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Confidential (FR) Class III FOMC

May 10, 1989

RECENT DEVELOPMENTS

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

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Economic activity appears to have decelerated in recent months. Employment gains diminished noticeably in March and April, and manufacturing payrolls have declined since January as factory orders have moved lower. Among domestic spending categories, housing activity has weakened considerably, and there is evidence of a slackening in consumer demand; by contrast, business fixed investment apparently has remained fairly buoyant. The uptrend in price inflation has been exacerbated by sharp increases in food and energy prices. Hourly compensation gains also appear to be trending upward, but at a surprisingly gradual rate, given the reported tightness of labor markets.

Labor Market Developments

Nonfarm payroll employment increased 200,000 on a strike-adjusted basis in March and 120,000 in April--compared with an average pace of 300,000 per month in the preceding half year. Nearly all of the April increase occurred in the services industry, though even there gains in business and health services were significantly less than those seen earlier in the year. Elsewhere in the service-producing sector, jobs in real estate and finance declined, and hiring at retail and wholesale trade establishments slackened considerably. Factory employment edged down last month as electrical machinery suffered a loss for the fifth consecutive month and weakness continued in the lumber and wood products industry, apparently reflecting slowing in construction activity. Moreover, revised data no longer show the sizable rebound in manufacturing employment previously reported for March.

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

	1987	1988	1988 Q3	1988 Q4	1989 Q1	1989 Feb.	1989 Mar.	1989 Apr.
	---------------Average Monthly Changes---------------							
Nonfarm payroll employment[2]	286	303	227	301	290	276	171	117
Strike-adjusted	283	303	229	296	301	278	199	121
Manufacturing	38	33	2	64	16	-12	6	-9
Durable	21	22	7	38	1	-19	-14	-7
Nondurable	16	11	-6	26	15	7	20	-2
Construction	21	26	19	22	16	-23	-35	6
Trade	68	80	52	73	116	92	97	16
Finance, insurance and real estate	16	10	4	16	7	24	4	-6
Services	99	112	88	111	101	127	101	99
Total government	28	28	51	3	24	57	-2	-14
Private nonfarm production workers	208	217	124	242	225	164	146	60
Manufacturing production workers	30	22	-3	50	10	-8	2	-11
Total employment[3]	257	189	123	213	376	142	283	-23
Nonagricultural	252	191	105	207	371	219	300	79

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

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

	1987	1988	1988 Q3	1988 Q4	1989 Q1	1989 Feb.	1989 Mar.	1989 Apr.
Civilian, 16 years and older	6.2	5.5	5.5	5.3	5.2	5.1	5.0	5.3
Teenagers	16.9	15.3	15.3	14.6	15.0	14.8	13.7	14.4
20-24 years old	9.7	8.7	8.5	8.7	8.4	8.1	7.7	8.4
Men, 25 years and older	4.8	4.2	4.1	4.1	4.0	4.0	3.8	4.2
Women, 25 years and older	4.8	4.3	4.4	4.2	4.0	3.9	4.0	4.1
White	5.3	4.7	4.8	4.6	4.4	4.3	4.2	4.6
Black	13.0	11.7	11.3	11.3	11.6	11.9	10.9	10.8
Fulltime workers	5.8	5.2	5.1	5.0	4.9	4.8	4.8	5.0
Memo:								
Total National[1]	6.1	5.4	5.4	5.3	5.1	5.1	4.9	5.2

1. Includes resident armed forces as employed.

As a result, the level of manufacturing employment in April was down 15,000 from January.

As measured by the household survey, nonagricultural employment also rose only modestly in April after expanding more than 1.1 million in the first quarter. Unemployment rose sharply, particularly among adult men. As a result, the civilian unemployment rate moved back up to 5.3 percent. This rise in joblessness apparently reflected the slower growth of job opportunities as data on new claims for unemployment insurance do not indicate an increase in layoffs.

Hourly compensation of private industry workers rose 4-1/2 percent in the twelve months ended in March, according to the employment cost index (ECI). This exceeds the increase over the year ended March 1988 by about 3/4 percentage point. Wage inflation has drifted up further to 4-1/4 percent, and benefits costs are still rising in excess of 5 percent.[1] Health insurance costs have continued to rise rapidly, but the contribution of social security taxes to the rise in benefits is much smaller this year than in 1988, when there was a jump in the payroll tax rate.

In the service-producing sector, the rise in hourly compensation over the past year has trended up to 5-1/4 percent. Large increases occurred in health services, where employment growth has continued strong and shortages of workers are frequently reported. Substantial gains also were recorded for sales workers in finance, insurance, and real estate, in which pay is

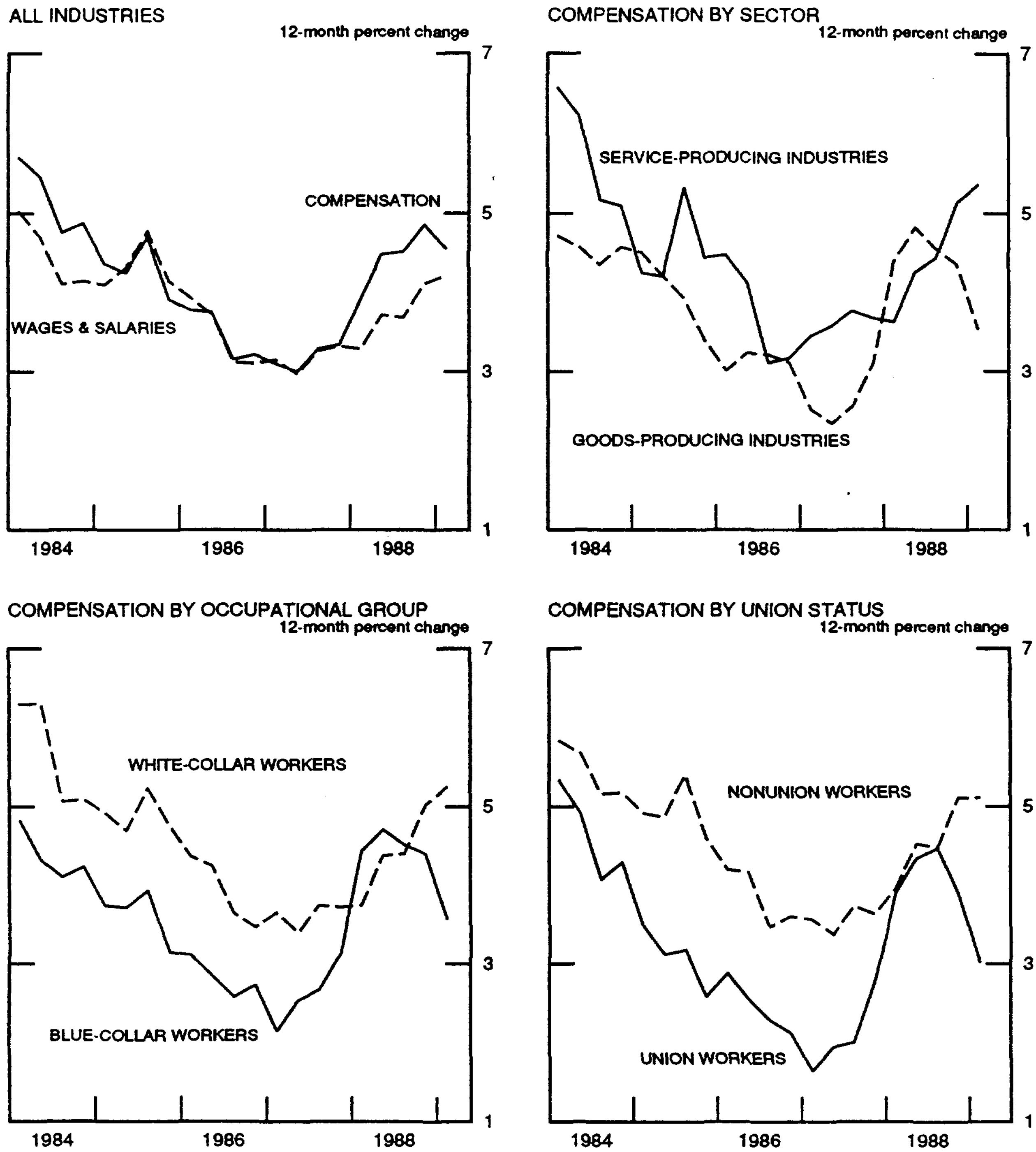
1. The quarterly series on ECI wages and salaries that is seasonally adjusted by the Board staff decelerated in the first quarter. This series, however, has fluctuated widely over the past year, raising some question about the quality of the seasonal adjustment.

EMPLOYMENT COST INDEX
(Private industry workers; twelve-month percent change[1])

	1987	1988	1988 Mar.	1988 June	1988 Sept.	1988 Dec.	1989 Mar.
Total compensation costs:							
Private industry workers	3.3	4.9	3.9	4.5	4.5	4.9	4.6
By industry:							
Goods-producing	3.1	4.4	4.4	4.8	4.5	4.4	3.5
Service-producing	3.7	5.1	3.6	4.3	4.4	5.1	5.3
By occupation:							
White-collar	3.7	5.0	3.7	4.4	4.4	5.0	5.2
Blue-collar	3.1	4.4	4.4	4.7	4.5	4.4	3.6
Service workers	2.4	5.3	2.9	3.6	4.6	5.3	4.9
By bargaining status							
Union	2.8	3.9	3.9	4.3	4.5	3.9	3.0
Nonunion	3.6	5.1	4.0	4.5	4.5	5.1	5.1
Memo:							
Wages and salaries	3.3	4.1	3.3	3.7	3.7	4.1	4.2
Benefits	3.5	6.8	5.8	6.4	6.7	6.8	5.4

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

Employment Cost Indexes: Private Industry



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

	1987	1988	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 April Monthly
Employment cost index[1]								
Compensation, all persons	3.3	4.9	5.4	5.3	3.9	4.8	4.3	--
By occupation:								
White collar	3.7	5.0	4.6	5.5	4.4	5.7	5.4	--
Blue collar	3.1	4.4	6.3	4.8	2.8	3.8	3.0	--
Service workers	2.4	5.3	4.9	6.0	5.3	4.9	3.4	--
By sector:								
Goods-producing	3.1	4.4	6.5	4.5	2.8	3.7	3.2	--
Service-producing	3.7	5.1	4.3	6.0	4.4	5.9	5.1	--
By bargaining status:								
Union	2.8	3.9	5.8	4.4	3.0	2.4	2.3	--
Nonunion	3.6	5.1	5.1	5.4	4.2	5.7	5.1	--
Wages and salaries, all persons	3.3	4.1	3.3	4.6	3.7	5.0	3.7	--
Benefits, all persons	3.5	6.8	12.6	6.0	4.2	4.5	7.0	--
Labor costs and productivity, all persons[2]								
Nonfarm Business Sector								
Output per hour	1.9	.7	3.4	-2.4	2.0	1.0	.5	--
Compensation per hour	4.1	4.8	3.5	4.2	5.7	5.2	5.7	--
Unit labor costs	2.1	4.0	.1	6.8	3.7	4.1	5.2	--
Manufacturing								
Output per hour	3.4	3.5	3.2	3.7	5.2	1.6	3.8	--
Compensation per hour	1.6	4.6	5.4	3.0	4.8	5.1	4.1	--
Unit labor costs	-1.8	1.1	2.2	-.7	-.5	3.5	.4	--
Major collective bargaining agreements[3]								
First-year wage adjustments	2.2	2.6	2.1	2.6	2.5	2.6	3.2	--
Total effective wage change	3.1	2.6	3.2	3.0	2.8	2.6	2.7	--
Average hourly earnings, production workers[2]								
Total private nonfarm	3.0	3.7	2.2	5.1	3.5	4.2	3.0	.7
Manufacturing	2.3	2.9	1.3	4.6	2.5	3.3	2.1	.2
Services	4.6	4.9	4.2	5.6	4.4	5.3	4.8	1.0
Hourly earnings index, wages of production workers[4]								
Total private nonfarm	2.6	3.5	3.1	3.8	2.9	4.1	2.8	.7

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

heavily influenced by volatile sales commissions. By contrast, the rise in hourly compensation in the goods-producing sector slowed about 3/4 percentage point to 3-1/2 percent in the year ended in March.

Wage data for the second quarter are limited to average hourly earnings in April, which increased almost 0.7 percent after moderate gains in the first quarter of about 1/4 percentage point per month. The sharpest increases occurred in business and health services, and in finance, insurance, and real estate.

Productivity in the nonfarm business sector was estimated to have risen just 1/2 percentage point in the first quarter, and it has grown at a rate somewhat less than our current trend estimate since mid-1988. Although the corresponding data on hourly compensation are not as reliable as the ECI, the deterioration in productivity growth does suggest some upward pressure on labor costs.

Industrial Production and Capacity Utilization

After rising rapidly through January, industrial production is estimated to have flattened in the next two months. Available data for April, however, now suggest a moderate gain in industrial production. In part, this pattern has been influenced by the auto sector. But more fundamentally, a slowdown in industrial activity is consistent with the softening in new orders for durable manufactured goods that emerged late last year.

For April, the combination of a rise in auto assemblies from 7.1 to 7.4 million units (FRB seasonals) and an increase in truck production is likely to add from 0.1 to 0.2 percentage point to the rise in industrial production. Other physical product data for April were mixed: Electricity

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

	1987[1]	1988[1]	1988 Q3	1988 Q4	1989 Q1	1989 Jan.	1989 Feb.	1989 Mar.
			---Annual rate---			--Monthly rate--		
Total Index	5.8	5.0	7.1	4.6	3.0	.4	.0	.0
Ex. motor vehicles	5.9	4.9	7.5	3.9	3.3	.4	.1	.2
Products	4.9	5.4	6.4	4.4	4.9	.6	.2	-.1
Consumer goods	3.2	6.0	6.6	7.5	4.6	.3	.3	-.4
Motor vehicles	4.4	8.8	-1.1	20.5	.0	-1.5	-.6	-2.3
Other	3.0	5.6	7.4	6.0	5.1	.5	.5	-.2
Business equipment	7.0	8.3	9.4	3.1	9.7	1.1	.6	.1
Motor vehicles	3.9	10.7	1.3	35.9	-14.6	-4.7	-1.6	-4.7
Computers	9.4	8.7	.1	.1	26.9	2.1	1.2	.1
Other	6.4	8.0	14.0	1.6	6.3	1.3	.6	.5
Construction supplies	4.7	5.2	.9	7.1	3.6	.6	-.6	.4
Materials	7.2	4.6	8.3	4.9	.1	.0	-.3	.1
Durable	8.0	6.9	9.0	6.5	-.1	..6	-.6	-.2
Consumer durable parts	1.8	9.0	5.5	8.6	-5.3	-.6	-.1	-1.8
Equipment parts	6.3	6.8	8.3	1.9	1.9	.8	.0	.1
Basic metals	21.3	3.6	24.7	8.8	-2.0	1.2	-1.1	.0
Nondurable	8.1	4.1	7.6	7.8	6.0	.8	-.2	.5
Paper	5.9	2.4	8.5	-.7	1.7	.1	-1.5	.7
Chemical	12.6	6.6	11.4	14.3	7.0	.4	.5	.8
Energy	4.5	-.1	7.7	-1.7	-5.8	-2.2	.2	.4
Memo:								
Manufacturing	5.9	5.6	7.2	5.1	4.6	.8	.1	-.1

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

PERCENT CHANGE IN ORDERS FOR DURABLE MANUFACTURING
(For industries that report unfilled orders; seasonally adjusted)

	1988 Q3	1988 Q4	1989 Q1	1989 Jan.	1989 Feb.	1989 Mar.
Orders for durable goods ex. civilian aircraft, defense, and motor vehicles	2.9	1.6	.9	.9	-2.3	-1.1
Nondefense capital goods excluding excluding aircraft	4.5	-2.3	4.9	6.0	-2.6	.9

Note: Percent change from previous comparable period.

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

	1967-88 Ave.	1973 Ave.	1978-79 Ave.	1988 Mar.	1989 Jan.	1989 Feb.	1989 Mar.
Total industry	81.6	87.9	85.0	82.4	84.4	84.2	84.0
Manufacturing	80.7	87.0	84.4	82.7	84.9	84.7	84.4
Primary processing	82.0	91.3	86.3	86.9	88.7	88.5	88.2
Advanced processing	80.2	85.1	83.3	80.7	83.2	83.1	82.8
Durable manufacturing	78.8	86.2	83.5	80.6	83.4	83.3	83.0
Iron and steel	79.0	97.9	88.2	83.2	92.2	89.1	88.9
Nonferrous metals	81.5	94.2	87.1	84.3	89.2	88.9	88.9
Fabricated metal products	78.0	84.0	84.6	82.4	84.6	84.4	84.1
Nonelectrical machinery	78.2	86.6	83.2	79.0	84.3	84.7	84.7
Motor vehicles & parts	78.2	94.5	83.6	79.3	86.6	85.4	82.4
Autos	76.1	89.3	81.7	65.8	75.7	72.9	71.7
Nondurable manufacturing	83.6	88.1	85.7	85.8	86.9	86.6	86.3
Paper and products	88.8	94.2	89.4	95.1	95.1	93.8	94.1
Chemicals and products	79.3	86.9	81.4	85.0	89.3	88.9	88.7
Petroleum products	86.9	97.1	87.8	88.5	87.5	88.6	86.4
Mining	86.5	91.4	90.5	80.6	82.3	81.2	81.6
Utilities	86.7	92.8	85.3	81.0	80.5	82.3	81.8
Memo:							
Industrial materials	82.3	91.1	86.7	82.4	84.8	84.3	84.2
Raw steel	80.7	100.4	90.7	86.5	93.3	87.6	87.8
Aluminum	87.8	93.8	94.0	99.2	100.2	99.2	99.6
Paper materials	92.0	96.8	92.1	97.8	98.1	96.2	96.5
Chemical materials	81.3	91.1	85.9	87.5	90.7	90.8	91.0

1. Data for iron and steel, nonferrous metals, paper and products, chemicals and products, raw steel, aluminum, paper materials, and chemical materials are unpublished estimates for March.

generation edged up; paper, paperboard, refinery products, and coal output increased, but raw steel production declined. Poduction worker hours, which are important indicators of activity in areas where physical product data are unavailable, rose entirely because of a rebound in the workweek. Weekly hours, which have fluctuated in recent months, were affected in April by the timing of Easter and probably do not provide a reliable signal of production.

For the first quarter as a whole, production of business equipment was an area of particular strength, consistent with the information on orders for nondefense capital goods (table). However, output of construction supplies slowed considerably, and production of durable and energy materials was down compared with its level at the end of last year. The drop in energy materials primarily reflected movements in coal mining and a fall in crude oil extraction in March--in part a result of the Alaskan oil spill. The weakness in durable materials stemmed from a decline in output of parts for consumer durable goods (related to a decline in first-quarter auto assemblies) and a sharp deceleration in the production of equipment parts.

Capacity utilization in manufacturing, mining, and utilities has slipped since January, consistent with the flatness in industrial production. Within manufacturing, utilization rates for both advanced and primary processing declined over the quarter. At the same time, there have been some indications of an easing of price pressures for intermediate materials.

<u>Personal Income and Consumption</u>

Real disposable income was about unchanged in March, after posting big gains in January and February. The slowdown in March reflected a drop in farm proprietors' income that came on the heels of sharp increases in January and February, reflecting higher government subsidy payments and BEA's assumption of a return to normal crop yields in 1989. In March, growth in wages and salaries--excluding special profit-sharing payments to workers in the automobile industry--was moderate for a second month. Meanwhile, the uptrend in short-term interest rates again showed through in personal interest income, while transfer payments were lifted by retroactive social security payments.[2] The large gains in real disposable income during January and February brought growth on a quarterly average basis to 7-3/4 percent at an annual rate.

Personal consumption expenditures fell 0.4 percent in real terms in March, owing in part to lower outlays for motor vehicles. Based on advance estimates of retail sales, spending in March also moved down sharply for apparel and food. For the first quarter as a whole, real PCE growth slowed to 1-1/4 percent at an annual rate, compared with growth of 3-3/4 percent over the four quarters of 1988. In part, the first-quarter slowdown reflected a weather-related dip in household energy expenditures and lackluster automobile sales, both of which are likely to rebound in the current quarter. Although the monthly consumption data often are revised substantially, they nonetheless provide some hint that the underlying strength of spending has eased somewhat in recent months, coincident with the slackening in labor markets.

As a result of the steep rise in disposable income and the slowing in consumption, the saving rate jumped from 4-1/4 percent in 1988-Q4 to

2. The "retroactive" social security payments resulted from recalculation of the earnings base underlying benefits for recent retirees.

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

	1988	1988 Q4	1989 Q1^p	1989 Jan.^r	1989 Feb.^r	1989 Mar.^p
Total personal income	21.8	28.7	49.6	71.1	43.7	34.1
Wages and salaries	14.7	18.2	20.8	29.7	11.6	21.0
Private	12.6	16.0	17.3	23.8	9.1	18.9
Other labor income	.9	1.0	1.0	1.0	.9	1.0
Proprietors' income	.1	1.0	12.5	25.1	17.8	-5.5
Farm	-1.5	-1.4	12.0	23.9	17.4	-5.2
Rent, dividends and interest	4.9	7.0	10.6	9.3	10.4	12.1
Transfer payments	3.3	2.7	8.2	14.5	3.5	6.7
Less: Personal contributions for social insurance	2.0	1.2	3.4	8.5	.6	1.2
Less: Personal tax and nontax payments	.2	4.0	6.5	11.2	2.1	6.3
Equals: Disposable personal income	21.7	24.7	43.1	59.9	41.6	27.8
Memo: Real disposable income	7.4	10.8	19.2	27.8	27.0	2.7

r--Revised.
P--Preliminary.

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from preceding period)

	1988	1988 Q4	1989 Q1^p	1989 Jan.^r	1989 Feb.^r	1989 Mar.^p
	----Annual rate----			----Monthly rate---		
Personal consumption expenditures	3.7	3.5	1.3	.0	.3	-.4
Durable goods	7.5	6.1	-3.2	-2.4	-1.5	-1.1
Excluding motor vehicles	7.2	9.3	4.6	.3	-.6	.4
Nondurable goods	1.9	1.3	2.0	1.0	.3	-.8
Excluding gasoline	1.9	1.1	3.0	1.0	.6	-1.0
Services	3.9	4.2	2.4	.0	.8	.0
Excluding energy	3.7	4.6	3.8	.6	.1	.2
Memo:						
Personal saving rate (percent)	4.2	4.3	5.7	5.1	5.8	6.3

r--Revised.
p--Preliminary.

5-3/4 percent in the first quarter. The rise in the saving rate over the past several quarters could reflect, at least to an extent, the adjustment of household spending to the lower level of net worth relative to income that has prevailed since the stock market peaked in August 1987. However, the rise in the saving rate in the first quarter also reflects several factors largely unrelated to longer-run saving and consumption decisions. Among these factors, measured farm proprietors' income increased $31 billion during the first quarter, reflecting an assumed absence of drought-related influences.[3] Assuming that farmers smoothed their consumption relative to the decline in NIPA income during 1988, the saving rate late last year probably was understated relative to an underlying level--perhaps on the order of 3/4 percentage point.[4]

A second factor boosting the saving rate during the first quarter was a $21 billion increase in transfer payments--roughly $12 billion of which reflected cost-of-living adjustments in social security benefits and other transfer payments. Because future increases in transfer payments are not expected to be as large as they were in the first quarter and because measured spending is expected to adjust gradually, the saving rate should be expected to decline, other things being equal, over the rest of the year. Assuming these transitory increases in income are not repeated and that

3. The largest part of the increase in farm proprietors' income--roughly $25 billion--is attributable to the assumed return of farm yields for 1989 to a level unaffected by the drought. An additional, indirect effect of the drought is the fact that federal set-aside requirements have been relaxed, leading to a higher percentage of land expected to be under cultivation for the 1989 crop year.

4. Note that farm income in the NIPA is a measure of profits from current production and, therefore, nets out the receipts from sales of farm inventories. The cash income of farmers, which includes the receipts from sales of inventories, was much stronger last year than the NIPA measure. Thus, it appears that farmers as a group were not cash constrained in 1988.

outlays for motor vehicles and energy consumption increase in the second quarter, the saving rate could be expected to drop sharply.[5]

Autos and Trucks

Sales of domestically produced cars picked up to an annual rate of 7.5 million units in April (BEA seasonals), reflecting the introduction of a new round of incentive plans. The latest batch of incentives is scheduled to expire in late May at Ford and in early June at GM; Chrysler's program is open-ended. However, given the relatively modest gains in sales that have accompanied the recent round of incentives, all three domestic automakers likely will find it necessary to maintain incentives in some form through the end of the model year. GM already has supplemented the program less than two weeks after implementing it, with the announcement of beefed-up rebates on several particularly slow-selling models.

Despite the pickup in sales last month, inventories of domestic makes remained on the hefty side. Stocks at both GM and Ford have grown nearly 100,000 units (not seasonally adjusted) since the end of 1988. Apparently, all three domestic automakers intend to finish production of 1989 models at relatively high rates while supporting sales with incentive programs. Production plans for the second quarter have been trimmed only modestly in recent weeks, from 7.3 million units as of the last Greenbook to 7.1 million

5. The saving rate in the second quarter also likely will be depressed by an upsurge in income tax payments. This subject is discussed in greater detail in the Federal Government section.

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

	1988	1988 Q4	1989 Q1	1989 Feb.	1989 Mar.	1989 Apr.
Autos and light trucks	15.45	15.15	14.21	14.38	13.84	15.82
Autos	10.64	10.49	9.72	9.85	9.54	10.78
Light trucks	4.81	4.65	4.49	4.53	4.30	5.04
Domestically produced[2]	11.74	11.59	10.92	11.13	10.46	12.02
Autos	7.54	7.47	6.91 r	7.07 r	6.63 r	7.52
Light trucks	4.21	4.12	4.01 r	4.06 r	3.83 r	4.50
Imports	3.70	3.55	3.30	3.25	3.39	3.79
Autos	3.10	3.02	2.81	2.78	2.91	3.26
Light trucks[3]	.60	.53	.49	.47	.47	.53

Note: Data on sales of trucks and imported autos for the current month are preliminary and subject to revision.
1. Components may not add to totals due to rounding.
2. Includes vehicles produced in Canada and Mexico and vehicles made in U.S. plants of foreign manufacturers.
3. Based on seasonals for domestic light trucks.
r--revised not seasonally adjusted data.

units currently. Plans for the third quarter call for an assembly rate of 7.2 million units.[6]

Sales of light trucks recorded a strong pace of 4.5 million units in April, while sales of imported automobiles also picked up to a 3.3 million unit annual pace--the fastest monthly selling rate since early 1988. Because of the softer sales in the first quarter, many of the foreign automakers also are running incentive programs. Indeed, only a few popular foreign brand names, including Mercedes-Benz, Toyota, and Honda have managed to keep dealers' supplies at levels well below the 60-day mark.

For the second year in a row, shipments from Japan during the twelve months ended March 31 fell below the ceiling imposed by the Voluntary Export Restraint (VER). Nissan accounted for most of the shortfall, but its shipments picked up during the second half of the agreement year--with the introduction of two new models. Although the Japanese Ministry of International Trade and Industry has decided to extend the VERs for another year, individual company allotments have not yet been announced.

Business Fixed Investment

BEA estimated real business fixed investment to have risen 9-1/2 percent at an annual rate in the first quarter, rebounding from the weakness apparent at the end of last year. Purchases of equipment were estimated to have increased 10-1/4 percent, after falling 3-1/2 percent in the fourth quarter. Real outlays for nonresidential structures rose at an

6. The automakers have scheduled model changeover earlier this year than the BEA seasonal factors are expecting; as a result, the planned July assembly rate registers only 4.9 million units on a seasonally adjusted basis, while the August and September rates are 9.0 and 8.0 million units respectively.

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

	1988		1989	1989		
	Q3	Q4	Q1	Jan.	Feb.	Mar.
Producers' durable equipment						
Shipments of nondefense capital goods	2.6	.9	3.1	2.0	.4	1.7
Excluding aircraft and parts	2.4	.8	3.2	-.1	1.1	-.2
Office and computing equipment	.7	-3.3	-.3	-1.9	-4.3	9.1
All other categories	2.8	1.9	4.0	.4	2.3	-2.2
Weighted PDE shipments[1]	2.2	.8	3.1	-1.3	2.0	-.2
Shipments of complete aircraft[2]	-8.8	-14.8	--	95.3	-27.6	--
Sales of heavy-weight trucks	-2.3	7.7	-3.0	10.0	-5.3	-9.6
Orders of nondefense capital goods	9.1	.0	5.2	2.3	-7.8	2.4
Excluding aircraft and parts	4.5	-2.3	4.9	6.0	-2.6	.9
Office and computing equipment	-.4	-4.1	-.4	.5	-12.2	18.7
All other categories	5.8	-1.8	6.1	7.4	-.4	-2.7
Weighted PDE orders[1]	4.1	-.3	2.5	.1	-.9	.3
Nonresidential structures						
Construction put-in-place	1.6	1.1	2.8	.9	-1.0	3.7
Office	1.0	-1.4	5.4	2.8	2.1	.8
Other commercial	-2.4	-4.1	8.7	3.2	1.0	3.7
Public utilities	10.1	1.2	-5.7	-6.7	-2.5	2.9
Industrial	.1	11.3	2.6	5.6	-5.7	12.2
All other	-3.4	4.1	6.0	4.4	-1.7	3.2
Rotary drilling rigs in use	-8.5	-16.0	-5.4	-6.8	6.0	7.9

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

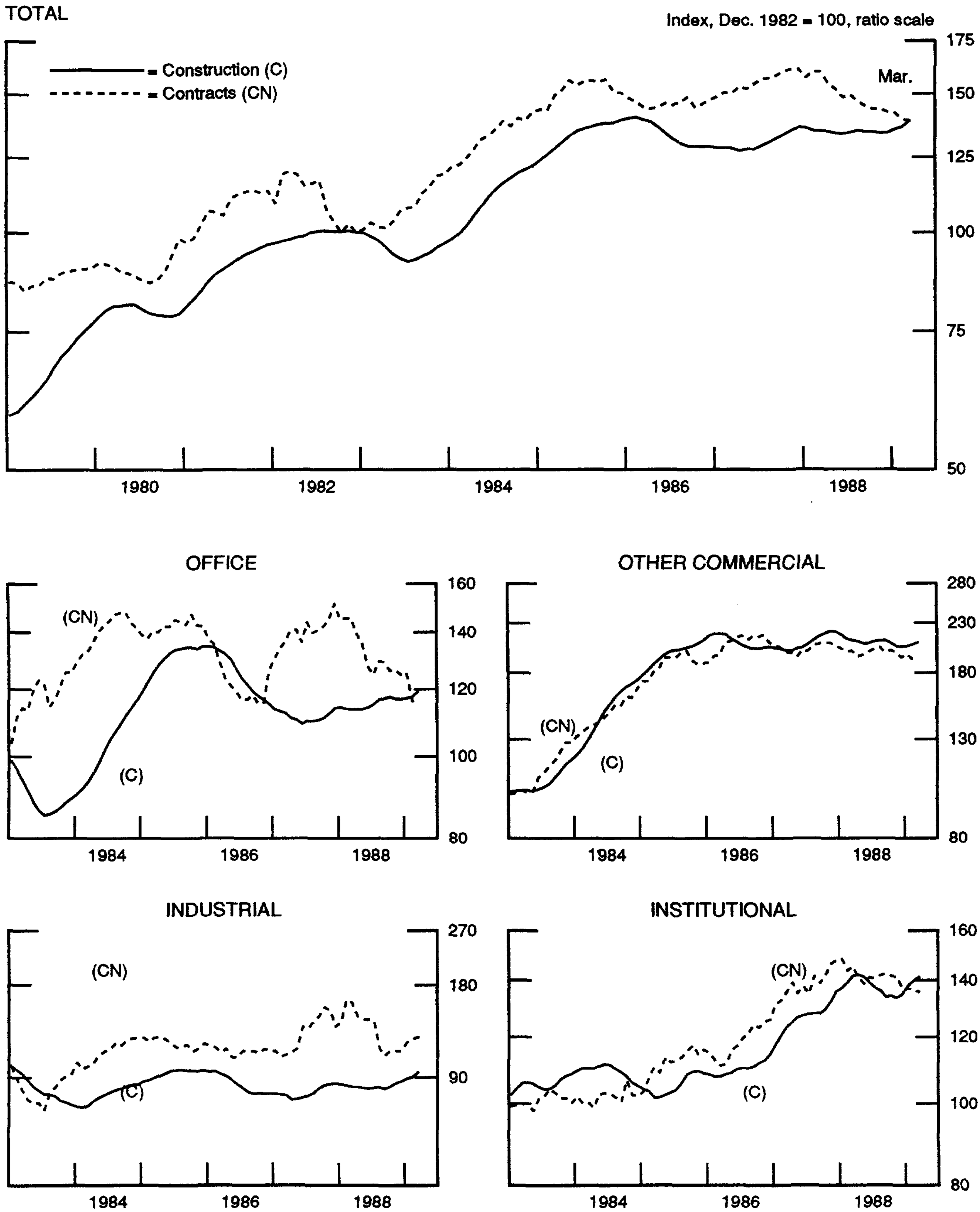
8 percent annual rate in the first quarter, after a 1 percent decline in the fourth quarter. However, data released since the BEA's advance estimate suggest some downward revision to these figures. March shipments of nondefense capital goods were a bit weaker than BEA had assumed, implying a downward revision--perhaps $1 to $2 billion, or about 1 to 2 percentage points at an annual rate--to first-quarter PDE spending in the next estimate. Similarly, first-quarter construction put-in-place data were lower than BEA had assumed and imply about a $1 billion downward revision, or 3-1/2 percentage points, to spending on structures.

Despite the potential for some downward revision, the first quarter still appears strong, reflecting sizable increases for most types of industrial machinery. Computers, for which spending fell sharply in the fourth quarter in real terms, also posted a sizable increase in the first quarter. Among the major components of equipment spending, only business purchases of motor vehicles, both automobiles and trucks, declined significantly. In addition, gains in nonresidential construction were widespread, with notable strength in the office and other commercial sectors.

Equipment spending should continue to post healthy increases in the near term, as new orders for nondefense capital goods, excluding the aircraft group, rose 5 percent (2-1/2 percent when weighted to reflect the fraction of business investment spending across categories) in the first quarter.[7] Furthermore, despite large monthly fluctuations, aircraft

7. One area of weakness has been in office and computing equipment, where nominal bookings have been sluggish since late last summer. There have been some reports that the weakness in computer demand may be the result of buyers taking time to evaluate the new, more powerful workstations and PCs hitting the market.

Nonresidential Construction and Contracts <1>



<1> Six-month moving average for all series shown.

orders have been very strong. In that regard, the late April press announcements of aircraft orders by United Airlines and the GPA leasing company--the largest ever in U.S. commercial aviation--added to an already considerable backlog.

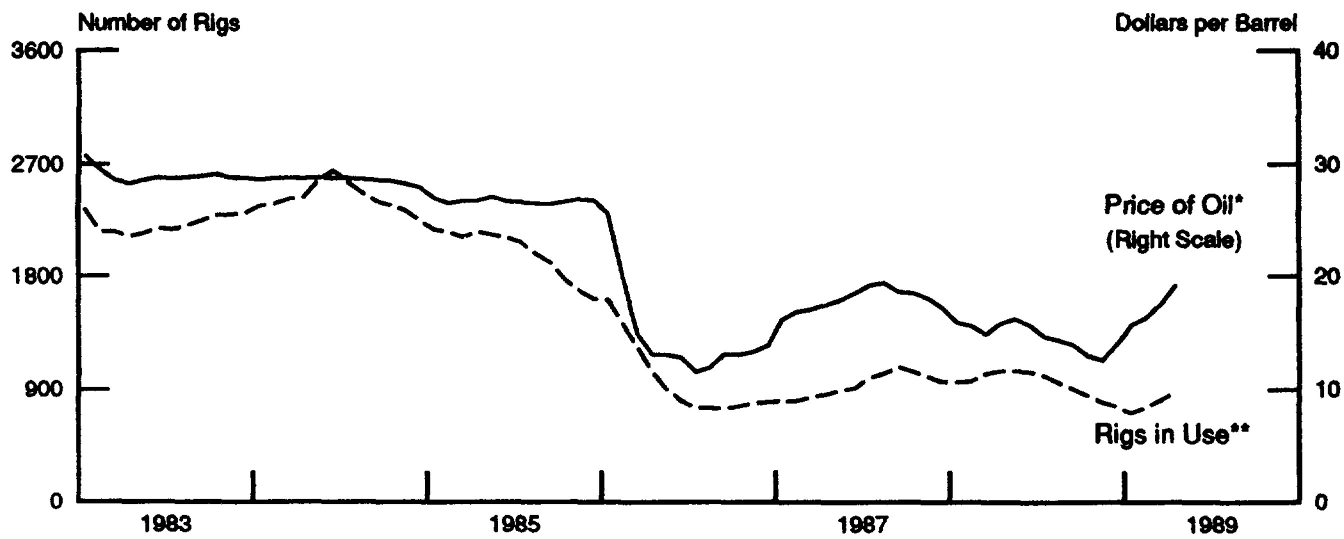
The outlook is weaker for structures. The value of new construction contracts, a broad indicator of future building activity, has moved lower since 1987, suggesting that it is unlikely that nonresidential construction can continue to rise at its recent pace. The primary exception is the industrial sector, where new contracts have been increasing since late last year--a pattern typical of periods of tight capacity. In addition, petroleum drilling also appears to have turned around in response to the increase in oil prices. In the past, drilling activity has tended to follow crude oil prices with a relatively short lag. The number of drilling rigs in use in April was 16 percent above the first-quarter average.

The latest Commerce Department survey of business plans for plant and equipment outlays, taken in January through March, indicates a 9.1 percent rise in nominal outlays this year. These intentions are stronger than the plans reported in the survey taken last fall, and the upward revision was widespread across industries. Like the fall survey, a wide confidence interval must be placed around this forecast. Nevertheless, the strength in investment spending suggested by this survey is broadly consistent with the continued increase in new orders for a wide range of capital goods.

Business Inventories

In current-cost terms, manufacturers' inventories rose at a $27 billion annual rate during the first quarter, similar to the average rate of in-

The Price of Oil and Rigs in Use



* Refiners' acquisition cost of crude oil.
** Rotary drilling rigs in operation, seasonally adjusted.

SURVEYS OF PLANT AND EQUIPMENT EXPENDITURES
(Percent change from previous year, current dollars)

		Planned for 1989	
	1988[1]	Commerce (Oct.-Nov.)	Commerce (Jan.-Mar.)
All business	10.3	6.0	9.1
Manufacturing	13.6	4.3	7.8
Durable	10.0	2.0	5.8
Nondurables	17.0	6.4	9.6
Nonmanufacturing	8.3	7.0	9.9
Memo:[2]			
Mean error		-.4	.4
Mean absolute error		2.6	2.9

1. As estimated in the January-March Commerce Department Survey.
2. Estimated from 1970 to the present.

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

	1988 Q3	1988 Q4	1989 Q1	1989 Jan.	1989 Feb.	1989 Mar.
Current-cost basis:						
Total	76.4	38.7	--	73.0	40.0	--
Total ex. auto	53.2	41.3	--	64.6	37.2	--
Manufacturing	23.3	25.5	27.0	39.5	19.2	22.3
Wholesale	19.2	5.4	5.6	17.4	.6	-1.3
Retail	33.9	7.8	--	16.1	20.2	--
Automotive	23.2	-2.6	--	8.4	2.8	--
Ex. auto	10.7	10.4	--	7.7	17.4	--
Constant-dollar basis:						
Total	25.5	26.3	--	43.0	3.7	--
Total ex. auto	16.8	18.8	--	26.4	-.6	--
Manufacturing	5.7	11.2	--	19.2	-5.6	--
Wholesale	8.1	2.2	---	6.5	-2.3	--
Retail	11.7	12.9	--	17.2	11.5	--
Automotive	8.7	7.5	--	16.6	4.3	--
Ex. auto	3.0	5.5	--	.6	7.2	--

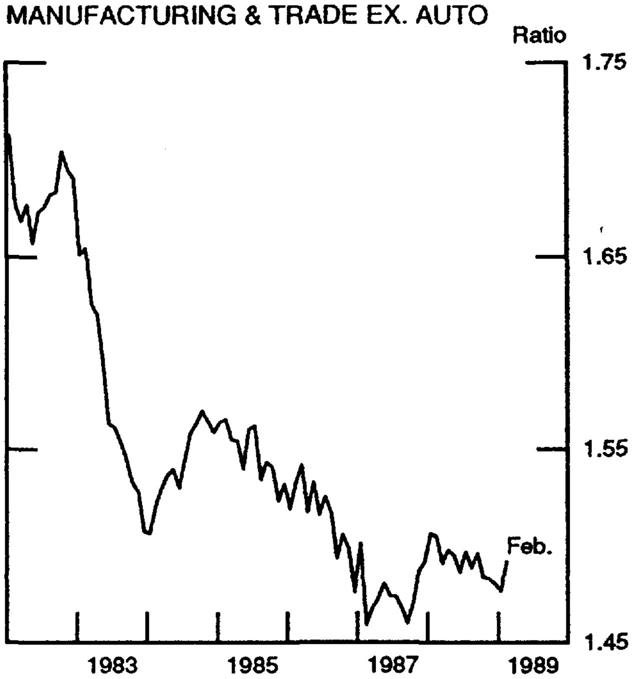
INVENTORIES RELATIVE TO SALES[1]
(Months supply; based on seasonally adjusted data)

	Range in preceding 12 months:[2] Low	High	1988 Q3	1988 Q4	1989 Q1	1989 Jan.	1989 Feb.	1989 Mar.
Current-cost basis:								
Total	1.48	1.52	1.52	1.50	--	1.48	1.50	--
Total ex. auto	1.46	1.50	1.49	1.48	--	1.46	1.47	--
Manufacturing	1.53	1.62	1.58	1.57	1.57	1.54	1.57	1.58
Wholesale	1.28	1.32	1.31	1.30	1.28	1.28	1.29	1.28
Retail	1.54	1.62	1.61	1.59	--	1.59	1.61	--
Automotive	1.66	2.01	1.98	1.88	--	1.93	1.98	--
Ex. auto	1.48	1.51	1.51	1.51	--	1.49	1.51	--
Constant-dollar basis:								
Total	1.50	1.52	1.52	1.52	--	1.51	1.53	--
Total ex. auto	1.48	1.51	1.50	1.49	--	1.48	1.49	--
Manufacturing	1.55	1.62	1.59	1.58	--	1.57	1.59	--
Wholesale	1.30	1.33	1.33	1.32	--	1.31	1.31	--
Retail	1.55	1.62	1.61	1.61	--	1.62	1.64	--
Automotive	1.70	2.03	1.93	1.94	--	2.03	2.08	--
Ex. auto	1.50	1.53	1.52	1.52	--	1.51	1.52	--

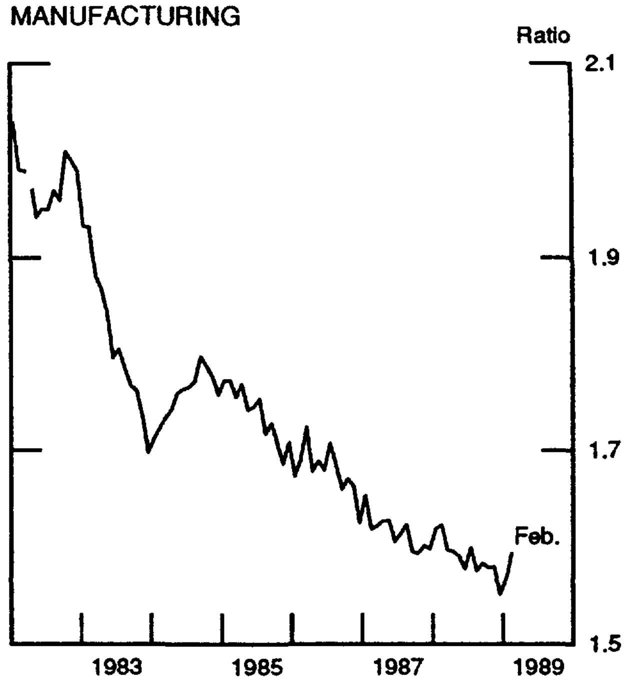
1. Ratio of end-of period inventories to average monthly sales for the period.
2. Highs and lows are specific to each series and are not necessarily coincident Range is for the 12-month period preceding the latest month for which data are available.

Ratio of Inventories to Sales
(Constant dollar basis)

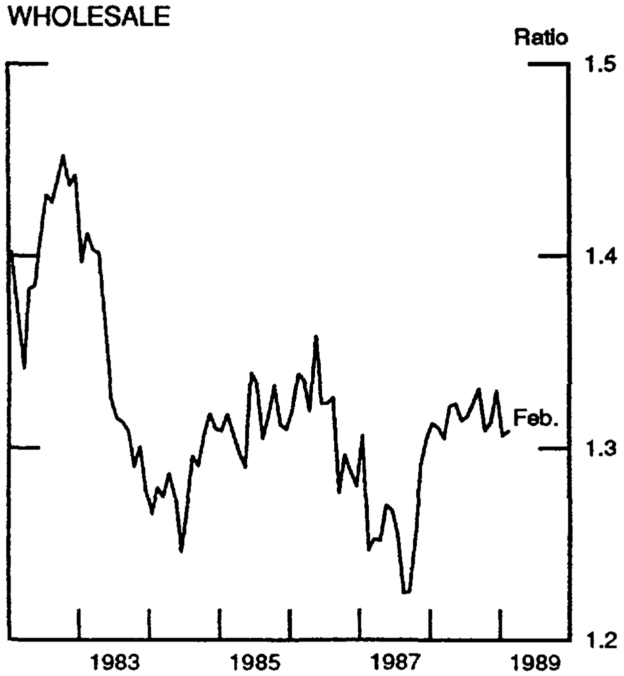
MANUFACTURING & TRADE EX. AUTO



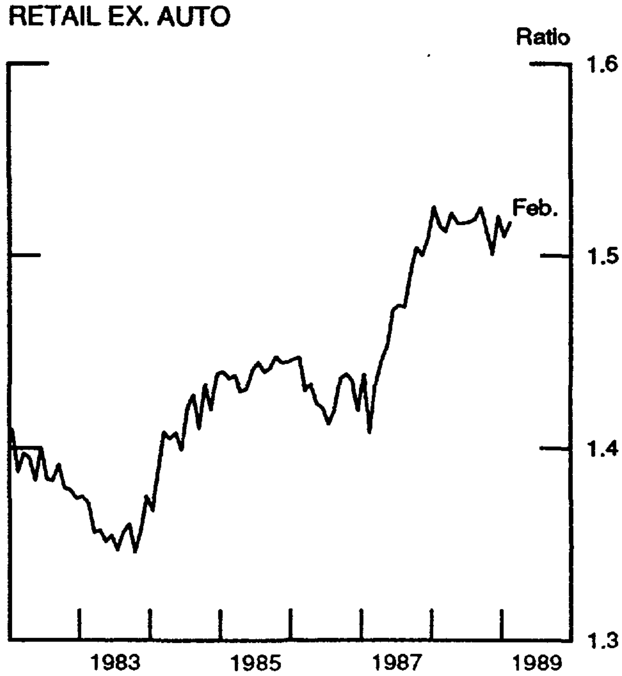
MANUFACTURING



WHOLESALE



RETAIL EX. AUTO



crease observed last year. A substantial part of the first-quarter accumulation was in stocks of work-in-process in transportation equipment, likely reflecting increased parts and components in the aircraft industry where new orders and production remain on a distinct uptrend. Elsewhere, the inventory position of manufacturers does not appear to be much different from late last year; despite some uptick in February and March, the overall inventory-to-shipments ratio at the end of the first quarter was about the same as that posted in the fourth quarter.

In the trade sector, current-cost figures for the first quarter show that the expansion of wholesale inventories continued at about the modest fourth-quarter pace. Drawdowns of inventories of farm products partially offset buildups in stocks of durable goods, especially motor vehicles and electrical goods. In retail trade, the accumulation of inventories has remained predominantly in the automotive area, but in February there also was a fairly large rise in stocks at apparel and general merchandise establishments. With retail sales at apparel and general merchandise stores sluggish, the inventory-sales ratios edged up. However, the ratios for these two types of retail establishments in February were still below the recent highs set in early 1988, and as yet there are only scattered reports of troubling imbalances.

Housing Markets

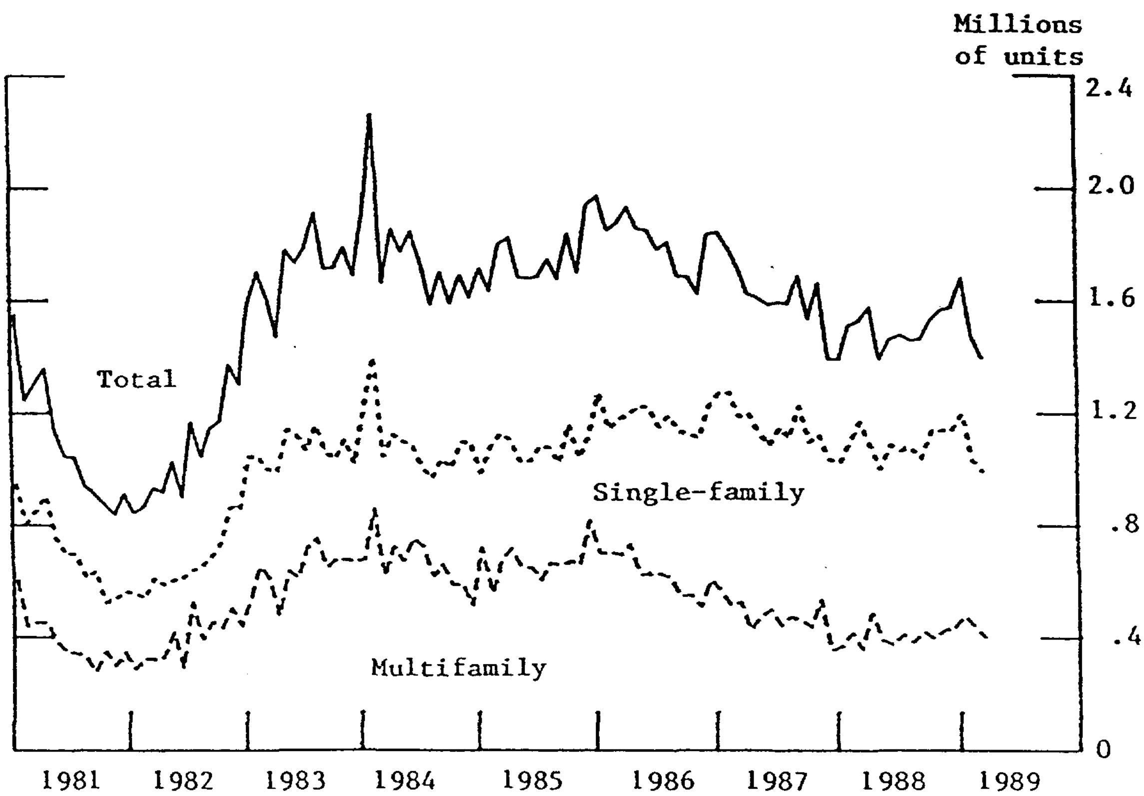
Housing activity, according to virtually every major indicator--starts, permits, and sales--weakened over the course of the first quarter. Total housing starts averaged 1.52 million units, down 3 percent from the fourth quarter, and building permits fell 10 percent to 1.38 million units. Sales of new and existing homes also moved lower in recent months. The diminished

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

	1988	1988		1989	1989		
	Annual	Q3	Q4	Q1^p	Jan.^r	Feb.^r	Mar.^p
All units							
Permits	1.45	1.43	1.53	1.38	1.51	1.42	1.22
Starts	1.49	1.47	1.56	1.52	1.68	1.48	1.40
Single-family units							
Permits	1.00	.99	1.05	.98	1.06	1.00	.87
Starts	1.08	1.06	1.14	1.08	1.20	1.03	.99
Sales							
New homes	.68	.70	.68	.64	.69	.63	.59
Existing homes	3.59	3.66	3.77	3.45	3.55	3.48	3.33
Multifamily units							
Permits	.45	.43	.48	.41	.44	.42	.35
Starts	.41	.41	.42	.44	.48	.44	.40

p--preliminary estimates. r--revised.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



pace of activity in housing markets likely reflects a response to higher interest rates on fixed- and adjustable-rate mortgages, which are up, on average, about 40 and 50 basis points, respectively, from the fourth quarter of last year.

In March, total starts fell 5 percent to 1.40 million units, and building permit issuance dropped 14 percent. The weakening was evident in both the single and multifamily sectors. The March declines do not appear to be weather related. But even so, the figures look weaker than would ordinarily be implied by interest rates and income growth, and some rebound seems probable in the near term. In the multifamily sector, vacancy rates remained at 9-1/4 percent in the first quarter, suggesting that building likely will remain damped in coming months.

Federal Government

According to BEA's advance estimate, real federal purchases fell at a 2-3/4 percent annual rate in the first quarter and, excluding changes in CCC inventories, were down 6-1/2 percent. A $6-1/2 billion drop in defense spending more than accounted for the overall decline. A generally weakening (though uneven) pattern of defense expenditures has characterized the past few years when military budgets have been constrained (chart). Federal compensation was boosted by the annual federal pay raise, while the annual COLA in social security and some other indexed programs raised transfer payments to persons.

On the receipts side of the budget, monthly Treasury data indicate that withheld personal income taxes plus social security taxes rose 8-1/4 percent in the first quarter on a year-over-year basis, up from 7-1/2 percent in the fourth quarter. Individual nonwithheld tax collections in the first quarter were about 7 percent above year-earlier levels, but more recent daily data show a surge in receipts that could lift this year's peak April-May collections as much as 20 percent above receipts from last year. Moreover, refund payments appeared to slow in April after a strong upswing in March. At this point, the causes underlying the higher revenues are not clear.[8]

Comparing receipt and outlay figures on a total budget basis, data for the first half of FY1989 show a deficit of $128.4 billion, up from $119.6 billion a year ago. The strength in receipts in April and May, however, suggests a lower full-year deficit than would be implied by a simple extrapolation from these numbers, even though higher interest rates are boosting the cost of debt service.

Meanwhile, Congress is proceeding to lay the groundwork for the FY1990 budget. The broad outlines were established in an April 14 bipartisan budget agreement between the President and the joint leadership of the Congress, which indicates deficit reduction amounting to roughly $28 billion.[9] OMB estimates that the agreement is consistent with the $100 billion Gramm-Rudmann target for the FY1990 deficit, based on the economic projections used by President Bush in February. More recently,

8. It also is not clear how BEA will treat these higher payments in the NIPA. Normally, they seasonally adjust final tax payments and refunds, which are heavily concentrated in the second quarter, effectively spreading normal payments throughout the year. To the extent that BEA decides to treat the recent strength in collections as reflecting continuing growth in taxes owed--possibly from larger-than-estimated increases in nonwage income or the base-broadening provisions of the 1986 Act--they will raise NIPA personal tax payments in each quarter of 1989 to take account of this spring's experience. However, if they treat some or all of the recent surge as reflecting temporary, special factors--perhaps one-time responses to the two-step phasing in of lower tax rates or to financial market developments--the transitory amount would be shown, at an annual rate, entirely in the second quarter.

9. Further information on the leadership agreement and on the Senate and House budget resolutions is presented in the appendix.

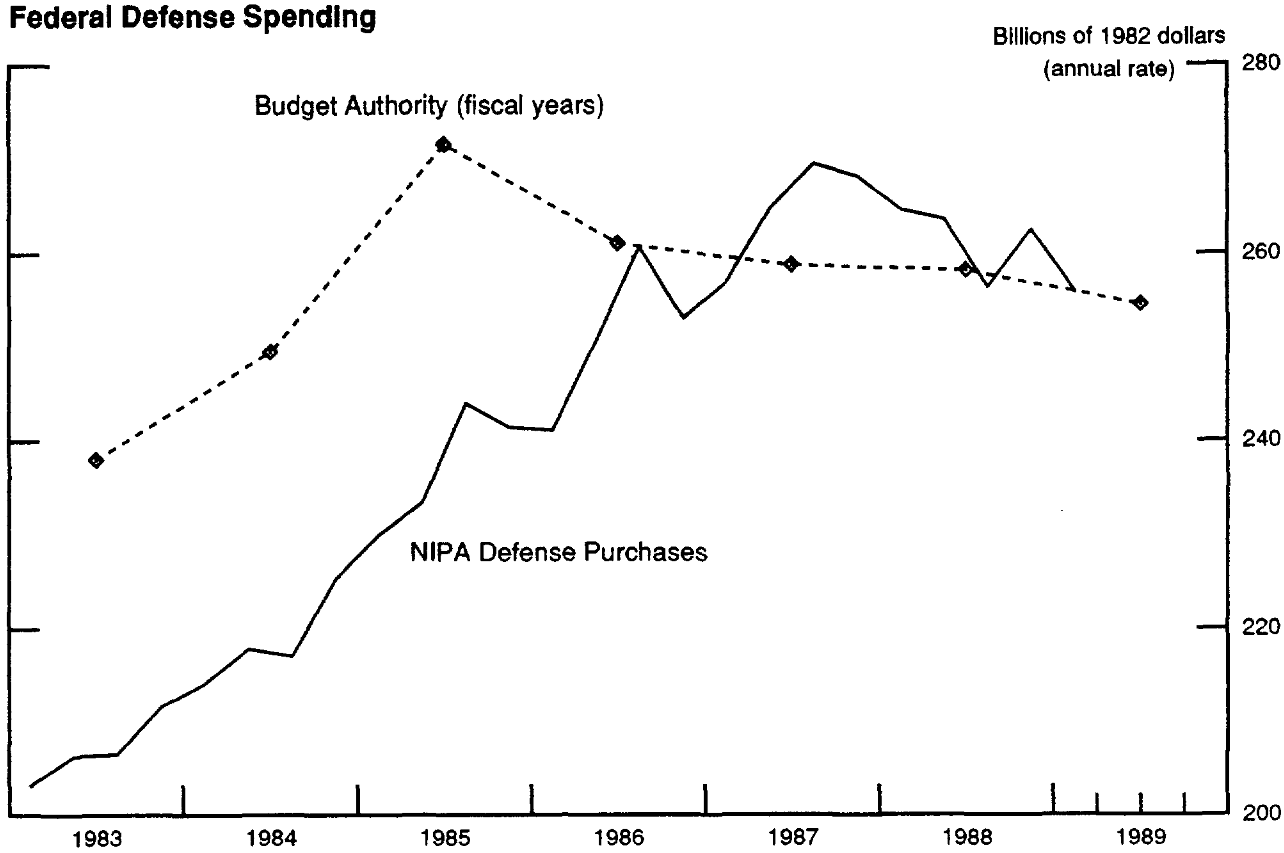
both the Senate and the House of Representatives have passed their respective versions of the Congressional budget resolution, the first step toward implementing the bipartisan agreement. Once a single resolution is adopted, the stage will be set for specific appropriations and other substantive legislation.

State and Local Government Sector

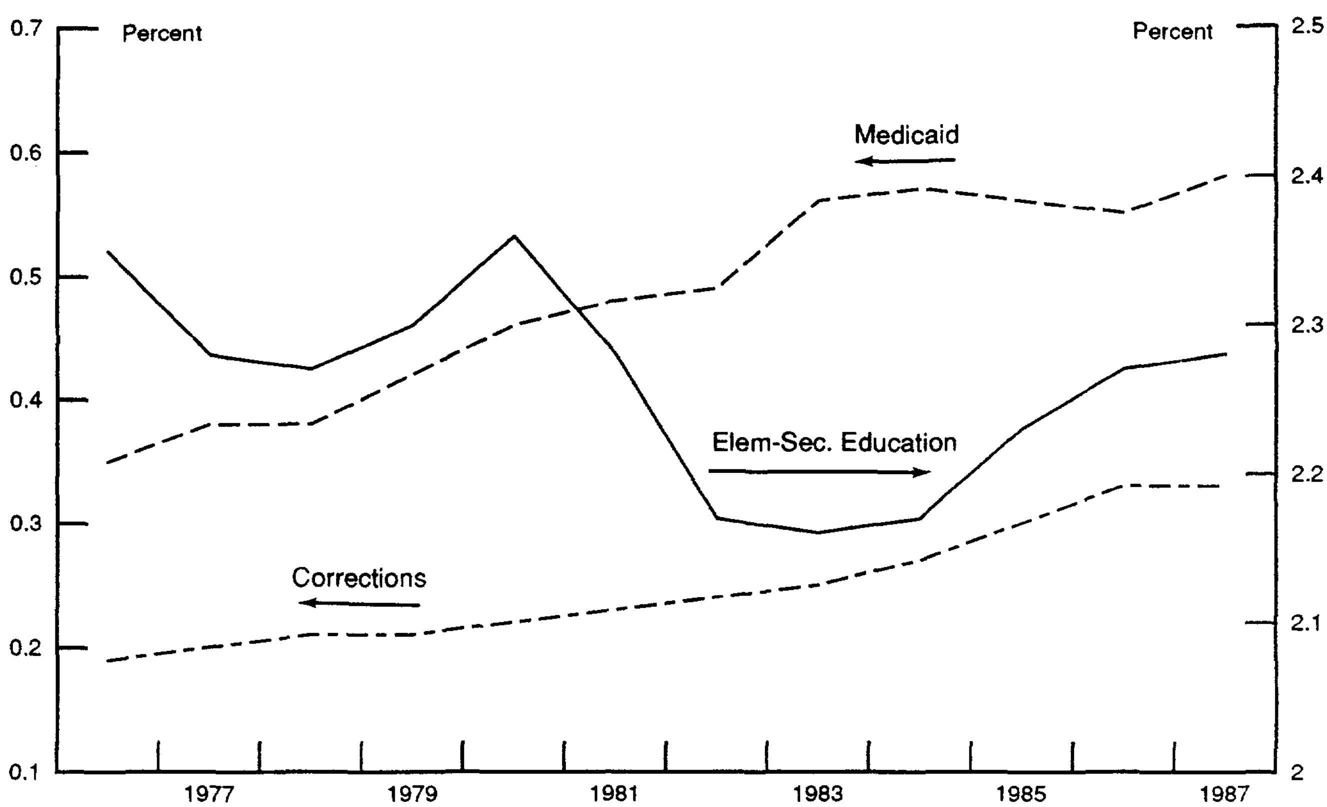
BEA estimated that real purchases of goods and services by state and local governments increased at a 4 percent annual pace in the first quarter, quite a bit below the 6 percent gain at the end of last year, but still robust. More recent data, however, indicate that real state and local construction expenditures declined at a 9-1/2 percent monthly rate in March (based on BEA seasonals), a much greater decline than that assumed by BEA at the time of the advance GNP estimates. These data suggest that quarterly growth in total real purchases will be revised down, probably to around 2-1/2 percent; this represents a downward revision to real purchases of $1-1/2 billion.

For the first quarter as a whole, the fiscal situation for the sector appeared to deteriorate further, as the deficit on operating and capital accounts (excluding social insurance funds) probably increased to about $18 billion or so (FRB staff estimate), compared with an annual average of $13 billion in calendar year 1988 and less than $10 billion in 1987. The pressure on state and local budgets appears to have several origins. Among state governments, most categories of spending have increased relative to personal income. Spending in three key areas--Medicaid, corrections, and education (chart)--is likely to be driven still higher by various government

Federal Defense Spending



Selected Components of State Spending, as a Percent of Personal Income



Note: State spending from own sources, except for corrections which includes some spending from federal aid.
Source: National Conference of State Legislatures.

mandates already in place.[10] As yet, few state governments have moved aggressively to increase broad-based taxes or reduce spending in other areas, raising the prospect that operating and capital accounts may remain in deficit for some time.

Prices

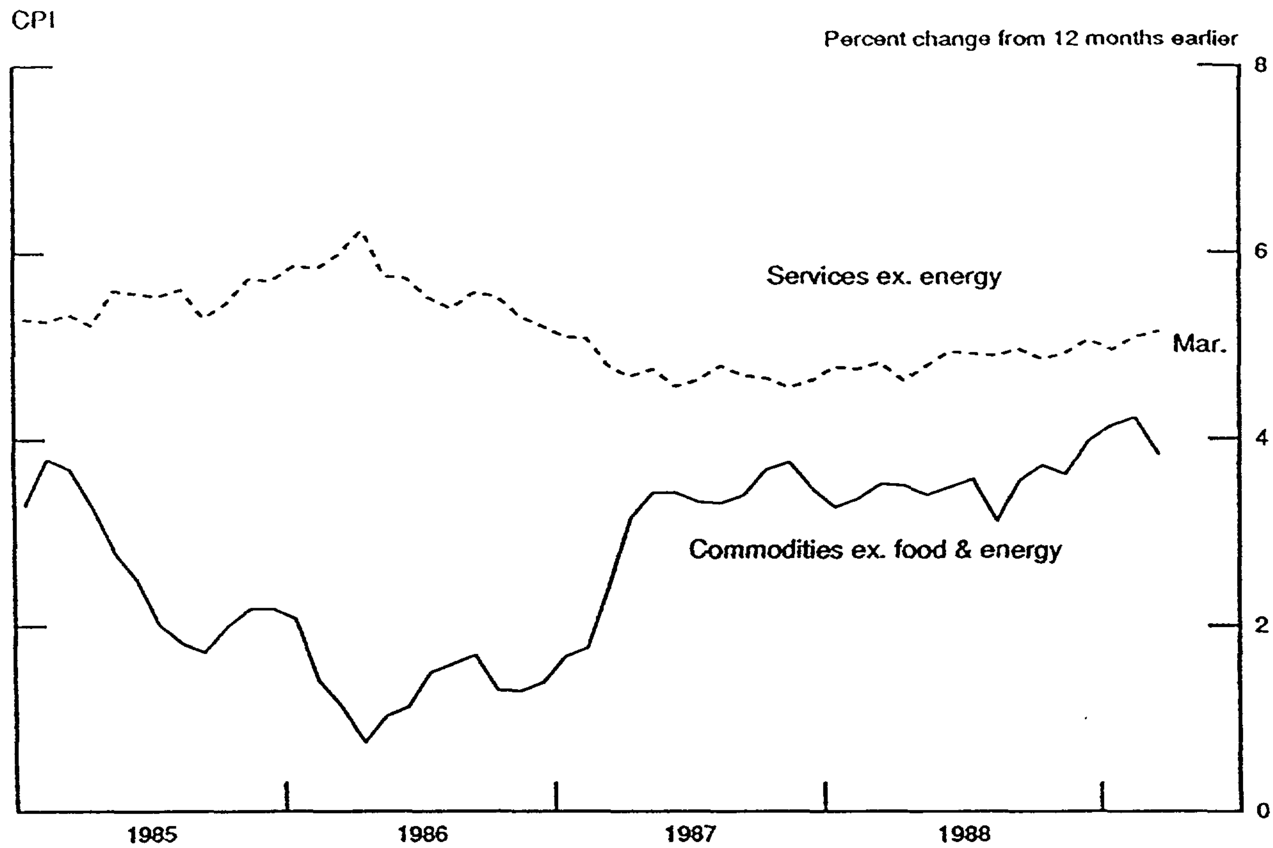
The CPI for all urban consumers rose 0.5 percent in March, equal to the average January-February pace. The PPI for finished goods increased 0.4 percent in March, after surging 1 percent in each of the preceding two months. Over the first three months of the year, these measures rose at annual rates of about 6 percent and 10 percent respectively. Upward pressures on food and energy prices were the principal factors boosting inflation in the first quarter. But the acceleration was not limited to food and energy: Price increases picked up for consumer services and, at the producer level, for other consumer goods and for capital equipment.

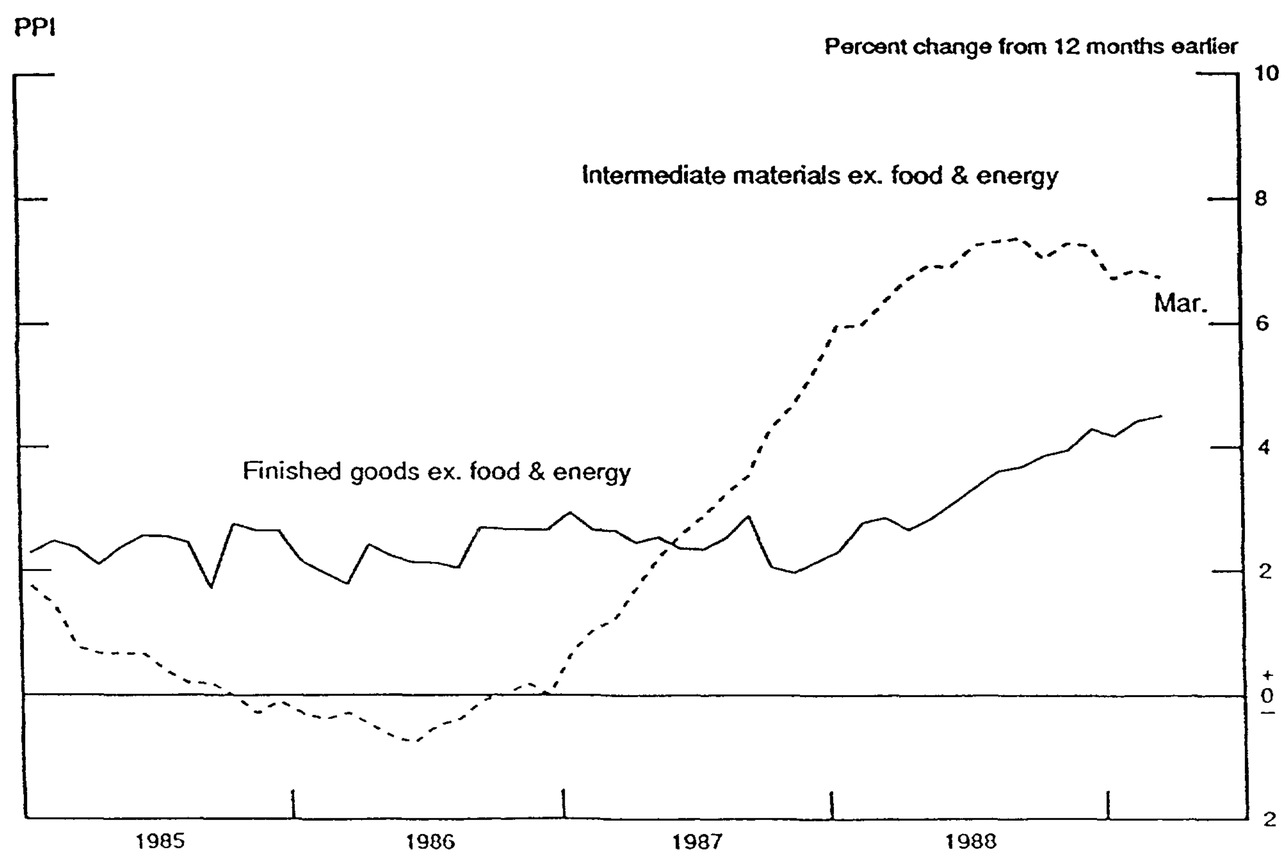
Excluding food and energy, the CPI rose 0.4 percent in March, the same as in February. The commodities component increased 0.3 percent, as a marked decline in prices for house furnishings offset much of an increase in apparel prices associated with the introduction of higher-priced spring and summer clothing.[11] The seasonal pattern of recent years, which is not yet fully reflected in the adjustment factors, suggests that the April CPI could show another sizable increase for apparel.

10. Medicaid costs have increased owing to the escalation in medical prices, and an expansion in the scope of federal coverage and services. In the area of corrections, prison populations have swelled, partly in response to stricter sentencing policies, and courts have been setting population limits and other conditions on confinement. Similarly, for education, state and local governments are faced with rising school enrollments along with legislative pressures to improve educational achievement.

11. The drop in prices for house furnishings could reflect the lowering of prices at Sears.

Recent Inflation Trends





So far this year, the CPI for nonfood nonenergy commodities has risen at about a 4 percent annual rate, similar to the stepped up pace observed in 1988. Recent data indicate that pressures from import prices have eased, at least for the present, while prices of domestically produced goods have continued to accelerate. According to the latest BLS report, price increases for imported consumer goods slowed considerably; over the twelve months ended in March, these prices increased 3-1/2 percent, about half the pace of the preceding year. In contrast, domestic producer prices of finished consumer goods (nonfood, nonenergy) accelerated more than 1 percentage point to a 6 percent annual rate during the first quarter. Some of the first-quarter pickup reflects higher automobile prices and likely will be reversed, at least in part, as the recent expansion of incentive programs is reflected in the PPI. Nevertheless, producer prices accelerated in the first quarter for a variety of other consumer goods, notably for recreational products, home electronic equipment, and alcoholic beverages.

A pickup also was evident in the first quarter in the CPI for nonenergy services, up at about a 6 percent annual pace, compared with a 1988 increase of 5 percent. The acceleration included a sharp jump for lodging out of town, in part reflecting an atypical and likely temporary pattern of seasonal rates.[12] But prices also accelerated in the first quarter for a broad range of services, including the medical and entertainment categories.

Capital equipment prices were up about 5 percent in the first quarter, compared with an increase of 3-1/2 percent last year. Price increases were

12. One contributing factor was a late ski season in the West, so that "in-season" rates there remained in effect longer than usual.

particularly large for new cars, transformers, pumps and compressors, and construction and paper industry machinery.

In contrast to greater price pressures among finished goods and services, price inflation has eased a bit at the intermediate level, the easing likely associated with the firmer dollar and some slowing in demand for industrial materials. The PPI for intermediate materials (nonfood, nonenergy) rose at a 6-1/4 percent rate during the first quarter, somewhat below the average 1988 pace. However, some renewed upward pressures could emerge in the months ahead, as higher crude oil costs are passed through into prices of petrochemicals and other petroleum-based products.

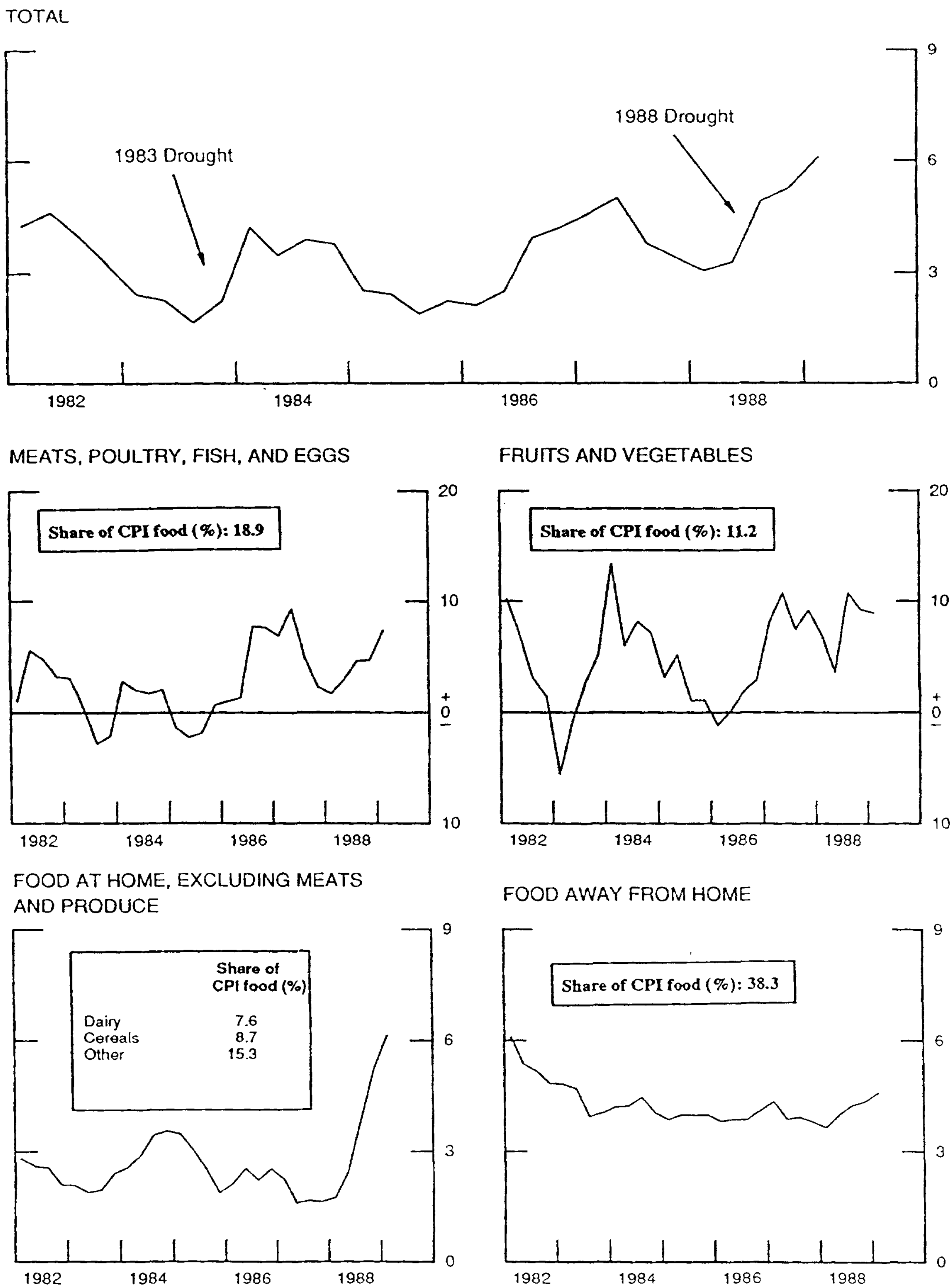
The PPI for crude nonfood materials less energy increased at nearly an 18 percent annual rate in the first quarter. However, smoothing through the considerable quarterly fluctuations, these prices have risen about 6 percent over the past year. Since March, prices in spot commodity markets have, on balance, registered relatively small net changes, although the longer-run trends still show these prices rising a bit faster than overall inflation. The patterns among commodities have diverged widely, as prices rebounded for aluminum, rose further for tin and cotton, and dropped back for hides and zinc.

Food Prices. Consumer food prices rose 0.8 percent in March, bringing the year-over-year rise in the first quarter to a bit above 6 percent. Some of the recent runup in retail food prices is attributable to higher retail prices for meats and produce. These prices are especially sensitive to changes in farm product values, which rose sharply in the first quarter.[13]

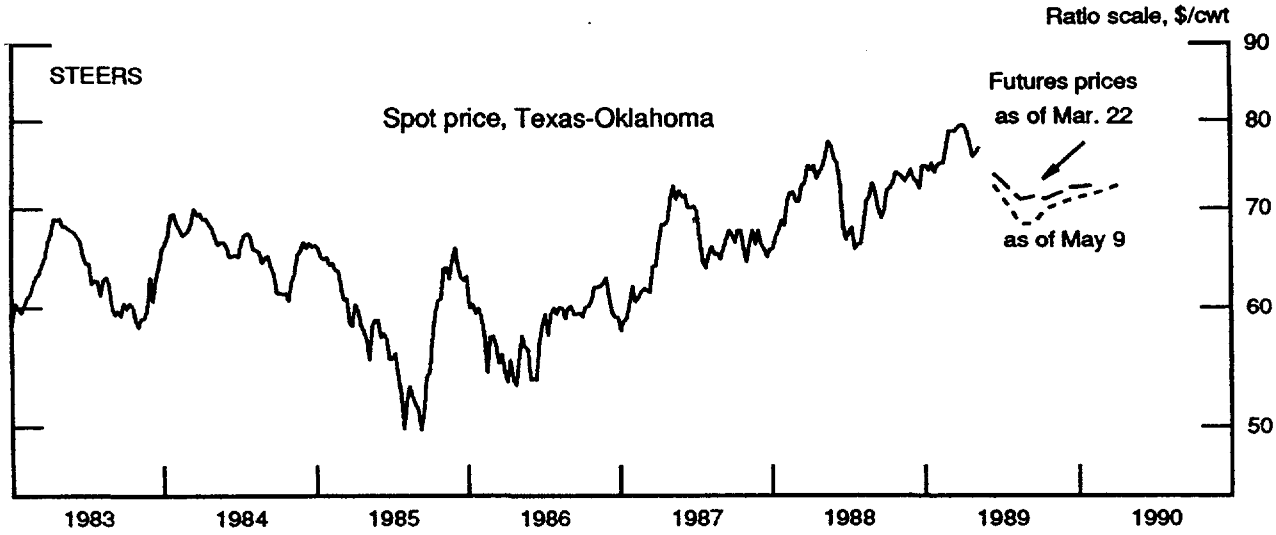
13. The farm value of retail prices for meats is roughly one-half; and for produce, farm product value added is about one-third.

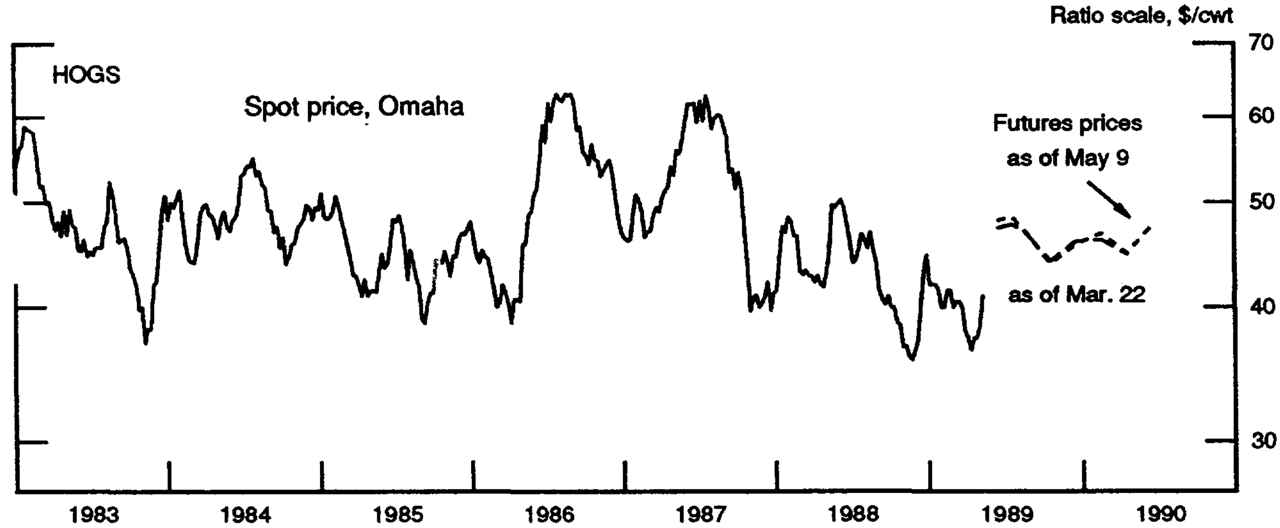
Consumer Price Indexes for Food

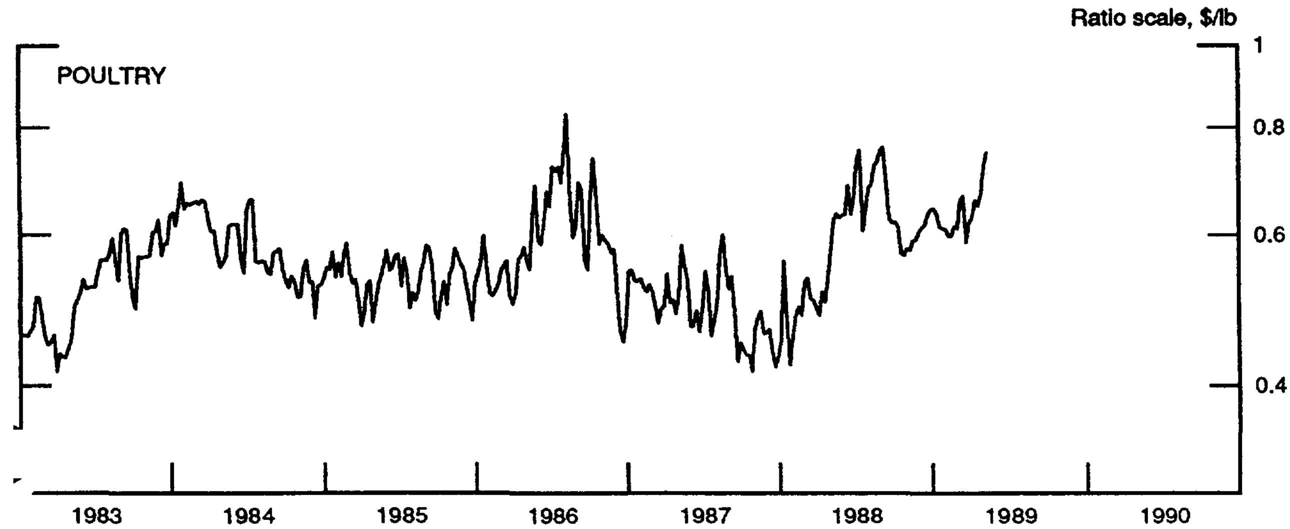
(Percent change from year earlier)



Livestock Prices
(Not seasonally adjusted)







However, the upward pressures on retail food prices do not seem to have come solely from farm prices. Retail prices of foods other than meats and produce, which account for more than two-thirds of the CPI for food and are relatively more sensitive to changes in labor and packaging costs, have accelerated nearly 4 percentage points from a year ago.[14] Prices for food consumed away from home, for instance, are influenced more by labor costs than by farm product prices and have accelerated about 1 percentage point over the past year.

Looking ahead, the deterioration in underlying trends in food price inflation is likely to be obscured by the more favorable developments at the farm level, a pattern that is roughly consistent with that observed after the 1983 drought and the more localized drought in 1986. Sizable movements of cattle into feedlots have helped depress spot and futures prices lately and should ensure that supplies of beef will be ample in coming months. However, futures quotes for hogs suggest that traders expect prices to rebound from recent declines, partly reflecting seasonal price swings as well as some diminished supply stemming from the current trimming of herds. Retail prices for pork likely will follow a smoother path than spot prices because retailers have maintained high margins for pork over the past few months. Although broiler prices have been strong this year, the USDA forecasts that production will expand about 4 percent, which should push prices down later in the year.

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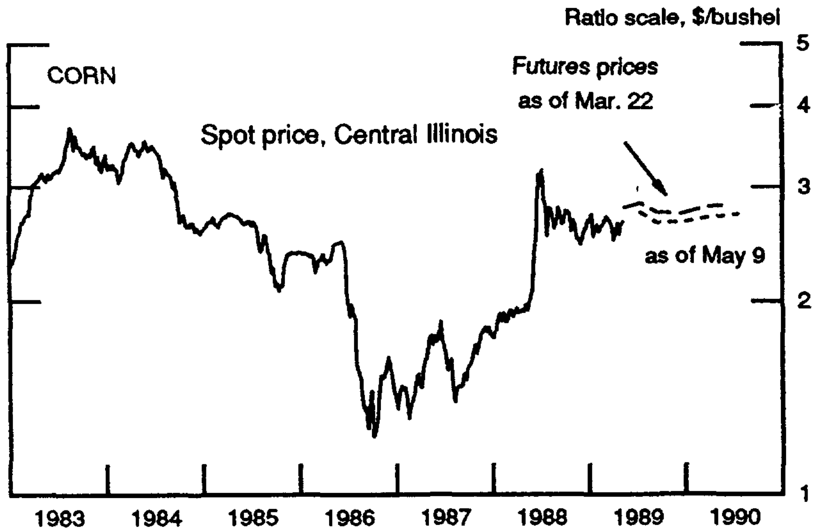
14. Of course, the lingering effects from last summer's drought may be contributing to the relatively large increases in prices for foods such as dairy products, cereal and bakery products, and fats and oils. However, even for these food groups, farm inputs account for a relatively small share of retail value, and the large price increases that have occurred this year probably also reflect rising costs for nonfarm inputs.

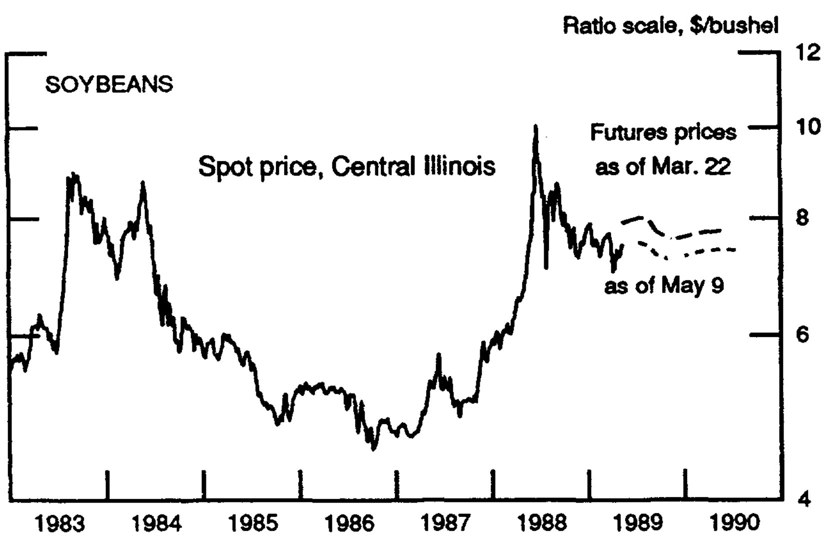
Farm Crop Prices
(Not seasonally adjusted)



Corn Production

	Acres planted (millions)	Yield (bushels per acre)
1986	76.6	119.3
1987	65.7	119.4
1988	67.6	84.6
1989	73.3*	n.a.

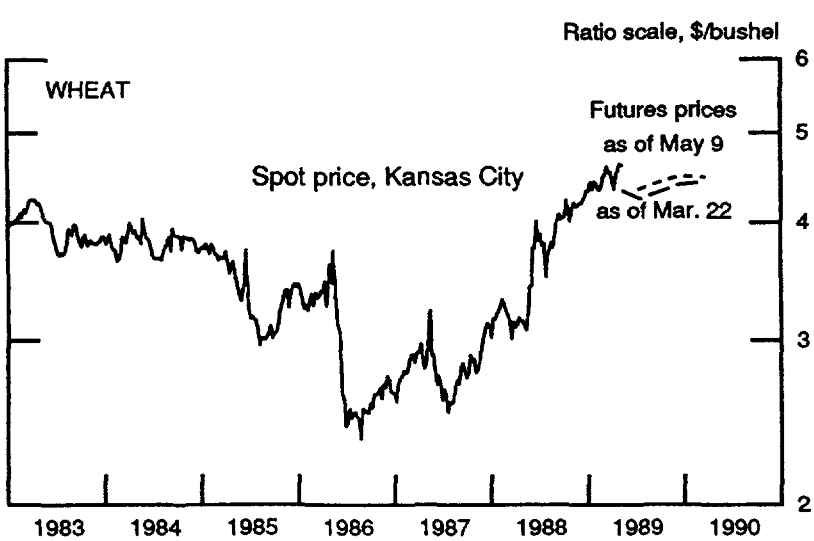
* Farmers' intentions, as of March 1989.



Soybean Production

	Acres planted (millions)	Yield (bushels per acre)
1986	60.4	33.3
1987	58.0	33.7
1988	58.9	26.8
1989	61.7*	n.a.

* Farmers' intentions, as of March 1989.



Wheat Production

	Acres planted (millions)	Yield (bushels per acre)
1986	72.1	34.4
1987	65.8	37.7
1988	65.5	34.1
1989	74.3*	n.a.

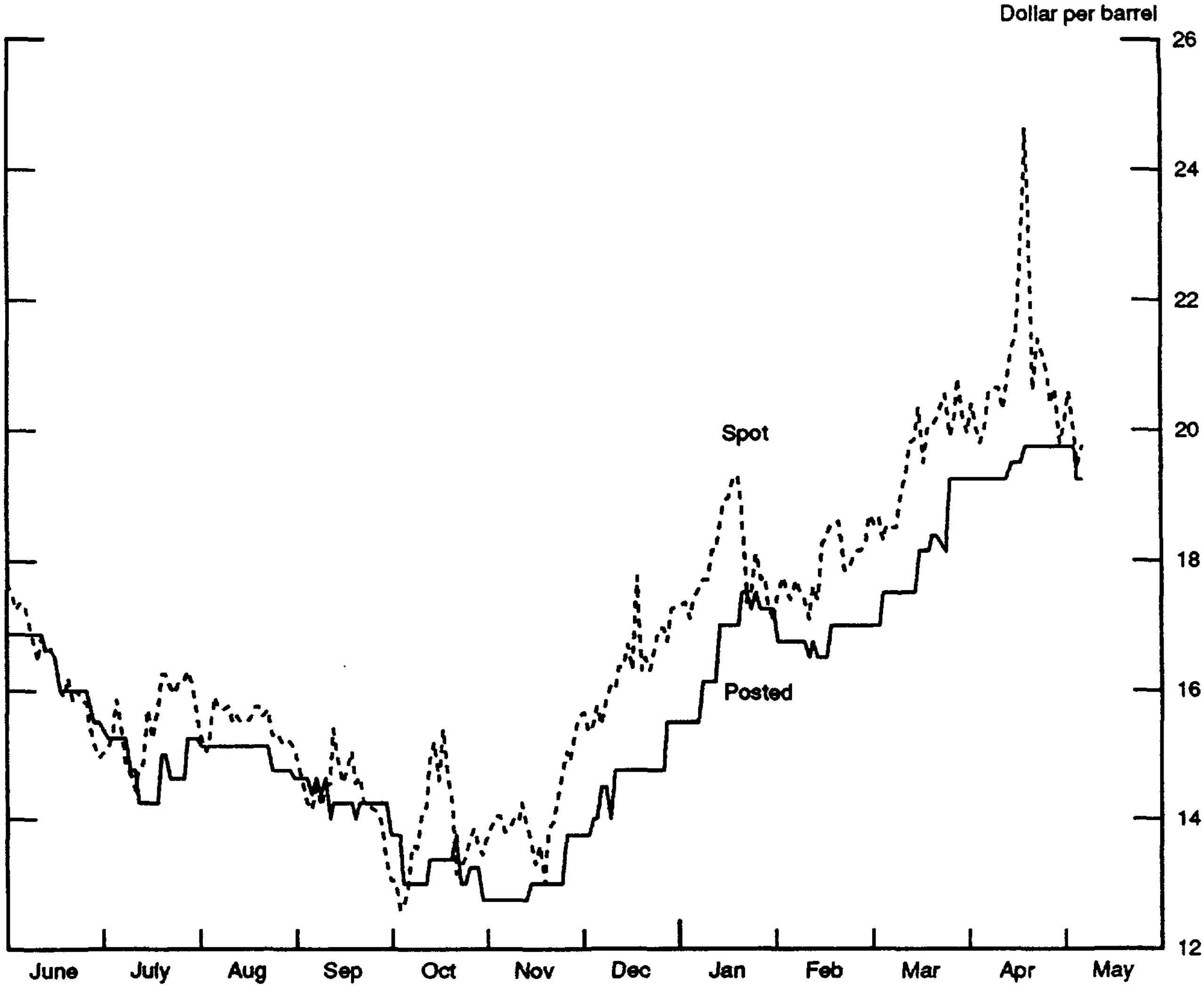
* Farmers' intentions, as of March 1989.

At this early point in the current growing cycle, a significant rebound in overall crop production seems likely, although drought still is affecting some regions. Acreage set-asides that are required for farmers to receive government subsidies have been reduced this year, and the acreage that farmers plan to devote to the major grain crops has increased. In addition, moisture conditions have improved in several areas. However, the condition of the winter wheat crop is poor in Kansas and fair elsewhere, and at this time it appears that wheat stocks may remain relatively tight for another year. Moreover, with recent major grain purchases by the Soviet Union, and with grain demand likely to remain strong for rebuilding inventories worldwide, the runups in futures prices for delivery after the 1989 harvest that resulted from last year's drought have not reversed.

Energy Prices. Consumer energy prices rose more than 1 percent in March and were up 5-3/4 percent at an annual rate in the first quarter. On a quarterly average basis, gasoline prices rose only 6-1/4 percent at an annual rate in the first quarter. In addition, prices for heating oil and for natural gas have advanced sharply in recent months, rising at annual rates of 23-1/4 and 9-1/4 percent respectively in the first quarter.

Recent developments suggest that energy prices will accelerate markedly in the second quarter, followed by a partial reversal in the second half of this year. The Alaskan oil spill and a major platform accident in the North Sea (both of which occurred after mid-March) have reduced non-OPEC oil production, while OPEC countries have restrained output; the resulting shortfall of crude oil has forced prices up to their highest levels since early 1986. The posted price of West Texas Intermediate (the benchmark crude oil in the United States), for instance, has risen from roughly $17

Daily Spot and Posted Prices of West Texas Intermediate



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

MONTHLY AVERAGE PRICES—WEST TEXAS INTERMEDIATE

Month	Posted	Spot
June	16.44	16.53
July	14.81	15.50
August	15.06	15.52
September	14.33	14.47
October	13.29	13.80
November	12.98	13.98
December	14.55	16.27
January	16.68	17.98
February	16.79	17.83
March	17.93	19.45
April	19.46	21.04
May *	19.61	20.05

* Price through May 9, 1989.

per barrel in mid-March to just under $20 per barrel. These higher crude oil costs likely will be passed on to consumer prices in the next few months.

It should be stressed, however, that crude oil production in the North Sea is expected to return to full capacity by the end of May, and Alaska production already has returned to full capacity; hence, the impact of these accidents on crude oil prices probably will be temporary. Consistent with this view, futures prices for crude oil to be delivered in June have been running about $3 per barrel higher than oil to be delivered in December.

On a somewhat different note, EPA's March ruling on gasoline Reid Vapor Pressure (RVP), designed to control summertime smog problems, likely will accentuate the pattern in energy prices this year. (Moreover, seven Northeastern states recently have been granted waivers to apply even tighter RVP standards than those mandated in March.) To produce less volatile gasoline requires higher crude oil inputs, creating additional demands on the U.S. refining industry at a time when refinery capacity already is tight. Moreover, several recent refinery problems in the West have further tightened gasoline markets, contributing to a drawdown in gasoline inventories as we enter the summer driving season.[15]

The staff estimates, albeit with substantial uncertainty, that the tighter summertime RVP standards will push gasoline prices up an additional

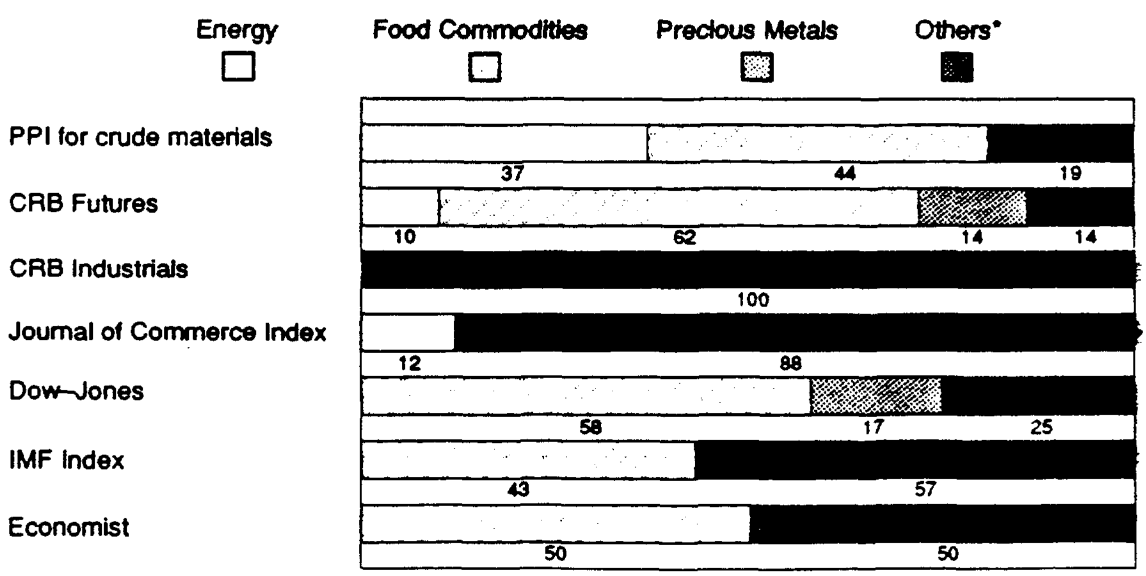
15. In March, an explosion at a refinery in California cut refinery capacity by roughly 40,000 barrels per day. In addition, many of the refineries along the West Coast typically process Alaskan crude, and they were forced to operate at reduced levels following the Alaskan oil spill until alternative crude oil supplies could be acquired. These events contributed to a drawdown of gasoline inventories in the past month, particularly in the West, creating further upward pressure on gasoline prices.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last Obser-vation	Percent change[2] 1987	1988	1989 To Mar. 21	Mar. 21* To Date	Memo: Year Earlier To Date
1. PPI for crude materials[3]	Mar.	8.9	2.8	6.3	n.a.	9.6
1a. Foods and feeds	Mar.	1.8	14.2	3.8	n.a.	13.9
1b. Energy	Mar.	10.7	-9.4	9.7	n.a.	6.6
1c. Ex. food and energy	Mar.	22.6	6.0	4.9	n.a.	6.1
1d. Ex. food and energy, seas. adj.	Mar.	22.8	5.9	4.2	n.a.	6.1
2. Commodity Research Bureau						
2a. Futures prices	May 9	11.7	8.5	-2.0	-2.3	2.0
2b. Industrial spot prices	May 8	19.2	7.3	5.0	-1.0	9.6
3. Journal of Commerce industrials	May 9	10.7	3.8	2.6	.9	7.1
4. Dow-Jones Spot	May 9	17.0	6.9	-3.3	.0	5.5
5. IMF commodity index[3]	Mar.	30.8	12.6	-1.2	n.a.	9.6
5a. Metals	Mar.	51.9	33.7	-1.7	n.a.	16.9
5b. Nonfood agric.	Mar.	47.5	-9.4	-.4	n.a.	-2.6
6. Economist (U.S. dollar index)	May 2	42.5	17.7	-5.8	-1.9	3.4
6a. Industrials	May 2	62.6	18.9	-7.8	-1.6	-.7

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

Index Weights



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

4 cents per gallon this summer, adding to the near-term acceleration in energy prices. However, because the new volatility measures apply only in the summer, gasoline prices should retrace the RVP effects in the fourth quarter, adding to the anticipated deceleration in energy prices in the second half.

APPENDIX

BUDGET UPDATE: THE BIPARTISAN AGREEMENT AND BUDGET RESOLUTIONS

The President and the bipartisan leadership of the Congress announced on April 14 an agreement on the broad outlines of a budget plan for fiscal year 1990. The deficit in this agreement is estimated to be $99.4 billion, premised largely on the same economic and technical assumptions as used by President Bush in his February plan. As shown in table 1, this deficit is $8 billion above the corresponding deficit proposed by the President, reflecting higher nondefense spending in the bipartisan agreement.

The structure of the recent compromise generally follows the pattern of the 1987 budget summit. Like that agreement, this year's compromise specifies a level of defense appropriations--$303.5 billion, little changed in nominal terms from the FY89 level of $298.8 billion--and a level of outlays expected to be associated with these appropriations.[1] It also determines a level of discretionary spending for international affairs, which allows for roughly $2 billion more gross discretionary spending than in 1989. Finally, in the area of domestic spending, the agreement calls for changes in a few entitlement programs, increases in user fees, and new sales of asset, and caps the total amount of annual appropriations (and associated outlays) for all domestic discretionary programs.

Given the planned deficit-reducing actions (shown in table 2), total outlays are estimated in the agreement to rise by $23 billion from FY89 levels, about half the average annual increase registered during the current cyclical expansion. The agreement trims $22 billion from the CBO baseline (essentially current services) that will be used for keeping score of legislative actions in the Congress.[2] In addition, the agreement calls for $5.3 billion of unspecified revenue raising measures and assumes that

1. In deriving these outlays, the Agreement adopted CBO's slower spendout rates. This lowers outlays for 1990 by $3.5 billion compared with OMB estimates, as indicated in the estimating adjustments line of table 1 (second column), but would raise outyear spending correspondingly.

2. This baseline represents an extrapolation of current laws and policies into FY90 using CBO's economic and technical estimating assumptions. Receipts are projected for FY90 under current tax laws, implying year-to-year growth of $86 billion, given CBO's assumed income growth. Estimated spending for entitlements rises to allow for projected increases in beneficiaries and for cost-of-living adjustments; all other spending grows as implied by maintaining a constant real value of appropriations between FY89 and FY90, except that about $1 billion was added for FY90 to cover special program costs such as the decennial census. Total outlays in this CBO baseline rise by $74 billion between FY89 and FY90. The deficit in the agreement, calculated on the same assumptions as this baseline, would be $19.9 billion higher than the $99.4 billion level shown using administration assumptions (see the estimating adjustment in table 1, third column). Both OMB and CBO estimates assume that resolution of the thrift problem will be essentially off-budget, as proposed by the President.

strengthened tax enforcement would yield a further $0.5 billion. Taken together with the spending constraints, the plan calls for $28 billion of deficit reduction, measured from the CBO baseline.

Within the broad outlines of the bipartisan agreement, the Senate and the House each have passed budget resolutions that ratify the levels of spending for defense and international affairs, distribute domestic spending across the other budget functions, and incorporate the planned increases in revenues. The domestic spending priorities reflected in these resolutions are indicated in table 3 by the pattern of small changes in domestic discretionary spending from baseline levels. Both houses aim to raise spending on science and to hold spending increases for such broad areas as energy, resource management, transportation, and community development below the rate of inflation. The House assigns higher priority to education, while the Senate would put greater emphasis on criminal justice. Both resolutions contain reconciliation instructions, directing other committees of the Congress to formulate legislation that would reduce costs of farm price supports and Medicare and raise user fees and general revenue.

Table 1

BUDGET PLANS FOR FY90
(Billions of dollars)

	Bush plan (Feb. 9)	Bipartisan agreement (OMB est.)	CBO estimates	
			Bipartisan agreement	Change from baseline[1]
Receipts	1065.6	1065.7	1074.4	+5.8
Outlays, total[1]	1156.7	1168.7	1193.8	-22.2
Defense	300.3	299.2	299.2	-4.2
International	17.2	16.7[2]	16.7[2]	.0
Interest	173.3	173.2	181.0	-1.1
All other	665.9	679.6	696.9	-16.9
Deficit, before adj.	-91.1	-103.0	-119.4	+28.0
less: estimating adjustments	n.a.	3.5		
Deficit	-91.4	-99.4		
Memo:				
Deficit, ex. asset sales	-94.8	-105.1		

n.a.--not applicable.
1. With asset sales.
2. Includes estimated effects of loan repayments; discretionary component of spending specified in agreement is $17.0 billion.

Passage of a single resolution by both houses of the Congress--once a conference compromises the differences--will set the stage for enactment of regular appropriation bills and of a reconciliation bill that will implement aspects of the budget agreement. Achievement of an agreement at this time is permitting the budget process to proceed more expeditiously than has been the case in a number of recent years. However, several hurdles remain before the intended deficit reduction is actually achieved and the budget process for FY90 is completed. First, appropriations must be held within bounds if budget targets are to be realized. The Congress has given some recent indication of being serious about budget restraint by sending back to committee a costly supplemental appropriation bill for FY89. Second, agreement must be achieved on specific measures to meet the objective of raising $5.3 billion of additional revenue. Third, specific steps must be legislated to reduce entitlement spending and other types of outlays.

These steps may vary considerably in their economic consequences. Putting the Postal Service off-budget is one action planned in the agreement that will have no fundamental economic effect (and will not change the NIPA accounts). Some reports have suggested that a significant proportion of the remaining spending constraint also could be implemented by changes in timing or accounting that would have little fundamental or lasting economic effect;

Table 2

COMPOSITION OF FY90 DEFICIT REDUCTION
(Deficit effect compared with CBO baseline, billions of dollars)

Outlay reductions from baseline	
Defense	4.2
International affairs	.0
Interest	1.1
Entitlements and mandatory spending (gross)	
Medicare	2.7
Agriculture	1.9
Pension and miscellaneous reforms	.7
Other entitlements	1.1
Discretionary programs (gross)	.3
User fees and offsetting collections	2.7
Asset sales	5.7
Postal service off-budget	1.8
Subtotal, outlays	22.2
Revenue measures and improved collections	5.8
Total deficit reduction	28.0

however, the exact nature of these measures will remain uncertain until the legislative process is further advanced.

The bipartisan agreement specifies that $5.7 billion of deficit reduction is to be achieved by further sales of assets; these sales, which have tended to fall short of plans in the past, are a one-time deficit reduction that does not count toward achieving Gramm-Rudman deficit targets. Thus, the deficit foreseen in the current budget compromise, calculated on a Gramm-Rudman accounting basis, is about $105 billion. This estimate implies only a $5 billion margin for error in achieving legislative goals for budget restraint--or for any upward reestimates in the August sequester report--if the $110 billion trigger for sequester is to be avoided.

On balance, the bipartisan agreement seems likely to provide a small amount of additional fiscal restraint in 1990. (Some restraint already had been set in place by the lagged effects of previous declines in real defense

Table 3

FY90 DOMESTIC SPENDING PRIORITIES[1]
(Discretionary spending, billions of dollars)

	Change from CBO baseline	
	Senate	House
Science	+.4	+.6
Energy, natural resources, and agriculture (excluding entitlements)	-.6	-.7
Commerce, transportation, and community development	-.3	-.2
Education, health, income security, and veterans (all excluding entitlements)	+.1	+.7
Justice and general government	+.2	-.5
Total	-.3	-.3
Memo:		
	FY89	FY90
Level of budget authority for domestic discretionary programs	142.8	157.5
Level of outlays for these programs	170.2	181.3

1. Details may not add to totals because of rounding. Increases in budget authority considerably exceed changes in outlays provided for transportation, education, health, and justice in the Senate, and for education, health, and income security in the House.

appropriations and the step up in social security tax rates scheduled for the first of January.) Nonetheless, the agreement does not make much progress on a multiyear budget strategy. Indeed, the President and congressional leadership are committed in the agreement to continued consultation on further deficit reduction.

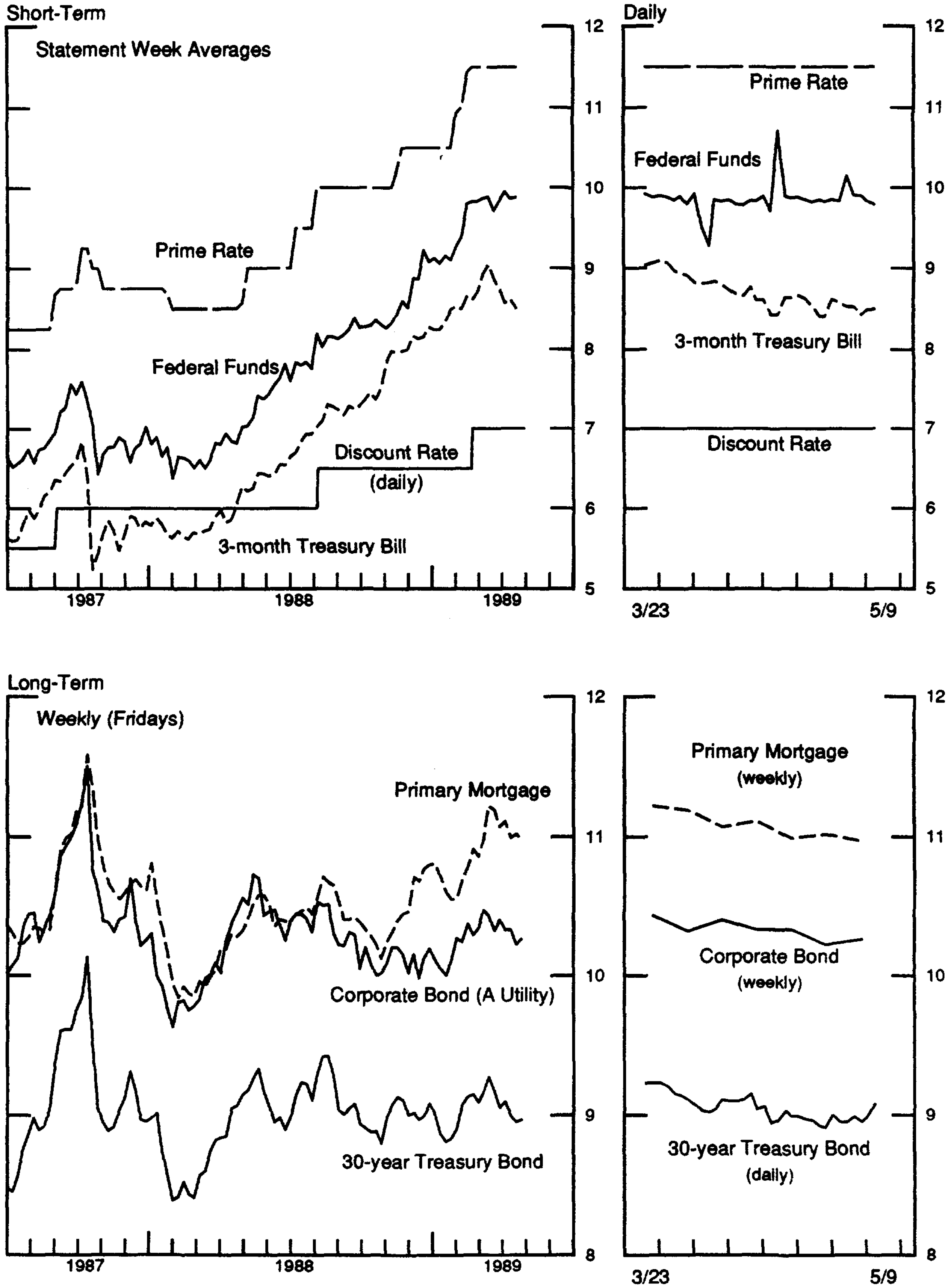
SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

	1987 Oct. 16[2]	1988 Feb lows	1989 FOMC Mar 28	1989 May 9	Change from: Feb 88 lows	Change from: FOMC Mar 28
Short-term rates						
Federal funds[3]	7.59	6.38	9.85	9.87	3.49	.02
Treasury bills[4]						
3-month	6.93	5.59	9.07	8.50	2.91	-.57
6-month	7.58	5.77	9.12	8.50	2.73	-.62
1-year	7.74	6.10	8.99	8.47	2.37	-.52
Commercial paper						
1-month	7.94	6.41	10.00	9.69	3.28	-.31
3-month	8.65	6.45	10.08	9.63	3.18	-.45
Large negotiable CDs[4]						
1-month	7.92	6.44	10.00	9.70	3.26	-.30
3-month	8.90	6.49	10.21	9.74	3.25	-.47
6-month	9.12	6.55	10.60	9.79	3.24	-.81
Eurodollar deposits[5]						
1-month	8.00	6.44	10.06	9.75	3.31	-.31
3-month	9.06	6.50	10.31	9.81	3.31	-.50
Bank prime rate	9.25	8.50	11.50	11.50	3.00	.00
Intermediate- and long-term rates						
U.S. Treasury (constant maturity)						
3-year	9.52	7.28	9.80	9.16	1.88	-.64
10-year	10.23	8.11	9.41	9.15	1.04	-.26
30-year	10.24	8.32	9.20	9.08	.76	-.12
Municipal revenue[6] (Bond Buyer)	9.59	7.76	7.95	7.63	-.13	-.32
Corporate A utility (recently offered)	11.50	9.63	10.40	10.36	.73	-.04
Home mortgage rates[7]						
S&L fixed-rate	11.58	9.84	11.22	10.97	1.13	-.25
S&L ARM, 1-yr.	8.45	7.59	9.30	9.36	1.77	.06

	1987 Record highs	1987 Lows	1989 FOMC Mar 28	1989 May 9	Percent change from: Record highs	Percent change from: FOMC Mar 28
Stock prices						
Dow-Jones Industrial	2722.42	1738.74	2275.54	2371.33	-12.90	4.21
NYSE Composite	187.99	125.91	163.88	170.80	-9.14	4.22
AMEX Composite	365.01	231.90	325.45	345.09	-5.46	6.03
NASDAQ (OTC)	455.26	291.88	402.60	428.97	-5.77	6.55

1. One-day quotes except as noted.
2. Last business day prior to stock market decline on Monday, October 19, 1987.
3. Average for two-week reserve maintenance period closest to date shown except Feb. low which is the average for the statement week ended 2/10/88. Last observation is average-to-date for maintenance period ending 5/17/89.
4. Secondary market.
5. Bid rates for Eurodollar deposits at 11 a.m. London time.
6. Based on one-day Thursday quotes and futures-market index changes.
7. Quotes for week ending Friday closest to date shown.

*Selected Interest Rates**
(percent)



*--Friday weeks through May 5, Wednesday weeks through May 3.

Federal funds have continued to trade generally in the 9-3/4 to 9-7/8 percent range, but other market interest rates have declined considerably since the previous FOMC meeting in the wake of reports suggesting that economic activity has decelerated. Key Treasury bill rates have fallen more than 1/2 percentage point, while yields on longer-term notes and bonds have fallen 1/8 to 1/4 of a point. Rates on private market instruments also have declined across the maturity spectrum, but spreads between private and Treasury yields have widened slightly. Meanwhile, share prices have touched new postcrash highs.

Expansion of the broader monetary aggregates remained sluggish in April, and run-offs in M1 deposits quickened. Among the nontransactions components of the broader aggregates, the relatively liquid components weakened further, while small time deposits accelerated from their already rapid pace. The opportunity costs of holding liquid accounts remain large, but those on small time deposits have become quite small at banks and disappeared at thrifts. In addition, overall weakness in M2 growth may reflect use of balances to meet unexpectedly large tax obligations and shortfalls in refunds.

Overall demand for credit may have moderated in April. In the nonfinancial business sector, public bond offerings fell off sharply, while borrowing from banks and issuance of commercial paper picked up from the March pace. Growth in total business credit appears to have slackened from the first-quarter pace, with a drop-off in net equity retirements following the bulge associated with the RJR-Nabisco deal. Long-term borrowing by state and local governments remains sluggish; the federal

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

	1988[1]	1988 Q4	1989 Q1	1989 Feb	1989 Mar	1989 Apr pe	Growth Q4 88- Apr 89pe
	------------Percent change at annual rates------------						
1. M1	4.3	2.3	-0.4	1.7	-1.7	-5	-1¼
2. M2	5.2	3.6	1.9	1.5	3.8	2	2
3. M3	6.3	5.0	3.8	2.9	6.7	4	4
	------------Percent change at annual rates------------						Levels bil. $ Mar 89
Selected components							
4. M1-A	2.5	1.7	-0.2	3.6	1.7	-6	507.2
5. Currency	8.1	6.6	7.0	5.1	7.3	2	215.6
6. Demand deposits	-1.2	-1.8	-5.5	3.4	-2.1	-13	284.3
7. Other checkable deposits	7.7	3.3	-0.7	-1.7	-7.7	-2	279.1
8. M2 minus M1[2]	5.5	4.1	2.7	1.4	5.7	4	2292.9
9. Overnight RPs and Eurodollars, NSA	-5.9	-9.2	15.7	-38.2	-22.8	-23	77.6
10. General purpose and broker/dealer money market mutual fund shares, NSA	7.4	9.5	21.2	28.8	44.1	17	256.5
11. Commercial banks	6.9	6.8	5.4	4.5	8.3	8	1000.7
12. Savings deposits, SA, plus MMDAs, NSA[3]	1.4	-1.7	-8.4	-14.0	-9.2	-15	528.7
13. Small time deposits	14.7	18.0	22.4	26.6	28.6	35	472.0
14. Thrift institutions	4.6	0.3	-3.1	-5.2	-4.1	-2	961.1
15. Savings deposits, SA, plus MMDAs, NSA[3]	-4.3	-8.6	-14.0	-20.6	-15.3	-31	372.4
16. Small time deposits	11.7	6.6	4.2	4.9	2.9	16	588.6
17. M3 minus M2[4]	10.6	10.0	10.7	8.0	17.2	11	875.2
18. Large time deposits	11.0	11.3	12.5	15.7	15.2	19	558.4
19. At commercial banks, net[5]	12.2	13.0	17.8	24.0	22.5	21	385.1
20. At thrift institutions	8.8	8.0	1.2	-2.1	-0.7	13	173.3
21. Institution-only money market mutual fund shares, NSA	-0.8	10.9	10.6	4.0	-26.8	4	87.6
22. Term RPs, NSA	15.0	8.4	10.1	29.3	24.0	-2	132.5
23. Term Eurodollars, NSA	13.3	9.8	-4.2	-5.9	62.7	-37	106.8
	-----Average monthly change in billions of dollars----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	4.9	4.7	5.3	9.3	7.7	1	659.6
25. Large time deposits, gross	3.3	3.2	5.8	5.4	6.3	6	446.6
26. Nondeposit funds	1.6	1.5	-0.5	3.9	1.4	-5	213.0
27. Net due to related foreign institutions, SA	-0.4	-0.5	0.5	2.7	-2.5	-7	8.1
28. Other[7]	2.0	2.0	-1.0	1.2	3.9	3	204.9
29. U.S. government deposits at commercial banks[8]	0.0	0.5	-1.5	0.0	0.0	0	20.3

1. Amounts shown are from fourth quarter to fourth quarter.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Commercial bank savings deposits excluding MMDAs grew during March and April at rates of -10.7 percent and -21 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during March and April at rates of -10.8 percent and -24 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
6. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
7. Consists of borrowing from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowing from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimate
8. Consists of Treasury demand deposits and note balances at commercial banks.

pe - preliminary estimate

government's need for cash has declined more than seasonally in the current quarter, with heavier-than-expected net revenues during the April-May tax period boosting the Treasury cash balance. Data on the household sector are sparse, but they suggest that the pace of growth in mortgage and consumer credit was little changed last month.

Monetary Aggregates and Bank Credit

In April, M2 and M3 grew at estimated annual rates of 2 and 4 percent, respectively, slower than in March but in line with their weak growth during the first quarter. M1 contracted at a 5 percent annual rate last month, after edging down in the first quarter. Relative to their annual target ranges, M2 remained just below and M3 remained just above the lower bounds of their cones.

The weakness in M1 was attributable both to sharp run-offs in demand deposits and to a deceleration in currency growth. Demand deposits have contracted noticeably on net this year; the contraction likely reflects a continuation of an underlying trend toward the use of fees in lieu of compensating balances as well as the high short-run interest elasticity of compensating balances. Outflows from other checkable deposits (OCD) moderated in April, because balances may have been boosted to cover income tax payments.

The deceleration of M2 growth in April resulted primarily from the weakness in M1, but growth in the nontransactions component also slackened somewhat. Outsized tax payments likely contributed to some weakness in M2. Futhermore, the sluggish adjustment of rates paid on savings deposits and money market deposit accounts (MMDAs) since the spring of 1988 has greatly increased the opportunity costs of holding these instruments. Recent declines in market interest rates have reduced these opportunity costs, but they remain substantial at about 3-1/2 and 2-1/2 percentage points for savings deposits and MMDAs respectively. By contrast, spreads between yields on market instruments and offering rates on small time deposits apparently have narrowed at commercial banks and have shifted in favor of small time deposits at thrift institutions, thereby likely contributing to the robust growth of these components of M2.

Much of the strength in the non-M2 components of M3 resulted from depositories substituting large time deposits for managed liabilities not encompassed by the monetary measures. At banks, net balances due to their foreign branches continued to contract in April. Several large, healthy S&Ls reportedly replaced advances from the Federal Home Loan Banks (FHLBs) with borrowings by their parent holding companies, which were downstreamed as time deposits. These funding decisions by large thrifts contributed to a leveling-off of advances in April after five months of very large increases that totaled about $30 billion.

Banks and thrifts continued to display marked differences in deposit flows in April. Although savings deposits and MMDAs fell at both sets of depositories, they generally declined more at thrifts, particularly those insured by the FSLIC. Also, inflows to small time deposits were much more rapid at banks than at thrifts, despite relatively more aggressive deposit pricing by thrifts. After dipping below 20 basis points in early March, spreads between rates on 6-month retail CDs offered by thrifts and by banks widened recently to about 50 basis points. Nevertheless, the continuing cloud cast by the FSLIC crisis likely offset some of the advantage implied by this rate spread and damped growth of small time deposits at FSLIC-insured thrifts. On balance, thrift institutions lost core deposits again in April, albeit at a slower rate than earlier this year. In large part, funds leaving thrifts apparently have gone either to commercial banks or to MMMFs, so that effects on M2 probably have been quite small.

Bank credit expanded at an estimated 3 percent annual rate in April, marking the second month of moderate growth since the February surge in loans associated with the buyout of RJR-Nabisco. Holdings of securities ran off slightly, and loan growth remained modest. Total loans in April were paced by robust real-estate lending. Merger-related financings boosted business loans early in the month, but much less than they did in February. Consumer loan growth picked up a bit despite securitization, which damped it about 2 percentage points, and despite stiff competition for new-car loans from auto finance companies. The timing of consumer and home-equity lending suggests such lending may have been bolstered by the need to cover unexpectedly large tax payments. Total loan growth was depressed by declines in the volatile security loans and "other loans" categories.

Business Finance

Available data indicate that total net borrowing by nonfinancial businesses in April was about in line with the reduced March pace, as faster growth of commercial paper and bank loans offset a fall-off in new public issues of corporate bonds. For the second quarter as a whole, credit demands stemming from corporate restructurings are expected to be substantially weaker than in the first quarter. With the bulk of the RJR-Nabisco financings completed, net equity retirements are projected to total

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

	1987:Q4 to 1988:Q4	1988 Q4	1989 Q1	1989 Feb.	1989 Mar.	1989 Aprilp	Levels bil.$ Aprilp
	---------- Commercial Bank Credit ----------						
1. Total loans and securities at banks	7.3	6.1	7.8	14.4	6.4	3.0	2461.1
2. Securities	4.7	5.0	2.0	4.6	13.5	-1.7	557.3
3. U.S. government securities	7.4	10.4	8.7	5.3	22.8	5.5	372.0
4. Other securities	.2	-5.1	-10.6	3.2	-4.5	-16.0	185.3
5. Total loans	8.1	6.4	9.5	17.3	4.4	4.4	1903.8
6. Business loans	6.3	4.0	9.9	23.8	-3.9	5.7	617.4
Security loans	-6.2	13.1	52.8	227.0	-30.0	-100.7	39.3
8. Real estate loans	13.4	11.0	12.4	12.7	12.6	15.8	694.4
9. Consumer loans	8.6	8.3	5.2	3.0	6.7	7.7	362.2
10. Other loans	.2	-5.9	-2.5	-.6	5.6	-22.3	190.5
	---------- Short- and Intermediate-Term Business Credit ----------						
11. Business loans net of bankers acceptances	6.4	4.1	10.3	24.5	-3.3	5.9	615.0
12. Loans at foreign branches[2]	30.3	11.4	51.9	28.7	168.2	-9.8	24.2
13. Sum of lines 11 & 12	7.1	4.4	11.7	24.5	2.3	5.7	639.3
14. Commercial paper issued by nonfinancial firms	15.6	50.0	37.5	19.9	31.6	42.4	117.2
15. Sum of lines 13 & 14	8.2	10.3	15.5	23.8	6.8	10.9	756.4
16. Bankers acceptances: U.S. trade related[3,4]	-6.8	11.0	16.7	28.3	6.9	n.a.	34.9[5]
17. Line 15 plus bankers acceptances: U.S. trade related	7.4	10.3	15.5	24.0	6.8	n.a.	784.5[5]
18. Finance company loans to business[3]	12.3	12.1	8.0	4.1	17.9	n.a.	238.8[5]
19. Total short- and intermediate-term business credit (sum of lines 17 & 18)	8.5	10.8	13.7	19.3	9.3	n.a.	1023.3[5]

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

about $125 billion (annual rate) in the quarter, down from $180 billion in the first quarter.

Gross public offerings of corporate bonds slowed in April from the heavy volume in March, when investment-grade firms issued nearly $10 billion in bonds with maturities of five years or less. Many firms had turned to the swap market to transform these fixed-rate obligations into floating-rate liabilities with rates below LIBOR. In April, as spreads among these obligations shifted and the profitability of such arbitrage declined, issuance of bonds with shorter maturities dropped to $3 billion. Although yields on investment-grade corporate bonds have fallen only slightly since the last FOMC, investor concerns about event risk and borrower expectations that interest rates will fall further in coming months reportedly have continued to deter issuance of investment-grade bonds with longer maturities.

In contrast to yields on high-grade bonds, yields on junk bonds rose in the intermeeting period. Spreads between junk bonds and investment-grade bonds widened 30 to 40 basis points by early May. While the junk-bond market apparently already had discounted the news of Drexel's settlement with the SEC, several other developments depressed this market. The market faced a heavy calendar of new issues, notably impending offerings of up to $4 billion by RJR-Nabisco as well as $2.3 billion of securities issued directly to RJR shareholders in early May. In addition, rumors surfaced of substantial sales of junk bonds by an investment firm that has ties to Michael Milken and by open-end mutual funds and thrift institutions. Reports of the continued troubles of the Southmark and Fruehauf leveraged

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

	1987 Year	1988 Year	1989 Q1p	1989 Feb.	1989 Mar.p	1989 Apr.p
Corporate securities - total[1]	24.08	22.23	18.84	13.97	25.42	14.34
Public offerings in U.S.	21.89	20.21	16.55	11.96	23.41	11.84
Stocks--total[2]	4.45	3.53	2.20	2.53	.91	.84
Nonfinancial	2.32	1.14	1.33	1.13	.61	.65
Utility	.57	.24	.74	.03	.00	.11
Industrial	1.75	.90	.59	1.10	.61	.54
Financial	2.12	2.39	.87	1.40	.30	.19
Bonds--total[1]	17.44	16.68	14.35	9.43	22.50	11.00
Nonfinancial	6.61	6.08	4.45	2.24	7.80	4.00
Utility	2.02	1.77	.60	.97	.20	2.00
Industrial	4.59	4.31	3.85	1.26	7.60	2.00
Financial	10.83	10.60	9.90	7.19	14.70	7.00
By quality[3]						
Aaa and Aa	3.25	2.68	3.34	2.08	5.90	3.50
A and Baa	5.20	5.57	4.83	3.24	8.90	3.75
Less than Baa	2.77	2.51	1.91	1.33	2.27	2.50
No rating (or unknown)	.07	.07	.11	.03	.00	.05
Memo items:						
Equity-based bonds[4]	.87	.28	.17	.31	.40	.10
Mortgage-backed bonds	5.19	4.69	2.63	1.57	3.61	.60
Other asset-backed	.96	1.26	1.53	1.18	1.82	.60
Variable-rate notes	1.88	1.17	.87	.53	1.19	1.00
Bonds sold abroad - total	2.03	1.93	2.28	1.99	2.00	2.50
Nonfinancial	.94	.69	.94	.78	1.00	.80
Financial	1.09	1.24	1.34	1.21	1.00	1.70
Stocks sold abroad - total	.16	.09	.01	.02	.01	.00
Nonfinancial	.12	.08	.01	.02	.01	.00
Financial	.04	.01	.00	.00	.00	.00

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. Includes equity issues associated with debt/equity swaps.
3. Bonds categorized according to Moody's bond ratings or 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.

buyouts also may have caused investors to re-evaluate potential credit losses on junk bonds.

Stock prices have risen about 5 percent since the last FOMC and about 11 percent since the first of the year. The price-earnings ratio, as measured by the S&P 500 index, has risen only slightly because reported earnings generally have kept pace with the rise in share prices. Higher stock prices have not induced firms to tap the equity market, however; new issues of shares by nonfinancial corporations, in particular, remain light. New offerings of closed-end mutual funds dropped off considerably in March and April; small investors still seem to be shying away from equities, and investor demand for new shares in closed-end funds that invest in high-yield bonds also may have been weakened by setbacks in the junk-bond market.

Municipal Securities

Gross issuance of long-term municipal securities slowed to $6.8 billion in April, down from March's already light pace of $8.6 billion. This decline reflected primarily a fall-off of refunding issues in lagged response to the run-up in yields on long-term municipal securities at the end of March; at $790 million, refundings were at their lowest level since the summer of 1984.

Short-term issuance surged to $4.9 billion in April, as New York State issued $3.9 billion in tax- and revenue-anticipation notes. Market participants were surprised by the top ratings given the New York issues by Moody's and Standard & Poor's; the agencies reportedly were impressed by the short-run implications of the state's recently passed budget, but they left ratings on general obligation bonds unchanged at a notch or two below the top because of continuing concerns about New York's long-run fiscal health. Investor demand for the notes evidently was strong.

Over the intermeeting period, yields on tax-exempt securities have declined about 1/3 percentage point, a bit more than 30-year Treasuries.

GROSS OFFERINGS OF MUNICIPAL SECURITIES

(Monthly rates, not seasonally adjusted, billions of dollars)

	1988	1988			1989	1989		
	Year	Q2	Q3	Q4	Q1	Feb.	Mar.	Apr.[p]
Total offerings[1]	10.88	11.73	11.50	11.58	9.20	9.56	10.43	11.97
Total tax-exempt	10.60	11.41	11.30	11.21	8.92	9.34	10.01	11.70
Long-term	9.01	9.20	8.00	10.09	7.77	8.05	8.63	6.82
Refundings[2]	2.75	3.18	1.87	2.91	2.49	2.83	2.14	.79
New capital	6.26	6.02	6.93	7.18	5.28	5.22	6.49	6.03
Short-term[3]	1.59	2.21	2.52	1.12	1.15	1.29	1.38	4.88
Total taxable	.28	.32	.23	.37	.28	.22	.42	.27
Memo item:								
Bank-qualified[4]	.58	.80	.63	.40	.42	.37	.52	.54

1. Includes issues for public and private purposes; also includes taxable issues.
2. Includes all refunding bonds, not just advance refundings.
3. Does not include tax-exempt commercial paper.
4. Bank-qualified bonds are the only tax-exempt bonds that banks can purchase and still deduct 80 percent of the carrying costs. Bonds are bank-qualified if issued by local governments that do not expect to issue more than $10 million of municipal bonds during the year.

p--preliminary.

The spread between the Bond Buyer revenue-bond index and general-obligation index shrank to about 20 basis points in mid-April, its lowest level since records were first kept in 1979. The narrowing of this spread has been attributed to the scarcity of new issues, which has caused investors who otherwise might prefer general obligation bonds to purchase revenue bonds.

Treasury and Sponsored-Agency Financing

Taking account of an unusually strong seasonal pickup in tax receipts, the staff is now projecting a $15 billion second-quarter federal budget surplus, after the $61 billion deficit posted last quarter. With reduced financing needs, marketable borrowing is expected to fall by more than three-fourths from its first-quarter level and should translate into an $18 billion increase in the Treasury's cash balance. Nonmarketable borrowing has tapered off because issuance of SLGs has ebbed in line with the sluggish pace of offerings of municipal refunding bonds; "other borrowing" should remain negligible because the FSLIC no longer is issuing notes.

As usual, most of the swing in borrowing needs is being accommodated in the bill markets. The outstanding stock of Treasury bills is declining appreciably in the current quarter, reflecting maturation of a cash management bill and smaller weekly bill auctions. Gross sizes of these auctions have been decreased in recent weeks from $14.4 billion to $13.2 billion. Net issuance of coupon securities also is expected to decline in the current quarter, but it will remain substantial at about $24 billion as the Treasury follows its usual practice of maintaining regular and predictible coupon auctions and letting the cash balance build up at mid-year.

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

	1989				
	Q1	Q2[e]	Apr.[p]	May[e]	June[e]
Treasury financing					
Total surplus/deficit (-)	-60.8	15.3	30.6	-17.4	2.1
Means of financing deficit:					
Net cash borrowing from the public	37.9	8.9	-1.8	8.0	2.7
Marketable borrowings/ repayments (-)	32.0	6.9	-2.6	7.4	2.1
Bills	3.0	-17.3	-7.0	-4.1	-6.2
Coupons	29.0	24.2	4.4	11.5	8.3
Nonmarketable	6.0	2.0	.8	.6	.6
Other borrowing[2]	-.2	.0	.0	.0	.0
Decrease in the cash balance	19.0	-17.8	-38.9	26.3	-5.2
Memo: Cash balance at end of period	14.7	32.4	53.5	27.2	32.4
Other[3]	4.0	-6.4	10.1	-16.9	.4
Federally sponsored credit agencies, net cash borrowing[4]	13.5[p]	-	-	-	-
FHLBs	14.1	-	4.2[p]	-	-
FNMA	-.8	-	-	-	-
Farm Credit Banks	-1.1	-	-.4[p]	-	-
FAC[5]	.0	-	.2	-	-
FHLMC	-1.1[p]	-	-	-	-
FICO	.6	-	.5	-	-
SLMA	1.7	-	-	-	-

1. Data reported on a not seasonally adjusted, payment basis.
2. Securities issued by federal agencies under special financing authorities (primarily FSLIC).
3. Includes checks issued less checks paid, accrued items and other transactions.
4. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
5. Financial Assistance Corporation, an institution within Farm Credit System, was created in January 1988 by Congress to provide financial assistance to Farm Credit Banks. It first issued bonds in July 1988.
e--staff estimate.
p--preliminary.
Note: Details may not add to totals due to rounding.

5/10/89

Borrowing by the Federal Home Loan Banks has remained heavy. As demand for advances to member institutions surged, indebtedness of the FHLBs increased more than $31 billion from June 1988 through March of this year, and accounted for nearly 80 percent of the net borrowing by all federally sponsored credit agencies. During most of that period, yields on FHLB securities fluctuated without clear direction relative to those on Treasury securities. In the past two months, however, spreads on FHLB securities have widened noticeably. FHLB spreads typically have fluctuated more or less with the Home Loan Banks' credit demands (chart) and, on several occasions, have approached or exceeded current levels. For example, in mid-1981, spreads on shorter-term issues were about 10 basis points higher and those on intermediate-term securities more than 40 basis points higher than they are currently.

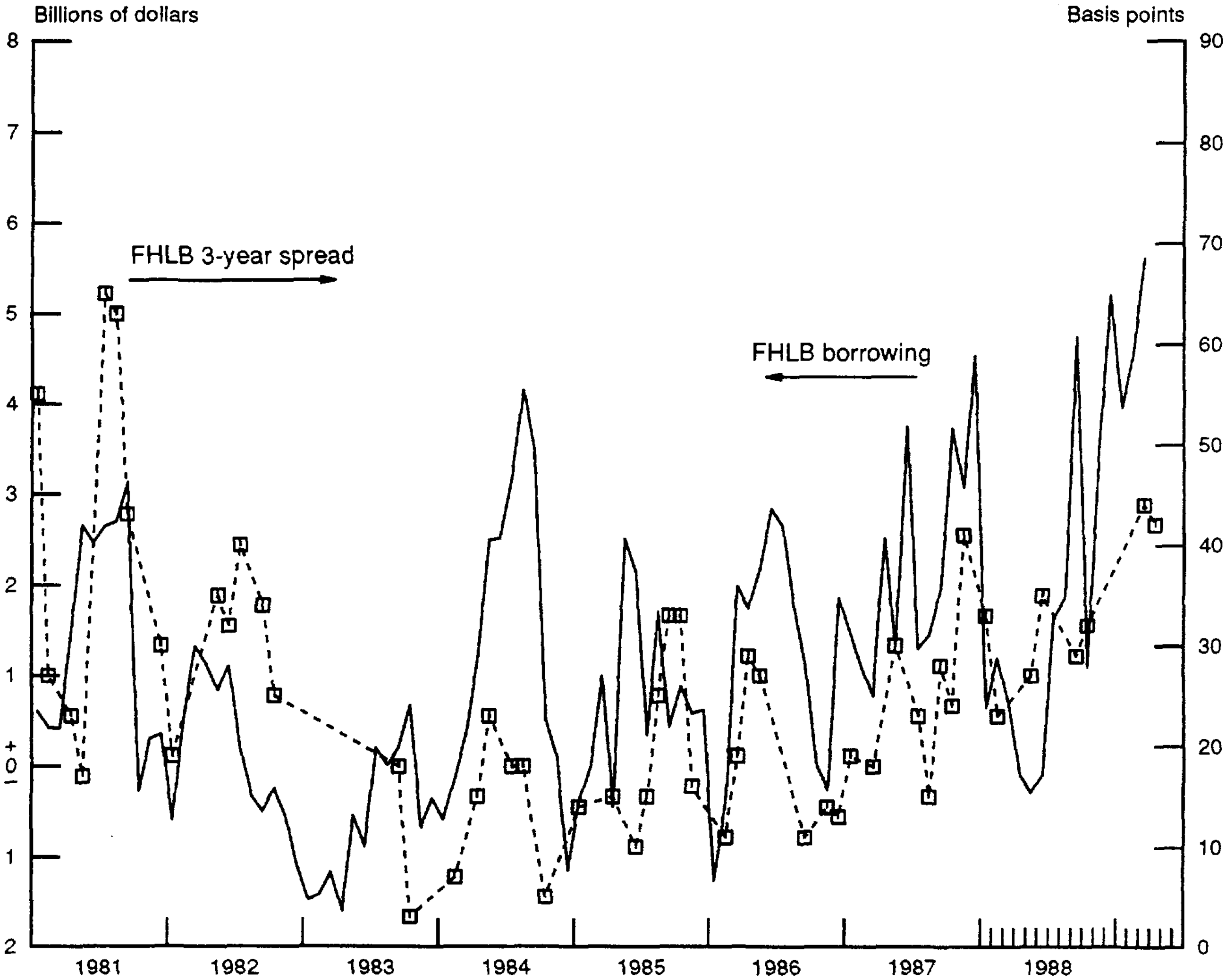
The upward movement in FHLB spreads in March coincided with a step-up in corporate borrowing, especially by investment-grade firms, that was concentrated in the short- and intermediate-term maturities preferred by the FHLBs. Yields on Farm Credit System obligations, too, have moved up roughly 15 to 35 basis points relative to Treasury rates since February, despite the agency's continued debt paydown during 1989.

Mortgage Markets

Participating in the recent rally in long-term capital markets, secondary market yields on fixed-rate mortgage (FRM) instruments declined about 40 basis points on average since the last FOMC meeting. However, the spread of mortgage yields over the 10-year Treasury yield has continued the upward trend that began late in 1988 (chart). A major reason for the increase in the spread has been the flattening of the Treasury yield curve,

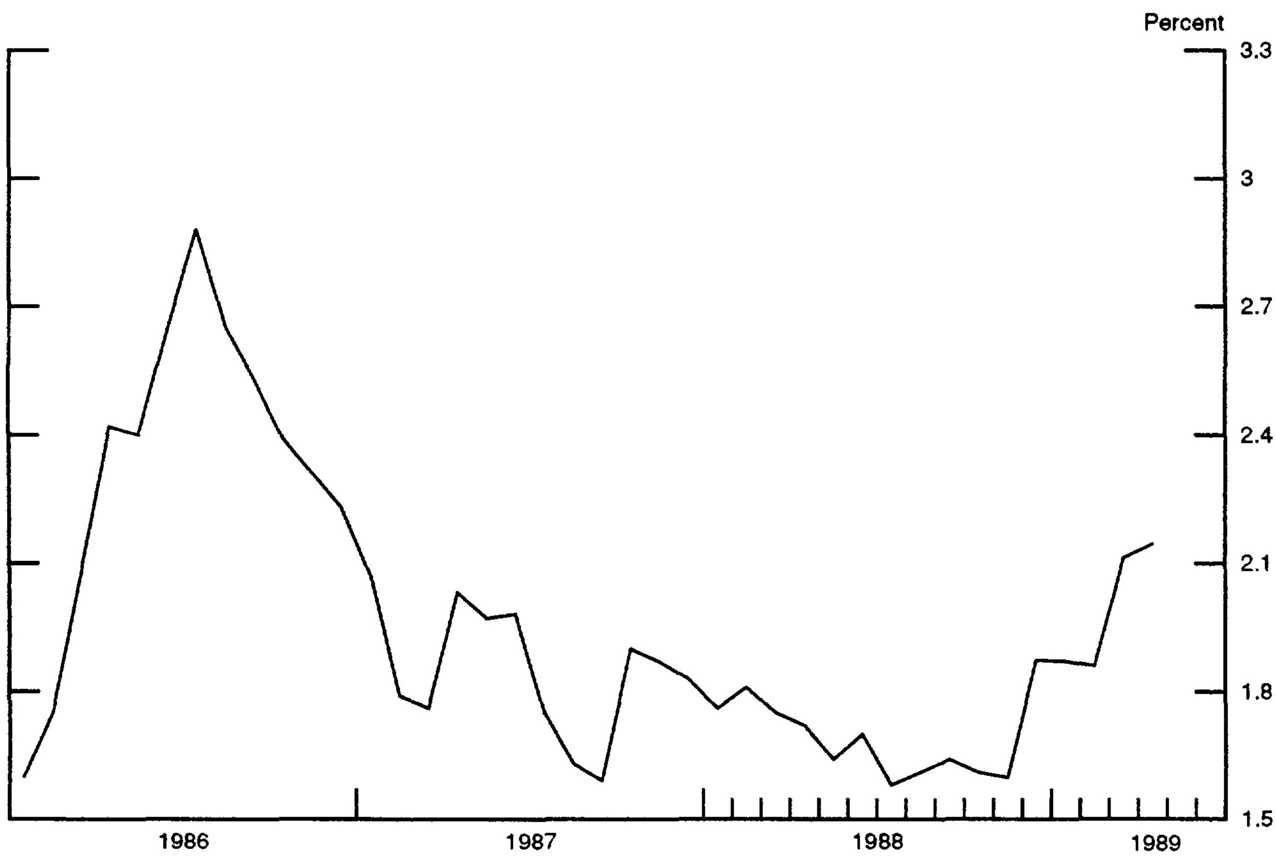
Net Borrowing by Federal Home Loan Banks and the Yield on Its Securities Relative to Treasury Securities

(Monthly data)



Note: The spread is the difference between the yield on three-year FHLB securities and comparable Treasury securities at the FHLB monthly offering. In some months, no three-year securities were issued.

FNMA Required Yield on FRMs Less Yield on 10-year Treasury Securities
(Mo'.thly data)



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

	Mortgage transactions			Net change in mortgage assets[1]		
	Origina-tions	Commit-ments	Sales	Total	Mortgage loans	Mortgage-backed securities
1985	16.4	14.9	8.2	4.1	4.2	-.2
1986	22.1	19.8	14.1	4.7	1.3	3.4
1987	21.1	20.1	10.3	6.1	2.4	3.7
1988	20.0	19.4	8.8	4.9	3.9	1.0
1988-Q1	19.0	18.0	7.9	3.0	2.9	.1
Q2	19.6	18.8	9.4	6.1	4.1	2.0
Q3	21.4	20.9	8.5	6.4	5.7	.7
Q4 r	19.8	19.9	9.5	4.0	2.8	1.2
1989-Q1 p	20.2	19.2	8.1	4.3	2.4	1.9
1989-Jan. r	21.3	19.3	7.6	.5	2.4	-1.9
Feb. r	19.6	19.9	8.6	4.7	1.6	3.0
Mar. p	19.8	18.3	8.2	7.9	3.3	4.6

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

NEW ISSUES OF MORTGAGE-BACKED PASS-THROUGH SECURITIES
BY FEDERALLY RELATED AGENCIES
(Monthly averages, billions of dollars)

	Seasonally adjusted				Not seasonally adjusted	
Period	Total	GNMAs	FHLMCs	FNMAs	Total	ARM-backed
1985	9.0	3.8	3.2	2.0	9.0	.3
1986	21.3	8.1	8.2	5.0	21.6	.7
1987	20.2	8.2	6.7	5.3	19.6	1.2
1988	12.4	4.6	3.3	4.6	12.6	2.4
1988-Q1	9.8	3.8	2.6	3.4	8.5	.9
Q2	12.1	4.5	2.8	4.8	12.5	3.0
Q3	13.3	5.5	3.4	4.4	14.9	3.0
Q4	14.6	4.8	4.2	5.6	14.5	2.6
1989-Q1 p	15.6	4.6	5.1	5.9	13.3	3.1
1989-Jan.	14.1	4.6	4.8	4.7	12.1	.9
Feb.	15.9	4.7	5.7	5.5	13.7	3.5
Mar. p	16.9	4.5	4.8	7.6	14.0	4.8

r--revised. p--preliminary.

which reduced the profitability of collateralized mortgage obligation (CMO) arbitrage and consequently the demand for mortgage-backed securities (MBS) as collateral for CMOs.[1]

More recently, increased uncertainty about interest rates, which raises the option value of the mortgage, and fears of future MBS liquidations by thrifts have driven the spread even higher. While press reports have attributed the weakness in the MBS market to heavy sales by thrifts, balance sheet data indicate that thrifts were net purchasers of such securities in the first quarter (table). However, if thrifts were to experience pressure to liquidate MBS assets heavily in the future it would have important implications for the MBS market. Thrifts hold roughly one-fourth of the $760 billion in outstanding MBSs, with $45 billion held by insolvent institutions.[2] Markets might have difficulty in the short run absorbing a liquidation of MBS holdings by these insolvent thrifts without significant price declines.

Mortgage debt growth was robust in March at major lenders. Net mortgage assets at FSLIC-insured thrifts grew by $8 billion, the largest increase since mid-1988. The volume of mortgages closed at these institutions was about $20 billion in March, equal to the 1988 average.

In March, the volume of new issues of mortgage-backed pass-through securities by federally related agencies rose to $16.9 billion on a seasonally adjusted basis, pushing the first-quarter average to the highest

1. A flatter yield curve lowers the value of shorter-term tranches relative to the costs of the long-term collateral. The high risk inherent in CMO residual tranches, along with well-publicized problems of the primary investors (REITs and thrifts) in these instruments, has impinged upon CMO arbitrage potential as well.

2. Insolvency is defined on a tangible capital basis, that is, capital equals estimated GAAP net worth less goodwill.

ARM DISCOUNTS
(March 1989)

Size of discount (basis points)	Average initial rate (percent)	Average base rate (percent)[1]	Percent of total
0	9.29	9.29	36
100 or fewer	9.39	9.85	6
101 - 200	8.87	10.63	17
201 - 300	8.65	11.10	32
301 or more	8.30	11.99	10
All discounted loans	8.72	11.00	64

1. The base rate represents the rate to which the loan will adjust following the discount period. If an index-plus-margin formula determines the adjusted rate, the base rate uses the current value of the index.
Source: FHLBB survey of conventional home mortgages closed during the first five working days of the month.

AVERAGE ARM INDEX VALUES AND INITIAL RATE SPREADS
(Percent)

Period	Initial ARM rate[1]	One-year Treasury	FHLB 11th District cost of funds	ARM spreads Treasury	ARM spreads 11th District
(1)	(2)	(3)	(4)	(2)-(3)	(2)-(4)
1985	10.04	8.43	9.52	1.61	.52
1986	8.42	6.46	8.24	1.96	.18
1987	7.82	6.76	7.38	1.06	.44
1988	7.90	7.65	7.69	.25	.21
1988-Q1	7.66	6.78	7.59	.88	.07
Q2	7.71	7.30	7.55	.41	.17
Q3	8.00	8.00	7.70	0	.30
Q4	8.22	8.53	7.92	-.31	.30
1989-Q1	8.76	9.29	8.30	-.53	.46
1989-Jan.	8.55	9.05	8.13	-.50	.42
Feb.	8.65	9.25	8.35	-.60	.30
Mar.	9.09	9.57	8.42	-.48	.67
Apr.	9.40	9.36	n.a.	.04	n.a.

1. Initial rate on ARMs indexed to the one-year constant-maturity Treasury yield.

level in more than a year. The increase over the previous month reflected a pickup in issuance by FNMA, which also priced about $1 billion in new real estate mortgage investment conduits (REMICs) in March. FNMA and FHLMC have become increasingly important issuers of REMICs in 1989, accounting for more than half of the total issuance over the first two months of the year, compared with less than 20 percent in 1988.

In the primary market, yields on fixed-rate mortgages moved in tandem with those in the secondary market. By contrast, initial rates on adjustable-rate mortgages have not followed recent declines in short-term rates and have risen a bit on balance in recent weeks. The increase in the ARM rate lowered the initial-rate advantage of ARMs over FRMs to 1.65 percent in April, the narrowest month-average spread since early 1987. This narrowing may reflect, in part, regulatory pressure on lenders to avoid aggressive teaser rates on ARMs, as well as a recent decision by the FNMA to halt the purchase or securitization of deeply discounted ARMs, which would reduce their liquidity. In any case, the declining initial-rate advantage of ARMs, coupled with a reduction in FRM rates, likely will cause a drop-off in the ARM share of loans closed.

ARMs indexed to the FHLB 11th District cost of funds have declined in popularity in recent months, as investors have found the sluggish behavior of this index unattractive in an environment of rising rates. If the movement toward use of Treasury-indexed ARMs continues, the sensitivity of ARM-holder payments to changes in short-term interest rates would increase over time. To date, the existence of loans indexed to the FHLB cost of funds and loans with fixed-payment, adjustable-maturity features has helped damp effects of rises in interest rates on household cash flows.

CONSUMER CREDIT[1]
(Seasonally adjusted)

	Percent change (at annual rate)						Net change (billions of dollars)		Memo: Outstandings (billions of dollars)
			1988	1989	1989		1989		1989
	1987[r]	1988[r]	Q4[r]	Q1[p,2]	Feb.[r]	Mar.[p]	Feb.[r]	Mar.[p]	Mar.[p]
Total installment[3]	6.2	8.5	8.0	9.6	9.5	9.4	5.37	5.37	692.8
Installment, excluding auto	5.2	10.7	12.0	10.5	9.1	13.3	2.99	4.42	403.1
Selected types									
Auto	7.5	5.7	2.8	8.4	10.0	4.0	2.39	.95	289.7
Revolving	12.3	13.6	15.5	16.2	12.6	28.9	1.85	4.30	182.9
All other	.1	8.3	9.0	6.0	6.2	.6	1.14	.12	220.2
Selected holders									
Commercial banks	7.6	12.7	11.3	5.5	6.2	4.2	1.63	1.13	319.6
Finance companies	4.7	3.5	6.0	10.0	13.7	-2.9	1.62	-.35	143.1
Credit unions	5.1	7.5	5.7	11.3	9.9	10.0	.72	.73	88.5
Savings institutions[4]	6.6	3.8	-2.6	8.8	7.3	1.8	.24	.36	63.5
Asset pools (NSA)	n.a.	n.a.	n.a.	59.0	44.8	130.4	1.08	3.25	33.2
Memorandum:									
Total[5]	4.9	7.3	8.2	10.9	10.8	11.3	6.70	7.08	760.1

1. Details may not add to totals because of rounding.
2. Growth rates are adjusted for discontinuity in data between December 1988 and January 1989.
3. Includes items not shown separately.
4. Savings and loans, mutual savings banks, and federal savings banks.
5. Installment plus noninstallment.
r--revised. p--preliminary.

CONSUMER INTEREST RATES
(Annual percentage rate)

	1986	1987	1988	1988 May	1988 Aug.	1988 Nov.	1989 Feb.	1989 Mar.
At commercial banks[1]								
New cars (48 mo.)	11.33	10.46	10.86	10.55	10.93	11.22	11.76	...
Personal (24 mo.)	14.83	14.23	14.68	14.40	14.81	15.06	15.22	...
Credit cards	18.26	17.92	17.79	17.78	17.79	17.77	17.83	...
At auto finance cos.[2]								
New cars	9.44	10.73	12.60	12.29	12.64	13.20	13.07	13.07
Used cars	15.95	14.61	15.11	14.81	15.16	15.75	15.90	16.12

1. Average of "most common" rate charged for specified type and maturity during the first week of the mid-month of each quarter.
2. Average rate for all loans of each type made during the month regardless of maturity.

Consumer Installment Credit

Growth in consumer installment credit strengthened during the first quarter, averaging a 9-1/2 percent annual rate in March and for the quarter as a whole. The installment credit series have been restructured to show securitized consumer loans as holdings of "pools" under the auto, revolving, and "other" loan categories. Previously, securitized loans were attributed in these statistics to the originating institution, even though in most cases the originator no longer carried these loans on its balance sheet.[3]

A total of about $50 billion of consumer loans has been securitized since this activity began in 1985. Approximately $33 billion of these loans are estimated to have been outstanding at the end of March. New securitizations were quite robust during the first quarter because of several large offerings by Citicorp. Credit card securitization had its strongest quarter yet with issuance of $3.3 billion. At the same time, several scheduled issues were shelved; yields on two- and three-year paper, to which yields on securities backed by consumer loans are typically pegged, have risen relative to consumer-loan rates, and securitization has become less attractive.

Most measures of consumer-loan delinquency are not yet available for the first quarter, but data from the major automobile finance companies

3. Under the new treatment, wider month-to-month swings likely will characterize the growth rates of loans for specific lender groups, reflecting securitization activity as well as the volume of originations and repayments on the stock of debt. Many securitizations have involved $500 million to $1.0 billion of consumer receivables. Frequently, this amount is larger than the total of new loans less repayments for a given lender group within a type-of-credit category. Thus, it is probable that such subcategories as "revolving credit at commercial banks" will show negative growth in some months (historically, a rare occurrence), although "total revolving credit," incorporating an offsetting boost in pool holdings, would show a normal pattern of growth.

reported to the Board show delinquencies on the rise. The weighted-average delinquency rate of the auto finance companies was up to 2.5 percent in March, 1/2 percentage point higher than one year ago. Nonetheless, this measure remained below levels recorded at times during the 1970s, and, at least through year-end 1988, had not been accompanied by any comparable uptrend in auto-loan delinquencies at commercial banks. The finance companies put exceptionally large amounts of car loans on their books in 1986 under low-rate lending programs. With this earlier bulge of lending reaching the stage at which delinquency is most likely, and with the base of outstanding loans contracting a bit last year, a rise in the delinquency rate is not surprising.

U.S. Merchandise Trade

In February, the seasonally adjusted merchandise trade deficit was $10.5 billion (Census basis, customs valuation), compared with an $8.7 billion revised deficit in January. (The January deficit was first reported as $9.6 billion; these data continue to be volatile and subject to substantial revision.) February exports were only slightly higher than the revised January figure, while imports in February rose more than 5 percent, almost reversing the decline recorded for January. Data for March will be available on May 17.

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil (nsa)	Non-oil	Balance
1988-Apr	26.0	3.3	22.7	34.8	3.1	31.7	-8.8
May	27.5	3.1	24.3	35.7	3.6	32.1	-8.3
Jun	26.3	3.0	23.3	37.9	3.3	34.6	-11.7
Jul	26.5	3.1	23.4	34.5	3.1	31.4	-8.0
Aug	27.5	3.4	24.1	38.1	3.4	34.7	-10.6
Sep	28.0	3.6	24.4	37.2	3.0	34.1	-9.2
Oct	27.8	3.0	24.8	36.6	2.9	33.7	-8.8
Nov	27.5	3.0	24.5	38.2	2.9	35.3	-10.7
Dec	29.1	3.3	25.8	40.1	3.3	36.8	-11.0
1989-Jan[r]	28.7	3.2	25.5	37.4	3.5	33.9	-8.7
Feb[p]	28.9	3.3	25.6	39.4	3.2	36.2	-10.5

r--revised p--preliminary

Translating to a balance of payments basis, the deficit for January-February combined was somewhat smaller than the deficit recorded

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil	Non-oil	Balance
	- - - - - - - BOP basis (current dollars) - - - - - - -						
1987	250	30	220	410	43	367	-160
1988	320	38	281	446	39	407	-127
1988-1	301	36	265	441	40	401	-141
-2	318	38	280	438	41	397	-121
-3	327	41	286	443	39	404	-117
-4	335	38	296	462	37	426	-128
1989-1*	343	42	301	466	42	425	-123
	- - - - - BOP basis (constant 1982 dollars) [1] - - - -						
1988-1	329	39	290	463	82	381	-134
-2	340	40	301	458	85	373	-118
-3	341	37	304	465	87	379	-124
-4	349	36	313	479	90	389	-131
1989-1*	352	39	313	473	84	389	-121
Percent Change:							
Q1/Q1	7.0	0.0	7.9	2.2	2.4	2.1	
Q1/Q4	0.9	8.3	0.0	-1.3	-6.7	0.0	
(not AR)							
	- - - - - - GNP basis (constant 1982 dollars) - - - - -						
1988-1	329	39	290	463	82	381	-134
-2	339	40	299	459	85	374	-120
-3	346	38	308	471	87	384	-125
-4	352	36	316	486	91	395	-134
1989-1	360	38	321	483	86	397	-123
Percent Change:							
Q1/Q1	9.3	-2.2	10.9	4.3	5.0	4.2	
Q1/Q4	2.2	7.9	1.6	-0.6	-4.9	0.4	
(not AR)							

*/ FR staff estimate of January and February data at annual rates.
1. Constant dollar estimates are derived using deflators from the GNP accounts.

in the fourth quarter of last year, but was not significantly different from deficits in the second and third quarters.

Exports were about 2-1/2 percent higher for January-February combined than in the fourth quarter; much of the increase was in agricultural exports with the remainder spread across other trade categories. The increase in agricultural exports in the January-February period was primarily in the volume of wheat and soybeans. Shipments of wheat continued to be boosted by strong purchases from China and the re-entry of the Soviet Union into this market. Among other categories, exports of consumer goods (including a wide range of household durables) and industrial supplies (particularly nuclear fuels) rose noticeably during this period. However, the commodity breakdown of the growth in exports during January-February was clouded by an unusually large increase in undocumented exports to Canada. By geographical region, the increase in nonagricultural exports was widespread; the largest rise was to Canada.

Imports in January-February were less than 1 percent higher than in the fourth quarter. Increases in imports of oil, other industrial supplies, and capital goods were nearly offset by declines in imports of automotive products, consumer goods, and foods. Non-oil imports from Japan and the Asian NIEs declined, while non-oil imports from Canada and Mexico increased.

The value of imported oil in January-February rose significantly, as higher prices more than offset a decline in volume from the strong fourth quarter pace. Oil spot and import prices have risen substantially as a result of accidents in the North Sea, the oil spill in Alaska, and the cut in OPEC production (which so far this year has been reduced roughly 2-1/2 mbd from the rate of production in late 1988). The average price of imported oil rose more than $0.60 per barrel in February, following a rise of more than $1.50 per barrel in January. The cumulative increase has been about $2.80 per barrel since the low recorded last November.

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

	1988					1989	
	Year	Q1	Q2	Q3	Q4	Jan	Feb
Value (Bil. $)	39.29	39.84	41.03	39.35	36.94	42.83	40.47p
Price ($/BBL)	14.34	15.24	15.16	14.21	12.89	14.84	15.46p
Volume (mbd.)	7.49	7.15	7.39	7.57	7.83	7.91	7.17p

p--Preliminary

Import and Export Prices

Prices for total imports, as measured by the monthly index constructed by the Bureau of Labor Statistics (BLS), increased 0.7 percent in March (n.s.a.), more than reversing the decline in prices recorded in February. The March increase was attributable to a turnaround in the prices of imported industrial supplies (including oil) and capital goods, as well as to smaller price declines in other categories.

For the first quarter of 1989, total import prices rose 7.0 percent at an annual rate (n.s.a.), only slightly lower than the 8.2 percent rate of increase registered in the fourth quarter of last year. While

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

	1989-Q1 / 1988-Q1	Quarters (AR) 1988 Q3	1988 Q4	1989 Q1	Months 1989 Feb	1989 Mar
					(monthly rates)	
	- - - - - - - - - BLS Prices - - - - - - - - -					
Imports, Total	5.1	-5.0	8.2	7.0	-0.5	0.7
Foods, Feeds, Bev.	0.2	-3.5	5.4	-1.0	-2.5	-0.7
Industrial Supplies	9.3	-10.2	5.1	24.9	-0.3	2.6
Capital Goods	2.9	-6.0	10.6	0	-0.9	0.6
Automotive Products	4.4	0.6	10.6	-0.3	-0.5	-0.2
Consumer Goods	3.5	-4.1	7.9	3.5	0.1	-0.1
Memo:						
Oil	11.2	-32.8	-8.7	103.2	n.a.	n.a.
Non-oil	4.5	-2.5	9.6	1.6	-0.8	0.4
Exports, Total	6.3	9.1	-1.1	5.9	-0.4	0.5
Foods, Feeds, Bev.	22.4	63.5	-20.9	11.4	-2.8	1.4
Industrial Supplies	5.5	1.4	-0.3	6.6	0.2	-0.2
Capital Goods	3.3	2.3	3.1	3.8	-0.2	0.7
Automotive Products	3.6	6.6	4.6	1.5	-0.3	0.6
Consumer Goods	4.8	2.6	5.9	9.2	0.2	1.1
Memo:						
Agricultural	16.1	39.9	-20.2	12.5	-1.9	1.2
Nonagricultural	4.8	4.1	2.9	4.7	-0.1	0.4
	- - - - - - - Prices in the GNP Accounts - - - -					
Fixed-Weighted						
Imports, Total	4.6	-0.8	2.0	11.3	--	--
Oil	2.9	-22.0	-32.3	117.7	--	--
Non-oil	4.8	2.4	7.1	2.4	--	--
Exports, Total	6.6	13.8	0.8	4.2	--	--
Ag.	18.8	65.8	-5.8	3.6	--	--
Nonag.	4.3	5.4	2.2	4.3	--	--
Deflators						
Imports, Total	3.3	-1.8	5.3	8.7	--	--
Oil	2.9	-21.9	-32.4	117.8	--	--
Non-oil	3.5	0.1	10.1	-0.1	--	--
Exports, Total	6.7	9.9	1.0	6.8	--	--
Ag.	18.8	65.8	-5.8	3.6	--	--
Nonag.	5.2	4.1	2.4	6.9	--	--

the overall magnitude of the increases was little changed between the fourth quarter and the first quarter, there were significant and important differences in price movements among commodity categories. The first-quarter increase primarily reflected the strong rebound in oil prices, while the prices of most non-oil imports were about flat, after having increased at nearly a 10 percent rate in the fourth quarter of last year.

Monthly prices of exports have been influenced largely by the movements in prices of foods, feeds, and beverages. Export prices declined 0.4 percent in February, in part because of a decline in grain prices; the turnaround in export prices for March reflected price increases in almost all trade categories, particularly agricultural products. For the first quarter as a whole, the price of total exports resumed its upward trend following a slight decline in the preceding quarter, largely due to a turnaround in the indices for food, fuels, and crude materials.

The BLS price series for the first quarter as a whole were not available when BEA constructed the preliminary estimate for first quarter GNP. These data will be incorporated in the revised estimate of GNP due to be released on May 25. The staff anticipates little change in the BEA estimates of the NIA deflators for nonagricultural exports and non-oil imports based on the BLS price information.

U.S. International Financial Transactions

The large capital outflow reported by banks in January was partly reversed in February. (See line 1 of the U.S. International Transactions table.) The inflow of $5.3 billion helped finance large

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

	1987 Year	1988 Year	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1988 Dec.	1989 Jan.	1989 Feb.
Private Capital									
Banks									
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	47.5	23.2	-1.8	16.5	-1.1	9.4	8.2	-15.7	5.3
Securities									
2. Private securities transactions, net[1]	36.4	15.3	-2.2	10.9	5.7	0.9	-0.4	0.6	3.2
a) foreign net purchases (+) of U.S. corporate bonds	26.4	26.9	2.6	8.9	6.4	9.0	3.7	1.5	4.6
b) foreign net purchases (+) of U.S. corporate stocks	16.8	0.4	*	1.1	1.3	2.0	-1.2	0.2	-0.3
c) U.S. net purchases (-) of foreign securities	-6.9	-12.0	-4.9	1.0	-2.0	6.1	-2.8	-1.1	-1.1
3. Foreign net purchases (+) of U.S. Treasury obligations	-7.3	20.1	6.0	5.6	3.5	5.4	-3.6	2.4	4.8
Official Capital									
4. Changes in foreign official reserves assets in U.S. (+ = increase)	47.7	40.1	25.0	6.4	-2.0	-0.8	-1.2	1.8	2.1
a) By area									
G-10 countries (incl. Switz.)	38.8	15.5	17.7	-0.8	-6.8	5.3	-2.1	-2.0	0.3
OPEC	-8.9	-3.4	-1.5	-1.7	-0.8	0.7	0.8	0.4	3.8
All other countries	17.8	28.0	8.8	8.9	5.6	4.8	0.2	3.4	-2.1
b) By type									
U.S. Treasury securities	43.2	41.7	27.7	5.9	-3.8	1.9	2.1	-3.3	4.2
Other[2]	4.5	-1.6	-2.8	0.6	1.8	1.1	-3.3	5.1	-2.1
5. Changes in U.S. official reserve assets (+ = decrease)	9.1	-3.6	1.5	*	-7.4	2.3	0.5	-1.9	-0.5
Other transactions (Quarterly data)									
6. U.S. direct investment (-) abroad[4]	-44.5	-20.4	-6.5	0.5	-5.2	9.2	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.[4]	42.0	42.2	7.3	13.1	8.4	3.4	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[3,4]	4.6	1.9	3.3	-6.6	7.0	2.1	n.a.	n.a.	n.a.
9. U.S. current account balance[4]	-154.0	-135.3	-37.0	-33.8	-32.6	1.9	n.a.	n.a.	n.a.
10. Statistical discrepancy[4]	18.5	16.5	4.4	-12.6	23.7	1.0	n.a.	n.a.	n.a.
MEMO:									
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-160.3	-126.5	-35.2	-30.2	29.2	32.0	n.a.	n.a.	n.a.

1. These data have not been adjusted to exclude commissions on securities transactions and, therefore, do not match exactly the data on U.S. international transactions as published by the Department of Commerce. Line 2a includes all U.S. bonds other than Treasury obligations.

2. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.

3. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking and official transactions not shown elsewhere. In addition, it includes amounts resulting from adjustments to the data made by the Department of Commerce and revisions to the data in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

. Includes seasonal adjustment for quarterly data.

--Less than $50 million.

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

increases of merger-related loans at commercial banks. However, monthly average data for March and the first three weeks of April, reported on the International Banking Data table (line 1), show a return to outflows to own foreign offices and IBFs: $3.2 billion in March and $8.3 billion through April 24.

Significant capital inflows in February were also reported in the securities markets (lines 2 and 3 of the U.S. International Transactions table). The most important component of the net inflow in private securities was a large increase in foreign net purchases of U.S. corporate bonds of $4.6 billion (line 2a). About half of this amount was attributable to purchasers in Europe, with purchasers in Asia accounting for almost as much; Japanese investors took $1.6 billion net, with $1.3 billion of that in U.S. government agency bonds. This last figure underscores the fact that a growing percentage of the transactions in the "corporate bond" category is for bonds issued by U.S. government corporations and federally sponsored agencies. Private net purchases of such bonds totaled $3.1 billion in the first two months of 1989, compared with $5.4 billion in all of 1988. A further class of transactions included in this line is the purchase by foreigners of bonds guaranteed by states and municipalities. In March, Kentucky became the first state to issue a Eurobond. Its Development and Finance Authority issued $76 million equivalent of yen-denominated bonds in Japan; a swap transformed the obligation into a floating-rate dollar obligation.

The net inflow into U.S. Treasury securities was also large in February: $4.8 billion (line 3). Slightly more than half of the flow

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1986	1987		1988				1989			
	Dec.	Sept.	Dec.	Mar.	June	Sept.	Dec.	Jan.	Feb.	Mar.	Apr.[2]
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	22.3	-8.7	-10.9	8.7	-4.8	-4.9	-4.9	-3.4	-6.1	-2.9	5.4
(a) U.S.-chartered banks	31.7	12.6	15.2	27.8	17.0	16.6	21.6	21.1	18.6	20.4	24.7
(b) Foreign-chartered banks	-9.4	-20.3	-26.1	-19.0	-21.8	-21.5	-26.5	-24.5	-24.7	-23.3	-19.3
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	16.8	17.1	15.8	19.1	19.7	21.4	21.2	19.8	21.0	23.9	24.1
3. Eurodollar Holdings of U.S. Nonbank Residents[1]	124.5	141.1	132.6	128.9	138.1	141.1	145.3	143.9	143.1	146.1	145.2

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.
2. Through April 24, 1989.

went to Japanese buyers. The large inflow came in a month when net issuance of coupon securities by the Treasury rose to a six-month high of $13.8 billion.

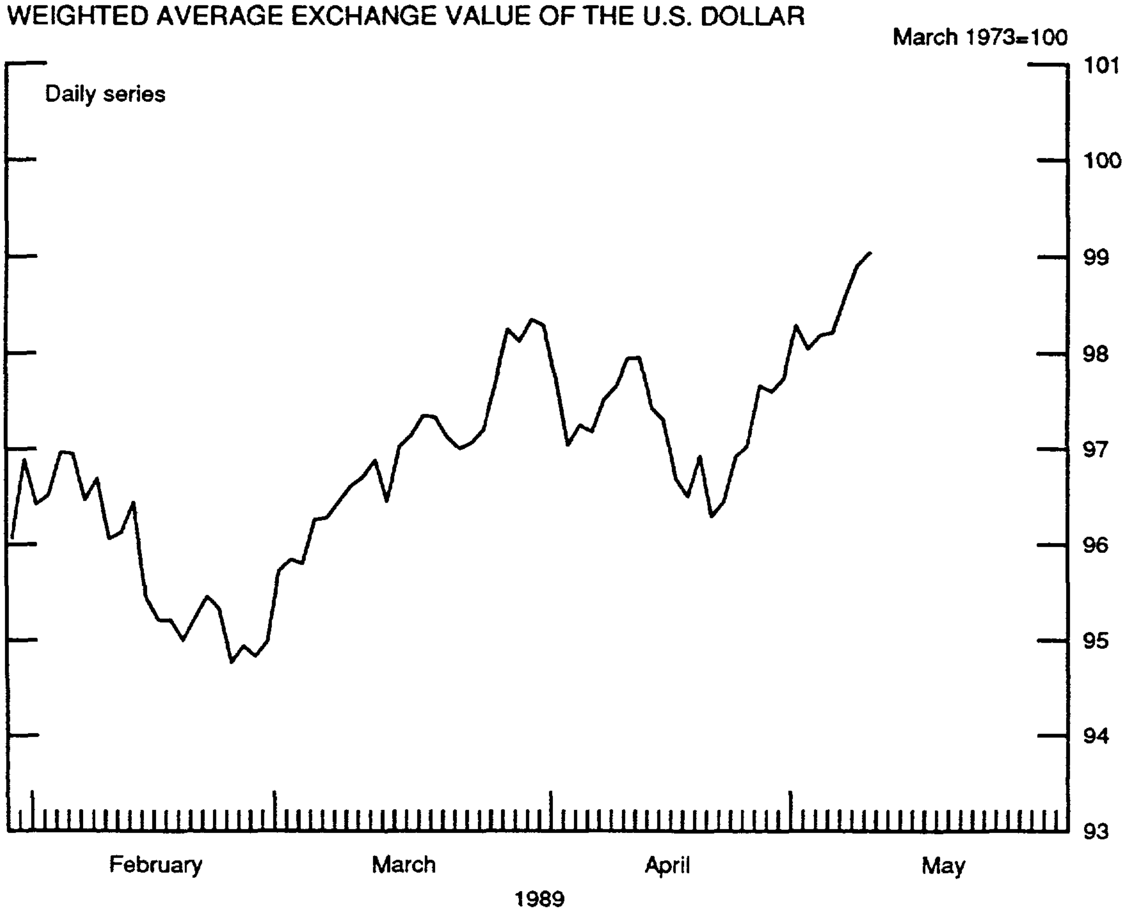
U.S. net purchases of foreign securities continued at a steady $1.1 billion pace in February (line 2c).

Foreign official reserve assets in the United States increased a moderate $2.1 billion in February (line 4). The total was more than accounted for by the increase in OPEC reserves of $3.8 billion (line 4a). G-10 official reserves in the United States were stable in February, despite significant reported intervention sales of dollars. Partial information for March from the FRBNY suggests an increase in official reserves held in the United States in the $3.5 billion range, with continued large increases of OPEC reserves.

Foreign Exchange Markets

The dollar strengthened, on balance, against most other major currencies during the intermeeting period. The trade-weighted foreign-exchange value of the dollar in terms of the other G-10 currencies, shown in Chart A, rose by about 1.0 percent. Through mid-April, the dollar fell as market participants perceived a renewed international commitment to containing the dollar upon the release of the G-7 communique . The dollar recovered by the end of the month, however, and strengthened further in early May, aided, perhaps, by concerns about political factors in Germany and Japan.

WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



. The Desk's sales exceeded $1.7 billion, of which, $1.15 billion was sold against marks.

. The Desk also sold $550 million against yen. Its initial purchases of yen were made during the week of the G-7 meeting in Washington and constituted its first yen purchases in the market since autumn of 1985. The Desk resumed purchasing yen in late April and early May.

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On April 20, the Bundesbank announced an increase in its Lombard and discount rates of 1/2 percentage point. The rise was followed by increases in the central bank lending rates of Austria, the Netherlands, Denmark, and Belgium. The Bundesbank's action heightened expectations of increases in official interest rates in a number of other countries, including Japan, France, and Italy. Since then, neither the yen, the French franc, nor the lira has weakened against the mark, and official interest rates have not been raised.

The dollar's overall strength occurred despite a continued narrowing of short-term interest rate differentials between dollar-denominated assets and both mark and yen assets. U.S. short-term rates have fallen slightly while early declines in German rates were more than offset by the increases which followed the rise in the Bundesbank's official lending rates. German short-term rates moved up by about 15 to 40 basis points, net, over the intermeeting period. In Japan, short-term rates have remained stable. Long-term rates in all three countries showed little net change over the period.

U.S. bank lending to foreigners

The dollar value of U.S.-chartered banks' claims (all currencies) on all foreigners decreased by about $8 billion (2 percent) in the fourth quarter of 1988, and by about $32 billion (8.5 percent) for the year as a whole. On average during the fourth quarter, the foreign exchange value of the dollar in terms of other G-10 currencies fell by 5.2 percent. Excluding estimated valuation effects due to changes in the value of the dollar, total claims on foreigners declined by an estimated $13 billion in the fourth quarter, and by an estimated $26 billion for the year. The aggregate decline in total claims for 1988, adjusted for exchange rate valuation effects, was roughly equivalent to the average decline in such claims during the years 1985 through 1987.

The decline in U.S. bank claims on non-OPEC developing countries also continued in the fourth quarter. For 1988 as a whole, claims on Latin America, Asia, and Africa, each fell by approximately 12 percent. In the case of claims on Latin America, this percentage decline was nearly 2-1/2 times the percentage decline in such claims (excluding exchange rate valuation effects) for banks located in the 17 countries,

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

	Changes (no sign = increase)								Out-
	1985	1986	1987	1988	1988				standing
	Year	Year	Year	Year	Q1	Q2	Q3	Q4	12/31/88
Total, all countries	-20.3	-0.3	-3.7	-32.4	-8.3	-20.5	4.3	-7.9	349.0
Non-OPEC developing countries	-7.6	-5.1	-1.4	-12.3	-3.7	-2.7	-4.3	-1.6	85.4
of which:									
(Latin America)	-3.9	-0.6	-1.7	-9.0	-2.2	-2.1	-2.4	-2.3	61.5
(Asia and Africa)	-3.5	-4.4	0.1	-3.3	-1.0	-0.8	-2.3	0.8	23.8
OPEC countries	-3.6	-2.0	-2.2	-0.6	0.1	-0.8	1.2	-1.1	16.5
Eastern Europe	-0.3	-0.9	-0.2	0.7	-0.1	0.2	-0.1	0.7	3.7
Smaller developed countries	-3.7	-4.2	0.5	-5.3	0.0	-2.5	-1.0	-1.8	20.9
G-10 countries	-2.1	10.6	3.4	-5.4	-3.3	-6.2	-1.0	5.1	154.6
Offshore banking centers	-2.7	-1.6	-7.0	-8.6	0.3	-9.3	4.5	-4.1	45.7
Miscellaneous	-0.4	2.9	3.4	-1.4	-1.7	0.7	4.8	-5.2	21.8
Memorandum:									
Total, adjusted for exchange rate changes (staff estimate)	-29	-11	-25	-26	-1	-17	5	-13	

including the United States, that report international banking data to the Bank for International Settlements.

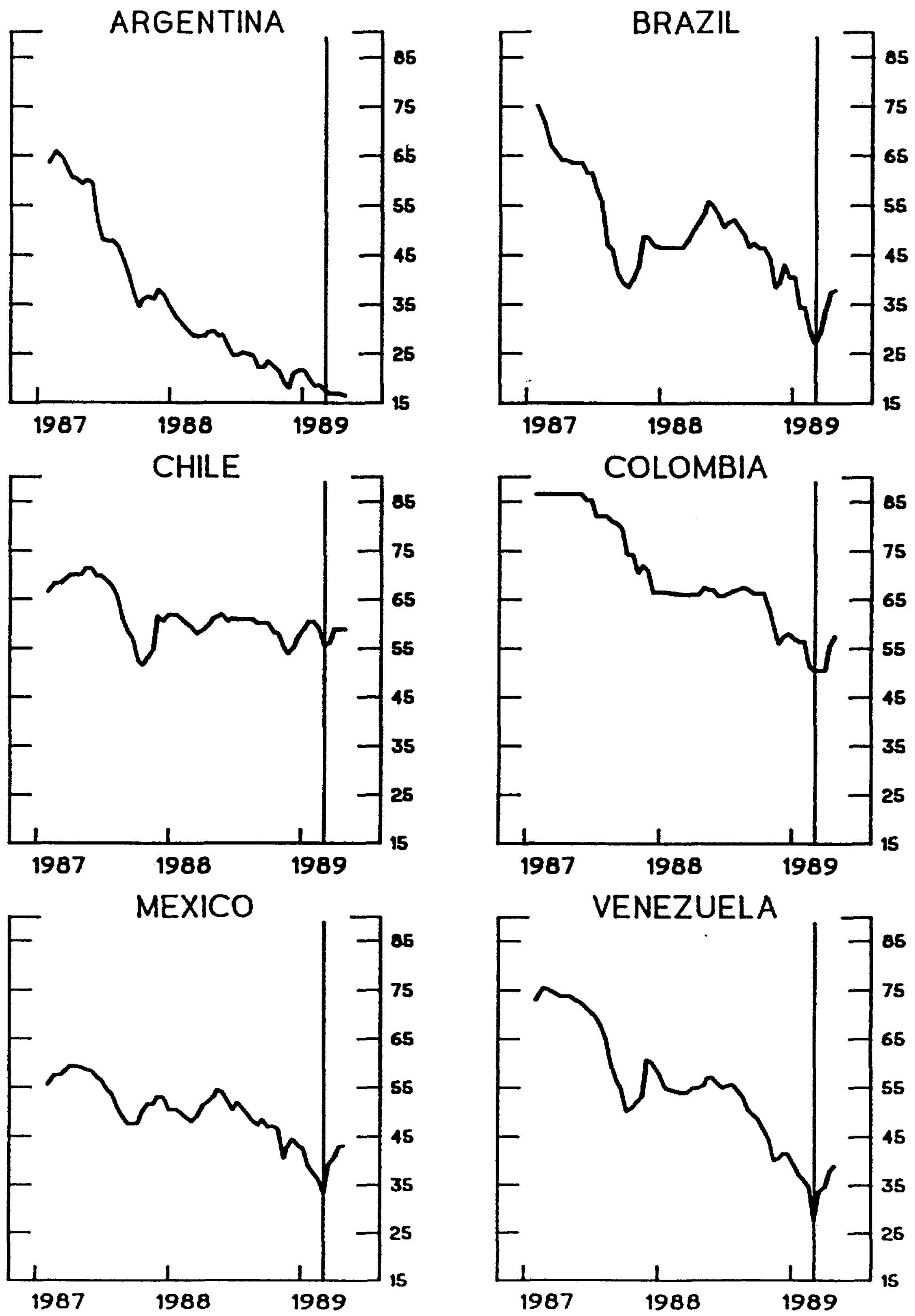
Claims of U.S.- chartered banks on Mexico declined by $4.8 billion (20 percent) for 1988 as a whole. In part, this was a result of pre-payments and debt-equity transactions, including, in the fourth quarter, purchases of debt on the secondary market linked to the privatizations of state enterprises in Mexico. U.S. bank claims on Brazil declined by $2.2 billion (9 percent) during 1988 as a whole. In the fourth quarter, however, these claims actually increased by $100 million, as Brazil received a disbursement of $4 billion under its 1988 new money package, approximately $1.2 billion (30 percent) of which came from U.S. banks.

Claims on other major country groups also declined in 1988, with the exception of a $700 million increase in claims on Eastern Europe. Although approximately one-half of the increase represented credit extended to the Soviet Union, U.S. banks continue to have a small level of exposure to that country ($700 million) relative to that of all banks for which exposure is reported to the Bank for International Settlements ($36 billion). For 1988 as a whole, BIS reporting banks extended approximately $5.5 billion in credit to the Soviet Union, excluding valuation effects due to changes in U.S. dollar exchange rates.

The secondary market prices of bank claims on the heavily indebted countries declined on average by 17 percent during 1988, and continued their decline through much of the first quarter of 1989. However, as indicated in the chart, the prices of claims on important debtor countries rose in the aftermath of the announcement of the Brady plan on March 10. The notable exception was Argentina where a further

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

(as a percent of face value)



Data shown for dates up to April 27, 1989.
Vertical bars mark the announcement of the Brady Initiative, March 10, 1989.

deterioration in conditions may have led to questions about that country qualifying for inclusion in the Brady plan. Since the last data point on the chart (April 27, 1989), there have been indications of partial reversals of the March-April increases in the secondary market prices of country debt.

Developments in Foreign Industrial Countries

Available indicators suggest that the pace of real economic growth and inflation increased, on balance, in the major foreign industrial countries in early 1989. The combined external surplus of these countries continued to rise. Industrial production rose rapidly in Japan in the first quarter, and unofficial estimates indicate that real GNP growth in Japan and Germany was strong. Growth also was strong in Italy. In contrast, industrial production rose slightly in France and declined slightly in Canada. In the United Kingdom, the tightening of monetary policy appears to have contributed to a lower level of industrial output in January and February.

Inflation rates increased in Japan, Germany, and Italy, partly the result of tax-related increases in consumer prices and oil-price increases. Both Canada and the United Kingdom continued to record relatively high inflation rates. In France, inflation remained below 3-1/2 percent, raising the prospect of convergence of French and German inflation by the end of the year.

Germany has continued to record a larger current account surplus on a cumulative basis thus far this year than in 1988, while Japan's surplus has remained at the increased rate recorded late last year. Trade and current account deficits in the United Kingdom continued at near record rates and Italy's deficit widened. The trade deficit in France narrowed in the first quarter.

Individual country notes. Economic activity in Japan was strong in the first quarter. As indicated in the table below, industrial production rose sharply in March, bringing first-quarter growth to 2.8 percent (s.a.). Retail sales increased sharply in February, the second consecutive strong monthly advance. The rate of capacity utilization in manufacturing rose 0.3 percent (s.a.) in January. Consistent with the strong pace of growth is evidence of further tightening in labor markets in the first quarter. The ratio of job offers to applicants increased in the first quarter as a whole, despite a decline in March. The unemployment rate remained steady in March at its lowest level in more than six years.

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

	1988		1989			
	Q3	Q4	Q1	Jan.	Feb.	Mar.
Industrial Production	2.5	2.4	2.8	0.9	-1.7	4.2
Retail Sales	0.3	2.7	--	1.4	1.5	--
Capacity Utilization	2.8	1.7	--	0.3	--	--
Job Offers/Applicants	9.0	3.7	1.8	0.9	0.9	-1.7
Unemployment Rate (level)	2.5	2.4	2.3	2.3	2.3	2.3

As expected, consumer and wholesale prices rose by about 1-1/2 percent in April, reflecting the combined result of the new 3 percent consumption tax and the removal of excise taxes on a range of consumer durable goods. Consumer prices in the Tokyo area increased 1.5 percent (n.s.a.) in April, boosting the 12-month inflation rate to 2.6 percent.

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

	Q4/Q4 1987	Q4/Q4 1988	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1988 Nov.	1988 Dec.	1989 Jan.	1989 Feb.	1989 Mar.	Latest 3 months from year ago 2
Canada												
GDP	6.1	3.4	1.1	.8	.6	n.a.	*	*	*	*	*	3.4
IP	8.5	2.9	1.1	.6	-.0	n.a.	-.3	.6	-.6	.0	n.a.	1.9
France												
GDP	2.7	2.9	.4	1.1	.4	n.a.	*	*	*	*	*	2.9
IP	3.2	4.2	.9	2.6	-.2	n.a.	3.8	-.5	.9	-.7	n.a.	4.9
Germany												
GNP	2.4	2.6	-.1	1.1	.3	n.a.	*	*	*	*	*	2.6
IP	1.5	4.0	.6	1.8	.6	2.2	-.4	2.0	1.3	.0	-.9	5.2
Italy												
GDP	2.7	n.a.	.8	1.5	n.a.	n.a.	*	*	*	*	*	3.9
IP	5.7	6.8	-.7	.1	4.5	n.a.	1.4	.5	n.a.	n.a.	n.a.	6.8
Japan												
GNP	5.7	4.7	-.8	2.3	.7	n.a.	*	*	*	*	*	4.7
IP	8.1	8.0	-.2	2.5	2.4	2.8	2.8	.9	.9	-1.7	4.2	7.5
United Kingdom												
GDP	4.2	3.0	.2	.3	.5	n.a.	*	*	*	*	*	3.0
IP	4.1	2.6	2.4	.7	.2	n.a.	.0	-.8	-1.2	-.3	n.a.	1.8
United States												
GNP	5.0	2.8	.7	.6	.6	1.4	*	*	*	*	*	3.3
IP	5.8	5.0	1.1	1.7	1.1	.7	.4	.4	.4	-.0	-.0	4.8

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

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

	Q4/Q4 1987	Q4/Q4 1988	1987 Q4	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Jan.	1989 Feb.	1989 Mar.	1989 Apr.	Latest 3 months from year ago
Canada													
CPI	4.2	4.1	.7	.8	1.3	1.1	.8	1.2	.5	.7	.5	n.a.	4.5
WPI	4.3	3.5	1.1	1.1	.9	1.0	.5	n.a.	.8	.0	n.a.	n.a.	3.3
France													
CPI	3.2	3.0	.5	.5	1.0	.9	.6	.8	.4	.3	.3	n.a.	3.4
WPI	2.6	7.2	1.0	1.0	1.0	2.7	2.3	n.a.	*	*	*	*	7.2
Germany													
CPI	1.0	1.5	.0	.5	.5	.1	.4	1.6	1.1	.3	.2	.6	2.8
WPI	-.7	2.7	-.2	.1	1.1	.4	1.2	2.7	1.7	.2	.6	n.a.	5.4
Italy													
CPI	5.2	5.2	1.7	1.1	1.0	1.0	1.9	2.0	.8	.8	.5	.7	6.5
WPI	4.6	5.4	1.2	1.1	1.3	1.2	1.7	n.a.	.8	.8	n.a.	n.a.	6.3
Japan													
CPI	1.1	1.5	.4	-.2	.6	.0	1.0	-.2	.1	-.1	.5	1.5	1.9
WPI	-.6	-1.4	-.4	-1.2	-.3	.9	-.8	.5	.3	.3	.2	n.a.	.2
United Kingdom													
CPI	4.1	6.5	1.1	.5	2.4	1.4	2.1	1.6	.6	.7	.4	n.a.	7.7
WPI	4.1	4.9	1.1	1.1	1.4	1.2	1.1	1.4	1.0	.3	.3	.5	5.1
United States													
CPI (SA)	4.4	4.3	.9	.9	1.1	1.2	1.1	1.3	.6	.4	.5	n.a.	4.8
WPI (SA)	2.5	3.4	.1	.6	.8	1.1	.9	2.2	1.0	1.0	.4	n.a.	5.0

1. Asterisk indicates that monthly data are not available.

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

	1987	1988	1987	1988				1989	1988	1989		
			Q4	Q1	Q2	Q3	Q4	Q1	Dec.	Jan.	Feb.	Mar.
Canada												
Trade	8.3	7.4	1.6	1.7	2.1	2.6	1.0	n.a.	.5	.7	.4	n.a.
Current account	-8.0	-9.2	-2.6	-1.6	-2.3	-1.8	-3.5	n.a.	*	*	*	*
France												
Trade	-5.2	-5.9	-1.0	-.8	-1.0	-1.9	-2.1	-.5	-.8	-.4	-.1	-.0
Current account	-4.1	-4.0	-2.3	1.5	-.7	-1.1	-3.7	n.a.	*	*	*	*
Germany												
Trade (NSA)	65.9	72.8	20.1	15.0	19.9	17.0	21.0	19.5	7.7	6.4	6.1	6.9
Current account (NSA)	45.4	49.1	15.3	9.2	15.0	8.7	16.1	15.5	5.7	6.1	4.6	4.8
Italy												
Trade	-9.1	-10.2	-2.9	-2.6	-1.8	-2.9	-2.8	n.a.	-1.5	-1.5	n.a.	n.a.
Current account (NSA)	-1.1	-4.4	-1.6	-5.1	1.1	.4	-.8	n.a.	*	*	*	*
Japan												
Trade	79.5	78.1	18.3	20.9	16.9	18.4	21.9	22.0	7.4	7.6	8.8	5.6
Current account [2]	87.0	79.5	20.7	22.3	17.1	18.1	21.2	20.9	6.6	6.7	8.8	5.4
United Kingdom												
Trade	-15.9	-36.2	-5.3	-7.1	-8.2	-9.4	-11.5	n.a.	-3.0	-3.7	-3.8	n.a.
Current account	-4.7	-25.3	-3.5	-5.1	-4.9	-6.3	-9.0	n.a.	-2.3	-2.8	-3.0	n.a.
United States												
Trade [2]	-160.3	-126.5	-41.2	-35.2	-30.2	-29.2	-32.0	n.a.	*	*	*	*
Current account	-154.0	-135.3	-33.5	-37.0	-33.8	-32.6	-31.9	n.a.	*	*	*	*

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

Wholesale prices rose 1.6 percent (n.s.a.) in the first 20 days of April, bringing the 12-month rate of increase to 2.7 percent. Official statements have continued to stress that inflationary pressures need to be monitored closely in light of the continued strong pace of domestic economic activity, rising oil prices, and the recent weakness of the yen.

Japan's trade and current account surpluses narrowed in March, reversing substantial increases in the previous month. For the first quarter as a whole, the trade surplus was $88 billion (s.a.a.r.), somewhat higher than the $83.7 billion surplus rate in the first quarter last year. The current account surplus was $83.7 billion (s.a.a.r.) in the first quarter, below the $89 billion surplus in the first quarter last year, which was the highest quarter of the year.

On April 25, Prime Minister Takeshita announced his intention to resign, prompted by further revelations of his involvement in the Recruit Cosmos scandal and continued decline in support for his government in public opinion polls. A new Prime Minister has not yet been announced. On April 28, the ruling Liberal Democratic Party unilaterally acted to pass its budget for the current fiscal year (which began in April) through the Lower House of the Diet, the first such action in over a century. Opposition parties had boycotted legislative action on the budget because of the Recruit scandal. Final approval of budget legislation by the Upper House of the Diet is expected before the current temporary budget expires on May 20.

The pace of economic activity increased in Germany in early 1989. According to unofficial government estimates, real GNP growth could be as high as 8 percent (s.a.a.r.) in the first quarter, the result of the warm winter and seasonal adjustment problems. Industrial production rose 2.2 percent (s.a.) in the first quarter, despite a decline of almost 1 percent in March. Much of the rise in industrial production also reflected the effects of unseasonally warm winter weather. Most affected was construction, which increased 25.4 percent in the first quarter. Excluding construction activity, industrial production rose 0.7 percent (s.a.) in the first quarter. Meanwhile, the volume of new orders rose 3.1 percent (s.a.) in the first quarter (see table below). Domestic orders were up 4 percent (s.a.) while foreign orders were up 1 percent. After eight successive months of decline, the unemployment rate edged up to 7.8 percent (s.a.) in April. The capacity utilization rate in manufacturing edged down to just under 88 percent in the first quarter.

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

	1988		1989			
	Q3	Q4	Q1	Feb.	Mar.	Apr.
Volume of Manufacturing Orders	4.1	-2.0	3.1	2.6	3.3	--
Domestic	4.1	-2.4	4.1	1.9	3.6	--
Foreign	3.2	0.2	1.0	5.1	2.1	--
Unemployment Rate (level)	8.8	8.5	7.9	7.9	7.7	7.8
Manufacturing Capacity Utilization Rate (level)	87.4	88.7	87.9	--	--	--

Inflation continued to increase in Germany in recent months, as shown in the table below. The across-the-board increase in inflation can be attributed largely to higher excise taxes in January, weakness in the deutsche-mark, and rising oil prices. Increased price pressures led the Bundesbank to raise the discount and Lombard rates by half a percentage point, effective April 21, to 4.5 percent and 6.5 percent, respectively. The Bundesbank's action, which was not expected in financial markets, also reflected concern over the rapid pace of recent monetary growth and possible increases in inflation and inflationary expectations. Through March, M3 growth was 6.2 percent (s.a.a.r.) from the 1988-Q4 target base, still above the Bundesbank's M3 target of "about 5 percent" growth. (M3 is currently being measured as a weighted average of weekly reported numbers.)

GERMAN INFLATION INDICATORS
(percent change from year earlier)

	1988		1989			
	Q3	Q4	Jan.	Feb.	Mar.	Apr.
Consumer Prices	1.2	1.5	2.6	2.6	2.7	3.0
Industrial Producer Prices	1.5	1.7	2.9	3.2	3.4	--
Wholesale Prices	1.4	2.7	5.1	5.4	5.8	--
Import Prices	1.2	2.2	5.9	5.9	7.2	--

Germany's external surplus has continued to rise in recent months. The trade surplus in the first quarter was $19.4 billion (n.s.a.), above the $15.0 billion surplus recorded in the first quarter of 1988. The current account surplus was $15.5 billion (n.s.a.) in the first quarter, above the $9.2 billion surplus recorded in the first quarter of 1988.

Election losses in Berlin (in late-January) and in Frankfurt (in March) and recent opinion polls have raised doubts about the political longevity of the ruling coalition. Partly as a result of that weakness, Chancellor Kohl executed a major change in the cabinet in April, and the government abolished the controversial 10 percent withholding tax on investment earnings, effective July 1. The tax, which had gone into effect in January, had been blamed for large capital outflows. The tax would have raised an estimated $2.3 billion in 1989; the revenue loss is expected to be made up by higher income tax revenues from faster-than-expected growth.

In France, economic activity has softened somewhat from the pace of late last year. Industrial production declined in February, reversing some of the sharp increase in January, but was still almost 5 percent above year-earlier levels. February unemployment moved down slightly to 10 percent (s.a.). Consumer price inflation slowed in the first quarter to slightly less than 3-1/2 percent (a.r.). Monetary data through February show that French M2 has continued to expand at a moderate rate within the target range of 4 to 6 percent for 1989. Although French short-term interest rates edged up following the surprise announcement in late April of increases in the German discount and Lombard rates, French intervention rates were left unchanged as the French franc remained steady within the EMS.

In the United Kingdom, there have been increasing signs that the monetary tightening that was initiated in the second half of last year is slowing the pace of economic activity. Industrial production declined by 0.3 percent (s.a.) in February, the third consecutive monthly decline, and retail sales volume in the first quarter was 0.4

percent below that in the fourth quarter last year. In contrast, the unemployment rate continued to decline in March.

In the first quarter, consumer price inflation was just above 6 percent (n.s.a.a.r.). Wholesale prices rose 6 percent (n.s.a.a.r.) in April matching the inflation rate recorded in the first quarter. The underlying rate of increase in average earnings in the 12 months ending in February was 9-1/4 percent, up 1/2 percentage point from the end of last year.

In Canada, real economic activity appears to have slowed in early 1989. The unemployment rate rose to 7.8 percent in April back to the level at the end of last year. Inflation remains a concern, with consumer prices rising in March to a level 4.6 percent above their level a year ago, and with major wage settlements increasing 4.5 percent (a.r.) in the fourth quarter last year.

On April 26, there was an embarrassing leak of the contents of Canada's budget that was scheduled to be announced the following day. The projected budget deficit for the 1989-90 fiscal year is C$30.5 billion (4.7 percent of GNP), up from about C$28.9 billion (4.8 percent of GNP) this year. Although additional corporate and excise taxes are to be levied and expenditures are to be cut by C$5 billion, the deficit will increase because of the higher interest costs of servicing government debt. A national sales tax and expenditure cuts of C$9 billion in fiscal year 1990-91 are projected to reduce the deficit in that year to C$28 billion (4.1 percent of GNP).

In <u>Italy</u>, preliminary annual data show that real GDP growth in 1988 was nearly 4 percent. The source of this strength was investment, exports and inventories. Increased industrial production (n.s.a., not shown in table) in the first two months of 1989 suggests that this strength has continued. Measured inflation at the retail level increased during the first quarter, partly the result of an increase in value-added taxes. Meanwhile, the merchandise trade balance deteriorated sharply in early 1989, the result of a slowing in export growth.

On April 20, the Italian Parliament passed the enabling legislation for the 1989 budget more than three months after the beginning of the fiscal year when the budget itself was passed. Included in the bill were measures to reduce tax evasion, the indexation of tax brackets to eliminate fiscal drag, a reduction in the number of tax brackets, the higher value-added tax rates, and an increase in the taxing power of local governments. The cabinet voted to introduce by decree-law fees for certain public health services that have provoked widespread protests and led the unions to call a general strike for May 10.

<u>Economic Situation in Major Developing Countries</u>

In Argentina, a near collapse of the austral has led to a significant acceleration of prices, replacement of the government's economic team, and new emergency stabilization measures as the May 14 presidential election draws near. Mexico reached an agreement with the IMF on April 11 for a three-year, SDR 2.8 billion EFF. In Brazil, the government announced new measures on April 17 in an effort to control inflation. On March 29, the IMF Executive Board approved Venezuela's request for a first-credit-tranche purchase of $453 million. Nigeria's early April deadline for clearing $30 million in interest arrears to commercial banks under its $5.7 billion rescheduling arrangement that was negotiated in March has been extended to June 7.

Individual country notes. In Argentina, a near collapse of the austral has led to a significant acceleration in inflation, replacement of the government's economic team, and new emergency stabilization measures as the May 14 presidential election draws near. During March, the free-market austral depreciated 75 percent. The deteriorating economic situation prompted the end-March replacement of Economy Minister Juan Sourrouille with Juan Carlos Pugliese. As a result of continued austral depreciation and losses of foreign exchange reserves, special exchange rates for commercial transactions were eliminated in mid-April to unify the exchange regime. However, the austral continued to weaken, depreciating about 40 percent during April. Monthly inflation rose from 9.6 percent in February to 17 percent in March and to 33.4 percent in April. By the end of April, nominal interest rates had reached 100 percent for short-term instruments, and a severe shortage of currency had developed as well.

At the beginning of May, new stabilization measures were announced, including a revision of the export tax system in an effort to increase the supply of dollars to the foreign exchange market, increases in public sector prices, an indefinite freeze on most private sector prices, and a temporary limit on withdrawals from bank deposits. Although the government announced several measures to reduce the fiscal deficit, including the higher public sector prices, new taxes and spending curtailments, it is not clear whether all these measures will actually be implemented. The authorities hope the program will stabilize the economy until the elections, after which it may be easier to develop support for policies that will permanently reduce the fiscal deficit. Since the announcement of the new package, financial markets have remained volatile, and the austral has continued to depreciate rapidly.

Mexico reached agreement with the IMF on April 11 on a three-year, SDR 2.8 billion EFF arrangement. The agreement basically endorses the policies that Mexico has been following. Performance criteria will be adjusted for unanticipated changes in oil export prices and world interest rates. Executive Board consideration has been set tentatively for May 26. After the IMF agreement is approved, Mexico is expected to seek a Paris Club rescheduling.

On April 19, Mexico opened negotiations with commercial banks with the aim of reducing its principal and/or interest rates on its debt, restructuring some debt maturities, and obtaining new money. Negotiations with the World Bank on a package of three policy-based loans totaling $1.5 billion are near completion.

Oil export earnings were $640 million larger over the first quarter than had been forecast at the beginning of the year. The average price over this period was $14.78 per barrel, and the average volume exported was 1.33 million barrels per day. Originally, official projections of fiscal revenues and the current account assumed a price of $10 per barrel and a volume of 1.25 million barrels per day.

On April 3, the government removed controls on interest rates on bank liabilities and restructured banks' portfolio requirements, reducing them as a source of government financing. Furthermore, bankers' acceptances, issued by banks at market determined interest rates, have grown rapidly in recent months, in part because banks are not required to invest as much in government securities as they are required to do on other bank liabilities. So far, however, bank deposit rates have remained at their pre-decontrol levels, which are well below market rates. The 28-day Treasury bill rate, which declined from late December to mid-March, thereafter turned up and was 51 percent on May 2, compared with 47 percent on March 14.

In March, the CPI was 1.1 percent higher than in February and 21 percent higher than a year earlier.

In Brazil, the government on April 17 announced new measures in an attempt to control inflation. Consumer prices rose 3.6 percent in February, 6.1 percent in March, and 7.3 percent in April. The measures included a 3.2 percent devaluation of the cruzado against the dollar, plans to reintroduce indexed government debt, and an increase in mandated prices for many goods. The cruzado was devalued another 2 percent on May 4.

The measures reflect the government's response to the deteriorating economic performance and rising popular discontent in recent months. Real GDP was reported to have fallen 0.3 percent in 1988. Interest rates have remained high in early 1989, although the central bank has lowered interest rates in the overnight market in recent weeks. Widespread shortages have once again appeared in response to the price controls imposed in January. Labor strikes increased in March and April and have included workers at commercial banks and the central bank. Although President Sarney announced measures limiting the ability of unions to call strikes, the measures have so far not been enforced.

In contrast to the deteriorating domestic conditions, the trade surplus reached an estimated $4 billion for the first three months of 1989, compared with a $3.1 billion surplus over the first quarter of 1988. However, although exchange rate devaluations have improved competitiveness, prices have risen faster since the devaluation in mid-January. The differential between the free-market dollar exchange rate and the official rate surpassed 150 percent in early May.

In late April, commercial banks disbursed the $600 million second tranche from the 1988 new money agreement, after Brazil cleared most of its interest arrears.

On March 29, the IMF Executive Board approved Venezuela's request for a first-credit-tranche purchase of $453 million. Upon receipt of the IMF funds Venezuela repaid a $450 million bridge loan that was disbursed by the U.S. Treasury in mid-March. Additional IMF and World Bank disbursements are expected within the next two months. Negotiations with commercial banks have resumed. The government plans to ask for debt reduction and new money. Venezuela has accumulated some interest arrears on its bank debt, but to date has not allowed interest payments on public sector debt to become more than 90 days overdue.

Consumer prices increased markedly in March and April compared with earlier months, but the increases were mainly the result of the exchange rate devaluation and unification in mid-March, the removal of price controls, and public sector price increases in late March. Consumer prices increased 21.3 percent in March and 13.5 percent in April, compared with 35.4 percent over the 12 months of 1988.

Nigeria missed an early April deadline for clearing interest arrears to commercial banks that had been agreed to under its $5.7 billion rescheduling arrangement negotiated in March. Nigeria was granted a one-time extension and now has until June 7 to eliminate arrears totaling about $30 million. Although a recent IMF mission was unable to complete a mid-term review of its program with Nigeria, Fund staff seem satisfied that difficulties can be resolved.