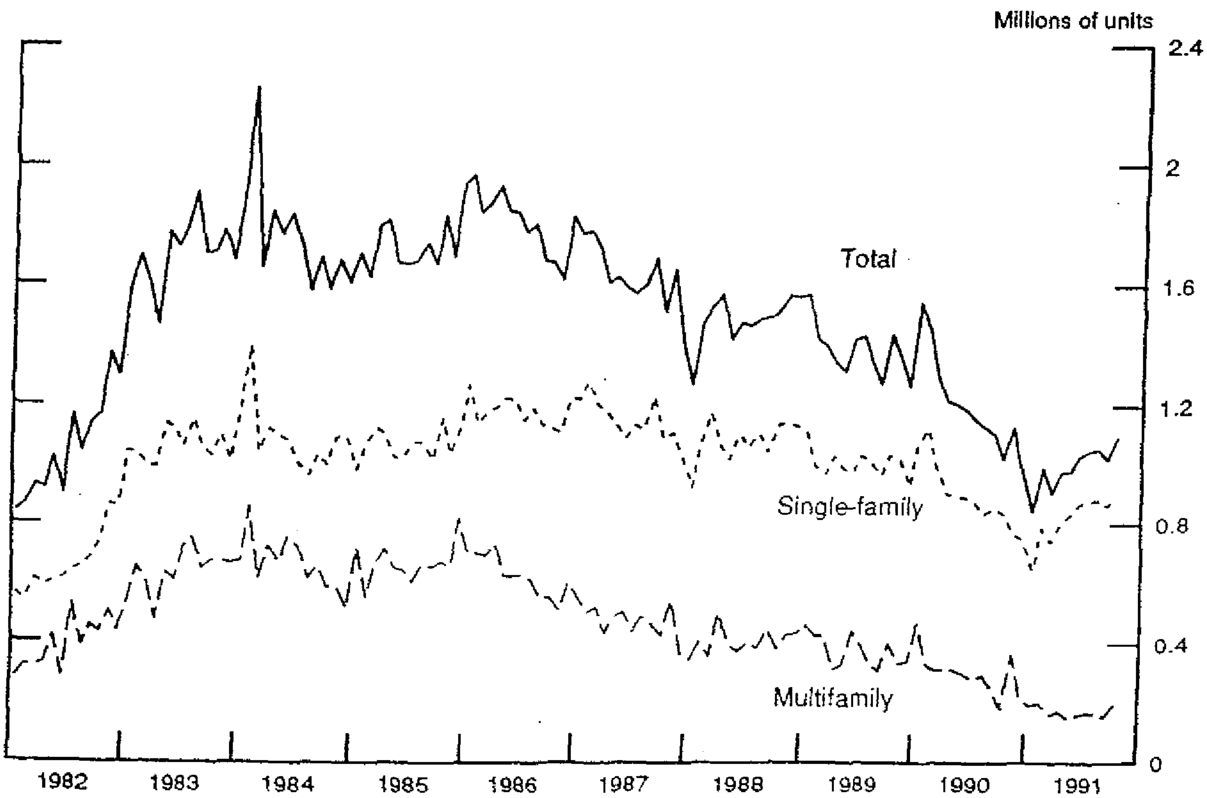
After a surge in September, manufacturers' inventories were little changed in October. In the durable goods category, machinery stocks continued to decline, while inventories held by motor vehicle and aircraft industries expanded moderately. At nondurable goods industries, a sharp drawdown in petroleum stocks was more than offset by an accumulation of food, apparel, and paper products. The manufacturers' inventory-to-shipments ratio continued its downtrend

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

	1990	1991			1991		
	Annual	Q1	Q2	Q3[r]	Aug.[r]	Sep.[r]	Oct.[p]
All units							
Permits	1.11	.86	.96	.98	.95	.98	1.04
Starts	1.19	.92	1.00	1.04	1.06	1.02	1.10
Single-family units							
Permits	.79	.67	.76	.78	.77	.78	.80
Starts	.90	.73	.83	.88	.88	.86	.90
Sales							
New homes	.53	.47	.51	.51	.53	.50	.51
Existing homes	3.30	3.09	3.48	3.23	3.25	3.12	3.15
Multifamily units							
Permits	.32	.19	.20	.20	.18	.20	.24
Starts	.30	.19	.16	.17	.17	.16	.20

p Preliminary. r Revised estimates. n.a. Not available.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



in October; at the end of that month, the ratio was close to its trough posted just before the onset of the 1990 recession.

Wholesale inventories were up slightly in October after a sizable decline in September. Wholesale data at the industry level showed a notable accumulation in stocks held by distributors of apparel and miscellaneous durable goods. By contrast, stocks of machinery fell for the third month in a row.

Housing Markets

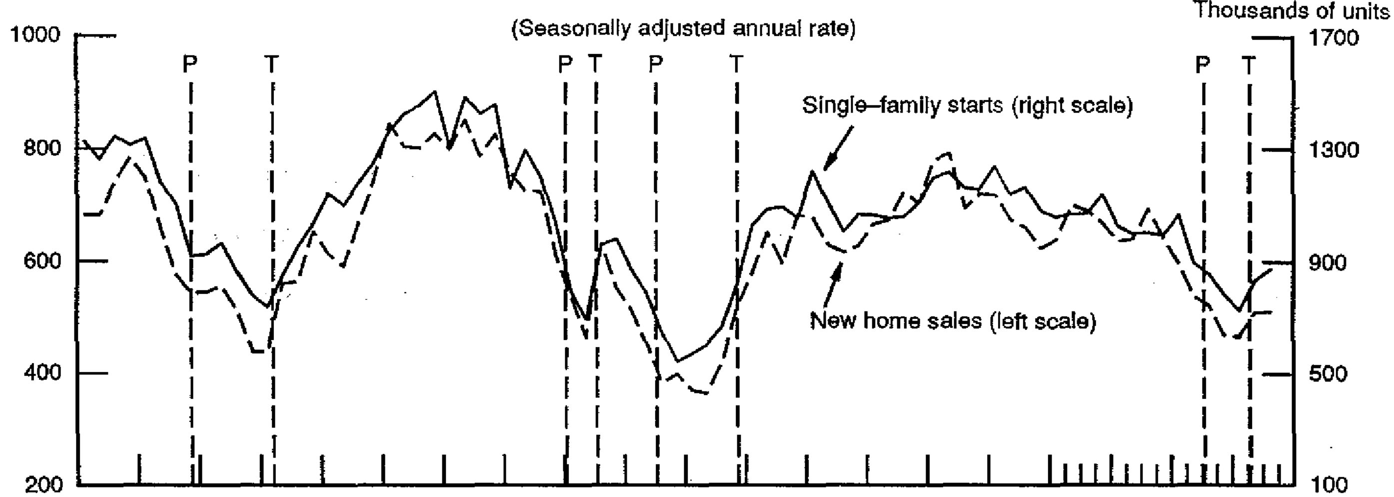
After declining in September, housing starts and sales of new and existing homes turned back up in October. However, November surveys of the attitudes of builders and consumers suggest no subsequent improvement, and the housing market remains remarkably soft against the backdrop of the lowest mortgage rates in many years.

In October, starts of single-family units more than recouped their September decline. A comparable increase in the issuance of building permits corroborates this pickup. Slightly more than half of all single-family starts are nonspeculative or built-to-order, so the increase in starts suggests some firming in demand.[6] New home sales rose 2 percent in October, and the September estimate was revised upward to an unusual extent. While these sales data also suggest some firming in demand, the volume of sales is still quite low (chart, top panel, "Single Family Starts").

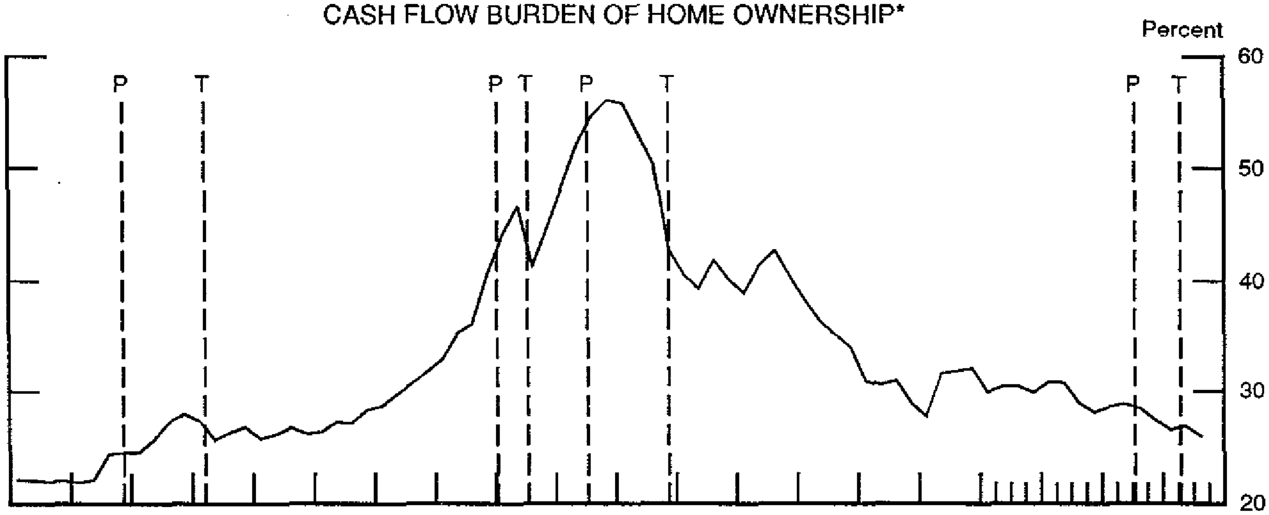
Construction of single-family housing has remained well below the average of the 1980s, even though low interest rates and flat house prices have made new homes more affordable on a cash-flow basis than at any time since the mid-1970s (middle panel). However,

6. New homes built and sold by merchant builders--who sell both the structure and the lot--typically account for about 60 percent of all single-family activity. The remaining 40 percent of single-family starts are units built-to-order on the buyer's land, either by contractors or by the landowners themselves.

SINGLE-FAMILY STARTS AND NEW HOME SALES

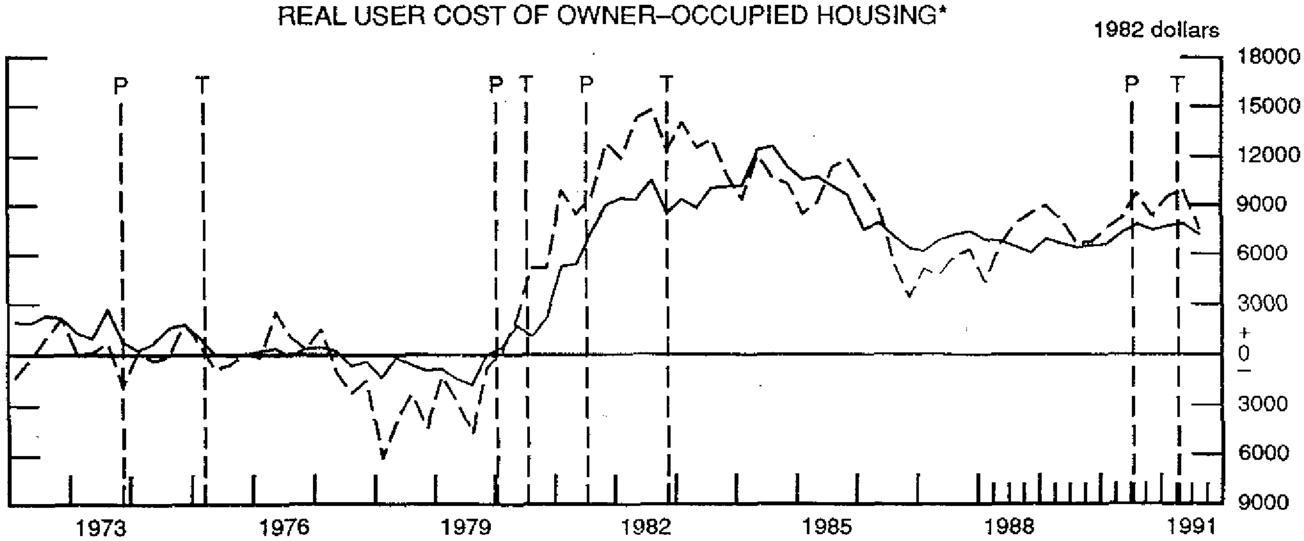


CASH FLOW BURDEN OF HOME OWNERSHIP*



* Financing cost of a constant-quality new home, as a percentage of average household income. Financing cost calculated as scheduled payment of principal and interest on a fixed-rate mortgage for 80% of the purchase price.

REAL USER COST OF OWNER-OCCUPIED HOUSING*



* Price in 1982 dollars of a constant-quality new home, multiplied by the fixed-rate mortgage rate less expected house price inflation. The solid line takes expected house price inflation to be the average experience of the previous three years. The dashed line assumes expectations are set by the experience of the previous year. This simplified measure of user costs abstracts from operating costs, depreciation, and tax considerations.

the recent weakness in house prices apparently has caused consumers to reduce their expectations of capital gains from homeownership. If consumers base their expectations of house price increases on the recent past, they might in fact be perceiving the overall cost of homeownership still to be relatively high. (Measures that factor in such expectations are shown in the bottom panel of the chart.)

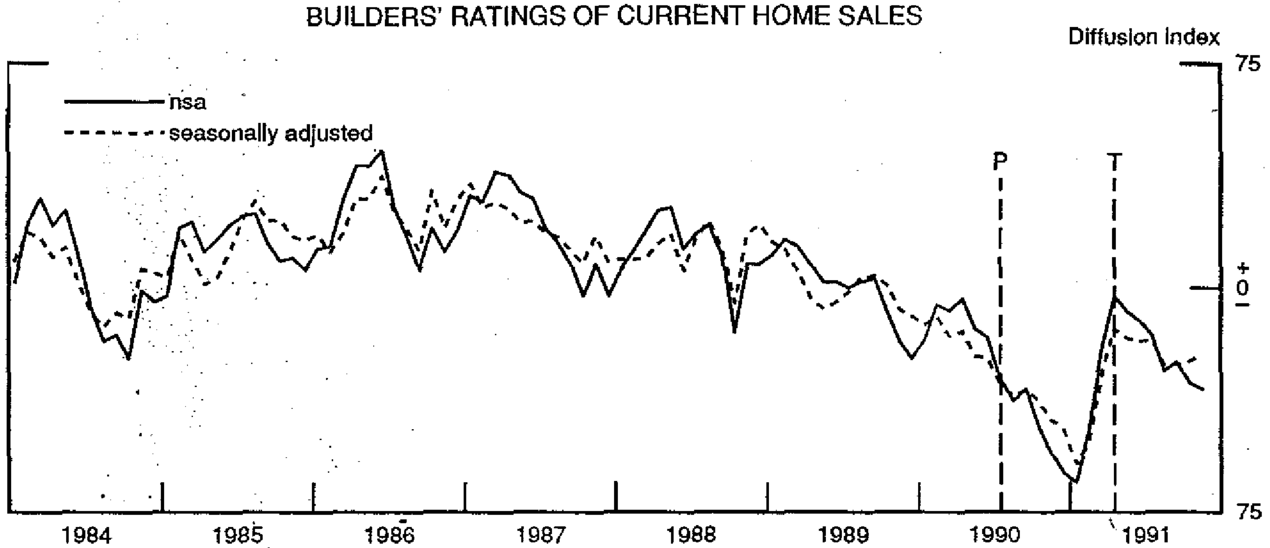
In the multifamily segment of the housing market, starts jumped in October. But it is unlikely that this pickup signals the start of a sustained recovery. Vacancy rates for multifamily rental housing rose again in the third quarter, and real rents show no signs of turning up. Until the low production of recent quarters begins to tighten market supply appreciably, starts in this segment of the market are likely to remain in the depressed range of 150,000 to 200,000 units per year.

Hard data on housing activity in November are not yet available, and the various straws in the wind are providing mixed signals. Based on a national sample of 400 builders interviewed during the first half of November, the National Association of Home Builders reported lower sales, but this decline appears to have been largely seasonal (top panel, "Builders' Ratings"). By contrast, the Home Builders' report of a falloff in expectations of sales six months hence (middle panel) was a bit more than seasonal. Consumers responding to the Michigan survey in November (bottom panel) continued to be relatively positive about conditions for home buying, but overall sentiment fell for the second month. Concerns about employment and poor conditions for home <u>selling</u> may be keeping trade-up home buyers out of the market.

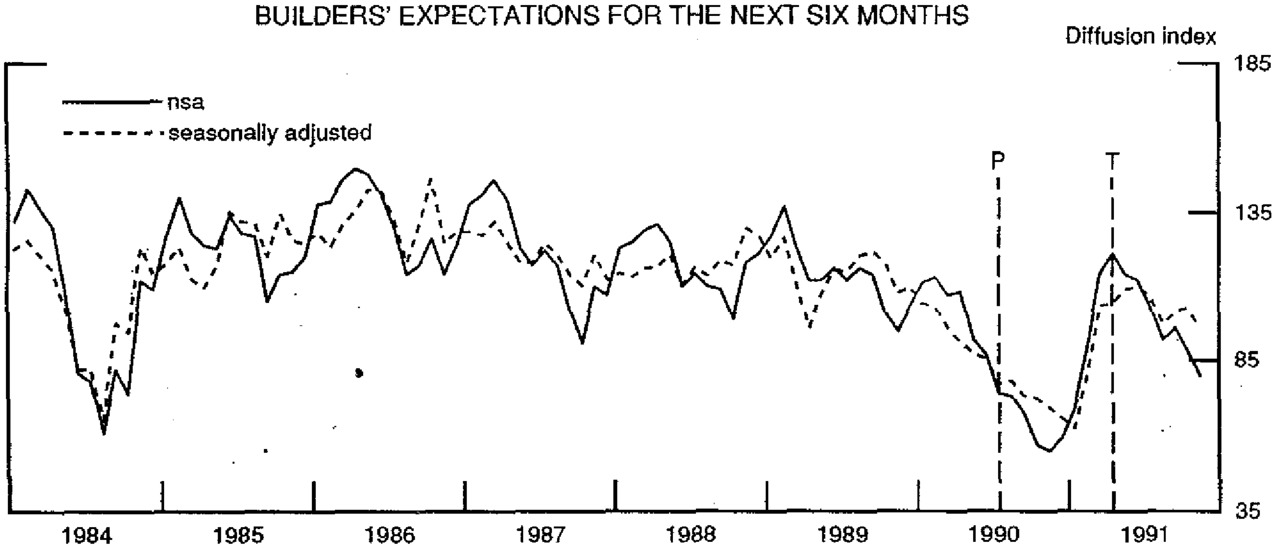
<u>Federal Sector</u>

Benchmark revisions to NIPA federal sector data had a relatively small effect on the pattern of real spending over recent

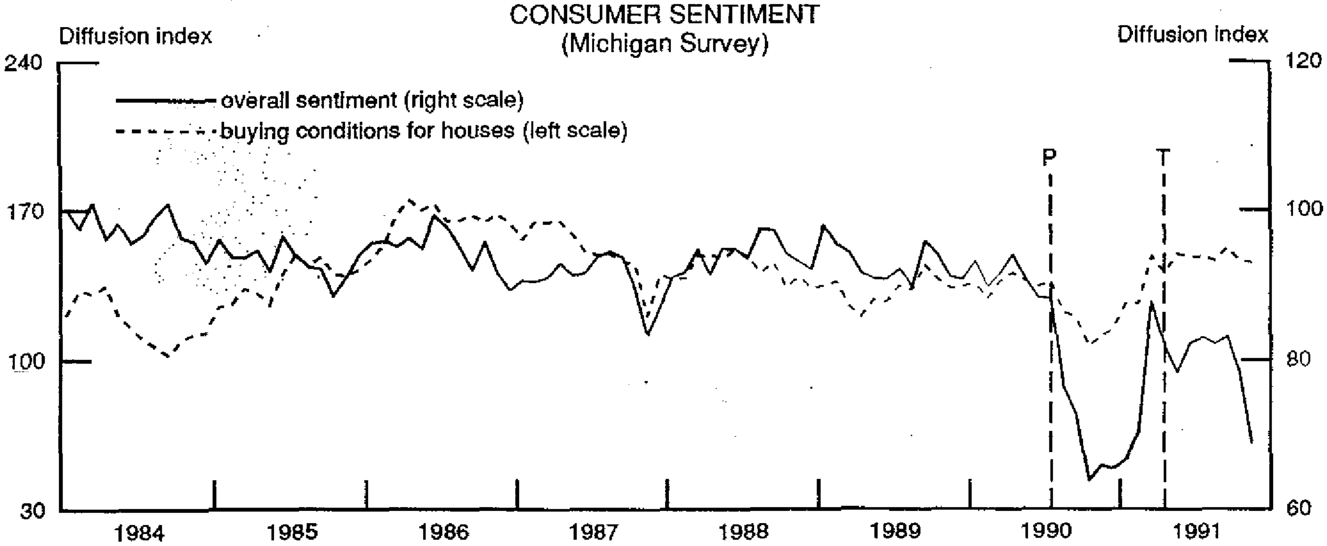
BUILDERS' RATINGS OF CURRENT HOME SALES



BUILDERS' EXPECTATIONS FOR THE NEXT SIX MONTHS



CONSUMER SENTIMENT
(Michigan Survey)



Note: diffusion index is the proportion of positive responses minus the proportion of negative responses, plus 100.

quarters; however, federal receipts were revised down substantially. For real purchases of goods and services, the revised figures still show a sharp increase in defense spending during the Persian Gulf war but a sizable decline since then. The recent quarterly pattern of real nondefense expenditures was little changed by the revisions and continues to show a moderate uptrend in recent quarters. The downward adjustment in receipts was concentrated in personal taxes, which were lowered substantially in each of the past five quarters; as a result, receipts are now estimated to have risen only 1.8 percent since the second quarter of 1990, less than the rise in nominal GDP. For fiscal year 1991, total federal receipts were revised down $19 billion, federal expenditures were revised up $1 billion, and the NIPA measure of the federal budget deficit was revised up $20 billion to $190 billion.

FEDERAL PURCHASES OF GOODS AND SERVICES
(Billions of 1987 dollars, NIPA basis, seasonally adjusted, at annual rates)

	FY90	FY91	Percent change	1990 Q4	1991 Q1	Q2	Q3
Real purchases	379	388	2.4	383	392	393	384
Real defense purchases	281	285	1.4	282	289	287	280
Real nondefense purchases	98	103	5.4	101	102	106	104

In October, the federal government ran a unified budget deficit of $36 billion, up about $5 billion from a year earlier. Over the past three months, the deficit has totaled $86 billion, compared with a $63 billion figure for the same three months in 1990. The widening of the deficit reflects both relatively slow growth in receipts, which were up only about 2 percent, and a rise in outlays of nearly 9 percent. Year-over-year increases in outlays in recent months have been concentrated in the categories of medicare and health, social security, and income security. On the receipts side,

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS
(Unified basis, billions of dollars, not seasonally adjusted, except where otherwise noted)

	October			Three-month total August-October		
	1990	1991	Percent change	1990	1991	Percent change
Outlays	108.3	114.0	5.3	321.7	349.3	8.6
Deposit insurance (DI)	7.0	1.4	-80.0	19.3	22.7	17.6
Defense cooperation account (DCA) contributions (-)	1.6	1.2	-23.9	1.6	3.8	132.4
Outlays ex DI and DCA	102.9	113.8	10.6	304.0	330.4	8.7
National defense ex DCA	25.0	25.0	0.0	75.2	77.5	3.0
Net interest	14.7	16.8	14.3	48.0	50.2	4.6
Social Security	21.0	22.7	8.1	62.9	68.0	8.1
Medicare and health	12.8	17.2	34.4	39.8	48.8	22.6
Income security	12.8	13.7	7.0	36.5	41.3	13.2
Other	16.5	18.5	12.1	41.6	44.7	7.5
Receipts	77.0	78.1	1.4	258.4	263.8	2.1
Personal income taxes	40.7	39.3	-3.4	123.9	121.9	-1.6
Social insurance taxes	26.6	28.4	6.8	89.6	93.9	4.8
Corporate income taxes	1.6	1.2	-25.0	20.5	21.1	2.9
Other	8.1	9.1	12.3	24.4	26.9	10.2
Deficit	31.3	36.0	15.0	63.2	85.5	35.3
Deficit ex DI and DCA	25.9	35.8	38.2	45.5	66.6	46.2

Note: Details may not add to totals due to rounding.

personal income tax collections have been running a little below year-ago levels. For social insurance taxes, however, the expanded medicare tax base legislated last year has led to relatively strong year-over-year revenue growth recently.

The final days of the congressional session that ended November 27 brought several new pieces of legislation: the extension of unemployment benefits; financing of the Bank Insurance Fund (BIF) and the Resolution Trust Corporation (RTC); extension of several expiring tax breaks; and the appropriation of $5.8 billion in emergency supplemental spending. The last of these pieces of legislation has not yet been signed by the President.

The unemployment bill, as amended November 26, extends benefits either thirteen weeks or twenty weeks depending on employment conditions in the state of residence. Extended benefits are available for workers who exhausted their regular benefits after March 1, 1991, and the program is scheduled to continue until June 13, 1992. The projected cost of the bill is $5.3 billion; in keeping with existing budget rules, this spending was financed by enacting measures that boost individual estimated taxes, by permanently extending the law withholding tax refunds from taxpayers in default on government loans, and by delaying for one year the scheduled 1996 drop in the unemployment compensation tax.

The Congress authorized loans totaling approximately $70 billion for BIF. The fund will be able to borrow working capital from the Federal Financing Bank of up to 90 percent of the estimated market value of assets that the FDIC has and will acquire from failed banks; these funds are expected to come to about $40 billion. Another $30 billion is a direct loan from the Treasury that is to be repaid over fifteen years out of deposit insurance premiums. Separate legislation appropriated $25 billion of the RTC's

$80 billion request, an amount projected to satisfy needs through April 1, 1992.

The Congress extended, for six months, twelve popular tax breaks that were set to expire in January, most notably the research and experimentation tax credit and the low-income housing tax credit. The revenue loss, about $3 billion over five years, was made up by enacting measures to accelerate corporate tax payments.

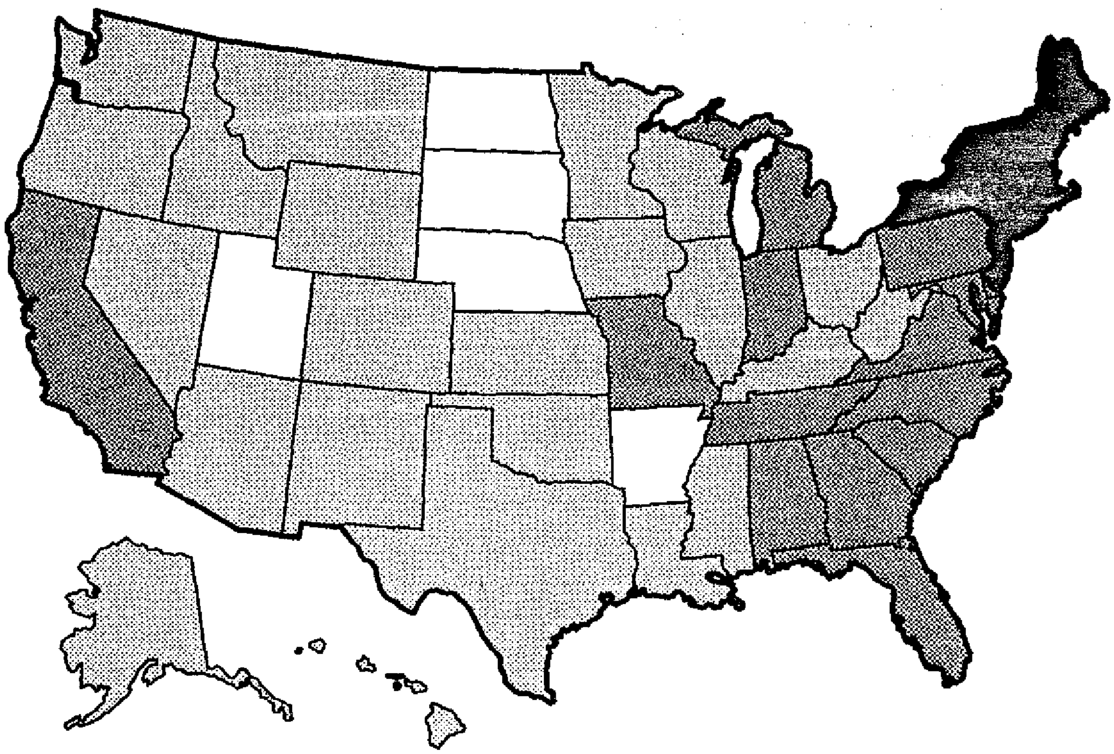
Twelve of the thirteen regular appropriations bills for fiscal 1992 are complete. Foreign operations, for which an appropriations bill has not yet been passed, are being funded under a continuing resolution. The $5.8 billion emergency supplemental appropriation includes $4 billion to replenish stocks used during Operation Desert Storm, $995 million for agriculture disaster assistance, and $800 million for the Federal Emergency Management Agency; these appropriations will be spent over several years and, because of the "emergency" designation, are not subject to the spending caps set in last year's budget agreement.

State and Local Government Sector

The comprehensive NIPA revision did not alter the recent pattern of state and local spending very much. Purchases of goods and services are now estimated to have declined at a 0.5 percent annual rate in the third quarter, after falling at a 1-1/4 percent annual rate in the first half. The slowing this year follows back-to-back increases of more than 3-1/2 percent in 1989 and 1990 and has encompassed all major types of purchases.

State and local employment rose slightly, on net, in October and November. However, these data are volatile and frequently have been revised substantially. When viewed over a slightly longer time period, employment has fallen, on balance, since midyear, after only small monthly increases, on average, in the first half. By

NONFARM PAYROLL EMPLOYMENT, PERCENTAGE CHANGE BY STATE
(Sept. 1990 – Sept. 1991)



☐ more than 2% ▨ –2% to 0%
▨ 0% to 2% ■ less than –2%

contrast, job gains in 1989 and 1990 averaged about 35,000 per month.

The slowing in spending this year, along with record tax hikes, has contributed to an improvement in the sector's fiscal position. Indeed, on an NIPA basis, the deficit of operating and capital accounts for all state and local governments, excluding social insurance funds, fell to $33 billion in the third quarter, about $14 billion below the peak reported in the fourth quarter of 1990. Nonetheless, about half the states have reported revenue shortfalls and spending overruns for the current fiscal year, setting the stage for another round of budget-balancing measures, and, thus, greater fiscal restraint. In California, the governor's office projects a fiscal 1992 budget gap of around $4 billion, with the size of the prospective deficit having mounted since mid-year. In New York, the governor has announced a prospective shortfall of about $900 million.

Not surprisingly, the fiscal imbalances of state and local governments have been most severe in those regions that have suffered the largest employment losses over the past year. The largest declines in payrolls, in percentage terms, were in New York, New Jersey, and the New England states, with smaller reductions elsewhere in the mid-Atlantic region and the South. Payroll employment also has fallen in California. By contrast, employment has grown in more than half the states, with a scattering of midwestern states experiencing relatively rapid growth in jobs (map).

Wage Developments

The incoming data on labor costs suggest that the rate of increase in wages is on a downtrend. Over the past twelve months the average hourly earnings of production or nonsupervisory workers have risen 3.0 percent; they had increased 3.6 percent in the previous 12-month period. The rate of increase since June has been less than 2 percent at an annual rate.

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

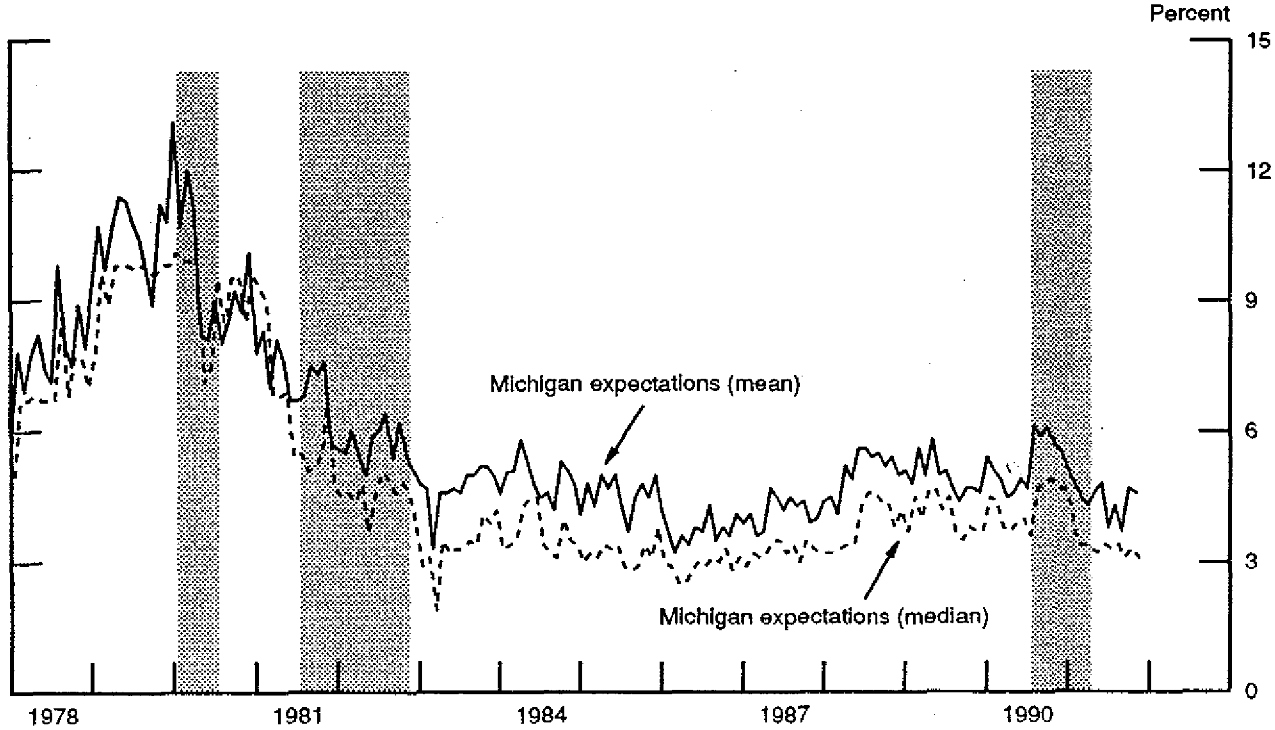
	1989	1990	1991 Q1	1991 Q2	1991 Q3	1991 Sep.	1991 Oct.	1991 Nov.
			--Annual rate--			--Monthly rate--		
Total private nonfarm	4.0	3.7	2.8	5.2	1.6	.1	-.1	.4
Manufacturing	2.7	3.6	2.2	5.2	2.2	.0	.1	.4
Excluding overtime	3.0	3.7	2.7	3.8	1.9	.0	.1	.3

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

Other than slack in the labor market, probably the most important determinant of labor costs is actual and expected inflation. One forward-looking indicator of inflation is provided by the Michigan survey of consumers. According to this survey, the mean expected price change over a twelve-month forecasting horizon has come down substantially from the late 1990 highs that followed the oil shock. But in the past two months, the mean expected price change has moved back up somewhat (chart).

More light can be shed on the meaning of these findings by examining not just the mean expected price increase but the full distribution of responses (table). This distribution is extremely diffuse, spanning a wide and nonsymmetric range of possible outcomes. The standard deviation in the recent past has been at least 5 percentage points; in addition, more than 20 percent of the respondents expect prices to remain flat or to fall over the next twelve months, and more than 10 percent of the respondents expect inflation of 10 percent or higher. The sharp drop in the mean last summer and the more recent rebound can be traced to a swing in the

INFLATION EXPECTATIONS
(Michigan Survey)



Expected Change in Prices During the Next 12 Months

	1990 Q4	1991 Q1	1991 Q2	1991 Q3	1991 Sep.	1991 Oct.	1991 Nov.
Mean increase	5.8	4.8	4.6	3.9	3.7	4.7	4.6
Standard deviation	6.8	6.9	7.0	5.4	5.0	7.4	7.9
Median increase	4.7	3.7	3.3	3.3	3.1	3.3	3.1
	------- percent of respondents --------						
Same or down	14	24	22	22	23	20	27
Will go up by:							
1-2 %	11	12	16	17	17	13	14
3-5 %	38	35	38	38	40	43	34
6-9 %	13	8	6	7	6	6	6
10-14 %	12	9	8	7	7	5	7
15% or higher	7	6	6	2	2	6	5
NA, don't know	5	5	5	6	5	7	7

proportion of respondents who think inflation will be unusually high--15 percent or more. By contrast, the median, which is less sensitive to extreme observations, has shown a gradual and fairly steady downward drift recently. The November readings for both the mean and the median were toward the low end of the ranges of the past several years (chart).

Prices

Like inflation expectations, the actual rate of price increase appears to be trending gradually lower, although the monthly patterns of change have been somewhat erratic in both the CPI and PPI. In October, the consumer price index rose only 0.1 percent, after an increase of 0.4 percent in September. Food prices edged down in October, energy prices were up only slightly, and the rise for items other than food and energy was unusually small--just 0.1 percent. At the producer level, the prices of finished goods rose 0.7 percent in October, but this jump followed four months of small advances or declines. Large price increases for energy and motor vehicles accounted for much of the October rise.[7]

Monthly changes in the CPI for food this year have largely reflected short-run volatility in the prices of fresh fruits and vegetables, superimposed on a very moderate trend rate of increase in the prices of other foods (chart). That pattern continued in October, when widespread price declines were reported for fresh fruits and vegetables; prices of fresh oranges dropped back especially sharply and began to retrace the climb that followed the freeze in California last winter. Meat prices also were down

7. The October PPI also included some sharp increases in prescription drugs, soaps, and detergents that reflected the end of temporary discounts; these discounts had helped to hold prices down in the September report. Moreover, according to the BLS, the October rise in consumer durable goods may have been overstated because of problems with seasonal adjustment.

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

	Relative importance Dec. 1990	1989	1990	1991 Q1	1991 Q2	1991 Q3	1991 Sep.	1991 Oct.
				-----Annual rate------			-Monthly rate-	
All items[2]	100.0	4.6	6.1	2.4	3.0	3.3	.4	.1
Food	16.2	5.6	5.3	2.4	5.1	-3.2	.1	-.1
Energy	8.2	5.1	18.1	-30.7	-1.2	1.6	1.0	.2
All items less food and energy	75.6	4.4	5.2	6.8	3.2	4.6	.4	.1
Commodities	24.5	2.7	3.4	7.9	3.2	4.1	.2	-.1
Services	51.1	5.3	6.0	6.4	3.0	4.6	.5	.3
Memorandum:								
CPI-W[3]	100.0	4.5	6.1	1.5	3.3	2.7	.4	.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.

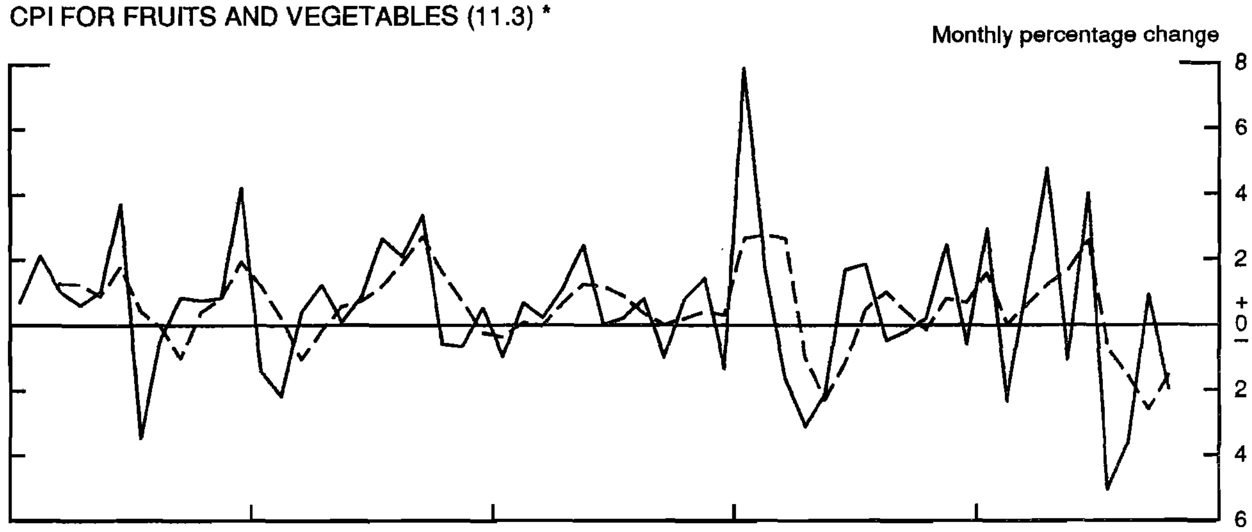
RECENT CHANGES IN PRODUCER PRICES
(Percentage change; based on seasonally adjusted data)[1]

	Relative importance Dec. 1990	1989	1990	1991 Q1	1991 Q2	1991 Q3	1991 Sep.	1991 Oct.
				-----Annual rate------			-Monthly rate-	
Finished goods	100.0	4.9	5.7	-3.5	.7	.3	.1	.7
Consumer foods	23.7	5.2	2.6	1.0	-.6	-6.3	-.5	.4
Consumer energy	16.8	9.5	30.7	-35.5	.0	5.3	.8	1.7
Other finished goods	59.5	4.2	3.5	5.4	1.5	1.5	.0	.5
Consumer goods	36.4	4.4	3.7	5.9	1.2	2.4	.0	.6
Capital equipment	23.1	3.8	3.4	4.6	1.6	1.0	.2	.4
Intermediate materials[2]	95.2	2.5	4.6	-9.8	-.7	.4	.1	-.1
Excluding food and energy	78.5	.9	1.9	-2.3	-1.0	-.3	.0	-.1
Crude food materials	34.4	2.8	-4.2	.0	-12.5	-8.1	1.5	.1
Crude energy	50.7	17.9	19.1	-54.0	.5	.0	-2.7	3.9
Other crude materials	14.9	-3.6	.6	-4.7	-13.3	-4.0	-.9	-.5

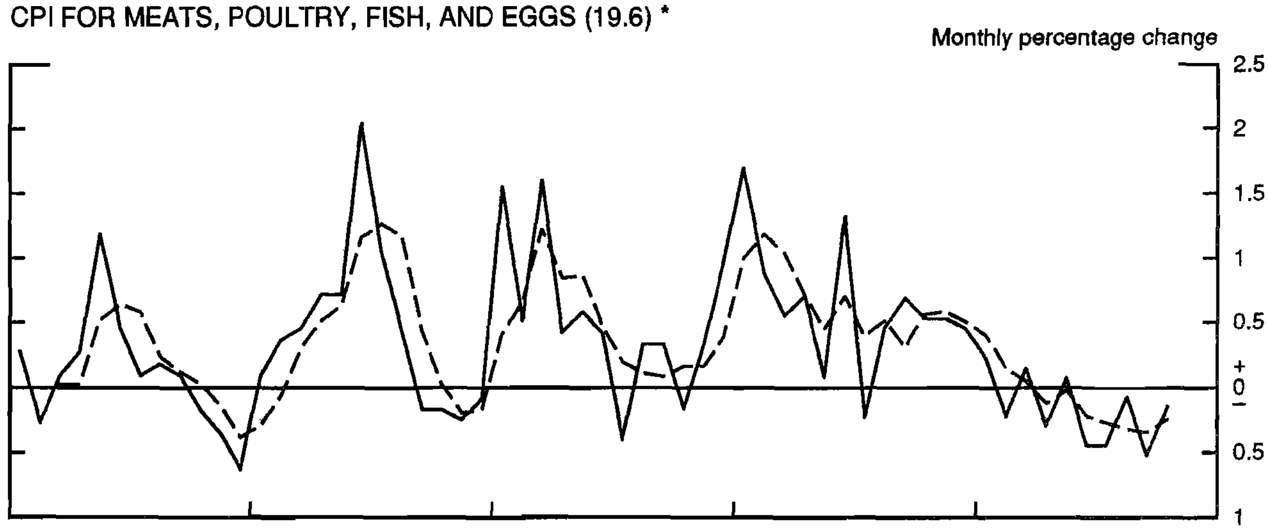
1. Changes are from final month of preceding period to final month of period indicated.
2. Excludes materials for food manufacturing and animal feeds.

CONSUMER FOOD PRICES

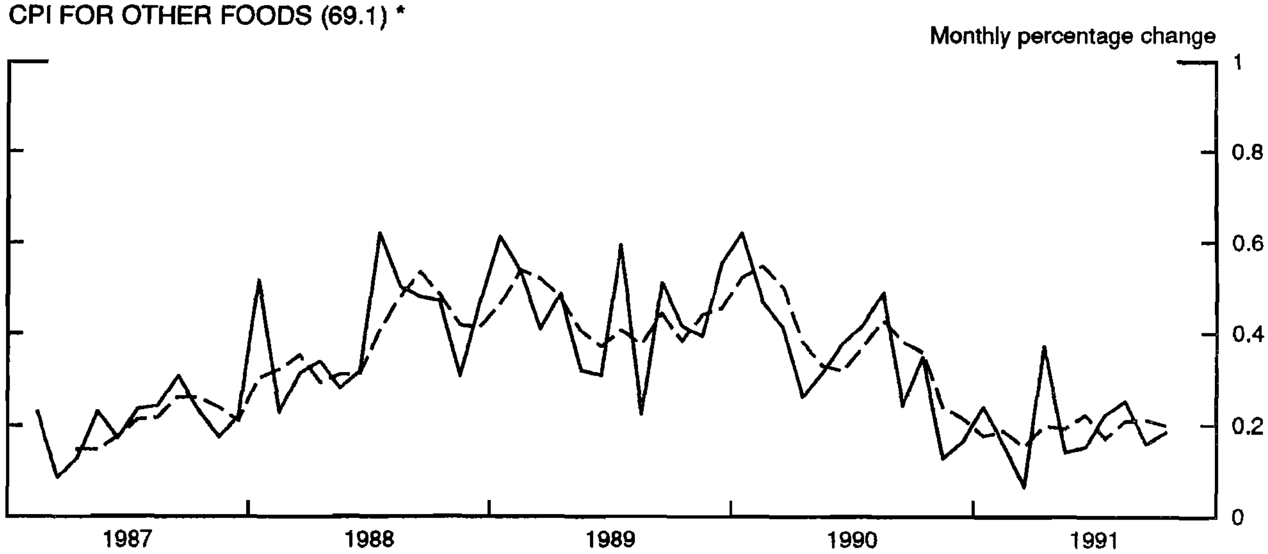
CPI FOR FRUITS AND VEGETABLES (11.3) *



CPI FOR MEATS, POULTRY, FISH, AND EGGS (19.6) *



CPI FOR OTHER FOODS (69.1) *



* Weights with respect to total CPI food. Dashed lines indicate 3–month moving averages.

somewhat further in October, while prices of other foods again rose moderately, on average, although a bit more than in September.

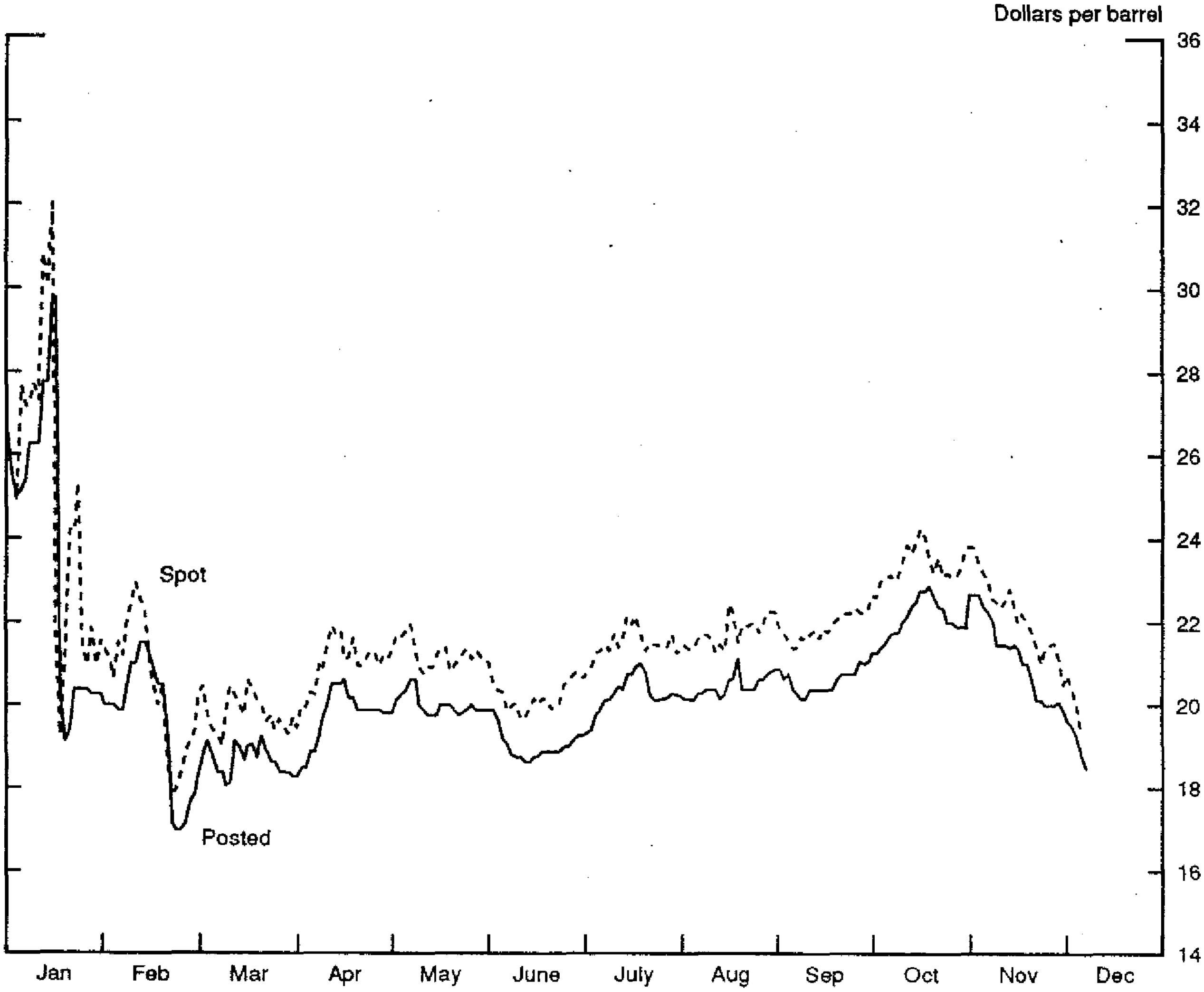
Some upward pressures on retail food prices may emerge in the next few months. Prices of some fresh vegetables, notably lettuce, have been boosted recently by an infestation of whiteflies in the desert areas of California and Arizona; these areas normally supply a large share of the nation's fresh produce from November to February.[8] In addition, the effects of recent increases in farm prices of milk and wheat probably have not yet been fully seen at retail. However, with average farm prices well below the levels of a year ago, livestock producers apparently locked into expansion, and futures prices subdued, the odds of a sustained runup in food prices seem small.

Energy prices rose 0.2 percent in the October CPI as declines for gasoline offset most of the increases in other components. Private survey data point to sizable increases in retail gasoline prices in November, and retail prices of fuel oil also are likely to move up, reflecting the passthrough of earlier increases in crude oil costs. However, these upward pressures should be short-lived; prices of crude oil have retreated markedly since October and by early December had more than reversed their runup of early autumn.

The October rise of 0.1 percent in the CPI excluding food and energy followed a four-month stretch in which the monthly increases in this indicator of core inflation had held stubbornly at 0.4 percent. Goods prices edged down, on average, in October, with

8. A huge runup in lettuce prices in the first half of November was partially reversed later in the month. According to some trade reports, the initial price runup may have been caused in part by panic buying in the wake of sensational media stories. Growers anticipate that supplies of produce will continue to be available from the desert areas this winter, albeit in smaller amounts than in the absence of the whitefly. As of early December, the wholesale prices of the vegetables were in a normal range overall but up sharply from the very low levels of October.

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
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	20.55	21.86
October	21.96	23.23
November	21.40	22.47
December [1]	19.38	20.23

1. Price through December 10.

declines in several categories. Apparel prices retreated for the second month, on a seasonally adjusted basis, after large increases in July and August that had reflected the early introduction of fall and winter apparel. Prices of new motor vehicles also registered seasonally adjusted declines. In addition, the CPI for nonenergy services rose a moderate 0.3 percent in October, held down in part by large declines in airfares and auto financing costs. Moreover, rent increases slowed after picking up in September.

The October CPI probably overstates the slowing in the core inflation rate, and increases in the next few months may not be as small. For example, the declines for apparel in part reflected problems with seasonal adjustment. In addition, the October PPI showed the prices of cars and light trucks moving up markedly further, to levels about 4-1/2 percent and 5-1/2 percent, respectively, above those a year earlier. In the absence of a marked enhancement of incentive programs, these increases at the manufacturers' level point to sizable advances in the CPI for new vehicles in coming months.[9] While there have been widespread reports of early discounting for a variety of other consumer goods, it is impossible to know at this point if the actual degree of discounting this year has been any greater than usual.

In the markets for industrial materials, upward price pressures have not been apparent of late. The PPI for intermediate materials (nonfood, nonenergy) was little changed in October for the fifth consecutive month, and the level of this index was somewhat below that of a year earlier. Prices of crude nonfood materials less energy were down 0.5 percent in October, reflecting large declines

9. In the CPI, new-model cars and trucks are phased into the sample over several months, starting in October, as they replace previous models on the dealers' lots. By contrast, the new-model vehicles enter the PPI sample--which reflects manufacturers' prices--in October and remain through the following September.

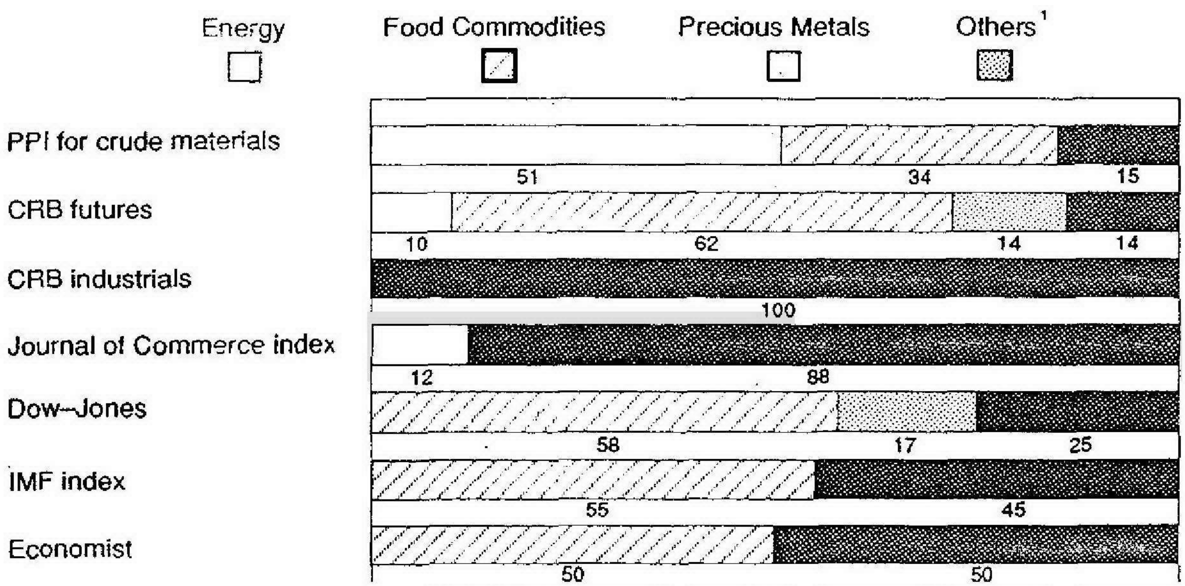
for aluminum scrap and cotton; these prices remained more than 9 percent below their level of a year earlier. Indexes of spot commodity prices traced out mixed patterns of change in November, but generally have moved lower in early December.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last observation	1989	1990	1991 To Oct. 29[3]	1991 Oct. 29[3] to date	Memo: Year earlier to date
		Percent change[2]				
1. PPI for crude materials[4]	Oct.	7.1	6.0	-9.9	n.a.	-20.2
1a. Foods and feeds	Oct.	2.8	-4.2	-5.0	n.a.	-7.2
1a. Energy	Oct.	.9	-2.7	-14.3	n.a.	-31.5
1b. Excluding food and energy	Oct.	-3.6	.6	-5.9	n.a.	-9.3
1c. Excluding food and energy, seasonally adjusted	Oct.	-3.6	.5	-6.1	n.a.	-9.4
2. Commodity Research Bureau						
2a. Futures prices	Dec. 10	-9.0	-2.7	-1.9	-3.5	-5.1
2b. Industrial spot prices	Dec. 9	-5.9	.6	-10.1	-.5	-10.7
3. *Journal of Commerce* industrials	Dec. 10	1.3	-2.4	-4.8	-1.8	-5.7
3a. Metals	Dec. 10	-7.2	-3.9	-7.4	.4	-7.2
4. Dow-Jones Spot	Dec. 10	-10.1	-1.7	-8.9	.0	-7.8
IMF commodity index[4]	Oct.	-12.9	-5.6	.0	n.a.	-3.8
a. Metals	Oct.	-23.4	-3.0	-9.1	n.a.	-17.3
5b. Nonfood agriculture	Oct.	-4.6	-3.5	1.5	n.a.	-3.5
6. *Economist* (U.S. dollar index)	Dec. 3	-22.8	-4.4	-8.1	-.2	-8.7
6a. Industrials	Dec. 3	-23.8	-3.2	-13.1	-.4	-11.7

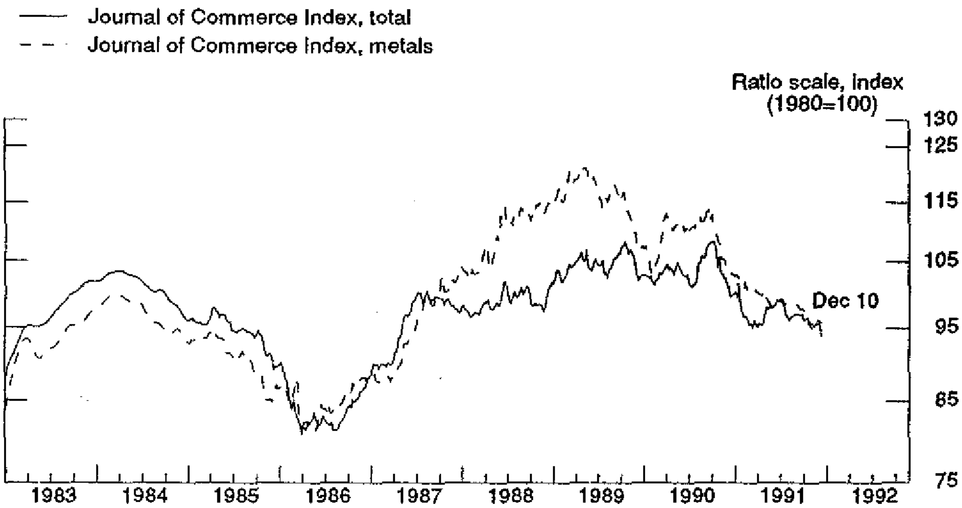
1. Not seasonally adjusted.
2. Change is measured to end of period, from last observation of previous period
3. Week of the October Greenbook.
4. Monthly observations. IMF index includes items not shown separately.
n.a. Not available

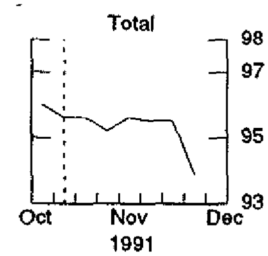
Index Weights

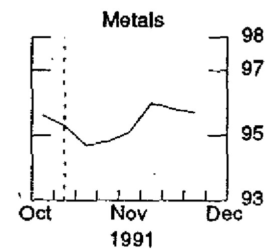


1. Forest products, industrial metals, and other industrial materials.

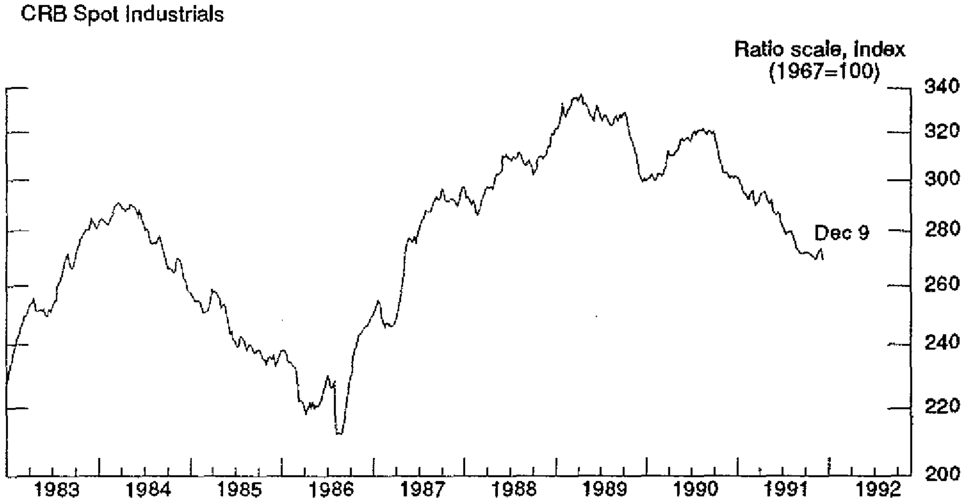
COMMODITY PRICE MEASURES *

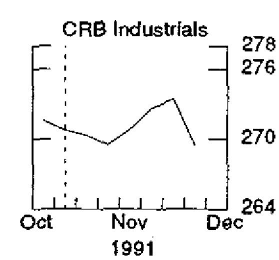




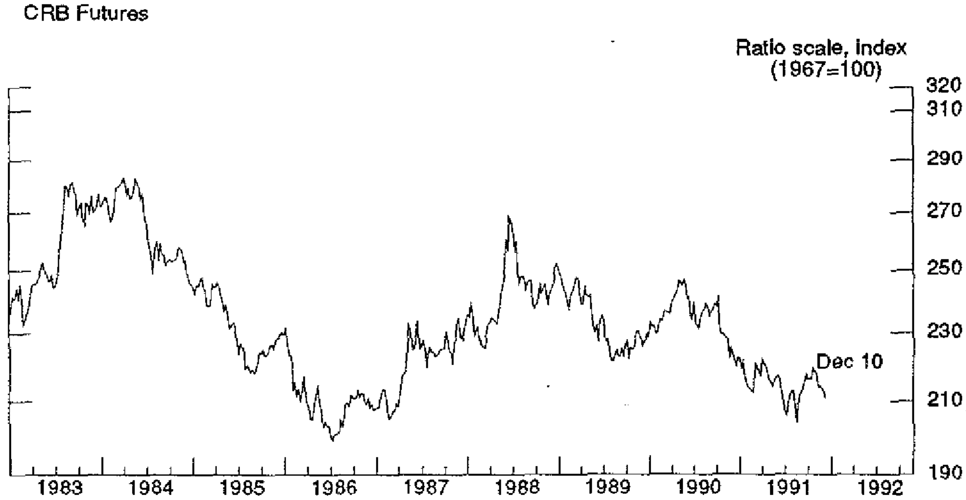


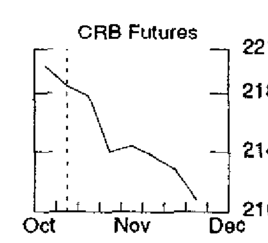
CRB Spot Industrials





CRB Futures





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

Dotted lines indicate week of last Greenbook.

DOMESTIC FINANCIAL DEVELOPMENTS

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(percent)

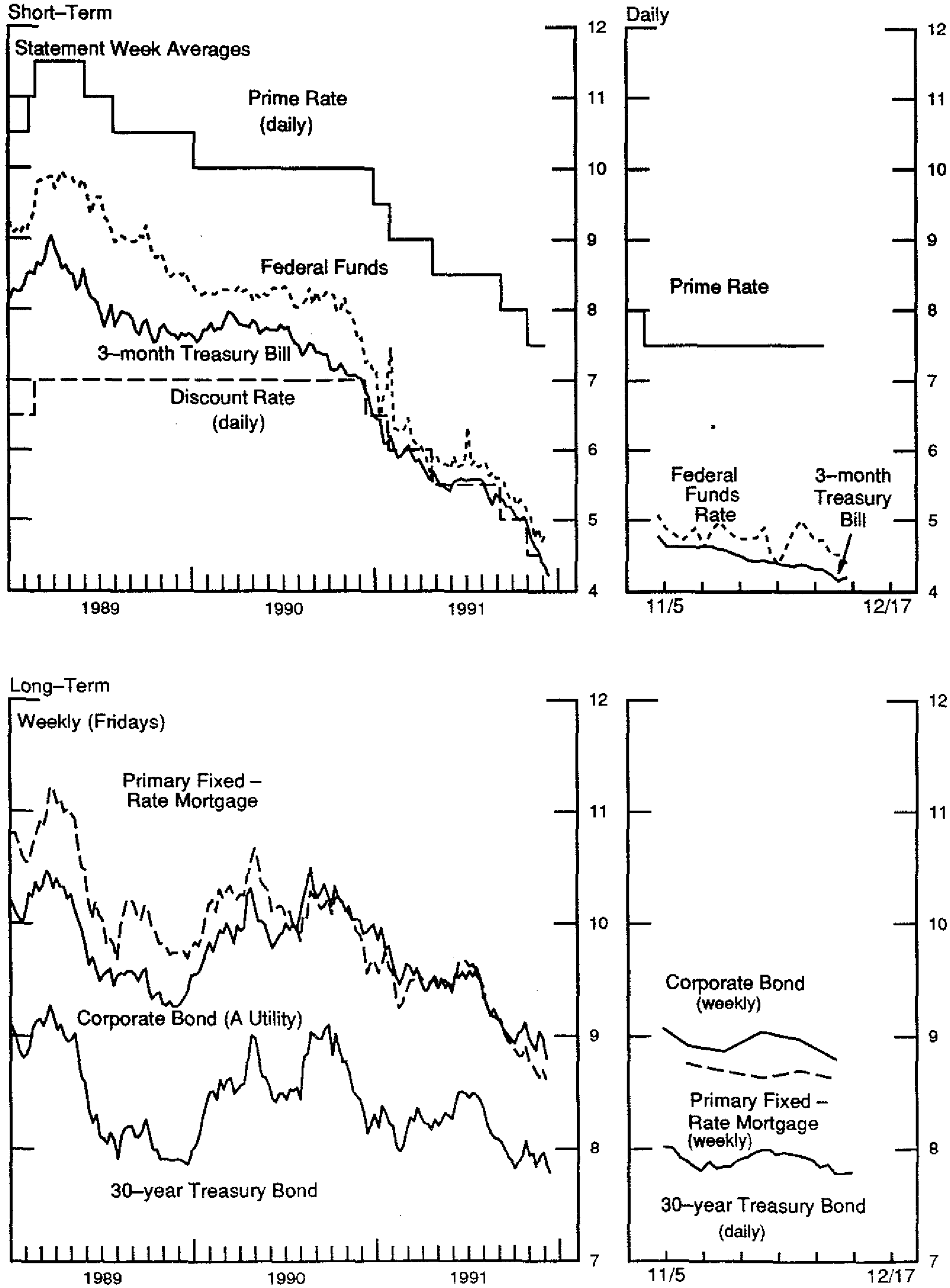
	1989 March highs	1990 July 13	1991 FOMC Nov 5	1991 Dec 10	Change from: Mar 89 highs	Change from: 1990 July 13	Change from: FOMC Nov 5
Short-term rates							
Federal funds[2]	9.85	8.31	5.17	4.67	-5.18	-3.64	-.50
Treasury bills[3]							
3-month	9.10	7.60	4.76	4.20	-4.90	-3.40	-.56
6-month	9.11	7.51	4.81	4.20	-4.91	-3.31	-.61
1-year	9.05	7.36	4.80	4.25	-4.80	-3.11	-.55
Commercial paper							
1-month	10.05	8.17	5.05	4.95	-5.10	-3.22	-.10
3-month	10.15	8.05	5.06	4.63	-5.52	-3.42	-.43
Large negotiable CDs[3]							
1-month	10.07	8.16	4.99	4.83	-5.24	-3.33	-.16
3-month	10.32	8.17	5.03	4.45	-5.87	-3.72	-.58
6-month	10.08	8.19	5.01	4.39	-5.69	-3.80	-.62
Eurodollar deposits[4]							
1-month	10.19	8.13	4.94	4.81	-5.38	-3.32	-.13
3-month	10.50	8.13	5.06	4.44	-6.06	-3.69	-.62
Bank prime rate	11.50	10.00	8.00	7.50	-4.00	-2.50	-.50
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	9.88	8.25	6.04	5.48	-4.40	-2.77	-.56
10-year	9.53	8.45	7.56	7.21	-2.32	-1.24	-.35
30-year	9.31	8.46	8.02	7.79	-1.52	-.67	-.23
Municipal revenue[5] (Bond Buyer)	7.95	7.40	6.86	6.96	-.99	-.44	.10
Corporate--A utility recently offered	10.47	9.94	9.07	8.79	-1.68	-1.15	-.28
Home mortgage rates[6]							
FHLMC 30-yr. FRM	11.22	10.11	8.78	8.62	-2.60	-1.49	-.16
FHLMC 1-yr. ARM	9.31	8.45	6.58	6.29	-3.02	-2.16	-.29

	Record highs	Date	1989 Lows Jan 3	1991 FOMC Nov 5	1991 Dec 10	Percent change from: Record highs	Percent change from: 1989 lows	Percent change from: FOMC Nov 5
Stock prices								
Dow-Jones Industrial	3077.15	10/18/91	2144.64	3031.31	2863.82	-6.93	33.53	-5.53
NYSE Composite	219.37	11/13/91	154.00	214.68	208.86	-4.79	35.62	-2.71
AMEX Composite	397.47	11/18/91	305.24	384.94	368.17	-7.37	20.62	-4.36
NASDAQ (OTC)	556.17	11/13/91	378.56	538.82	534.23	-3.94	41.12	-0.85
Wilshire	3862.46	11/13/91	2718.59	3773.53	3675.80	-4.83	35.21	-2.59

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 maintenance period ending December 11, 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 are plotted through December 6, statement weeks through December 4.

DOMESTIC FINANCIAL DEVELOPMENTS

Treasury bill rates have dropped more than 50 basis points since the November FOMC meeting, in association with actual and anticipated policy easings. The federal funds rate fell 1/4 point in early November in connection with a 1/2 point cut in the discount rate, and another 1/4 point in early December. Most private money market rates have declined by similar amounts, but concerns about securing funding over year-end have muted the decline in one-month rates, as maturity dates moved across the end of the year. Treasury bond rates have fallen about 25 basis points over the intermeeting period, resulting in a further steepening of the yield curve. Shortly after the cut in the discount rate, the prime rate was reduced 1/2 percentage point, to 7-1/2 percent, yet the spread between the prime rate and bank funding costs remains quite large.

Broad stock price indexes are down 3 to 5 percent over the intermeeting period. Negative news on the recovery weighed on the market, and a Senate vote to cap interest rates on credit cards precipitated a 120-point drop in the Dow on November 15. Bank stocks have been hit hard, with money center equity prices falling by about 11 percent since the last FOMC meeting.

M2 and M3, boosted by strength in their most liquid components, accelerated slightly in November, but remained close to the bottom of their target ranges. Meanwhile, M1 continued to expand briskly. Bank credit grew moderately again in November, as loans posted their first increase since June.

Overall borrowing by nonfinancial firms picked up slightly in November but was not robust. Gross bond issuance was strong, as firms took advantage of receptive markets to lengthen debt maturity and retire high-coupon issues. Despite the setback in the stock market, equity issuance set a record. Commercial paper expanded for

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

	1990[1]	1991 Q2	1991 Q3	1991 Sep	1991 Oct	1991 Nov pe	Growth Q4 90- Nov 91pe
	------------Percent change at annual rates						
1. M1	4.2	7.3	6.8	5.4	12.6	14	8
2. M2	3.8	4.7	-0.5	0.0	2.8	4	2½
3. M3	1.7	1.8	-2.4	-1.7	1.8	3	1
	------------Percent change at annual rates						Levels bil. $ Oct 91
Selected components							
4. M1-A	4.6	3.9	3.2	2.6	11.8	12	554.9
5. Currency	11.0	3.9	5.8	7.4	9.1	4	264.4
6. Demand deposits	-0.6	4.5	1.1	-2.1	14.2	20	282.6
7. Other checkable deposits	3.5	13.5	13.3	9.8	13.5	18	324.1
8. M2 minus M1[2]	3.7	3.9	-3.0	-1.9	-0.5	1	2517.9
9. Overnight RPs and Eurodollars, NSA	3.3	-7.4	-13.9	-14.1	62.6	44	70.6
10. General purpose and broker/dealer money market mutual fund shares	11.0	8.0	-10.9	-11.5	-4.4	-4	350.3
11. Commercial banks	9.9	7.3	6.9	4.4	3.9	1	1244.4
12. Savings deposits plus MMDAs	7.5	16.6	12.9	9.1	14.7	15	643.6
Small time deposits	12.4	-1.8	0.8	-0.8	-7.5	-14	600.8
Thrift institutions	-5.5	-2.1	-10.8	-8.4	-9.2	-4	854.1
Savings deposits plus MMDAs	-2.2	18.4	9.8	5.6	8.8	13	369.6
16. Small time deposits	-7.3	-14.7	-24.5	-18.9	-22.4	-18	484.5
17. M3 minus M2[3]	-6.4	-10.5	-10.8	-8.9	-2.9	-3	748.6
18. Large time deposits	-9.5	-7.6	-15.2	-19.8	-23.7	-18	467.3
19. At commercial banks, net[4]	-3.5	0.2	-8.4	-14.7	-18.0	-14	380.2
20. At thrift institutions	-23.9	-34.8	-40.8	-42.2	-46.4	-37	87.1
21. Institution-only money market mutual fund shares	20.2	23.0	0.8	37.3	49.0	43	155.4
22. Term RPs, NSA	-12.6	-27.8	-6.6	-16.9	-21.8	-2	75.7
23. Term Eurodollars, NSA	-12.1	-32.3	1.8	-23.2	-21.8	-15	64.8
	-----Average monthly change in billions of dollars---						
MEMORANDA:[5]							
24. Managed liabilities at commercial banks (25+26)	-0.1	-3.4	-2.8	1.7	4.9	-2	702.9
25. Large time deposits, gross	-2.6	0.3	-2.7	-3.3	-8.8	-3	435.1
26. Nondeposit funds	2.5	-3.7	-0.1	5.0	13.7	1	267.8
27. Net due to related foreign institutions	2.2	-3.7	0.2	2.8	10.8	1	30.6
28. Other[6]	0.3	-0.1	-0.3	2.3	2.8	0	237.2
29. U.S. government deposits at commercial banks[7]	0.3	-3.5	-0.4	-1.9	9.2	6	31.1

1. Amounts shown are from fourth quarter to fourth quarter.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. The non-M2 component of M3 is seasonally adjusted as a whole.
4. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
5. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
6. 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.
7. Consists of Treasury demand deposits and note balances at commercial banks.

pe - preliminary estimate

the first time since July, but bank business loans ran off. Installment borrowing by consumers remained sluggish through October as household spending on durables was weak, and data from commercial banks for November point to another slack month. Available data suggest some rebound in mortgage borrowing thus far in the fourth quarter.

Fourth-quarter borrowing by the federal government, though down on a not seasonally adjusted basis from the third quarter's torrid pace, is expected to remain heavy. Now that the Congress has authorized funds for the RTC and FDIC, auction sizes should increase around year-end. Borrowing by state and local governments accelerated in November, reflecting a step-up in bond issuance for both new capital and refunding and efforts to cope with budget deficits.

Monetary Aggregates and Bank Credit

M2 grew at a 4 percent annual rate in November, and M3 at a 3 percent pace, each about a percentage point above their October growth rates. The uptick in M2 growth came from its liquid deposit components, reflecting the further narrowing of opportunity costs that has accompanied policy easings. A 14 percent rate of expansion of M1 in November was sustained by accelerations in demand deposits and OCDs, while currency growth slowed because of decreased shipments abroad. Anecdotal evidence suggests that inflows to stock and bond mutual funds, which were very heavy through October, may not have abated in November, despite the break in stock market prices. Outflows from small time deposits and M2-type money market mutual funds stayed heavy last month. M3 growth benefited from a resumption of large CD issuance at branches and agencies of foreign

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

Category	Dec. 1989 to Dec. 1990	1991 Q2	1991 Q3	1991 Sep.	1991 Oct.	1991 Nov. p	Level (billions of dollars) 1991 Nov. p
	Commercial bank credit						
1. Total loans and securities at banks	5.3	1.7	0.8	3.2	6.8	6.5	2,799.5
2. Securities	8.6	11.9	14.7	18.5	30.3	18.4	721.3
3. U.S. government	13.9	19.8	21.7	22.2	37.0	24.5	549.2
4. Other	-3.1	-9.3	-5.3	6.4	9.8	-0.7	172.1
5. Loans	4.3	-1.5	-3.6	-1.8	-1.1	2.4	2,078.2
6. Business	1.9	-6.8	-4.3	6.2	0.0	-3.1	620.6
7. Real estate	9.5	5.3	-2.8	-0.7	1.1	3.2	856.5
8. Consumer	1.2	-3.2	-7.2	-11.7	-8.5	-4.6	361.3
9. Security	4.4	-5.2	58.5	36.6	-2.7	71.2	46.4
10. Other	-2.4	-9.3	-10.2	-22.1	0.0	13.8	193.4
	Short- and intermediate-term business credit						
11. Business loans net of bankers acceptances	1.9	-6.8	-4.4	6.7	0.6	-3.9	614.4
12. Loans at foreign branches[2]	19.3	-35.7	-3.4	21.0	20.6	40.5	24.5
13. Sum of lines 11 and 12	2.5	-7.9	-4.4	7.2	1.3	-2.4	638.9
14. Commercial paper issued by nonfinancial firms	12.2	-9.4	-26.3	-56.3	-22.9	18.0	135.6
15. Sum of lines 13 and 14	4.2	-8.2	-8.4	-4.5	-2.9	1.1	774.5
16. Bankers acceptances, U.S. trade-related[3]	-9.6	-22.0	-20.5	-8.6	4.3	n.a.	27.8[5]
17. Finance company loans to business[4]	13.1	4.6	11.6	14.7	11.4	n.a.	309.2[5]
18. Total (sum of lines 15, 16, and 17)	5.8	-5.2	-3.4	0.6	1.2	n.a.	1,112.5[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. Consists of acceptances that finance U.S. imports, U.S. exports, and domestic hipment and storage of goods. Based on average of data for current and preceding ends of month.
4. Based on average of data for current and preceding ends of month.
5. October 1991 data.
p--Preliminary.
n.a.--Not available.

banks and continued strong inflows to institution-only money market mutual funds.[1]

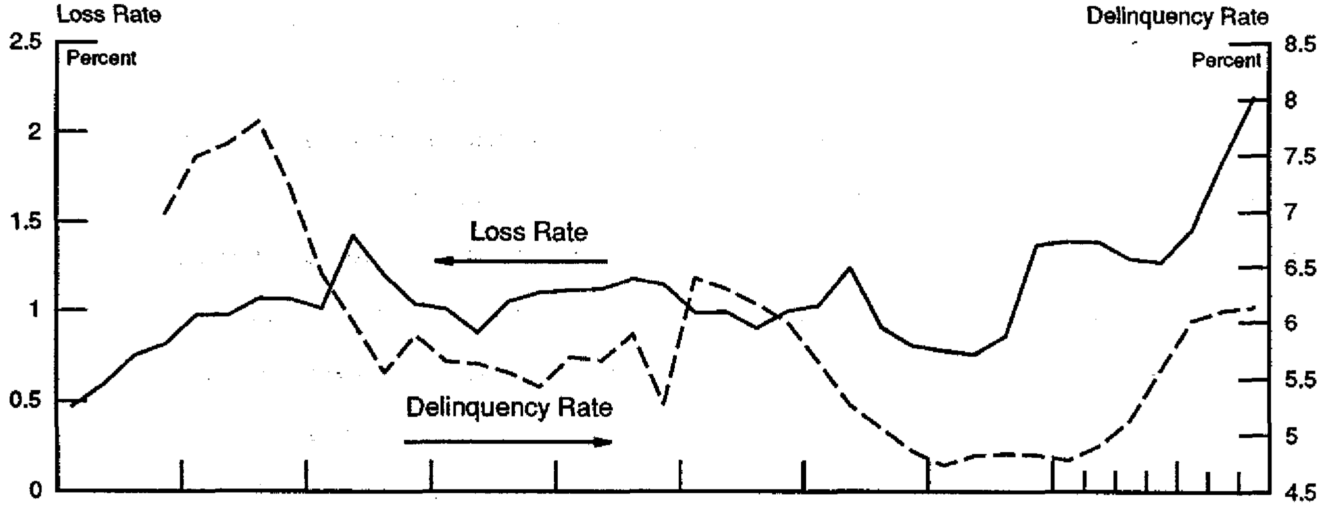
Bank credit grew at a 6-1/2 percent annual rate in November, with loan growth turning positive after several months of declines. Real estate loans advanced moderately for a second month, as runoffs at large domestic banks slowed. Despite an estimated 2-1/2 percentage point boost from rebookings of off-shore loans by foreign branches and agencies, business loans resumed their decline in November, with large domestic banks leading the way. Business loans at small banks dropped at a 10 percent annual rate, in line with the rapid declines seen recently. Over the past two quarters, C&I loans have contracted more rapidly at small than at large banks. November data from the Survey of the Terms of Bank Lending show that, since early this year, loan rates at small banks have softened relative to those at very large banks, suggesting that the unusual weakness at smaller banks owes importantly to slack demand. The weakness in business loans likely also reflected repayments of bank debt from the proceeds of reverse LBOs and other equity offerings. Total loan growth comprised strong advances in two volatile components, security loans and other loans. In view of the up-and-down nature of these series, the turnaround of bank lending in November may prove to be short-lived.

Acquisitions of U.S. government securities slowed in November, but again accounted for most of the growth in bank credit. At large banks, holdings of mortgage pass-throughs declined slightly on the month, continuing a pattern of runoffs in this instrument seen since spring. Data from bank call reports through September (table) show that acquisitions of pass-throughs stalled, on balance, over the second and third quarters. The stagnation in pass-throughs stemmed

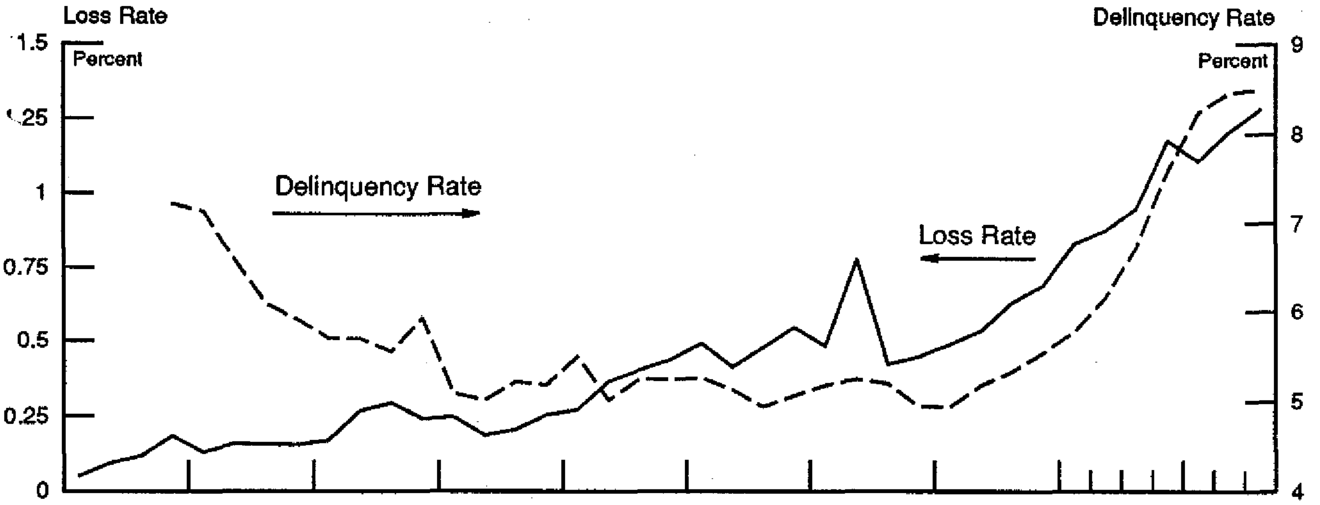
1. The monetary and credit aggregates in 1991 are discussed more fully in the appendix.

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

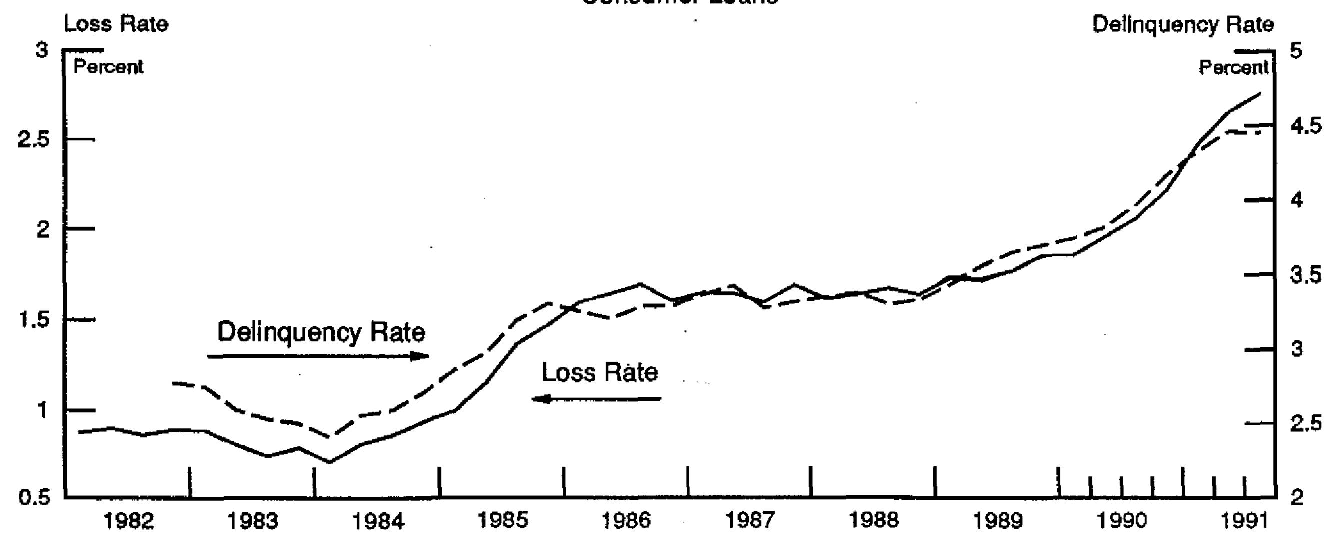
Commercial and Industrial Loans



Real Estate Loans



Consumer Loans



1. Loss rates are based on chargeoffs net of recoveries. Delinquent loans include those past due 30 days or more and still accruing interest, as well as those on nonaccrual status. Data are reported on the Quarterly Report of Condition by banks with at least $300 million in assets.

mainly from declines in GNMA-guaranteed issues, which were adversely affected by tougher underwriting standards for FHA loans implemented at midyear. Holdings of FNMA and FHLMC pass-throughs continued to rise moderately. Agency CMOs have accounted for a growing share of

CHANGE IN HOLDINGS OF U.S. GOVERNMENT SECURITIES
BY DOMESTIC COMMERCIAL BANKS
($ billions, not seasonally adjusted)

Period	Total	Treasury issues	Agency Issues					
			CMOs	Pass-Throughs			Other
				Total	GNMA	FNMA & FHLMC	
1991							
Q1	22.9	9.6	5.2	8.5	2.4	6.0	-0.3
Q2	17.6	11.5	8.0	-1.6	-4.8	3.2	-0.3
Q3	22.4	12.0	10.2	0.8	-2.0	2.7	-0.6

Source: Bank Reports of Condition. Changes are differences between end-of-quarter levels.

acquisitions of U.S. government securities, as banks seem to have bypassed pass-throughs for CMOs. Pass-throughs give the holder a share in a pool of mortgages whose average life may be quite long, but CMOs can offer banks the flexibility to add to their securities portfolio at particular maturities, while also offering a yield advantage over comparable Treasuries. According to the October 1991 Senior Loan Officer Opinion Survey, the average maturity of CMO tranches held by domestic respondent banks was about three years.

Chargeoffs net of recoveries rose for all three major components of bank loans--business, real estate, and consumer--in the third quarter and are now at their highest levels since the current series began in 1982 (chart). Delinquencies, however,

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

	1989	1990	1991 Q2	1991 Q3^p	1991 Sept.^p	1991 Oct.^p	1991 Nov.^p
Corporate securities - total[1]	19.85	19.88	35.16	30.65	31.94	35.67	33.32
Public offerings in U.S.	17.78	17.75	31.32	28.31	29.42	32.86	31.05
Stocks--total[2]	2.69	1.95	6.12	4.94	5.42	8.86	9.05
Nonfinancial	1.08	1.03	4.01	3.50	2.76	6.22	6.47
Utility	0.29	0.35	0.70	0.16	0.06	0.52	0.26
Industrial	0.79	0.68	3.31	3.34	2.70	5.70	6.21
Financial	1.60	0.92	2.11	1.44	2.67	2.62	2.58
Bonds	15.10	15.79	25.21	23.37	24.00	24.00	22.00
Nonfinancial	6.29	5.65	10.26	9.40	8.50	9.00	10.50
Utility	1.78	1.97	3.71	2.87	2.20	3.10	3.50
Industrial	4.50	3.69	6.55	6.54	6.30	5.90	7.00
Financial	8.81	10.14	14.94	13.97	15.50	15.00	11.50
By quality[3]							
Aaa and Aa	3.15	3.43	3.78	2.78	2.65	2.60	2.30
A and Baa	5.83	6.41	12.93	11.02	8.86	11.33	12.16
Less than Baa	2.39	0.15	1.33	0.47	0.45	0.80	1.87
No rating (or unknown)	0.05	0.04	0.01	0.01	0.00	0.00	0.00
Memo items:							
Equity-based bonds[4]	0.52	0.40	0.78	0.41	0.31	1.00	0.29
Mortgage-backed bonds	1.68	2.43	3.31	3.66	3.26	4.52	2.35
Other asset-backed	2.02	3.35	3.86	5.44	8.78	4.75	3.33
Variable-rate notes	1.03	0.82	0.82	0.89	0.72	0.61	0.97
..ds sold abroad - total	1.90	1.92	3.04	1.97	2.50	2.30	1.50
Nonfinancial	0.48	0.46	1.60	1.01	1.50	0.80	0.40
Financial	1.43	1.46	1.44	0.97	1.00	1.50	1.10
Stocks sold abroad - total	0.16	0.22	0.80	0.36	0.02	0.50	0.77
Nonfinancial	0.12	0.10	0.75	0.29	0.02	0.47	0.63
Financial	0.04	0.12	0.05	0.07	0.00	0.03	0.14

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.

continued to level out after rising markedly in 1990 and early this year.

Business Finance

The decline in business loans at banks in November was about matched by the first increase in nonfinancial commercial paper since July. Issuance of paper may have been boosted by firms selling paper with maturities in 1992 to avoid potential problems with the availability of funds at year-end. Indeed, the average maturity of outstanding commercial paper increased to an extremely high 43-1/2 days.

Underlying demands for financing, though, continued to be directed at the capital markets, as firms took advantage of low long-term rates and attractive share prices. Gross public bond issuance by nonfinancial corporations rose from $9 billion in October to $10.5 billion in November, and issuance so far in December also has been strong. Despite the strong issuance, spreads of investment-grade issues over Treasuries narrowed somewhat and may have benefited from increased demand from life insurance companies. Junk bond issuance about doubled in October and again in November, as stronger speculative-grade firms took advantage of lower yields to refinance more costly debt. The drop in rates probably reflected recent paydowns of junk bonds with the proceeds of equity issues, as well as strong demand from junk bond mutual funds, which have experienced significant inflows so far this year.

Nonfinancial corporations issued equity at a record pace in November despite a midmonth drop in stock prices, and issuance in December continues at a rapid pace. Several large issues have accounted for most of the volume of new equity. For example, early in November, Ford Motor Company raised badly needed new capital with a $2.2 billion offering of convertible preferred stock, the size of which was increased threefold because of strong investor demand. In the first week of December, General Motors completed a sale of $1 billion in preferred stock. Some firms took advantage of generally high stock prices to deleverage, even after the mid-November market decline. Moreover, the calendar of new issues remains full, although several scheduled IPOs have been withdrawn or postponed in the wake of increased price volatility.

Evidence of problems at major life insurance companies continued to emerge in the intermeeting period. Aetna announced its expectation that $740 million of its real estate loans will become delinquent in 1992 and another $530 million will require restructuring. In the first such move in decades, Metropolitan Life cut its dividend to policyholders. The 8 percent cut was attributed to reduced earnings stemming from lower interest rates and losses on real estate loans.

Insurance companies, with varying success, have tried to enhance liquidity and raise the average credit quality of their assets. An attempt by Mutual of New York to reduce reliance on guaranteed investment contract liabilities with pension funds, a highly volatile source of funds, was mostly unsuccessful. MONY offered its pension fund customers an opportunity to transfer these contracts to Metropolitan Life, but the pension funds balked at Metropolitan Life's harsh terms. Acquisitions of junk debt in the private placement market have been reduced, and firms have sought ways to remove troubled credits from their balance sheets. Connecticut General securitized $400 million of its junk bond portfolio but, by retaining the residual piece of $70 million, seems to have kept most of the risk. In contrast, market sources reported that Equitable located a buyer for the residual portion of a planned securitization of some of its junk bond portfolio. Prudential securitized, and placed privately, about $350 million of commercial real estate loans.

Treasury and Sponsored-Agency Financing

The staff anticipates a fourth-quarter federal deficit of $105 billion, up about $14 billion from the third quarter. Despite the increase in the deficit, the amount of marketable borrowing should be about $23 billion below that in the third quarter because of increased drawdowns of the cash balance and swings in nonmarketable borrowing and other means of finance. This quarter's reduced marketable borrowing, which is viewed by the Treasury as temporary, so far has occurred mainly in the bill sector, where the Treasury typically meets transitory fluctuations in borrowing needs. With legislative authority for renewed RTC and FDIC spending now in place, the staff expects substantial increases in both bill and coupon auction sizes beginning around year-end.[2]

In an effort to expand participation in auctions of its securities, the Treasury announced several rule changes in late October. These changes allowed all registered government securities brokers and dealers--not just primary dealers--to bid on behalf of customers. They also permitted anyone to bid without making a deposit at a Federal Reserve Bank, provided payment was adequately assured, and they increased from $1 million to $5 million the maximum award to any single noncompetitive bidder in note and bond auctions. It is too early to determine whether these changes will reduce Treasury borrowing costs. There is some reason for optimism,

2. Legislation passed on November 26, 1991, provided to the RTC another $25 billion, which must be spent by April 1992. The bill reorganized RTC by strengthening the role of the chief executive officer and replacing the current Oversight Board and Board of Directors with one board that will review policies rather than set them. Other legislation shored up the FDIC's Bank Insurance Fund by extending its line of credit with the Treasury from $5 billion to $30 billion and by providing for additional working-capital borrowing by FDIC.

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

	1991					
	Q2	Q3	Q4[p]	Oct.	Nov.[p]	Dec.[p]
Treasury financing						
Total surplus/deficit (-)	-25.7	-91.3	-105.4	-36.0	-48.3	-21.1
Means of financing deficit:						
Net cash borrowing from the public	43.1	95.0	83.5	40.7	24.2	18.6
Marketable borrowings/ repayments (-)	38.6	103.5	80.1	38.6	22.8	18.8
Bills	-11.7	43.0	25.4	21.3	3.8	.2
Coupons	50.3	60.4	54.7	17.2	18.9	18.6
Nonmarketable	4.5	-8.5	3.4	2.1	1.5	-.2
Decrease in the cash balance	-11.6	2.1	14.5	-11.2	28.2	-2.4
Memo: Cash balance at end of period	43.6	41.5	26.9	52.7	24.5	26.9
Other[2]	-5.8	-5.8	7.3	6.6	-4.1	4.9
Federally sponsored credit agencies, net cash borrowing[3]	-7.1	5.1	--	--	--	--
FHLBs	-6.5	.7	--	-.6	--	--
FHLMC	-2.6	2.7	--	--	--	--
FNMA	1.7	.9	--	1.1	--	--
Farm Credit Banks	-.2	.3	--	.5	--	--
SLMA	.5	.6	--	--	--	--

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.
p--projected.
Note: Details may not add to totals due to rounding.

though, as the tendency of yields at auctions to come in a bit higher than usual in the months following the squeeze in the May two-year note auction has abated recently.

None of the bills that would stiffen the regulation of government-sponsored enterprises passed the Congress before it adjourned for the year.

Municipal Securities

Gross issuance of long-term municipal securities surged to more than $15 billion in November, the highest monthly pace in five years. There were strong increases in offerings for both new capital and refundings. Despite a slight increase in rates on long-term municipals, yields remained low enough to make cost effective the refunding of some of the bonds issued in 1985, the market's heaviest year of issuance. Some refundings, however, reflected budgetary distress and were motivated by a desire to reduce current debt service costs by extending the maturity of debt.

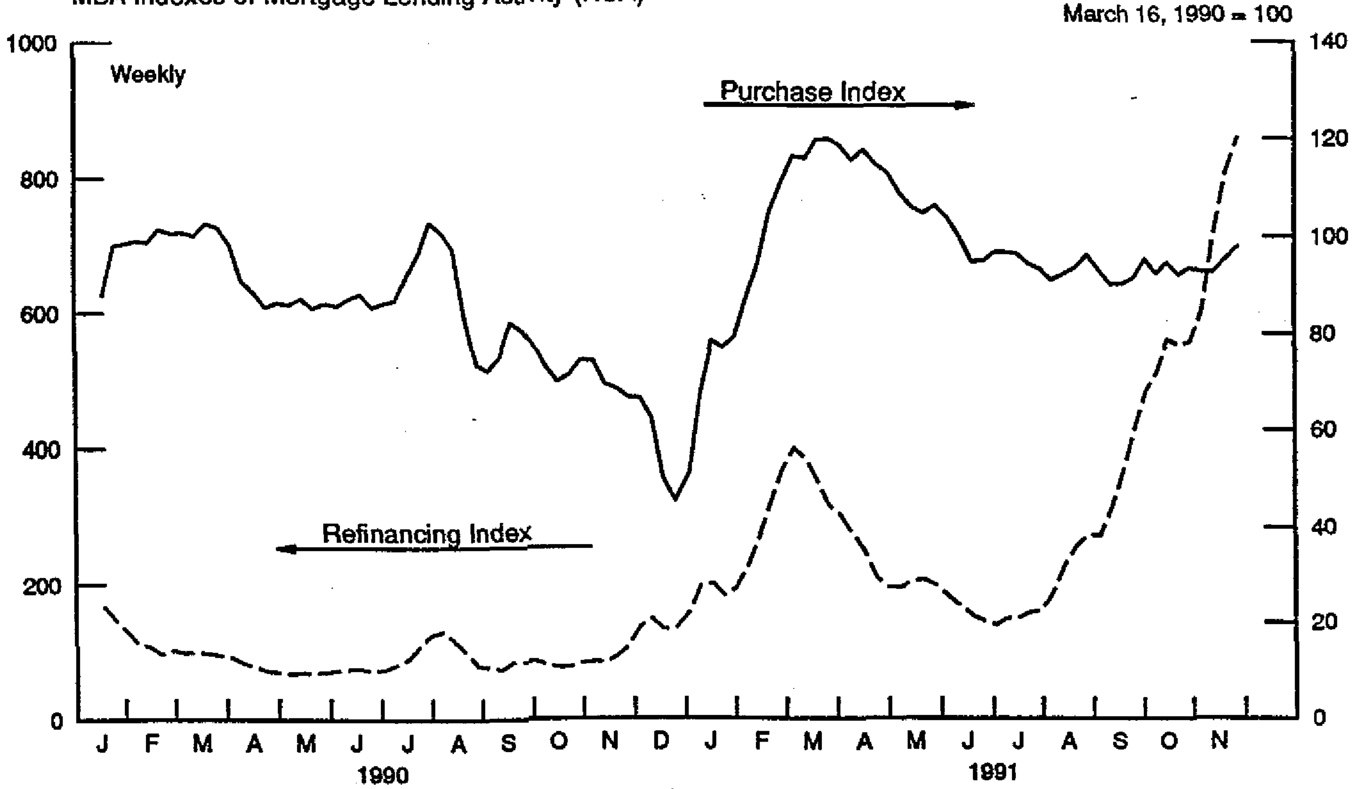
GROSS OFFERINGS OF MUNICIPAL SECURITIES
(Monthly rates, not seasonally adjusted, billions of dollars)

			1991					
	1989	1990	Q1	Q2	Q3	Sept.	Oct.[p]	Nov.[f]
Total offerings[1]	11.90	13.10	11.39	17.51	18.92	15.35	13.80	16.15
Total tax-exempt	11.65	12.85	11.25	17.20	18.16	15.20	13.54	16.07
Long-term	9.47	10.03	9.81	13.16	13.21	12.27	11.36	15.50
Refundings[2]	2.86	1.68	1.98	3.92	3.12	3.65	2.39	4.85
New capital	6.61	8.35	7.83	9.24	10.09	8.62	8.97	10.65
Short-term	2.17	2.82	1.44	4.04	4.95	2.93	2.18	.57
Total taxable	.25	.25	.14	.31	.76	.15	.26	.08

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

The mid-November announcement of the increase in New York State's 1993 budget deficit coincided with New York City's scheduled sale of $1.2 billion in refunding bonds. The city had planned to

MBA Indexes of Mortgage Lending Activity (NSA)*



*The refinancing index is assumed to have no significant seasonal pattern.
The purchase index is not seasonally adjusted because of its limited two-year history.

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	2.7	8.4	1.6	3.1	3.2	.3
1990	19.7	17.2	2.4	11.4	2.4	5.1	3.4	.5
1990-Q2	19.9	16.3	2.2	11.1	3.0	4.7	3.0	.4
Q3	18.3	17.4	1.7	12.1	2.7	6.5	2.3	.6
Q4	19.0	16.6	4.2	11.0	2.3	4.0	4.5	.3
1991-Q1	16.8	14.0	1.7	9.0	2.1	4.0	2.8	.1
Q2	24.7	21.4	1.7	18.6	3.0	8.2	6.8	.5
Q3 r	24.6	23.7	2.0	24.6	3.6	11.9	7.1	2.0
1991-Apr.	19.3	16.7	1.2	14.2	2.3	5.9	6.0	0.0
May	26.7	21.7	1.1	17.6	2.6	8.1	6.9	0.0
June	28.0	25.9	2.8	24.0	4.2	10.6	7.6	1.6
July	23.5	22.5	1.2	19.4	2.7	8.9	6.3	1.6
Aug. r	27.1	25.7	2.0	26.0	4.9	12.2	7.5	1.5
Sep. r	23.0	22.8	2.6	28.5	3.3	14.6	7.4	3.2
Oct. p	21.8	20.1	2.2	28.2	4.5	15.0	6.8	1.9
Nov. p	n.a.	n.a.	n.a.	n.a.	n.a.	12.2	n.a.	n.a.

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

take advantage of low yields to replace debt backed by credit enhancement with unenhanced debt.[3] Because of investor nervousness about the close links between state and city budgets, the announcement by the state led the city to postpone its bond sale by a day and may have cost the city 10 basis points on the long end of the serial issue.

The impact of California's lingering recession on state finances is a continuing concern for municipal market participants. Because of persistent revenue shortfalls, Standard & Poor's has warned that maintenance of California's triple-A rating will depend on swift adoption of budget-balancing measures.

The Tax Reform Act of 1986 eliminated the tax-exempt status of two classes of municipal bonds--single-family mortgage revenue bonds and small-scale industrial development bonds--starting at year-end 1987. Every year since then, the Congress has approved one-year extensions of tax-exempt status. Although market participants had thought prospects for another extension were slim, the Congress recently approved one for six months. Prior to the extension, however, there was no surge in offerings, partly because many entities had issued large volumes last year as the previous deadline approached, and partly because many states had reached the limits placed on private activity bond issuance by the 1986 tax reform act.

Mortgage Markets

Over the intermeeting period, contract rates on thirty-year, conventional, fixed-rate mortgages declined about fifteen basis points to their lowest levels since early 1977. Initial rates on adjustable-rate mortgages are at their lowest levels since the series was started in January 1984. The Mortgage Bankers

3. New York City's frequent forays into the credit markets have exhausted the capacity of insurance companies to insure the city's debt. New York City has not been able to issue an insured bond since its December 1990 offering.

Association's weekly survey indicates that applications for refinancing have nearly quadrupled since midsummer (chart). Applications for home purchase loans also have been rising, but at a much slower pace. Industry sources suggest that refinancings now account for more than half of all mortgage loan applications.

Prepayment rates on some outstanding mortgages rose sharply in October and November, and the current surge in refinancing applications suggests that prepayment rates will increase further in coming months. As a result, yield spreads on mortgage-backed securities, particularly those with premium coupons of 9.5 to 10.5 percent, have widened since the November FOMC meeting. The mortgages underlying these premium securities have interest rates of about 10 to 11.25 percent and are prime candidates for refinancing at current market rates.

Prepayment rates on conventional mortgages are likely to surge more than those on FHA mortgages because recent increases in mortgage insurance premiums and tighter downpayment requirements have raised the cost of refinancing an existing FHA mortgage with another FHA mortgage. Despite a relatively slow housing market, industry sources expect by year-end that the combination of faster prepayment rates, consumer preferences for fixed-rate loans, and larger loan origination shares for mortgage bankers will have resulted in the issuance of more than $260 billion in fixed-rate agency pass-throughs in 1991, surpassing the previous annual record of $255 billion in 1986.

In other developments, delinquency rates for home mortgages in the third quarter were mixed. According to the Mortgage Bankers Association, which measures the number of delinquent loans rather than the dollar amounts, the thirty-day "all loan" delinquency rate declined 0.21 percentage point in the third quarter to 5.07 percent, partly retracing the previous quarter's rise. However, the rate for single-family loans sixty days or more past due, a measure of more serious payment problems, edged up .03 percentage point to 1.67 percent, owing to increases in delinquency rates for FHA-insured and VA-guaranteed loans. Although this latest uptick marked the third consecutive quarterly increase, the sixty-day measure remains well below the average experience of 1985-86, when levels above 1.90 percent were common.

Consumer Installment Credit

Consumer installment credit edged up in October, increasing at an annual rate of 1-1/4 percent. September growth was revised upward to virtually no change from an initially reported decline of 2-1/2 percent. Auto credit declined less than originally estimated in September and was down only slightly in October. However, total installment debt and its auto component were still weak. Revolving credit remained the only component exhibiting positive growth. Installment debt outstanding peaked in November 1990 at $736.4 billion, then dropped about $6.5 billion through October, for an annual rate of decline of about 1 percent. Although it is too early to tell whether August represents the bottom in consumer credit, the nine-month period of decline to that point would still be the longest contraction since World War II, although credit contractions in 1958, 1974-75, and 1980 were larger in percentage terms.

Home equity lines of credit (categorized as mortgage rather than consumer debt) and automobile leasing may have shaved a percentage point off the growth rate of consumer installment debt since early last year, but the drop over this period is attributable mainly to weak consumer spending, particularly for automobiles and other durables often financed with installment debt. On the whole,

CONSUMER CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)							Memo: Outstandings (billions of dollars)
				1991		1991		1991
	1988	1989[1]	1990	H1	Q3[p]	Sep.[r]	Oct.[p]	Oct.[p]
Installment	8.8	5.9	2.3	-1.2	-.8	-.1	1.3	730.0
Auto	6.9	1.3	-2.1	-7.1	-6.2	-7.4	-.8	270.1
Excluding auto	10.2	9.2	5.2	2.5	2.5	4.5	2.5	459.9
Revolving	13.7	15.2	10.6	6.9	7.6	13.7	6.9	233.4
All other	7.4	4.5	.6	-1.8	-2.6	-4.7	-2.0	226.5
Noninstallment	6.0	2.6	-4.9	-8.7	-34.0	-39.5	-69.3	48.9
Total	7.2	5.8	1.7	-1.8	-3.2	-2.6	-3.4	778.9

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	1991	Aug.	Sept.	Oct.	Nov.
At commercial banks[1]							
New cars (48 mo.)	12.07	11.81	11.14	11.06	...	...	10.61
Personal (24 mo.)	15.44	15.46	15.18	15.24	...	...	14.88
Credit cards	18.02	18.17	18.23	18.24	...	...	18.19
At auto finance cos.[2]							
New cars	12.62	12.54	...	12.40	12.38	...	...
Used cars	16.18	15.99	...	15.63	15.60	...	...

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.

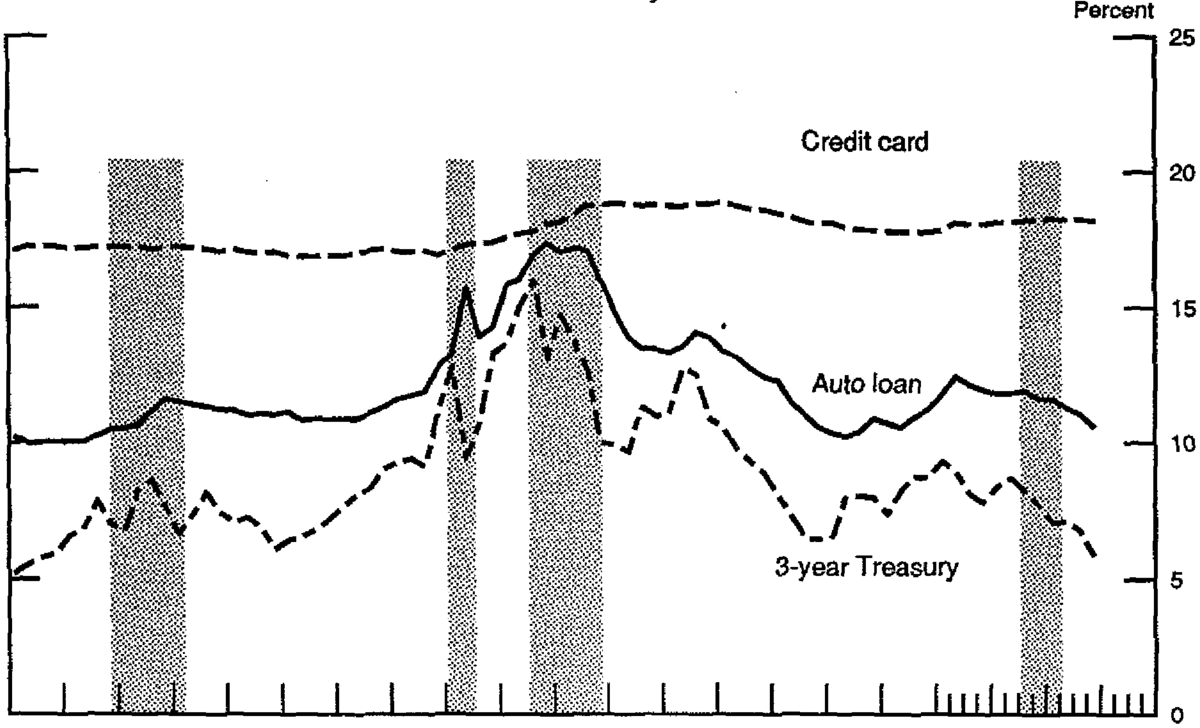
the pattern of consumer borrowing over the most recent business cycle is roughly in line with the experience of past cycles.

Trends in consumer loan delinquency rates also have mirrored historical patterns over the past several quarters. After bottoming out early in the economic expansion of the 1980s and rising steadily during the rest of the period, delinquency rates in the most recent recession reached approximately the same peak levels recorded during the previous two recessions. Data from the American Bankers Association on the number of delinquent loans in the third quarter were mixed, with the average delinquency rate on closed-end consumer loans rising a bit but the credit card delinquency rate unchanged. Delinquencies at auto finance companies dropped slightly. Experience indicates that consumer loan delinquencies drop sharply from their peaks near the beginning of a recovery. By that point, writeoffs of bad loans and a cautious approach to new lending have stopped the rise in delinquencies, and a turnaround in debt growth, as the economy picks up, reduces the delinquency ratio.

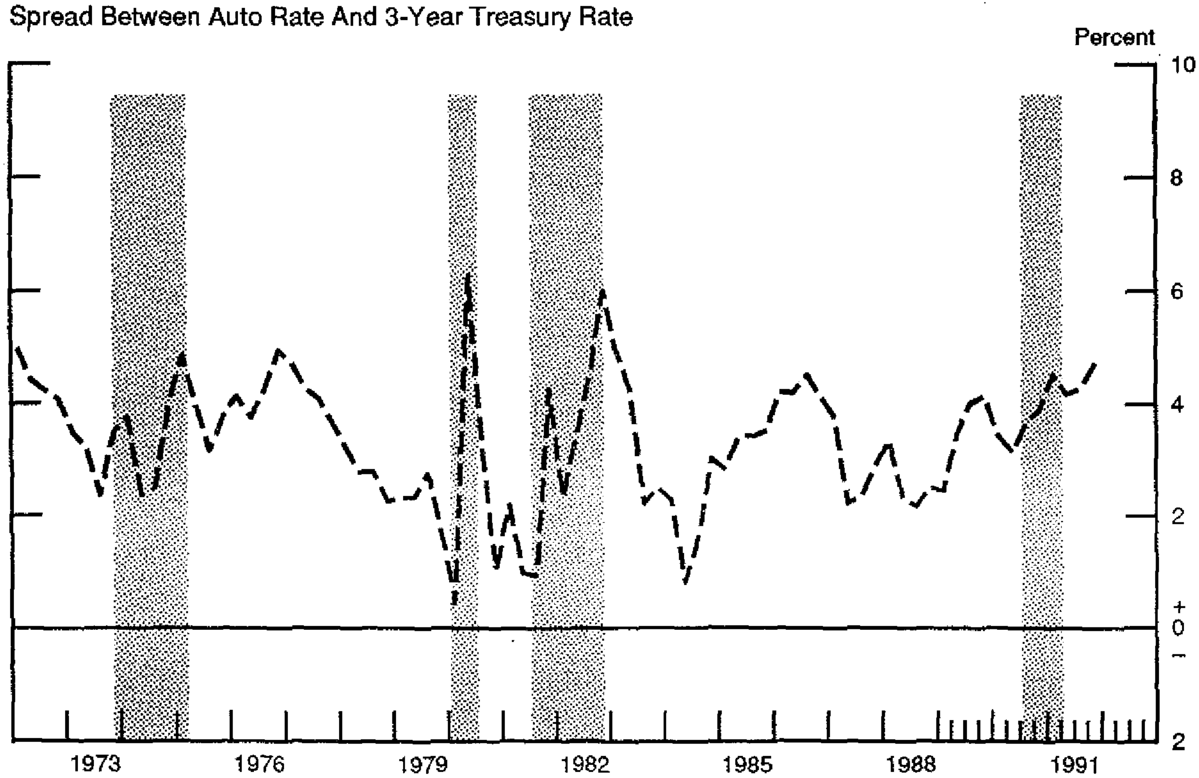
Bank willingness to make consumer loans, according to the October Senior Loan Officer Survey, has increased a bit, and consumer interest rates at banks, with the exception of credit card rates, have declined noticeably (table). Rates on 48-month new-car loans declined 1/2 percentage point between the August and November surveys. These rates are down nearly 2 percentage points from their peak in the second quarter of 1989 (chart). Although these declines are less than the declines in yields on Treasury securities of comparable maturity, they are generally in line with changes in three-year bank retail CD rates, a rough measure of marginal funding costs for car loans.

The failure of credit card interest rates to retreat in recent quarters led the Senate to pass, on November 14, a federal ceiling

Interest Rates On Consumer Loans And 3-Year Treasury Notes



Spread Between Auto Rate And 3-Year Treasury Rate



on these rates. After the Senate vote, issuance of asset-backed securities slowed considerably. Spreads initially jumped 20 to 40 basis points, as investors feared the prepayment consequences of a cap on rates. The cap did not become law, and spreads then narrowed, but they remain 5 to 10 basis points higher than before the vote. Rates on two large credit card issues sold by Citicorp at the end of October were raised about 5 basis points before settlement in mid-November. Spreads on securities backed by assets other than credit cards were little changed. Although the likelihood of a rate ceiling becoming law has faded, only one asset-backed issue, backed by home equity loans, has been placed since the bill's passage.

The recent rigidity of credit card rates continues a pattern that has persisted since the development of general-purpose credit cards in the mid-1960s. The aggregate data mask the variety of interest rates offered to consumers. They reflect only the "most common" rate charged, which, when multiple rates are offered, is usually the highest rate. In the Board's latest semiannual report on credit card terms at selected institutions, 11 percent of respondents had rates below 16 percent as of July 31. Another 5 percent offered plans with a tiered rate structure, assessing lower rates on higher balance levels. It also has become more common for issuers to offer several plans, with lower rates made available to more creditworthy customers. On the other hand, many large national issuers have been aggressive marketers, lowering credit standards for their regular cards and keeping interest rates high to compensate for higher credit risk.

The relative stability of credit card rates probably reflects interest-inelastic demand for credit card services, giving lenders little incentive to reduce rates to most cardholders. Reductions of

1 or 2 percentage points would stimulate little incremental usage by existing customers and would not attract enough new customers to offset the decline in interest income from lowering rates for all cardholders. Competition among issuers has instead focused on product differentiation through advertising, product enhancements (auto rental insurance, buyer protection plans, rebates), and reduction or waivers of annual fees.

APPENDIX

GROWTH OF MONEY AND CREDIT IN 1991

M2 and M3 expanded unusually slowly in 1991, while M1 grew briskly, according more closely with historical relationships with income and interest rates. During the first half of the year, the impetus to money growth from declining opportunity costs and the nascent economic recovery produced a modest acceleration in M2 and M3, placing them about at the midpoints of their annual target ranges. In the third quarter, though, M2 posted its first quarterly decline in the postwar period and its velocity increased markedly. M2 growth resumed in October and November--just enough to return its level to the 2-1/2 percent lower bound of its annual target range.

Several factors appear to have been important in slowing M2's advance this year. Perhaps most prominent has been the sluggish growth of nominal income and spending. However, the expansion of M2 fell well short of what would be expected based on historical relationships with income and opportunity costs; velocity was little changed over the year despite substantial declines in interest rates. Bond and stock mutual funds became an attractive alternative to retail CDs and M2 money funds as the yield curve steepened; net inflows to bond funds were especially brisk throughout the year. The wide gap between consumer credit rates and rates on M2 deposits, along with heavy repayment burdens, may have encouraged households to pay down debt by drawing on M2 balances. Finally, the abrogation of time deposit contracts and the general disruption in customer relationships attending RTC resolutions may have encouraged some depositors to shift from M2 to non-M2 financial assets.

The restructuring in the thrift industry and banks' efforts to restrain balance sheet growth were doubtless major factors behind M3's sharp decline in the third quarter and modest growth for the year. Since September, M3 has fluctuated around the 1 percent lower bound of its annual target range, with a little strengthening evident in the most recent data. The meager pace of M3 growth in 1991 was consistent with picture from the asset side of depository balance sheets--bank credit through November has edged up only 3 percent while thrift credit through August continued to contract. Although varying substantially from month to month, M1 this year has expanded at an 8 percent rate through November; with rates on M1 assets adjusting only sluggishly, or constrained by law, the decline in M1 opportunity costs was especially sharp.

Growth in total domestic nonfinancial debt averaged only 5 percent from the fourth quarter of last year through October, despite 11-1/2 percent growth in its federal debt component over the same interval. Nonfederal debt grew at only a 3 percent annual rate through October, its slowest pace in three decades, with business loans at banks and consumer credit registering substantial declines. Also holding business borrowing at bay was a sharp cutback in merger and LBO activity; indeed equity issuance turned positive after seven years of large net share retirements as many firms sought to deleverage their balance sheets. Households also appeared to "deleverage" during the course of the year, reining in spending, especially on durables, and trimming debt burdens. Mortgage debt growth slowed in 1991, owing primarily to the depressed market in commercial real estate. State and local governments issued debt at the fastest rate since 1985 with a large portion of new issues going

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

Growth rates or flows	1987	1988	1989	1990	1991[1]	Memo: Recent 1991 levels (billions of dollars)[1]
Growth rates (percent)						
M1	6.3	4.2	0.6	4.2	8.1	889.6
M2	4.3	5.2	4.7	3.8	2.5	3409.4
M3	5.8	6.3	3.6	1.7	1.1	4156.0
Domestic nonfinancial debt	9.7	9.2	7.7	6.7	4.9	10859.9
Bank credit	7.9	7.7	7.5	5.4	3.0	2799.5
Thrift credit	8.2	7.3	-3.2	-9.8	-9.9	1461.5
Flows ($ billions)						
M1						
Currency	15.5	15.8	10.1	24.2	20.2	265.3
Demand deposits	-2.8	-3.9	-8.4	-1.8	10.2	287.3
Other checkable deposits	31.4	19.8	2.8	9.9	36.2	329.0
M2						
Nontransactions M2	74.3	118.8	139.2	89.0	17.8	2519.8
Savings & MMDAs	13.6	-13.4	-45.4	32.7	107.4	1025.0
Small time deposits	42.8	119.0	120.0	20.1	-91.6	1070.9
General purpose and broker/dealer money market mutual fund assets	12.3	17.3	71.4	34.1	6.0	349.0
Overnight RPs, net (NSA)	6.9	0.1	-7.5	-1.8	-7.4	53.1
Overnight Eurodollars, net (NSA)	-1.2	-4.4	0.3	4.3	2.0	20.1
M3						
Non-M2 component	82.6	81.8	-5.1	-53.9	-37.6	746.6
Institution-only money market mutual fund assets	2.5	-0.5	14.7	20.5	39.1	161.0
Large time deposits	41.3	56.3	26.2	-53.4	-51.4	460.2
Term RPs, net (NSA)	28.8	15.8	-16.6	-13.4	-17.6	75.6
Term Eurodollars net (NSA)	11.4	10.4	-22.6	-9.7	-6.5	64.0

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

to refinance existing debt; state and local debt outstanding has grown only about 4 percent at an annual rate through October.

M1

M1 growth in 1991 has exceeded the pace of recent years. Early in the year, M1 was boosted by rapid growth in currency, spurred by safe-haven demands for U.S. currency amid the tensions in the Persian Gulf. Fueled by strong foreign shipments, currency growth in the first quarter topped 15 percent, at an annual rate, and was a substantial element in overall M1 growth. After the Gulf war, foreign demands for U.S. currency waned and currency growth in the second quarter slipped to about 4 percent.

Despite the deceleration in currency during the second quarter, M1 growth picked up as both demand deposits and other checkable deposits (OCD) began to respond to the substantial decline in opportunity costs since year-end 1990. Following their typical pattern, offering rates on OCD accounts responded very sluggishly to the steep decline in market rates in the first six months of 1991. The consequent narrowing in opportunity costs made OCD accounts more attractive relative to small time deposits and short-dated market instruments; through November, OCD growth has average 12-1/2 percent.

The decline in market rates brought new life to demand deposits as well. Demand deposits had been on a downtrend since 1987, apparently reflecting a secular decline in compensating balances as many businesses and banks opted for direct fee arrangements instead. This year, demand deposit growth through November has averaged 8 percent, although its path during the year has been quite erratic. Demand deposits decelerated in the third quarter but surged in October and November with monthly growth rates of 14 and 20 percent, respectively. In part, this renewed strength likely reflects increases in compensating balances occasioned by lower market rates. In part, it probably also reflect a pickup in mortgage refinancings; in some instances, mortgage prepayments are held temporarily as demand accounts by mortgage servicers. In addition, demand deposit growth in October was boosted by a change in accounting practice at Security Pacific's trust company subsidiary in New York, which produced a downward shift in CIPC and an upward level shift in its demand deposits.

M2

In the first half of 1991, M2 accelerated from its lackluster growth pace in 1990. Narrowing opportunity costs generated substantial inflows to liquid retail deposits that outweighed runoffs in small time deposits. Stronger M1 growth and the pickup in the nontransactions components of M2 combined to push the June level of M2 near the middle of its annual target range. Although M2 growth at that point in the year had been a bit weaker than predicted by the staff's standard M2 model, it was broadly consistent with the configuration of opportunity costs and various indicators of economic activity. M2 began to lose its momentum in June, however, presaging an unprecedented decline in the third quarter. The decline coincided with modest growth in nominal income and continued narrowing in opportunity costs. M2 velocity in the third quarter increased 4-3/4 percent at an annual rate--nearly 6 percentage points more than predicted by the standard M2 model--and the level of M2 by September had fallen just below the lower bound of its target range.

Moderate M2 growth resumed in the fourth quarter, at a 3 percent pace in October and close to 4 percent in November. Much of the turnaround reflected the continued strength in liquid components --OCD, savings and MMDAs--and a slower rate of decline in M2 money funds. Part of the increase also reflected a jump in overnight Eurodollars to a November level that was about $5 billion higher than the third-quarter average.

The primary factors slowing M2's advance this year, other than weak income growth, were taking shape near the end of the second quarter. Short-term market rates had been declining for several months while rates on longer-term securities had declined only modestly. M2 money funds, which earlier had boosted M2, began to decelerate after the uncertainties in the Persian Gulf had been resolved. By June, money fund investors were finding their returns far less attractive relative to other market instruments. Yields on bank and thrift retail CDs also fell sharply during the first half of the year and small time deposits began running off swiftly toward the end of the second quarter. In part, this reflected the usual compositional shift between liquid and small time deposits that occurs when market rates fall. However, by June, the declines in small time deposits more than offset inflows to liquid components such as savings and MMDAs. In the third quarter, money fund and retail CD holders seemed to be "reaching for yield" by extending the maturity of their portfolios. Bond and stock funds were major beneficiaries in this process. In fact, inflows to bond funds have been brisk throughout 1991 and have proceeded at a near-record pace since mid-year. Major bond funds actively pursued retail CD "rollover" money, running full page ads in major newspapers comparing their recent rates of return with those available on retail CDs.

In addition to portfolio shifts, it appears that household deleveraging and depository consolidation were also a drag on M2 growth this year. Low returns available on M2 assets juxtaposed with the high interest rates on consumer credit--especially considering the lack of federal tax deductibility--likely encouraged some households to draw down M2 balances. Indeed, consumer credit has been on a downtrend throughout most of 1991.

Finally, the rapid pace of RTC resolutions likely depressed M2 and M3 growth in the third quarter and throughout the year. Statistical evidence suggests that M2 growth may be relatively weak during quarters in which the RTC resolves a large number of thrifts. This phenomenon apparently occurs as depositor relationships are disrupted, most notably when acquiring institutions abrogate the small time deposit contracts of failed thrifts. Non-RTC mergers of depositories, including both federally assisted and non-assisted mergers, also appear to have contributed to runoffs of small time deposits this year.

M3

Weak loan demand together with the effects of capital constraints, the consolidation of the thrift industry, and a general rechannelling of credit flows away from financial intermediaries severely limited the scope for expansion in bank and thrift balance sheets during 1991. Early in the year, though, M3 displayed surprising strength. In part, this reflected the pickup in M2 growth showing through to the broader aggregate. In addition, M3 money funds grew rapidly in the first quarter, as nervous investors searched for a safe harbor prior to the Gulf war. However, the most important single factor contributing to early robust growth in M3 was the resurgence of the Yankee CD market sparked by the change in reserve requirements late in 1990. After the Board cut reserve requirements on nonpersonal time deposits and net Eurocurrency liabilities to zero, U.S. branches and agencies of foreign banks showed a distinct preference for funding with domestically issued CDs versus borrowing from their head office or in the federal funds market. Between December of 1990 and March of 1991, branches and agencies issued nearly $40 billion in Yankee CDs.

Domestic banks and thrifts shed large time deposits at a rapid rate throughout the year. In part, depositories were responding to core deposit inflows by paring more expensive managed liabilities such as wholesale CDs. The RTC also played a large role by, in effect, financing the assets it took on its books with Treasury securities rather than large time deposits.

Even apart from these forces, large time deposits were under pressure from the trend in financial flows away from intermediaries. The retrenchment in consumer debt and business reliance on corporate bond and equity issues to finance weak investment spending were likely major factors contributing to the 1/2 percent contraction in bank loans through November of this year. Supply effects also were important, as tighter capital requirements, higher deposit insurance premiums, and the increased risk in lending perceived by depositories and their examiners resulted in wider intermediary spreads and limited expansion in depository balance sheets.

Domestic Nonfinancial Sector Debt

Overall domestic nonfinancial debt is estimated to have grown only 5 percent in 1991, marking the slowest advance in three decades and placing the level of nonfinancial debt near the bottom of its monitoring range. Private sector debt growth slowed as both households and business acted to trim debt burdens. In contrast, federal debt has grown at a double-digit rate this year as the recession took its toll on government receipts and boosted some outlays. Spending associated with deposit insurance programs added about 2 percentage points to the rise in federal debt this year and one-half percentage point to total debt growth.

In the household sector, the low level of new home building and home sales cut mortgage debt growth to less than 7 percent--well below the pace of recent years. Much new home mortgage credit took the form of fixed-rate mortgages as homebuyers responded to the decline in mortgage rates to their lowest levels in nearly 15 years. Consumer debt declined fairly steadily until the fall; much of the weakness owed to a downturn in auto credit, consistent with sagging auto sales and car buyers' growing preference for leasing arrangements rather than ownership. In addition, households continued to substitute home equity loans for installment debt and other consumer credit.

Growth in business debt was especially weak this year. Many businesses moved to improve their balance sheet--shrinking commercial paper and bank loans, issuing equity, and relying on internal funds to finance outlays. The turnaround in equity financing has been especially striking; net issuance for the year turned positive for the first time in seven years. Despite the overall downturn in the growth of business debt, corporate bond issuance surged throughout the year in response to lower rates. Bond funds, flush with new money from investors dissatisfied with returns on bank retail CDs, absorbed much of the increase in corporate bond issues this year.

Budget pressure on state and local governments intensified during the year and, although some units financed current deficits by borrowing, net debt growth in this sector remained weak. Gross issuance of bonds was substantial over the year, but a sizable portion went to replace retiring debt or to refund existing debt at lower rates. Spreads on tax-exempt issues generally have been narrow this year despite several downgradings and the well-publicized financial woes of some local governments.

INTERNATIONAL DEVELOPMENTS

Merchandise Trade

The U.S. merchandise trade deficit widened in September to $6.8 billion (seasonally adjusted, Census basis) from a revised deficit of $6.5 billion in August, as imports rose more than exports. Most of the increase in imports in September was in consumer goods, especially apparel and toys. Data for October will be released on December 19.

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

	Exports			Imports			
	Total	Ag.	NonAg.	Total	Oil	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	35.2	3.4	31.8	41.2	4.0	37.2	-5.9
Aug	34.4	3.3	31.1	40.9	4.5	36.4	-6.5
Sep	35.4	3.3	32.2	42.2	4.5	37.8	-6.8

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

In the third quarter, the trade deficit was larger than that recorded in either of the two preceding quarters. Exports were at about the same record level as in the second quarter, well above levels in previous quarters (particularly machinery exports).

Imports in the third quarter were 5 percent above the second-quarter level. Most of the increase was in consumer goods and in automotive products from Canada and Japan. Imports of consumer goods rose 10 percent with strong increases recorded in apparel, TVs and VCRs, toys, and household appliances. Automotive imports from Canada continued to rise steadily from the low recorded

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

	Year 1990	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1991 Q3	$ Change Q3-Q3	$ Change Q3-Q2
Trade Balance	-108.1	-115.0	-110.9	-73.6	-61.6	-81.9	33.1	-20.4
Total U.S. Exports	389.6	386.6	402.3	403.6	417.0	418.1	31.6	1.1
Agricultural Export	40.2	39.3	37.8	39.8	38.2	40.6	1.4	2.4
Nonagric. Exports	349.3	347.3	364.5	363.8	378.8	377.5	30.2	-1.3
Industrial Suppl.	96.7	95.4	106.0	105.1	101.8	100.4	5.0	-1.3
Gold	3.0	3.0	4.4	4.1	3.3	3.4	0.4	0.2
Fuels	14.0	13.9	18.1	16.8	13.0	12.8	-1.1	-0.2
Other Ind. Suppl.	79.6	78.6	83.5	84.2	85.5	84.2	5.6	-1.3
Capital Goods	153.8	153.1	156.0	155.8	170.5	166.2	13.2	-4.3
Aircraft & Parts	32.3	31.6	30.9	30.8	38.9	35.6	3.9	-3.3
Computers & Parts	25.9	26.5	26.4	27.3	27.3	26.7	0.2	-0.6
Other Machinery	95.6	95.0	98.7	97.7	104.4	104.0	9.1	-0.4
Automotive Product	37.4	38.4	37.1	34.2	40.3	44.9	6.5	4.5
To Canada	22.6	23.5	21.5	19.5	22.3	25.7	2.2	3.4
To Other	14.8	14.9	15.6	14.7	18.1	19.2	4.3	1.1
Consumer Goods	43.3	42.8	45.8	45.9	44.5	44.8	2.0	0.3
Other Nonagric.	18.2	17.6	19.6	22.9	21.6	21.1	3.6	-0.5
Total U.S. Imports	497.7	501.6	513.2	477.2	478.5	500.1	-1.5	21.5
Oil Imports	62.1	61.8	72.1	52.9	51.7	52.0	-9.8	0.3
Non-Oil Imports	435.6	439.8	441.1	424.3	426.9	448.1	8.3	21.2
Industrial Suppl.	82.5	83.3	83.9	80.4	80.8	80.5	-2.8	-0.3
Gold	2.5	2.8	3.3	3.3	3.0	2.3	-0.5	-0.6
Other Fuels	3.6	3.5	4.3	3.9	4.3	3.9	0.4	-0.5
Other Ind. Suppl.	76.4	77.0	76.4	73.2	73.5	74.3	-2.8	0.8
Capital Goods	116.4	116.2	120.2	119.3	121.1	122.1	5.8	0.9
Aircraft & Parts	10.6	9.9	12.8	11.2	12.4	12.5	2.6	0.1
Computers & Parts	23.0	23.0	23.3	24.2	26.0	27.6	4.6	1.6
Other Machinery	82.8	83.3	84.1	83.9	82.7	82.0	-1.3	-0.8
Automotive Product	87.3	90.3	86.1	82.1	78.7	92.1	1.8	13.5
From Canada	29.7	32.2	27.3	23.5	28.4	34.1	1.9	5.7
From Other	56.5	58.1	58.8	58.5	50.2	58.0	-0.1	7.7
Consumer Goods	106.2	106.6	106.9	100.5	100.3	110.5	3.9	10.3
Foods	26.6	25.8	26.0	25.6	27.9	26.3	0.5	-1.6
All Other	16.4	17.5	18.1	16.6	18.0	16.6	-0.9	-1.5

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

in the first quarter as Big Three producers began shipping for the new model year. The increase in automotive imports from Japan partially reversed the sharp decline recorded in the second quarter and reflected, in part, increased shipments of luxury cars. Imports of computers continued to climb in the third quarter, reaching a new high. Aside from computers, imports of machinery declined for the third consecutive quarter.

The recent rise in imports appears to have been associated with a large buildup in retail inventories, most notably in September. Data on industrial production, retail inventories, and imports suggest that more than three fourths of the increase in inventories of apparel and miscellaneous non-durable goods (which include toys) in September was imported goods. To the extent that these inventories might now be viewed by retailers as excessive (given the recent slowdown in economic activity), any inventory correction in these categories is likely to be borne in large part by foreign producers.

The value of oil imported in the third quarter was about the same as recorded in the second quarter. The quantity of oil imports remained near 8.2 mb/d as an increase in domestic consumption was offset by a lower rate of stockbuilding. Weekly Department of

OIL IMPORTS
(BOP basis, seasonally adjusted annual rates)

	1991			Months			
	Q1	Q2	Q3	Jun	Jul	Aug	Sep
Value (Bil. $)	52.88	51.69	52.01	50.69	48.26	54.36	53.42
Price ($/BBL)	20.33	17.31	17.24	16.97	16.66	17.42	17.61
Quantity (mb/d)	7.13	8.18	8.26	8.18	7.93	8.54	8.31

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

Energy data indicate that stocks were drawn down rapidly in October (depressing imports), as market participants apparently expected prices to recede; this expectation was evidenced by a large discount of long term futures relative to near-term futures over most of October.

Spot oil prices have fallen almost $3 per barrel since late October, likely reflecting strong production by OPEC coupled with sluggish economic activity world wide. However, given past increases in spot prices and shipping and contract lags, import prices are likely to have increased through November.

Prices of Non-oil Imports and Exports

Prices of non-oil imports (as reported by the Bureau of Labor Statistics (BLS)) rose 0.5 percent in October, the second consecutive month of increase. These increases followed five months of declining prices. The largest increase in October was in automotive imports and reflected introduction of the new 1992 model year vehicles. All other major categories of imports showed small increases in prices with the exception of consumer goods, which remained unchanged from September.

Prices of nonagricultural exports increased 0.2 percent in October, with increases recorded in every major category. October was the second consecutive month of increase, following seven months of flat or falling prices. Prices of agricultural exports increased 3.5 percent in October, paced by an increase in the price of wheat.

National Income and Product Account fixed-weight prices will not be available until December 20th. The fixed-weight prices for the third quarter from the BLS showed a 3.2 percent decline in prices of non-oil imports and a 1.8 percent decline in prices of non-agricultural exports. Both non-oil imports and nonagricultural exports showed the largest declines in the industrial supplies category.

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

	Year 1991-Q3 / 1990-Q3	Quarters 1991 Q1	Q2	Q3	Months 1991 Sep	Oct
		(Quarterly Average, AR)			(Monthly Rates)	
	BLS Prices					
Imports, Total	-0.4	-11.9	-7.2	-3.4	0.3	0.6
Foods, Feeds, Bev.	3.1	7.8	3.1	-3.5	0.2	0.1
Industrial Supplies	-5.4	-40.4	-19.0	-6.2	0.0	0.6
Ind Supp Ex Oil*	-2.4	-0.2	-4.5	-7.2	-0.7	0.0
Capital Goods	0.7	4.9	-5.2	-4.6	0.1	0.8
Automotive Products	4.2	6.6	1.2	-1.1	0.4	1.3
Consumer Goods	0.4	2.5	-4.3	-0.6	0.7	0.0
Memo:						
Oil	-11.4	-73.1	-41.1	-4.4	1.5	1.7
Non-oil	1.0	3.7	-2.7	-3.2	0.2	0.5
Exports, Total	0.3	0.6	-1.2	-2.5	-0.1	0.6
Foods, Feeds, Bev.	-2.0	8.3	8.1	-5.8	-1.6	4.0
Industrial Supplies	-4.0	-9.6	-11.9	-8.0	-0.4	0.3
Capital Goods	3.1	5.6	3.5	1.5	0.4	0.1
Automotive Products	2.8	3.5	2.0	2.1	0.0	0.4
Consumer Goods	3.3	6.0	6.3	-2.4	0.5	0.1
Memo:						
Agricultural	-2.8	6.7	6.6	-8.5	-1.2	3.5
Nonagricultural	0.6	-0.6	-2.6	-1.8	0.1	0.2
	NIPA Prices					
Fixed-Weight+						
Imports, Total					--	--
Oil					--	--
Non-oil					--	--
Exports, Total					--	--
Ag					--	--
Nonag					--	--
Deflators						
Imports, Total	-1.8	-14.8	-10.8	-2.8	--	--
Oil	-11.3	-76.1	-47.3	-1.5	--	--
Non-oil	-0.5	1.1	-5.0	-3.1	--	--
Exports, Total	-1.3	1.7	-2.6	-3.9	--	--
Ag	-2.4	15.9	-0.1	-6.3	--	--
Nonag	-1.2	0.4	-2.8	-3.8	--	--

*/ Months not for publication.
+/ Fixed-Weight prices will not be available for the NIPA until December 20th, the final revision to third quarter GNP.

U.S. Current Account

The U.S. current account balance fell from a surplus of $12.1 (SAAR) billion in the second quarter to a deficit of $41.8 billion in the third quarter, as the balance on both trade and transfers deteriorated. Net transfers declined by $36.3 billion (AR), largely the result of a $28 billion (AR) reduction in cash grants from coalition partners in Operation Desert Storm and the provision of $11.6 billion (AR) in debt forgiveness to several countries, including Poland. (Approximately $1.2 billion (AR) of these grants was used to pay interest arrears, boosting portfolio receipts). Net service receipts rose slightly with an increase in receipts from foreigners traveling in the United States and a small gain in net military transactions.

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

	Trade Balance	Services net	Net Income: Direct Invest.	Net Income: Portfolio net	Transfers net	Current Account Balance
1988	-127.0	10.3	36.8	-31.5	-14.9	-126.2
1989	-115.9	22.4	42.5	-39.8	-15.5	-106.3
1990	-108.1	26.4	52.7	-40.7	-22.3	-92.1
1990-1	-110.1	23.6	51.9	-39.8	-16.1	-90.7
2	-96.4	26.4	43.6	-43.6	-18.8	-88.7
3	-115.0	25.6	53.5	-42.3	-17.3	-95.5
4	-110.9	29.9	61.7	-37.2	-37.1	-93.6
1991-1	-73.6	28.3	61.3	-41.8	67.8	42.0
2	-61.6	35.8	52.2	-42.8	28.5	12.1
3	-81.9	37.9	51.1	-41.1	-7.8	-41.8
$Change						
91Q3-91Q2	-20.3	2.1	-1.1	1.7	-36.3	-53.9
91Q2-91Q1	12.0	7.5	-9.1	-1.0	-39.3	-29.9
91Q1-90Q4	37.3	-1.6	-0.4	-4.6	104.9	135.6

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

U.S. International Financial Transactions

Banks and securities firms in the United States reported substantial capital outflows in October, partially reversing the inflows reported in the third quarter (line 1 of the Summary of U.S. International Transactions table). These month-end data have swung widely this year. Contributing to these swings have been sharp movements in lending by securities firms to Bermuda and the Netherlands Antilles to finance holdings of U.S. Treasury securities by certain mutual funds.

There was a small net outflow of $4.1 billion on securities transactions for the third quarter, which continued into October (lines 2 plus 3). A major element was the continued robust level of net purchases of foreign securities by U.S. residents ($13 billion for the third quarter and $6.5 billion in October, line 2c). The cumulative flow for the first three quarters has already surpassed the previous annual record registered in 1990. Two-thirds of the third quarter outflow was for net stock purchases, but in October the share shifted heavily toward foreign bonds. In September and October, a large share of the stock purchases was in Japan (a total of $2.4 billion). In October, purchases of foreign bonds by U.S. residents rose to $4.2 billion; they were primarily from the United Kingdom and, to a lesser extent, from Canada.

Foreign net purchases of U.S. corporate bonds were substantial, for both the third quarter and October (line 2a). By contrast, foreign net purchases of U.S. stocks were small in the third quarter and virtually zero in September and October (line 2b). Foreign net purchases of Treasury obligations were also very small (line 3).

Foreign official reserves in the United States fell by $6.2 billion in September, limiting the overall increase in the third quarter to $3.5 billion (line 4). For the quarter, substantial

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

	1989 Year	1990 Year	1990 Q4	1991 Q1	1991 Q2	1991 Q3	1991 Aug.	1991 Sep.	1991 Oct.
Private Capital									
Banks									
1. Change in net foreign positions of banking offices[1] in the U.S. (+ = inflow)	27.2	31.0	-1.4	0.6	-29.9	14.2	-2.0	12.5	-6.7
Securities									
2. Private securities transactions, net[2]	15.7	-29.2	-7.8	-5.0	3.7	-2.8	*	-1.9	-3.8
a) foreign net purchases (+) of U.S. corporate bonds[3]	31.8	16.2	6.3	3.5	7.7	8.0	4.1	1.8	2.3
b) foreign net purchases (+) of U.S. corporate stocks	7.9	-13.7	-5.0	1.8	7.7	2.3	1.6	-0.4	0.4
c) U.S. net purchases (-) of foreign securities	-24.0	-31.7	-9.0	-10.3	-11.7	-13.0	-5.7	-3.3	-6.5
3. Foreign net purchases (+) of U.S. Treasury obligations	30.1	-0.5	-2.8	4.2	13.5	-1.3	2.3	-4.4	1.2
Official Capital									
4. Changes in foreign official reserves assets in U.S. (+ = increase)	8.3	32.0	18.9	5.5	-3.5	3.5	6.3	-6.2	6.3
a) By area									
G-10 countries	-5.2	10.0	8.6	-12.1	-4.7	-1.9	1.3	-2.5	2.1
OPEC	10.1	1.2	-0.5	0.3	-2.9	-4.4	-2.8	-1.5	0.2
All other countries	3.4	20.8	10.8	17.3	4.1	9.8	7.8	-2.2	3.9
b) By type									
U.S. Treasury securities	0.1	29.6	19.7	2.4	-2.3	5.8	2.3	2.7	4.5
Other[4]	8.2	2.4	-0.8	3.1	-1.2	-2.3	4.0	-8.8	1.7
5. Changes in U.S. official reserve assets (+ = decrease)	-25.3	-2.2	-1.1	-0.4	1.4	3.9	1.3	1.1	0.3
Other transactions (Quarterly data)[5]									
6. U.S. direct investment (-) abroad	-33.4	-33.4	-3.8	-11.9	-1.8	-5.9	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	70.6	37.2	4.5	4.3	7.5	1.4	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[6]	-5.3	-6.3	-2.2	1.0	-2.4	-2.1	n.a.	n.a.	n.a.
9. U.S. current account balance	-106.3	-92.1	-23.4	10.5	3.0	-10.5	n.a.	n.a.	n.a.
10. Statistical discrepancy	18.4	63.5	19.1	-8.8	8.5	-0.4	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	-27.7	-18.4	-15.4	-20.5	n.a.	n.a.	n.a.

1. Includes changes in positions of all depository institutions, bank-holding companies, and certain transactions between brokers/dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements.)
2. 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.
3. Includes all U.S. bonds other than Treasury obligations.
4. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securitie
5. Seasonally adjusted.
6. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking a.. official transactions not shown elsewhere. In addition, it includes amounts resulting from adjustments to the data made by the Department of Commerce and revisions to the data in lines 1 through 5 since publication of the quarterly data in the _Survey of Current Business_.
*--Less than $50 million.
NOTE: Details may not add to total because of rounding.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1989				1990				1991			
	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Oct.
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	-14.1	-24.3
(a) U.S.-chartered banks	20.4	19.2	14.9	19.2	12.2	7.2	5.7	5.5	7.6	5.4	11.0	9.6
(b) Foreign-chartered banks	-23.3	-23.1	-21.3	-24.7	-23.9	-18.2	-21.3	-36.9	-31.3	-19.2	-25.2	-34.0
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	23.7	24.3
3. Eurodollar Holdings of U.S. Nonbank Residents 1/	144.8	131.5	130.3	123.5	110.6	106.5	109.1	116.1	114.6	105.8	98.8	97.2

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.

increases were registered by Taiwan, Spain and Mexico, with decreases in OPEC countries and Japan. In October, official holdings rose an additional $6.3 billion, with major increases reported for the United Kingdom, the BIS, and Taiwan.

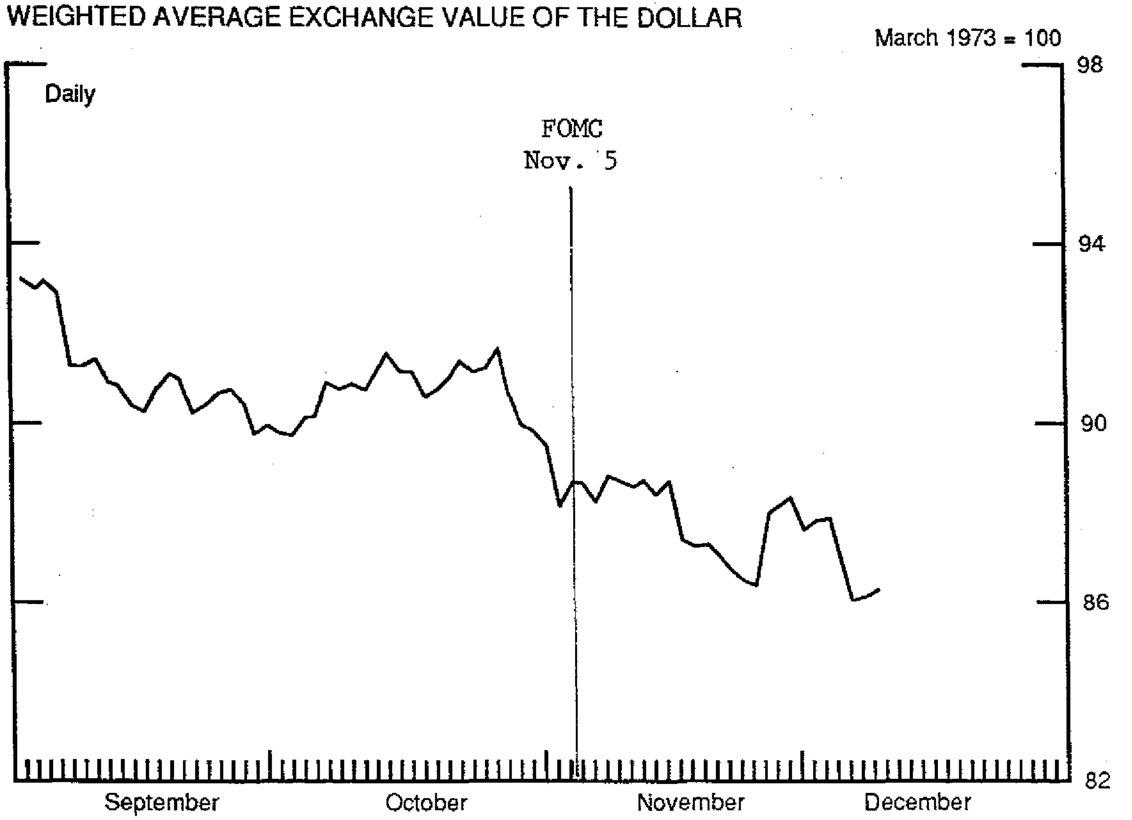
Recently released data show virtually no capital inflow in the third quarter for foreign direct investment in the United States (line 7); although the second quarter inflow was revised upward, the total inflow in 1991 through three quarters ($13.2 billion) is less than half of the corresponding inflow last year ($32.7 billion). Direct investment outflows were $5.9 billion in the third quarter (line 6); given the cumulative outflow through three quarters ($19.6 billion), it is likely that, for the year, U.S. direct investment abroad will outweigh foreign direct investment in the United States.

The statistical discrepancy for the third quarter was essentially zero, and the discrepancy for the second quarter was revised downward by over $13 billion to $8.5 billion (line 10). More than half of the revision was the result of the correction of a reporting error, where a bank had reported its customers' claims in lira rather than dollars.

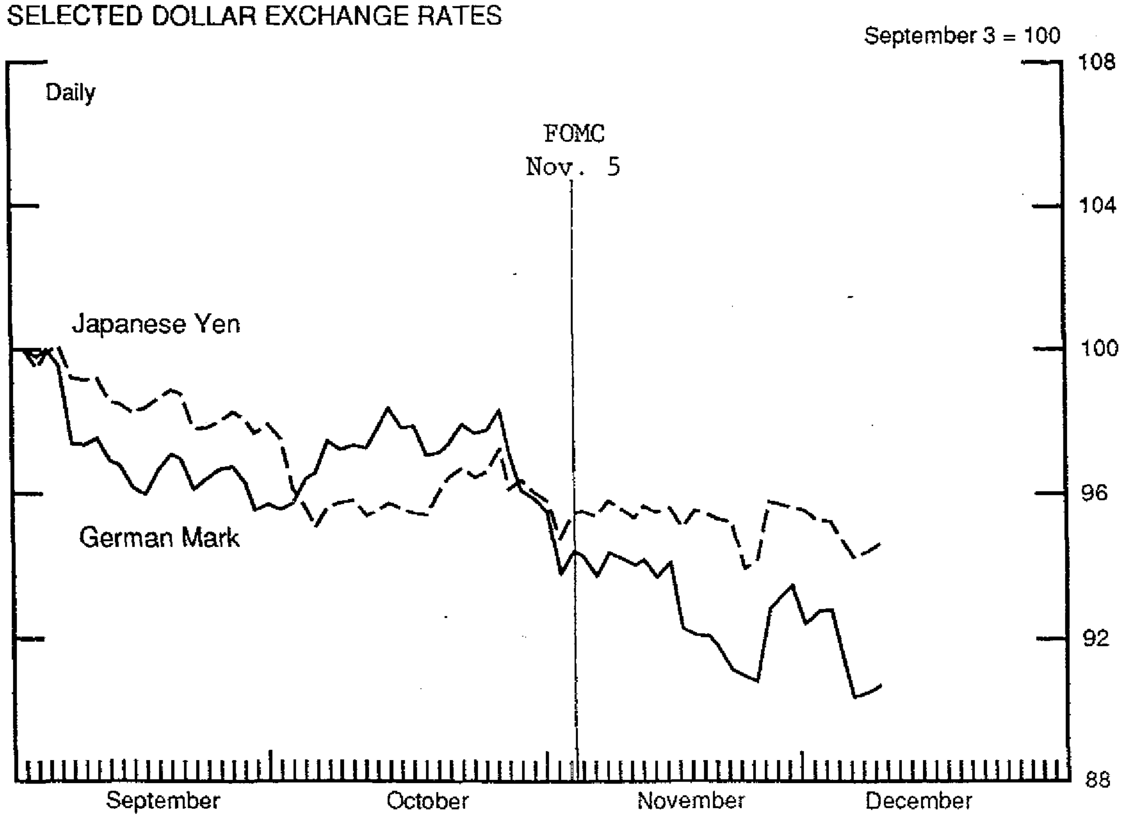
Foreign Exchange Markets

Since the last FOMC meeting the dollar's weighted average exchange value has depreciated just over 2 percent, on balance. The weakness of the dollar reflects the sluggish pace of the U.S. recovery, which has heightened prospects for further easing by the Federal Reserve on top of the two easings during the period. Most of the dollar's decline has come against the mark. The dollar fell about 3-1/4 percent against the mark while declining only 1/4 percent against the yen. The dollar had been even weaker earlier, but very late in the period firmed fairly sharply on renewed tensions in the Soviet Union.

WEIGHTED AVERAGE EXCHANGE VALUE OF THE DOLLAR



SELECTED DOLLAR EXCHANGE RATES



The dollar has tended to fluctuate more in terms of the mark than the yen during the intermeeting period. This volatility was in part the result of speculation that an EMS realignment could take place prior to or following the Maastricht summit meeting, and also reflects the rapid pace of developments in the former Soviet Union. While the likelihood of an EMS realignment has subsided for the short term, developments in the former Soviet Union are likely to add volatility to dollar/mark rates for the foreseeable future.

The mark has been supported by the expectation that interest rates will rise in Germany. This speculation has been fed by statements from Bundesbank officials indicating that the current level of German inflation is unacceptably high, and that interest rates in Germany will not be able to come down and may have to rise. Following the Bundesbank Council meeting on December 5, the Bundesbank announced that it would raise its target range for M3 growth to 3.5 to 5.5 percent for 1992 from 3 percent to 5 percent for 1991. An increase of this magnitude was perceived as a slight tightening, as growth of 4 to 6 percent was judged to be necessary to accommodate fully the anticipated demand for currency in Eastern Germany. Although the Bundesbank did not raise official lending rates at this meeting, perhaps so as not to exacerbate tensions in the EMS prior to the Maastricht summit meeting, market participants continue to expect that it will raise the Lombard rate within the next month or so. Since November 5, three-month interest rates in Germany have risen by 8 basis points to a level of 9.45 percent; and the yield on the bellwether bond has come down 10 basis points to 8.28 percent.

The mark has also been affected by developments in the former Soviet Union. During the intermeeting period, the mark has been weighed on by predictions of an imminent second Soviet coup, questions over the ability of the Soviets to repay their foreign debt, and uncertainty over the nature of future government(s) in that territory. This latter form of uncertainty was exacerbated by the decision of Ukraine, the Russian Federation, and the Republic of Byelorussia to form a commonwealth and to end the USSR. Very late in the period tensions were heightened further by the conflict between Yeltsin and Gorbachev over the control of the military. Developments in the former Soviet Union are likely to have a continuing impact on the mark.

The dollar's smaller decline against the yen was partly due to the weakness of Japan's economy and the expectation of further interest rate decreases in Japan. Since the last FOMC meeting, the Bank of Japan has cut its official discount rate by 1/2 percentage point to 5 percent, and market participants perceive that it has eased its target rate for call money 25 basis points to around 6.25 percent. Three month interest rates in Japan have come down 10 basis points to 6.10 percent, and the yield on the bellwether bond has fallen 36 basis points to 5.65 percent. The yen has also been weakened by the slumping Japanese equity market; the Nikkei Dow fell just under 14 percent during the intermeeting period.

The mark's strength has also placed a large amount of strain on EMS currencies and other currencies pegged to the ECU.

The exchange rate pressure caused by the mark appreciation has prompted some central banks to increase interest rates to defend their currencies. The Bank of France raised its money market intervention rate 1/2 percentage point to 9-1/4 percent and raised its 5 to 10 day RP rate 1/4 percentage point to 10 percent; the Bank of Italy raised its rate on fixed-term advances by 1/2 percentage point to 12 percent; and the Bank of Sweden raised its marginal lending rate 6 percentage points to 17.5 percent.

Developments in Foreign Industrial Countries

Recent data on economic activity in the foreign industrial countries have provided further evidence of relatively weak growth in the third quarter, with few indications yet of a revival in the fourth quarter. Real GNP declined in Germany in the third quarter, the second consecutive quarterly decline. In Japan, third quarter real GNP growth eased further to below 2 percent. Real GDP in both Canada and the United Kingdom grew only about 1 percent in the third quarter, and, in the case of the United Kingdom, growth was accounted for entirely by increased oil and gas output. The Italian recovery appears to have stalled, as industrial production declined in the third quarter. Only in France, where marketable GDP grew at more than a 3 percent rate in the third quarter, have there been clear signs of strength.

The trend of generally reduced inflation rates in the foreign industrial countries has on balance continued. The most recent monthly data showed reduced 12-month inflation rates in France, the United Kingdom, and Canada. However, there were recent monthly upticks in inflation rates in Germany and Japan.

Individual country notes. In Japan, the pace of real GNP growth has continued to slacken. In the third quarter, real GNP grew 1.6 percent (s.a.a.r.), compared with rates of 8.3 percent and 2.8 percent in the preceding two quarters. Consumption growth eased (to 3.6 percent) in the third quarter while plant and equipment

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

	Q4/Q4 1989	Q4/Q4 1990	1990 Q4	1991 Q1	1991 Q2	1991 Q3	1991 June	1991 July	1991 Aug.	1991 Sept.	1991 Oct.	Latest 3 months from year ago 2
Canada												
GDP	2.1	-1.1	-1.2	-1.2	1.4	.2	*	*	*	*	*	-.8
IP	-1.1	-6.3	-3.3	-2.2	1.3	1.2	.7	.4	-.2	.6	n.a.	-3.1
France												
GDP	3.9	1.9	-.1	.2	.7	n.a.	*	*	*	*	*	1.5
IP	2.8	-.3	-2.7	.3	1.3	.2	.2	.6	.0	-1.1	n.a.	-.9
West Germany												
GNP	3.2	5.3	.6	2.4	-.6	-.5	*	*	*	*	*	1.9
IP	4.8	5.4	.4	2.0	-.1	-.5	3.8	-1.4	-2.1	.5	-1.0	.5
Italy												
GDP	2.9	1.3	.2	.2	.3	n.a.	*	*	*	*	*	1.4
IP	3.2	-3.8	-2.0	.4	-2.1	-.2	5.6	-3.8	-2.1	3.2	n.a.	-3.8
Japan												
GNP	4.9	4.7	1.0	2.0	.7	.4	*	*	*	*	*	4.1
IP	4.2	6.9	1.7	-.1	-.7	.3	-2.8	3.2	-2.5	.5	-.4	-.4
United Kingdom												
GDP	1.6	-1.1	-.2	-.8	-.6	.3	*	*	*	*	*	-1.3
IP	.3	-3.4	-1.8	-.3	-1.2	1.3	3.9	.1	-2.0	.9	n.a.	-1.9
United States												
GNP	1.7	-.1	-1.0	-.6	.3	.4	*	*	*	*	*	-.9
IP	1.1	.3	-1.8	-2.5	.6	1.6	.8	.7	-.1	.2	-.0	-2.0

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

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

	Q4/Q4 1989	Q4/Q4 1990	1990 Q2	1990 Q3	1990 Q4	1991 Q1	1991 Q2	1991 Q3	1991 Aug.	1991 Sept.	1991 Oct.	1991 Nov.	Latest 3 months from year ago
Canada													
CPI	5.2	4.9	.9	1.1	1.4	2.9	.7	.6	.1	-.2	-.2	n.a.	5.2
WPI	.2	1.6	.3	-.1	1.0	.1	-1.6	-.9	-.5	-.2	.0	n.a.	-1.9
France													
CPI	3.6	3.6	.9	1.0	1.0	.5	.7	.8	.2	.2	.2	n.a.	2.6
WPI	.9	.7	-.3	.2	1.1	-.5	-1.3	n.a.	*	*	*	*	-.5
West Germany													
CPI	3.0	3.0	.5	.4	.9	.8	.9	1.5	.0	.2	.3	.4	3.9
WPI	4.3	.9	.6	.2	.4	.5	.3	.7	-.9	.1	.3	n.a.	1.0
Italy													
CPI	6.6	6.3	1.2	1.4	2.0	1.9	1.4	1.0	.3	.4	.8	.7	6.1
WPI	n.a.	9.9	-.0	3.9	4.3	.2	-1.0	.5	.3	.9	n.a.	n.a.	4.0
Japan													
CPI	2.9	3.2	1.3	.2	1.2	.8	.8	.4	.3	.1	.9	.5	3.2
WPI	3.7	1.9	.8	.0	.7	.1	-.4	-.4	.0	-.3	-.4	n.a.	-.4
United Kingdom													
CPI	7.6	10.0	4.7	1.6	1.6	.6	2.0	.4	.2	.4	.4	n.a.	4.2
WPI	5.2	5.9	2.1	.9	1.1	2.0	1.8	.7	.1	.1	.1	.4	5.3
United States													
CPI (SA)	4.6	6.3	1.0	1.7	1.7	.9	.5	.7	.2	.4	.1	n.a.	3.3
WPI (SA)	4.9	6.5	.1	1.6	2.6	-.6	-.1	-.2	.2	.1	.7	n.a.	.8

1. Asterisk indicates that monthly data are not available.

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

	1989	1990	1990			1991			1991			
			Q2	Q3	Q4	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Canada												
Trade	6.0	9.4	2.7	2.8	2.3	2.3	2.6	1.1	.9	-.3	n.a.	n.a.
Current account	-14.1	-14.0	-3.6	-2.9	-3.1	-4.8	-4.8	-6.3	*	*	*	*
France												
Trade	-6.9	-9.3	-2.0	-3.6	-3.1	-2.6	-1.4	-1.9	-.7	-.5	1.2	n.a.
Current account	-3.1	-8.0	-2.9	-3.5	-1.4	-2.9	n.a.	n.a.	*	*	*	*
Germany [2]												
Trade (NSA)	71.6	65.2	16.7	16.0	10.1	4.4	-1.1	2.8	1.8	.9	1.3	n.a.
Current Account (NSA)	57.3	47.3	10.7	9.4	8.5	-5.9	-5.9	-6.1	-1.8	-1.0	-1.8	n.a.
Italy												
Trade	-12.6	-12.1	-1.9	-3.2	-3.6	-1.2	-4.1	-5.3	-1.2	-1.6	-1.3	n.a.
Current account (NSA)	-10.7	-14.2	-2.2	.7	-3.7	-7.6	-4.7	n.a.	*	*	*	*
Japan												
Trade	64.6	51.8	14.2	14.2	8.5	17.4	18.8	20.8	7.3	7.6	6.5	7.4
Current account	57.7	35.8	7.9	7.0	6.4	17.8	18.8	19.4	7.1	7.6	6.4	n.a.
United Kingdom												
Trade	-39.4	-33.5	-8.7	-8.9	-6.1	-5.4	-3.7	-3.9	-1.3	-1.6	n.a.	n.a.
Current account	-32.5	-26.5	-8.3	-5.9	-3.7	-4.9	-1.4	-2.6	-1.0	-.9	-1.0	n.a.
United States												
Trade	-116.0	-108.1	-24.1	-28.8	-27.7	-18.4	-15.4	-20.5	-7.0	-7.0	n.a.	n.a.
Current account	-106.3	-92.1	-22.2	-23.9	-23.4	10.5	3.0	n.a.	*	*	*	*

1. The current account includes goods, services, and private and official transfers. Asterisk indicates that monthly data are not available.
2. Before July 1990, West Germany only.

investment resumed positive growth (up 2.6 percent) and housing investment remained negative (down 8.6 percent). Inventory investment and net exports both had about neutral impacts on third-quarter growth.

Recent monthly indicators of activity have been mixed. New machinery orders (s.a.) rose for the third consecutive month in September and were 20.8 percent above their year-earlier level. The index of leading indicators was at its highest level in 13 months in September. New passenger car registrations (s.a.) rose 3.1 percent in October, but remained 4.7 percent below their level of last October. Industrial production (s.a.) declined by 0.4 percent in October, falling 2.1 percent below its year-earlier level. Housing starts (s.a.) fell for the fifth consecutive month in October and showed a cumulative decline of 25.4 percent over the previous 12 months. The unemployment rate (s.a.) declined to 2 percent in October, returning to its record low level reached earlier in the year. However, a more sensitive measure of job market conditions, the job offers to applicants ratio (s.a.), declined for the third consecutive month in October, falling 9.5 percent below its recent peak.

Underlying inflationary pressures appear to have remained about unchanged. In November, the 12-month increase of consumer prices in the Tokyo area rose to 3.7 percent. However, most of this increase was due to a weather-related jump in the price of perishable foods. Excluding these items, the 12-month consumer price inflation rate eased to 2.6 percent. Wholesale prices showed a 12-month decrease of 0.9 percent.

The trade surplus (s.a.) remained above its year-earlier level in November as it has in each month this year. Through the first 11 months of the year, the trade surplus was $77.4 billion (a.r.), over

$20 billion larger than the surplus rate in the same period last year.

Real GNP in western <u>Germany</u> (adjusted for seasonal and calendar variations) fell at an annual rate of 1.9 percent in the third quarter, after falling 2.4 percent the second quarter. A sharp 7.2 percent decline in private consumption was the main cause of the third-quarter decline. Increases in payroll and income taxes are thought to have been major factors behind the drop in consumption in the third quarter. The decline in consumption was partially offset by strong west German exports (including shipments to eastern Germany). West German exports increased 19.5 percent (a.r.) in the third quarter after falling 7.7 percent in the second quarter. Net exports contributed 2.2 percentage points to third-quarter growth. A run-off of inventories reduced third-quarter GNP growth by 0.9 percentage point.

Recent monthly indicators have been mixed. Preliminary data suggest that industrial production in western Germany (s.a.) fell 1 percent in October after increasing 0.5 percent in September. The volume of new orders for west German manufactured goods (s.a.) fell 0.2 percent in October after falling 2.5 percent in September. However, these declines follow a cumulative increase of 4.2 percent between April and August. In September, the volume of retail sales (s.a.) in western Germany increased 0.3 percent after falling 4.8 percent over the previous two months. The west German unemployment rate (s.a.) remained at 6.3 in October and November after declining 0.1 percentage point in September.

Industrial production in eastern Germany (n.s.a.) fell 5.2 percent in August after posting large gains between April and July. New orders for east German manufactured goods (n.s.a.) increased 19.1 percent in August and were up almost 25 percent since May. New construction orders in eastern Germany (n.s.a.) have increased steadily since February, and August's level was 77 percent above the average level for the second half of 1990. The overall status of the labor market has improved since the second quarter. The east German unemployment rate (n.s.a.) increased 0.2 percentage point to 11.9 percent in October, but it remained below the July peak of 12.1 percent. Short-time workers declined to 13.6 percent of the labor force in October, down from 21.5 percent in June.

West German consumer prices (n.s.a.) increased 0.4 percent in November, and on a year-over-year basis, consumer price inflation increased from 3.5 percent in October to 4.2 percent in November. West German wholesale prices (n.s.a.) increased 0.3 percent in October, and on a year-over-year basis, wholesale price inflation was 0.7 percent in October, compared with 1 percent in September. West German import prices (n.s.a.) increased 0.2 percent in October to a level 2.5 percent below where they were the year before.

Accelerating unit labor costs in western Germany continue to be a source of concern. Average hourly earnings in western Germany increased 8.6 percent in the year to September, compared with 6.4 percent at the end of last year. In contrast, output per hour in west German industry increased only 2.1 percent in the year to August, compared with 3.8 percent at the end of last year. Negotiations over wage agreements for 1992 are in the early stages. Negotiations covering public sector employees and the metalworkers have not formally begun, but the unions have indicated that they will demand increases of more than 10 percent.

For the third quarter as a whole, the combined German trade balance (s.a.) was in surplus by $9 billion (a.r.), compared with a $1.6 billion deficit in the second quarter. Exports (s.a.) increased 5 percent in the third quarter, while imports increased

2.1 percent. On a non-seasonally adjusted basis, the trade surplus increased from $11 billion (a.r.) in September to $16 billion in October. The combined German current account deficit (s.a.) fell to $14.2 billion (a.r.) in the third quarter from $22.6 billion in the second quarter. On a non-seasonally adjusted basis, the current account deficit increased from $12 billion (a.r.) in September to $22 billion in October.

The combined deficit for federal, state, and local governments is expected to widened to 4-3/4 percent of GNP (DM 135 billion) in 1991. The lower house of the German parliament has approved a 1992 budget with a projected public sector deficit equal to 4-1/4 percent of GNP (DM 125 billion). However, the upper house, which is not controlled by Chancellor Kohl's coalition, has blocked final approval of a variety of tax changes, including a 1 percentage point increase in the VAT rate that is scheduled to take effect at the beginning of 1993.

In France, the economic recovery that began in the second quarter appears to have continued into the third and fourth quarters. Marketable GDP, a reliable preliminary indicator of total GDP, rose 3.2 percent (s.a.a.r.) in both the second and third quarters. Monthly indicators of economic activity, which appeared to weaken at the end of the third quarter, with industrial production (s.a.) falling one percent in September, have recovered so far in the fourth quarter. Increases (s.a.) were registered in October in business output and orders, retail sales, exports, and consumption of manufactured products. A less favorable development was a slight increase in the unemployment rate (s.a.) in October to 9.7 percent.

The consumer price index in October was only 2.5 percent above its level a year earlier, down from 2.6 percent in the previous month. This slowing in inflation is supported by continued moderate wage growth, with hourly wages rising 4.7 percent in October from their level a year earlier, down from 4.8 percent in July.

In October, France registered a trade surplus (s.a.) of $1.2 billion, its largest in over ten years. Even after an adjustment to exports for two special items, the sale of a cruise ship and the launch of a satellite, this surplus remains substantial at $0.5 billion. This strong trade performance is primarily the result of strong export growth, suggesting that the external sector has continued to be a source of strength in the fourth quarter.

In Italy, a modest and uneven recovery appeared to stall during the summer, following an increase in GDP of 1.2 percent (s.a.a.r.) in the second quarter. Industrial production (s.a.) rose a preliminary 3.2 percent in September following two months of declines. The average for the third quarter was down 0.2 percent from the previous quarter. Household confidence (n.s.a.) dropped sharply in October, possibly portending a slowdown in previously strong growth in consumer spending that was the main source of demand growth during the first half of the year.

Inflation has slowed in Italy but remains well above rates in its key EMS partners, Germany and France. Consumer prices in November were 6.2 percent above their level a year earlier, up slightly from the 6.1 percent rise of October. Wholesale prices in September were 2.1 percent above a year earlier, down from 3.1 percent in August.

Italy's trade deficit has widened in the past few months as exports have fallen noticeably from last year. The cumulative trade deficit for January through October was $14.2 billion (s.a.a.r.), somewhat above last year's $12.1 billion. Preliminary data on the Italian current account show a deficit of $12.3 billion (n.s.a.)

during the first half of 1991, compared with a deficit of $11.2 billion in the same period a year earlier.

The United Kingdom appears to have recorded positive growth in the third quarter of 1991, the first such increase since the second quarter of 1990. A provisional measure of real GDP grew 1.2 percent (s.a.a.r) in the third quarter after it fell by a cumulative 3.7 percent since the onset of the recession. However, the growth in real GDP was entirely accounted for by a rebound in North Sea oil production; excluding oil and gas, real GDP fell 1.2 percent (s.a.a.r) in the third quarter. Although most sectors of the economy, including services and manufacturing, appear to have bottomed out, there is little evidence of recovery from the recession in the most recent data. Retail sales (s.a.) fell in October to a level 0.8 percent below the third-quarter average. After increasing steadily since the Gulf War ended, consumer confidence (n.s.a.) fell back a bit in October and November, giving rise to fears that the United Kingdom could slide into a double-dip recession. Housing starts were flat in the three months from August to October compared with the previous three months. However, unemployment (s.a.) leveled off at a rate of 8.7 percent in October.

The year-over-year inflation rate has more than halved during the past year; consumer price inflation fell to 3.7 percent in October compared with a peak rate of 10.9 percent a year ago. The government's measure of underlying inflation, which excludes mortgage interest rates, stood at 5.5 percent in the year to October, down from a rate of 9.5 percent last October. Producer prices (n.s.a.) rose 0.4 percent in November to stand 5.1 percent above year-ago levels.

In the annual Autumn statement, Chancellor of the Exchequer Lamont announced a sharp rise in government spending for the 1992-93 fiscal year starting next April. While some of the increase in spending is due to the cyclical downturn, there also are discretionary increases in spending on health, transportation, and pensions.

In Canada, real GDP rose 0.9 percent (s.a.a.r.) in the third quarter, after increasing at a revised 5.7 percent rate in the second quarter. However, the level of GDP was still about 1.3 percent below its peak in the first quarter of 1990. Total domestic demand increased 4.2 percent in the third quarter, but the external balance was much weaker, as exports were unable to keep up with the 26 percent growth in imports. The 2 percent increase in investment was due entirely to continued strength in residential construction, which grew 17 percent, as spending on non-residential structures and machinery and equipment declined.

Recent monthly data suggest that the recovery remains tentative. The unemployment rate (s.a.) rose from 10.2 percent to 10.3 percent in October, partially reversing September's 0.4 percentage point decline. In September, factory shipments (s.a.) fell 0.4 percent, new orders (s.a.) were down 0.3 percent, and retail sales excluding automobiles (s.a.) declined 0.4 percent, erasing a modest increase in August. However, industrial production (s.a.) increased 0.6 percent in September, housing starts (s.a.) rose 12 percent in October, and motor vehicle sales (s.a.) were up 13 percent in September.

October price data suggest that the government's anti-inflation efforts are bearing fruit. The all-items consumer price index (n.s.a.) posted its second consecutive 0.2 percent decline, causing twelve-month inflation to fall from 5.4 percent to 4.4 percent. The CPI excluding food and energy (n.s.a.) was up 0.2 percent in October, but has increased only 3.5 percent (a.r.) since the 7 percent Goods and Services Tax was introduced in January. Industrial product prices were unchanged after seven consecutive monthly declines, for a twelve-month decrease of 2.4 percent. Wage settlements rose 3.3 percent (s.a.a.r.) in the third quarter, their smallest increase in five years.

The current account deficit (s.a.) increased sharply to a record high $25.1 billion (a.r.) in the third quarter, as Canada's September merchandise trade balance (s.a.) showed its first monthly deficit in 15 years.

Developments in the Soviet Union and Eastern European Countries

While the political structure of the former Soviet Union evolves, the economic situation continues to deteriorate. The fiscal situation has worsened steadily as expenditures continue to grow and republics withhold revenues from the central government. Parliamentary refusal in late November to increase the center's deficit financing this year provoked a fiscal crisis, as Gosbank (the central bank) claimed to have insufficient funds. Russian President Yeltsin subsequently agreed to provide resources to finance the union budget and guarantee Gosbank credits. The central government has been weakened by Russian assumption of control of many functions that were once centrally administered, by Ukraine's overwhelming vote in favor of independence on December 1, and by the creation of a Commonwealth of Independent States by the Russian Republic, Ukraine, and Byelorussia on December 8.

In early December, Gosbank removed controls on the fixed tourist exchange rate of 47 rubles per dollar. Subsequently, the Soviet Bank for Foreign Economic Affairs (Vneshekonombank or VEB) started trading hard currency at market-determined rates of about 90 rubles per dollar. By December 10, the rate was quoted as high as 170 rubles per dollar.

In late November, G-7 countries agreed to defer Soviet principal repayments on foreign debt, to support short-term credit lines and guarantees provided by G-7 export credit agencies, and to offer an emergency financing facility of up to $1 billion in a swap against gold. The republics agreed to seek comparable treatment from other official and private sector creditors and to cooperate closely with the IMF to implement appropriate macroeconomic and structural reform programs. Approximately $3.6 billion in payments due to G-7 creditors through the end of 1992 are expected to be deferred. Prior to negotiating this agreement, Soviet republics agreed to assume joint and several responsibility for servicing the country's foreign debt that is currently estimated at over $70 billion.

On December 5, VEB informed commercial banks that principal payments would be halted on all loans contracted before January 1, 1991. At a meeting on December 6, commercial bank creditors and the Soviets discussed a postponement of principal payments due in the first quarter of 1992.

In Eastern Europe, Poland, Hungary and the Czech and Slovak Federal Republic reached agreement with the European Community (EC) at the end of November to expand market access for their exports to the EC. The three Eastern European countries have also signed an agreement setting a framework to free trade among themselves over the next five years. Further, in early December the United States passed legislation allowing permanent most favored nation status for the Czech and Slovak Federal Republic, Hungary, and the Baltics.

In Poland, the lower house of parliament (SEJM) elected lawyer and civil rights activist Jan Olszewski to be the new Prime Minister. Key differences in economic policy among the members of the coalition of center-right parties that backs Olszewski remain to be resolved. Also, President Walesa nominated Hanna Gronkeiwicz-Waltz, a banking law specialist at Warsaw University, to head Poland's central bank.

Industrial sales rose 9.4 percent in October (largely reflecting seasonal factors) but remain 21.5 percent below a year earlier. The unemployment rate rose 1.0 percent to 11.8 percent in November. October inflation was 3.2 percent, and prices are 64.8 percent above year-earlier levels.

In Hungary, Prime Minister Antall named Industry and Trade Minister Peter Akos Bod as president of the Central Bank, succeeding Gyorgy Suranyi. The replacement of the respected independent Suranyi was allowed by the recently approved central bank law that restructured the Central Bank along Western lines. The government has stated that current policies, which have helped to reduce inflation substantially since January 1991, will not change. Consumer prices rose 1.3 percent in October to a level 33.9 percent above their year-ago level. Industrial production fell slightly in September and has declined 18.8 percent in the first nine months of 1991 compared with the same period in 1990. In October, the unemployment rate rose 0.5 percentage point to 6.6 percent.

Economic Situation in Other Countries

The Mexican government unified the controlled and free exchange rates in mid-November and modified its managed exchange rate policy. At the same time, it renewed its anti-inflation pact with business and organized labor. On November 18, IMF Managing Director Camdessus announced plans to complete agreement with Argentina on a three-year Extended Fund Facility stand-by arrangement by the end of the first quarter of 1992. The Brazilian congress is considering a tax proposal that must be approved if Brazil is to have a chance of receiving a 20-month, $2 billion IMF stand-by arrangement. Drawings by Venezuela on its Extended Fund Facility arrangement with the IMF have resumed. The Venezuelan government sold 40 percent of the shares of the national telephone company on November 15. An IMF mission to the Philippines last month withheld its approval of the government's 1992 economic program pending congressional passage of tax measures. In Korea, rapid economic activity has continued to put pressure on prices and to stimulate import growth. In Taiwan, economic activity has picked up this year due to stronger exports and rising public investment.

Individual country notes. On November 11, the Mexican government unified the controlled and free peso exchange rates and moved to a "target zone" exchange rate policy whose limits will be depreciated against the dollar by 20 centavos per day, or 2.4 percent at an annual rate. The controlled rate had been crawling by 40 centavos per dollar per day since November 1990. The free rate had been very close to it for about a year and often was slightly above it. Since the new policy was announced, the peso has firmed against the dollar. On December 9, the rate was 0.4 percent higher than the controlled rate on November 8.

At the same time, the anti-inflation pact between government, business, and organized labor, which was due to expire at the end of 1991, was extended until January 31, 1993. The agreement raised minimum wages by 12 percent, lowered the value-added tax from 15 to 10 percent, and raised various administered prices. With the price increases, the CPI, which rose by 1.2 percent in October, jumped by 2.5 percent in November and is likely to rise nearly as much again in December. As a result, interest rates firmed in late November, but then eased when the authorities allowed market liquidity to rise. At the December 3 auction, the 28-day Treasury bill rate was 16.11 percent, down from 16.24 percent on November 12.

Mexico's cumulative trade deficit for January-September was $3.95 billion, up from $0.5 billion in the same period of 1990. Imports were 25 percent higher than a year earlier, and exports were 10 percent higher. While the monthly trade deficit continued to grow, the capital inflows slowed after the Bank of Mexico, in August, imposed reserve requirements against Euro-currency certificates of deposit issued by Mexican banks. As a result, international reserves, including gold and the proceeds from the privatization of the telephone system, fell to $16.7 billion on October 31 from their July peak, estimated at about $18.4 billion.

The 1992 budget, sent to the Mexican congress on November 15, calls for an overall surplus of 0.8 percent of GDP, excluding privatization revenues. The 1991 overall fiscal deficit, excluding privatization revenues, originally budgeted at 1.9 percent of GDP, is now officially estimated at 1.3 percent of GDP.

In July and August, industrial production was 2.9 percent higher than a year earlier. This is about the same rate of increase as in the second quarter.

On November 18, IMF Managing Director Camdessus announced plans to complete an agreement with Argentina on a three-year Extended Fund Facility arrangement by the end of the first quarter of 1992. Argentina seeks to convert its current one-year IMF stand-by, which was approved in July 1991, into a three-year EFF arrangement in order to acquire the financing necessary to support a debt-reduction package with its commercial bank creditors. However, it will need a waiver to receive the second drawing under its stand-by arrangement, since a greater fraction of the overall fiscal surplus for the third quarter derived from asset sales than was specified under the arrangement. The waiver is expected to be approved, in part because preliminary data show that the deviation from this target was considerably smaller in October.

In late November, Argentina declared plans to open negotiations with the commercial banks by January 1992. Argentina currently is making monthly interest payments of $60 million on its medium- and long-term debt to commercial banks, compared with interest obligations of about $170 million monthly; the stock of interest arrears exceeds $8 billion.

To maintain the pace of fiscal reform, Argentina announced on November 13 that it aims to complete its privatization program by end-1992, by selling waterworks, utilities, railways, and other companies worth an estimated $10 to $20 billion. A decree of October 31 removes controls in many areas of economic activity and eliminates some financial taxes.

Monthly consumer price inflation dropped to 0.4 percent in November from 1.4 percent in October, the lowest rate in several decades. Industrial activity in September, while still below the levels reached in 1988, was 9.2 percent higher than a year earlier.

In Brazil, congress is presently considering a tax proposal that must be approved if Brazil is to have a chance of receiving a 20-month, $2 billion IMF stand-by arrangement. In the letter of intent supporting its request for the stand-by, the government proposes to achieve a primary budgetary surplus equal to 3 percent of GDP in 1992 and 4 percent of GDP in 1993, and promises to reduce inflation to 2 percent per month by the end of 1992. If Congress passes the tax package, which is likely, Executive Board approval is expected in early January.

Negotiations with creditor banks on the restructuring of Brazil's medium and long-term external debt resumed December 4.

Negotiations have stalled since September because banks want rolling interest guarantees, which Brazil is resisting.

Since the privatization of USIMINAS (steel) for $1.15 billion in late October, three small government enterprises have been sold.

Inflation is still very high. The "preliminary" General Price Index, which covers the 30 days through November 20, rose by 25.6 percent, compared with calendar-month increases of 25.9 percent and 16.2 percent in October and September, respectively. Real GDP rose by nearly 1 percent for the year through September, following a decline of 4 percent in 1990. Available data and anecdotal evidence indicate that economic activity since late September has fallen in response to record high real interest rates (even for Brazil). The 30-day bank certificate of deposit rate was recently 35 percent per month, or about 10 percent per month in real terms.

The recorded trade surplus for July to October was $2.2 billion, compared with $3.6 billion over the same period in 1990. The decline in the surplus reflects trade liberalization and underinvoicing of exports and overinvoicing of imports to facilitate capital flight. The latest official estimate of liquid international reserves is $7 billion at the end of September, compared with a recent peak of $9.2 billion in June. However, high domestic real interest rates have induced capital inflows recently. International reserves rose by $400 million in the first week of December. Capital inflows through the parallel market helped narrow the spread between the parallel and official exchange rate to less than 3 percent on December 9, the lowest in years.

Since August, the Venezuelan government has taken steps to limit the 1991 fiscal deficit to 1.2 percent of GDP. In light of these corrective measures, the IMF approved a Venezuelan drawing under its Extended Fund Facility arrangement. The Fund also extended the arrangement for six months, to March 1993, and rephased two quarterly purchases originally scheduled for this year to the final half-year of the arrangement. Having been unable to make all the IMF purchases planned for 1991, Venezuela will need waivers from the commercial banks providing new money bonds under the country's 1990 debt restructuring agreement in order to issue the third and last tranche of these bonds, for $300 million, in January 1992.

The Venezuelan government began privatizing the national telephone company on November 15 when it sold 40 percent of the shares to a consortium, including GTE and ATT. The winning bid was $1.9 billion, well above the government's minimum of $800 million. The government's remaining stake in the company is to be sold later.

Venezuela's strong recovery from the deep recession of 1989 is continuing. Real GDP growth for 1991 is projected to exceed 7 percent. Partly as a result, inflation has not fallen this year as the authorities had hoped; in November, the CPI was 32 percent higher than a year earlier.

An IMF mission to the Philippines in November withheld its approval of the government's 1992 economic program pending congressional passage of a package of new tax measures. The Philippines missed its June and September IMF targets and is currently out of compliance with its IMF program. The IMF has given the Philippines until the end of this year to enact the revenue package, but congress has been reluctant to act until after the May 1992 presidential and congressional elections. Congress will recess shortly, but may reconvene in January to consider the tax package.

In Korea, rapid economic activity has continued to put pressure on prices and to stimulate import growth. However, real GNP growth slowed somewhat to 8.1 percent at an annual rate in the third quarter of 1991 from 9 percent in the first half, in part due to a large decline in the growth of export volumes. Consumer prices were 9.8 percent higher in November than a year earlier. The current account deficit rose to a record $9.2 billion in the first eleven months of 1991 from $1.2 billion in the same period of last year, as a steep rise in imports of oil and capital goods more than offset a recovery in exports.

In Taiwan, economic activity has picked up this year due to stronger exports and rising public investment. In the first three quarters of 1991, real GNP expanded 7.3 percent at an annual rate compared with 5 percent in 1990. In the first eleven months of 1991, the cumulative trade surplus (on a customs basis) was $12.4 billion, up slightly from $11.9 billion in the same period of last year. Inflation has risen somewhat this year. Consumer prices were 5.3 percent higher in November than a year earlier; this compares with 3.9 percent in the same period last year.