

Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,¹ and then making the scanned versions text-searchable.² Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

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

² A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

June 27, 1990

RECENT DEVELOPMENTS

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

TABLE OF CONTENTS

| | <u>Section</u> | <u>Page</u> |
|---|----------------|-------------|
| DOMESTIC NONFINANCIAL DEVELOPMENTS | II | |
| Employment and unemployment..... | | 1 |
| Labor cost developments..... | | 5 |
| Industrial production..... | | 7 |
| Autos and light trucks..... | | 12 |
| Consumption and personal income..... | | 13 |
| Business fixed investment..... | | 16 |
| Business inventories..... | | 23 |
| Housing markets..... | | 23 |
| Federal sector..... | | 28 |
| State and local government sector..... | | 33 |
| Prices..... | | 34 |
| Probability of recession..... | | 40 |
| <u>Tables</u> | | |
| Changes in employment..... | | 2 |
| Selected unemployment rates..... | | 2 |
| Average hourly earnings..... | | 6 |
| Employer costs for compensation..... | | 6 |
| Growth in selected components of industrial production..... | | 8 |
| Percent change in orders for manufactured goods..... | | 8 |
| Capacity utilization in industry..... | | 11 |
| Sales of automobiles and light trucks..... | | 12 |
| Real personal consumption expenditures..... | | 14 |
| Personal income..... | | 14 |
| Business capital spending indicators..... | | 17 |
| Commerce surveys of plant and equipment expenditures..... | | 21 |
| Changes in manufacturing and trade inventories..... | | 24 |
| Inventories relative to sales..... | | 24 |
| Private housing activity..... | | 26 |
| Federal government outlays and receipts..... | | 29 |
| Evolution of federal budget deficit projections..... | | 29 |
| Recent changes in consumer prices..... | | 35 |
| Recent changes in producer prices..... | | 35 |
| Price indexes for commodities and materials..... | | 39 |
| <u>Charts</u> | | |
| Labor force..... | | 4 |
| Population growth..... | | 4 |
| Labor force participation rate..... | | 4 |
| Indicators of industrial activity..... | | 10 |
| Consumption of goods excluding motor vehicles..... | | 15 |
| Recent data on orders and shipments..... | | 18 |
| Nonresidential construction and selected indicators..... | | 19 |
| Real business fixed investment..... | | 22 |
| Acceleration of business output..... | | 22 |
| Cost of capital equipment..... | | 22 |
| Cash flow..... | | 22 |
| Ratio of inventories to sales..... | | 25 |
| Private housing starts..... | | 26 |
| Multifamily housing starts, by rental and sale units..... | | 27 |
| Multifamily condominium starts, by region..... | | 27 |
| State budgets and school, Medicaid, and prison populations..... | | 32 |
| Consumer price measures..... | | 36 |
| Commodity price measures..... | | 38 |

| | |
|---|------------|
| Index weights..... | 39 |
| Probability of a recession..... | 41 |
| DOMESTIC FINANCIAL DEVELOPMENTS | III |
| Monetary aggregates and bank credit..... | 5 |
| Business finance..... | 9 |
| Resolution Trust Corporation Activity..... | 11 |
| Treasury and sponsored-agency financing..... | 13 |
| Municipal securities..... | 14 |
| Mortgage markets..... | 17 |
| Consumer credit..... | 19 |
| <u>Tables</u> | |
| Monetary aggregates..... | 2 |
| Commercial bank credit and short- and intermediate-term business credit..... | 6 |
| Gross offerings of securities by U.S. corporations..... | 8 |
| Treasury and agency financing..... | 12 |
| Gross offerings of municipal securities..... | 15 |
| Consumer credit..... | 18 |
| Consumer interest rates..... | 18 |
| <u>Charts</u> | |
| Interest rates on selected M2 instruments and on six-month Treasury bills..... | 4 |
| Flow of total bank and thrift credit relative to the flow of M2... | 4 |
| M2 velocity and its opportunity cost..... | 4 |
| Mortgage interest rates..... | 16 |
| Consumer loan interest rates at banks..... | 20 |
| Spread between consumer rates and Treasury yield..... | 20 |
| INTERNATIONAL DEVELOPMENTS | IV |
| U.S. merchandise trade..... | 1 |
| Import and export prices..... | 5 |
| U.S. current account in the fourth quarter of 1990..... | 7 |
| U.S. international financial transactions..... | 8 |
| Foreign exchange markets..... | 12 |
| Developments in foreign industrial countries..... | 15 |
| Developments in Eastern European economies..... | 25 |
| U.S. bank lending to foreigners..... | 26 |
| <u>Tables</u> | |
| U.S. merchandise trade: Monthly data--revised..... | 1 |
| Oil imports..... | 2 |
| U.S. merchandise trade: Quarterly data..... | 3 |
| Major trade categories..... | 4 |
| Import and export price measures..... | 6 |
| U.S. current account..... | 7 |
| Summary of U.S. international transactions..... | 9 |
| International banking data..... | 11 |
| Major industrial countries | |
| Real GNP and industrial production..... | 17 |
| Consumer and wholesale prices..... | 18 |
| Trade and current account balances..... | 19 |
| International exposures of U.S. banks..... | 28 |
| <u>Charts</u> | |
| Weighted average exchange value of the dollar..... | 13 |
| Selected dollar exchange rates..... | 13 |

DOMESTIC NONFINANCIAL DEVELOPMENTS

DOMESTIC NONFINANCIAL DEVELOPMENTS

On the whole, indicators of economic activity point to slow growth in the second quarter. Initial estimates of retail sales for May suggest a marked weakening in demand for consumer goods, while construction activity has slumped in the aftermath of the winter's weather-related bulge. All of the growth in the current quarter is likely to be accounted for by a sharp rebound in auto and truck production. Factory utilization rates have edged back up, and the unemployment rate has remained near 5-1/4 percent. As expected, inflation has retreated from its elevated first-quarter pace; even so, year-over-year increases in wages and prices have remained in the upper part of their recent ranges.

Employment and Unemployment

Employment growth has been relatively slow on average since February, with hiring by the Census Bureau more than accounting for the gain. A slackening in private employment growth was to be expected, given the temporary boost provided in January and February by the warm weather, which especially swelled construction payrolls. But the recent weakness suggests a more fundamental softening in labor demand, likely arising from a lagged adjustment of work forces to slower trends of output growth.

In May, private payrolls rose only 10,000, following a decrease of 126,000 in April (originally reported as a drop of 64,000). Employment in manufacturing declined an additional 35,000 in May, bringing the cumulative drop in the past year to almost 300,000. Construction employment also fell in May; these payrolls are now below their level of last fall, consistent with the weakness in some other measures of building activity. Gains in

CHANGES IN EMPLOYMENT¹
(Thousands of employees; based on seasonally adjusted data)

| | 1988 | 1989 | 1989 | | 1990 | 1989 | | |
|---|------|------|------|-----|------|------|------|-----|
| | | | Q3 | Q4 | Q1 | Mar. | Apr. | May |
| -----Average monthly changes----- | | | | | | | | |
| Nonfarm payroll employment ² | 276 | 206 | 163 | 158 | 286 | 123 | -23 | 164 |
| Private | 248 | 177 | 115 | 156 | 205 | 11 | -126 | 10 |
| Manufacturing | 29 | -8 | -30 | -23 | -22 | -29 | -19 | -35 |
| Durable | 20 | -13 | -29 | -24 | -8 | -13 | -33 | -13 |
| Nondurable | 9 | 5 | -1 | 0 | -14 | -16 | 14 | -22 |
| Construction | 14 | 8 | 14 | -7 | 43 | -53 | -100 | -19 |
| Trade | 64 | 48 | 38 | 44 | 33 | 1 | 18 | 12 |
| Finance, insurance, real estate | 11 | 12 | 15 | 11 | 12 | 6 | -3 | 5 |
| Services | 118 | 99 | 76 | 87 | 121 | 74 | -22 | 37 |
| Total government | 27 | 29 | 48 | 2 | 81 | 112 | 103 | 154 |
| Census | | | | | 39 | 90 | 61 | 147 |
| Private nonfarm production workers | 197 | 144 | 94 | 129 | 167 | 24 | -112 | -28 |
| Manufacturing production workers | 20 | -10 | -27 | -19 | -24 | -26 | 1 | -23 |
| Total employment ³ | 192 | 146 | -41 | 156 | 149 | 299 | -218 | 234 |
| Nonagricultural | 193 | 145 | -68 | 164 | 147 | 176 | -150 | 62 |

1. Average change from final month of preceding period to final month of period indicated.

2. Survey of establishments.

3. Survey of households.

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

| | 1988 | 1989 | 1989 | | 1990 | 1989 | | |
|------------------------------|------|------|------|------|------|------|------|------|
| | | | Q3 | Q4 | Q1 | Mar. | Apr. | May |
| Civilian, 16 years and older | 5.5 | 5.3 | 5.3 | 5.3 | 5.2 | 5.2 | 5.4 | 5.3 |
| Teenagers | 15.3 | 15.0 | 15.0 | 15.2 | 14.5 | 14.4 | 14.7 | 15.5 |
| 20-24 years old | 8.7 | 8.6 | 8.7 | 8.9 | 8.4 | 8.3 | 9.3 | 8.5 |
| Men, 25 years and older | 4.2 | 3.9 | 3.9 | 4.0 | 4.1 | 4.0 | 4.2 | 4.1 |
| Women, 25 years and older | 4.3 | 4.2 | 4.2 | 4.3 | 4.2 | 4.2 | 4.2 | 4.1 |
| White | 4.7 | 4.5 | 4.5 | 4.5 | 4.6 | 4.5 | 4.8 | 4.6 |
| Black | 11.7 | 11.5 | 11.3 | 11.8 | 10.8 | 10.6 | 10.4 | 10.4 |
| Fulltime workers | 5.2 | 4.9 | 5.0 | 5.0 | 4.9 | 4.9 | 5.1 | 4.9 |
| Memo: | | | | | | | | |
| Total National ¹ | 5.4 | 5.2 | 5.2 | 5.3 | 5.2 | 5.1 | 5.3 | 5.3 |

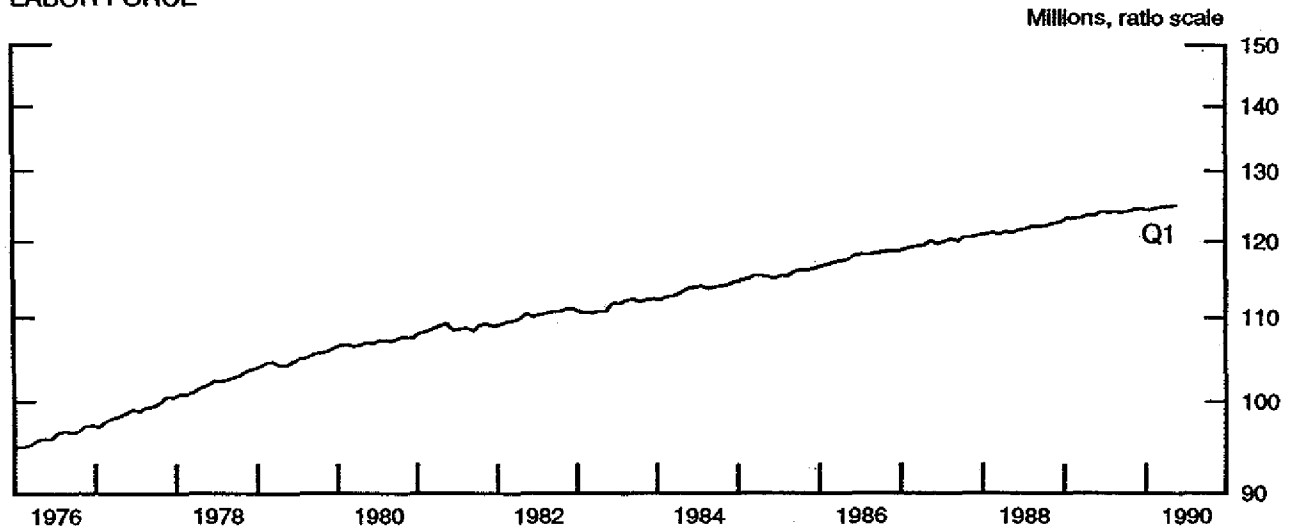
1. Includes resident armed forces as employed.

services, which had been exceptionally strong earlier in the year, also have slowed, most notably at firms providing business services; over the past three months, employment in services has risen only 30,000 per month on average, well below the 1989 average monthly gain of 100,000. In contrast, government employment has posted large increases of late, mainly because of the hiring of 325,000 Census workers. Although it is possible that, in the absence of the Census, some of these workers might have taken private-sector jobs, neither the patterns during past Censuses nor available information on the characteristics of recent Census hires provides support for this hypothesis.

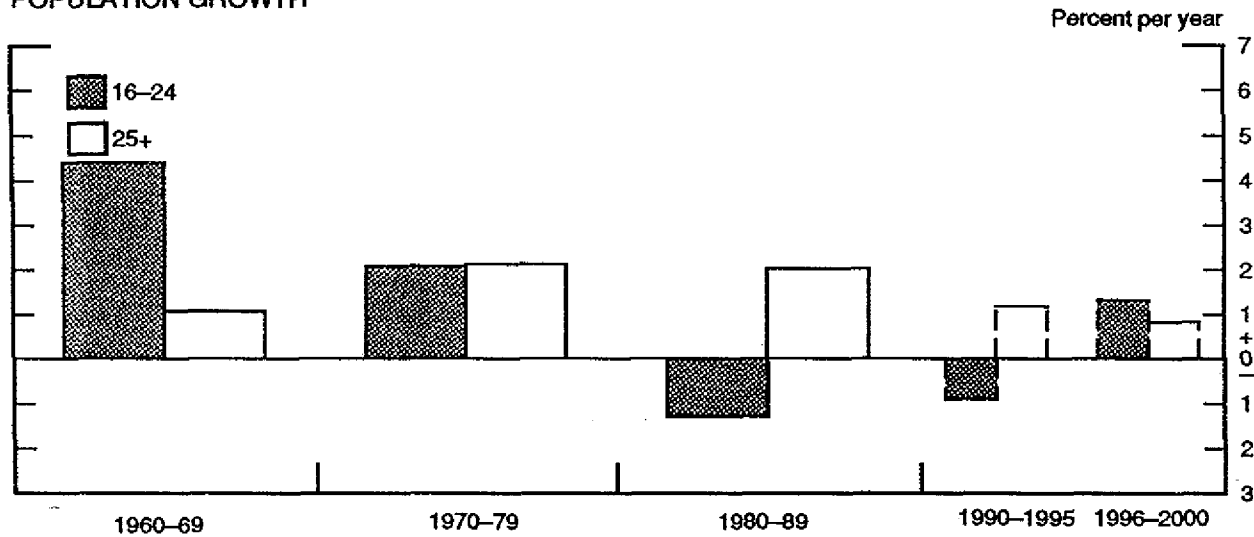
The household measure of employment--like the payroll series--has slowed considerably over the past year. Nonetheless, the unemployment rate, which edged back down to 5.3 percent in May, has been essentially unchanged for a year and a half. Since mid-1989, a rise in the number of workers who lost jobs has been offset by a decline in the number of entrants and reentrants to the labor force who had not yet found jobs.

Taking a longer perspective, labor force growth has slowed in the past couple of years. In part, this slowing reflects factors that emerged earlier in the 1980s and that are likely to persist. Notably, as the "baby bust" generation has aged, the young working-age population (ages 16 to 24) has begun to decline. According to projections by the Census Bureau, the number of these young workers will continue to shrink well into the coming decade, although at a progressively slower rate after 1991. Further, the trend in overall labor force participation has been rising less rapidly: The sharp increases in the labor force participation rates of women seen in the 1970s and early 1980s have tapered off, and the participation rates of

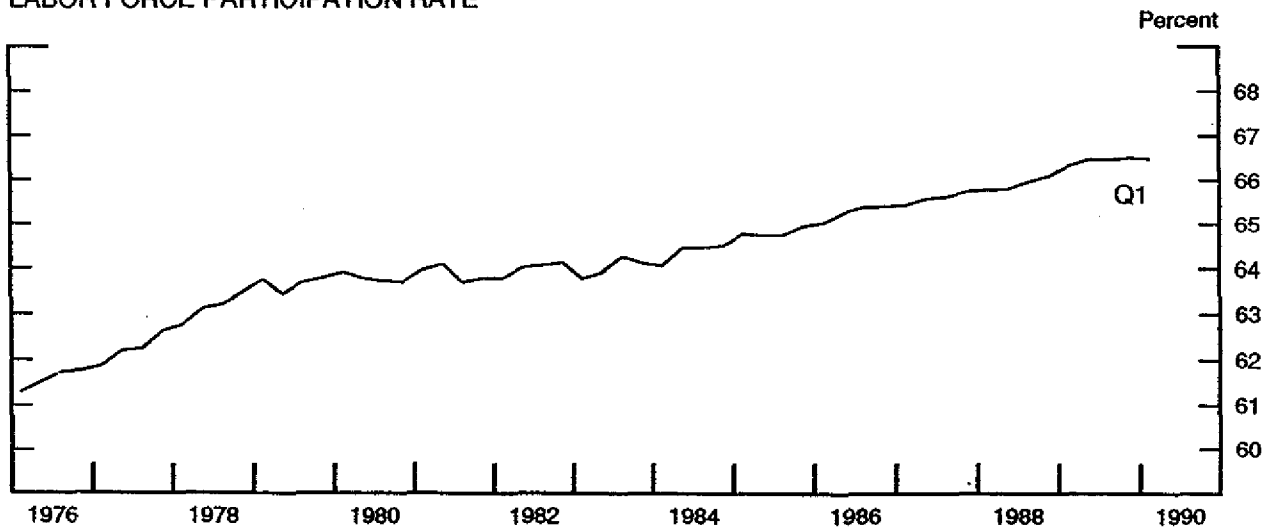
LABOR FORCE



POPULATION GROWTH



LABOR FORCE PARTICIPATION RATE



adult men have continued to trend down in line with a decline in the average age of retirement.

In recent quarters particularly, the labor force participation rate appears to have flattened out. Although we cannot fully explain this, it is possible that fewer individuals were attracted into the labor force as labor demand slowed over the past year. The sharpest drop in labor force participation rates occurred among women 20-24 years old.

Labor Cost Developments

Average hourly earnings of production or nonsupervisory workers rose 0.4 percent in May, with large increases in construction and in manufacturing. However, excluding overtime, average hourly earnings in manufacturing were little changed in May, after increasing 0.8 percent in April.

Wage effects of the April 1 increase in the minimum wage are not discernible in the recent data. In particular, average hourly earnings in retail trade increased just 0.1 percent in April and 0.3 percent in May. And although hourly earnings in services did increase sharply in April, they were flat in May; thus, the average increase over the two-month period was not much different than the readings for the preceding few quarters. It is possible that shifts in the composition of employment within these broad industry categories are obscuring the influence of the new minimum wage on the hourly earnings measure and that these effects therefore will be more evident in the employment cost index for the second quarter to be released in July; that said, data in hand suggest that the effect of the new minimum wage was limited, perhaps because there were so few workers near or below the new floor.

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

| | 1988 | 1989 | 1989 | | 1990 | 1990 | | |
|--|------|------|-------------------|-----|------|----------------------|------|-----|
| | | | Q3 | Q4 | Q1 | Mar. | Apr. | May |
| | | | ---Annual rate--- | | | ----Monthly rate---- | | |
| Total private nonfarm | 3.7 | 3.9 | 4.1 | 3.8 | 3.3 | .4 | .3 | .4 |
| Manufacturing | 3.0 | 2.7 | 3.6 | 2.3 | 2.3 | .6 | .2 | .9 |
| Excluding overtime | 2.9 | 2.8 | 3.7 | 2.4 | 3.2 | .5 | .8 | -.1 |
| Durable | 2.8 | 2.4 | 4.1 | 1.0 | 1.3 | .7 | -.1 | 1.2 |
| Nondurable | 3.1 | 3.4 | 3.3 | 4.4 | 3.7 | .6 | .4 | .5 |
| Contract construction | 2.3 | 3.1 | 2.1 | 3.8 | -3.1 | .3 | -.6 | 1.2 |
| Transportation and public utilities | 2.0 | 2.3 | 2.7 | 1.6 | 5.0 | .3 | .5 | .0 |
| Finance, insurance and real estate | 5.3 | 4.5 | 5.6 | 4.5 | 1.7 | .4 | .8 | .0 |
| Wholesale trade | 3.9 | 4.5 | 4.3 | 4.8 | 2.2 | .3 | .9 | -.5 |
| Retail trade | 3.8 | 3.4 | 3.5 | 3.7 | 5.8 | .6 | .1 | .3 |
| Services | 4.9 | 5.6 | 5.7 | 5.2 | 3.2 | .5 | .8 | .0 |

1. Annual changes are measured from final quarter of preceding year to final quarter of year indicated.

EMPLOYER COSTS FOR COMPENSATION
(Private industry workers)

| | Dollars per hour ¹ | | Percentage change ² | | |
|-----------------------------|-------------------------------|-------|--------------------------------|------|------|
| | 1989 | 1990 | 1988 | 1989 | 1990 |
| Total compensation | 14.28 | 14.96 | 2.8 | 3.6 | 4.8 |
| Wages | 10.38 | 10.84 | 1.9 | 3.6 | 4.4 |
| Total benefits ³ | 3.90 | 4.13 | 4.7 | 3.5 | 5.9 |
| Nonproduction bonuses | .12 | .16 | .0 | .0 | 33.3 |
| Insurance | .85 | .92 | 8.3 | 9.0 | 8.2 |
| Retirement and savings | .42 | .45 | -6.3 | -6.7 | 7.1 |
| Social security | .84 | .89 | 8.0 | 3.7 | 6.0 |
| Workers' compensation | .27 | .31 | 14.3 | 12.5 | 14.8 |
| Memo: | | | | | |
| Employment cost index | | | 3.8 | 4.6 | 5.2 |

1. Levels in March.
2. Percent changes are from March of preceding year to March of year indicated.
3. Includes detail not shown separately.

BLS recently published detailed data on benefits from a once-a-year survey conducted in March.¹ Continuing the trend of recent years, benefit costs--constituting 28 percent of total compensation--rose faster than wages between March 1989 and March 1990. Last year's increase in benefit costs reflected a further large rise (more than 8 percent) in insurance costs--which include health care premiums, a surge in bonuses including lump-sum payments, and a rebound in employer contributions to pension plans.

On the collective bargaining front, the United Auto Workers (UAW) is scheduled to begin negotiations in July with the Big Three automakers on new three-year contracts for about 500,000 workers whose current contracts expire on September 14. The negotiations will mark the first time since 1979 that the UAW has bargained simultaneously with all three automakers. At its national convention in May, the UAW decided to focus on the issue of job security and indicated that it would push for job guarantees; benefits also are likely to receive high priority.

Industrial Production

The trend in industrial activity appears to have improved slightly this year. The index of total industrial production rose 0.6 percent in May; with an upward revision to the level of total output in April, the April-May average was about 2-1/4 percent (annual rate) above that in the fourth quarter of 1989. IP was boosted 0.4 percentage point in May by an increase in output of motor vehicles and parts. Auto assemblies moved up to an annual rate of 6.4 million units (FRB seasonals)--the same as in the fourth

1. In contrast to the procedure used for computing pay changes in the Employment Cost Index (ECI), which uses fixed employment weights from the 1980 census, this survey uses current employment weights each year. Over the past three years, employer costs increased at a somewhat slower rate than the ECI, suggesting a shift toward lower-paid workers and industries.

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

| | Proportion in total IP 1989:Q4 | 1989 | | 1990 | 1990 | | |
|---|--------------------------------------|-----------------------|-----------------|-------------|--------------------|-------|------|
| | | H1 ¹ | H2 ¹ | Apr.-May/Q4 | Mar. | Apr. | May |
| | | -----Annual rate----- | | | ---Monthly rate--- | | |
| Total index | 100.0 | 2.8 | -.5 | 2.2 | .5 | 0 | .6 |
| Previous | | 2.8 | -.5 | | .5 | -.4 | |
| Excluding motor vehicles and parts | 95.7 | 3.3 | .1 | 2.3 | .1 | .4 | .2 |
| Major market groups: Products, total | 61.2 | 3.8 | -.1 | 2.8 | .7 | -.1 | .7 |
| Final products | 46.6 | 4.1 | -.4 | 3.2 | 1.0 | -.1 | .9 |
| Consumer goods | 25.9 | 1.9 | 1.7 | .1 | .6 | -.2 | .5 |
| Motor vehicles | 1.4 | -10.1 | -16.1 | 2.9 | 16.3 | -11.2 | 10.7 |
| Other consumer goods | 24.5 | 2.8 | 2.8 | 0 | -.2 | .5 | 0 |
| Business equipment | 15.2 | 8.6 | -3.6 | 8.1 | 1.8 | -.3 | 1.7 |
| Motor vehicles | 1.1 | -12.6 | -13.9 | 4.8 | 14.0 | -8.9 | 10.2 |
| Computers | 2.5 | 23.9 | 2.8 | 19.9 | 2.1 | 2.8 | .8 |
| Aircraft | 1.1 | 24.6 | -18.5 | 48.2 | 1.9 | .7 | 2.2 |
| Other | 10.5 | 6.6 | -2.1 | 1.9 | .5 | -.3 | .9 |
| Construction supplies | 6.0 | 2.0 | 1.4 | -.6 | -1.3 | -.3 | -.1 |
| Materials | 38.8 | 1.1 | -1.2 | 1.4 | .1 | .3 | .5 |
| Durable | 19.8 | .5 | -2.3 | 1.0 | 0 | -.3 | 1.4 |
| Consumer parts | 4.0 | -2.3 | -9.8 | -1.7 | 1.6 | -2.3 | 4.3 |
| Metals | 2.8 | -2.0 | -4.5 | -1.9 | -2.5 | 1.4 | 0 |
| Nondurable | 8.8 | 2.9 | -.9 | 1.9 | -.4 | .8 | -.1 |
| Chemicals | 3.7 | 1.7 | -2.5 | 3.3 | .2 | -.1 | -.3 |
| Major industry groups: | | | | | | | |
| Manufacturing | 84.9 | 2.9 | -1.1 | 2.6 | .2 | -.2 | .8 |
| Mining | 7.4 | -.7 | -.8 | 3.7 | -.2 | 1.7 | 0 |
| Utilities | 7.8 | 4.4 | 8.2 | -4.8 | 3.6 | .7 | -1.1 |

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

PERCENT CHANGE IN ORDERS FOR MANUFACTURED GOODS¹
(For industries that report unfilled orders; seasonally adjusted)

| | 1989 | 1990 | 1990 | | |
|--|------|------|------|------|------|
| | Q4 | Q1 | Mar. | Apr. | May |
| Durable goods excluding civilian aircraft, defense, and motor vehicles and parts | 2.6 | -.2 | 1.2 | -.2 | 1.6 |
| Nonelectrical machinery ² | -.4 | 2.1 | -.5 | -3.6 | 3.3 |
| Nondurable goods | -1.0 | 2.8 | 1.9 | 1.3 | n.a. |

1. Percent change from prior comparable period.
2. Excluding farm equipment.

quarter of last year--while truck production increased to a 4.2 million unit annual rate, about 14 percent higher than the fourth-quarter pace. In addition to the boost from motor vehicles--and its spillover to supplier industries--the advances in production this year likely reflect continued growth in exports of manufactured goods (chart).

Output of business equipment has firmed this year, reflecting the upswing in motor vehicles, strength in aircraft, and big gains in the production of information-processing equipment, the latter stemming in part from a surge in exports of computers. In addition, production of other types of business equipment has increased about 2 percent at an annual rate so far this year, retracing its decline over the second half of last year. In contrast, output of consumer goods excluding motor vehicles has been relatively sluggish in recent months.

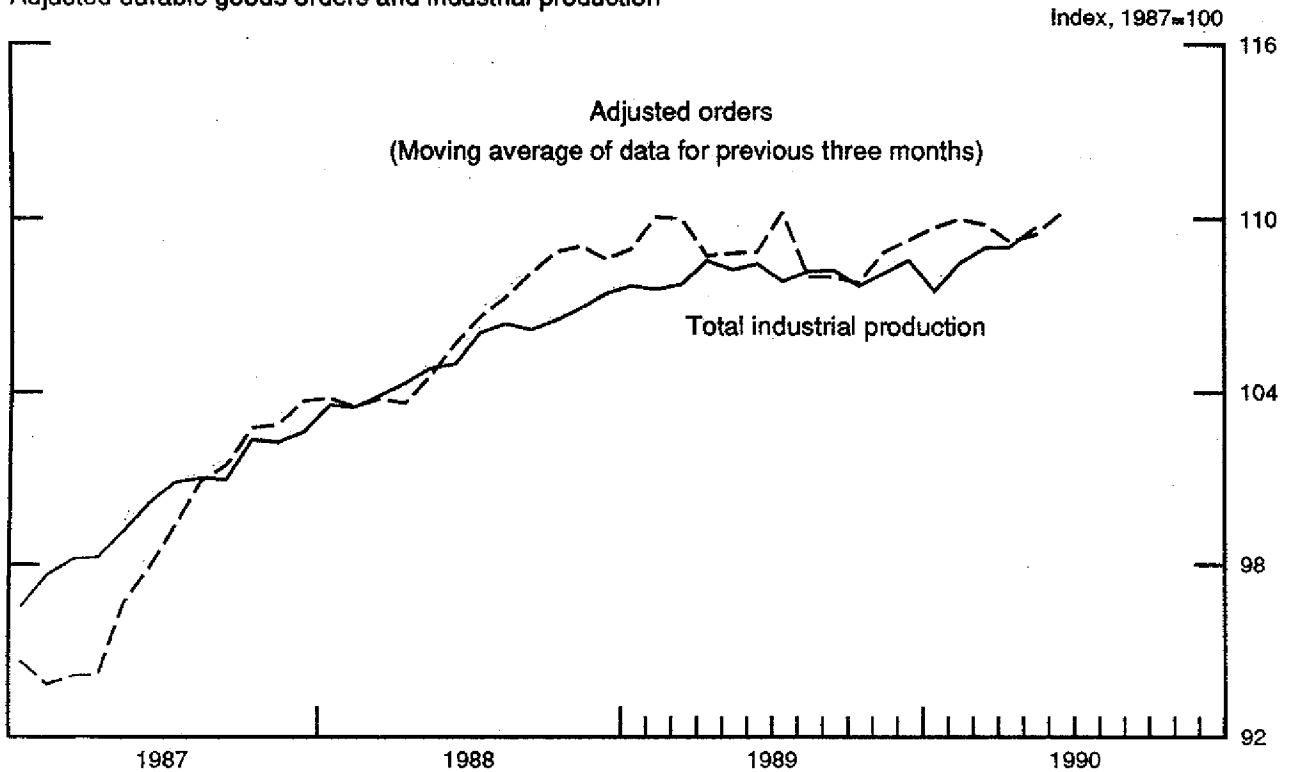
Looking ahead, indicators of manufacturing activity, such as orders for durable goods, are consistent with modest growth in output in coming months. Moreover, motor vehicle production looks to have increased further in June--by enough to boost directly total industrial production 1/4 percent after allowing for the accompanying rise in output of motor vehicle parts. Production at industries such as metals, machinery, and plastics that supply materials to automakers likely benefited as well.

Gains in manufacturing output so far this year have about matched the expansion of capacity, and the factory operating rate inched up to 83 percent in May. Utilization both at advanced and at primary processing industries has been little changed, on balance; the rate for primary processing had declined somewhat in 1989 but remains at a relatively high level compared with its historical average. Among industries, utilization

INDICATORS OF INDUSTRIAL ACTIVITY

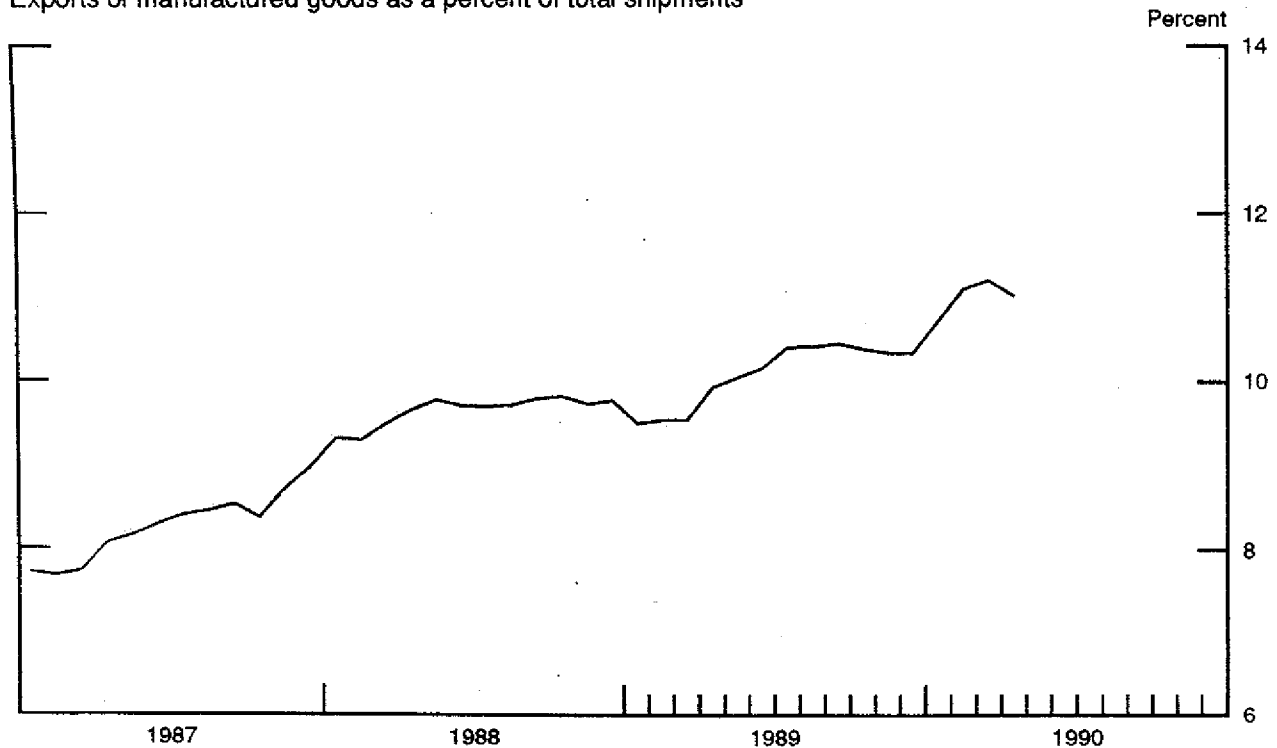
(Based on monthly, seasonally adjusted data)

Adjusted durable goods orders and industrial production



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

Exports of manufactured goods as a percent of total shipments



Note: Exports are on a census basis and seasonally adjusted by FRB staff. Three-month moving average taken.

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

| | 1967-89 | 1978-79 | 1988-89 | 1989 | 1990 | | |
|--|---------|---------|---------|------|------|------|------|
| | Avg. | High | High | Dec. | Mar. | Apr. | May |
| Total industry | 82.2 | 87.3 | 85.0 | 83.7 | 83.4 | 83.3 | 83.6 |
| Manufacturing | 81.5 | 87.3 | 85.1 | 82.8 | 82.9 | 82.6 | 83.0 |
| Primary processing | 82.3 | 89.7 | 89.0 | 85.2 | 85.2 | 85.1 | 85.2 |
| Advanced processing | 81.1 | 86.3 | 83.6 | 81.8 | 82.0 | 81.5 | 82.1 |
| Durable manufacturing | 79.5 | 86.9 | 84.0 | 81.4 | 81.9 | 81.2 | 82.0 |
| Primary metals | 79.8 | 102.4 | 91.6 | 80.8 | 82.8 | 83.5 | 83.5 |
| Iron and steel | 79.4 | 110.4 | 92.0 | 76.1 | 80.4 | 80.7 | 80.2 |
| Nonferrous metals | 80.8 | 90.5 | 95.0 | 88.0 | 86.4 | 87.8 | 88.5 |
| Fabricated metal products | 77.7 | 83.9 | 85.1 | 81.8 | 80.8 | 80.1 | 80.8 |
| Nonelectrical machinery | 81.3 | 92.1 | 83.5 | 82.2 | 82.3 | 82.8 | 83.0 |
| Electrical machinery | 80.4 | 89.4 | 83.1 | 80.7 | 81.5 | 80.3 | 80.3 |
| Motor vehicles and parts | 76.7 | 93.0 | 85.5 | 74.8 | 77.9 | 72.0 | 78.2 |
| Autos and light trucks ¹ | | 92.2 | 83.6 | 71.3 | 76.3 | 67.4 | 74.3 |
| Aerospace and miscellaneous transportation equipment | 75.3 | 80.5 | 86.2 | 82.5 | 83.7 | 84.4 | 84.7 |
| Nondurable manufacturing | 83.7 | 87.0 | 86.7 | 84.5 | 84.3 | 84.4 | 84.3 |
| Textile mill products | 86.0 | 90.5 | 91.2 | 86.3 | 86.9 | 87.6 | 87.7 |
| Paper and products | 89.7 | 94.2 | 95.8 | 91.1 | 90.2 | 91.9 | 92.1 |
| Chemicals and products | 79.8 | 85.1 | 86.8 | 81.2 | 81.8 | 82.0 | 81.7 |
| Petroleum products | 85.1 | 89.5 | 90.3 | 86.1 | 90.1 | 90.6 | 88.8 |
| Mining | 87.3 | 95.2 | 87.2 | 86.3 | 87.2 | 88.9 | 88.9 |
| Utilities | 86.8 | 88.3 | 92.3 | 92.3 | 85.4 | 85.9 | 84.9 |
| Electric utilities | 89.0 | 88.3 | 96.2 | 96.2 | 91.4 | 92.0 | 90.9 |
| Gas utilities | 83.3 | 92.5 | 80.3 | 80.3 | 66.6 | 67.1 | 66.4 |

1. Series begins in 1977.

rates for motor vehicles, nonelectrical machinery, metals, and paper are up, while operating rates for producers of stone, clay, and glass and for lumber are down, reflecting the underlying weakness in building activity.

Autos and Light Trucks

Sales of autos and light trucks have remained sluggish through mid-June. Sales of domestically produced cars have been virtually flat at about a 6-3/4 million unit annual rate (BEA seasonals) since February, and sales of imported cars have fluctuated around 2-3/4 million units. Meanwhile, sales of light trucks have eased slightly from their first-quarter pace. Despite the relatively subdued pace of sales, the domestic automakers thus far have been able to hold their inventories in check; at the end of May, stocks of domestic autos stood at 1.29 million units--only a 60 days' supply even at the sluggish May sales pace.

SALES OF AUTOMOBILES AND LIGHT TRUCKS¹
(Millions of units at an annual rate, BEA seasonals)

| | 1988 | 1989 | 1989 Q4 | 1990 Q1 | 1990 | | |
|-----------------------------|------|------|------------|------------|------|------|------|
| | | | | | Mar. | Apr. | May |
| Autos and light trucks | 15.4 | 14.5 | 13.0 | 14.2 | 13.8 | 14.0 | 13.7 |
| Autos | 10.6 | 9.9 | 8.8 | 9.7 | 9.5 | 9.5 | 9.3 |
| Light trucks | 4.8 | 4.6 | 4.3 | 4.5 | 4.3 | 4.5 | 4.4 |
| Domestic total ² | 11.7 | 11.2 | 10.0 | 11.1 | 10.5 | 10.8 | 10.6 |
| Autos | 7.5 | 7.1 | 6.2 | 7.0 | 6.6 | 6.7 | 6.7 |
| Light trucks | 4.2 | 4.1 | 3.8 | 4.1 | 3.9 | 4.1 | 3.9 |
| Import total | 3.7 | 3.3 | 3.0 | 3.2 | 3.3 | 3.3 | 3.1 |
| Autos | 3.1 | 2.8 | 2.6 | 2.8 | 2.9 | 2.9 | 2.6 |
| Light trucks ³ | .6 | .5 | .5 | .4 | .4 | .4 | .5 |

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.

Auto production in the second quarter is expected to total 6-1/4 million units at an annual rate (BEA seasonals)--up about 3/4 million from the depressed first-quarter pace. All else equal, this rise in assemblies--along with an expected increase in truck output--is expected to contribute 1-1/4 percentage points to this quarter's real GNP growth. Schedules for the third quarter call for automobile assemblies at a 7-1/2 million unit pace. Although these plans seem a bit high, there have been reports that the automakers may be planning to build a buffer stock of cars in anticipation of a possible UAW strike in September. Nevertheless, our industry contacts insist that production plans have not been boosted in anticipation of a possible strike; they say they would rather have too few cars on hand in the event of a strike than too many cars without a strike.

Consumption and Personal Income

Real personal consumption expenditures appear to have slowed considerably. The latest figures from BEA show first-quarter growth in real PCE at only 1-1/2 percent (annual rate), down from 2-1/2 percent over the four quarters of 1989. For the second quarter, current estimates place the average level of spending in April and May about even with the first-quarter pace in real terms. Outlays for goods excluding motor vehicles have been especially weak; they fell for the third straight month in May, while spending on motor vehicles also declined. In addition, the trend in the growth of services excluding energy appears to have moderated; after rising 4-1/2 percent in 1989, spending for nonenergy services has been expanding at a pace of about 3-1/2 percent (annual rate) so far this year.

BEA's estimates of spending for nonauto goods reflect the movements in retail sales excluding those at automotive dealers and at building and

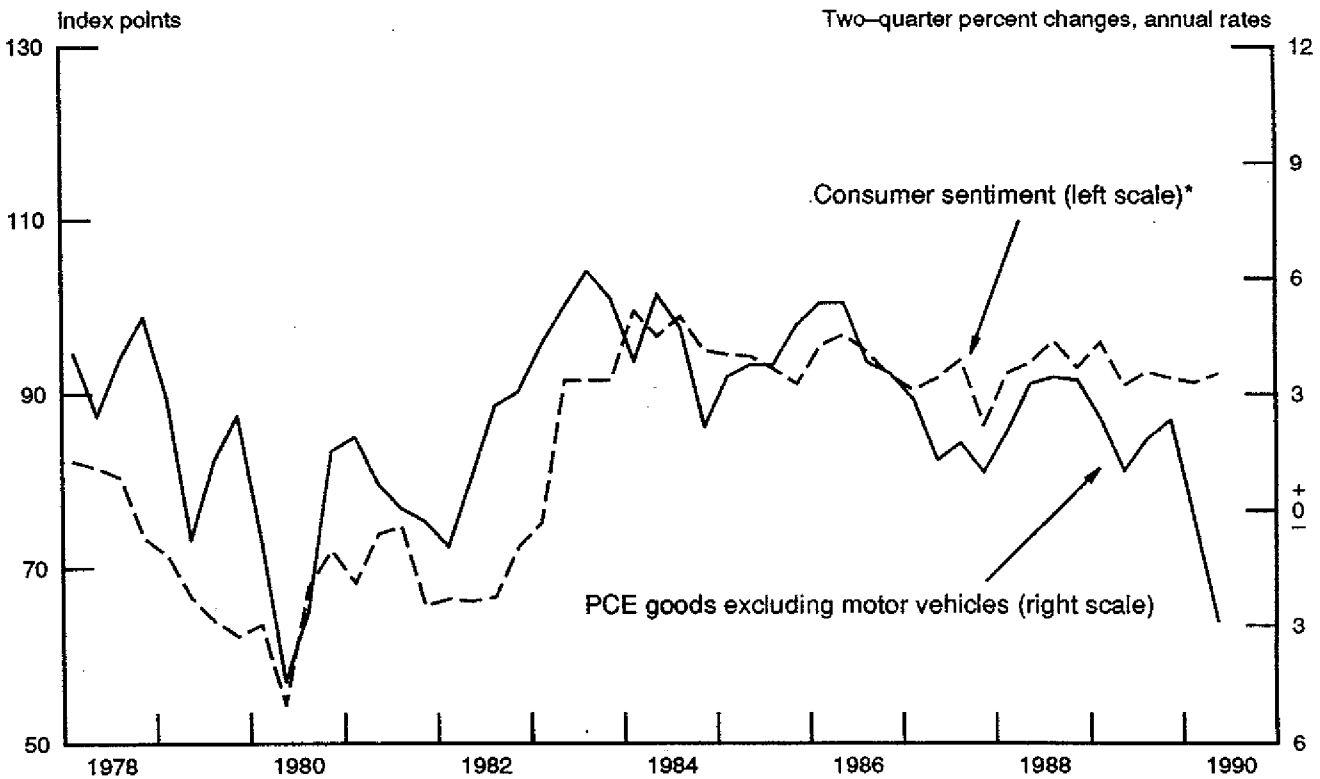
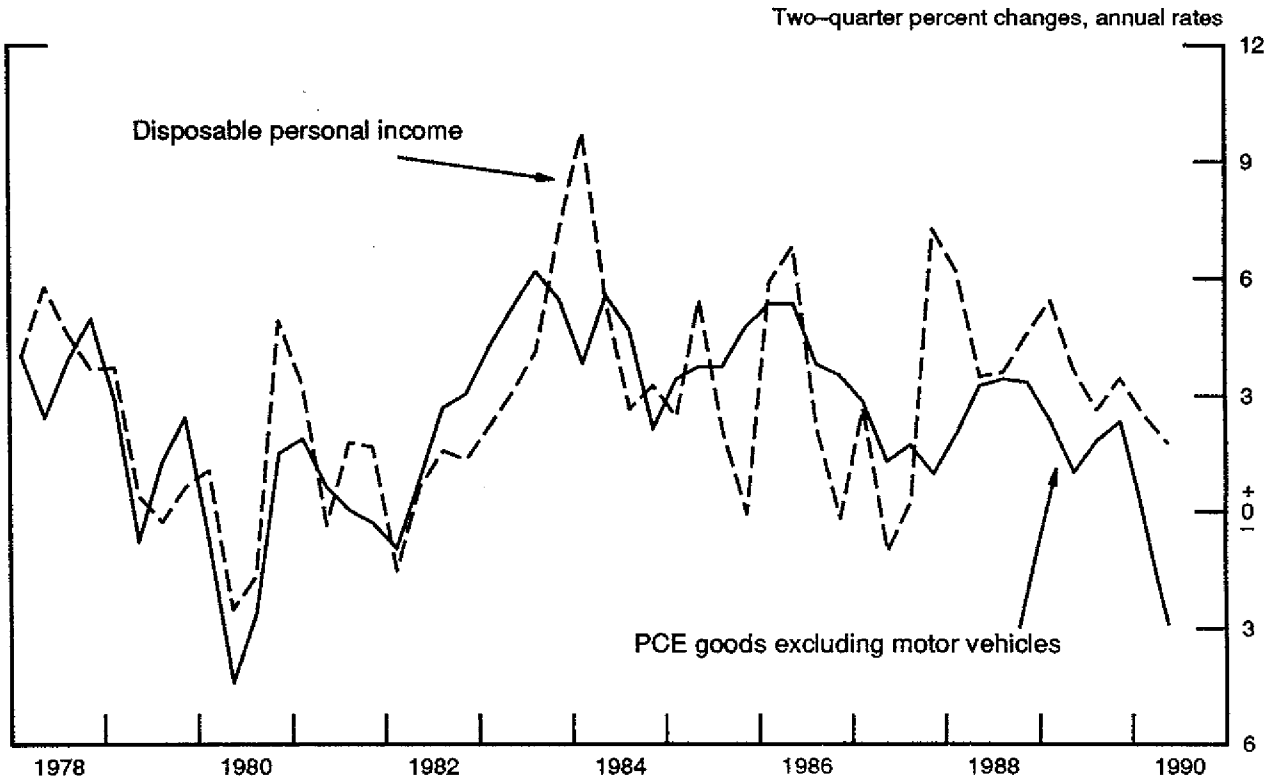
REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from the preceding period)

| | 1989 | 1989 | | 1990 | 1990 | | |
|-----------------------------------|------|---------------------|-------|------|----------------------|-------|------|
| | | Q3 | Q4 | Q1 | March | April | May |
| | | ----Annual rate---- | | | ---Monthly rate----- | | |
| Personal consumption expenditures | 2.5 | 5.6 | .5 | 1.6 | -.3 | .4 | -.3 |
| Durable goods | .0 | 11.3 | -14.0 | 14.1 | -.8 | 1.9 | -2.5 |
| Excluding motor vehicles | 4.2 | .2 | 3.1 | 7.2 | -.9 | -.8 | -.7 |
| Nondurable goods | 1.0 | 5.0 | .1 | -3.4 | -1.1 | -.6 | -.2 |
| Excluding gasoline | 1.2 | 5.5 | -.5 | -2.6 | -.9 | -.4 | -.1 |
| Services | 4.4 | 4.3 | 5.9 | 1.3 | .5 | .5 | .3 |
| Excluding energy | 4.5 | 4.7 | 4.8 | 3.6 | .3 | .4 | .2 |
| Memo: | | | | | | | |
| Personal saving rate (percent) | 5.4 | 5.1 | 5.6 | 5.8 | 6.3 | 6.0 | 6.2 |

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

| | 1989 | 1989 | 1990 | 1990 | | |
|---|------|------|------|-------|-------|------|
| | | Q4 | Q1 | March | April | May |
| Total personal income | 29.8 | 32.3 | 36.9 | 36.9 | 12.0 | 14.0 |
| Wages and salaries | 16.3 | 14.6 | 17.2 | 16.0 | 16.4 | 10.3 |
| Private | 13.7 | 12.4 | 13.7 | 13.3 | 14.0 | 7.4 |
| Other labor income | 1.6 | 1.6 | 2.2 | 2.1 | 1.5 | 1.6 |
| Proprietors' income | 2.2 | 4.2 | 11.6 | 15.6 | -9.6 | -2.2 |
| Farm | .7 | 1.4 | 8.4 | 13.5 | -9.9 | -2.9 |
| Rent | -.3 | 4.6 | -1.6 | .3 | .3 | .4 |
| Dividend | .8 | .9 | .8 | .7 | 1.0 | 1.2 |
| Interest | 6.2 | 3.6 | 1.9 | 1.8 | 2.0 | 2.2 |
| Transfer payments | 4.6 | 3.7 | 7.6 | 3.0 | -1.7 | 2.7 |
| Less: Personal contributions for social insurance | 1.6 | .9 | 2.8 | 2.5 | -2.0 | 2.1 |
| Less: Personal tax and nontax payments | 5.6 | 4.9 | 2.7 | 3.5 | 5.7 | 5.3 |
| Equals: Disposable personal income | 24.2 | 27.4 | 34.2 | 33.4 | 6.3 | 8.7 |
| Memo: Real disposable income | 9.0 | 9.6 | 5.3 | 7.6 | .0 | -3.4 |

CONSUMPTION OF GOODS (EXCLUDING MOTOR VEHICLES)



Notes: 1990-Q2 values are averages of April-May data.

Income and PCE data are in constant dollars.

*Source: Michigan Survey Research Center

supply stores. These retail sales currently are estimated to have fallen 6-1/4 percent (annual rate) in nominal terms between February and May. BEA's most recent estimates of consumer spending build in a stronger figure for May than would be implied by a strict reading of the retail sales data. Even so, the resulting figures imply extremely weak growth in outlays for goods excluding motor vehicles (chart).

Meanwhile, other indicators that in the past have been useful in explaining trends in spending on nonauto goods paint a stronger picture for the current quarter than do the most recent figures on consumption. Although growth in personal income has slowed in recent quarters, it has not slowed nearly as much as has spending. Also, the University of Michigan's Index of Consumer Sentiment remained about flat through May, at levels similar to those since the mid-1980s and well above those reached during 1980-82, the last time outlays declined on net over two quarters. These other indicators raise the possibility that consumption is not as weak as implied by the latest data.

Business Fixed Investment

Growth in real business fixed investment has slowed appreciably since mid-1989, and current indicators point to a continuation of this pattern in the near term. Equipment spending has risen only about 1-1/2 percent at an annual rate over the past three quarters, with investment in information-processing equipment the main source of growth. Outlays for nonresidential structures did register a sizable gain in the first quarter--probably boosted in part by the warm weather--but the trend in this sector remains weak.

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

| | 1989 | | 1990 | 1990 | | |
|---|------|-------|------|-------|-------|------|
| | Q3 | Q4 | Q1 | March | April | May |
| <u>Producers' durable equipment</u> | | | | | | |
| Shipments of nondefense capital goods | 2.2 | -2.7 | 4.8 | -1.8 | -2.4 | -.3 |
| Excluding aircraft and parts | -.2 | -.4 | 2.8 | 2.2 | -4.4 | .3 |
| Office and computing | -1.0 | -2.1 | 4.0 | 3.7 | -3.9 | .6 |
| All other categories | .0 | .1 | 2.5 | 1.8 | -4.5 | .2 |
| Weighted PDE shipments ¹ | 1.2 | .8 | 2.4 | 1.6 | -3.5 | .5 |
| Shipments of complete aircraft ² | 46.2 | -42.0 | 67.5 | -59.1 | 59.0 | n.a. |
| Sales of heavy-weight trucks | -2.2 | -4.7 | .4 | -5.3 | -6.0 | 5.1 |
| Orders of nondefense capital goods | -2.5 | 4.7 | -3.3 | 13.3 | -10.5 | -1.4 |
| Excluding aircraft and parts | -4.2 | 2.2 | .5 | -1.1 | -1.1 | .2 |
| Office and computing | 6.5 | -2.5 | 1.8 | 6.6 | -3.4 | 3.0 |
| All other categories | -6.6 | 3.4 | .3 | -2.9 | -.5 | -.5 |
| Weighted PDE orders ¹ | -.4 | 2.6 | .1 | -1.2 | -.5 | .7 |
| <u>Nonresidential structures</u> | | | | | | |
| Construction put-in-place | 1.9 | -.3 | 3.9 | -1.5 | .4 | n.a. |
| Office | -3.5 | -2.6 | -1.1 | -5.4 | -2.7 | n.a. |
| Other commercial | 5.4 | 1.3 | 1.6 | -7.2 | -1.3 | n.a. |
| Public utilities | -1.8 | 1.1 | 2.9 | 1.2 | .4 | n.a. |
| Industrial | 7.0 | 2.5 | 15.2 | .6 | 7.0 | n.a. |
| All other | 5.3 | -2.9 | 5.4 | 3.7 | .3 | n.a. |
| Rotary drilling rigs in use | 3.3 | -2.7 | 2.3 | 9.5 | 8.5 | 5.5 |

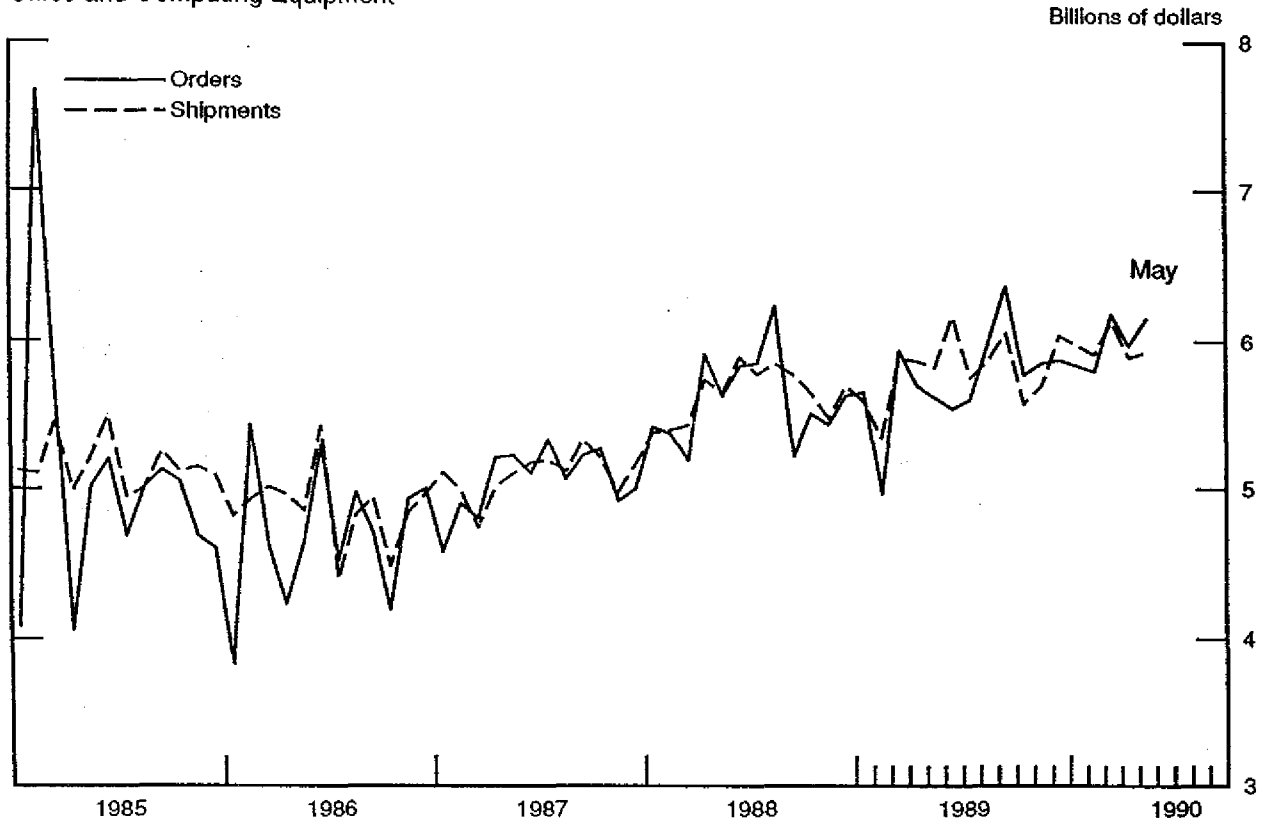
1. Computed as the weighted sum of 25 individual equipment series (excluding aircraft) from the Census M-3 report with weights equal to the fraction of final business spending for each type of equipment.

2. From the Current Industrial Report (CIR) titled Civil Aircraft and Aircraft Engines. Seasonally adjusted with BEA seasonal factors. To estimate PDE spending for aircraft, BEA uses the aircraft shipments shown in that report, not the corresponding Census M-3 series. The CIR does not provide information on aircraft orders.

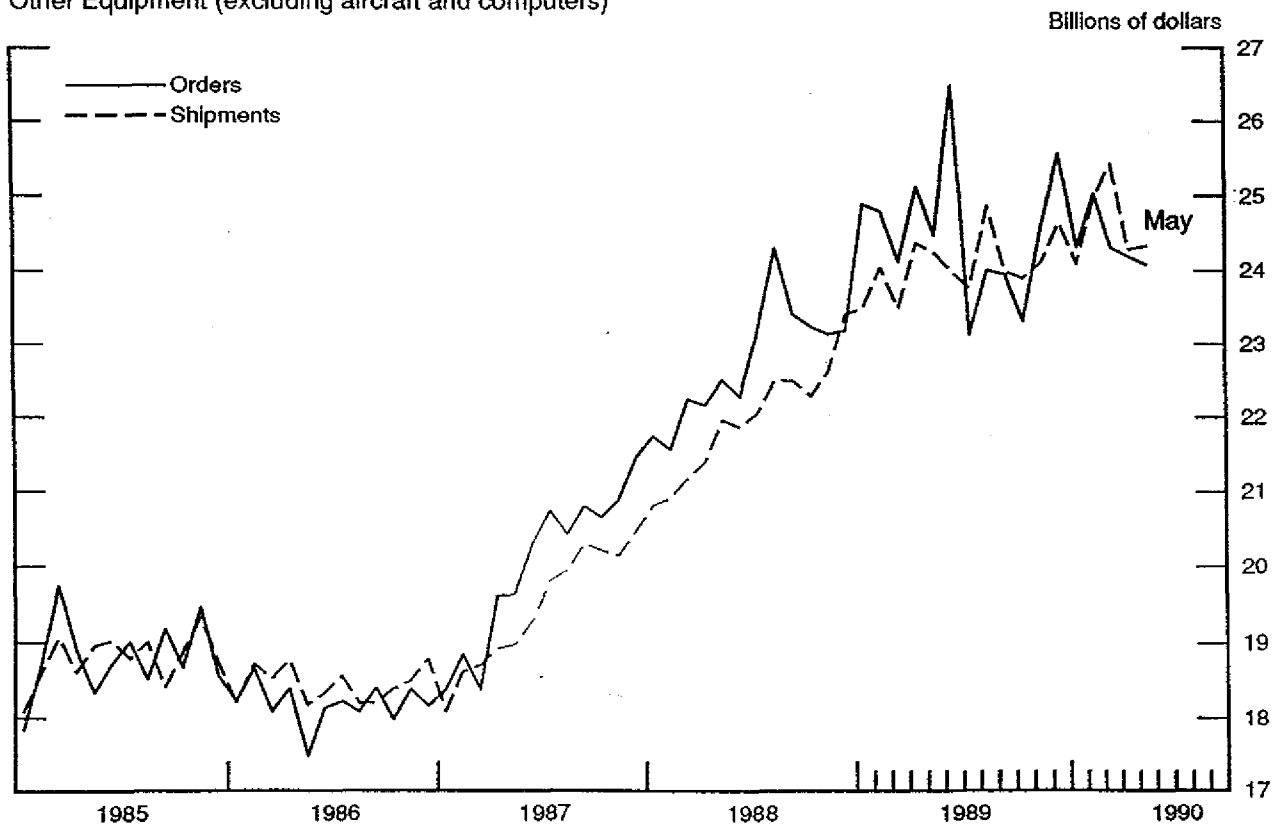
n.a. Not available.

RECENT DATA ON ORDERS AND SHIPMENTS

Office and Computing Equipment



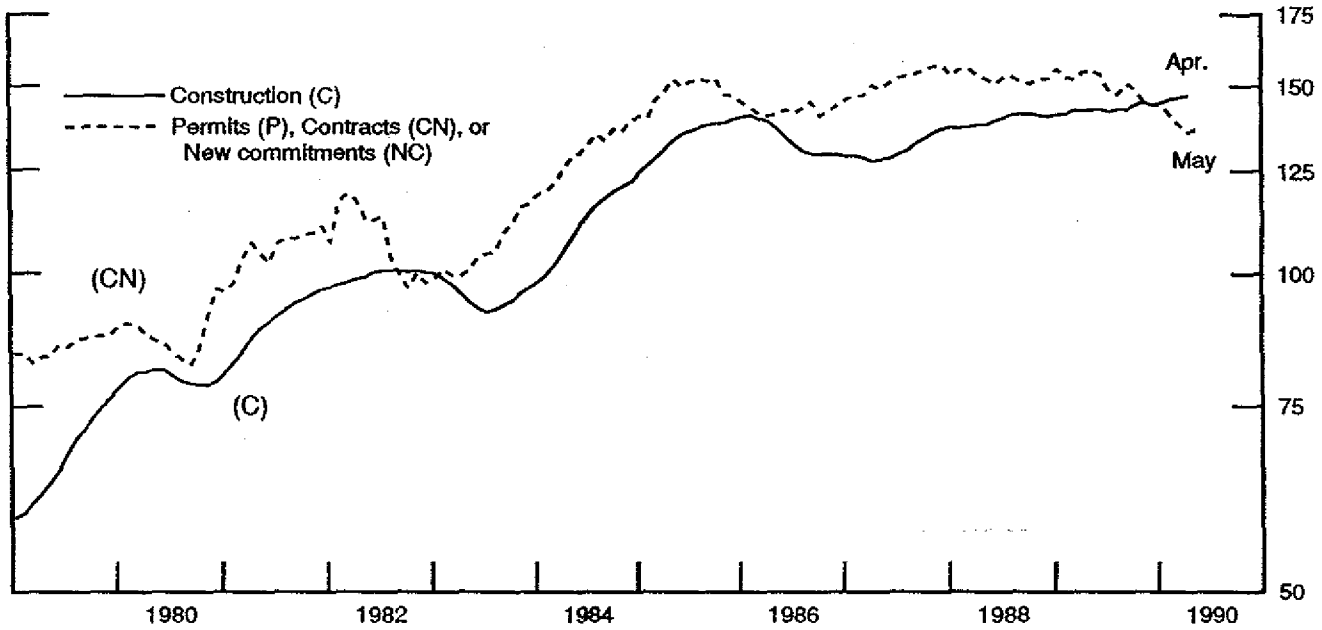
Other Equipment (excluding aircraft and computers)



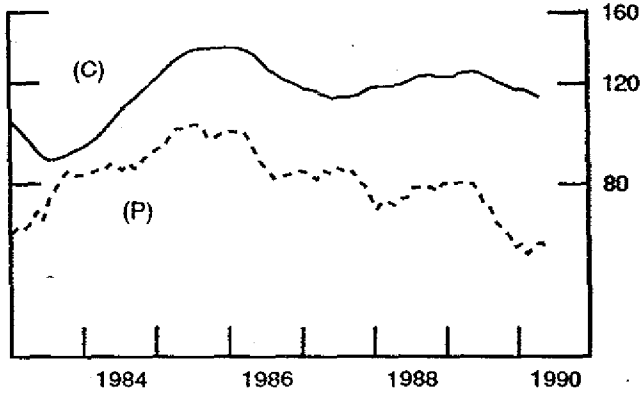
NONRESIDENTIAL CONSTRUCTION AND SELECTED INDICATORS*

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

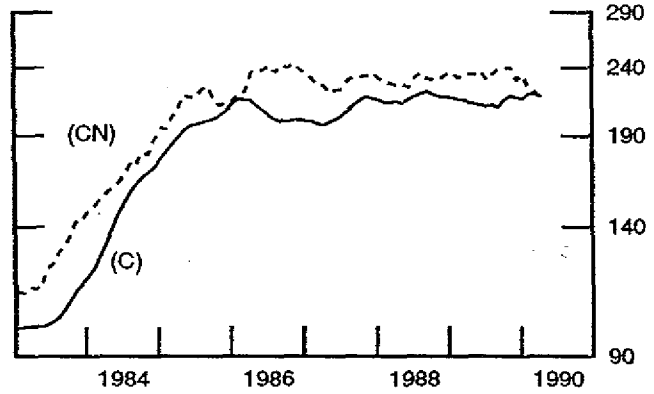
Total



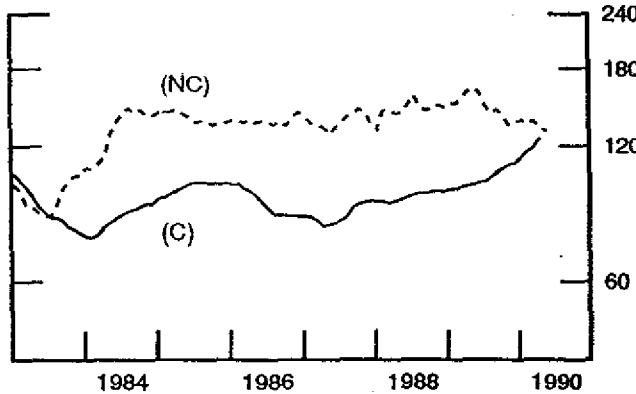
Office



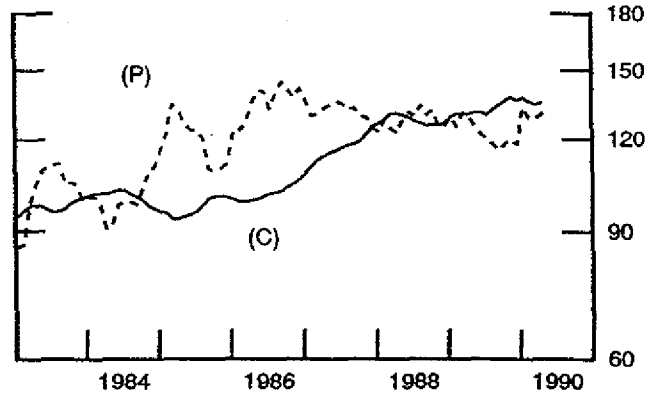
Other Commercial



Industrial



Institutional



*Six-month moving average for all series shown. Data for permits, contracts, and new commitments extend to May.

For the second quarter, indicators of equipment spending point to a slight decline in these outlays in real terms. Nominal shipments of nondefense capital goods (excluding aircraft) rose 0.3 percent in May but were still 2 percent below the first-quarter level; in particular, shipments of nonelectrical machinery were weak in April and May. Taking into account the appropriate PDE weights for each category to remove portions that are not final business purchases, shipments were up 0.5 percent in May, but the April-May average was 1-1/2 percent below the first-quarter level.

Looking ahead, orders for nondefense capital goods excluding aircraft edged up 0.2 percent in May, but remained 1 percent below the first-quarter level. Outside of aircraft and computers, orders have advanced little, on balance, since the beginning of last year. However, bookings for office and computing equipment continued to rise in April and May. Taken together, these data point to some improvement in real PDE following the weak second quarter (chart).

On the construction side, industrial construction rose sharply in the first quarter, and preliminary put-in-place data point to a further gain in April. Outlays for office and other commercial construction, however, were down again that month. Office construction, in particular, is showing the effects of overbuilding in many parts of the country and perhaps a tightening of credit standards.

Looking forward, most of the indicators for construction continue to paint a bleak picture. Permits for office construction have plummeted in recent months (chart), and the Coldwell-Banker office measure of metropolitan office vacancies still held in the 20 percent range at the end of March, the latest reading. Contracts for other commercial construction

also have softened. Although industrial construction has been climbing steeply recently, the permits and contracts data suggest that this trajectory is unlikely to continue for long.

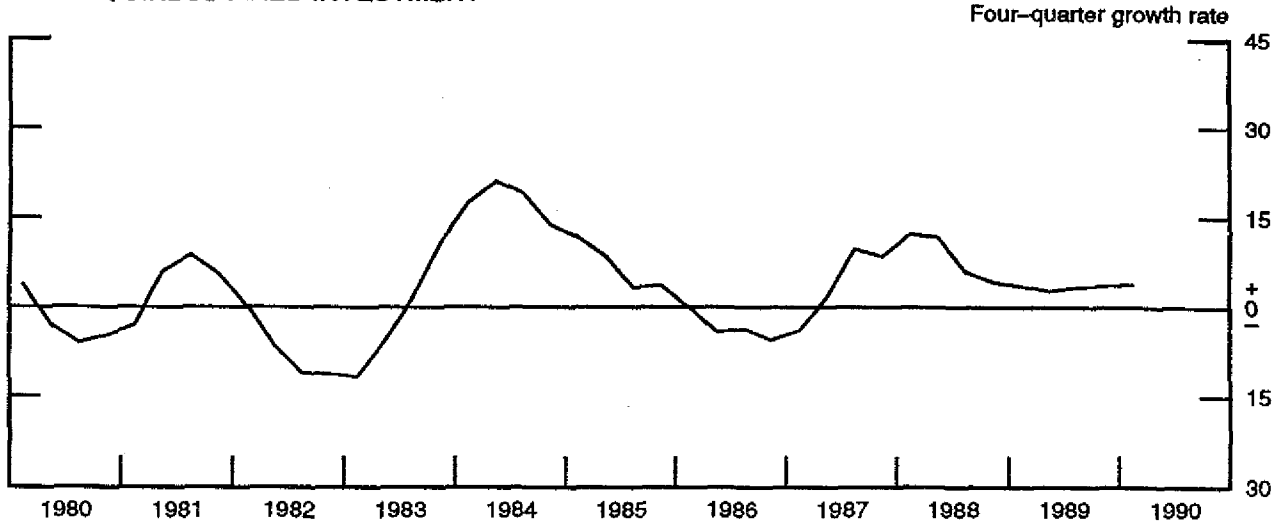
The most recent Commerce Department survey of capital spending, taken in April and May, also points to a slowing in investment from last year; its respondents plan to increase nominal outlays 6-3/4 percent in 1990, a rate well below last year's 10-1/2 percent advance. Macroeconomic factors that are generally believed to influence investment also point to sluggishness this year (chart). First, nonfarm business output--which typically affects investment with a lag--has been decelerating since early 1988. Second, the cost of capital--for items other than computers--moved up early this year, reflecting the rise in long-term interest rates, only part of which has since been reversed. Finally, cash flow has been stagnant since early 1989.

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

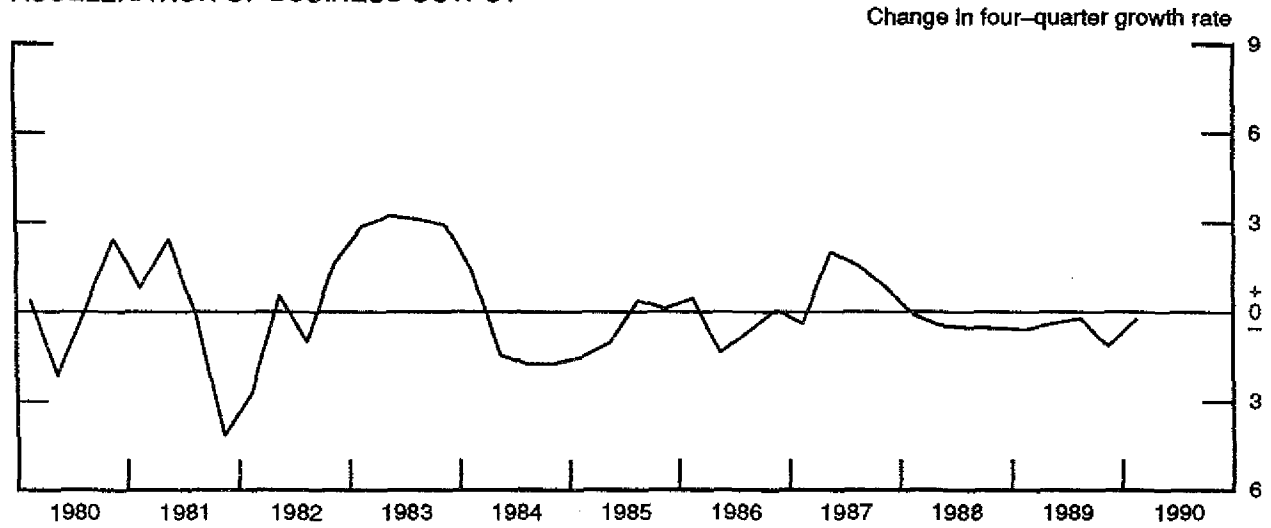
| | 1989 ¹ | Planned for 1990 | | |
|---------------------|-------------------|------------------|------------|-----------|
| | | Oct.-Nov. | Jan.-March | April-May |
| All business | 10.4 | 6.4 | 7.8 | 6.7 |
| Manufacturing | 11.0 | 3.8 | 4.9 | 3.4 |
| Durable | 6.9 | .2 | 2.1 | 2.4 |
| Nondurable | 14.6 | 6.8 | 7.1 | 4.3 |
| Nonmanufacturing | 10.0 | 8.0 | 9.7 | 8.7 |
| Memo: ² | | | | |
| Mean error | | -1.2 | .3 | .2 |
| Mean absolute error | | 2.9 | 2.8 | 1.4 |

1. As estimated in the April-May Commerce Department Survey.
2. Anticipated less actual change.

REAL BUSINESS FIXED INVESTMENT

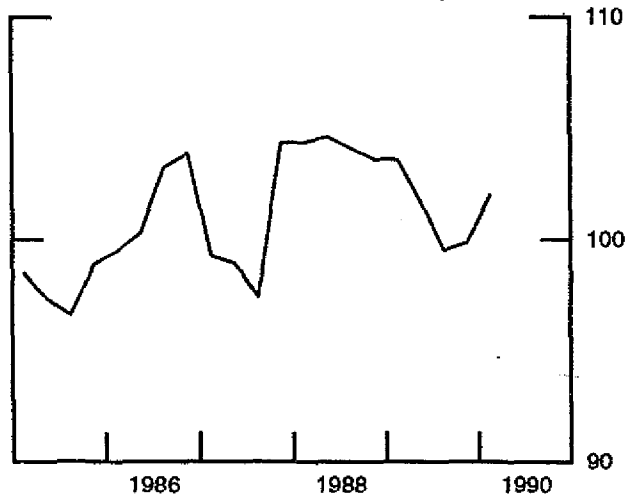


ACCELERATION OF BUSINESS OUTPUT



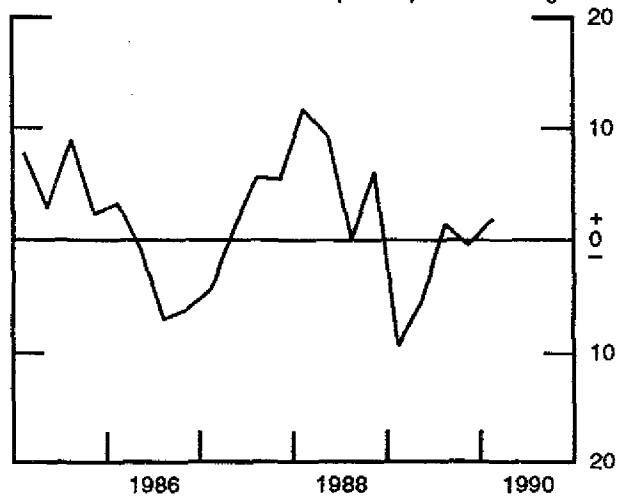
COST OF CAPITAL - EQUIPMENT*

Index, 1987 = 100



CASH FLOW**

Four-quarter percent change



*Excludes computers.

**Cash flow (1982 dollars) is undistributed corporate profits plus depreciation allowances with inventory valuation and capital consumption adjustments.

Business Inventories

Inventory investment has been restrained this year, as businesses have sought to keep stocks under tight control. Preliminary current-cost data for April indicate a relatively small increase in overall manufacturing and trade stocks, after a decrease in the first quarter. Since the start of the year, stocks have been pared sharply at motor vehicle dealers, and inventories in most other sectors have either been trimmed or expanded only modestly. Retailers of nonauto goods also liquidated stocks this winter; but with consumer spending weak, the inventory-sales ratio for this sector has since retraced its earlier decline. Inventory-sales ratios for the manufacturing and wholesale sectors at the end of April, on a current-cost basis, were down from the levels of late 1989 and generally toward the middle of the range of the past year.

Housing Markets

Residential construction activity weakened appreciably this spring. Housing starts averaged 1.21 million units (annual rate) in April and May, substantially below the 1.45 million unit pace of the first quarter. Part of the recent drop may have been a payback after the warm winter; even so, averaging through the weather effects, starts are running below the already reduced pace of activity registered in 1989.

The recent weakness in housing reflects both supply and demand factors. On the supply side, industry reports suggest that builders may be finding it more difficult to obtain loans because of more stringent thrift capital standards, loan-to-one-borrower limits under FIRREA, and tightened examination standards for commercial banks. On the demand side, sales of new homes have been trending lower for almost a year, and sales of existing

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

| | 1989 | | 1990 | | 1990 | |
|-----------------------------|------|-------|-------|-------|-------|------|
| | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. |
| Current-cost basis: | | | | | | |
| Total | 39.3 | 13.2 | -7.0 | -38.2 | -4.2 | 9.2 |
| Total excluding retail auto | 30.4 | 27.7 | 9.1 | -25.3 | -2.7 | 11.5 |
| Manufacturing | 17.6 | .8 | 2.7 | -11.5 | -17.1 | 6.1 |
| Wholesale | 1.4 | 14.9 | 2.2 | -6.3 | 6.2 | -5.2 |
| Retail | 20.3 | -2.5 | -11.8 | -20.4 | 6.7 | 8.3 |
| Automotive | 8.9 | -14.5 | -16.1 | -12.9 | -1.5 | -2.3 |
| Excluding auto | 11.3 | 12.0 | 4.3 | -7.5 | 8.2 | 10.7 |
| Constant-dollar basis: | | | | | | |
| Total | 9.9 | 19.8 | -21.0 | -51.0 | 3.6 | 6.7 |
| Total excluding retail auto | 18.9 | 12.0 | .0 | -24.9 | -6.3 | 8.1 |
| Manufacturing | 12.0 | -4.5 | 3.0 | -9.6 | -13.2 | 11.4 |
| Wholesale | -.5 | 11.1 | .4 | -2.0 | 4.1 | -8.6 |
| Retail | -1.6 | 13.2 | -24.4 | -39.3 | 12.6 | 3.8 |
| Automotive | -9.0 | 7.9 | -21.0 | -26.1 | 9.9 | -1.5 |
| Excluding auto | 7.4 | 5.3 | -3.4 | -13.2 | 2.8 | 5.3 |

INVENTORIES RELATIVE TO SALES¹
(Months supply; based on seasonally adjusted data)

| | 1989 | | 1990 | | 1990 | | | |
|---|------|------|------|------|------|------|------|------|
| | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. | | |
| Range in preceding 12 months: ² Low High ----- | | | | | | | | |
| Current-cost basis: | | | | | | | | |
| Total | 1.47 | 1.53 | 1.51 | 1.51 | 1.48 | 1.48 | 1.47 | 1.49 |
| Total excluding retail auto | 1.45 | 1.50 | 1.47 | 1.48 | 1.46 | 1.46 | 1.45 | 1.47 |
| Manufacturing | 1.56 | 1.65 | 1.59 | 1.60 | 1.60 | 1.59 | 1.57 | 1.59 |
| Wholesale | 1.24 | 1.28 | 1.27 | 1.27 | 1.25 | 1.25 | 1.24 | 1.25 |
| Retail | 1.55 | 1.62 | 1.61 | 1.62 | 1.55 | 1.55 | 1.56 | 1.58 |
| Automotive | 1.81 | 2.07 | 2.04 | 2.04 | 1.84 | 1.88 | 1.87 | 1.90 |
| Excluding auto | 1.46 | 1.50 | 1.49 | 1.50 | 1.48 | 1.46 | 1.47 | 1.49 |
| Constant-dollar basis: | | | | | | | | |
| Total | 1.48 | 1.52 | 1.49 | 1.51 | 1.49 | 1.49 | 1.48 | 1.50 |
| Total excluding retail auto | 1.46 | 1.51 | 1.48 | 1.48 | 1.48 | 1.48 | 1.47 | 1.49 |
| Manufacturing | 1.55 | 1.65 | 1.58 | 1.59 | 1.59 | 1.59 | 1.57 | 1.59 |
| Wholesale | 1.31 | 1.34 | 1.32 | 1.32 | 1.31 | 1.32 | 1.31 | 1.32 |
| Retail | 1.49 | 1.57 | 1.52 | 1.56 | 1.51 | 1.49 | 1.51 | 1.53 |
| Automotive | 1.65 | 1.94 | 1.72 | 1.90 | 1.67 | 1.67 | 1.69 | 1.71 |
| Excluding auto | 1.45 | 1.48 | 1.46 | 1.47 | 1.46 | 1.45 | 1.47 | 1.48 |

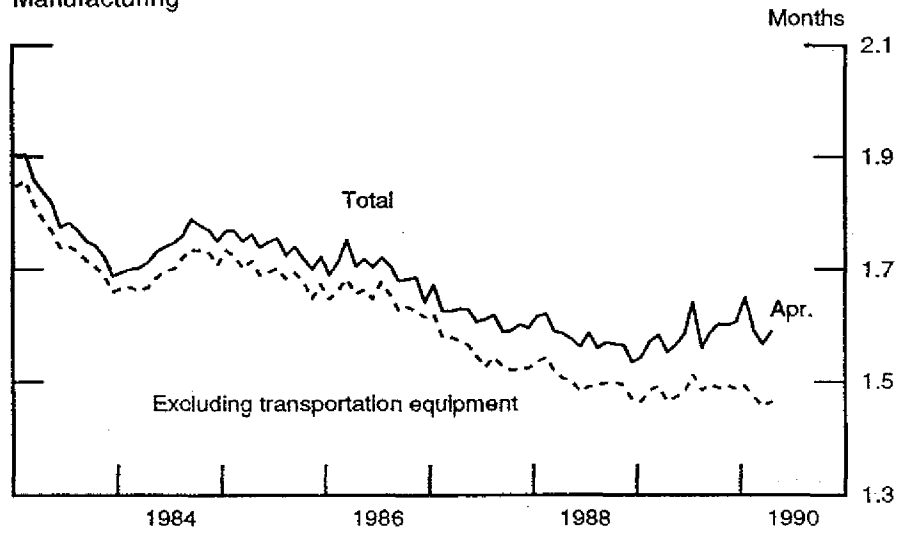
1. Ratio of end of period inventories to average monthly sales for the period.

2. Highs and lows are specific to each series and are not necessarily coincidental. Range is for the 12-month period preceding the latest month for which data are available.

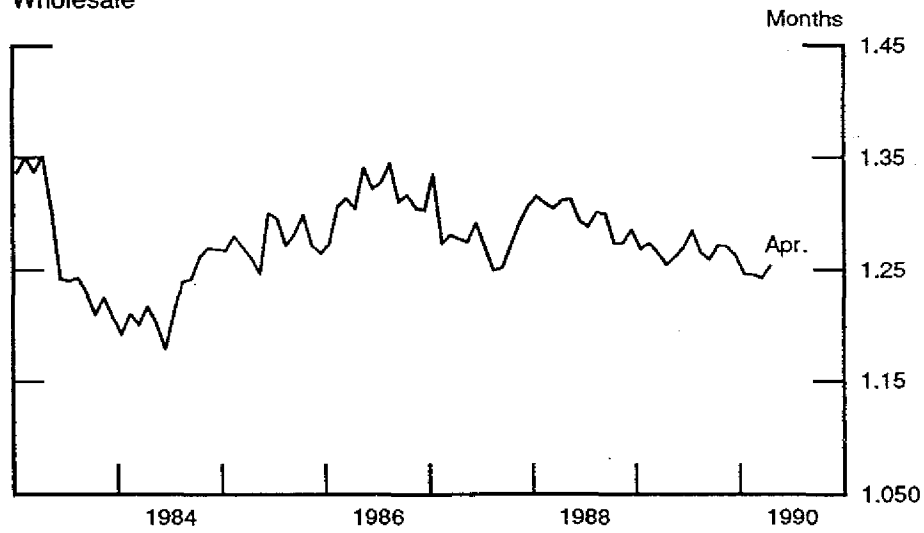
RATIO OF INVENTORIES TO SALES

(Current-cost data)

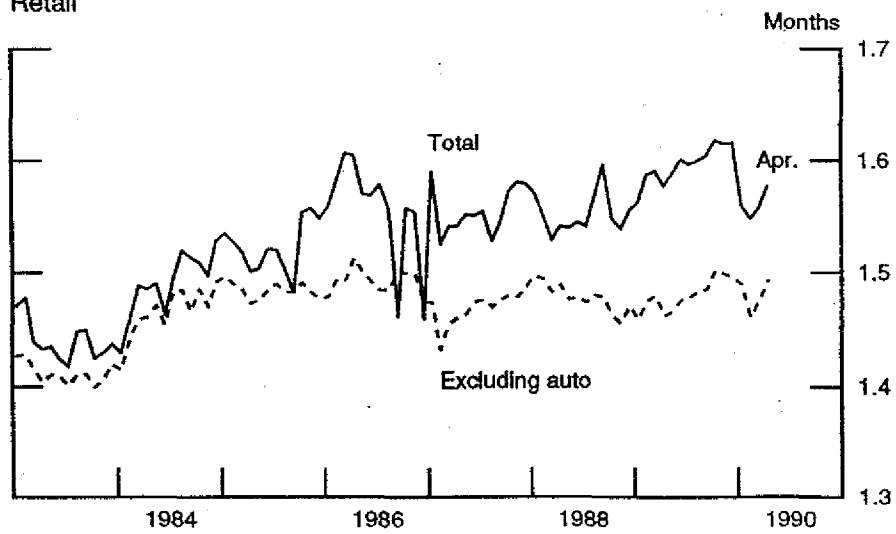
Manufacturing



Wholesale



Retail

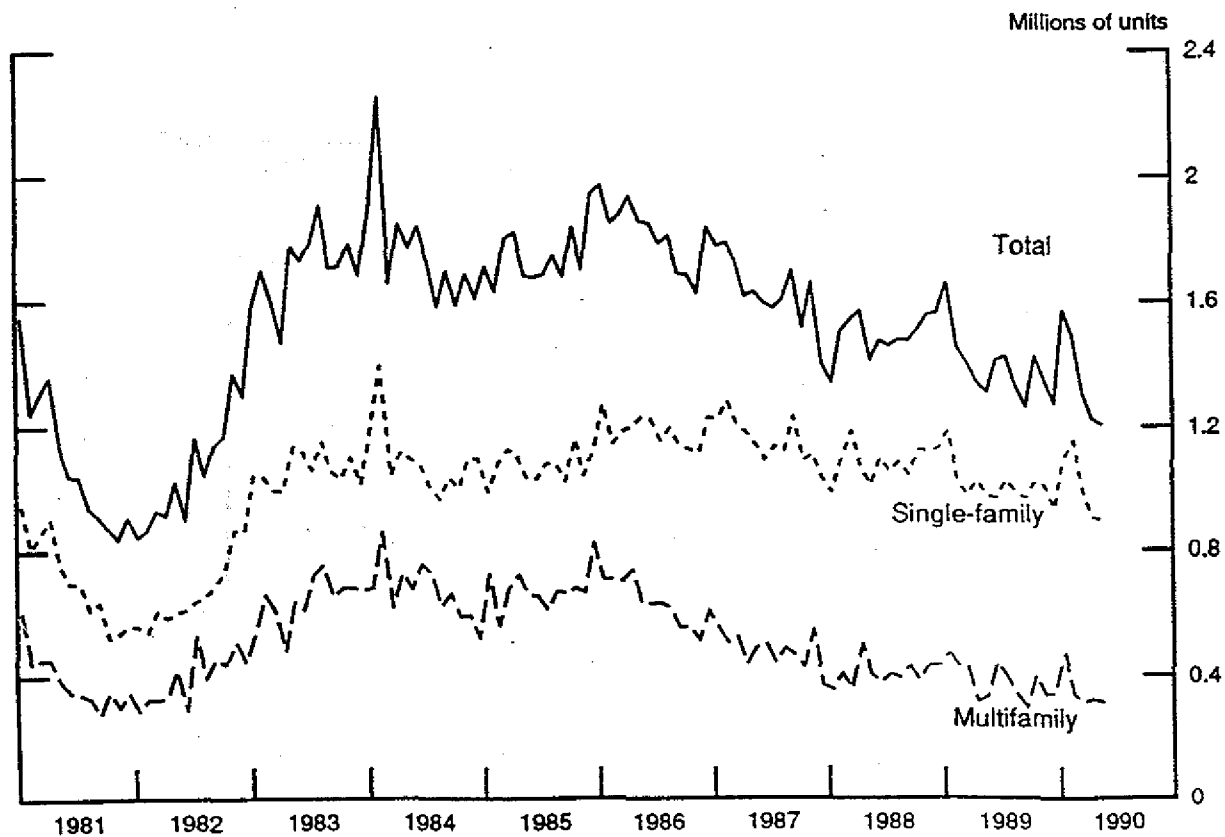


PRIVATE HOUSING ACTIVITY
(Seasonally adjusted annual rates; millions of units)

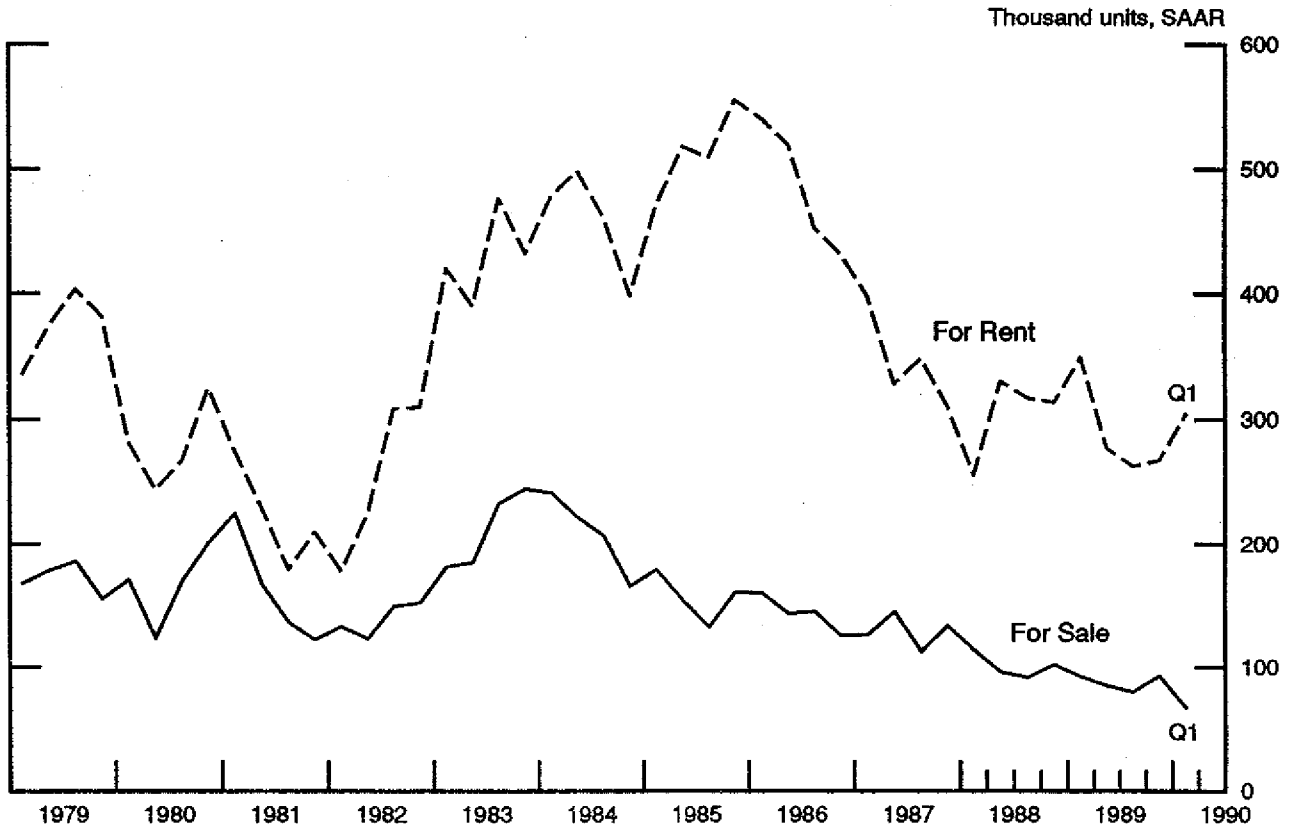
| | 1989 | 1989 | | 1990 | 1990 | | |
|---------------------------------|------|------|------|------|------|------|------|
| | | Q3 | Q4 | Q1 | Mar. | Apr. | May |
| All units | | | | | | | |
| Permits | 1.34 | 1.31 | 1.38 | 1.42 | 1.23 | 1.11 | 1.06 |
| Starts | 1.38 | 1.34 | 1.35 | 1.45 | 1.31 | 1.22 | 1.21 |
| Single-family units | | | | | | | |
| Permits | .93 | .93 | .98 | .96 | .91 | .81 | .79 |
| Starts | 1.00 | 1.00 | .99 | 1.08 | 1.00 | .91 | .90 |
| Sales | | | | | | | |
| New homes | .65 | .70 | .65 | .59 | .56 | .55 | n.a. |
| Existing homes | 3.44 | 3.44 | 3.54 | 3.44 | 3.40 | 3.33 | 3.29 |
| Multifamily units | | | | | | | |
| Permits | .41 | .38 | .41 | .47 | .32 | .30 | .27 |
| Starts | .37 | .34 | .36 | .37 | .31 | .32 | .31 |
| Vacancy rate¹ | | | | | | | |
| Rental units | 9.1 | 9.2 | 8.6 | 9.3 | n.a. | n.a. | n.a. |
| Owned units | 6.7 | 7.6 | 6.4 | 6.3 | n.a. | n.a. | n.a. |

1. Percent. Owned units consist mainly of condominiums.
n.a. Not available.

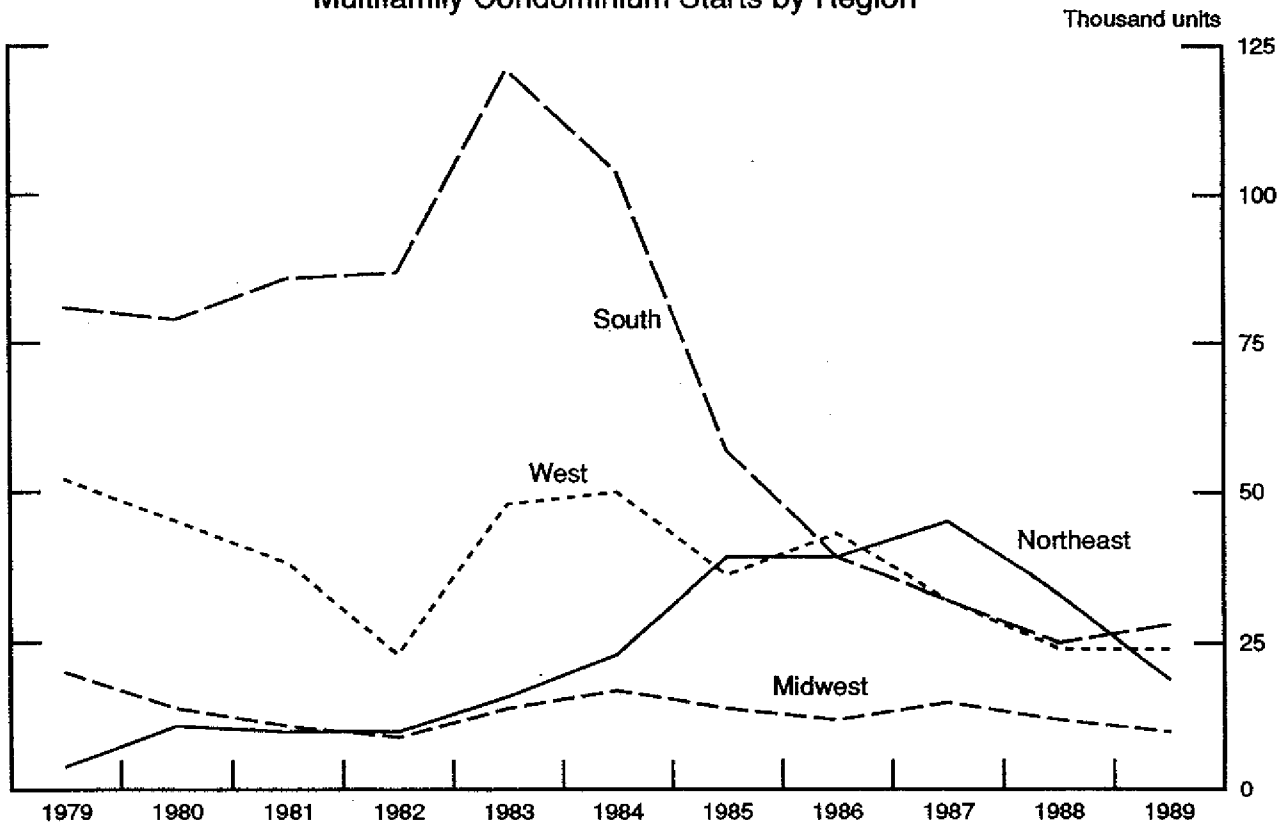
PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



Multifamily Housing Starts by Purpose of Construction



Multifamily Condominium Starts by Region



homes slipped further in May to a 3.29 million unit annual pace. In part, housing demand may have been restrained by slower growth in incomes and the rise in fixed-rate mortgage rates through early May. It should be noted that an industry survey of leading mortgage bankers undertaken in May failed to uncover any evidence of widespread cutbacks in the availability of home mortgages; these survey findings are reinforced by the relatively stable spread between interest rates on mortgages and other long-term instruments.

In the multifamily sector, weakness continues to be evident in both rental and condominium markets (chart); rates of return on multifamily rental investment remain damped, and the multifamily rental vacancy rate in the first quarter, at 9.3 percent, was not far below the record high of 9.8 percent recorded in 1988. In addition, condominium construction has continued to decline, although less sharply than in the mid-1980s when activity in the South collapsed (chart). The recent softening has been concentrated in the Northeast.

Federal Sector

In May the federal government recorded a \$43 billion deficit, compared with a figure of \$26 billion in the same month of 1989. The increase mainly reflected higher outlays, principally payments for deposit insurance. For the October to May period, the deficit stood at \$152 billion, compared with \$113 billion a year earlier; as receipts grew slowly in this period, deposit insurance outlays surged, and spending in most other areas--with the notable exceptions of defense and agriculture--continued to expand.

Nonwithheld personal income tax collections for April and May (primarily final payments for 1989 and the first quarterly installment on 1990 estimated taxes) totaled \$70 billion, \$7 billion below a year earlier.

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

| | May | | October-May | | | |
|--------------------------------|---------|------|-------------|--------|------------|----------------|
| | 1989 | 1990 | FY1989 | FY1990 | Net change | Percent change |
| | Outlays | 96.5 | 111.8 | 754.1 | 818.8 | 64.7 |
| National defense | 25.0 | 26.3 | 198.6 | 198.6 | 0 | 0 |
| Net interest | 14.6 | 16.1 | 112.2 | 120.9 | 8.7 | 7.7 |
| Social Security | 19.3 | 20.7 | 151.8 | 162.0 | 10.2 | 6.7 |
| Medicare and health | 12.2 | 13.7 | 86.4 | 100.4 | 14.0 | 16.2 |
| Deposit insurance | 0 | 8.2 | 9.3 | 24.4 | 15.1 | 163.2 |
| Agriculture | 1.5 | 1.3 | 16.3 | 11.2 | -5.0 | -30.9 |
| Other | 23.9 | 25.5 | 179.4 | 201.2 | 21.8 | 12.2 |
| Receipts | 71.0 | 69.2 | 640.9 | 667.1 | 26.2 | 4.1 |
| Personal income taxes | 25.3 | 21.5 | 284.5 | 300.6 | 16.2 | 5.7 |
| Social insurance contributions | 35.3 | 37.5 | 242.5 | 253.1 | 10.6 | 4.4 |
| Corporate income taxes | 1.9 | 1.6 | 59.0 | 53.9 | -5.0 | -8.6 |
| Other | 8.5 | 8.7 | 55.0 | 59.5 | 4.5 | 8.2 |
| Deficit | 25.5 | 42.6 | 113.2 | 151.7 | 38.5 | 34.0 |

EVOLUTION OF FEDERAL BUDGET DEFICIT PROJECTIONS
(Billions of dollars)

| Fiscal year | CBO | | | OMB ¹ | |
|--|---------|-------|------|------------------|---------|
| | January | March | June | January | Current |
| -----Deficit including RTC spending----- | | | | | |
| 1990 | 138 | 159 | 195 | 124 | 181-203 |
| 1991 | 138 | 161 | 232 | 101 | 200-227 |
| -----Deficit excluding RTC spending----- | | | | | |
| 1990 | 124 | 126 | 159 | 121 | 155 |
| 1991 | 133 | 130 | 162 | 94 | 159 |

1. Baseline, excluding policy changes, Congressional Quarterly June 9 and Wall Street Journal June 11.

n.a. Not available.

This pattern provides evidence that some of the surge in last year's final payments reflected temporary factors. Refunds in April and May combined were about the same as in 1989; however, for the January-May period as a whole--during which about 85 percent of total refunds typically are paid--refunds were about \$3 billion above last year's level. Daily data indicate that quarterly declarations for individual income taxes (due in mid-June) are running slightly above a year earlier, while corporate income tax declarations are below last year's pace.

In late March, the Resolution Trust Corporation (RTC) announced "Operation Clean Sweep," a plan to sell or liquidate 141 thrifts during the second quarter. This operation was expected to cost up to \$46 billion, after taking account of the \$3.5 billion provided by the Resolution Funding Corporation (REFCORP). Outlays in April were essentially zero on net as spending for thrift resolutions was offset by the proceeds of the April REFCORP offering. However, spending picked up to \$7 billion in May and to \$13 billion in the first three weeks of June. Any shortfall relative to the \$46 billion target is expected to be made up in the next few months, along with additional spending to close some of the 50 to 75 thrifts targeted for resolution during the third quarter.

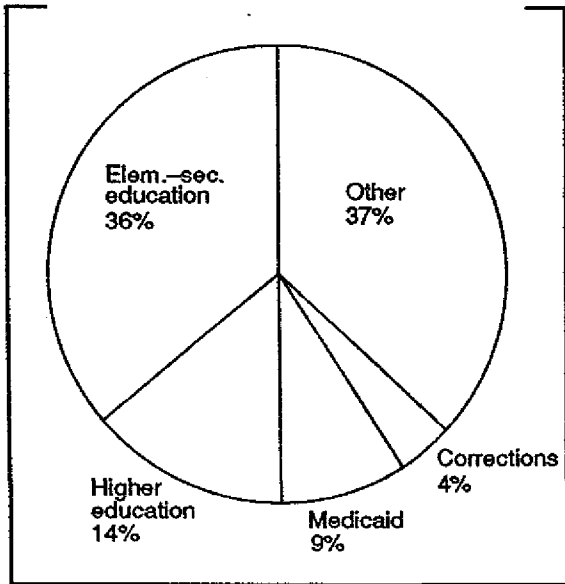
Estimates of the FY1990 and FY1991 deficits have risen substantially since January, reflecting the lower tax collections that have accompanied weaker economic activity, higher interest rates, and substantially higher RTC spending, especially for working capital. The Congressional Budget Office released its summer budget estimates in June--two months earlier than normal; they show a deficit, excluding RTC spending, of \$159 billion for FY1990 and a \$162 billion current services deficit for FY1991. RTC spending

is estimated to total \$36 billion in FY1990 and \$70 billion in FY1991, assuming new legislation is passed to provide additional spending authority. The Office of Management and Budget will release its Mid-Session Review in mid-July; it will include new deficit figures and provide information on the effects of a sequester. Press reports indicate that OMB's deficit projections, excluding RTC, will be in the neighborhood of \$155 billion for FY1990 and \$159 billion for FY1991. OMB has estimated that FY1990 RTC spending will range between \$26 billion to \$48 billion, and from \$41 billion to \$68 billion in FY1991.

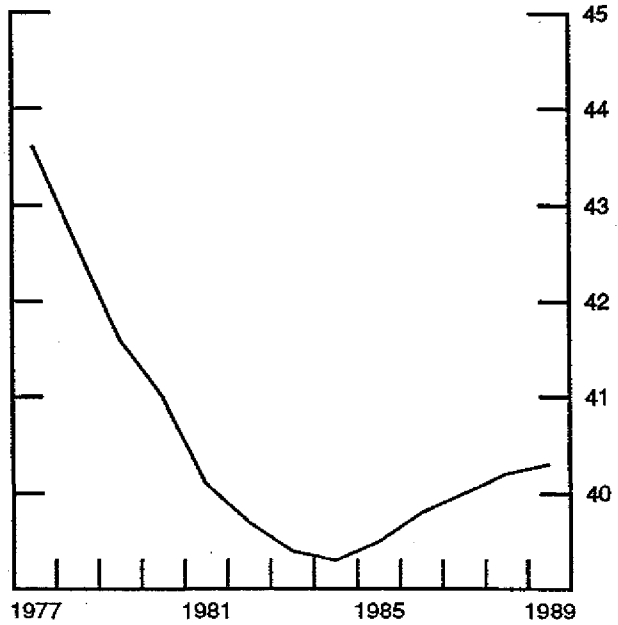
The House and the Senate have passed budget resolutions that are consistent with the \$64 billion target, based on OMB's January economic and technical assumptions, and have begun to work on FY1991 appropriations.² Meanwhile, the congressional leadership and the Administration are in the midst of negotiations on the FY1991 budget, and the President announced his willingness to consider tax increases as part of a deficit-reduction package. Looking ahead, the public debt may reach the statutory limit as early as late July; in the past, debt ceiling bills have served as vehicles for the Gramm-Rudman-Hollings law. Under the current G-R-H law, the OMB deficit estimates cited in press reports imply a sequester of up to \$163 billion on October 15. Even if the law is modified to exclude RTC spending from the calculations, the sequester could still be as much as \$95 billion. A sequester of \$95 billion would impose across-the-board cuts of 36 percent on affected nondefense programs and 24 percent on affected defense programs.

2. According to CBO calculations, both FY1991 resolutions cut defense spending by over \$11 billion. The House resolution allows for a \$4 billion increase in domestic discretionary spending, while the Senate's measure reduces it by \$4 billion.

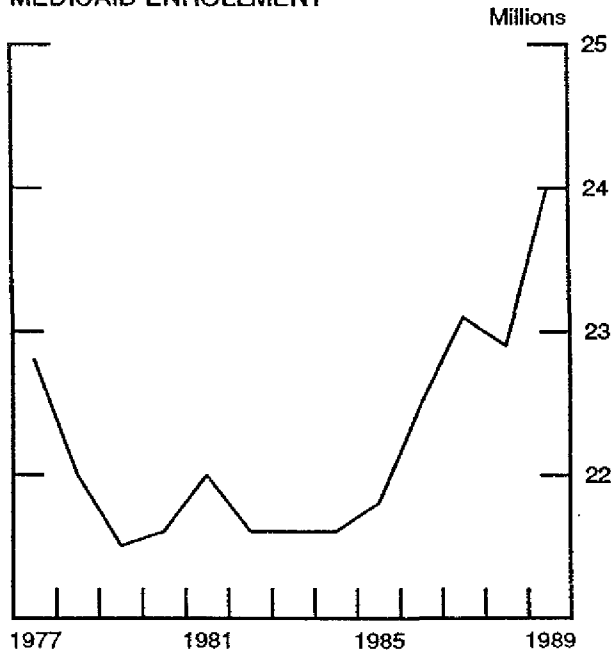
STATES' GENERAL FUND BUDGETS
FY 1990



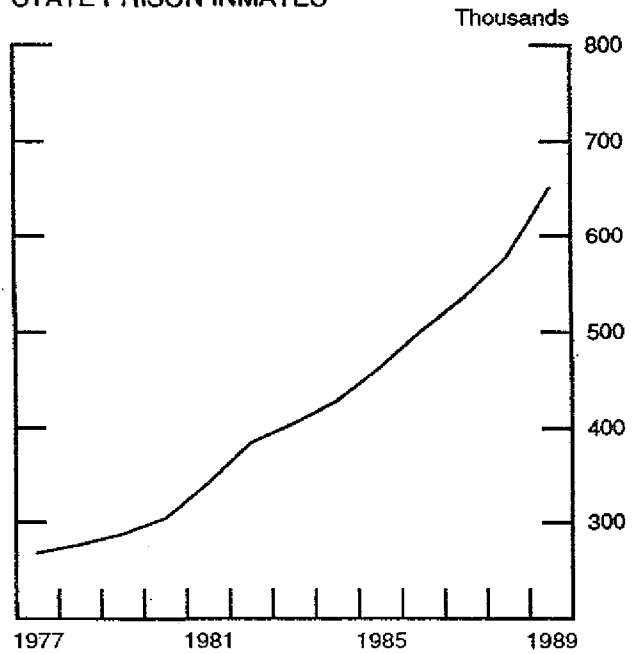
PUBLIC SCHOOL ENROLLMENT: K-12
Millions



MEDICAID ENROLLMENT
Millions



STATE PRISON INMATES
Thousands



State and Local Government Sector

Activity in the state and local government sector has moderated this spring, after two quarters of robust growth. On balance, employment continued to advance in April and May but less rapidly than earlier in the year. Real outlays on structures dropped sharply again in April to a level well below the first-quarter average. In particular, outlays for highways have declined substantially after peaking in February and are now back in the range reported during most of last year.

The NIPA deficit of operating and capital accounts for the entire state and local sector remains unusually high, and budgetary gaps have remained a focus of recent sessions of state legislatures. State governments often turn to spending cuts first when stabilizing shaky budgets, but in recent years they have been besieged by local demands, court orders, and federal mandates that have resulted in increased spending in areas like education, medicaid, and corrections. Spending in these three areas accounts for nearly two-thirds of states' general fund budgets currently (chart), and it is likely to continue rising at a pace exceeding GNP growth.³ Public school enrollment began to rise in 1985, and population statistics indicate that the baby-boom echo will continue to boost enrollments in the 1990s as well. Medicaid expenditures also have increased in recent years as the federal government has required the states to cover individuals at higher levels of income and to cover previously optional services. Finally,

3. State general fund budgets cover around 60 percent of total state outlays, primarily operating expenditures, and are required constitutionally or statutorily to be balanced (except in Vermont). In addition to current receipts and expenditures as recorded in the national income accounts, states' general fund accounts also may include resources available from previous years, funds borrowed in capital markets, and even proposed, but not yet enacted, tax hikes.

corrections spending has been the fastest growing component of states' general fund budgets for the past five years. The state prison population has more than doubled in the past decade, and with many states under court order to relieve overcrowding, outlays for new structures are expected to continue rising.

Prices

As expected, the first-quarter burst of inflation subsided this spring. The consumer price index increased 0.2 percent in both April and May, and producer prices of finished goods were unchanged on net over the two-month period. Developments in the food and energy sectors have turned more favorable of late, and deceleration also has been evident in price measures that exclude food and energy. Nonetheless, with the average rate of consumer price increase up this year from the 1989 pace, a clear turn in the inflation trend still is lacking.

The CPI for energy retreated 0.4 percent in April and 0.7 percent in May, when declines were posted for gasoline and fuel oil. With oil producers still having difficulty restraining production, crude oil prices have remained under downward pressure in June. Nevertheless, gasoline prices--supported by tight supplies associated with refinery shutdowns--have stayed relatively high, and private survey data point to an increase at retail in June. As refineries come back on line, margins likely will fall.

Retail food prices were down 0.2 percent in April and unchanged in May. The index for fresh fruits and vegetables fell further and now has largely retraced its runup of earlier this year. Meat prices, however, have continued to rise this spring, as pork production has dropped sharply, and on balance the year-to-year rate of increase in the prices of other foods is

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

| | Relative importance Dec. 1989 | 1988 | 1989 | 1989 | | 1990 | 1990 | |
|-----------------------------------|----------------------------------|------|------|-----------------------|-----|------|----------------|-----|
| | | | | Q3 | Q4 | Q1 | Apr. | May |
| | | | | -----Annual rate----- | | | -Monthly rate- | |
| All items ² | 100.0 | 4.4 | 4.6 | 2.3 | 4.9 | 8.5 | .2 | .2 |
| Food | 16.3 | 5.2 | 5.6 | 3.6 | 5.5 | 11.4 | -.2 | .0 |
| Energy | 7.4 | .5 | 5.1 | -12.6 | 3.9 | 14.8 | -.4 | -.7 |
| All items less food and energy | 76.3 | 4.7 | 4.4 | 3.5 | 4.7 | 7.5 | .2 | .3 |
| Commodities | 25.2 | 4.0 | 2.7 | 1.3 | 3.4 | 7.8 | .0 | .1 |
| Services | 51.1 | 5.0 | 5.3 | 4.5 | 5.7 | 7.2 | .4 | .4 |
| Memorandum: | | | | | | | | |
| CPI-W ³ | 100.0 | 4.4 | 4.5 | 2.0 | 4.6 | 8.3 | .1 | .1 |

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

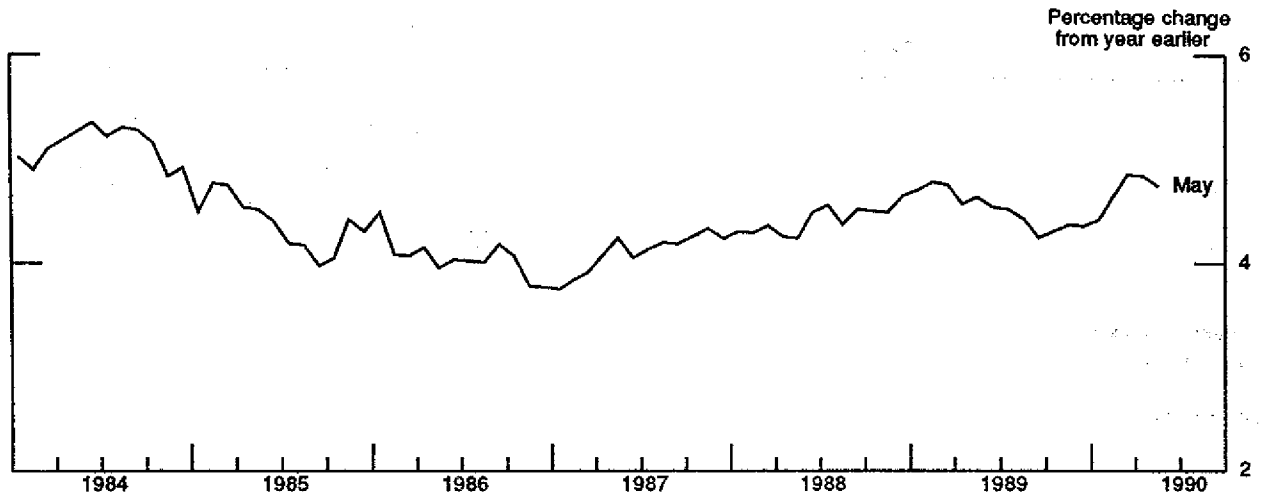
RECENT CHANGES IN PRODUCER PRICES
(Percentage change; based on seasonally adjusted data)¹

| | Relative importance Dec. 1989 | 1988 | 1989 | 1989 | | 1990 | 1990 | |
|-------------------------------------|----------------------------------|------|------|-----------------------|-------|------|----------------|------|
| | | | | Q3 | Q4 | Q1 | Apr. | May |
| | | | | -----Annual rate----- | | | -Monthly rate- | |
| Finished goods | 100.0 | 4.0 | 4.9 | .4 | 5.0 | 6.7 | -.3 | .3 |
| Consumer foods | 25.9 | 5.7 | 5.2 | .7 | 12.4 | 9.5 | -.6 | .6 |
| Consumer energy | 9.2 | -3.6 | 9.5 | -15.3 | -5.3 | 24.0 | -1.7 | -1.0 |
| Other finished goods | 64.9 | 4.3 | 4.2 | 3.0 | 3.6 | 3.3 | .2 | .2 |
| Consumer goods | 39.5 | 4.8 | 4.4 | 2.3 | 4.2 | 3.5 | .1 | .5 |
| Capital equipment | 25.4 | 3.6 | 3.8 | 4.4 | 2.0 | 3.4 | .2 | .0 |
| Intermediate materials ² | 94.9 | 5.3 | 2.5 | -.7 | -.4 | 2.5 | .0 | -.1 |
| Excluding food and energy | 82.5 | 7.2 | .9 | -.7 | -1.0 | 1.3 | .1 | .1 |
| Crude food materials | 41.9 | 14.2 | 2.8 | -2.2 | 19.2 | 8.7 | -.8 | -2.5 |
| Crude energy | 40.5 | -9.5 | 17.9 | -7.0 | 13.2 | 1.0 | -7.8 | 2.1 |
| Other crude materials | 17.5 | 7.5 | -3.6 | .6 | -15.3 | 4.3 | 2.2 | 1.0 |

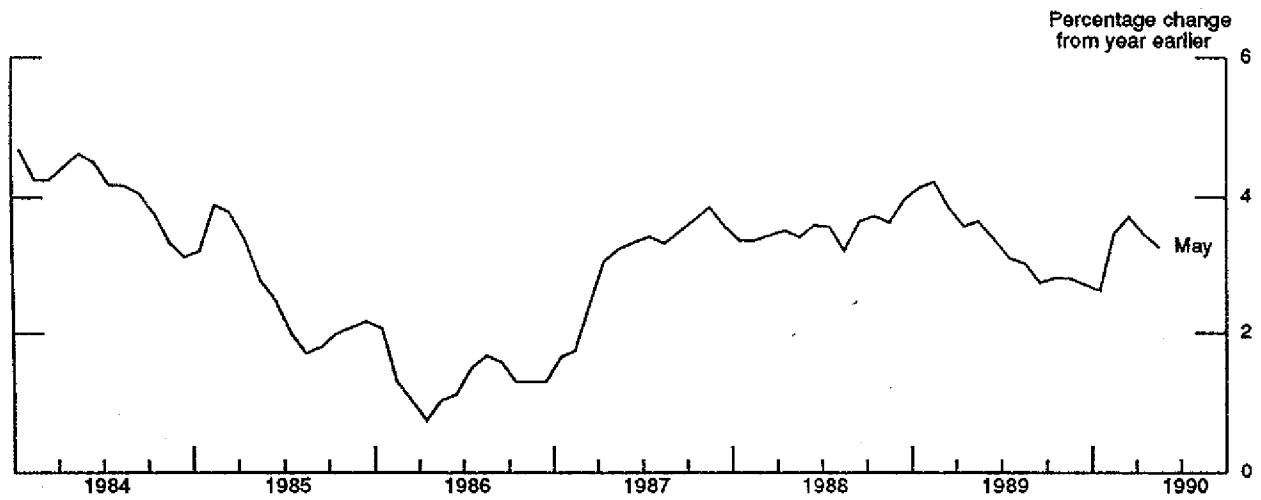
1. Changes are from final month of preceding period to final month of period indicated.
2. Excludes materials for food manufacturing and animal feeds.

CONSUMER PRICE MEASURES

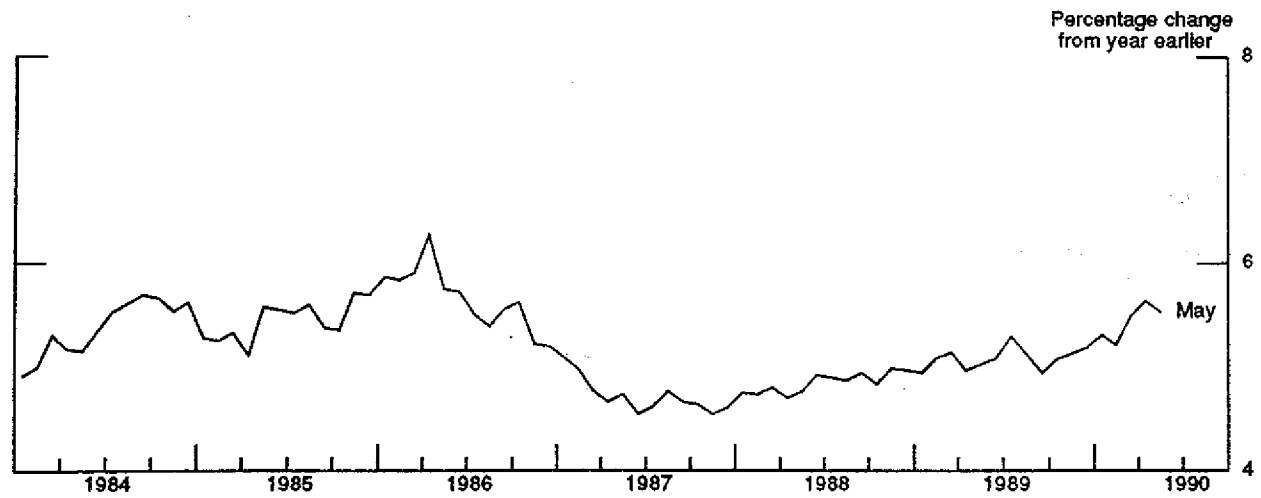
All Items Less Food and Energy



Commodities Less Food and Energy



Services Less Energy



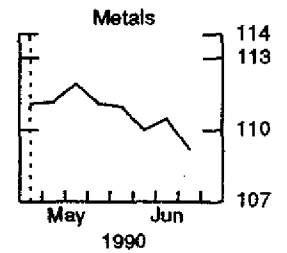
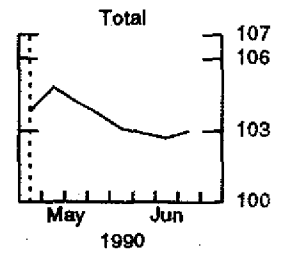
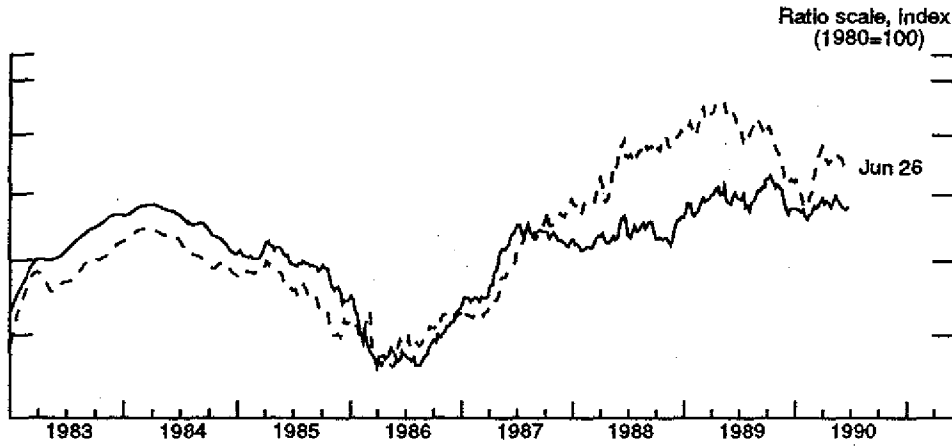
running about in line with general inflation. At the farm level, about one-third of the nation's winter wheat crop has been harvested as of June 24; total wheat production likely will be up considerably this year from the low levels of the past four years. The other major crops appeared to be in reasonably good condition as of late June, even though persistent rains through the spring may have caused farmers either to alter their mix of crops or, in some cases, even to leave water-logged acreage idle. With inventories of many crops running at low levels, a serious shortfall in this year's harvest might well put sharp upward pressure on prices.

Excluding food and energy items, retail prices of other goods were unchanged in April and edged up 0.1 percent in May. In considerable part, the slowing after the first quarter reflected movements in apparel prices, which registered no change in April and fell 0.5 percent in May after rising more than 5 percent in the February-March period. Declines also were posted for prices of new cars and, in April, for house furnishings. The CPI for non-energy services rose 0.4 percent in April and May, well below the first-quarter rate but similar to the pace in recent years. Prices declined or slowed for several items that had boosted the pace this winter, notably for lodging out-of-town and airfares. However, prices rose rapidly in a number of other categories, including legal, medical, and cable TV services.

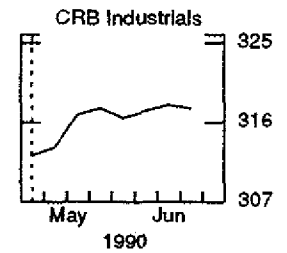
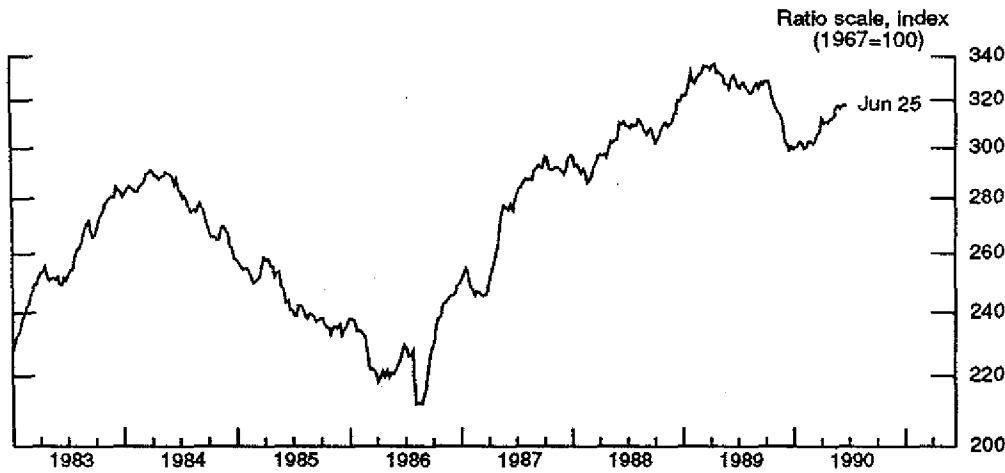
Despite the moderation in April and May, the CPI total excluding food and energy items has risen 4.8 percent over the last twelve months, at the upper end of the range observed during the past seven years (chart). Businesses have continued to face labor cost pressures, and with import prices turning up this year, this source of downward pressure on domestic expenditure prices has been eliminated.

COMMODITY PRICE MEASURES *

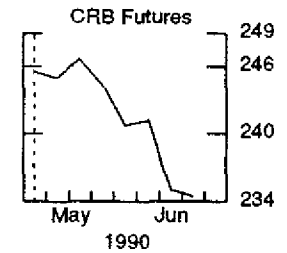
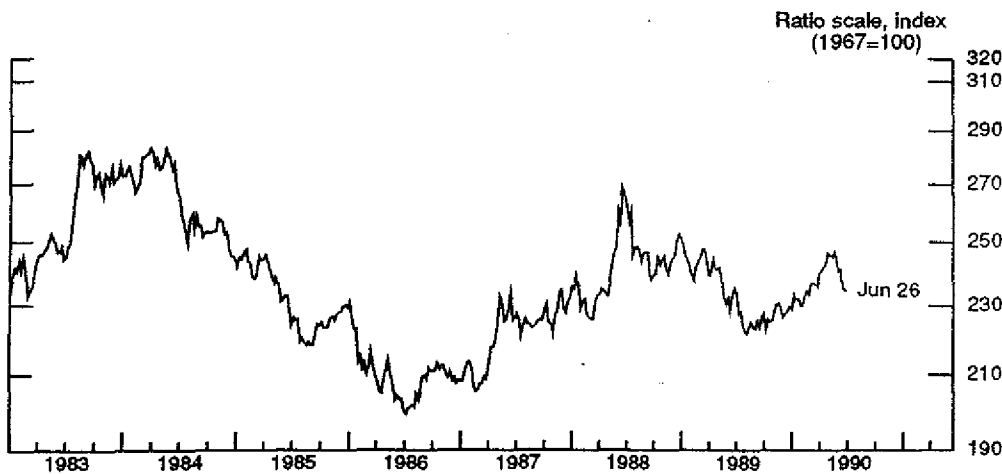
— Journal of Commerce Index, total
 - - - Journal of Commerce Index, metals



CRB Spot Industrials



CRB Futures



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

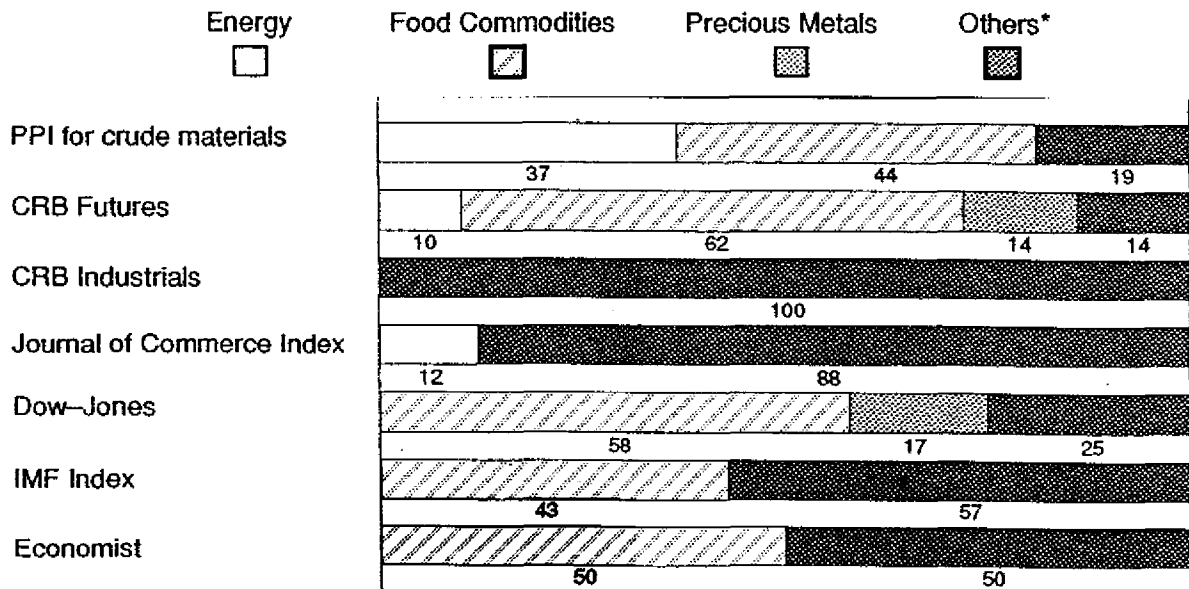
Dotted lines indicate week of last Greenbook.

PRICE INDEXES FOR COMMODITIES AND MATERIALS¹

| | Last obser- vation | 1990 | | | | Memo: Year earlier to date |
|---|-----------------------|------|-------|-----------|----------------------------------|-------------------------------------|
| | | 1988 | 1989 | To May | May 8 ³ to date | |
| 1. PPI for crude materials ⁴ | May | 3.1 | 6.9 | .0 | n.a. | -1.8 |
| 1a. Foods and feeds | May | 14.2 | 2.6 | 3.6 | n.a. | 1.6 |
| 1b. Energy | May | -9.5 | 17.9 | -5.6 | n.a. | -5.4 |
| 1c. Excluding food and energy | May | 7.5 | -3.8 | 4.8 | n.a. | -1.4 |
| 1d. Excluding food and energy, seasonally adjusted | May | 7.6 | -3.9 | 4.2 | n.a. | -1.4 |
| 2. Commodity Research Bureau | | | | | | |
| 2a. Futures prices | June 26 | 8.5 | -9.0 | 6.9 | -4.5 | -.4 |
| 2b. Industrial spot prices | June 25 | 7.3 | -5.9 | 3.9 | 1.7 | -3.5 |
| 3. <u>Journal of Commerce</u> industrials | June 26 | 3.8 | 1.3 | .9 | -.8 | -1.5 |
| 4. Dow-Jones Spot | June 26 | 6.9 | -10.1 | 5.0 | -2.9 | -1.6 |
| 5. IMF commodity index ⁴ | May | 12.6 | -12.9 | 1.7 | n.a. | -8.1 |
| 5a. Metals | May | 33.7 | -23.4 | 6.6 | n.a. | -10.3 |
| 5b. Nonfood agric. | May | -9.4 | -4.6 | .3 | n.a. | -2.0 |
| 6. <u>Economist</u> (U.S. dollar index) | June 19 | 17.7 | -22.8 | 6.9 | -3.8 | -8.7 |
| 6a. Industrials | June 19 | 18.9 | -23.8 | 5.2 | -2.2 | -6.3 |

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

Index Weights



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

At the producer level, prices of finished goods less food and energy rose 0.2 percent in April and May, held down by declines for motor vehicles. Discounting by motor vehicle manufacturers has been largely responsible for the slower pace of this PPI measure over the first five months of the year--about 3 percent at an annual rate compared with 4-1/4 percent in 1988 and 1989. Prices of intermediate materials less food and energy have risen only a little this year. However, the PPI for crude nonfood materials less energy has increased more than 5 percent since February, mainly reflecting the firming in prices of metal scrap. Nevertheless, this index remained below its level of a year earlier. Since the mid-May pricing date for the PPI, price movements in spot commodity markets for industrial materials have been mixed, with declines for copper but some net increases for steel scrap and cotton.

Probability of Recession

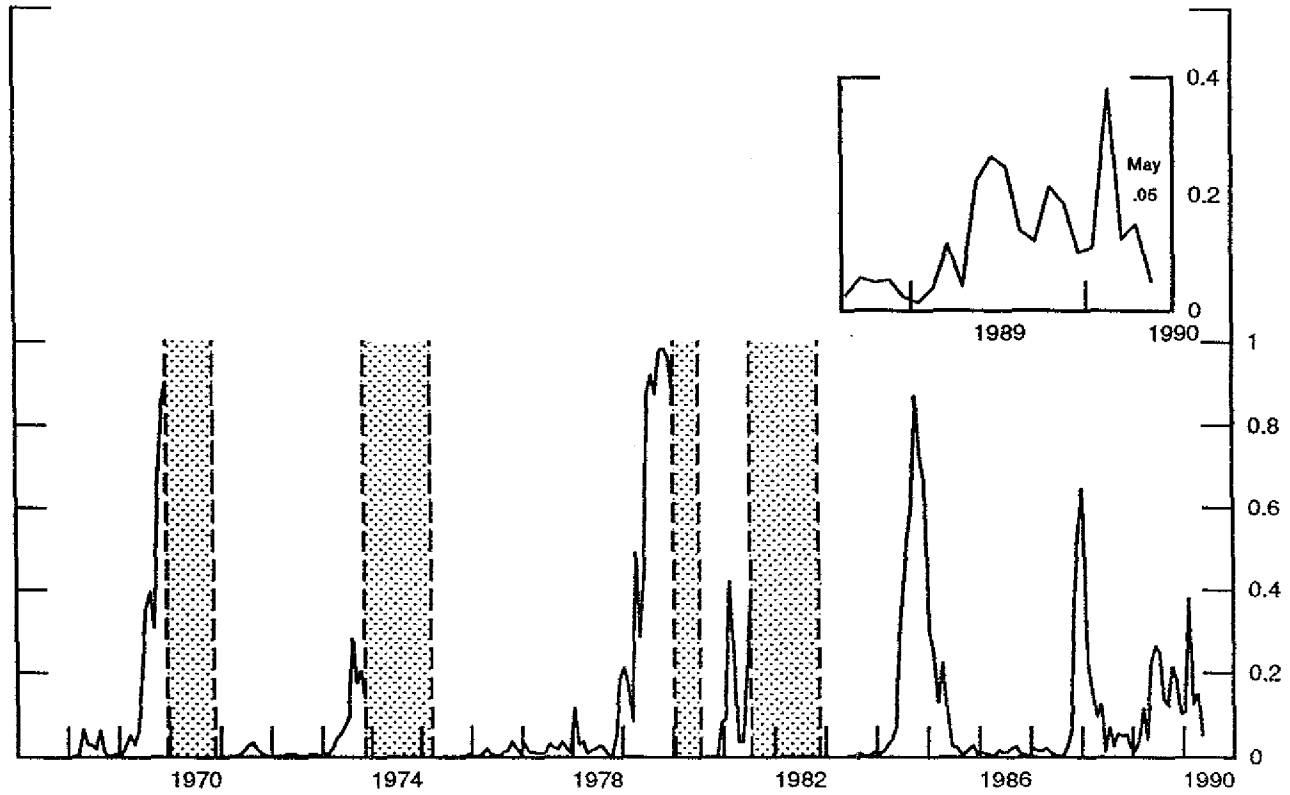
Despite apparent slow growth in the economy, a recession-probability measure based on the Commerce Department's May index of leading economic indicators suggests that the probability of a recession starting in the next six months is only 5 percent (chart).⁴ A second probability measure, compiled by the National Bureau of Economic Research, shows a 7 percent probability of recession in its most recent reading.⁵

4. This measure is described in Francis X. Diebold and Glenn D. Rudebusch, "Scoring the Leading Indicators," *Journal of Business*, vol. 62 (July 1989), pp. 369-91.

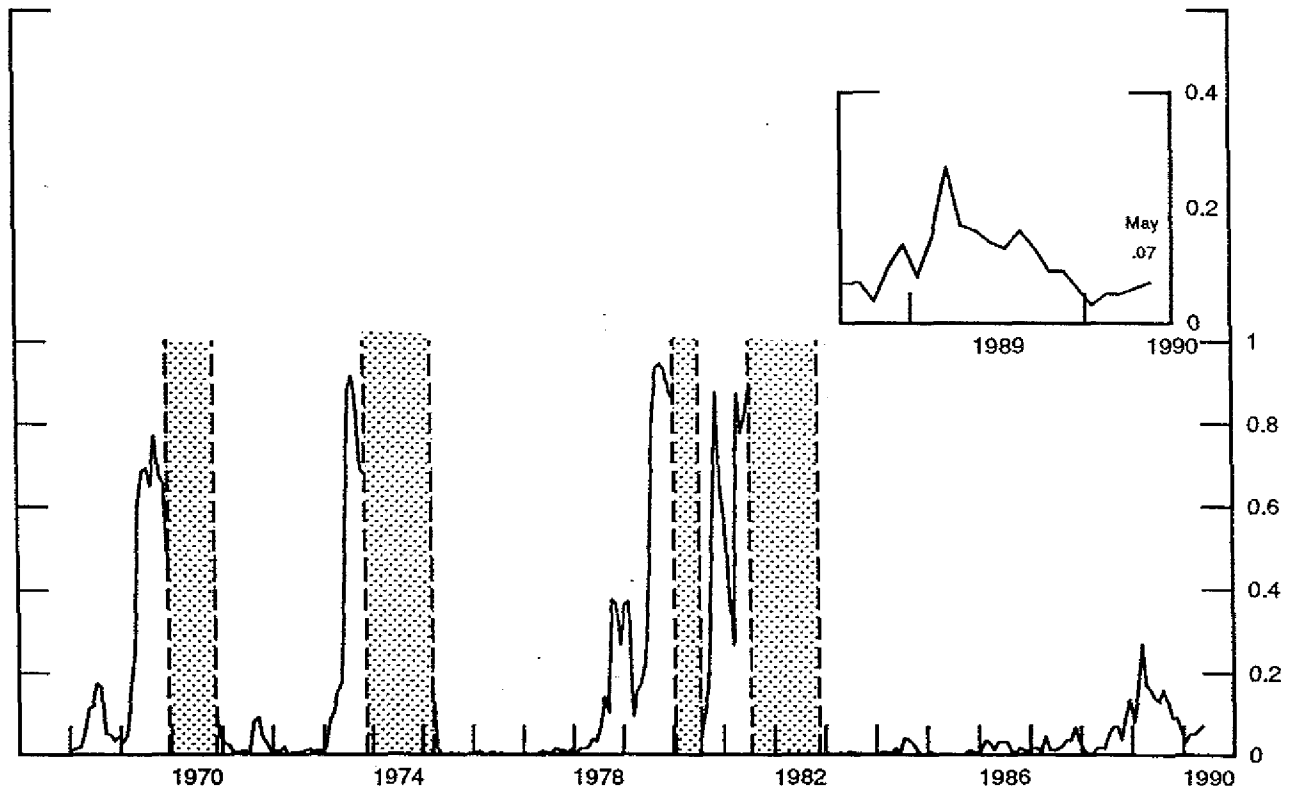
5. The index and the forecasting procedure are described in James H. Stock and Mark W. Watson, "New Indexes of Coincident and Leading Economic Indicators," in Olivier Jean Blanchard and Stanley Fischer, eds., *NBER Macroeconomics Annual 1989* (MIT Press, 1989), pp. 351-94.

Probability of a Recession*

GENERATED FROM COMMERCE LEADING INDEX



GENERATED FROM NBER LEADING INDEX



*Each probability represents the likelihood that a recession will begin during the next six months.

**DOMESTIC FINANCIAL
DEVELOPMENTS**

III-T-1 1
 SELECTED FINANCIAL MARKET QUOTATIONS
 (percent)

| | 1987 | 1989 | | 1990 | | Change from: | | |
|--|-------------|-------|-------|--------|---------|--------------|--------|--------|
| | 2 Oct 16 | March | Dec | FOMC | June 26 | Mar 89 | Dec 89 | FOMC |
| | | highs | lows | May 15 | | highs | lows | May 15 |
| Short-term rates | | | | | | | | |
| Federal funds ³ | 7.59 | 9.85 | 8.45 | 8.23 | 8.27 | -1.58 | -.18 | .04 |
| Treasury bills ⁴ | | | | | | | | |
| 3-month | 6.93 | 9.09 | 7.53 | 7.65 | 7.80 | -1.29 | .27 | .15 |
| 6-month | 7.58 | 9.11 | 7.29 | 7.67 | 7.70 | -1.41 | .41 | .03 |
| 1-year | 7.74 | 9.05 | 7.11 | 7.65 | 7.62 | -1.43 | .51 | -.03 |
| Commercial paper | | | | | | | | |
| 1-month | 7.94 | 10.05 | 8.51 | 8.22 | 8.24 | -1.81 | -.27 | .02 |
| 3-month | 8.65 | 10.15 | 8.22 | 8.20 | 8.16 | -1.99 | -.06 | -.04 |
| Large negotiable CDs ⁴ | | | | | | | | |
| 1-month | 7.92 | 10.07 | 8.52 | 8.23 | 8.26 | -1.81 | -.26 | .03 |
| 3-month | 8.90 | 10.32 | 8.22 | 8.28 | 8.28 | -2.04 | .06 | .00 |
| 6-month | 9.12 | 10.08 | 8.01 | 8.39 | 8.35 | -1.73 | .34 | -.04 |
| Eurodollar deposits ⁵ | | | | | | | | |
| 1-month | 8.00 | 10.19 | 8.38 | 8.19 | 8.25 | -1.94 | -.13 | .06 |
| 3-month | 9.06 | 10.50 | 8.25 | 8.25 | 8.25 | -2.25 | .00 | .00 |
| Bank prime rate | 9.25 | 11.50 | 10.50 | 10.00 | 10.00 | -1.50 | -.50 | .00 |
| Intermediate- and long-term rates | | | | | | | | |
| U.S. Treasury (constant maturity) | | | | | | | | |
| 3-year | 9.52 | 9.88 | 7.69 | 8.58 | 8.49 | -1.39 | .80 | -.09 |
| 10-year | 10.23 | 9.53 | 7.77 | 8.65 | 8.56 | -.97 | .79 | -.09 |
| 30-year | 10.24 | 9.31 | 7.83 | 8.62 | 8.53 | -.78 | .70 | -.09 |
| Municipal revenue ⁶ (Bond Buyer) | 9.59 | 7.95 | 7.28 | 7.66 | 7.43 | -.52 | .15 | -.23 |
| Corporate--A utility recently offered | 11.50 | 10.47 | 9.29 | 10.04 | 9.94 | -.53 | .65 | -.10 |
| Home mortgage rates ⁷ | | | | | | | | |
| S&L fixed-rate | 11.58 | 11.22 | 9.69 | 10.54 | 10.16 | -1.06 | .47 | -.38 |
| S&L ARM, 1-yr. | 8.45 | 9.31 | 8.34 | 8.63 | 8.50 | -.81 | .16 | -.13 |

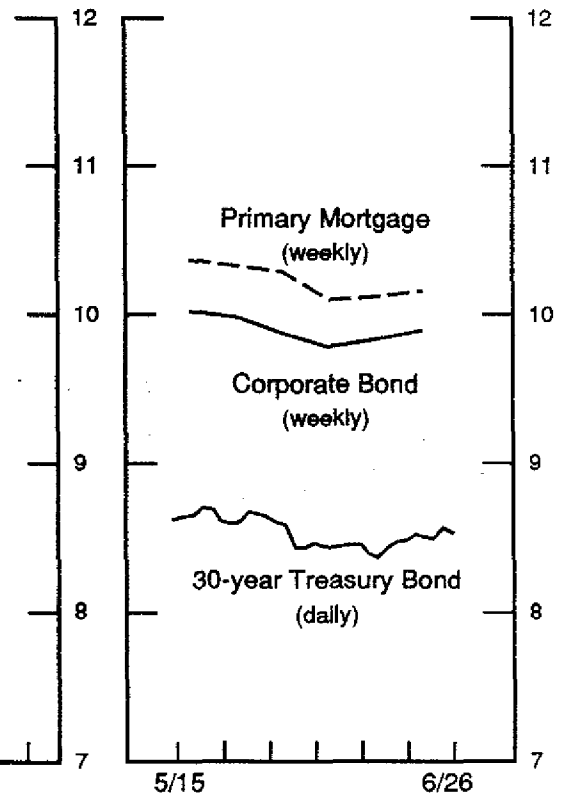
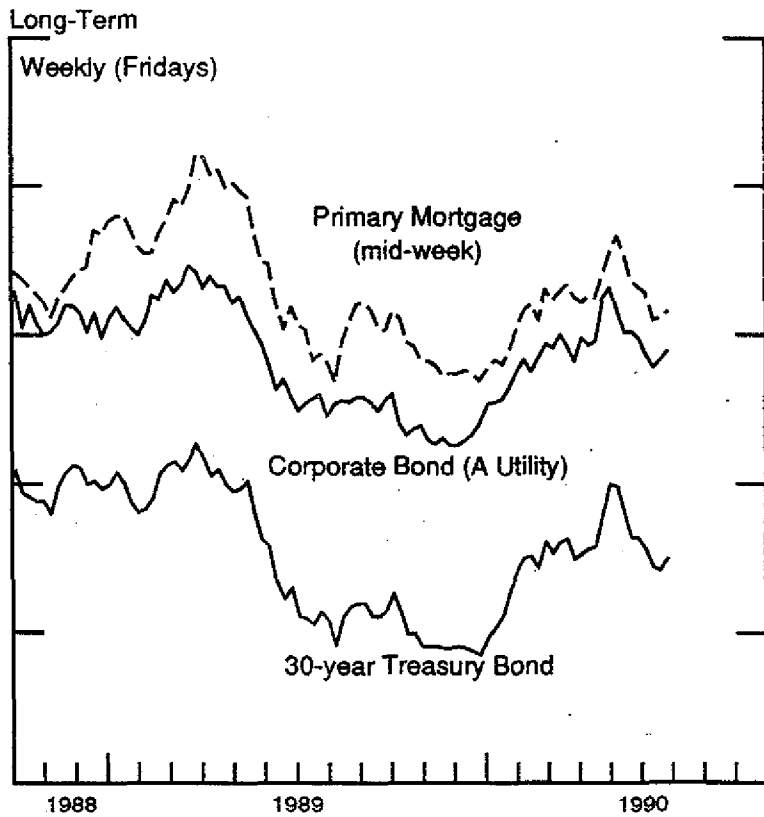
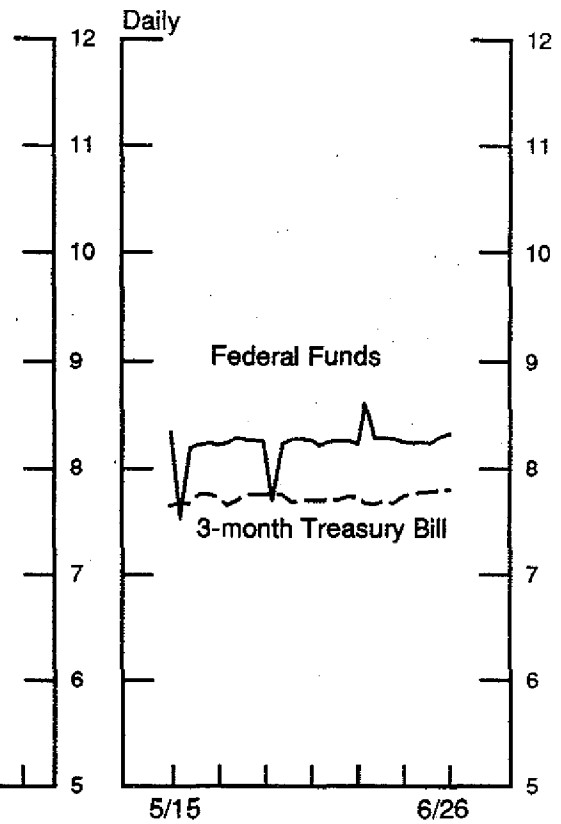
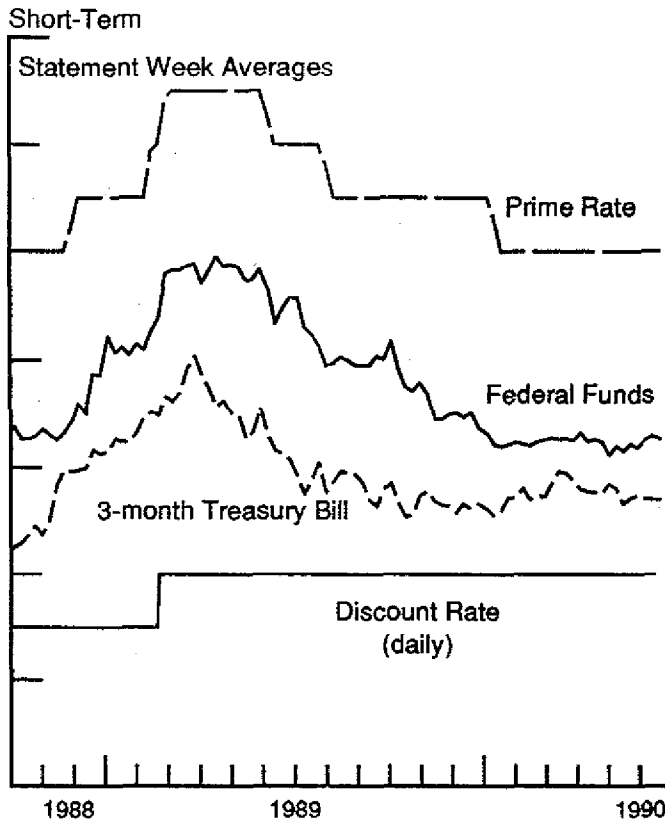
| | Record highs | Date | 1989 | 1990 | | Percent change from: | | |
|----------------------|-----------------|----------|---------------|---------|-----------------|----------------------|-------|--------|
| | | | Lows Jan 3 | FOMC | Record highs | 1989 | FOMC | |
| | | | | May 15 | | June 26 | lows | May 15 |
| Stock prices | | | | | | | | |
| Dow-Jones Industrial | 2935.89 | 6/15/90 | 2144.64 | 2822.45 | 2842.33 | -3.19 | 32.53 | .70 |
| NYSE Composite | 200.21 | 6/4/90 | 154.98 | 193.31 | 192.47 | -3.87 | 24.19 | -.43 |
| AMEX Composite | 397.03 | 10/10/89 | 305.24 | 353.56 | 356.80 | -10.13 | 16.89 | .92 |
| NASDAQ (OTC) | 485.73 | 10/9/89 | 378.56 | 442.50 | 455.38 | -6.25 | 20.29 | 2.91 |
| Wilshire | 3523.47 | 10/9/89 | 2718.59 | 3373.68 | 3373.68 | -4.25 | 24.10 | .00 |

- 1/ One-day quotes except as noted.
 2/ Last business day prior to stock market decline on Monday Oct. 19, 1987.
 3/ Average for two-week reserve maintenance period closest to date shown. Last observation is average to date for the maintenance period ending June 27, 1990.

- 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 June 22, Wednesday weeks through June 20.

DOMESTIC FINANCIAL DEVELOPMENTS

Anchored by a stable federal funds rate, most money market yields have changed little on balance since the May FOMC meeting. At the same time, however, a run of soft economic indicators and confirmation of the expected slowing of price increases have bolstered sentiment in the bond market and pushed long-term yields somewhat lower, especially on private instruments. Stock prices rose sharply early in June but have fallen since then, and most broad indexes are little changed, on net, over the period.

M2 declined in May, dragging it well below the midpoint of its 3 to 7 percent target range for 1990. M3 also fell, leaving it below its 2-1/2 to 6-1/2 percent target range. The recent weakness in the monetary aggregates has been caused partly by the increased pace of restructuring of the thrift industry and an associated decline in the amount of financial intermediation taking place at depository institutions, as large amounts of thrift assets have gone to the Resolution Trust Corporation (RTC) and other nondepositories. For banks, the combination of weakened demands for credit, some restrictions on credit to certain classes of borrowers, and substantial inflows of core deposits from thrifts has reduced the need to attract deposits and has fostered recent declines in offering rates. Preliminary data for June suggest a rebound to moderate growth in all the aggregates.

Overall Treasury borrowing slowed in the second quarter, despite the large funding requirements of the RTC. Borrowing by state and local governments remained subdued over much of the quarter, but offerings in June were buoyed by a pickup in short-term volume. Private credit flows appear to have remained weak in the second quarter. Nonfinancial business

III-2

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

| | 1989 ¹ | 1989 Q4 | 1990 Q1 | 1990 Mar | 1990 Apr | 1990 May p | Growth Q4 89- May 90p |
|--|-------------------|------------|------------|-------------|-------------|---------------|------------------------------|
| -----Percent change at annual rates----- | | | | | | | |
| 1. M1 | 0.6 | 5.1 | 4.8 | 5.1 | 3.9 | -2.4 | 3.8 |
| 2. M2 | 4.5 | 7.0 | 6.0 | 5.1 | 1.9 | -2.7 | 3.9 |
| 3. M3 | 3.3 | 1.8 | 2.6 | 0.8 | 1.0 | -2.4 | 1.4 |
| -----Percent change at annual rates----- | | | | | | | |
| | | | | | | | Levels bil. \$ May 90p |
| <u>Selected components</u> | | | | | | | |
| 4. M1-A | 0.4 | 2.5 | 4.2 | 2.1 | 0.7 | -3.7 | 514.0 |
| 5. Currency | 4.8 | 4.0 | 10.3 | 9.5 | 8.9 | 8.3 | 231.7 |
| 6. Demand deposits | -2.8 | 1.1 | -0.9 | -3.9 | -6.4 | -13.8 | 274.6 |
| 7. Other checkable deposits | 1.0 | 9.8 | 5.9 | 10.5 | 9.5 | 0.0 | 291.8 |
| 8. M2 minus M1 ² | 5.9 | 7.7 | 6.4 | 5.1 | 1.4 | -2.8 | 2458.5 |
| 9. Overnight RPs and Eurodollars, NSA | -9.2 | -12.8 | 28.0 | -8.9 | -43.1 | 30.8 | 79.8 |
| 10. General purpose and broker/dealer money market mutual fund shares | 29.7 | 29.1 | 18.8 | 1.8 | -0.7 | -20.0 | 319.4 |
| 11. Commercial banks | 7.5 | 10.9 | 8.5 | 8.0 | 8.6 | 14.1 | 1110.4 |
| 12. Savings deposits plus MMDAs ³ | -1.7 | 10.4 | 9.3 | 10.3 | 7.8 | 6.7 | 559.2 |
| 13. Small time deposits | 19.0 | 11.3 | 7.8 | 5.6 | 9.4 | 21.7 | 551.2 |
| 14. Thrift institutions | -0.2 | -0.9 | -1.7 | 2.4 | -3.0 | -13.1 | 950.7 |
| Savings deposits plus MMDAs ³ | -9.3 | 1.9 | 2.8 | 6.1 | 5.4 | -7.4 | 356.4 |
| Small time deposits | 5.8 | -2.5 | -4.3 | 0.2 | -7.7 | -16.7 | 594.3 |
| 17. M3 minus M2 ⁴ | -1.5 | -17.1 | -10.6 | -16.7 | -3.0 | -1.2 | 792.5 |
| 18. Large time deposits | 4.2 | -6.7 | -8.3 | -12.9 | -13.2 | -6.7 | 534.6 |
| 19. At commercial banks, net ⁵ | 9.9 | 2.7 | -1.6 | -9.3 | -5.1 | 5.5 | 396.4 |
| 20. At thrift institutions | -7.8 | -28.8 | -24.7 | -24.0 | -34.2 | -41.1 | 138.1 |
| 21. Institution-only money market mutual fund shares | 17.1 | 3.2 | 10.2 | 19.7 | 15.9 | 5.6 | 107.3 |
| 22. Term RPs, NSA | -16.0 | -48.9 | -39.8 | -22.8 | -5.2 | 5.2 | 93.1 |
| 23. Term Eurodollars, NSA | -22.0 | -39.6 | -50.4 | -38.4 | -9.0 | 52.6 | 69.0 |

-----Average monthly change in billions of dollars-----

MEMORANDA:⁶

| | | | | | | | |
|--|------|------|------|------|------|------|-------|
| 24. Managed liabilities at commercial banks (25+26) | 5.9 | 4.5 | 2.1 | 0.1 | -4.9 | -0.4 | 720.8 |
| 25. Large time deposits, gross | 2.6 | 1.4 | -2.3 | -3.3 | -2.2 | -0.5 | 454.6 |
| 26. Nondeposit funds | 3.3 | 3.1 | 4.4 | 3.4 | -2.7 | 0.1 | 266.2 |
| 27. Net due to related foreign institutions | 0.2 | -1.2 | 3.3 | 2.6 | -0.7 | 7.8 | 24.3 |
| 28. Other ⁷ | 3.1 | 4.4 | 1.2 | 0.8 | -2.1 | -7.6 | 241.9 |
| 29. U.S. government deposits at commercial banks ⁸ | -0.3 | -0.6 | -0.6 | 1.4 | 2.0 | -2.6 | 18.6 |

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 April and May at rates of 2.5 percent and -1.2 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during April and May at rates of 4.3 percent and -1.6 percent, respectively.

4. The non-M2 component of M3 is seasonally adjusted as a whole.

5. Net of large denomination time deposits held by money market mutual funds and thrift institutions.

6. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.

7. Consists of borrowing from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowing from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.

8. Consists of Treasury demand deposits and note balances at commercial banks.

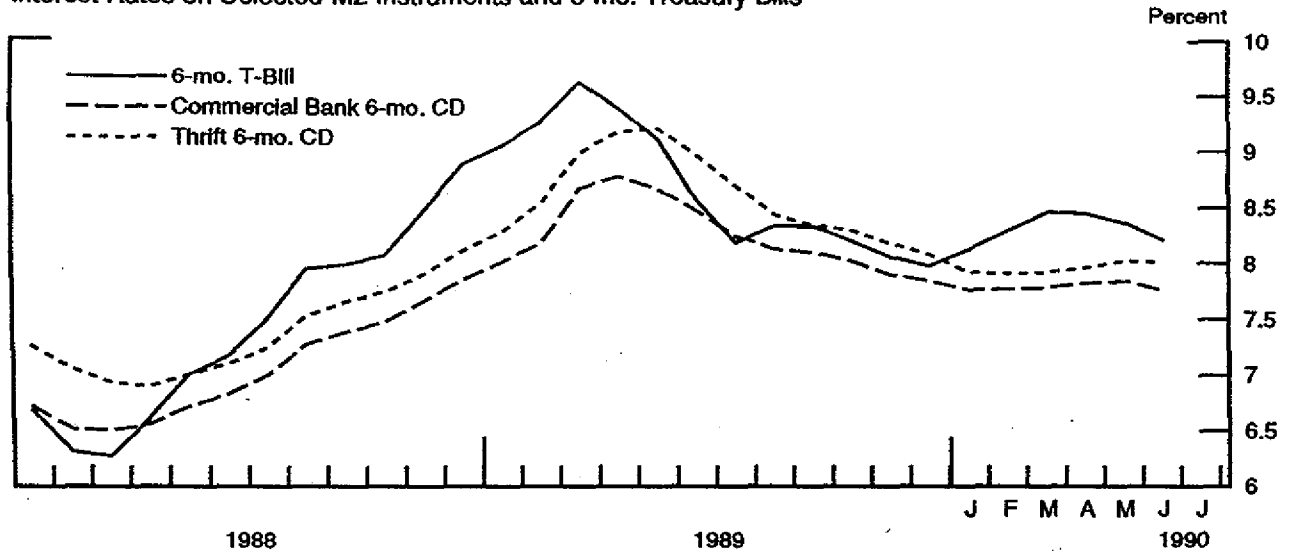
p - preliminary

borrowing was moderate, despite some strengthening in bond issuance. Although mortgage rates declined from their April peak, housing data through May suggest that residential mortgage lending has slowed. Consumer installment credit, which posted its weakest advance in three years in the first quarter, has shown no signs of strength this quarter.

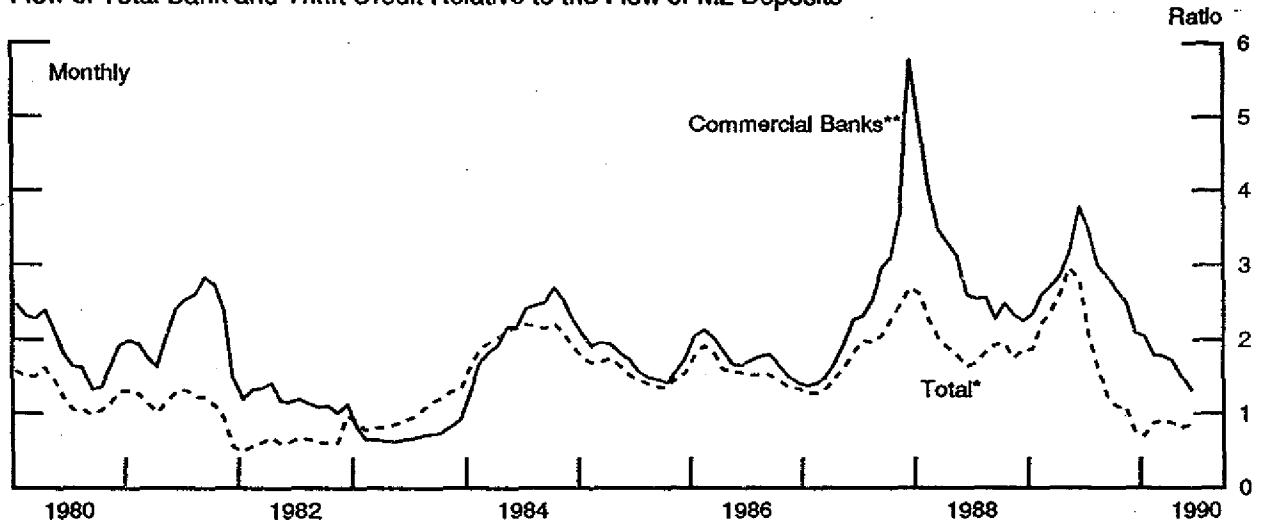
Over the intermeeting period concerns persisted that the economy was experiencing a "credit crunch" with lenders pulling back on credit supplies in response to perceived pressures from examiners, capital constraints, and asset quality problems that have led to recent downgradings of bank holding company debt. Available evidence has continued to suggest that such shifts in credit supply have had either a regional (Northeast) or a sectoral (real estate) focus. Just how much of any cutback was the response of banks to a weaker economy and perceived risks, and how much to regulatory change, hasn't been clear.

The signals of credit stringency are mixed for business finance. The willingness of banks and investors to finance highly leveraged restructurings clearly has diminished. It also appears, but is difficult to confirm in macro statistics, that a broader effect has been felt by smaller businesses. Surveys taken in the spring by the Federal Reserve indicate that banks had tightened their terms for small- and intermediate-sized business borrowers. Nonetheless, surveys by the National Federation of Independent Business show that, while an increasing number of businesses have discerned some firming in credit availability in recent months, the firming has not been very substantial. For home mortgages and for most forms of consumer credit, unusual credit restraint does not appear to be an important explanation for slower loan growth. In short, the evidence

Interest Rates on Selected M2 Instruments and 6-mo. Treasury Bills

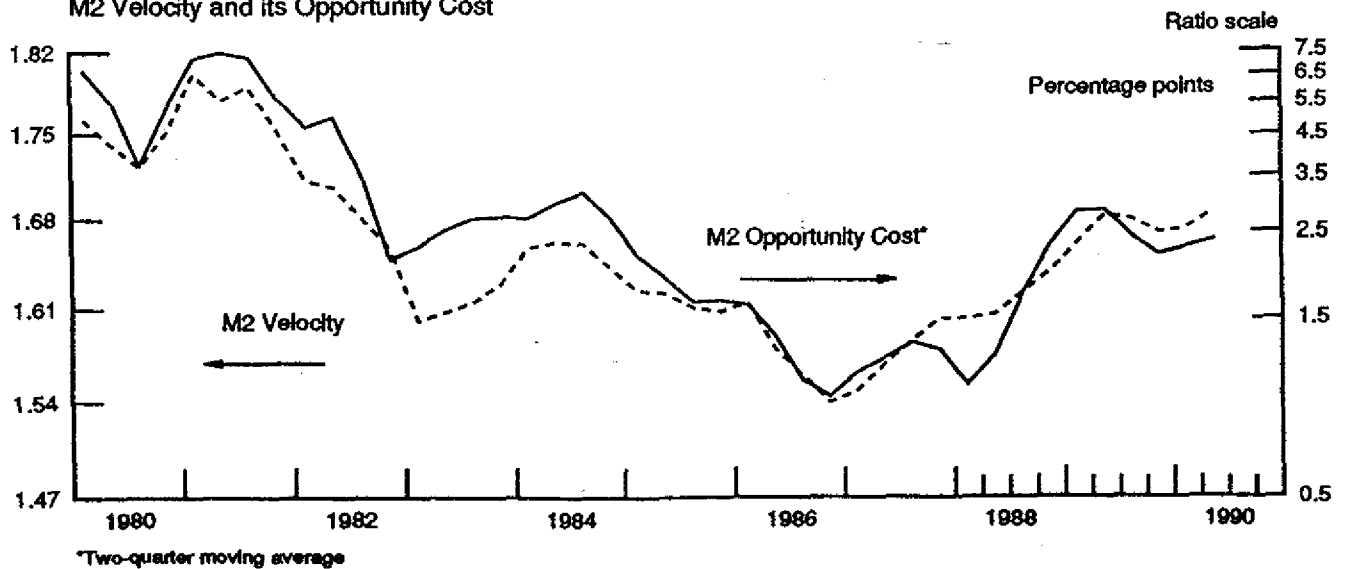


Flow of Total Bank and Thrift Credit Relative to the Flow of M2 Deposits



* Ratio of 12-mo. change in bank and thrift credit to 12-mo. change in M2 deposits.
 ** Ratio of 12-mo. change in bank credit to 12-mo. change in M2 deposits at banks.

M2 Velocity and its Opportunity Cost



suggests that the shift in credit conditions is a real phenomenon, but most likely of much lesser importance than the decibel level of complaint might suggest.

Monetary Aggregates and Bank Credit

All the monetary aggregates contracted in May: M1 at a 2-1/2 percent rate, M2 at a 2-3/4 percent rate, and M3 at a 2-1/2 percent rate.¹ Within M1, demand deposits fell sharply. Inquiries of corporate cash managers did not uncover any special reason for this runoff, but part of it may have reflected a response of compensating balances to the first-quarter increase in money market yields. Other checkable deposits (OCDs) were flat in May, after expanding briskly over the previous three months. So far in June, OCDs have been growing at a double-digit rate, suggesting that May's weakness was an aberration, perhaps because of the incomplete capture by the seasonal factors of tax-related outflows. Currency remained a source of strength in May, though growing more slowly than in the first quarter.

Growth in the sum of savings, MMDAs, and small time deposits slowed to a crawl in May. Substantial transfers of these core deposits from thrift institutions to banks, through the activities of the RTC, may have depressed overall deposit growth, as banks, in the face of weak credit growth, held down offering rates on small time deposits (chart). Even at these relatively low offering rates, M2 deposit inflows rose further relative to the increase in bank credit (chart), and, given the decline in thrift assets, they more than covered the expansion of depository institution credit.

1. A longer-run view of M1, M2, and M3 is given in Mr. Reinhart's memo to the FOMC entitled "The Behavior of the Monetary Aggregates in the First Half of 1990."

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

| | 1988:Q4 | 1989 | 1990 | | | | Levels |
|---|---------|------|-------|-------|-------|-------|---------------------|
| | to | | Q4 | Q1 | Mar. | Apr. | May p |
| | 1989:Q4 | | | | | | bil.\$ |
| | | | | | | | May p |
| ----- Commercial Bank Credit ----- | | | | | | | |
| 1. Total loans and securities at banks | 7.2 | 6.9 | 6.8 | 9.2 | 5.1 | 4.1 | 2644.1 |
| 2. Securities | 3.9 | 9.6 | 16.8 | 13.8 | 8.8 | 7.2 | 607.1 |
| 3. U.S. government securities | 9.7 | 16.9 | 24.6 | 19.5 | 10.9 | 14.8 | 427.9 |
| 4. Other securities | -6.9 | -5.5 | -.2 | .7 | 4.0 | -10.6 | 179.2 |
| 5. Total loans | 8.1 | 6.1 | 3.9 | 7.8 | 4.1 | 3.2 | 2037.0 |
| 6. Business loans | 6.8 | 3.0 | .6 | 9.6 | 10.1 | -.6 | 647.9 |
| 7. Real estate loans | 12.9 | 11.2 | 10.1 | 9.7 | 7.7 | 12.5 | 787.5 |
| 8. Consumer loans | 6.3 | 6.4 | 3.7 | 1.0 | -4.4 | 4.4 | 379.2 |
| 9. Security loans | 3.8 | -1.0 | -23.3 | -75.6 | -19.4 | -39.3 | 35.4 |
| 10. Other loans | .6 | -1.9 | -4.1 | 26.3 | -9.4 | -16.5 | 187.0 |
| ----- Short- and Intermediate-Term Business Credit ----- | | | | | | | |
| 11. Business loans net of bankers acceptances | 6.8 | 2.7 | .1 | 9.1 | 10.0 | -.8 | 639.6 |
| 2. Loans at foreign branches ² | -5.0 | 9.5 | 3.7 | -21.7 | 11.1 | 16.4 | 22.2 |
| 13. Sum of lines 11 & 12 | 6.4 | 2.9 | .3 | 8.3 | 9.7 | .0 | 661.8 |
| 14. Commercial paper issued by nonfinancial firms | 31.2 | 21.0 | 24.5 | 43.7 | 55.7 | -31.4 | 145.0 |
| 15. Sum of lines 13 & 14 | 9.8 | 5.9 | 4.4 | 14.4 | 17.9 | -5.8 | 806.8 |
| 16. Bankers acceptances: U.S. trade related ^{3,4} | 6.1 | -9.1 | -19.8 | -32.1 | -36.7 | -15.1 | 31.3 |
| 17. Line 15 plus bankers acceptances: U.S. trade related | 9.7 | 5.3 | 3.4 | 12.5 | 15.7 | -6.1 | 838.1 |
| 18. Finance company loans to business ^{3,6} | 10.6 | 6.2 | 4.7 | 5.1 | 7.8 | n.a. | 262.0 ³ |
| 19. Total short- and intermediate-term business credit (sum of lines 17 & 18) | 9.9 | 5.4 | 3.7 | 10.6 | 13.8 | n.a. | 1104.4 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. April data.

p--preliminary.

n.a.--not available

M2 growth in May also was held down by a sharp runoff in shares of money market mutual funds (MMMFs). The recent reversal of MMMF growth rates reflected a shift in relative yields, with MMMFs currently yielding about 25 to 50 basis points less than six-month T-bills. In addition, buoyancy in stock and bond markets in May reportedly siphoned funds from MMMFs into stock and bond mutual funds in May and to a lesser extent in June. With small time deposit rates low relative to market yields, some funds likely were diverted to Treasury issues and other market paper; noncompetitive tenders remained strong last month. The rise in opportunity costs of holding M2 contributed to an estimated further increase in its velocity in the second quarter (chart). However, this increase in velocity appears to be greater than can be explained by past relationships with standard measures of opportunity costs and may be an aspect of the shifting of household liquid assets associated with the massive volume of thrift resolutions.

The drop in M3 reflected a substantial decline in thrift assets together with continued moderate expansion in bank credit. The non-M2 component of M3 fell at about the same rate as in April. Contraction of large time deposits at thrifts accelerated, as the RTC hit its stride, but these deposits resumed growth at banks after having fallen for several months.

Bank credit expanded at a 4 percent annual rate in May, about matching the pace seen in April. Acquisitions of U.S. government securities accelerated in May in part because of net additions of mortgage-backed securities. Real estate loans rebounded to a 12-1/2 percent pace, after two months of single-digit growth. About 1-1/2 percentage points of this growth

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

| | 1987 | 1988 | 1989 | 1990 | | | | |
|---|-------|-------|-------|-----------------|-------------------|-------------------|------------------|-------------------|
| | Year | Year | Year | Q1 ^P | Mar. ^P | Apr. ^P | May ^P | June ^e |
| Corporate securities - total ¹ | 24.10 | 22.32 | 19.67 | 16.91 | 21.54 | 14.23 | 21.59 | 22.50 |
| Public offerings in U.S. | 21.91 | 20.30 | 17.61 | 15.04 | 19.29 | 13.06 | 18.35 | 19.50 |
| Stocks--total ² | 4.45 | 3.53 | 2.69 | 2.99 | 3.79 | 1.76 | 2.35 | 1.50 |
| Nonfinancial | 2.32 | 1.14 | 1.09 | 1.58 | 1.61 | 1.14 | 1.67 | .75 |
| Utility | .57 | .24 | .29 | .40 | .53 | .92 | .79 | .10 |
| Industrial | 1.75 | .90 | .80 | 1.18 | 1.08 | .22 | .88 | .65 |
| Financial | 2.12 | 2.39 | 1.60 | 1.41 | 2.18 | .62 | .68 | .75 |
| Bonds--total ¹ | 17.46 | 16.77 | 14.92 | 12.05 | 15.50 | 11.30 | 16.00 | 18.00 |
| Nonfinancial | 6.58 | 6.13 | 6.17 | 3.73 | 4.10 | 4.95 | 4.40 | 9.00 |
| Utility | 2.02 | 1.78 | 1.73 | 1.23 | 1.40 | 1.20 | 1.90 | 4.00 |
| Industrial | 4.56 | 4.35 | 4.44 | 2.50 | 2.70 | 3.75 | 2.50 | 5.00 |
| Financial ³ | 10.88 | 10.64 | 8.75 | 8.32 | 11.40 | 6.35 | 11.60 | 9.00 |
| By quality ³ | | | | | | | | |
| Aaa and Aa | 3.28 | 2.71 | 3.26 | 2.66 | 2.74 | 2.60 | 4.80 | 2.50 |
| A and Baa | 5.22 | 5.48 | 5.55 | 4.25 | 6.30 | 4.80 | 4.35 | 8.60 |
| Less than Baa | 2.77 | 2.59 | 2.39 | .17 | .00 | .05 | .40 | .30 |
| No rating (or unknown) | .07 | .04 | .03 | .00 | .00 | .00 | .00 | .00 |
| Memo items: | | | | | | | | |
| Equity-based bonds ⁴ | .87 | .28 | .52 | .05 | .00 | .22 | .40 | 2.00 |
| Mortgage-backed bonds | 5.19 | 4.69 | 1.66 | 1.69 | 1.93 | 2.50 | 4.20 | 1.00 |
| Other asset-backed | .93 | 1.26 | 2.03 | 3.28 | 4.53 | 1.35 | 2.25 | 5.60 |
| Variable-rate notes | 1.88 | 1.19 | 1.01 | 1.39 | 1.64 | .23 | .20 | .10 |
| Bonds sold abroad - total | 2.03 | 1.93 | 1.90 | 1.61 | 1.89 | 1.00 | 2.80 | 2.80 |
| Nonfinancial | .94 | .73 | .48 | .50 | .76 | .50 | .45 | 1.00 |
| Financial | 1.09 | 1.20 | 1.42 | 1.11 | 1.13 | .50 | 2.35 | 1.80 |
| Stocks sold abroad - total | .16 | .09 | .16 | .27 | .36 | .17 | .44 | .20 |
| Nonfinancial | .12 | .08 | .12 | .10 | .12 | .09 | .31 | .15 |
| Financial | .04 | .01 | .04 | .17 | .24 | .08 | .13 | .05 |

1. Securities issued in the private placement market are not included.

Total reflects gross proceeds rather than par value of original discount bonds.

2. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings. Such swaps totaled \$20.4 billion in 1989.

3. Bonds categorized according to Moody's bond ratings, or to Standard and Poors' if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.

4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.

p--preliminary. e--staff estimates.

was attributable to transfers of thrift assets to commercial banks. In addition, part of the slowing of real estate loans in March and April probably reflected increased loan charge-offs.

Business loans contracted in May. This weakness, which partly reflected the absence of merger-related loans, was widespread across regions of the country. The May survey of the terms of bank lending to businesses (STBL) suggested that rate and non-rate terms of loans to smaller business have firmed a little since the winter. These results are consistent with previous surveys of bank officers and small businesses, which indicated some tightening of credit supplies, but nothing like a widespread cutoff of funds.

Consumer loans rebounded to a 4-1/2 percent pace, reflecting less securitization than in April. Adjusted for securitization, April and May growth rates were both about 5 percent, somewhat below the first quarter pace. So far in June, growth of bank credit at large banks has picked up a bit, mainly on the strength of increases in U.S. government securities.

Business Finance

Short-term borrowing by nonfinancial firms has been sluggish in recent weeks. Both bank loans and commercial paper contracted in May and have expanded only slightly in June.² Some firms apparently have taken advantage of lower bond yields to issue longer-term debt. Gross public bond issuance by nonfinancial corporations with investment-grade ratings surged in June. Offerings by utilities were especially strong, while industrial issuance also strengthened. Proceeds from some of the offerings were used

2. The recent downgradings of two large financial issuers, Citicorp and Chrysler Financial, do not appear to have led to disruptions in the commercial paper market as a whole.

to retire commercial paper and bank debt. Several large convertible bond issues have been among this month's offerings, as have bonds with put options.

Issuance of junk bonds picked up in May and June, but remained well below the pace of recent years. In contrast to 1988 and 1989, most of the junk issues in 1990 have included a feature allowing the bonds to be converted into stock. The proceeds from some of these convertible offerings have been used to pay down or redeem conventional debt obligations. In addition, some firms have used the proceeds from asset sales, bank loans, or private placements to buy back more than \$2 billion of public junk bonds. Some speculative-grade companies also have issued equity to finance reverse LBOs, in which a company formerly taken private goes public by issuing stock. Thus far in 1990, reverse LBOs have totaled about \$700 million, about equal to their volume in each of the years 1988 and 1989. Such reductions in leverage have been available only to companies with improving credit fundamentals, however, as outside investors have not been willing to take equity positions in companies whose cash flows barely cover their debt service.

Prices of junk bonds, and in particular those of RJR-Nabisco, the largest debtor in the high-yield market, were generally higher over the intermeeting period, and spreads over comparable Treasury issues narrowed by 30 to 40 basis points. Reports circulated that Kohlberg, Kravis, and Roberts, the owners of RJR-Nabisco, were prepared to inject more equity into this LBO by buying back some of the bonds with reset features before their April, 1991 deadline. On the negative side, defaults by a few high-profile

issuers in June brought the total for the year to \$10.5 billion, about equal to defaults for all of 1989.

The Dow-Jones Industrial Average and the NYSE Composite Index rose to record levels in early June, but later fell back considerably, and on balance over the intermeeting period are little changed. The S&P 500 price-earnings ratio increased to its highest level since November 1987.

Resolution Trust Corporation Activity

Since the beginning of the second quarter, the RTC has resolved 138 thrifts, making it likely that the Corporation will meet its goal of 141 resolutions for the quarter. Since the enactment of FIRREA, 190 thrifts, with liabilities of \$63 billion, have been resolved, including 21 liquidations, 85 insured deposit transfers, and 84 purchase and assumptions. In dollar terms most of the insured deposit transfers and purchases and assumptions involved commercial banks, with the remainder being acquired by other thrift institutions. Only a portion of the assets have been sold in these transactions, so that the RTC is holding about \$20 billion of the resolved thrifts' assets on its books. Since acquirers have been given options to put some assets back to the RTC, the Corporation may soon end up with considerably more assets.

Through the middle of June, out of \$78 billion authorized, the RTC had spent about \$55 billion, with three-fourths going to resolutions (to eliminate negative net worth and finance assets acquired) and the remainder being pumped into thrifts operating in conservatorship. The final resolution cost for the 182 thrifts for which data are available was estimated at \$21 billion.

TREASURY AND AGENCY FINANCING¹
(Total for period; billions of dollars)

| | 1990 | | | | |
|--|-------|-----------------|------------------|-------------------|-------------------|
| | Q1 | Q2 ^e | Apr. | May | June ^e |
| <u>Treasury financing</u> | | | | | |
| Total surplus/deficit (-) | -80.3 | -16.9 | 41.8 | -42.6 | -16.1 |
| Means of financing deficit: | | | | | |
| Net cash borrowing | | | | | |
| from the public | 90.1 | 40.1 | -5.9 | 23.4 | 22.7 |
| Marketable borrowings/ repayments (-) | 51.0 | 32.4 | -13.1 | 23.3 | 22.2 |
| Bills | 22.4 | 0.2 | -20.0 | 6.8 | 13.4 |
| Coupons | 28.6 | 32.2 | 6.9 | 16.4 | 8.8 |
| Nonmarketable ² | 39.1 | 7.7 | 7.2 | .1 | .4 |
| Decrease in the cash balance | 8.4 | -13.7 | -20.8 | 25.6 | -18.4 |
| Memo: Cash balance at end of period | 18.5 | 32.2 | 39.3 | 13.7 | 32.2 |
| Other ³ | -18.2 | -9.5 | -15.0 | -6.4 | 11.9 |
| <u>Federally sponsored credit agencies, net cash borrowing⁴</u> | | | | | |
| | 2.3 | -- | 2.5 ⁵ | -- | -- |
| FHLBS | -4.6 | -- | -4.1 | -1.9 ^p | -- |
| FHLMC | .0 | -- | 2.6 | -- | -- |
| FNMA | .8 | -- | .5 | .8 | -- |
| Farm Credit Banks | -1.1 | -- | .0 | .1 | -- |
| FAC | .0 | .3 | .0 | .0 | .3 |
| SLMA | 2.3 | -- | -- | -- | -- |
| FICO | .0 | .0 | .0 | .0 | .0 |
| REFCORP | 5.0 | 3.5 | 3.5 | .0 | .0 |

1. Data reported on a not seasonally adjusted, payment basis.

2. Includes proceeds from securities issued by federal agencies under special financing authorities (primarily FSLIC) and the face value of the zero coupon bonds issued to REFCORP. The discount from face value is offset in other means of finance.

3. Includes checks issued less checks paid, accrued items and other transactions.

4. Excludes mortgage pass-through securities issued by FNMA and FHLMC.

5. Excluding SLMA.

e--staff estimate

p--preliminary

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

Despite the quickened pace of resolutions, 259 thrifts remained in conservatorship. Over half of the \$163 billion in assets at these thrifts were loans that were either nonperforming or that did not conform to underwriting standards in the secondary mortgage market. Another one-fourth of these assets was in the form of cash and securities, with the remainder consisting of real estate owned and other assets. In the near future another 270 thrifts, holding \$170 billion in assets, are expected to be placed in conservatorship.

The pace of asset sales has been slowed by startup delays for the new agency, a highly restrictive rule in the FIRREA law for determining fair market value of assets, and restrictions on the amount of seller financing that the RTC can provide. Nonetheless, the Corporation remained hopeful that several large loan packages would be sold this summer.

Treasury and Sponsored Agency Financing

About \$30 billion of Treasury outlays for the RTC eliminated the federal government's seasonal surplus, leaving a small deficit for the second quarter. Because of RTC funding needs, the Treasury has been raising the gross sizes of its regular bill auctions. The gross sizes of some coupon issues also have been increased. The \$20 billion decline in total marketable borrowing that the staff estimates occurred in the second quarter was largely accounted for by a swing in net cash management bill issuance from \$10 billion of cash raised in the first quarter to a paydown of \$19 billion in the second.

In general, debt issuance by government sponsored enterprises (GSEs) has been light, and yield spreads to Treasury securities have remained relatively tight. The Federal Home Loan Banks (FHLBs) have continued to pay

down debt at a brisk pace as the demand for advances by their member institutions has ebbed. The Farm Credit System Financial Assistance Corporation (FAC) came to market in June for the first time in more than a year. The \$325 million, 15-year issue was priced at a spread of 34 basis points over the 10-year Treasury note and was intended to retire the remaining liabilities of the bankrupt Federal Land Bank of Jackson, Mississippi. Press reports indicate that the U.S. Postal Service (which has full agency status) is proposing to sell debt directly to the public for the first time since 1972.

At the end of May, the Treasury released its congressionally mandated study of the GSEs. The study stressed that the special relationship that the market perceives to exist between GSEs and the federal government can lead to a bias toward excessive risk-taking by highly leveraged GSEs. To counteract this bias, the Treasury recommended that GSEs take steps that would ensure a triple-A credit rating, apart from any implicit federal guarantee. Those GSEs that did not comply within five years would lose their ties to the federal government. There was no apparent market impact of this report on agency debt. The General Accounting Office is expected to release its study of GSEs in about a month.

Municipal Securities

Municipal bond issuance picked up slightly in May and June, boosted by a large volume of education and housing issues. Refunding volume continued light during most of this period before spurting late in June in response to yield declines. Short-term volume surged to a record of more than \$7 billion in June, including more than \$4 billion of borrowing by New York

State to cover a budgetary shortfall and about \$1 billion of seasonal borrowing by Los Angeles County.

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

| | 1988 | 1989 | 1989 | | 1990 | 1990 | | |
|------------------------------|-------|-------|-------|-------|------|------|------------------|-------------------|
| | Year | Year | Q3 | Q4 | Q1 | Apr. | May ^p | June ^f |
| Total offerings ¹ | 11.73 | 11.90 | 12.78 | 12.47 | 8.85 | -- | -- | -- |
| Total tax-exempt | 11.41 | 11.65 | 12.58 | 12.13 | 8.73 | 9.01 | 10.33 | 16.25 |
| Long-term | 9.54 | 9.47 | 9.79 | 10.76 | 7.63 | 8.58 | 9.15 | 9.00 |
| Refundings ² | 2.90 | 2.47 | 2.83 | 2.35 | 1.45 | .54 | .71 | 2.00 |
| New capital | 6.64 | 7.01 | 6.97 | 8.41 | 6.19 | 7.74 | 8.44 | 7.00 |
| Short-term | 1.87 | 2.17 | 2.78 | 1.37 | 1.10 | .42 | 1.19 | 7.25 |
| Total taxable | .32 | .25 | .20 | .34 | .12 | -- | -- | -- |

p--preliminary. f--forecast.

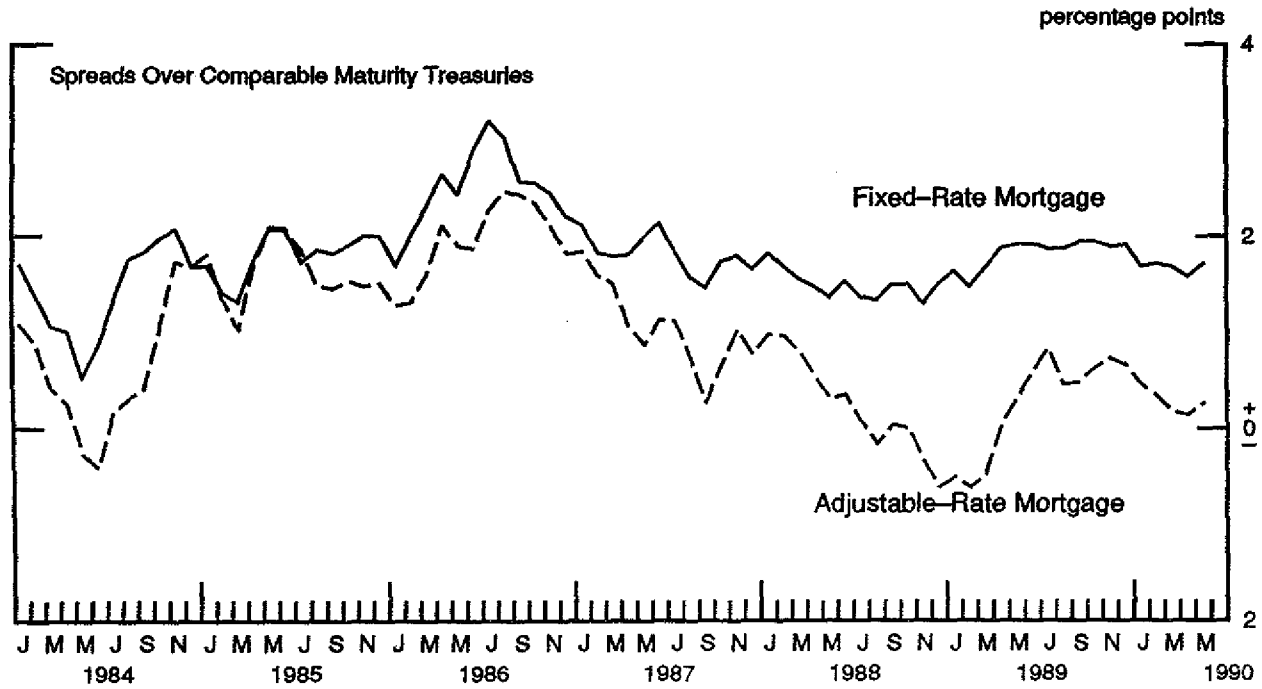
1. Includes issues for public and private purposes; also includes taxable issues.

2. Includes all refunding bonds, not just advance refundings.

Reflecting weaker economic conditions in the Northeast, downgradings of municipal credit ratings by Standard and Poor's outpaced upgradings by three to one in the first quarter. Of the 87 downgradings in the first quarter, three-fifths were for issuers in Northeastern states, with most concentrated among state agencies and housing authorities. The first-quarter pattern was a reversal of 1989 experience, when upgradings exceeded downgradings.

The volume of municipal bond offerings has dropped sharply since passage of the Tax Reform Act that limited uses of tax-exempt financing for certain private purposes and tightened arbitrage restrictions. In the first half of 1990, issuance has been running at an estimated annual pace of \$95 billion, well below the record high \$214 billion in 1985. This drop in volume, and a corresponding drop in underwriting profitability, led Bank of

Mortgage Interest Rates



Boston Corporation and Citicorp early in June to announce the closing of their municipal securities underwriting subsidiaries.

Mortgage Markets

Mortgage lending slowed in the early part of 1990, most noticeably in the case of construction credit. Construction loans on the books of commercial banks edged down during the first quarter, as they had a quarter earlier. At SAIF-insured thrifts the latest data available showed construction loans falling by 14 percent in the five months ending in January. Sluggish rates of residential construction through May and a declining trend in contracts for nonresidential structures suggest continued softness in construction lending in the second quarter. The pricing of construction credit has not changed appreciably this year, but nonprice terms have tightened. Bank officers surveyed earlier this year reported lower maximum loan amounts, lower allowable loan-to-value ratios, and new restrictions on out-of-area lending.

Judging from the low volume of new and existing home sales in recent months, growth of home mortgages probably has slowed further in the second quarter. The slowdown in home credit growth seems to be coming from reduced demand. Spreads of yields on primary market mortgages over Treasury securities of comparable maturity have not widened in recent months, suggesting that pricing practices in the residential mortgage market have not been altered (chart). Downpayment requirements and other nonprice terms have not changed much of late, either, and a recent industry survey of mortgage bankers found no evidence of a general cutback in credit supply to home buyers.

CONSUMER CREDIT
(Seasonally adjusted)

| | Percent change (at annual rate) | | | | | | Net change (billions of dollars) | | Memo: Outstandings (billions of dollars) |
|--------------------------------|------------------------------------|-------------------|------|-----------------|-------------------|-------------------|--|-------------------|---|
| | 1988 | 1989 ¹ | 1989 | 1990 | 1990 | | 1990 | | 1990 Apr. ^P |
| | | | Q4 | Q1 ^r | Mar. ^r | Apr. ^P | Mar. ^r | Apr. ^P | |
| Total installment | 8.9 | 5.5 | 6.2 | 2.0 | 4.0 | 1.0 | 2.4 | .6 | 720.9 |
| Installment, excluding auto | 10.3 | 8.6 | 8.6 | 2.8 | 1.7 | 8.7 | .6 | 3.1 | 431.9 |
| Selected types | | | | | | | | | |
| Auto | 7.0 | 1.3 | 2.7 | .9 | 7.5 | -10.3 | 1.8 | -2.5 | 288.9 |
| Revolving | 13.7 | 14.2 | 14.1 | 9.1 | 10.2 | 14.0 | 1.7 | 2.4 | 204.0 |
| All other | 7.6 | 4.2 | 4.0 | -2.7 | -5.8 | 3.8 | -1.1 | .7 | 227.9 |
| Memorandum: | | | | | | | | | |
| Total ² | 7.3 | 5.0 | 5.1 | 2.4 | 2.9 | -2.4 | 1.9 | -1.5 | 781.1 |

1. Growth rates are adjusted for discontinuity in data between December 1988 and January 1989.

2. Installment plus noninstallment.

r--revised. p--preliminary.

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

CONSUMER INTEREST RATES
(Annual percentage rate)

| | 1987 | 1988 | 1989 | 1990 | | | | |
|-----------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| | | | | Jan. | Feb. | Mar. | Apr. | May |
| At commercial banks ¹ | | | | | | | | |
| New cars (48 mo.) | 10.46 | 10.86 | 12.07 | ... | 11.80 | ... | ... | 11.82 |
| Personal (24 mo.) | 14.23 | 14.68 | 15.44 | ... | 15.27 | ... | ... | 15.41 |
| Credit cards | 17.92 | 17.79 | 18.02 | ... | 18.12 | ... | ... | 18.14 |
| At auto finance cos. ² | | | | | | | | |
| New cars | 10.73 | 12.60 | 12.62 | 12.64 | 12.67 | 12.31 | 12.21 | ... |
| Used cars | 14.61 | 15.11 | 16.18 | 15.77 | 15.91 | 15.97 | 16.02 | ... |

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

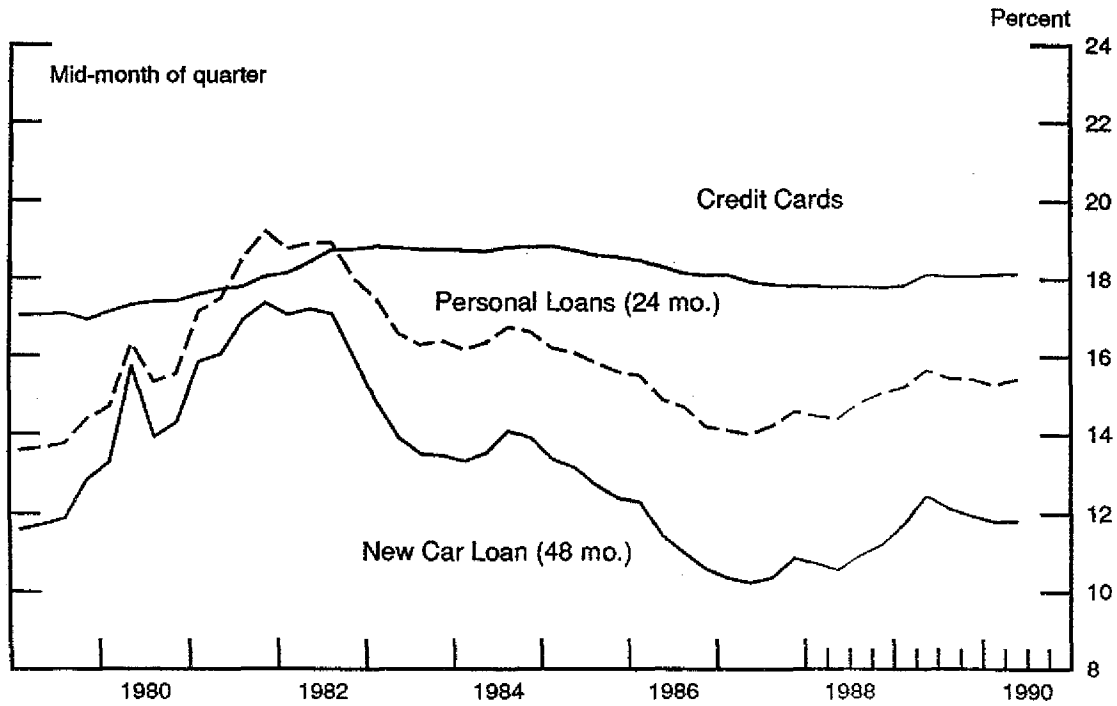
2. Average rate for all loans of each type made during the month regardless of maturity.

Indicators of mortgage credit quality for the first quarter of 1990 have been mixed. At banks, the delinquency rate on mortgages of all types rose to 5.9 percent, the highest rate since 1984. The net charge-off rate, which has a strong seasonal component, was 0.68 percent in the first quarter, well above the same-quarter rate in recent years. At life insurance companies, delinquent loans on commercial properties fueled a sharp increase in overall delinquencies in the first quarter. Although high by recent standards, delinquencies at insurance companies remained well below rates recorded in 1986 and 1987. Delinquencies on home mortgages declined significantly during the quarter, according to a Mortgage Bankers Association survey of servicers of these loans.

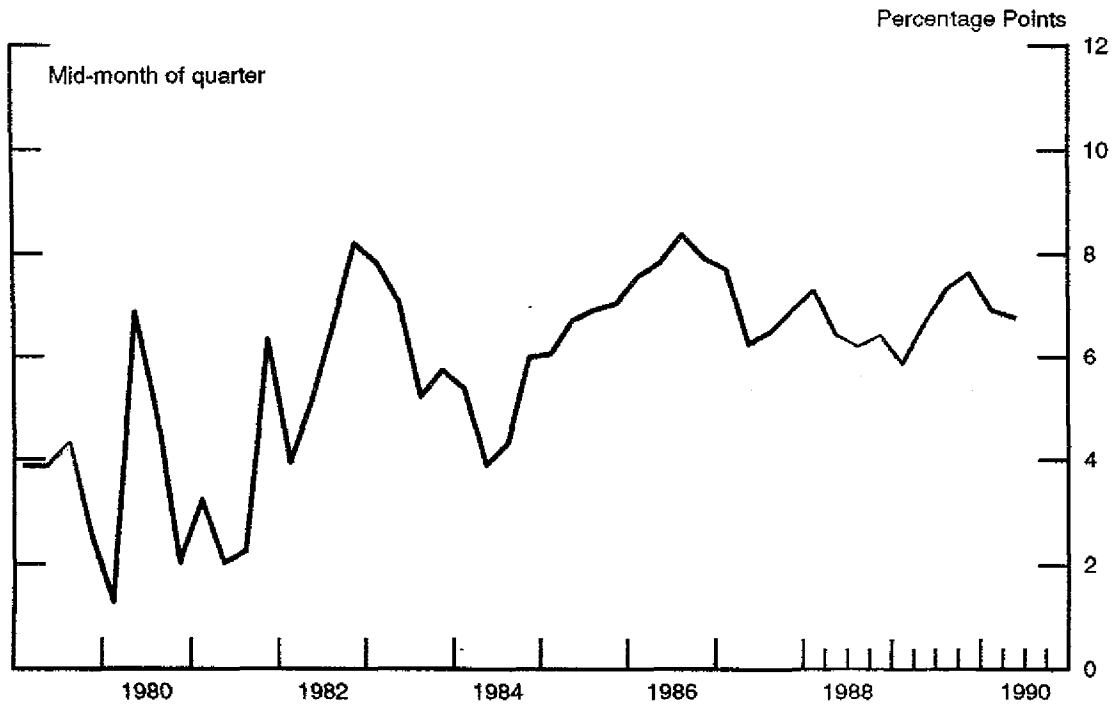
Consumer Credit

Consumer installment credit in April grew at only a 1 percent annual rate, following its weakest quarter in three years. The anemic pace was attributable to the auto credit component, which declined at a 10 percent annual rate in April. Revolving credit picked up to a 14 percent rate, close to the pace of last year. Most of the statistics and qualitative reports in the financial press suggest that conditions in the consumer credit market probably have tightened a bit, but not enough to explain the slackening in loan growth. The weakest element of consumer credit in April, auto loans, was the one least likely to undergo substantial supply constraint, because it is a secured form of credit and because the finance subsidiaries of the car manufacturers tend to take up the slack when other financial institutions retreat from the market. Responses on recent Senior Loan Officer Opinion Surveys about banks' willingness to make consumer loans have not provided evidence of tightening, and interest rates on consumer

CONSUMER LOAN INTEREST RATES AT BANKS



SPREAD BETWEEN CONSUMER RATES AND TREASURY YIELD *



Spread is calculated as the rate on 24-month personal loans at banks less the yield on 2-year Treasury securities.

loans at banks have been fairly flat (chart). While spreads of consumer loan rates relative to Treasury yields have been much higher than in the early 1980s (when state usury ceilings capped consumer rates in some areas), they have changed little on balance since 1985 (chart). Moreover, none of the available delinquency series has pointed to any pronounced worsening of consumer loan quality in recent months.

INTERNATIONAL DEVELOPMENTS

INTERNATIONAL DEVELOPMENTS

U.S. Merchandise Trade

The U.S. merchandise trade balance narrowed in April to a preliminary deficit of \$6.9 billion (seasonally adjusted, Census basis), from the March deficit (revised) of \$8.4 billion. Both imports and exports fell in April, with lower oil imports and agricultural exports accounting for about one-third of the decline in each respective category. Much of the remaining decline in total exports and imports was the result of a drop in exports and imports of automotive products that reversed large increases in February and March.

The decline in the value of oil imports in April reflected a 9 percent decline in price and a 13 percent decline in volume. The sharp drop in

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

| | Exports | | | Imports | | | Balance |
|------------------|---------|-----|--------|---------|-----|---------|---------|
| | Total | Ag. | Nonag. | Total | Oil | Non-oil | |
| 1989-Jan | 28.4 | 3.2 | 25.1 | 36.9 | 3.5 | 33.4 | -8.5 |
| Feb | 28.6 | 3.4 | 25.2 | 37.5 | 3.2 | 34.3 | -8.9 |
| Mar | 31.1 | 3.9 | 27.2 | 40.0 | 3.7 | 36.3 | -8.9 |
| Apr | 31.0 | 3.7 | 27.3 | 38.6 | 4.0 | 34.6 | -7.6 |
| May | 30.6 | 3.5 | 27.1 | 41.0 | 4.7 | 36.2 | -10.4 |
| Jun | 31.2 | 3.3 | 27.9 | 39.7 | 4.2 | 35.5 | -8.5 |
| Jul | 29.7 | 3.3 | 26.3 | 39.2 | 4.3 | 34.9 | -9.6 |
| Aug | 30.2 | 3.1 | 27.2 | 40.4 | 4.3 | 36.1 | -10.2 |
| Sep | 30.4 | 3.3 | 27.1 | 38.5 | 4.0 | 34.5 | -8.2 |
| Oct | 31.5 | 3.2 | 28.3 | 41.9 | 4.4 | 37.5 | -10.4 |
| Nov | 30.6 | 3.4 | 27.3 | 40.7 | 4.4 | 36.4 | -10.1 |
| Dec | 30.8 | 3.3 | 27.5 | 38.5 | 4.1 | 34.5 | -7.7 |
| 1990-Jan | 31.9 | 3.6 | 28.3 | 41.3 | 5.9 | 35.4 | -9.3 |
| Feb | 31.8 | 3.4 | 28.4 | 37.9 | 4.7 | 33.2 | -6.1 |
| Mar ^r | 33.5 | 3.7 | 29.8 | 41.9 | 4.7 | 37.2 | -8.4 |
| Apr ^p | 32.3 | 3.3 | 29.0 | 39.2 | 3.8 | 35.4 | -6.9 |

r--revised

p--preliminary

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

prices was in line with the behavior of spot and posted prices throughout March and early April. Oil prices, weak as a result of strong OPEC production throughout a mild first quarter, temporarily strengthened after the announcement of an emergency OPEC session to be held early in May. Prices have generally fallen since the emergency session due to the lack of evidence of widespread OPEC production restraint. This recent weakness in spot prices should result in a further \$1 drop in the price of imported oil over the next two months. The decline in volume in April was also anticipated, but the size of the decline was substantially greater than had been indicated in advance by preliminary Department of Energy data, which are now likely to be revised significantly. Declines in agricultural exports were spread across many different commodities.

For the first quarter, the value of imported oil was significantly higher than in any quarter of last year. The average price of imported oil

OIL IMPORTS
(BOP basis, value at annual rates)

| | 1989 | | | | 1990 | | | |
|-----------------|-------|-------|-------|-------|-------|-------|-------|-------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Feb | Mar | Apr-p |
| Value (Bil. \$) | 43.52 | 54.08 | 52.69 | 53.29 | 62.43 | 57.85 | 58.05 | 46.28 |
| Price (\$/BBL) | 15.44 | 18.32 | 16.75 | 17.67 | 19.47 | 19.66 | 18.36 | 16.84 |
| Quantity (mb/d) | 7.83 | 8.11 | 8.55 | 8.20 | 8.91 | 8.76 | 8.50 | 7.63 |

p--preliminary.

was \$1.80 per barrel above that of the fourth quarter. The quantity of oil imported in the first quarter was 6 percent higher than in the fourth quarter. A surge of oil imports in January reflected the rebuilding of stocks that were depleted during the cold snap last December, while the strength in February and March was attributable to declines in domestic production.

In the first quarter, a surge in exports, coupled with flat non-oil imports, led to a \$10 billion decline (seasonally adjusted annual rate) in the merchandise trade deficit on a balance-of-payments basis (see table below). This was the lowest quarterly deficit recorded in five years.

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

| | Exports | | | Imports | | | Balance |
|------------------|---------|------|--------|---------|------|---------|---------|
| | Total | Ag. | Nonag. | Total | Oil | Non-oil | |
| <u>Years:</u> | | | | | | | |
| 1987 | 250.3 | 29.5 | 220.7 | 409.8 | 42.9 | 366.8 | -159.5 |
| 1988-r | 320.3 | 38.2 | 282.1 | 447.3 | 39.6 | 407.7 | -127.0 |
| 1989-r | 360.5 | 41.5 | 319.0 | 475.3 | 50.9 | 424.4 | -114.9 |
| <u>Quarters:</u> | | | | | | | |
| 1988-1-r | 306.0 | 35.7 | 270.2 | 440.0 | 39.9 | 400.0 | -134.0 |
| 2-r | 317.6 | 37.4 | 280.2 | 442.0 | 41.1 | 400.8 | -124.4 |
| 3-r | 322.0 | 40.5 | 281.6 | 445.2 | 39.5 | 405.6 | -123.1 |
| 4-r | 335.7 | 39.4 | 296.4 | 462.2 | 37.9 | 424.3 | -126.5 |
| 1989-1-r | 353.1 | 42.6 | 310.5 | 465.4 | 43.5 | 421.9 | -112.4 |
| 2-r | 364.4 | 42.7 | 321.7 | 477.3 | 54.1 | 423.3 | -112.9 |
| 3-r | 357.4 | 39.7 | 317.7 | 476.6 | 52.7 | 423.9 | -119.2 |
| 4-r | 367.0 | 40.9 | 326.1 | 481.9 | 53.3 | 428.6 | -115.0 |
| 1990-1 | 384.2 | 43.8 | 340.4 | 489.7 | 62.4 | 427.2 | -105.5 |

r--revised.

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

Non-oil imports were about the same in the first quarter as in the fourth quarter of last year; a 1 percent decline in quantity was about offset by a small increase in import prices. Declines in both the value and quantity of imported consumer goods, industrial supplies (especially gold, steel, and other metals), and automotive products from Canada were offset by increases in imported foods, automotive products from Japan and Europe, and other imported products. The decline in imports of automotive products from Canada reflects in part the effects of reduced automotive production during January designed to shrink inventories.

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

| | Year | 1989 | | | | 1990 |
|-------------------------|-------|-------|-------|-------|-------|-------|
| | 1989 | Q1 | Q2 | Q3 | Q4 | Q1 |
| Nonagricultural Exports | 319.0 | 310.5 | 321.7 | 317.7 | 326.1 | 340.4 |
| Industrial Supplies | 90.6 | 88.9 | 94.0 | 90.5 | 89.0 | 94.0 |
| Gold | 2.5 | 2.3 | 3.0 | 2.6 | 2.1 | 2.4 |
| Fuels | 12.1 | 12.4 | 12.8 | 11.0 | 12.2 | 12.8 |
| Other Ind. Supp. | 76.0 | 74.2 | 78.2 | 76.9 | 74.7 | 78.8 |
| Capital Goods | 138.0 | 131.9 | 138.4 | 141.1 | 140.8 | 152.9 |
| Aircraft & Parts | 26.5 | 23.5 | 27.3 | 29.7 | 25.6 | 32.3 |
| Computers & Parts | 24.2 | 23.4 | 24.1 | 24.6 | 24.7 | 26.5 |
| Other Machinery | 87.3 | 85.0 | 87.0 | 86.8 | 90.5 | 94.1 |
| Automotive Products | 34.7 | 35.9 | 34.3 | 33.0 | 35.6 | 34.6 |
| Canada | 22.5 | 23.5 | 22.0 | 21.5 | 22.8 | 20.8 |
| Other | 12.2 | 12.3 | 12.2 | 11.5 | 12.9 | 13.8 |
| Consumer Goods | 35.4 | 33.6 | 35.0 | 35.0 | 38.0 | 40.7 |
| Other Nonagric. | 20.3 | 20.2 | 20.1 | 18.1 | 22.7 | 18.3 |
| Non-Oil Imports | 424.4 | 421.9 | 423.3 | 423.9 | 428.6 | 427.2 |
| Industrial Supplies | 84.1 | 85.4 | 85.1 | 82.5 | 83.2 | 80.1 |
| Gold | 3.6 | 3.2 | 3.7 | 3.4 | 4.3 | 1.8 |
| Other Fuels | 3.2 | 2.9 | 3.2 | 3.1 | 3.7 | 2.9 |
| Other Ind. Supp. | 77.3 | 79.3 | 78.2 | 76.0 | 75.2 | 75.4 |
| Capital Goods | 113.1 | 108.9 | 114.0 | 113.1 | 116.5 | 115.5 |
| Aircraft & Parts | 9.5 | 8.1 | 10.2 | 9.2 | 9.0 | 9.3 |
| Computers & Parts | 21.5 | 19.4 | 20.9 | 22.5 | 23.4 | 23.0 |
| Other Machinery | 82.1 | 81.4 | 82.9 | 81.4 | 84.1 | 83.2 |
| Automotive Products | 86.0 | 91.1 | 84.5 | 85.4 | 83.0 | 84.0 |
| Canada | 22.5 | 30.1 | 29.1 | 29.1 | 29.6 | 27.7 |
| Other | 56.5 | 61.0 | 55.4 | 56.3 | 53.4 | 56.3 |
| Consumer Goods | 102.8 | 98.6 | 101.3 | 104.9 | 106.4 | 103.3 |
| Foods | 25.1 | 25.2 | 25.2 | 24.7 | 25.0 | 27.7 |
| Other Non-oil | 13.4 | 12.6 | 13.1 | 13.3 | 14.5 | 16.7 |

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

Exports in the first quarter were about 5 percent above the fourth-quarter level; the increase was entirely in quantity as prices were little changed from the fourth quarter. The increase in both value and quantity was largely in aircraft, other capital goods, and industrial

supplies. Aircraft exports rebounded in the first quarter as normal production resumed and backlogs in deliveries were reduced sharply following the strike at Boeing from early October to late November of last year. A decrease in exports of automotive products to Canada (reflecting reduced U.S. production in the first quarter) more than offset an increase in exports of automotive products to other areas. Agricultural exports rose 7 percent in the first quarter, with most of the increase in quantity; exports were bolstered by a pickup in Soviet purchases of wheat.

Import and Export Prices

In April, prices for U.S. exports increased 0.4 percent, according to Bureau of Labor Statistics data, largely because of a 1.6 percent increase in the index for agricultural products (see table on the next page). Prices of exports of wheat and corn rose in April, the second consecutive month in which prices for exports of corn increased. Prices of non-agricultural exports showed no increase for April, after increasing slightly in March. Among capital goods, increases in prices for exported oil drilling equipment and agricultural machinery were offset by declines in prices for exported computers and electrical equipment. Prices of non-oil imports fell 0.2 percent in April, the first decline since last August. Declines in prices for both imported capital goods and automotive vehicles were attributable in part to lagged effects of the appreciation of the dollar in March. Price data for May, to be released on June 28, will be covered in the Greenbook supplement.

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

| | Year | | Quarters | | | Months | |
|--|----------------|---------|----------|------|------|-----------------|-----|
| | 1990-Q1 | 1989-Q1 | 1989 | | 1990 | 1990 | |
| | | | Q3 | Q4 | Q1 | Mar | Apr |
| | (annual rates) | | | | | (monthly rates) | |
| ----- BLS Prices ----- | | | | | | | |
| <u>Imports, Total</u> | 1.3 | -4.6 | 5.3 | 4.9 | -0.2 | -1.1 | |
| Foods, Feeds, Bev. | -1.7 | -15.5 | 7.4 | 11.2 | -1.5 | -0.4 | |
| Industrial Supplies | 1.0 | -14.1 | 8.7 | 1.6 | -1.8 | -3.0 | |
| Ind Supp Ex Oil | -4.3 | -7.4 | -2.4 | -2.4 | 0.5* | 0.1* | |
| Capital Goods | 1.8 | -1.2 | 2.8 | 10.4 | 1.4 | -0.4 | |
| Automotive Products | 0.6 | 0.0 | 5.7 | -0.4 | 0.2 | -0.8 | |
| Consumer Goods | 3.4 | 1.2 | 4.1 | 7.4 | 0.6 | 0.3 | |
| Memo: | | | | | | | |
| Oil | 13.4 | -24.4 | 36.0 | 8.7 | -6.0 | -8.9 | |
| Non-oil | 0.2 | -2.8 | 2.8 | 4.1 | 0.5 | -0.2 | |
| <u>Exports, Total</u> | -0.4 | -2.8 | 0.0 | 1.6 | 0.3 | 0.4 | |
| Foods, Feeds, Bev. | -11.2 | -21.6 | -7.4 | -3.2 | 0.8 | 1.7 | |
| Industrial Supplies | -1.6 | -4.6 | -2.8 | 0.4 | 0.3 | 0.0 | |
| Capital Goods | 3.0 | 3.0 | 2.4 | 4.1 | -0.1 | 0.2 | |
| Automotive Products | 2.8 | 3.0 | 4.9 | 1.6 | 0.1 | 0.2 | |
| Consumer Goods | 3.2 | 2.8 | 2.0 | 6.6 | 0.6 | 0.0 | |
| Memo: | | | | | | | |
| Agricultural | -7.0 | -15.8 | -5.1 | -1.2 | 0.6 | 1.6 | |
| Nonagricultural | 0.8 | -0.4 | 0.4 | 2.4 | 0.2 | 0.0 | |
| ----- Prices in the GNP Accounts ----- | | | | | | | |
| <u>Fixed-Weight</u> | | | | | | | |
| Imports, Total | 3.0 | -8.9 | 4.0 | 10.1 | -- | -- | |
| Oil | 25.9 | -31.0 | 23.5 | 47.9 | -- | -- | |
| Non-oil | -0.1 | -4.9 | 1.3 | 4.9 | -- | -- | |
| Exports, Total | 0.1 | -4.1 | -1.1 | 3.1 | -- | -- | |
| Ag. | -5.9 | -9.4 | -12.9 | 2.7 | -- | -- | |
| Nonag. | 1.4 | -2.9 | 1.4 | 3.1 | -- | -- | |
| <u>Deflators</u> | | | | | | | |
| Imports, Total | -1.0 | -11.1 | 2.2 | 5.5 | -- | -- | |
| Oil | 25.9 | -30.7 | 22.9 | 47.3 | -- | -- | |
| Non-oil | -3.3 | -7.1 | -2.7 | 3.4 | -- | -- | |
| Exports, Total | -2.2 | -5.5 | -2.4 | -0.2 | -- | -- | |
| Ag. | -5.9 | -9.4 | -12.9 | 2.7 | -- | -- | |
| Nonag. | -1.5 | -4.5 | -1.3 | -0.7 | -- | -- | |

*Not for publication.

U.S. Current Account in the First Quarter of 1990

The U.S. current account deficit narrowed to \$92 billion (seasonally adjusted annual rate) in the first quarter, from \$107 billion (revised) in the fourth quarter (see table below). Two-thirds of the improvement in the first quarter was accounted for by merchandise trade. Most of the remaining improvement was a reduction in unilateral transfers from the strong fourth quarter level. There were only small changes in the levels of net direct investment income and in net portfolio income. The balance on other services declined slightly, as increases in net travel and passenger fare receipts were more than offset by an increase in net payments on reinsurance transactions.

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

| | 1989 | | | 1990 |
|--|--------|--------|--------|--------|
| | Year | 03-r | 04-r | 01-p |
| 1. Trade Balance | -114.9 | -119.2 | -115.0 | -105.5 |
| 2. Exports | 360.5 | 357.4 | 367.0 | 384.2 |
| 3. Imports | 475.3 | 476.6 | 481.9 | 489.7 |
| 4. Investment Income, net* | -0.9 | 0.1 | 2.2 | 2.4 |
| 5. Direct Investment, net* | 39.6 | 40.1 | 44.1 | 43.9 |
| 6. Portfolio Income, net | -40.5 | -40.0 | -41.9 | -41.5 |
| 7. Service Transactions | | | | |
| 8. Military, net | -6.3 | -4.5 | -7.1 | -5.5 |
| 9. Other Services, net | 26.8 | 27.4 | 31.6 | 30.7 |
| 10. Unilateral Transfers | -14.7 | -14.1 | -18.5 | -14.0 |
| 11. Current Account Balance | -110.0 | -110.4 | -106.8 | -91.8 |
| Memo: | | | | |
| 12. Capital Gains or Losses ¹ | -0.6 | 1.2 | -1.2 | 0.8 |

* Includes capital gains and losses.

1. Gains or losses on net financial assets have been revised to include only realized capital gains (or losses) resulting from the sale of assets for more (or less) than book value. Unrealized gains (or losses), largely resulting from the revaluation at current exchange rates of assets and liabilities denominated in foreign currencies, have been removed from the published data.

Plus = gain; minus = loss, r--revised p--preliminary

U.S. International Financial Transactions

Recently released data for U.S. international transactions for the first quarter of 1990 show a dramatic decline in the flow of foreign direct investment into the United States. The inflow of \$7.6 billion for the first quarter, down from an average of \$18 billion per quarter in 1989, was the lowest in over two years (line 7 of the Summary of U.S. International Transactions table). One reason for this slowdown was the partial reversal of large fourth quarter inflows of intracompany debt between foreign parents and U.S. subsidiaries. In addition, foreign takeovers of U.S. companies slowed somewhat from the rate in 1989. However, it is likely that the preliminary number for the direct investment inflow will be revised upward as more information becomes available. Since the beginning of 1988, revisions have raised the preliminary figure for all but one quarter, with an average increase of \$4.5 billion (quarterly rate) between the preliminary and revised data.

The flow of direct investment abroad remained near recent historical levels (line 6), so that the net inflow of direct investment in the first quarter fell to zero, contrary to earlier expectations. It was noted in the May Greenbook, on the basis of advance information provided in the Treasury International Capital (TIC) reports, that the capital account counterpart to the current account deficit in the first quarter was not likely to be evident in other reported capital flows. The Summary table shows that this was in fact the case. The substantial banking inflow of \$17.4 billion in the first quarter (line 1) was nearly balanced by outflows associated with the other, non-direct-investment items in the table: modest declines in foreign holdings of U.S. securities (\$0.8 billion, lines 2 and 3), a decline of foreign official reserve assets held in the United States (\$7.8 billion, line 4), a rise in U.S. official reserve assets (\$3.2 billion, line 5), and

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

| | 1988 | 1989 | 1989 | | | 1990 | 1990 | | |
|--|--------|--------|-------|-------|-------|-------|------|------|------|
| | Year | Year | Q2 | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. |
| Private Capital | | | | | | | | | |
| Banks | | | | | | | | | |
| 1. Change in net foreign positions of banking offices in the U.S. (+ = inflow) | 22.2 | 25.0 | 0.2 | 15.6 | 7.4 | 17.4 | 9.8 | 14.8 | 2.5 |
| Securities | | | | | | | | | |
| 2. Private securities transactions, net ¹ | 17.8 | 16.7 | 3.2 | 0.6 | 6.4 | -0.1 | 1.5 | -4.3 | -2.9 |
| a) foreign net purchases (+) of U.S. corporate bonds ² | 26.8 | 33.0 | 6.1 | 5.6 | 12.5 | 6.0 | 2.9 | 1.2 | .8 |
| b) foreign net purchases (+) of U.S. corporate stocks | 0.4 | 7.6 | 3.8 | 5.1 | -1.5 | -3.2 | -0.3 | -2.5 | -1.0 |
| c) U.S. net purchases (-) of foreign securities | -9.4 | -23.9 | -6.6 | -10.1 | -4.7 | -3.0 | -1.1 | -3.1 | -2.7 |
| 3. Foreign net purchases (+) of U.S. Treasury obligations | 20.6 | 30.5 | 2.5 | 12.8 | 5.8 | -0.7 | 3.3 | -4.9 | -3.3 |
| Official Capital | | | | | | | | | |
| 4. Changes in foreign official reserves assets in U.S. (+ = increase) | 40.2 | 8.5 | -5.4 | 13.4 | -7.4 | -7.8 | -5.0 | 0.4 | 2.5 |
| a) By area | | | | | | | | | |
| G-10 countries (incl. Switz.) | 15.5 | -5.0 | -9.4 | 6.1 | -2.0 | -6.3 | -2.6 | -3.3 | -0.9 |
| OPEC | -3.4 | 10.1 | 0.3 | 4.6 | -1.5 | 3.1 | 0.8 | 1.7 | 0.4 |
| All other countries | 28.1 | 3.4 | 3.6 | 2.7 | -3.9 | -4.6 | -3.1 | 2.0 | 2.9 |
| b) By type | | | | | | | | | |
| U.S. Treasury securities ³ | 41.7 | 0.3 | -9.7 | 12.8 | -7.3 | -5.9 | -4.5 | -0.9 | 2.0 |
| Other | -1.5 | 8.2 | 4.3 | 0.6 | -0.1 | -1.9 | -0.5 | 1.4 | .4 |
| Changes in U.S. official reserve assets (+ = decrease) | -3.9 | -25.3 | -12.1 | -6.0 | -3.2 | -3.2 | 0.6 | 3.1 | n.a. |
| Other transactions (Quarterly data) ⁴ | | | | | | | | | |
| 6. U.S. direct investment (-) abroad | -16.2 | -31.7 | -7.3 | -9.6 | -8.8 | -7.6 | n.a. | n.a. | n.a. |
| 7. Foreign direct investment (+) in U.S. | 58.4 | 72.2 | 17.1 | 12.4 | 21.5 | 7.6 | n.a. | n.a. | n.a. |
| 8. Other capital flows (+ = inflow) ⁵ | -1.8 | -8.3 | 3.2 | -9.1 | -1.1 | -3.6 | n.a. | n.a. | n.a. |
| 9. U.S. current account balance | -128.9 | -110.0 | -28.6 | -27.6 | -26.7 | -22.9 | n.a. | n.a. | n.a. |
| 10. Statistical discrepancy | -8.4 | 22.4 | 27.2 | -2.5 | 6.1 | 20.9 | n.a. | n.a. | n.a. |

MEMO:

U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)

-127.2 -114.9 -28.2 -29.8 -28.7 -26.4 n.a. n.a. n.a.

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

2. Includes all U.S. bonds other than Treasury obligations.

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

4. Seasonally adjusted.

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

*--Less than \$50 million.

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

changes in miscellaneous items (\$3.6 billion, line 8). The net result was a statistical discrepancy of almost \$21 billion, 90 percent of the current account deficit for the quarter.

The capital account counterpart to the current account deficit again was not evident in the April data reported in the Summary table. Outflows related to private securities transactions (line 2) and foreign net sales of Treasury obligations (line 3) outweighed the small inflows associated with banks (line 1) and holdings of official reserve assets in the United States (line 4). The net sales of U.S. stocks by foreigners in April continued the pattern established since the stock market drop in October.

More recent data, however, indicate a pickup of capital inflows in May through U.S. banking offices and the Eurobond market. Line 1 of the International Banking Data table shows a reduction in the net claims of U.S. banking offices on their own foreign offices and IBFs of almost \$12 billion in May. Moreover, public offerings of Eurobonds by U.S. corporations jumped to \$2.8 billion in May, the largest total since June of 1989. Over \$1 billion of this amount was denominated in foreign currencies.

Finally, line 3 of the table on International Banking Data suggests a partial explanation of the statistical discrepancy in the first quarter. Eurodollar holdings of U.S. nonbank residents, an item significantly under-reported in the U.S. international transactions accounts, showed a net capital inflow of \$10.8 billion between December and March (and an additional inflow of \$5.9 billion in April). In contrast, the TIC data used in the U.S. international transactions accounts showed an inflow of less than \$1 billion in the first quarter for the same category.

INTERNATIONAL BANKING DATA
(Billions of dollars)

| | 1988 | 1989 | 1989 | | | 1990 | | | | |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | Dec. | Dec. | Mar. | June | Sept. | Dec. | Feb. | Mar. | Apr. | May |
| 1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS | -4.9 | -5.5 | -2.9 | -3.9 | -6.4 | -5.5 | -9.8 | -11.7 | -9.9 | -21.8 |
| (a) U.S.-chartered banks | 21.6 | 19.2 | 20.4 | 19.2 | 14.9 | 19.2 | 11.7 | 12.2 | 11.3 | 2.3 |
| (b) Foreign-chartered banks | -26.5 | -24.7 | -23.3 | -23.1 | -21.3 | -24.7 | 21.5 | -23.9 | -21.2 | -24.1 |
| 2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks | 21.2 | 20.7 | 24.0 | 26.0 | 21.6 | 20.7 | 21.7 | 21.8 | 22.2 | 22.4 |
| 3. Eurodollar Holdings of U.S. Nonbank Residents <u>1/</u> | 145.3 | 123.5 | 144.8 | 131.5 | 130.3 | 123.5 | 116.9 | 112.7 | 106.8 | 110.9 |

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.

Foreign Exchange Markets

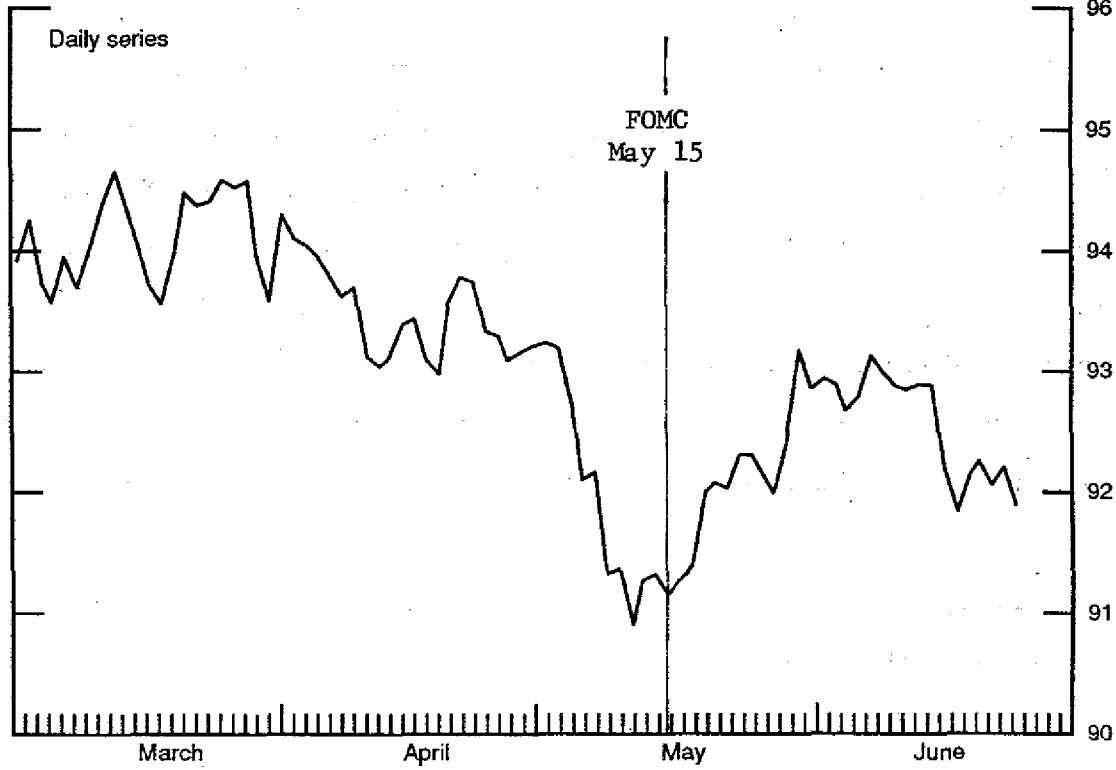
Since the May 15 FOMC meeting, the trade-weighted, foreign exchange value of the dollar against the other G-10 currencies is about unchanged on balance. Early in the period, the dollar moved up, supported in part by perceptions that the Federal Reserve is not likely to ease soon, despite the release of data showing signs of weakening U.S. economic activity. The dollar also firmed in reaction to the apparent deterioration of support for the policies of Soviet President Gorbachev, as well as with other political developments in Germany, Japan, and Canada. Later, however, the dollar declined on expectations of lower U.S. interest rates following a statement by President Bush in which he indicated that tax revenue increases should be a part of the budget deficit reduction measures considered in the budget summit.

The mark weakened more than 3/4 percent against the dollar during the intermeeting period. The yield on the bellwether bond rose slightly, while short-term interest rates in Germany were little changed. News of the details of financing the East German budget deficit, opposition by some members of the Social Democratic Party to the unification treaty, concerns about unresolved legal issues in the unification process, and statements by Bundesbank officials questioning the need for higher interest rates as the unification process continues, all weighed on the mark. Unrest in the Soviet Union also contributed to the downward pressure.

The yen declined more than 1-3/4 percent against the dollar during the period, and the yield on the bellwether bond rose nearly 30 basis points to about 7.20 percent. Background factors cited in financial market commentary include a by-election loss by the Liberal Democratic Party, the possibility of yet another stock scandal in Japan, this one involving an aid to Prime Minister Kaifu, and renewed difficulties in U.S.-Japan trade negotiations.

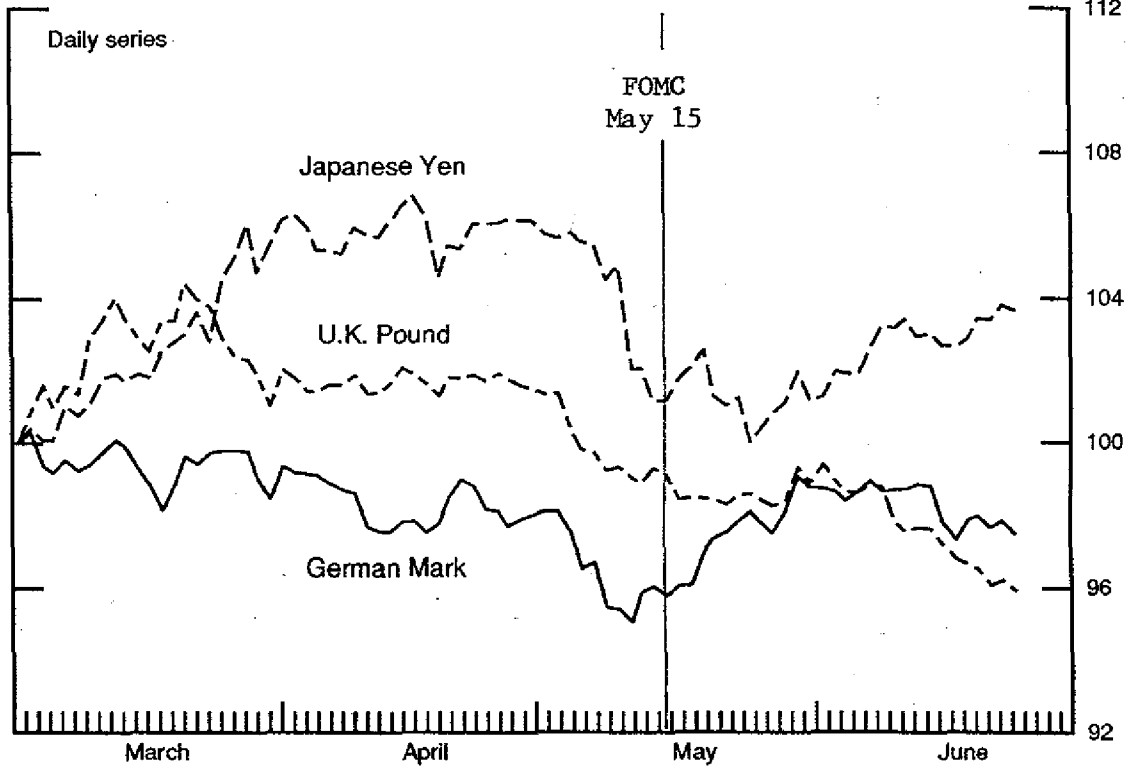
WEIGHTED AVERAGE EXCHANGE VALUE OF THE DOLLAR

March 1973 = 100



SELECTED DOLLAR EXCHANGE RATES

March 1 = 100



Short-term interest rates in Japan were little changed during most of the period, but have recently edged upward. The rate on 3-month CDs rose 10 basis points over the intermeeting period to about 7.45 percent.

After fluctuating widely in reaction to waves of pessimism and optimism about the passage of the Meech Lake accord, the Canadian dollar ended the intermeeting period $3/4$ percent higher against the U.S. dollar. Expectations at the beginning of the period that Canadian interest rates might fall in the near term were damped by official statements indicating that inflation is still a concern. These statements, coupled with expectations late in the period that the scope for U.S. interest rates to fall might increase, appear to have supported the Canadian dollar.

Sterling continued to move up, rising nearly 4 percent against the dollar and more than $4-3/4$ percent against the mark during the period. U.K. bond and stock prices also moved up considerably. The yield on the bellwether bond in the United Kingdom declined 80 basis points to 11.30 percent, and stock prices rose $11-1/4$ percent. Apparently, inflation expectations were revised downward and the credibility of U.K. monetary policy was enhanced following indications that Prime Minister Thatcher had withdrawn her opposition to joining the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS). Sterling moved up further later in reaction to a news report that indicated sterling may enter the ERM as soon as this autumn.

Within the ERM of the EMS, the lira remained at the top of the narrow band and the French franc at the bottom. To counter the lira's strength, Italian authorities lowered the discount rate 1 percentage point to $12-1/2$ percent and have allowed three-month interest rates to decline nearly 150 basis points to 11 percent. Comparable interest rates in France have risen

nearly 50 basis points to 10 percent.

On May 29, the Desk began a program of quiet mark sales into the market for the account of the Treasury. These sales are designed to reduce the large holdings of marks and increase holdings of dollars available to the Treasury's Exchange Stabilization Fund (ESF). The proceeds of these operations will enable the ESF to pay down some of the marks warehoused with the Federal Reserve. As of this writing, a little more than \$500 million has been purchased.

The price of gold has declined 5 percent to \$349.35 over the intermeeting period, amid reports that the Soviet Union is selling gold to obtain hard currency.

Developments in Foreign Industrial Countries

Latest data indicate that on average real GNP growth picked up in the first quarter, although this strength was not evenly distributed. In both Germany and Japan, real GNP grew at double-digit annual rates in the first quarter. In both countries, however, special factors (a weather-related construction boom in Germany and a changing seasonal pattern of auto exports in Japan) appear to have accounted for much of this surge in recorded growth. Preliminary indications early in the second quarter suggest a return to more moderate growth rates in both countries. First-quarter real GDP growth rates were moderate in Canada, France and the United Kingdom, ranging between 2 percent and 3 percent at annual rates.

Inflation rates have been unchanged or somewhat lower in recent months, except in the United Kingdom where special factors helped push the 12-month consumer-price inflation rate up to nearly 10 percent.

Movements of trade balances so far this year have been mixed. Trade surpluses in Germany, Japan, and Canada were at higher rates in the first quarter than in the previous quarter, while the trade deficits in Italy and the United Kingdom increased over this period.

Individual Country Notes. In Japan, real GNP (s.a.a.r.) increased 10.4 percent in the first quarter. This was a sharp rise from the 3.4 percent growth rate in the previous quarter. The more rapid growth was due entirely to a sharp swing from negative to positive in the contribution from the external sector. In contrast, domestic demand, especially consumption and investment in plant and equipment, continued to slow. In the first quarter, consumption increased at an annual rate of only 2.2 percent. Plant and equipment spending increased at an 11.3 percent rate, and residential investment grew at an 8.5 percent rate. The substantial contribution from net exports in the first quarter reflected a strong 38.7 percent rate of export growth (distorted upward by a changing seasonal pattern of auto exports) and a slowing of import growth to 8.8 percent.

Other more recent indicators of the pace of real activity have been somewhat mixed, but in general seem to indicate continued strains on industrial capacity and labor markets. Industrial production, which rose only 3.5 percent (s.a.a.r.) in the first quarter and declined by 1 percent in April, increased 2.4 percent in May. The rate of capacity utilization (s.a.) rose by 2.2 percent in March, reaching its highest level in seven months, and retail sales, which grew 11.1 percent (s.a.a.r.) in the first quarter, rose an additional 1.7 percent in April. The unemployment rate

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

| | Q4/Q4 1988 | Q4/Q4 1989 | 1989 | | | 1990 | 1990 | | | | | Latest 3 months from year ago 2 |
|-----------------------|---------------|---------------|------|-----|-----|------|------|------|------|------|------|------------------------------------|
| | | | Q2 | Q3 | Q4 | Q1 | Jan. | Feb. | Mar. | Apr. | May | |
| Canada | | | | | | | | | | | | |
| GDP | 3.1 | 2.9 | .3 | .8 | .6 | .5 | * | * | * | * | * | 2.2 |
| IP | 2.7 | .4 | .7 | -.2 | -.4 | -1.1 | -1.4 | -.2 | -.0 | -.1 | n.a. | -1.3 |
| France | | | | | | | | | | | | |
| GDP | 3.5 | 3.5 | .6 | .5 | .8 | n.a. | * | * | * | * | * | 3.5 |
| IP | 4.6 | 2.8 | 2.4 | .1 | -.1 | -.3 | 1.3 | -1.7 | .7 | 1.4 | n.a. | 1.3 |
| Germany | | | | | | | | | | | | |
| GNP | 3.0 | 3.7 | .2 | -.1 | 1.0 | 3.3 | * | * | * | * | * | 4.4 |
| IP | 4.0 | 4.6 | -1.5 | 2.2 | .4 | 2.9 | 2.4 | -.9 | 1.1 | -2.0 | n.a. | 4.3 |
| Italy | | | | | | | | | | | | |
| GDP | 3.5 | 2.8 | .7 | .7 | .4 | n.a. | * | * | * | * | * | 2.8 |
| IP | 7.5 | 3.2 | -.6 | 1.2 | 3.3 | -2.0 | -6.8 | 3.6 | -.7 | -.6 | n.a. | 2.6 |
| Japan | | | | | | | | | | | | |
| GNP | 5.1 | 4.8 | -.8 | 2.9 | .8 | 2.5 | * | * | * | * | * | 5.6 |
| IP | 7.6 | 4.2 | .3 | -.0 | .7 | .9 | -.1 | .3 | 1.7 | -1.0 | 2.4 | 2.6 |
| United Kingdom | | | | | | | | | | | | |
| GDP | 3.7 | 1.7 | -.4 | .9 | .4 | .7 | * | * | * | * | * | 1.6 |
| IP | 2.1 | .6 | -.5 | 1.0 | .1 | -.1 | -.5 | -.6 | 2.0 | .4 | n.a. | .5 |
| United States | | | | | | | | | | | | |
| GNP | 3.4 | 2.6 | .6 | .7 | .3 | .5 | * | * | * | * | * | 2.1 |
| IP | 4.5 | 1.1 | .7 | -.3 | .0 | .2 | -1.0 | .9 | .5 | .0 | .6 | 1.0 |

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

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

| | Q4/Q4 1988 | Q4/Q4 1989 | 1988 | | 1989 | | | | 1990 | | 1990 | | | | Latest 3 months from year ago |
|-----------------------|---------------|---------------|------|------|------|-----|------|-----|------|------|------|------|------|--|----------------------------------|
| | | | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. | May | | | |
| Canada | | | | | | | | | | | | | | | |
| CPI | 4.1 | 5.2 | .8 | 1.2 | 1.7 | 1.4 | .7 | 1.4 | .6 | .3 | .1 | .5 | 4.9 | | |
| WPI | 3.7 | .7 | .6 | 1.0 | .3 | -.2 | -.4 | .6 | 1.0 | -.1 | -.2 | n.a. | .4 | | |
| France | | | | | | | | | | | | | | | |
| CPI | 3.0 | 3.6 | .6 | .8 | 1.2 | .7 | .8 | .7 | .2 | .3 | .4 | .2 | 3.2 | | |
| WPI | 7.2 | 1.2 | 2.5 | 2.4 | .4 | -.5 | -1.0 | -.5 | * | * | * | * | -1.6 | | |
| Germany | | | | | | | | | | | | | | | |
| CPI | 1.6 | 3.1 | .3 | 1.5 | .9 | .0 | .6 | 1.1 | .4 | .1 | .2 | .2 | 2.4 | | |
| WPI | 2.2 | 4.3 | 1.1 | 3.0 | 1.5 | -.6 | .3 | -.3 | -.6 | .6 | .3 | .3 | .3 | | |
| Italy | | | | | | | | | | | | | | | |
| CPI | 5.2 | 6.6 | 1.9 | 2.0 | 1.7 | 1.0 | 1.8 | 1.6 | .7 | .4 | .4 | .3 | 5.9 | | |
| WPI | n.a. | n.a. | n.a. | n.a. | 1.7 | .0 | 2.5 | 2.1 | -1.0 | .0 | .2 | n.a. | 5.2 | | |
| Japan | | | | | | | | | | | | | | | |
| CPI | 1.5 | 2.9 | 1.0 | -.2 | 2.2 | .1 | .9 | .4 | .2 | .4 | .7 | -.6 | 3.0 | | |
| WPI | -1.4 | 3.7 | -.8 | .5 | 2.7 | .8 | -.3 | .4 | .1 | .7 | .6 | -.3 | 2.8 | | |
| United Kingdom | | | | | | | | | | | | | | | |
| CPI | 6.5 | 7.6 | 2.1 | 1.6 | 2.9 | .9 | 2.0 | 1.8 | .6 | 1.0 | 3.0 | .9 | 9.1 | | |
| WPI | 4.9 | 5.2 | 1.1 | 1.4 | 1.2 | 1.2 | 1.2 | 1.6 | .3 | .7 | 1.0 | .5 | 6.0 | | |
| United States | | | | | | | | | | | | | | | |
| CPI (SA) | 4.3 | 4.6 | 1.1 | 1.3 | 1.5 | .7 | 1.0 | 2.0 | .5 | .5 | .2 | .2 | 4.8 | | |
| WPI (SA) | 3.4 | 4.9 | 1.0 | 2.0 | 1.6 | .0 | 1.2 | 2.2 | -.1 | -.2 | -.3 | .3 | 3.7 | | |

1. Asterisk indicates that monthly data are not available.

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

| | 1988 | 1989 | 1988 | | 1989 | | | | 1990 | | 1990 | | | | | |
|-----------------------|--------|--------|-------|-------|-------|-------|-------|-------|------|------|------|------|--|--|--|--|
| | | | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. | May | | | | |
| <u>Canada</u> | | | | | | | | | | | | | | | | |
| Trade | 8.0 | 3.9 | 1.6 | 2.0 | 1.9 | 1.9 | 2.2 | 1.1 | .2 | .3 | .1 | n.a. | | | | |
| Current account | -8.4 | -14.1 | -3.2 | -2.6 | -4.0 | -3.5 | -4.0 | -4.3 | * | * | * | * | | | | |
| <u>France</u> | | | | | | | | | | | | | | | | |
| Trade | -5.4 | -6.3 | -2.0 | -.7 | -1.5 | -2.0 | -2.1 | -.4 | -.2 | -.2 | -.8 | -1.0 | | | | |
| Current account | -3.4 | -3.8 | -3.1 | 1.6 | -1.3 | -1.7 | -2.4 | 1.0 | * | * | * | * | | | | |
| <u>Germany</u> | | | | | | | | | | | | | | | | |
| Trade (NSA) | 72.9 | 71.6 | 21.0 | 19.4 | 17.7 | 17.8 | 16.6 | 22.3 | 6.3 | 8.4 | 4.5 | n.a. | | | | |
| Current account (NSA) | 50.5 | 55.5 | 16.9 | 16.8 | 14.0 | 11.1 | 13.5 | 17.0 | 4.9 | 6.1 | 3.4 | n.a. | | | | |
| <u>Italy</u> | | | | | | | | | | | | | | | | |
| Trade | -9.9 | -12.4 | -2.9 | -4.2 | -3.2 | -2.9 | -2.1 | -3.8 | -1.0 | -1.2 | n.a. | n.a. | | | | |
| Current account (NSA) | -6.3 | -10.6 | -1.7 | -8.2 | -1.1 | .1 | -1.5 | n.a. | * | * | * | * | | | | |
| <u>Japan</u> | | | | | | | | | | | | | | | | |
| Trade | 77.4 | 64.8 | 21.9 | 21.9 | 15.4 | 15.0 | 12.6 | 15.5 | 5.7 | 5.9 | 3.2 | 3.4 | | | | |
| Current account 2 | 79.6 | 57.2 | 20.8 | 21.5 | 12.6 | 13.2 | 9.7 | 15.4 | 5.2 | 7.2 | 2.4 | n.a. | | | | |
| <u>United Kingdom</u> | | | | | | | | | | | | | | | | |
| Trade | -37.0 | -37.9 | -11.3 | -10.5 | -10.3 | -10.2 | -6.9 | -9.0 | -2.4 | -3.4 | -3.0 | -2.6 | | | | |
| Current account | -26.0 | -31.2 | -9.6 | -7.4 | -7.5 | -9.6 | -6.6 | -7.8 | -1.9 | -3.0 | -2.6 | -2.2 | | | | |
| <u>United States</u> | | | | | | | | | | | | | | | | |
| Trade 2 | -127.2 | -113.2 | -31.6 | -28.1 | -28.2 | -29.8 | -28.7 | -26.4 | * | * | * | * | | | | |
| Current account | -126.5 | -105.9 | -28.7 | -30.4 | -32.0 | -22.9 | -20.6 | 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.

(s.a.), after reaching a ten-year low of 2 percent in March, edged up to 2.1 percent in April.

Twelve-month inflation rates have eased in recent months, reflecting in large part the passing of the impact from the introduction of the consumption tax in April of last year. In May, Tokyo consumer prices (n.s.a.) showed a 12-month increase of 2.7 percent, well below the 3.8 percent peak rate of February. Wholesale prices (n.s.a.) declined by 0.3 percent in May, and the 12-month increase fell to 1.7 percent, compared with a peak of 3.9 percent in March. The decline in wholesale prices in May was due in large part to a 2.2 percent fall in import prices in the month, reflecting the yen's recovery on exchange markets. In March and April, in contrast, when the yen depreciated, import prices rose by a total of 6.1 percent.

The trade surplus (s.a.a.r.) in the first five months of the year, at \$53.1 billion, was well below the surplus of \$77.3 billion recorded in the same period last year, but was about unchanged from the \$53.9 billion surplus rate in the last five months of last year. The current account has shown a similar pattern.

Real GNP (s.a.a.r.) in Germany increased 14.1 percent in the first quarter. Every category of domestic demand rose strongly with the exception of inventory accumulation which fell sharply. The most spectacular increase in investment came in construction, which was up 104 percent, due to mild weather and strong demand caused by recent immigration. Investment in equipment increased 29.4 percent. Private consumption increased 10.6 percent in response to a cut in personal tax rates and strong retail demand from East German residents. Both imports and exports were also up sharply, 22.3 and 36.9 percent, respectively.

Industrial production (s.a.) fell 2 percent in April. The largest component of the decline was a weather-related 15.2 percent drop in construction activity. Industrial production excluding construction fell 1 percent in April to a level just 2.1 percent above where it was one year earlier. The volume of new orders (s.a.) also declined in April, by 3.4 percent, all but erasing the sharp increase of the previous month. April's decline was concentrated in foreign orders, which fell 8.6 percent. Average new orders volume for March and April combined was 2.1 percent above the level for January and February, but only 1.9 percent above the level of a year earlier.

The unemployment rate (s.a.) remained at 7.3 percent in May, unchanged since February. The rate of migration from East to West Germany slowed from 1,700 per day in the week prior to the East German election on March 18 to 300 per day in the last week of May. As of the beginning of June, over 184,000 immigrants from East Germany had arrived in West Germany since the beginning of the year, and another 179,000 have arrived from other East European countries.

Consumer price inflation (n.s.a.) on a 12-month basis declined from 2.7 percent in the first quarter to 2.3 percent in April and May. This appears to be a delayed response to significant moderation in import, wholesale, and producer prices that began in the fourth quarter. Wholesale prices (n.s.a.) increased 0.3 percent in May, but were just 0.2 percent above year-earlier levels. Producer prices (n.s.a.) increased 0.1 percent in May, and on a 12-month basis were up only 1.5 percent. Import prices (n.s.a.) fell 0.9 percent in May and were 5.4 percent below their year-earlier levels. Wages and salaries per hour were 5 percent above year-earlier levels in the first quarter, up from 3.6 percent in the fourth quarter.

In the first quarter, Germany's external surpluses increased sharply. The current account surplus (s.a.a.r.) was \$64 billion in the first quarter, compared with \$42 billion in the fourth quarter. However, the first quarter surplus was still somewhat below the record level of one year earlier.

On June 21 the parliaments of East and West Germany approved a treaty that sets the terms under which German economic and monetary union will be established on July 1. The basic goal of the treaty is to introduce the West German mark as the currency of East Germany, while at the same time altering the institutional structure of the East German economy to make it, as much as possible, similar to that of West Germany. The treaty has three basic components. First, it sets the terms under which the West German mark will replace the East German mark, including the rates of conversion for financial assets and other contracts denominated in East German marks. Second, the treaty lays out specific reforms in the fiscal structure of the East German public sector and specifies how East German government deficits will be financed. Third, it lays out a broad set of fundamental market-oriented economic reforms that East Germany must implement.

The fiscal impact of the Treaty is likely to be significant. After the initial conversion, government debt is expected to increase substantially, due primarily to fiscal deficits of the East German central government. The likely monetary impact of the treaty appears to be more modest. Under the agreed terms of conversion, M3 will increase by about 10 percent, roughly in line with the potential output of East Germany. No decision has yet been made regarding how or whether the target for M3 growth in 1990 will be adjusted after the German monetary union is established on July 1. (As of May, M3 growth since 1989-Q4 (s.a.a.r.) was 4 percent, at the low end of the Bundesbank's 1990 target range of 4 to 6 percent.) Although it appears unlikely that monetary targeting will be given up all together, Bundesbank

officials have indicated that the level of M3 will probably play a less important role in short-run monetary policy decisions after July 1, due to the inherent uncertainties in money demand. The Bundesbank is expected to rely more heavily on leading indicators of domestic price pressures, including the exchange rate.

Economic activity in France has slowed since mid-1989. Industrial production (s.a.a.r.) fell 1.3 percent in the first quarter, and was up 2.1 percent on a 12-month basis. Growth of real marketable GDP (an early indicator of total GDP that excludes part of the state-funded sector and comprises about 85 percent of the total economy) slowed to 2.8 percent (s.a.a.r.) in the first quarter. Domestic demand continues to be paced by gross fixed investment, which grew 9.1 percent. The external account has shown signs of improvement, with real exports growing 13.4 percent.

Recent data for the United Kingdom show that stagflation continues to beset the economy. Industrial production (s.a.), after falling in January and February, rose in March and April but was still only 0.5 percent above its level a year earlier. Real GDP growth (s.a.a.r.) rebounded somewhat in the first quarter to 2.8 percent from 1.7 percent in the fourth quarter, but the increase from year-earlier levels remained at 1.6 percent. After 44 consecutive months of decline, unemployment (s.a.) rose in April and May to a rate of 5.7 percent.

Retail prices (n.s.a.) have risen sharply in recent months primarily as a result of the institution of community charges and excise tax increases. In May, the overall 12-month rate of retail price inflation was 9.7 percent, the highest since 1982. Excluding mortgage interest payments and the poll tax, the "underlying" rate of inflation rose to 7 percent in May. The government has stated that it will use the latter measure of inflation (which is more comparable to those of other EC countries) in

assessing whether U.K. inflation has fallen to European levels, the main remaining condition for joining the exchange rate mechanism of the EMS. In May, output prices for manufactured goods (n.s.a.) rose 0.5 percent to 6.2 percent above year-earlier levels. In April the underlying 12-month increase in average earnings remained at 9-1/2 percent.

In Italy, recent price data indicate continued slowing of inflation. In May, the consumer price index (n.s.a.) was 5.7 percent above its level a year earlier, down from 5.8 percent in the previous month. The wholesale price index (n.s.a.) increased in April by 4.4 percent from its level a year earlier, down sharply from the the 5.3 percent increase in March.

On May 18, the government introduced a supplemental budget intended to reduce the projected 1990 budget deficit by \$10 billion equivalent. The expenditure measures, accounting for more than half of the proposed deficit reduction, are mostly in the form of expenditure delays. The revenue increases result from increases in excise and transaction taxes. However, there are already indications that the measures contained in this package will not be sufficient to reach the 1990 deficit target.

First-quarter national income data from Canada suggest widespread weakness in economic activity. Although real GDP (s.a.a.r.) increased 2.2 percent, the same as the upwardly revised fourth-quarter figure, domestic demand was significantly weaker in the first quarter. Growth in consumption expenditures fell from 4.3 percent in the fourth quarter to 0.8 percent in the first; private business investment in fixed capital fell from 9.3 percent to 1.1 percent. Inventory investment also was weak. Growth was maintained by increases in government investment and by a substantial increase in real net exports. Real imports fell 7.8 percent while real exports rose 2 percent. Partial evidence from the second quarter suggests

continued weakness. Unemployment (s.a.) rose from 7.2 percent in April to 7.6 percent in May.

Political uncertainty in Canada over the future of Quebec continues. Two provincial legislatures failed to ratify the Meech Lake Accord, under which Quebec would have joined the federal constitution, by its June 23 legal deadline. Quebec is currently negotiating with the Federal government about repatriating control over immigration policy, but has not yet officially raised the possibility of seceding from Canada.

Developments in East European Economies

On June 21, Hungary received a \$280 million bridge loan from the Bank for International Settlements. (The U.S. portion was \$20 million.) Hungary requested the loan after its international reserves fell precipitously as foreign banks withdrew or did not renew lines of credit to the National Bank of Hungary. First-quarter data indicate an improved trade and current account performance by Hungary. A hard currency trade surplus of \$350 million (against a projected surplus of \$18 million) contributed to a hard currency current account deficit estimated at less than \$100 million (compared with the 1989 first-quarter deficit of \$669 million). Export value of non-traditional exports (light manufacturing and high-technology products) rose more than 20 percent. However, production levels are off, and unemployment officially now exists (about 1 percent of the labor force). Inflation is still running somewhat higher than the objective of 20 percent for the year as a whole.

The Polish government declared that Poland's switch to a free-market economy is complete, albeit imperfect, and that it is time to ease austerity measures. This shift in policy is due, in part, to continued declines in industrial sales (off 30 percent from a year ago) and increases in unemployment (to about 3.8 percent of the labor force). However, inflation

has not been beaten -- monthly inflation in May was about 5 percent (albeit down from a monthly inflation rate of near 80 percent in January).

Private-sector development and restructuring of the state-owned sector are moving slowly. Two large conglomerates have been broken-up -- one in coal and steel and one in the transportation sector. The Gdansk shipyard has been transformed into a joint-stock company in preparation for selling shares to employees and investors. The first private bank in Poland has been licensed; 10 Polish investors contributed paid-in capital of 10 billion zloties (about \$3 million).

Poland is negotiating with private and official creditors on its proposal to reduce debt and debt service by about 80 percent. Last October, Poland informed the commercial banks that they would receive only 15 percent of interest due through end-1989 on the due date with the remainder after six months with no penalties. Since the end of 1989, Poland has paid interest on only short-term trade credits and on new bank debt. In February, Polish authorities signed a generous "Paris Club" rescheduling agreement with official creditors that covered \$9.5 billion in debt payments rescheduled over 14-years with an eight-year grace period.

U.S. Bank Lending to Foreigners

U.S. bank exposure to all countries, as measured by the Country Exposure Lending Survey, declined 6.5 percent during 1989. As indicated in the table, exposure to G-10 countries declined only slightly, with a small increase in exposure by the money center banks more than offset by a small decline among other banks. A decline in interbank exposure to Japan was offset by increases to other industrial countries. Exposure to all other regions also showed a decline, with the largest decrease associated with developing countries.

U.S. bank exposure to Latin American countries continued to decline in 1989, falling by 20 percent. Preliminary data for the first quarter of 1990 indicate a further decline in U.S. bank exposure of about 10 percent to major debtors in Latin America. Mexico's financing agreement, completed in March 1990, accounted for a portion of the decline as some U.S. banks exchanged their debt for bonds discounted by 35 percent. Exposure to Brazil also declined, consistent with reports that Brazilian public sector enterprises have been repurchasing Brazilian debt on the secondary market.

Recent financing agreements negotiated under the Brady initiative framework have resulted in the conversion of significant amounts of public sector debt to banks into negotiable bonds. Most bank exposure to Mexico and Costa Rica is now held in the form of negotiable bonds, and the Venezuelan preliminary agreement also allows for the conversion of bank debt into bonds. In addition to these debt-for-bond swaps, some Mexican public and private sector entities have been able to return to the market with new issues, albeit in small amounts. Also, several countries have indicated that they will allow new bond issues to be used for financing privatizations and other bank debt-for-equity arrangements. Such arrangements would present further opportunities for banks to reduce their exposure by selling their bonds to other investors willing to take equity positions in companies in those countries.

INTERNATIONAL EXPOSURES OF U.S. BANKS¹
(billions of dollars)

| Exposure to: | December 1988 | | | December 1989 | | |
|-------------------------------|---------------|----------------------|------------------------------|---------------|----------------------|------------------------------|
| | All Banks | 9 Money Center Banks | All Other ² Banks | All Banks | 9 Money Center Banks | All Other ² Banks |
| G-10 Countries | 139.7 | 68.7 | 71.0 | 138.0 | 70.0 | 68.0 |
| of which: | | | | | | |
| Japan | 62.2 | 26.5 | 35.7 | 56.1 | 22.3 | 33.8 |
| United Kingdom | 20.5 | 13.3 | 7.2 | 22.3 | 16.0 | 6.3 |
| Canada | 10.4 | 4.5 | 5.9 | 9.9 | 5.0 | 4.9 |
| Non-G-10 Developed Countries | 21.8 | 13.3 | 8.5 | 20.9 | 12.3 | 8.6 |
| Eastern Europe | 3.4 | 2.3 | 1.1 | 2.7 | 1.9 | 0.8 |
| OPEC | 13.1 | 9.4 | 3.7 | 11.3 | 9.0 | 2.3 |
| Non-OPEC Developing Countries | 72.9 | 50.9 | 22.0 | 61.2 | 44.4 | 16.8 |
| of which: | | | | | | |
| Latin America | 55.1 | 40.3 | 14.8 | 44.2 | 34.2 | 10.0 |
| Asia | 16.3 | 9.4 | 6.9 | 15.8 | 9.2 | 6.6 |
| Other | 1.5 | 1.2 | 0.3 | 1.2 | 1.0 | 0.2 |
| Offshore Center and others | 8.4 | 5.4 | 3.0 | 8.2 | 5.3 | 2.9 |
| Grand Total | 259.2 | 150.0 | 109.2 | 242.3 | 142.9 | 99.4 |

Source: Country Exposure Lending Survey.

1. Exposure calculated allocating risks to country of ultimate guarantor, including claims on banks located in countries other than in which they are based.

2. All other U.S. banks reporting on Country Exposure Lending survey.

Economic Situation in Major Developing Countries

In Brazil, large wage increases and opposition to the government's plans for substantial cuts in public sector employment are posing serious challenges to the government's anti-inflation program. The government has reacted to these inflationary pressures by threatening to restrict monetary expansion at the cost of deepening the current recession. In an

would be fired by the end of June from 360,000 workers (20 percent of the public sector workforce) to between 120,000 to 200,000 workers; moreover, it is not clear that the government will be able to come close to its goal. Petrobras, the government monopoly in petroleum extraction, refining, and distribution, was to have begun firing 20 percent of its estimated 65,000 workers by June 18, but so far few workers have been fired.

Serious opposition has also developed toward the government's attempt to end wage indexation and reduce the state's role in propagating wage inflation. In late May, the Supreme Court overturned a presidential decree designed to limit the power of the courts to resolve wage disputes. In recent weeks, regional labor courts have granted workers several large wage increases ranging from 20 to 160 percent. The government has also announced that wage increases resulting from collective bargaining agreements cannot be passed through to prices, but it is not clear that this provision can be enforced.

The government is threatening to curb wage demands by limiting monetary expansion, at the cost of deepening the current recession; dismissals of industrial workers in Sao Paulo during April were at their highest level since 1981. Labor unions have organized strikes in several areas recently, but strike activity has been limited by the current recession and the threat of future layoffs. Despite recent setbacks to the stabilization effort, interest rates and the parallel market exchange rate have remained relatively stable in recent weeks; this stability, in part, reflects government intervention to support the currency.

Brazil's monthly trade surplus was \$1.8 billion in May, the largest surplus this year. The accumulated five-month trade surplus to May 1990 is \$4.7 billion, compared with \$6.9 billion over the same period in 1989.

In Mexico, the rate at which the peso is being devalued daily against the dollar was reduced to 80 centavos per day from 1 peso per day, effective May 28. The change was made under an agreement extending the anti-inflation pact between government, business, and organized labor through January 1991. Contrary to expectations, the new agreement made no change in minimum wages but raised a selective list of public sector prices by varying percentages. Over a full year, measured from May 28, the new rate of crawl will raise the peso price of the dollar by 10.4 percent, whereas the old rate would have raised it by 13 percent. The government is taking the calculated risk that, in the absence of an increase in minimum wages, the price level will increase less than it otherwise would have and the real appreciation of the peso in coming months will, therefore, not be larger than it would have been with the old rate of crawl.

At the first Treasury-bill auction following the pact extension, the 28-day rate fell by about 3 percentage points. On June 19, this rate was 32.4 percent, more than 15 percentage points lower than at the most recent peak in mid-March 1990. The bulk of the decline since mid-March reflects a rise in public confidence in Mexican policies and prospects following the March 28 implementation of the bank financing package and the May 2 announcement that the government was seeking to return the nationalized commercial banks to private ownership. A constitutional amendment to authorize the bank reprivatization was approved by the Mexican Congress in May and awaits ratification by 17 of the 31 State legislatures.

Mexico has drawn all of the \$1.3 billion in short-term bridge financing provided on March 28 by the Federal Reserve System (\$700 million) and the U.S. Treasury (\$600 million); \$550 million of the bridge amount had been invested initially in U.S. government securities until Mexico met

certain conditions. As of June 26, Mexico had repaid about \$564 million of the credit.

Argentina has continued to implement the economic stabilization program initiated in March, but inflation has not declined as rapidly as anticipated. After falling from 95.5 percent (monthly basis) in March to 11.4 percent in April, inflation rose to 13.6 percent in May and is projected at about 15 percent in June. The June increase is attributed, in part, to an 8 percent increase in the austral price of the dollar during the second week of the month; this depreciation reflected various factors, including a correction of the substantial real overvaluation of the exchange rate that had occurred during the previous three months. Financial markets remain somewhat unsettled following the movement in the exchange rate, and short-term interest rates currently are about 20 percent (monthly basis) compared with about 10 percent during the first week of June.

On May 25, the IMF's Executive Board approved a modification of the stand-by arrangement that was approved initially in November 1989 and became inoperative after Argentina missed its December 1989 targets. The modified program specifies deeper fiscal adjustments than the original program, and also calls for the normalization of Argentina's relations with its commercial bank creditors; interest arrears on Argentina's medium- and long-term debt to commercial banks currently total about \$6 billion.

To pave the way toward re-opening negotiations with the commercial banks, Argentina paid \$40 million in interest to them on June 7, the first such payment since end-1988, and promised to continue payments of \$40 million per month through the end of 1990; this compares with monthly interest of \$280 million that will accrue on its medium- and long-term debt to commercial banks during this period. On the same day, Argentina met with its bank advisory committee to discuss the normalization of financial

relations, as well as the granting of waivers by the banks to allow the privatization of Argentine public enterprises with debts to those institutions. No resolution of either of these issues was reached at that meeting, nor has an additional meeting been scheduled.

As of June 26, Venezuela and its commercial bank creditors were completing the final details of a term sheet for the package to provide new money and debt and debt-service reduction agreed in March. Following distribution of the term sheet, creditors will choose among the available options, including a provision for a large but temporary interest rate reduction, an option not available in the Mexican debt agreement.

The limited monthly economic data available suggest that Venezuela's sharp recession, which began last spring and entailed an 8 percent decline in real GDP in calendar 1989, may have bottomed out. Cement sales were 30 percent higher in May than in April, mainly due to strong export demand, while motor vehicle sales in May rose 41 percent above their April level. Inflation has remained roughly stable at an average of 2.2 percent per month during the first five months of this year, compared with an average monthly rate of 5.1 percent in 1989. The Caracas CPI rose 2.5 percent in May, paced by a 4.2 percent increase in food prices. To combat food-price inflation, the government has extended its trade liberalization program to many agricultural commodities.

When the Central Bank of Venezuela reduced short-term interest rates during May in an effort to stimulate economic activity, the floating-rate bolivar depreciated from 44 per dollar at end-April to 48 per dollar at end-May. The central bank responded by reversing the decline in interest rates, which stabilized the currency. In mid-June, the interest rate on three-month central bank bills stood at 39 percent (annual rate, not compounded), compared with 28 percent in mid-May.

Costa Rica and its commercial bank creditors completed a debt restructuring package on May 21, 1990, which will lower the stock of commercial bank debt from \$1.6 billion to \$0.8 billion and reduce the interest rate on most of the remaining debt to 6.25 percent. The package lowers Costa Rica's annual debt service obligations on its commercial bank debt by over two-thirds. Costa Rica bought back about 62 percent of the base debt and past due interest at 16 percent of face value.