

## **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,<sup>1</sup> and then making the scanned versions text-searchable.<sup>2</sup> 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.

---

<sup>1</sup> 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).

<sup>2</sup> 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.

August 15, 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>
<b>DOMESTIC NONFINANCIAL DEVELOPMENTS</b>	<b>II</b>	
Employment and unemployment.....		1
Labor costs.....		3
Industrial production.....		9
Personal consumption expenditures.....		13
Autos and light trucks.....		17
Business fixed investment.....		19
Business inventories.....		25
Housing markets.....		29
Federal sector.....		30
State and local government sector.....		33
Energy prices and supplies.....		35
Food prices and agricultural conditions.....		37
Prices.....		41
Appendix A: Annual revision to the national income and product accounts.....	II-A-1	
Appendix B: Mid-session review of the budget.....	II-B-1	
 <u>Tables</u>		
Changes in employment.....		2
Selected unemployment rates.....		2
Employment cost index:Private industry workers.....		6
Negotiated wage rate changes under major collective bargaining settlements.....		6
Employment cost index.....		8
Growth in selected components of industrial production.....		10
Percent change in orders for manufactured goods.....		10
Capacity utilization in industry.....		12
Retail sales.....		14
Sales of automobiles and light trucks.....		16
Business capital spending indicators.....		20
Changes in manufacturing and trade inventories.....		24
Inventories relative to sales.....		24
Private housing activity.....		28
Federal government outlays and receipts.....		32
Monthly average prices--West Texas Intermediate.....		36
U.S. agricultural production and inventories.....		38
Recent changes in producer prices.....		40
Recent changes in consumer prices.....		40
Price indexes for commodities and materials.....		42
 <u>Charts</u>		
Other labor market indicators.....		4
Unemployment insurance.....		4
Employment cost index: Private industry workers.....		7
Employment cost index.....		8
Real business fixed investment.....		18
Investment and cash flow.....		18
Recent data on orders and shipments.....		22
Nonresidential construction and selected indicators.....		23
Ratio of inventories to sales.....		26
Private housing starts.....		28
Real federal purchases of goods and services.....		32
Fiscal position of the state and local sector.....		34

Daily spot and posted prices of West Texas Intermediate.....	36
Index weights .....	42
Commodity price measures.....	43

**DOMESTIC FINANCIAL DEVELOPMENTS**

**III**

Monetary aggregates and bank credit.....	5
Business finance.....	11
Thrift industry developments.....	12
Treasury and sponsored agency financing.....	13
State and local government finance.....	16
Mortgage markets.....	17
Consumer installment credit.....	21

Tables

Monetary aggregates.....	4
Commercial bank credit and short- and intermediate-term business credit.....	8
Gross offerings of securities by U.S. corporations.....	10
Treasury and agency financing.....	14
Gross offerings of municipal securities.....	17
Mortgage-backed security issuance.....	19
Consumer credit.....	20
Consumer interest rates.....	20
Retail sales of auto dealers and automobile credit.....	22
Delinquency rates on home equity lines of credit at banks.....	24

Charts

Long-term Treasury yields and implied forward rates.....	2
Interest rates on selected M2 instruments and six-month Treasury bills.....	6
Mortgage markets.....	18
Growth in consumer installment credit and consumption.....	22

**INTERNATIONAL DEVELOPMENTS**

**IV**

U.S. merchandise trade.....	1
Import and export prices.....	3
U.S. international financial transactions.....	6
Foreign exchange markets.....	10
Developments in foreign industrial countries.....	14
Developments in East European economies.....	22
Economic situation in major developing countries.....	24

Tables

U.S. merchandise trade: Monthly data.....	1
Oil imports.....	2
U.S. merchandise trade: Quarterly data.....	3
Major trade categories.....	4
Import and export price measures.....	5
Summary of U.S. international transactions.....	8
International banking data.....	9
Selected financial markets indicators.....	13
Major industrial countries	
Real GNP and industrial production.....	15
Trade and current account balances.....	16
Consumer and wholesale prices.....	17

Charts

Weighted average exchange value of the dollar.....	11
--	----

# **DOMESTIC NONFINANCIAL DEVELOPMENTS**

---

## DOMESTIC NONFINANCIAL DEVELOPMENTS

---

The Commerce Department's advance estimates indicate that real GNP grew at a 1-1/4 percent annual rate in the second quarter, and the available evidence suggests continued slow growth in the current quarter. Labor demand has been sluggish, but even so, wage increases have not abated. The underlying inflation trend appears to have been no better than stable through the first half of the year, and the recent oil price shock presages some bad price figures in coming months. In addition, the steep rise in energy prices is likely to result in a significant erosion of consumer purchasing power.

### Employment and Unemployment

Employment growth slowed substantially in the second quarter, and the labor market continued to weaken in July. Nonfarm payrolls shrank 219,000 last month--pushed down, in part, by a 162,000 decline in Census employment. Private payroll employment dropped 45,000, after small gains during the second quarter.

The services industry lost 11,000 jobs in July, as employment declined in business services and hiring slowed in health services. The pace of hiring at retail and wholesale trade establishments also appears to have slowed considerably in recent months. Construction employment fell in July for the fifth consecutive month and has now more than retraced its winter spurt. Manufacturing payrolls also declined further, albeit at a pace slower than that over the first half of the year; all of the job loss in July occurred among supervisory workers, while the employment of production workers edged up. By industry, the losses in manufacturing last month were

CHANGES IN EMPLOYMENT<sup>1</sup>  
(Thousands of employees; based on seasonally adjusted data)

	1988	1989	1989	1990		1990		
			Q4	Q1	Q2	May	June	July
-----Average Monthly Changes-----								
Nonfarm payroll employment <sup>2</sup>	276	206	158	286	166	369	155	-219
Excluding census workers				247	83	169	166	-57
Private	248	177	156	205	34	109	118	-45
Manufacturing	29	-8	-23	-22	-21	-20	-23	-7
Durable	20	-13	-24	-8	-21	-9	-18	-10
Nondurable	9	5	0	-14	0	-11	-5	3
Construction	14	8	-7	43	-50	-14	-28	-51
Trade	64	48	44	33	20	31	8	14
Finance, insurance, real estate	11	12	11	12	5	12	3	6
Services	118	99	87	121	66	77	142	-11
Total government	27	29	2	81	132	260	37	-174
Private nonfarm production workers	197	144	129	167	36	86	135	-55
Manufacturing production workers	20	-10	-19	-24	-13	-28	-12	7
Total employment <sup>3</sup>	192	146	156	149	18	234	39	-436
Nonagricultural	193	145	164	147	-31	62	-4	-174

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		1990		
			Q4	Q1	Q2	May	June	July
Civilian, 16 years and older	5.5	5.3	5.3	5.2	5.3	5.3	5.2	5.5
Teenagers	15.3	15.0	15.2	14.5	14.8	15.5	14.1	16.3
20-24 years old	8.7	8.6	8.9	8.4	8.7	8.5	8.2	8.3
Men, 25 years and older	4.2	3.9	4.0	4.1	4.1	4.1	4.1	4.4
Women, 25 years and older	4.3	4.2	4.3	4.2	4.1	4.1	4.1	4.2
White	4.7	4.5	4.5	4.6	4.6	4.6	4.5	4.6
Black	11.7	11.5	11.8	10.8	10.4	10.4	10.4	11.3
Fulltime workers	5.2	4.9	5.0	4.9	4.9	4.9	4.8	5.0
Memo:								
Total National <sup>1</sup>	5.4	5.2	5.3	5.2	5.2	5.3	5.1	5.4

1. Includes resident armed forces as employed.

concentrated in electrical machinery and construction-related industries, such as lumber and stone, clay, and glass.

Although employment declined and the unemployment rate moved up to 5.5 percent in July, other data paint a more sanguine picture of underlying labor market conditions. Hours of production and nonsupervisory workers edged up in July to a level about 1-1/2 percent at an annual rate above the second-quarter average. Also, data from the household survey indicate that the number of recent layoffs as a percentage of employment fell last month. Finally, initial claims for unemployment insurance have fluctuated around the 350,000 to 360,000 per week average pace observed in the first half of 1990.

#### Labor Costs

As measured by the employment cost index (ECI), hourly compensation for private industry workers rose 5-1/4 percent over the twelve months ended in June--about 3/4 percentage point faster than over the comparable period in 1989.<sup>1</sup> Wage and salary inflation edged up to a 4-1/2 percent pace over the past twelve months from the 4 percent rate that had prevailed for nearly a year and a half.<sup>2</sup> Benefit costs continued to increase faster than wages and salaries. The 7 percent increase in benefit costs over the past twelve

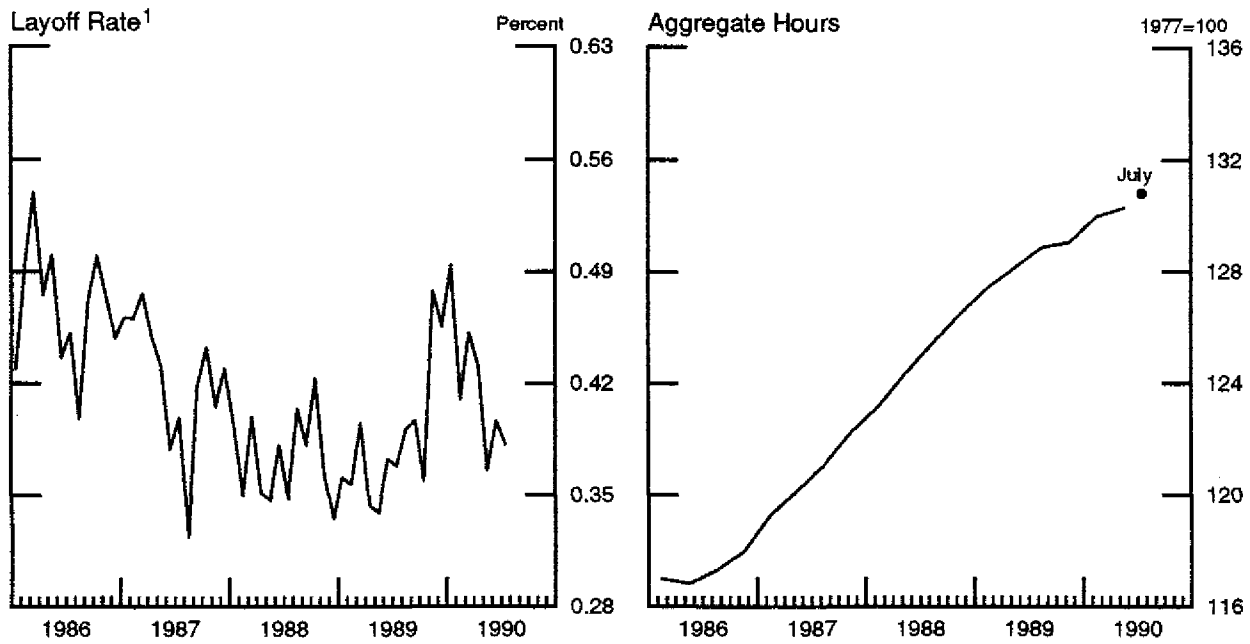
---

1. The BLS recently has made available unpublished, seasonally adjusted data for the Employment Cost Index on a confidential basis (table). These data will be available officially in January 1991, with the release of data for the fourth quarter of 1990. The new seasonally adjusted series do not differ significantly from those produced in the past by Board staff. Hourly compensation increased at a 5.1 percent annual rate in the second quarter, as benefits decelerated to a 5.4 percent annual rate, while wages and salaries increased at a 5.1 percent annual pace.

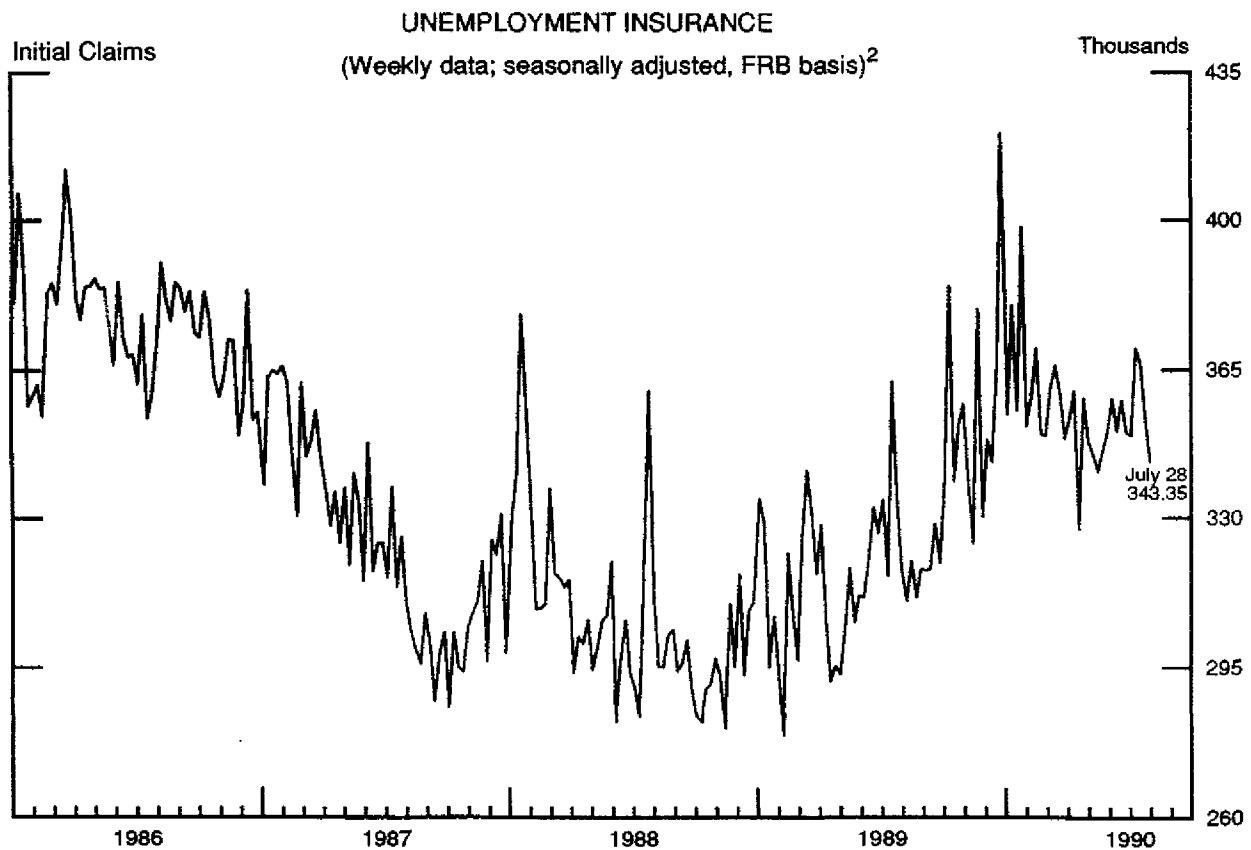
2. The April increase in the minimum wage from \$3.35 to \$3.85 per hour appears to have had only a minor influence on average wages, even within the service sector. According to the BLS, the ECI figures suggest that the minimum wage increase added at most 0.1 percentage point to private sector wage growth over the year ending in the second quarter.



OTHER LABOR MARKET INDICATORS



1. Recent layoffs as a percentage of household employment.



2. Only the state program components of these series are seasonally adjusted.

months reflected, in part, a 12 percent increase in employers' health insurance costs as well as increases in both the social security tax rate paid by employers and the social security tax base.

By industry, hourly compensation in the goods-producing and the service-producing sectors increased at about the same pace over the 12 months ended in June. Hourly compensation in the service-producing sector has been rising at a bit above a 5 percent annual rate over the past year, while hourly compensation costs in goods-producing industries have accelerated from 3-1/2 percent to 5-1/4 percent over the same period.

In the union sector, hourly compensation rose a bit more than 4 percent over the past 12 months, up a percentage point from the preceding year. The acceleration in union wages also was apparent in the second-quarter data on major collective bargaining agreements--those covering 1,000 workers or more. The first-year adjustments in these contracts averaged 4-1/4 percent, 2 percentage points larger than in the agreements they replaced, most of which had been signed two or three years ago.

Contract negotiations between the UAW and the Big Three automakers began in mid-July. In early September, the UAW will target one of the three firms and negotiate exclusively with that firm until a settlement has been reached. Ford's strong economic position relative to Chrysler and GM would seem to make it a likely choice as the target company. Executives at Chrysler have indicated that they would like to be the target company in order to pursue "innovative" discussions of a proposed multi-employer health care trust as well as other issues. Despite Ford's and Chrysler's positions, union members publicly are urging union leaders to select GM as the target company. GM reportedly has angered UAW members by laying off

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

	1988	1989	1989			1990	
			June	Sept.	Dec.	March	June
Total compensation costs:							
Private industry workers	4.8	4.8	4.5	4.8	4.8	5.2	5.2
By industry:							
Goods-producing	4.4	4.3	3.6	4.1	4.3	5.1	5.2
Service-producing	5.1	5.1	5.2	5.3	5.1	5.1	5.2
By occupation:							
White-collar	5.0	5.2	5.2	5.4	5.2	5.3	5.5
Blue-collar	4.5	4.1	3.7	4.1	4.1	4.8	4.7
Service workers	5.3	4.4	4.6	4.1	4.4	4.7	4.9
By bargaining status:							
Union	3.9	3.7	3.1	3.3	3.7	4.3	4.1
Nonunion	5.1	5.1	4.9	5.3	5.1	5.4	5.5
By region:							
Northeast	5.9	6.4	6.6	7.2	6.4	5.8	5.3
Midwest	4.7	4.1	4.0	4.1	4.1	4.7	4.8
South	4.4	4.2	3.4	3.9	4.2	5.1	5.7
West	3.8	4.2	3.8	4.1	4.2	4.6	4.5
Memo:							
Wages and salaries	4.1	4.1	4.1	4.3	4.1	4.2	4.5
Benefits	6.9	6.1	5.6	6.0	6.1	7.2	6.9

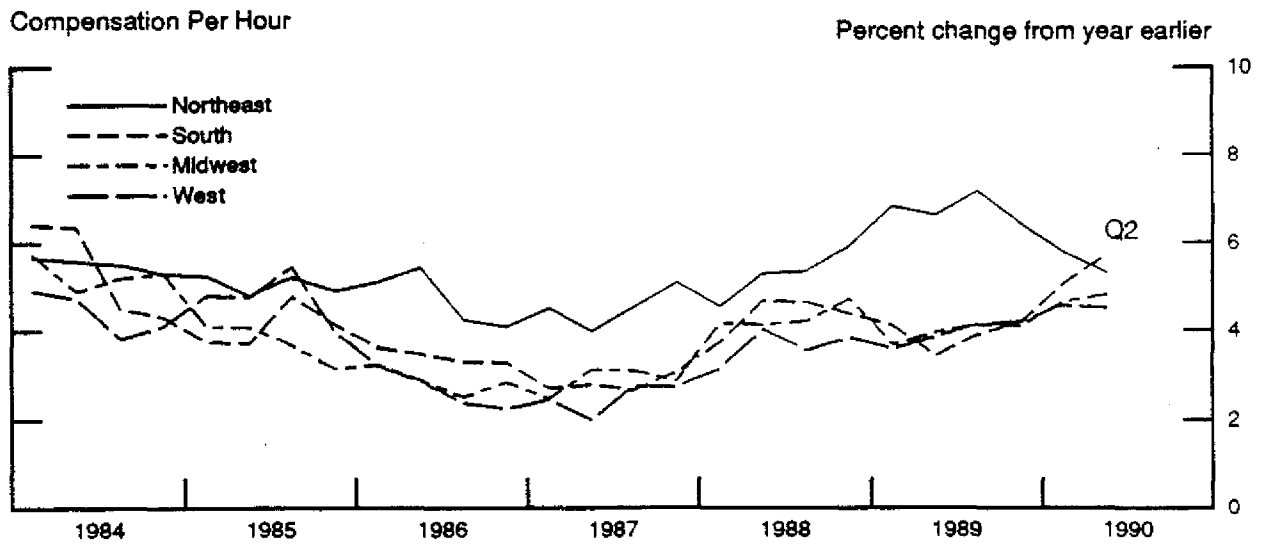
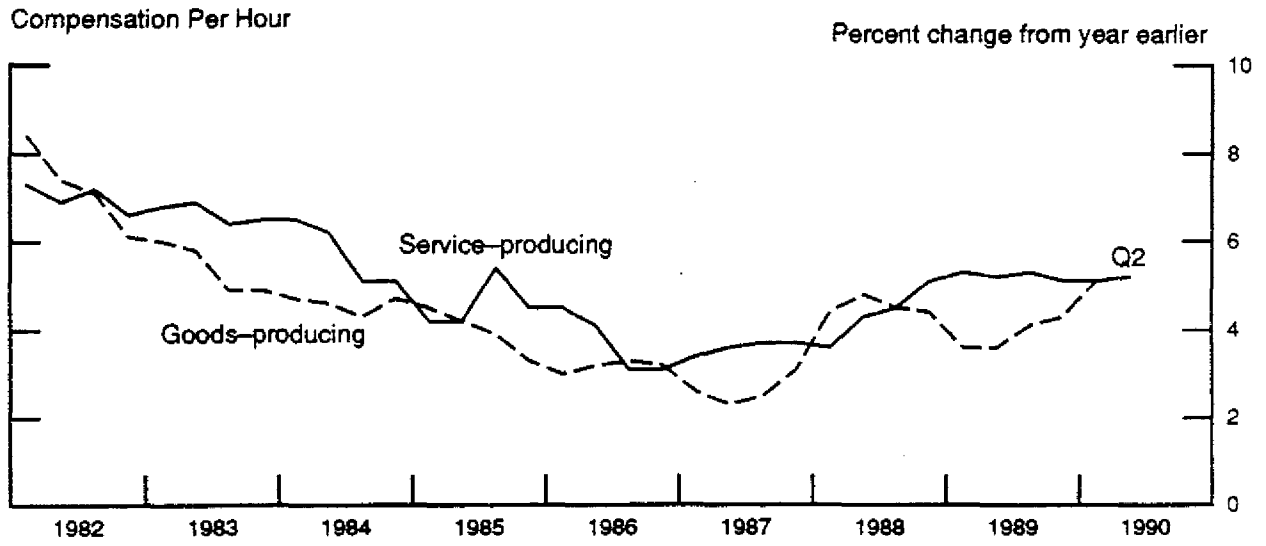
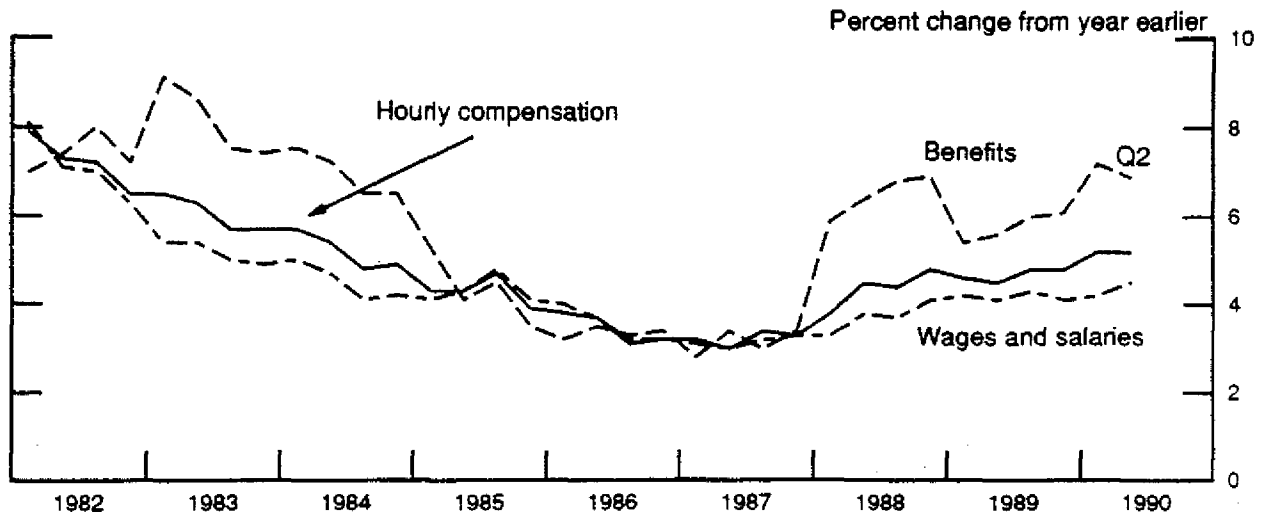
NEGOTIATED WAGE RATE CHANGES  
UNDER MAJOR COLLECTIVE BARGAINING SETTLEMENTS<sup>1</sup>  
(Percent change)

	1987	1988	1989	Same parties under prior settlements	1990
					First six months
All industries					
First-year adjustments	2.2	2.5	4.0	2.3	4.2
Average over life of contract	2.1	2.4	3.3	2.2	3.8
Workers affected (in thousands)	2037	1799	1847	--	810

1. Contracts covering 1,000 or more workers; estimates exclude lump-sum payments and potential gains under cost-of-living clauses.

# EMPLOYMENT COST INDEX

Private Industry Workers



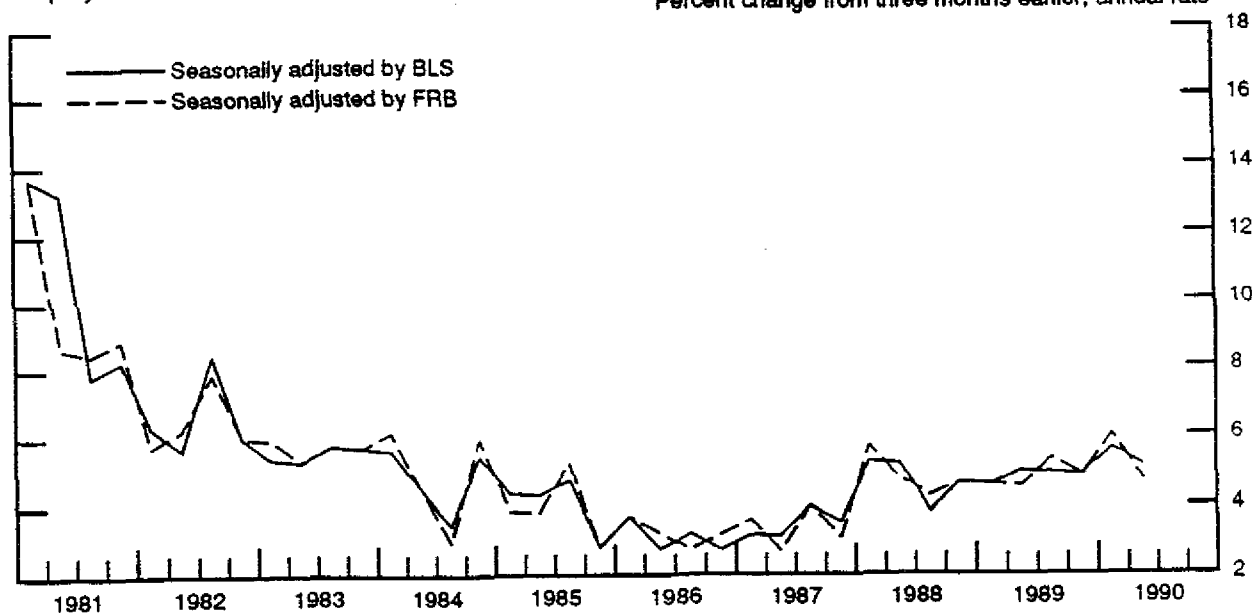
**EMPLOYMENT COST INDEX**  
 (Percent change from preceding period at compound annual rates;  
 based on seasonally adjusted data<sup>1</sup>)

	1989				1990	
	Mar.	June	Sept.	Dec.	Mar.	June
<b>Total compensation costs:</b>						
Private industry workers	4.6	4.9	4.9	4.8	5.6	5.1
<i>(FRB Seasonals)</i>	4.6	4.5	5.3	4.8	6.0	4.7
<b>By industry:</b>						
Goods-producing	3.7	4.1	5.3	4.4	6.0	5.1
<i>(FRB Seasonals)</i>	3.7	4.1	4.9	4.8	6.4	4.7
Service-producing	5.4	5.4	4.9	4.4	5.2	5.9
<i>(FRB Seasonals)</i>	5.9	4.5	5.3	4.8	5.6	5.1
<b>Memo:</b>						
Wages and salaries	4.6	4.1	4.1	4.4	4.0	5.1
<i>(FRB Seasonals)</i>	3.7	4.1	4.5	4.0	4.4	4.7
Benefits	5.5	7.1	6.6	5.2	10.1	5.4
<i>(FRB Seasonals)</i>	8.1	5.4	5.7	5.2	12.6	4.2

1. Changes are from final month of preceding period to final month of period indicated. Percent changes are seasonally adjusted by the Bureau of Labor Statistics. **These data are unpublished and confidential until released by the BLS in January 1991.**

Employment Cost Index

Percent change from three months earlier, annual rate



thousands of workers over the last three years, despite job security measures negotiated under the 1987 contract.

Under the expiring UAW agreement, workers received a 3 percent wage increase in 1987 and lump-sum payments in 1988 and 1989 equal to 3 percent of the previous year's earnings. COLAs and profit sharing also boosted autoworkers' earnings over the term of the last contract. The job security program negotiated in 1987 was the centerpiece of the agreement and guaranteed employment levels on a plant-by-plant basis. However, automakers, particularly GM, circumvented this agreement by "indefinitely idling" rather than permanently laying off workers.<sup>3</sup> The union is currently challenging GM in court.

Negotiations this year reportedly will focus on job security, COLAs for pensions, outsourcing, wage increases, overtime reductions, and reductions in overall work time. The last strike in the auto industry, which occurred in 1976 against Ford, involved 166,000 workers and lasted approximately three weeks.

At this point, information on wage developments in the third quarter is limited to average hourly earnings for July, which increased 0.6 percent. Sharp increases in services and finance, insurance, and real estate were only partly offset by moderate gains in manufacturing and construction. Over the past 12 months, this narrow measure of labor costs grew 4 percent, as it has since mid-1988.

#### Industrial Production

Total industrial production, which had increased a total of 1 percent over the preceding two months, was unchanged in July. Assemblies of both

---

3. The number of autoworkers is now 32,000 below the September 1987 level.

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

	Proportion in total IP 1989:Q4	1989	1990		1990			
		H2 <sup>1</sup>	H1 <sup>1</sup>	Q1	Q2	May	June	July
		-----Annual rate-----				---Monthly rate---		
Total index	100.0	-0.5	2.3	0.6	4.0	0.6	0.4	0.0
Excluding motor vehicles and parts	95.7	0.1	2.1	2.1	2.2	0.2	0.3	0.2
Major market groups:								
Products, total	61.2	-0.1	2.8	1.5	4.2	0.6	0.4	-0.4
Final products	46.6	-0.4	3.2	0.9	5.6	0.7	0.5	-0.5
Consumer goods	25.9	1.7	-0.1	-3.1	2.9	0.2	0.7	-0.4
Motor vehicles	1.4	-16.1	11.1	-36.1	93.0	10.3	6.9	-7.2
Other consumer goods	24.5	2.8	-0.7	-1.0	-0.5	-0.3	0.3	0.1
Business equipment	15.2	-3.6	8.3	6.6	10.1	1.6	0.2	-0.6
Motor vehicles	1.1	-13.9	14.2	-32.4	92.9	11.1	6.2	-7.7
Computers	2.5	2.8	14.9	18.2	11.7	-0.3	-0.5	-1.5
Aircraft	1.1	-18.5	49.5	92.2	16.3	1.0	1.0	1.3
Other	11.6	-3.9	6.4	8.7	4.2	1.1	-0.2	0.4
Construction supplies	6.0	1.4	-2.1	3.6	-7.5	-0.8	0.0	-1.1
Materials	38.8	-1.2	1.6	-0.6	3.8	0.5	0.5	0.7
Durable	19.8	-2.3	2.8	-1.1	6.9	1.5	0.6	0.5
Consumer parts	4.0	-9.8	3.0	-13.7	22.9	5.1	-0.3	0.1
Metals	2.8	-4.5	1.5	-3.7	6.9	-0.9	2.6	1.4
Nondurable	8.8	-0.9	1.2	1.3	1.1	-0.9	0.7	0.5
Chemicals	3.7	-2.5	2.2	5.2	-0.8	-2.0	1.8	0.7
Major industry groups:								
Manufacturing	84.9	-1.1	2.7	1.9	3.6	0.7	0.3	-0.1
Excluding motor vehicles and aircraft	77.8	0.4	1.7	2.3	1.2	0.3	0.1	0.2
Motor vehicles and parts	4.3	-14.4	7.1	-27.6	58.4	8.6	3.8	-4.8
Mining	7.4	-0.8	4.1	2.5	5.8	-0.3	0.0	1.0
Utilities	7.8	8.2	-5.4	-16.8	7.5	0.3	1.9	-0.4

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

PERCENT CHANGE IN ORDERS FOR MANUFACTURED GOODS<sup>1</sup>  
(For industries that report unfilled orders; seasonally adjusted)

	1990		1990		
	Q1	Q2	April	May	June
Durable goods excluding civilian aircraft, defense, and motor vehicles and parts	-0.2	1.2	-0.1	1.9	-2.4
Nonelectrical machinery	2.1	-2.5	-3.5	3.7	-2.5
Nondurable goods	2.8	2.3	1.4	-1.5	-0.9

1. Percent change from prior comparable period.

autos and trucks fell back last month, after rebounding in May and June. Excluding motor vehicles, total industrial output rose 0.2 percent in July, continuing the 2-1/4 percent annual rate of growth that has persisted since January.

In July, the gain in production outside of the motor vehicle industry was concentrated in further increases in industrial materials. Gains were spread among metals, paper, and chemical and energy materials. In contrast, output of construction supplies declined further, consistent with the weakness in building activity. Among final products, output of consumer goods other than motor vehicles changed little in July, as drops in the output of appliances and miscellaneous home goods largely offset small increases in most categories of nondurable goods. Production of both defense equipment and business equipment other than motor vehicles was unchanged. Within business equipment, output of industrial equipment and equipment used in commercial aircraft rose while production of information processing equipment declined for a second month.

In the second quarter, total IP is now estimated to have grown at an annual rate of 4.0 percent--boosted almost 2 percentage points by a rise in assemblies of motor vehicles and parts. Increased production at industries that supply materials to automakers likely contributed an additional 1 percentage point to total IP growth.

Capacity utilization in total industry declined 0.2 percentage point in July to 83.4 percent. The rates for manufacturing and utilities declined, while the rate for mining increased about 1 percentage point. The rise in operating rates for mining reflected gains in production of coal, metal ores, and crude oil. Within manufacturing, utilization in advanced



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

	1967-89	1978-79	1988-89	1990			
	Avg.	High	High	Jan.	May	June	July
Total industry	82.2	87.3	85.0	82.7	83.4	83.6	83.4
Manufacturing	81.5	87.3	85.1	82.0	82.8	82.9	82.6
Primary processing	82.3	89.7	89.0	85.7	84.9	85.2	85.5
Textile mill products	86.0	90.5	91.2	86.9	88.1	88.2	87.5
Lumber and products	82.7	87.6	91.2	86.3	81.7	81.3	80.9
Pulp and paper	92.2	98.2	97.7	93.1	90.7	91.2	93.7
Chemicals and products	79.8	85.1	86.8	82.6	81.1	81.4	81.5
Petroleum products	85.1	89.5	90.3	89.7	86.4	89.0	90.5
Stone, clay and glass	78.3	87.0	86.4	85.3	82.1	81.5	80.3
Primary metals	79.8	102.4	91.6	82.6	83.4	86.0	87.3
Iron and steel	79.4	110.4	92.0	79.3	79.9	84.4	86.2
Nonferrous metals	80.8	90.5	95.0	87.8	88.8	88.6	89.0
Fabricated metal products	77.7	83.9	85.1	80.8	81.8	81.5	81.8
Advanced processing	81.1	86.3	83.6	80.5	82.0	81.9	81.4
Furniture and fixtures	82.7	86.6	88.3	84.5	86.4	85.9	86.1
Nonelectrical machinery	81.3	92.1	83.5	81.9	82.8	82.1	81.5
Electrical machinery	80.4	89.4	83.1	80.5	80.8	80.9	80.3
Motor vehicles and parts	76.7	93.0	85.5	58.1	77.9	80.7	76.7
Aerospace and miscellaneous transport equipment	75.3	80.5	86.2	83.4	84.5	84.3	84.7
Instruments	83.1	92.5	83.9	79.8	79.1	78.2	78.4
Mining	87.3	95.2	87.2	87.8	89.0	89.1	90.2
Utilities	86.8	88.3	92.3	84.8	84.7	86.2	85.7
Electric utilities	89.0	88.3	96.2	89.5	90.5	92.2	91.7

processing industries fell, while that in primary processing industries rose slightly to 85.5 percent. Operating rates increased notably for pulp and paper, petroleum refining, and steel in June and July.

Over the past year, capacity utilization trends have mirrored the patterns in production. Manufacturing utilization fell 2-1/2 percentage points between the second quarter of 1989 and January 1990. Since then the factory operating rate has remained in a narrow range between 82.5 percent and 83.0 percent. Aside from primary aluminum ingot, which is being exported in volume, utilization rates for metals, paper, chemicals, plastics and synthetic fibers, petroleum refining, lumber and stone, clay, and glass are significantly below earlier cyclical highs.

The runup in crude oil prices, if sustained, is likely to result in an increase in domestic exploration activity. As of July, 1,071 rotary rigs were in operation in this country, up from a low of 870 last year but well below the peak of almost 4,000 in 1981. Similarly, oil and gas well footage drilled has recovered a bit from its 1989 trough but still is only one-third of its pace in 1981. Industry contacts suggest that if crude oil prices were to rise to about the \$30 per barrel mark, rotary rigs in use might increase to a bit more than 1,500 within 12 months. A lack of skilled labor in the drilling and supplier industries is thought to be a constraint on the rate at which exploration activity can be expanded.

#### Personal Consumption Expenditures

Total retail sales are estimated to have edged up 0.1 percent in July in nominal terms according to the advance report from the Census Bureau. In the control category, which excludes automotive dealers and building material and supply stores, sales in July were essentially unchanged from

RETAIL SALES  
(Seasonally adjusted percentage change)

	1989	1990		1990		
	Q4	Q1	Q2	May	June	July
Total sales	- .4	2.7	- .9	- .1	1.1	.1
Previous estimate <sup>1</sup>			-1.4	- .6	.5	
Retail control <sup>2</sup>	1.2	2.3	.0	- .2	1.0	- .0
Previous estimate <sup>1</sup>			- .5	- .7	.6	
GAF <sup>3</sup>	1.3	2.4	- .7	- .4	2.0	.8
Previous estimate <sup>1</sup>			-1.1	- .5	1.2	
Durable goods stores	-3.2	3.7	-3.1	- .2	.4	.3
Previous estimate <sup>1</sup>			-3.3	- .3	- .1	
Automotive dealers	-5.0	3.7	-3.6	.1	.6	- .6
Furniture and appliances	.8	2.8	- .3	- .4	-1.4	2.5
Other durable goods	-1.1	4.0	-3.2	- .5	.9	.9
Nondurable goods stores	1.2	2.1	.4	.0	1.5	- .0
Previous estimate <sup>1</sup>			- .3	- .7	.9	
Apparel	.4	1.0	2.0	2.8	2.1	- .9
Food	1.2	1.6	1.1	- .6	.7	.4
General merchandise <sup>4</sup>	1.9	2.8	-2.1	-1.8	3.5	.8
Gasoline stations	1.5	2.4	- .7	1.0	1.0	- .3
Other nondurables <sup>5</sup>	1.0	2.4	1.1	.6	1.1	- .6
<u>Memo:</u>						
Motor vehicle sales <sup>6</sup>	13.1	14.4	14.0	13.8	14.3	14.4
Autos	8.8	9.8	9.5	9.4	9.8	9.7
Light trucks	4.3	4.6	4.4	4.4	4.5	4.7

1. Based on incomplete sample counts approximately one month ago.

2. Total retail sales less building material and supply stores and automotive dealers, except auto and home supply stores.

3. General merchandise, apparel, furniture, and appliance stores.

4. General merchandise excludes mail order nonstores; mail order sales are also excluded in the GAF grouping.

5. Includes sales at eating and drinking places, drug and proprietary stores.

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

their June level. The July sales results were mixed across categories of stores, with increases at food stores, general merchandise outlets, and furniture and appliance stores offsetting declines at apparel stores, and at miscellaneous other durable and nondurable goods stores.<sup>4</sup>

The July retail sales report also contained large upward revisions to the estimates for May and June. Growth in sales during those months now is estimated at -0.2 percent and 1.0 percent, respectively, a cumulative upward adjustment of 0.9 percent. The revisions were concentrated among nondurable goods stores and were especially large in dollar terms at food stores. For the second quarter as a whole, previous estimates had shown a decline in the retail control grouping of roughly 2 percent at an annual rate; the revised data now show the second-quarter level as about unchanged from the first quarter. This upward revision likely will be translated by the BEA into a sizable upward adjustment in second-quarter real personal consumption expenditures--perhaps as much as \$6 billion, which would boost estimated growth in total real PCE during the quarter from a decline of 1/4 percent at an annual rate to an advance of about 1/2 percent.

Despite the upward revision to second-quarter PCE, we still expect the revised data to show real outlays for goods declining during the first half of 1990 at about a 1 percent annual rate. In contrast, outlays for services are estimated to have grown so far this year at a 3-1/2 percent average annual rate.

---

4. Included among "other durable goods stores" are camera and photographic supplies stores, sporting goods stores, optical goods stores, and book stores. The "other nondurable goods store" category includes eating and drinking places, drug and proprietary stores, fuel and ice dealers, florist shops, vending machines, and house-to-house canvassers.

SALES OF AUTOMOBILES AND LIGHT TRUCKS<sup>1</sup>  
(Millions of units at an annual rate, BEA seasonals)

	1988	1989	1990	1990	1990		
			Q1	Q2	May	June	July
Autos and light trucks	15.4	14.5	14.4	14.0	13.8	14.3	14.4
Autos	10.6	9.9	9.8	9.5	9.4	9.9	9.7
Light trucks	4.8	4.6	4.6	4.4	4.4	4.5	4.7
Domestically produced <sup>2</sup>	11.7	11.2	11.2	10.8	10.6	11.1	11.5
Autos	7.5	7.1	7.0	6.8	6.7	7.1	7.1
Light trucks	4.2	4.1	4.1	4.0	3.9	4.0	4.3
Imports	3.7	3.3	3.2	3.2	3.2	3.2	2.9
Autos	3.1	2.8	2.8	2.7	2.7	2.7	2.5
Light trucks <sup>3</sup>	.6	.5	.4	.4	.5	.5	.4

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.

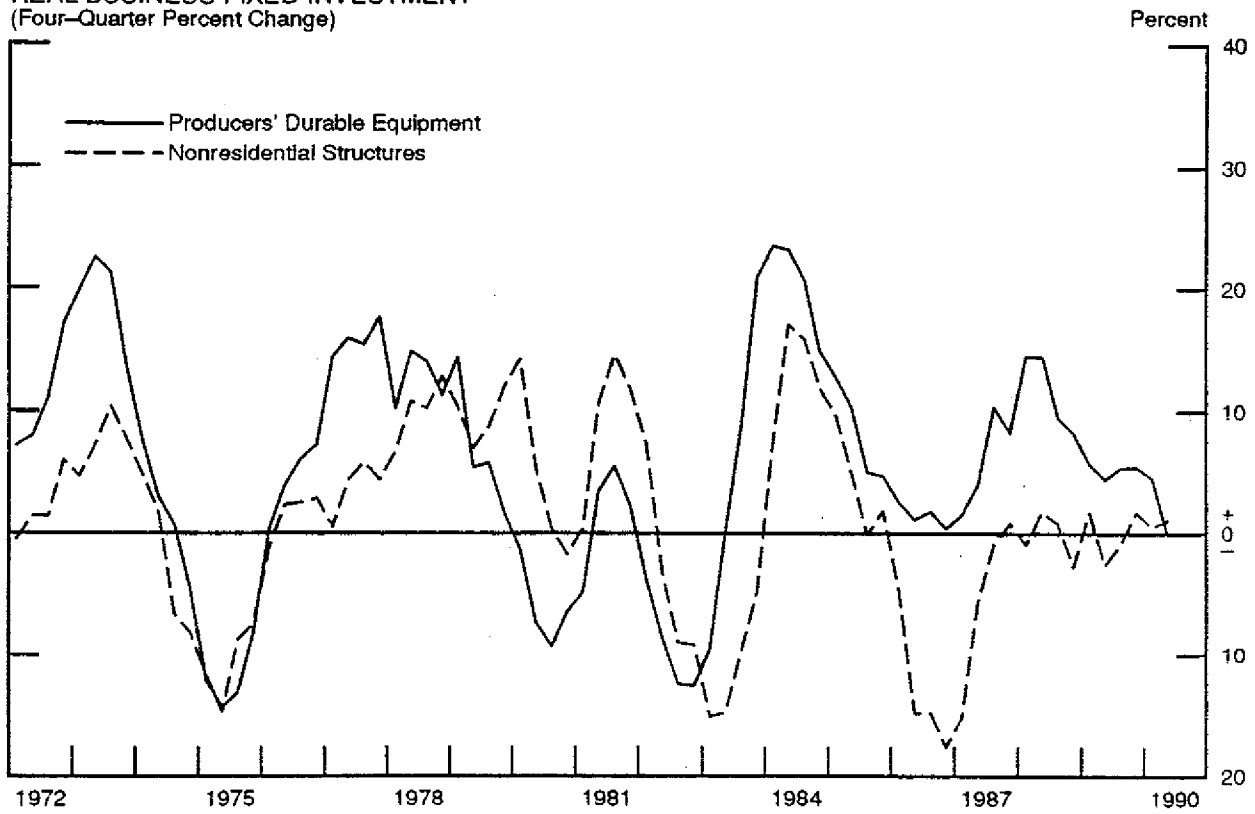
Autos and Light Trucks

In contrast to spending on other goods and services, demand for motor vehicles has been well maintained so far this year, and apparently it firmed a bit in June and July. Sales of domestically produced and imported autos during the past two months averaged 9-3/4 million units, while sales of light trucks averaged slightly more than 4-1/2 million units.

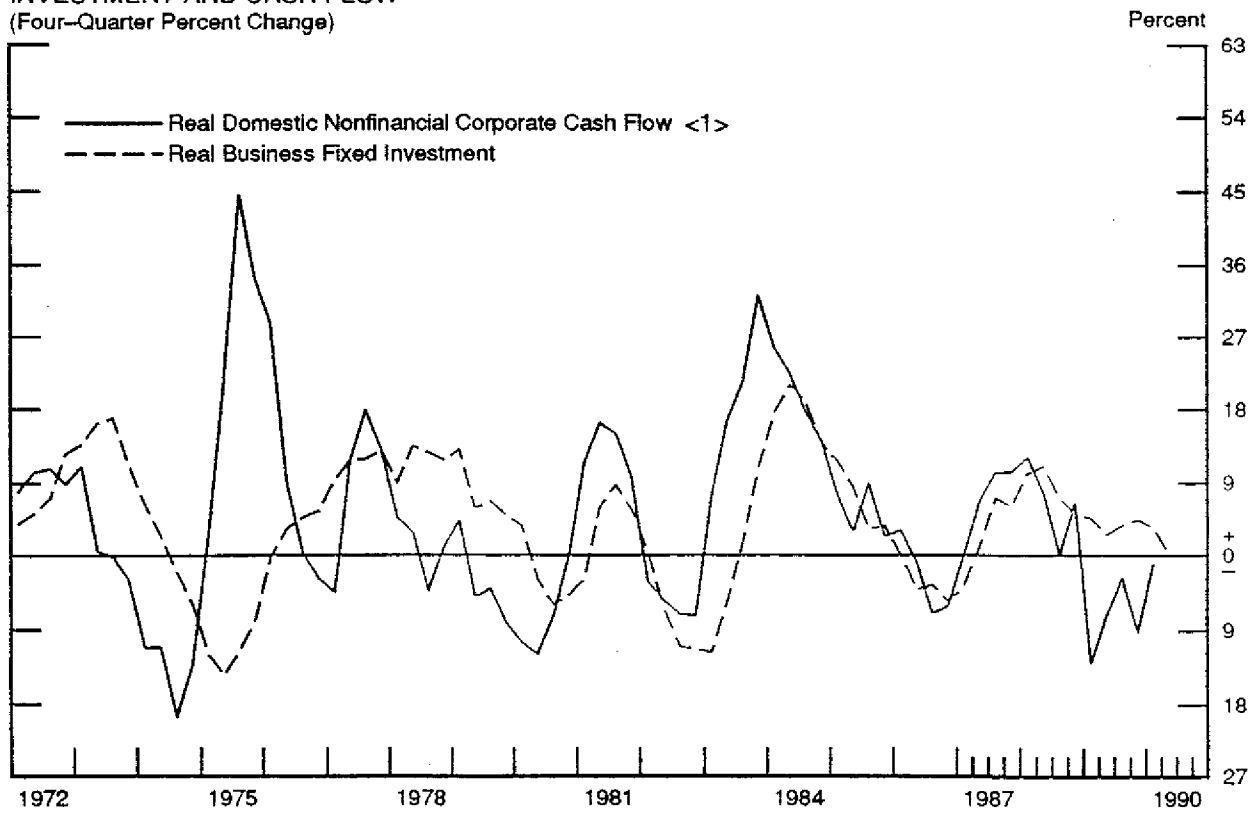
As of mid-July, 95 percent of vehicles sold by the Big Three automakers were covered by incentive programs; the average value of the incentives per vehicle was \$1,010--nearly equal (in nominal terms) to the record-high average for the third quarter of 1989. The low level of inventories currently on hand suggests that the domestic automakers probably will not have to sweeten current programs substantially to clear out 1990 stocks. Indeed, inventories of domestically produced automobiles at the end of July stood at an estimated 1.1 million units (BEA basis), the lowest level since mid-1983. In recent years, the only time that automakers did not stage a big end-of-model-year clearance sale was in 1988, when inventory accumulation had been held in check by cautious scheduling of assemblies after the 1987 stock market crash.

Although production schedules for the third quarter currently call for a substantial increase in assemblies to 7.8 million units (BEA seasonals), production was likely held down in August by a five-day walkout of workers at a General Motors plant in Flint, Michigan, which ended this week. Consistent with the corporation's move in recent years toward just-in-time inventory control, the disruption in the supply of parts began almost immediately to affect assembly operations, and, over the course of the

**REAL BUSINESS FIXED INVESTMENT**  
(Four-Quarter Percent Change)



**INVESTMENT AND CASH FLOW**  
(Four-Quarter Percent Change)



1. Excluding dividends. With inventory valuation adjustment and capital consumption adjustment.

strike, total vehicle assemblies are estimated to have been reduced by about 300,000 units at an annual rate.

#### Business Fixed Investment

According to BEA's advance estimate, real business fixed investment fell 6 percent at an annual rate in the second quarter--reflecting moderate declines for both equipment and structures.<sup>5</sup> Decreased purchases of industrial equipment accounted for more than half of the second-quarter fall in equipment spending, although almost every other major category of equipment edged down as well. In nonresidential structures, office and other commercial construction continued to fall in the second quarter, with some offset from institutional building.

Although not as weak as last quarter's decline would suggest, the underlying trend in investment is decidedly sluggish (chart). From the second quarter of 1989 to the second quarter of this year, equipment outlays posted no growth, as increases in spending on computers offset declines in purchases of industrial equipment and motor vehicles. Similarly, second-quarter outlays on nonresidential structures were essentially unchanged from the level of a year earlier as modest gains in drilling and mining and industrial building offset declines in the commercial sector.

Recent indicators suggest that business investment will continue to post little or no growth in the near term. With regard to equipment, the nominal value of orders for nondefense capital goods (excluding aircraft)

---

5. The recent revisions to shipments of nondefense capital goods during May and June were small and suggest little change in BEA's estimate of PDE spending in the second quarter. In contrast, construction put-in-place in June was much stronger than BEA's assumption, and data for April and May were revised up. This implies about a \$2-1/2 billion upward revision to real NRS in the second quarter, producing a growth rate of about 2 percent at an annual rate.



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

	1989	1990		1990		
	Q4	Q1	Q2	Apr.	May	June
<u>Producers' durable equipment</u>						
Shipments of nondefense capital goods	-2.7	4.8	-.9	-2.4	.0	3.6
Excluding aircraft and parts	-.4	2.8	-1.6	-4.4	.3	1.0
Office and computing	-2.1	4.0	-1.4	-4.0	-1.1	3.8
All other categories	.1	2.5	-1.7	-4.5	.7	.3
Weighted PDE shipments <sup>1</sup>	.8	2.4	-1.6	-3.5	.3	.2
Shipments of complete aircraft <sup>2</sup>	-42.0	67.5	n.a.	59.0	-10.2	n.a.
Sales of heavy-weight trucks	-4.7	-.6	-5.9	-7.6	4.1	1.6
Orders of nondefense capital goods	4.7	-3.3	-5.8	-10.6	-1.8	.6
Excluding aircraft and parts	2.2	.5	-1.5	-1.1	.1	-1.4
Office and computing	-2.5	1.8	-1.5	-3.6	-.8	-3.7
All other categories	3.4	.3	-1.5	-.5	.3	-.8
Weighted PDE orders <sup>1</sup>	2.6	.1	-.8	-.5	.3	-1.2
<u>Nonresidential structures</u>						
Construction put-in-place	-.1	1.0	.6	-.9	-.4	3.2
Office	-3.1	-4.0	-3.2	-2.5	-3.4	9.9
Other commercial	2.9	-1.5	-3.3	-2.5	-.8	.6
Public utilities	2.4	2.2	1.6	-.4	.9	.6
Industrial	-1.2	8.2	2.8	.3	-.8	2.1
All other	-2.4	2.5	5.3	.7	1.1	3.8
Rotary drilling rigs in use	-2.7	2.3	21.6	8.5	5.5	3.1

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.

fell 1-1/2 percent (not an annual rate) in the second quarter, after increasing 1/2 percent in the first quarter. The second-quarter decline reflected reduced nominal orders for virtually every type of nonelectrical machinery, although in real terms, computer purchases are likely to rebound. Moreover, outlays for aircraft should remain on an uptrend, providing some support for gains in real equipment purchases in the current quarter.

Advance indicators for nonresidential structures paint a generally weak picture. Construction permits and contracts have trended down during the past year in most sectors (chart). Although office construction activity reportedly rose in June, the sector remains quite weak. In contrast, the Baker-Hughes count of oil and gas rigs in use is up significantly this year. The outlook for increases in drilling activity over the near term is quite favorable given the recent oil price developments.

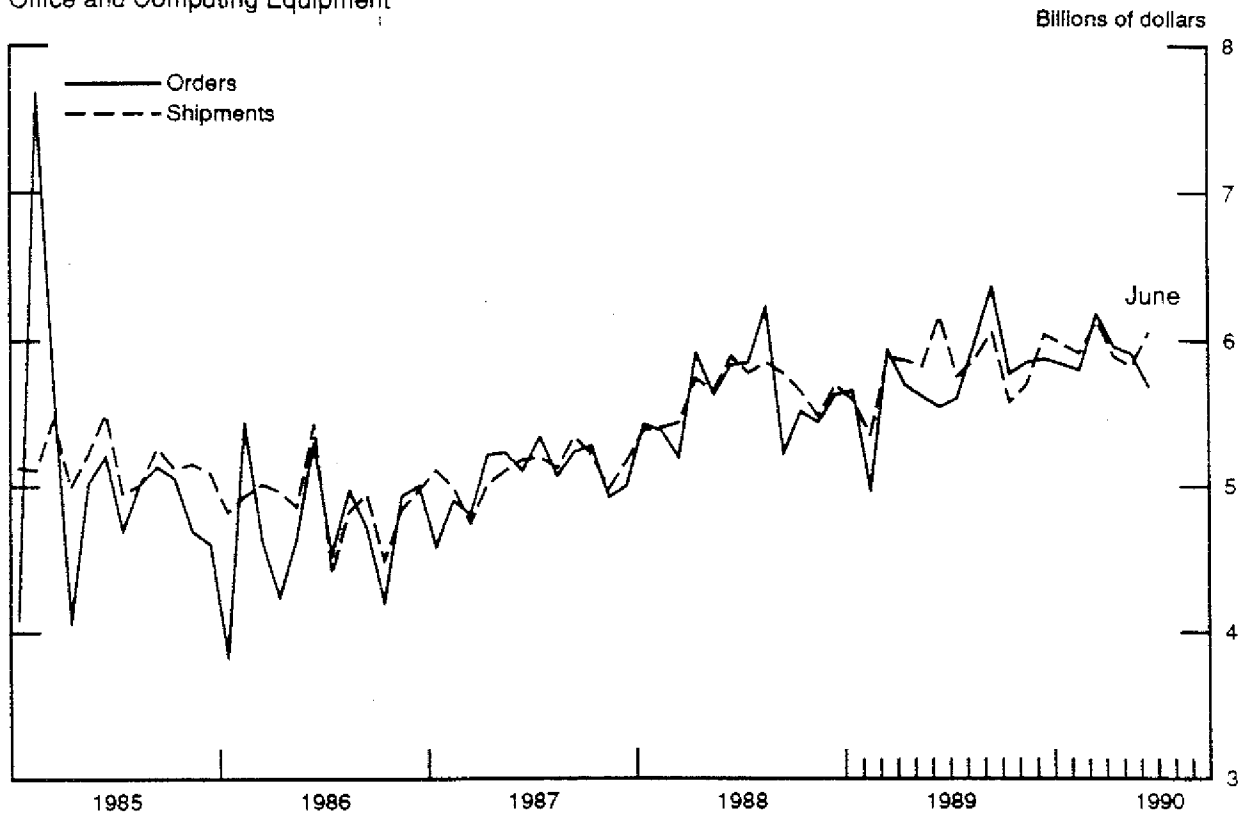
In addition to the indicators discussed above, potential constraints on both internal and external finance also may be affecting investment spending in the near term. Growth in real gross business fixed investment and real cash flow have moved together in recent years (chart), with cash flow generally leading investment in the 1980s by one or two quarters.<sup>6</sup> The decline in internal cash flow during the past year likely has been a factor restraining capital spending thus far in 1990, and is likely to restrain expenditures in coming months. With regard to external finance, anecdotal reports suggest cutbacks in lending for commercial real estate developments, and construction put-in-place data for the second quarter indicate reductions in building activity in this area. Outside of the commercial

---

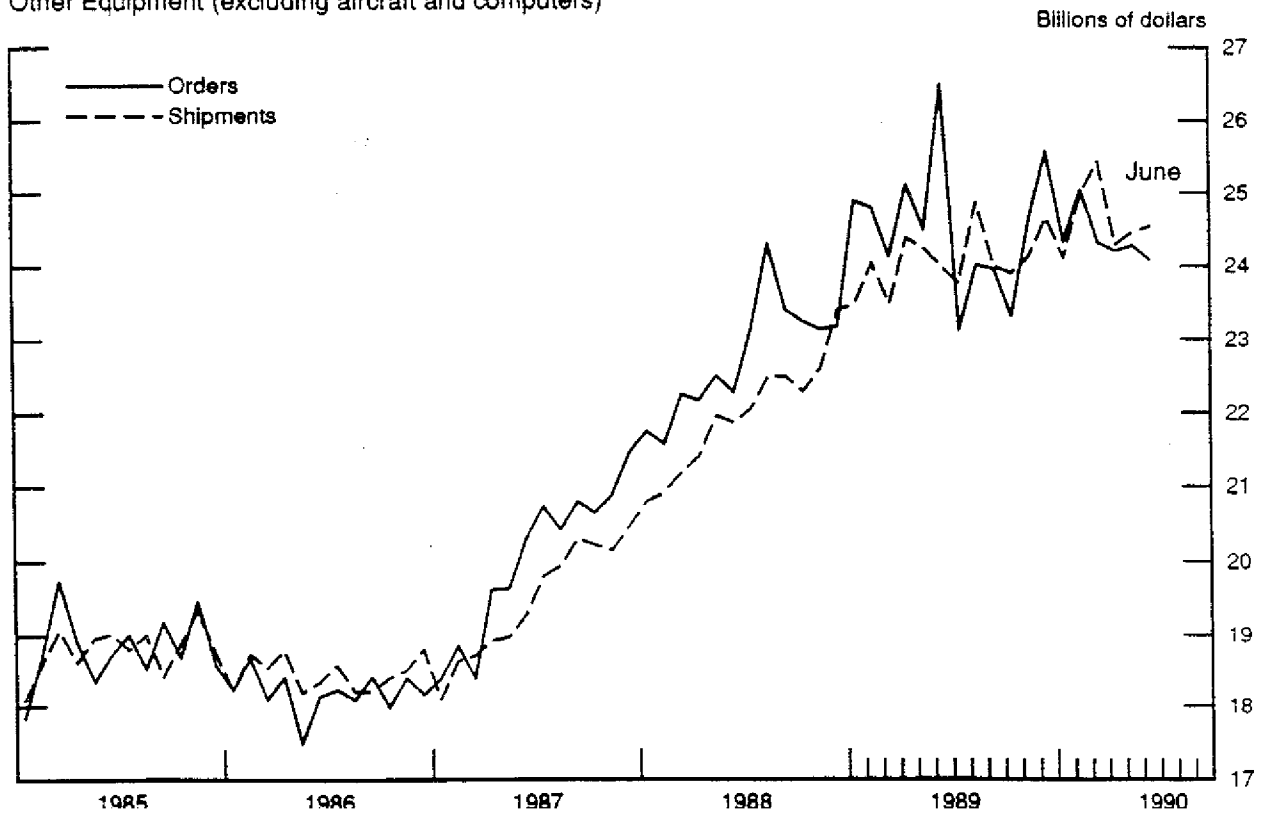
6. Cash flow is defined here as the sum of undistributed after-tax profits and capital consumption allowances, with capital consumption and inventory valuation adjustments.

### RECENT DATA ON ORDERS AND SHIPMENTS

Office and Computing Equipment



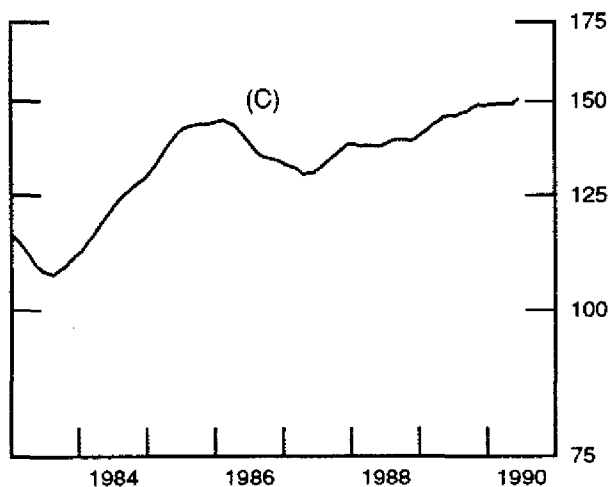
Other Equipment (excluding aircraft and computers)



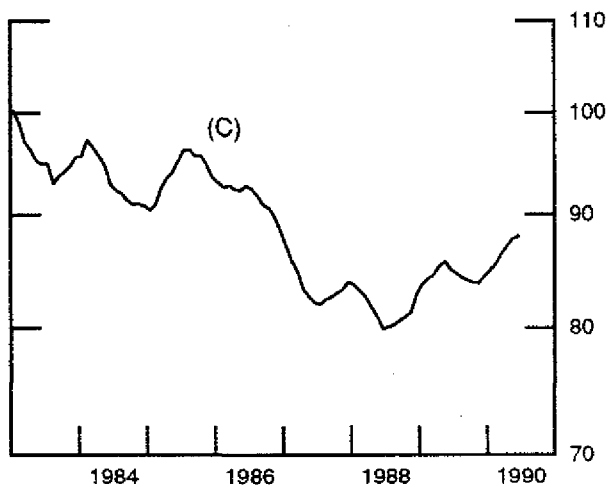
### NONRESIDENTIAL CONSTRUCTION AND SELECTED INDICATORS <1>

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

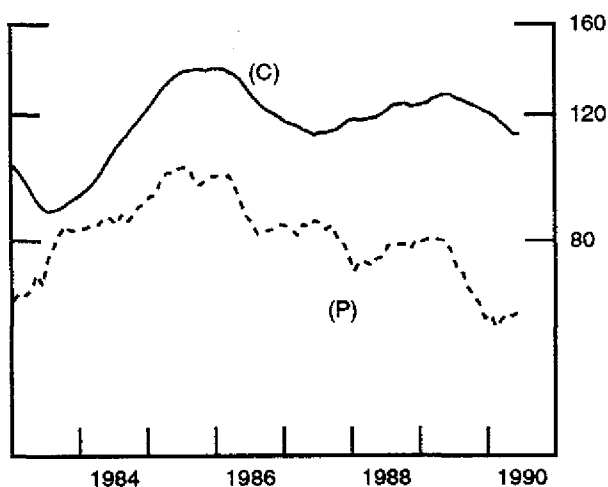
Total



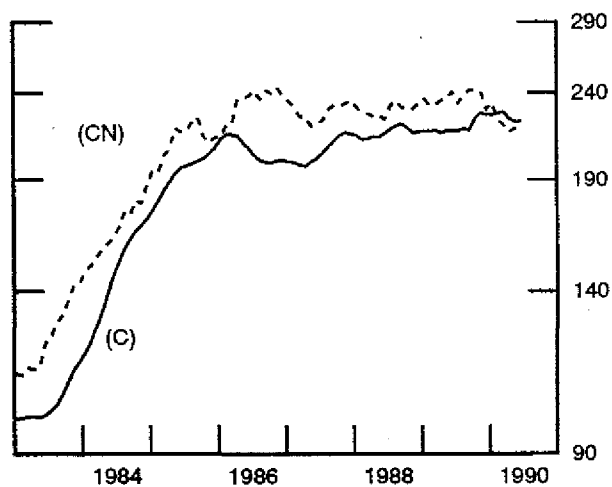
Public Utilities



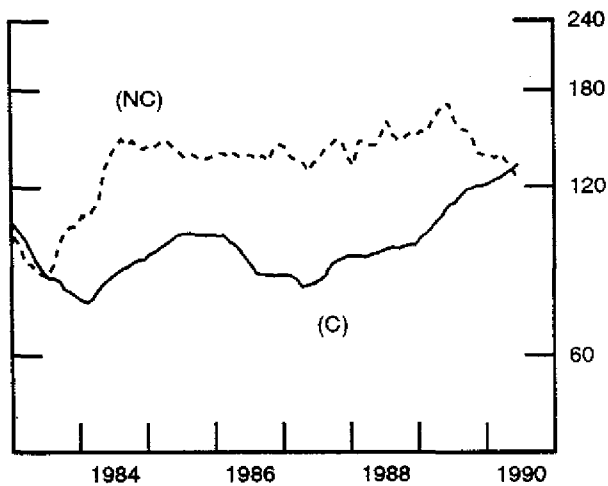
Office



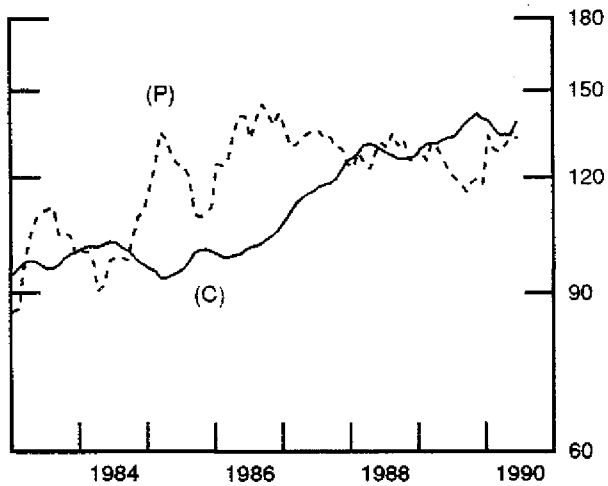
Other Commercial



Industrial



Institutional



<1> Six month moving average for all series shown; data end in June 1990.

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

	1989	1990		1990		
	Q4	Q1	Q2	Apr.	May	June
Current-cost basis:						
Total	13.2	-7.0	14.5	28.6	52.2	-37.2
Total excluding retail auto	27.7	9.1	12.3	36.0	43.2	-42.3
Manufacturing	.8	2.7	-4.9	6.6	1.0	-22.3
Wholesale	14.9	2.2	9.1	18.5	27.6	-18.7
Retail	-2.5	-11.8	10.3	3.4	23.6	3.8
Automotive	-14.5	-16.1	2.2	-7.4	9.0	5.1
Excluding auto	12.0	4.3	8.1	10.9	14.6	-1.3
Constant-dollar basis:						
Total	14.2	-25.0	n.a.	27.6	30.0	n.a.
Total excluding retail auto	6.9	-2.4	n.a.	33.3	28.5	n.a.
Manufacturing	-5.7	1.7	n.a.	13.2	2.1	n.a.
Wholesale	7.7	-1.1	n.a.	13.8	22.9	n.a.
Retail	12.2	-25.6	n.a.	.6	5.0	n.a.
Automotive	7.3	-22.6	n.a.	-5.7	1.5	n.a.
Excluding auto	4.9	-3.0	n.a.	6.3	3.5	n.a.

n.a. Not available.

INVENTORIES RELATIVE TO SALES<sup>1</sup>  
(Months supply; based on seasonally adjusted data)

	1989		1990		1990			
	Q4	Q1	Q2	Apr.	May	June		
Range in preceding 12 months: <sup>2</sup>								
	Low	High						
Current-cost basis:								
Total	1.47	1.53	1.51	1.49	1.48	1.49	1.49	1.46
Total excluding retail auto	1.45	1.50	1.48	1.46	1.45	1.47	1.46	1.44
Manufacturing	1.56	1.65	1.60	1.60	1.56	1.59	1.56	1.54
Wholesale	1.24	1.28	1.27	1.25	1.25	1.26	1.27	1.24
Retail	1.55	1.62	1.62	1.55	1.59	1.57	1.59	1.57
Automotive	1.81	2.07	2.04	1.84	1.92	1.89	1.91	1.92
Excluding auto	1.46	1.51	1.50	1.48	1.50	1.49	1.50	1.48

1. Ratio of end of period inventories to average monthly sales for the period. Constant-dollar ratios are not available because sales data are under revision.

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.

construction sector, however, tightened lending standards or reduced availability of external funds do not appear to have had a significant effect on investment in the first half of this year.

#### Business Inventories

Business inventory investment was moderate in the second quarter, and, at the current pace of sales, imbalances do not seem to be widespread. Excluding retail auto dealers, manufacturing and trade inventories rose in the second quarter at a \$12.3 billion annual rate, a pace similar to the average pace of stockbuilding in the first three months of 1990. The inventory-sales ratio edged down to 1.45 months in the second quarter, at the low end of the range over the past year. Nonetheless, there was substantial variation in the pace of inventory accumulation over the course of the second quarter, as manufacturing and trade stocks excluding auto dealers fell at a \$42.3 billion annual rate in current-cost terms in June, after an average increase of about \$40 billion in April and May.<sup>7</sup>

In the retail trade sector, nonauto inventories fell at a \$1.3 billion annual rate in current-cost terms in June, following average increases of about \$13 billion per month in April and May. For the second quarter as a whole, nonauto retail trade stocks increased \$8 billion, with the bulk of the increase occurring at stores that sell durable goods, food, and apparel. With the gains in sales, stock-sales ratios dropped back in June after widespread increases in April and May. On the whole, there did not appear

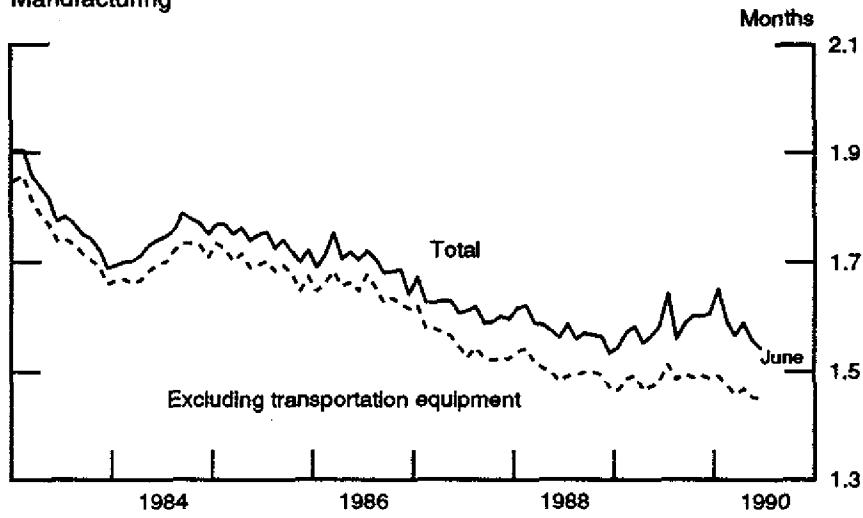
---

7. In its advance report of GNP, BEA assumed a \$5 billion current-cost increase in June in manufacturing and trade inventories excluding retail autos. Based on the actual current-cost data, the staff expects a sizable downward revision to nonfarm inventory investment (in constant dollars) in BEA's preliminary GNP estimate for the second quarter.

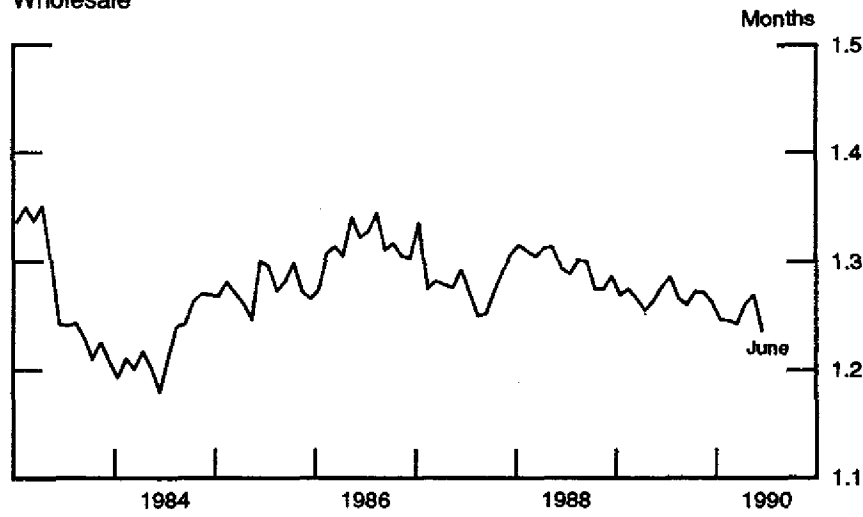
### RATIO OF INVENTORIES TO SALES

(Current-cost data)

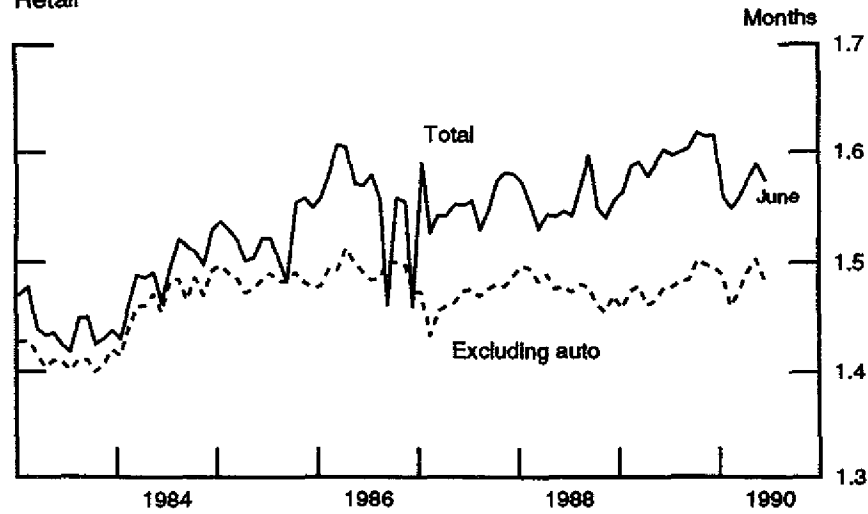
#### Manufacturing



#### Wholesale



#### Retail



to be serious imbalances in retail inventories at the end of the second quarter.

In wholesale trade, machinery and miscellaneous nondurable goods accounted for the bulk of the second-quarter accumulation. Because roughly one-fourth of the machinery stocks at the wholesale level consists of construction machinery, the accumulation of inventories in this category may, in part, reflect the widespread weakness in the construction industry. As for the diverse miscellaneous nondurable goods category, the rise in stocks in the second quarter reversed declines during the previous two quarters. Indeed, the level of wholesale nondurable miscellaneous stocks at the end of June was little changed from a year earlier.

In manufacturing, inventory drawdowns in June (in current-cost terms) more than reversed buildups in April and May. The bulk of the liquidation occurred in stocks held by two key industries--machinery and transportation equipment. Moreover, stage-of-processing data indicated that a significant portion of the June reduction was in materials and work-in-process inventories in the machinery industry. Given the relatively large accumulation of machinery stocks at the wholesale level in April and May, the runoff in the manufacturing sector in June may reflect some intended inventory adjustments upstream in the overall channel of machinery production and distribution. Thus far, there has been no evidence of excess buildup of finished goods inventories in the manufacturing sector, and the overall inventory-to-shipments ratio has continued to trend down (chart, upper panel).



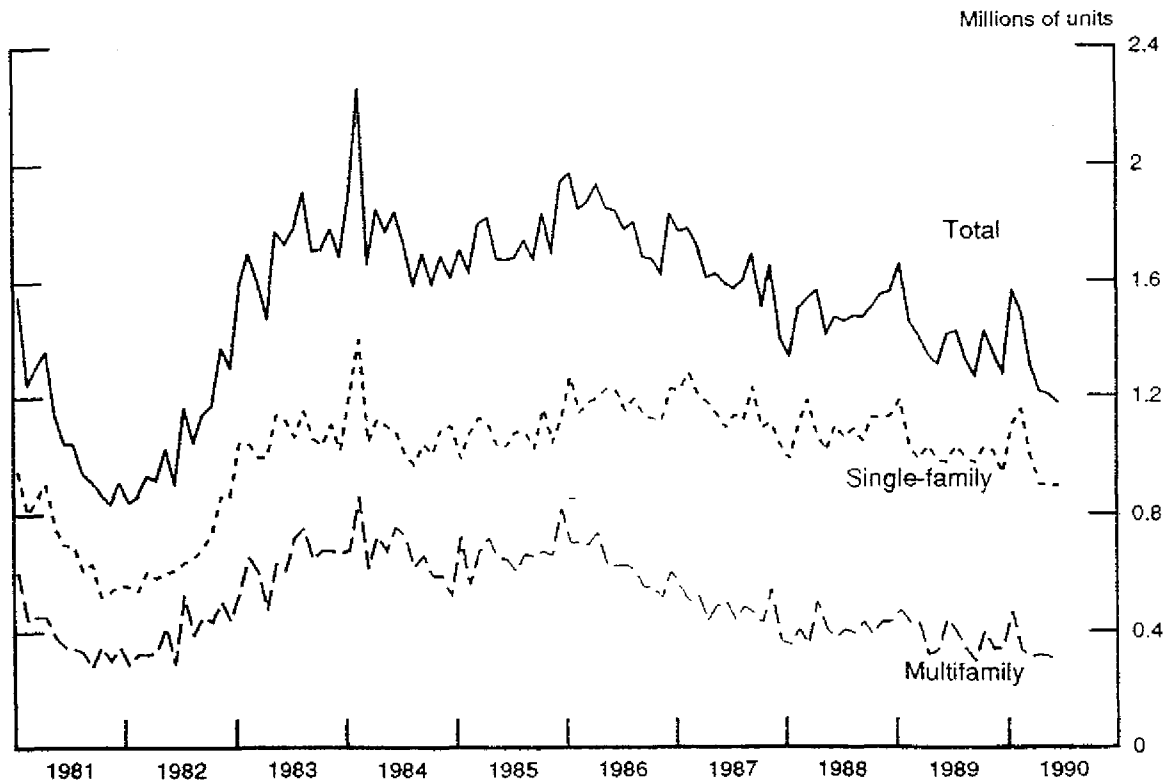
II-28  
PRIVATE HOUSING ACTIVITY  
(Seasonally adjusted annual rates; millions of units)

	1989	1989	1990		1990		
	Annual	Q4	Q1	Q2 <sup>P</sup>	Apr. <sup>r</sup>	May <sup>r</sup>	June <sup>P</sup>
<b>All units</b>							
Permits	1.34	1.38	1.42	1.09	1.11	1.07	1.11
Starts	1.38	1.35	1.45	1.20	1.22	1.21	1.18
<b>Single-family units</b>							
Permits	.93	.98	.96	.80	.81	.80	.80
Starts	1.00	.99	1.08	.89	.90	.89	.89
<b>Sales</b>							
New homes	.65	.65	.59	.55	.53	.54	.58
Existing homes	3.44	3.54	3.44	3.32	3.33	3.30	3.34
<b>Multifamily units</b>							
Permits	.41	.41	.47	.29	.30	.26	.31
Starts	.37	.36	.37	.31	.32	.31	.29
<b>Vacancy rate<sup>1</sup></b>							
Rental units	9.3	8.8	9.4	8.5	n.a.	n.a.	n.a.
Owned units	7.1	6.8	7.6	7.9	n.a.	n.a.	n.a.

1. Percent. Owned units consist mainly of condominiums. All vacancy rate data are revised.

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

PRIVATE HOUSING STARTS  
(Seasonally adjusted annual rate)



Housing Markets

Residential construction activity remained weak in June, as total housing starts edged down further to an annual rate of 1.18 million units. In the single-family sector, starts were about unchanged at 892,000 units in June--despite a decline in mortgage interest rates during May. On the demand side, sales of new homes increased somewhat in June, but remained at a comparatively low level. The firming of sales resulted in some drawdown in the stock of homes for sale; however, for the second quarter overall, the weakness of sales caused the months' supply of new homes to rise to its highest level since mid-1982.

More than likely, the reduced demand for single-family homes partly reflects damped expectations of house price appreciation. The constant-quality new home price index was about unchanged in the second quarter from its year ago level. In June the average price of new homes sold (not quality adjusted) was down slightly from its year-earlier level, while the median price of new homes was up 6 percent. This pattern of larger increases in median prices indicates that new home demand is relatively weak in the upper part of the price distribution and is consistent with anecdotal reports of weak sales and swollen inventories of homes for sale in that price range.<sup>8</sup>

On a regional basis, new home sales in the Northeast were about 5 percent lower during the first half of 1990 than their 1989 average, while sales declined 10 to 18 percent in other areas of the country. During the same period, median new home prices increased 5 to 8 percent in the Midwest,

---

8. This pattern holds for each region as well as nationally. Therefore, shifting geographic composition of sales does not account for the different rates of increase in average and median prices.

South, and West but have fallen 4 percent in the Northeast. The weakness of prices in the Northeast suggests that the relative stability of sales there may reflect the price concessions being offered by builders to help reduce bulging inventories of new homes.

In the multifamily sector, construction activity remained weak. Starts dropped 9 percent further in June to 285,000 units--the lowest level since early 1982. However, with multifamily construction slow for the past three and one-half years, some progress seems to have been made toward working off the persistent overstock of rental units. The vacancy rate for multifamily rental properties during the second quarter declined almost 1 percentage point to 8.5 percent.

#### Federal Sector

According to BEA's advance estimates, real federal purchases of goods and services, excluding the CCC, rose at an annual rate of 5.4 percent during the second quarter. Nondefense purchases grew at an annual rate of 11.7 percent during this period, owing partly to spending on the decennial census. Real defense purchases increased more than 3 percent at an annual rate. Increases in defense are not expected to continue, given that nominal spending in this category is constrained by flat budget appropriations for procurement and for operations and maintenance over the past five years. "Operation Desert Shield" is expected to have only a small effect on defense spending in the near term because it is composed mainly of personnel and operations and maintenance expenditures that have already been incorporated into this year's budget or can be accommodated by reallocating existing outlay plans. As yet, no "imminent danger pay" has been authorized for the vast majority of the military personnel involved in the operation.

In June, the federal government recorded an \$11 billion deficit, compared with an \$8 billion surplus in the same month of 1989. Rising payments by the Resolution Trust Corporation for the thrift bailout accounted for the increase. For the October-to-June period, the deficit stood at \$163 billion, compared with \$105 billion during the same period a year earlier. The increase reflects sluggish receipts growth, surging deposit insurance outlays, and growth in most other outlay functions with the exception of defense and agriculture.<sup>9</sup>

Net spending by the RTC totaled \$23 billion in the second quarter, compared with a \$4-1/2 billion average pace during the previous two quarters. The Oversight Board approved a \$36 billion net spending plan (\$41 billion in resolutions and advances less \$5 billion in REFCORP borrowing) for the July-to-September period to resolve another 77 cases. Both RTC Chairman Seidman and Under Secretary of the Treasury Glauber have suggested that RTC will hit its obligation limits in the fourth quarter.<sup>10</sup>

The Office of Management and Budget released its Mid-Session Review of the Budget showing a deficit estimate of \$219 billion for FY1990--\$161 billion excluding RTC (see appendix B for details). The GRH baseline deficit estimate for FY1991 of \$148 billion implies an \$84 billion sequester if no further legislation is passed by October 15, or roughly \$100 billion

---

9. Deposit insurance outlays were \$31 billion higher than a year earlier.

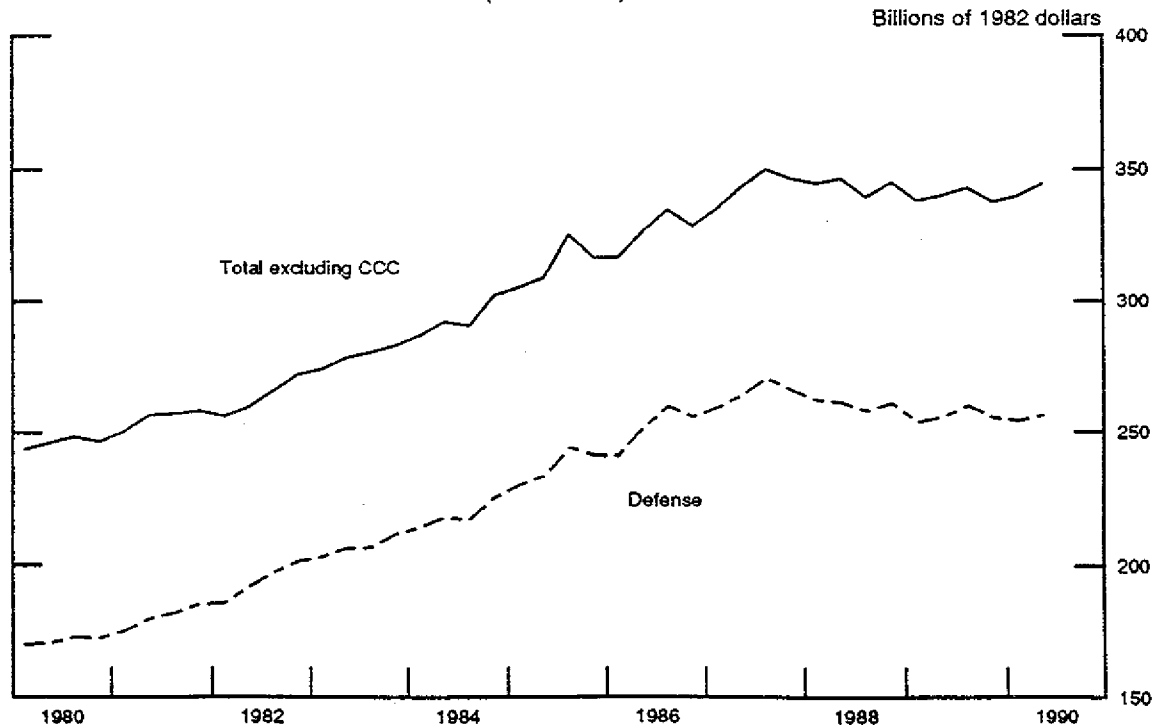
10. Under the currently implemented interpretation of FIRREA's "note cap" provision, RTC is essentially required to keep a 15 percent capital cushion, denominated in unused REFCORP funds, against working capital borrowing. This requirement effectively prevents full use of the original \$50 billion spending authority and could stop RTC activity in early October if planned third-quarter resolutions are carried out and Congress does not approve additional budget authority.

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

	June		October-June			
	1989	1990	FY1989	FY1990	Net change	Percent change
	Outlays	100.5	121.8	854.5	940.8	86.3
National defense	29.0	27.9	227.7	226.5	-1.2	-0.5
Net interest	13.4	14.5	125.6	135.4	9.8	7.8
Social Security	22.3	24.0	174.2	186.0	11.8	6.8
Medicare and health	12.4	13.8	98.8	114.2	15.4	15.6
Income security	9.8	11.0	103.2	112.8	9.6	9.3
Deposit insurance	1.5	17.5	10.8	41.9	31.1	288.5
Agriculture	0.5	0.2	16.8	11.4	-5.4	-32.0
Other	11.5	13.0	97.5	112.7	15.1	15.5
Receipts	108.3	110.6	749.1	777.7	28.6	3.8
Personal income taxes	49.9	49.6	334.4	350.3	15.9	4.8
Social insurance cont.	31.3	34.3	273.7	287.4	13.6	5.0
Corporate income taxes	20.9	18.6	79.9	72.5	-7.4	-9.2
Other	6.2	8.1	61.2	67.6	6.4	10.5
Deficit	-7.8	11.4	105.4	163.1	57.7	54.7

Details may not add due to rounding.

REAL FEDERAL PURCHASES OF GOODS AND SERVICES  
 (NIPA basis)



if the Food Stamp program is reauthorized.<sup>11</sup> Most spending is protected from sequestration by law, and the President has exercised his option to exempt military personnel as well; thus, a \$100 billion (7 percent) cut in baseline outlays, if it were to occur, would make a sizable dent in affected programs: Outlays of affected nondefense programs would be cut 38 percent while affected defense accounts would be reduced 41 percent. Budget negotiators made little progress before Congress adjourned, and none of the thirteen regular appropriations bills that control discretionary spending has been passed.

#### State and Local Government Sector

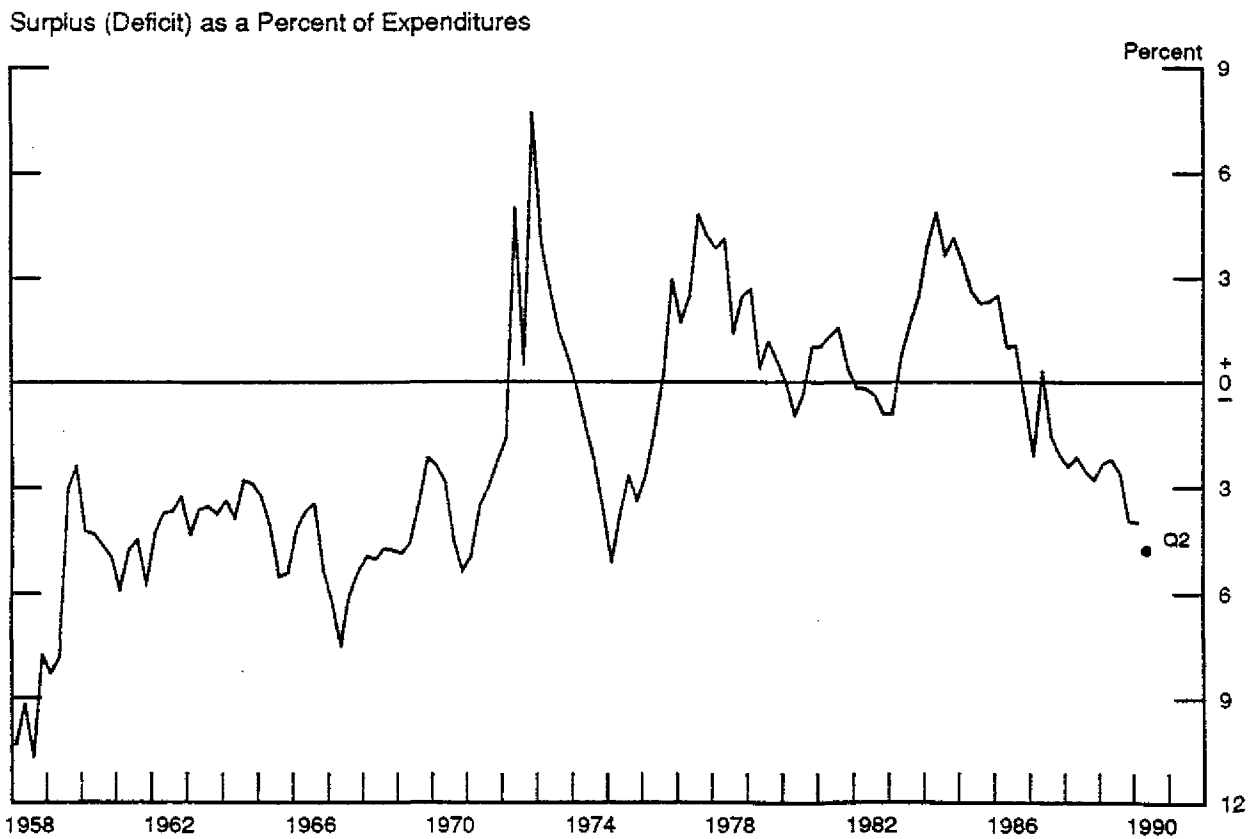
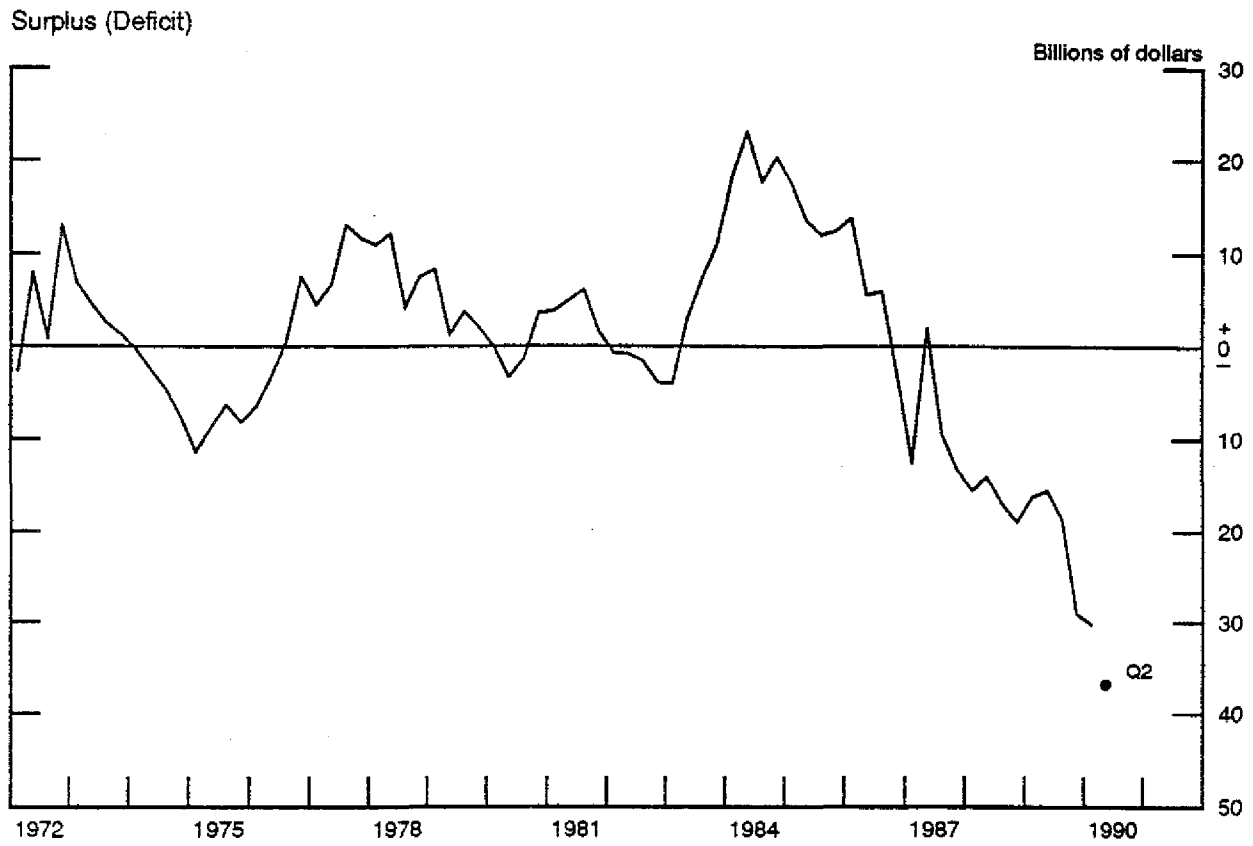
Real purchases of goods and services by state and local governments were essentially flat in the second quarter, after having risen for three years. During the second quarter, construction spending fell 9.5 percent as highway construction declined substantially following the earthquake-related surge last winter. Revenues appeared to have been little changed with both sales tax accruals and federal grants declining. As a result, the deficit of operating and capital accounts, which excludes social insurance funds, is estimated to have widened further. As a share of state and local government expenditures, the deficit currently stands in the range last seen during the 1973-1974 recession.

A recent survey by the National League of Cities suggests that local governments, along with state governments, are facing more fiscal pressure

---

11. The GRH baseline deficit estimate essentially uses current laws to estimate revenues and mandatory spending and estimates discretionary spending by boosting FY1990 spending by the rate of inflation. The OMB presented an alternative baseline that includes the reauthorization of the Food Stamp program and RTC spending and adjusts for the end of the decennial census. These adjustments yield an FY1991 deficit of \$231 billion, or \$169 billion excluding RTC.

FISCAL POSITION OF THE STATE AND LOCAL SECTOR\*  
(Quarterly)



\*Data are for operating and capital accounts, excluding social insurance funds. Q2 is a staff estimate.

than they did last year. The problems are widespread but appear to be most severe in the Northeast. To cope with these pressures, many cities have increased or implemented new fees and charges and raised property tax rates. On the expenditure side, more than 50 percent of the cities have cut the growth of operating outlays and nearly 40 percent have reduced the level of capital spending. Even with these adjustments, 54 percent of cities, compared with between 24 and 40 percent during the prior six fiscal years, reported expenditures outstripping receipts in FY1990.

#### Energy Prices and Supplies

The Iraqi invasion of Kuwait resulted in a significant runup in crude oil prices. Although U.S. crude and product prices had been rising since early July following an OPEC accord to reduce overproduction,<sup>12</sup> the recent invasion so far has added \$5.75 to both the spot and contract prices of West Texas Intermediate crude oil (chart). On balance, spot and contract prices of WTI have risen \$10 and \$9.50, respectively, since their trough in early July.

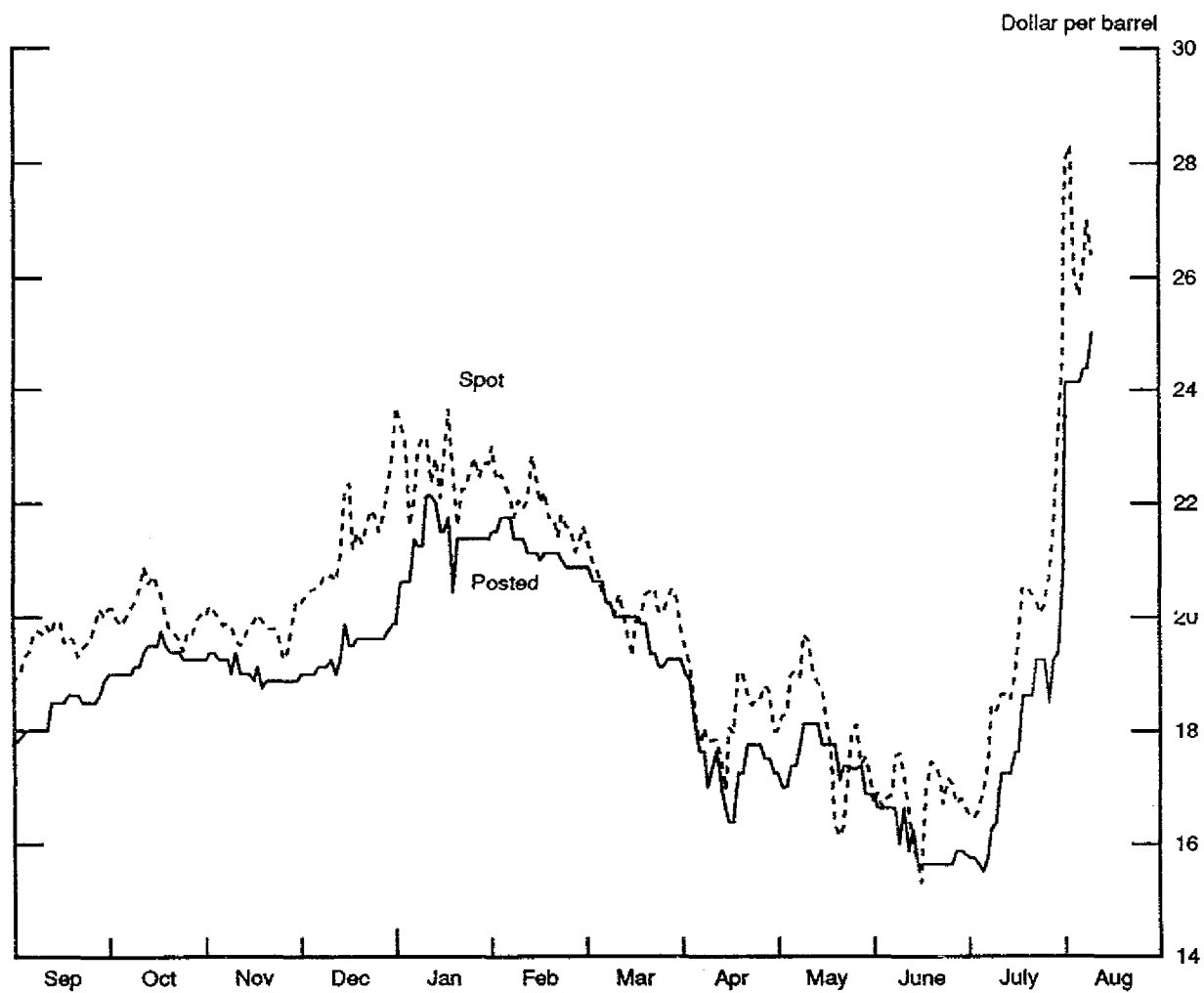
These movements in crude oil prices already have resulted in a runup in spot prices for gasoline and heating oil. Data from the most recent Lundberg survey point to a substantial increase at the wholesale level in August. While prices at the retail level usually lag wholesale prices by about a month, surveys of gasoline stations by Lundberg and the AAA indicate that retail prices nationwide rose 14 cents per gallon in the first two weeks after the Iraqi invasion. Thus, the price response is occurring much

---

12. See the International Developments Section for the details of the July OPEC accord.



DAILY SPOT AND POSTED PRICES OF WEST TEXAS INTERMEDIATE



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

MONTHLY AVERAGE PRICES—WEST TEXAS INTERMEDIATE

Month	Posted	Spot
September	18.31	19.59
October	19.25	20.09
November	19.07	19.82
December	19.32	21.09
January	21.21	22.64
February	21.27	22.12
March	20.08	20.42
April	17.77	18.58
May	17.55	18.24
June	16.15	16.87
July	17.23	18.64
August *	22.94	25.68

\* Price through August 14, 1990.

faster than usual, and the surge in the consumer price index for energy is likely to be spread over both August and September.

Prior to the OPEC accord and Iraqi invasion, energy prices were weakening somewhat. In the July PPI, which was sampled in the second week of the month, finished energy prices fell 0.5 percent. PPI gasoline prices dropped 5.3 percent in July, reflecting the lagged response to earlier declines in crude oil costs as well as some pickup in production after a series of refinery shutdowns in the spring. However, this drop in gasoline prices was partially offset by a jump in natural gas prices and a small increase in the price of home heating oil. Energy prices also were down in the July PPI at the intermediate and crude stages of processing.

The United States appears better prepared to weather a disruption of crude oil supplies than it was in either 1973 or 1979. Although oil imports have returned to 1979 peak levels, oil inventories, including the Strategic Petroleum Reserve, are significantly higher than in 1979. Privately held inventories amount to about 65 days of supply, as in 1979, but the Strategic Petroleum Reserve now adds another 35 days of consumption.

#### Food Prices and Agricultural Conditions

Food prices jumped 0.8 percent in the June CPI--after changing little in April and May. Prices for fresh vegetables picked up substantially, owing mainly to a sharp runup in tomato prices. In addition, the CPI for meats, poultry, fish, and eggs rose 1-1/2 percent in June, and this index now is 7 percent higher than a year earlier. Much of the recent increases can be traced to farm prices for hogs, cattle, and poultry, which were quite strong through June; however, farm prices for hogs and poultry have slipped downward in recent weeks. Indeed, prices for finished consumer foods in the

U.S. AGRICULTURAL PRODUCTION AND INVENTORIES<sup>1</sup>CROP PRODUCTION

	Millions of bushels						
	1980 to 1989			1988	1989	Projected for 1990	
	High	Low	Ave.			as of June 12	as of Aug. 9
Wheat	2785	1812	2342	1812	2036	2689	2706
Corn	8875	4174	7153	4929	7527	8100	7850
Soybeans	2190	1549	1893	1549	1927	1925	1836

CROP INVENTORIES

	Months' supply at end of marketing year						
	1980 to 1989			Marketing year beginning		Projected for 1990	
	High	Low	Avg.	1988	1989	as of June 12	as of Aug. 9
Wheat	11.69	2.35	6.44	3.52	2.35	3.88	4.20
Corn	7.93	1.80	4.42	3.19	1.88	1.79	1.82
Soybeans	3.42	1.17	1.99	1.31	1.95	2.20	1.44

LIVESTOCK PRODUCTION

	Percent change from previous year								
	1985	1986	1987	1988	1989	Projected			
						1990		1991	
						as of June 12	as of Aug. 9	as of July 12	as of Aug. 9
Red meats and poultry	1.7	1.7	2.0	3.7	1.8	2.1	1.4	--	3.2
Beef	.6	2.8	-3.3	.1	-.2	.0	-1.2	--	1.3
Pork	.1	-5.0	2.3	9.1	.9	-1.8	-2.6	--	3.3
Poultry	4.9	6.3	9.5	4.2	7.1	7.4	7.1	--	5.1
Milk	5.7	.7	-.7	2.1	-.8	2.1	2.4	--	1.3

1. Derived from data in USDA's World Agricultural Supply and Demand Estimates, August 9, 1990. Production, consumption, and stocks are measured on a "marketing year" basis, which differs from crop to crop.

PPI for July were flat, as substantial declines in prices for beef, pork, and eggs offset a surge in fresh fruit prices. USDA production estimates indicate that the trend in output of red meats should pick up in coming quarters, and futures prices for cattle and hogs seem to corroborate a general expectation of expanding supplies and falling prices near the end of 1990. In addition, broiler prices have fallen sharply in recent weeks, reflecting a return of seasonal weather patterns in the Southeast which reduced the production problems that were associated with excessive heat and drought in June and July.

Developments in markets for the major grains help shape, to a large degree, the longer-term outlook for livestock production, and according to August estimates of production by the USDA (table), output of corn and soybeans now is expected to be smaller than was indicated in June, prior to the last Greenbook. This weakness reflects poor weather conditions in the Cornbelt while the crops were being planted, as well as the hot, dry weather in the South. In terms of months' supply of grain, inventories of both corn and soybeans are near the low end of the range seen during the past decade. As a result, prices of both crops have been particularly sensitive to reports of crop conditions of late, and news of fluctuations in demand or production prospects have caused considerable swings in farm prices for grain. In contrast, wheat stocks now are rebuilding, and this year's bumper crop in the United States, along with good harvests abroad, is depressing prices.

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

	Relative importance		1989	1989			1990	
	Dec. 1989	1988		Q4	Q1	Q2	June	July
				-----Annual rate-----			-Monthly rate-	
Finished goods	100.0	4.0	4.9	5.0	7.1	.3	.2	-.1
Consumer foods	25.9	5.7	5.2	12.4	10.6	-2.9	-.4	.0
Consumer energy	9.2	-3.6	9.5	-5.3	24.7	-14.3	-.9	-.5
Other finished goods	64.9	4.3	4.2	3.6	3.6	3.9	.6	-.1
Consumer goods	39.5	4.8	4.4	4.2	3.5	5.1	.7	-.2
Capital equipment	25.4	3.6	3.8	2.0	4.0	1.7	.4	.3
Intermediate materials <sup>2</sup>	94.9	5.3	2.5	-.4	2.5	-1.1	-.2	-.1
Excluding food and energy	82.5	7.2	.9	-1.0	1.0	.7	-.1	.1
Crude food materials	41.9	14.2	2.8	19.2	9.1	-11.5	.4	1.0
Crude energy	40.5	-9.5	17.9	13.2	.5	-38.9	-6.2	-.1
Other crude materials	17.5	7.5	-3.6	-15.3	4.0	10.9	-.6	.9

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

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

	Relative importance		1989	1989			1990	
	Dec. 1989	1988		Q4	Q1	Q2	May	June
				-----Annual rate-----			-Monthly rate-	
All items <sup>2</sup>	100.0	4.4	4.6	4.9	8.5	3.5	.2	.5
Food	16.3	5.2	5.6	5.5	11.4	2.1	.0	.8
Energy	7.4	.5	5.1	3.9	14.8	-2.0	-.7	.6
All items less food and energy	76.3	4.7	4.4	4.7	7.5	3.9	.3	.4
Commodities	25.2	4.0	2.7	3.4	7.8	.7	.1	.1
Services	51.1	5.0	5.3	5.7	7.2	5.5	.4	.6
Memorandum:								
CPI-W <sup>3</sup>	100.0	4.4	4.5	4.6	8.3	3.2	.1	.6

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.

Prices

Excluding food and energy items, the CPI advanced 0.4 percent in June. Service prices rose 0.6 percent, boosted by a jump of about 1 percent in the index for owners' equivalent rent. Prices of commodities less food and energy edged up only 0.1 percent, despite a sharp increase for tobacco products, owing to discounting for house furnishings, apparel, and motor vehicles.

Over the first six months of the year, the CPI less food and energy rose at a 5-3/4 percent annual rate, a percentage point or more above the increases in 1988 and 1989. Prices of nonenergy services registered a 6-1/4 percent rate during the first half of the year, compared with 5 and 5-1/4 percent, respectively, in 1988 and 1989. This acceleration reflected large increases for a variety of items, including airfares, cable television, and medical, legal, and financial services. The index for commodities less food and energy rose at a 4-1/4 percent rate through June, up from the reduced 2-3/4 percent pace last year but not much above the 1988 increase of 4 percent. Apparel prices more than accounted for the acceleration in this component.

Producer prices of finished goods excluding food and energy fell 0.1 percent in July following a 0.6 percent increase in June. Much of the movement between these two months reflects swings in tobacco prices, which are distorted by inappropriate seasonal factors. In addition, car prices fell 0.5 percent in July, after a large runup in June, as the enhancement of incentive programs more than offset announced increases in sticker prices on 1990 model vehicles. Prices of intermediate materials less food and energy

PRICE INDEXES FOR COMMODITIES AND MATERIALS<sup>1</sup>

	Last obser- vation	Percent change <sup>2</sup>				Memo: Year earlier to date
		1988	1989	1990 <sup>3</sup>		
				To June 26 <sup>3</sup>	June 26 to date	
1. PPI for crude materials <sup>4</sup>	July	3.1	7.1	-3.1	.2	-2.6
1a. Foods and feeds	July	14.2	2.8	2.3	.2	4.8
1b. Energy	July	-9.5	17.9	-11.5	-.1	-12.0
1c. Excluding food and energy	July	7.5	-3.6	3.9	.4	1.6
1d. Excluding food and energy, seasonally adjusted	July	7.6	-3.6	3.6	.9	1.7
2. Commodity Research Bureau						
2a. Futures prices	Aug. 14	8.5	-9.0	2.0	1.3	6.4
2b. Industrial spot prices	Aug. 13	7.3	-5.9	5.7	1.1	-.6
3. <u>Journal of Commerce</u> industrials	Aug. 14	3.8	1.3	.1	1.7	.9
4. Dow-Jones Spot	Aug. 14	6.9	-10.1	1.9	1.9	2.7
5. IMF commodity index <sup>4</sup>	July	12.6	-12.9	-1.0	.9	-4.8
5a. Metals	July	33.7	-23.4	4.1	3.2	-.3
5b. Nonfood agric.	July	-9.4	-4.6	.4	1.3	-3.6
6. <u>Economist</u> (U.S. dollar index)	Aug. 7	17.7	-22.8	2.5	2.5	-1.8
6a. Industrials	Aug. 7	18.9	-23.8	2.7	6.7	1.5

1. Not seasonally adjusted.

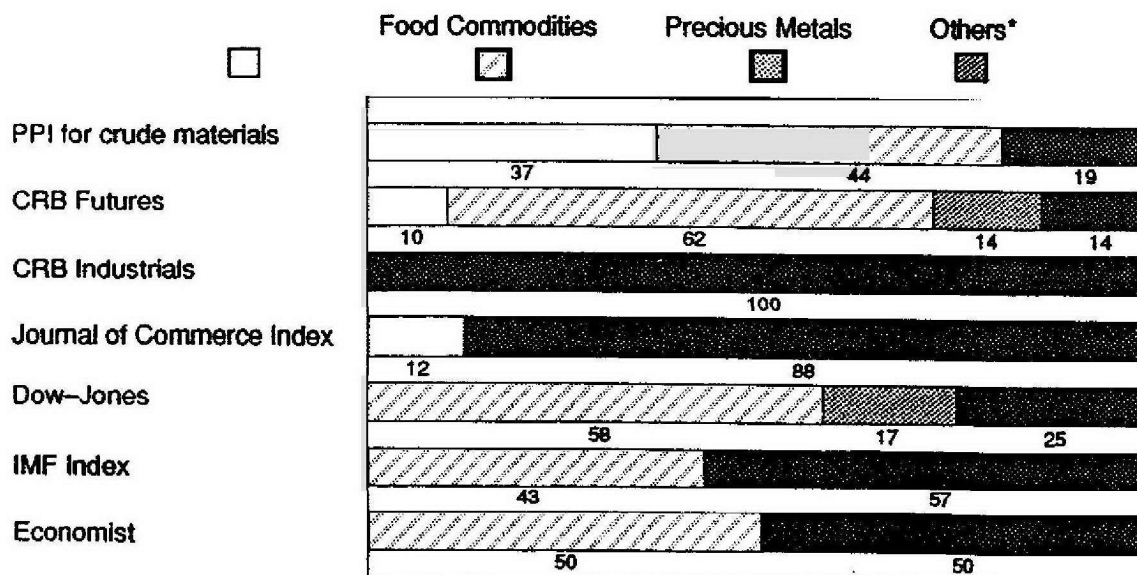
2. Change is measured to end of period, from last observation of previous period.

3. Week of the June Greenbook.

4. Monthly observations. IMF index includes items not shown separately.

n.a. Not available.

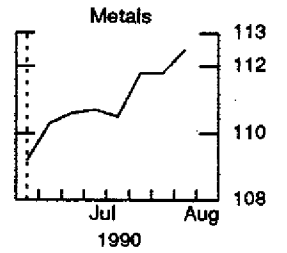
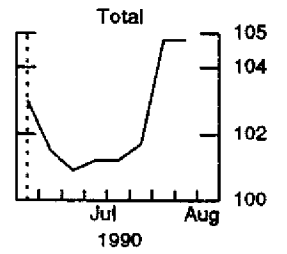
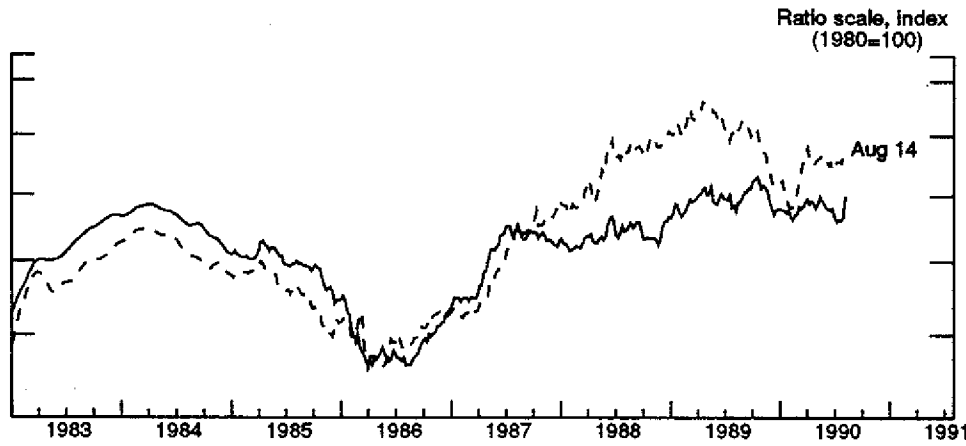
Index Weights



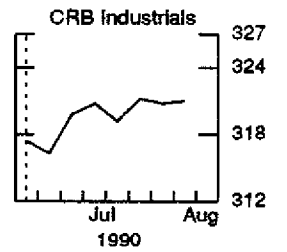
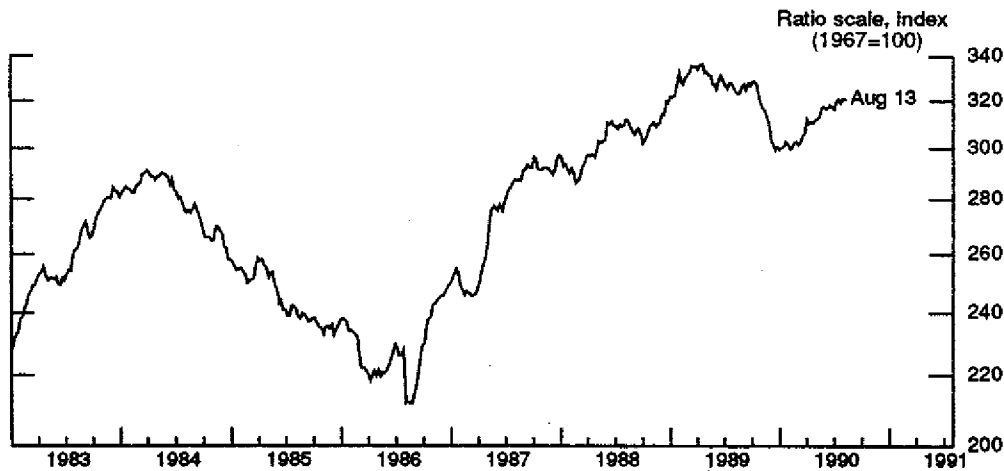
\*Forest products, industrial metals, and other industrial materials.

# COMMODITY PRICE MEASURES \*

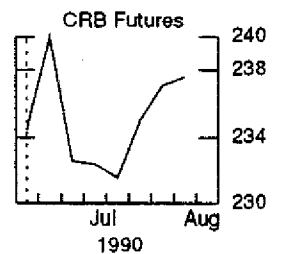
— Journal of Commerce Index, total  
 - - - Journal of Commerce Index, metals



CRB Spot Industrials



CRB Futures



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

Dotted lines indicate week of last Greenbook.



were little changed over the two months and have risen at about a 1 percent annual rate so far this year.

More recently, however, prices on spot commodity markets have turned up markedly for most industrial metals as well as for gold. Most of the increases for industrial metals occurred before the Iraqi invasion of Kuwait. The Journal of Commerce index for industrial metals (upper panel of chart) moved back around its recent high reached early in April but remained, nonetheless, below its levels during most of 1989. Supply disruptions have contributed to upward pressures on some metals, notably copper; and, according to market reports, world metal markets generally have been supported by continued demand from Europe and East Asia. Prices of steel scrap surged in late July and are currently just below their most recent highs reached in 1988-1989. Although aluminum prices also turned up sharply in late July, they have retraced just a fraction of their steep decline from mid-1988 until early this year.

## APPENDIX A

### ANNUAL REVISION TO THE NATIONAL INCOME AND PRODUCT ACCOUNTS

The Commerce Department released its annual revision to the National Income and Product Accounts on July 27. This revision incorporated new source data and revised estimates of seasonal factors back to the first quarter of 1987. The new figures show that growth in real activity was somewhat slower over 1987-89 than was previously estimated. Real GNP growth was revised down 0.4 percentage point over 1987 and 0.8 percentage point over 1989, while the estimate for 1988 was little changed. The revision did not greatly affect BEA's estimates of inflation. The GNP fixed-weight price index continues to show increases of about 4 percent over 1987 and 1989 and about 4-1/2 percent over 1988.

With this revision, real growth over 1989 now stands at 1.8 percent. A sharply lower estimate of real consumer spending accounts fully for the downward adjustment to output growth last year. Most of the revision to real PCE occurred in spending for services and reflected the results of the Census Bureau's Service Annual Survey for 1989. This adjustment was concentrated in medical care services, though there were smaller downward revisions for various other nonhousing-related services. Outside the consumer sector, revisions to spending growth last year were small on the whole. For 1987, the lower estimate of real GNP growth reflects, in large part, a downward adjustment to growth in business purchases of computing equipment, along with smaller estimated increases in purchases by state and local governments. State and local purchases were revised down in 1988 and 1989 as well, and the trend growth in this sector is now shown to have been lower in recent years than previously estimated.

On the income side of the accounts, the most significant change was the \$58 billion downward adjustment to the level of wages and salaries in 1989. The revised figure is based on fairly comprehensive tabulations of payroll data submitted by firms to state unemployment insurance offices.<sup>2</sup> As a result primarily of the new figures on wages and salaries, disposable personal income was revised down \$53 billion last year. Because this downward adjustment to income substantially exceeded that to personal outlays, the estimate of the personal saving rate in 1989 was lowered 0.8 percentage point to 4.6 percent. This revision considerably mutes, but does not eliminate, the pickup in the saving rate over the past two years. Among other components of income, the level of corporate profits was raised about \$10 billion across the entire 1987-89 period. Accordingly, the share of corporate profits (with the inventory valuation and capital consumption adjustments) in nominal GNP was revised up 0.2 percentage point in each year. However, this level adjustment did not alter the sharp decline in the profit share over the four quarters of 1989.

---

1. Excluding the 1989-Q1 rebound in farm output from the 1988 drought, real GNP growth over 1989 is only 1.3 percent.

2. The downward-revised level of wages and salaries suggests that employment growth over 1989 may have been somewhat weaker than is now reported in the BLS data on payroll employment. Revisions to the BLS employment data will be available in early September.

## REAL GROSS NATIONAL PRODUCT AND RELATED ITEMS

(Percent change from previous period)

	1986-Q4 to 1987-Q4	1987-Q4 to 1988-Q4	1988-Q4 to 1989-Q4
1. Gross national product	5.0	3.5	1.8
<i>Previous</i>	<i>(5.4)</i>	<i>(3.4)</i>	<i>(2.6)</i>
2. Gross domestic purchases	4.2	2.6	1.1
<i>Previous</i>	<i>(4.6)</i>	<i>(2.4)</i>	<i>(1.9)</i>
3. Personal consumption expenditures	2.3	4.1	1.2
<i>Previous</i>	<i>(2.2)</i>	<i>(3.8)</i>	<i>(2.5)</i>
4. Business fixed investment	6.1	5.3	4.5
<i>Previous</i>	<i>(8.5)</i>	<i>(4.2)</i>	<i>(3.7)</i>
5. Residential structures	-2.2	-1	-7.1
<i>Previous</i>	<i>(-4.2)</i>	<i>(3.2)</i>	<i>(-7.0)</i>
6. Government purchases	2.0	1.1	.3
<i>Previous</i>	<i>(2.1)</i>	<i>(1.8)</i>	<i>(.5)</i>
-----			
<i>ADDENDA:</i>			
7. Change in net exports <sup>1</sup>	24.1	35.6	27.8
<i>Previous</i>	<i>(25.6)</i>	<i>(36.0)</i>	<i>(26.6)</i>
8. Net exports <sup>2</sup>	-111.3	-75.7	-47.9
<i>Previous</i>	<i>(-109.8)</i>	<i>(-73.8)</i>	<i>(-47.2)</i>
9. Change in nonfarm inventories <sup>2</sup>	55.4	27.2	15.3
<i>Previous</i>	<i>(55.6)</i>	<i>(31.9)</i>	<i>(18.0)</i>
10. Nominal GNP	8.2	7.8	5.6
<i>Previous</i>	<i>(8.6)</i>	<i>(7.5)</i>	<i>(6.4)</i>
11. GNP fixed-weight price index	3.8	4.6	4.0
<i>Previous</i>	<i>(4.0)</i>	<i>(4.5)</i>	<i>(4.1)</i>
12. GNP implicit price deflator	3.0	4.1	3.7
<i>Previous</i>	<i>(3.0)</i>	<i>(4.0)</i>	<i>(3.7)</i>
13. Real disposable personal income	2.7	4.3	1.7
<i>Previous</i>	<i>(3.0)</i>	<i>(4.0)</i>	<i>(3.6)</i>

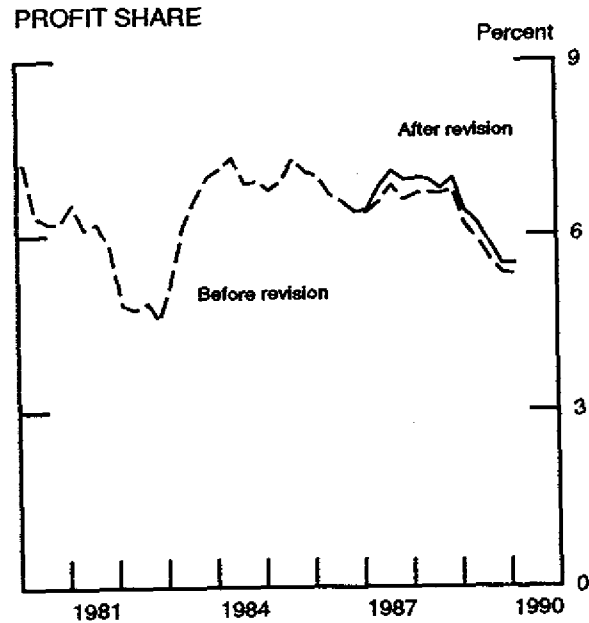
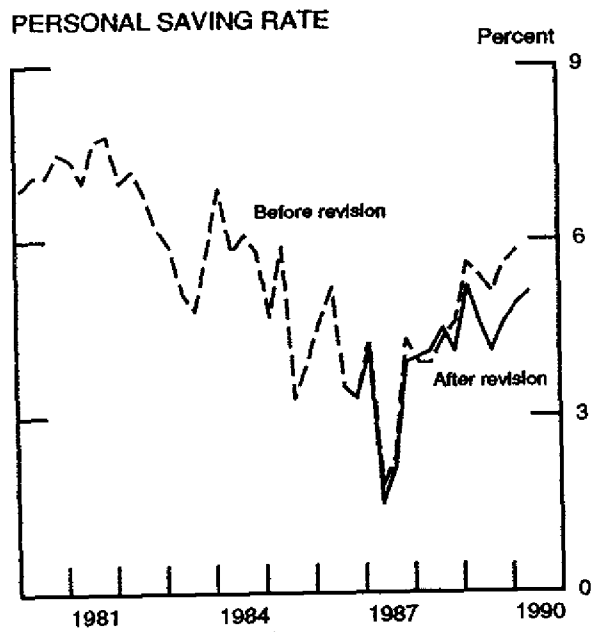
1. Over four quarters of the year, billions of 1982 dollars.

2. End of period, billions of 1982 dollars

**Personal Income**  
(Revisions in level, billions of dollars)

	1987	1988	1989
1. Personal income	-11.2	6.3	-43.0
2. Wages and salaries	.3	2.1	-57.9
3. Other personal income	-11.5	4.2	14.9
4. Personal tax and nontax payments	-.1	5.0	10.3
<b>5. Disposable personal income</b>	<b>-11.2</b>	<b>1.4</b>	<b>-53.3</b>
6. Personal outlays	-1.9	.5	-20.7
7. Personal saving rate <sup>1</sup>	-.3	.0	-.8
<i>Memo:</i>			
8. Corporate profits with inventory valuation and capital consumption adjustments	9.6	9.0	10.3
9. Profit share as a percent of GNP <sup>1</sup>	.2	.2	.2

1. Revision in level, percentage points.



APPENDIX B

MID-SESSION REVIEW OF THE BUDGET

The Administration has released its Mid-Session Review of the Budget. The document contains new deficit estimates, which are substantially higher than those presented in last January's budget; it also provides a preliminary assessment of the sequester amounts that are required to meet the Gramm-Rudman-Hollings targets for FY1991. The Congressional Budget Office (CBO) has issued its usual summer report, The Economic and Budget Outlook: An Update, as well; apart from spending by the Resolution Trust Corporation (RTC), CBO's deficit projections for FY1990 and FY1991 are similar to those of the Administration.

Near-Term Budget Developments and Prospects

The Administration now projects a baseline deficit of \$219 billion in FY1990, compared with a figure of \$122 billion in the January budget (table 1). Higher outlays by the RTC account for about half of the increase. But the expected deficit excluding the RTC also has been raised substantially; at \$161 billion, it stands a bit above the actual deficits that were recorded during FY1987-89. For FY1991, the Administration now estimates the baseline deficit--including the reauthorization of the food

Table 1

EVOLUTION OF PROJECTIONS FOR THE  
BASELINE BUDGET DEFICIT<sup>1</sup>  
(Billions of dollars)

Fiscal year	Administration		CBO	
	January	July	March	July
-----Deficit including RTC spending-----				
1990	122	219	159	195
1991	101	231	161	232
-----Deficit excluding RTC spending-----				
1990	120	161	126	159
1991	93	169	130	162

1. Administration figures are for the "adjusted consolidated baseline deficit." The CBO baseline includes "additional RTC spending needs." Both baselines include the extension of the food stamp program, which is scheduled to expire at the end of FY1990.

stamp program and full funding for the RTC<sup>1</sup>--at \$231 billion; the deficit excluding the RTC also is expected to edge up further.

As table 2 shows, OMB has raised its projections of baseline outlays \$68 billion in FY1990 and \$96 billion in FY1991. The largest change is in net outlays for the RTC, which are now expected to total \$57 billion this year and \$63 billion next year;<sup>2</sup> in the January budget, these outlays were \$2 billion and \$7 billion respectively. A substantial rise in projected interest outlays--especially in 1991--reflects the larger projected deficits and higher interest rates (table 3), which now are assumed to be roughly a percentage point above those in the January budget. Other notable upward revisions this year are for defense, the financing of foreign military sales, and the FDIC.

OMB has made a significant downward revision to its estimates of receipts for this year and next--\$29 billion and \$35 billion respectively--largely in response to the information on incoming collections. In particular, the level this spring of final settlements of 1989 individual income tax liabilities was lower than expected. The shortfall probably reflects, in part, the lower level of personal income now estimated for 1989. (See Appendix A for a discussion of the revisions to personal income.) But it also suggests that temporary phenomena were a bigger factor in the strong final payments in early 1989 than had been thought previously and hence that the permanent component was somewhat smaller. Moreover, OMB has reduced its projection of corporate taxes, based not only on a reassessment of the effects of tax reform but also on the lower profits now expected for 1990 and 1991.

As noted above, the revisions to interest rates and to corporate profits add significantly to the deficits in FY1990 and in later years. Among other key economic assumptions, real growth this year has been slower than OMB had forecast in January, and inflation has been more rapid. On the

1. Under current law, the food stamp program is scheduled to expire at the end of FY1990. In addition, the estimates of RTC net outlays in the G-R-H baseline are constrained by the \$50 billion provided by FIRREA to cover losses and by provisions limiting borrowing for working capital. The latter will likely become binding within the next few months and would hold RTC spending essentially to zero next year. Given the virtual certainty that additional funding will be authorized for these programs, OMB provides some alternative baselines, one of which includes the continuation of food stamps, full funding for RTC, and other accounting adjustments and shows a deficit of \$231 billion in FY1991. CBO also offers an alternative baseline (with "additional RTC").

2. Over the first three quarters of FY1990, net RTC outlays totaled \$32 billion, and for the July to September period, the Oversight Board has approved a \$36 billion net spending plan. For FY1991, the Administration has developed three scenarios based on different assumptions for loss rates and for the number of thrifts to be resolved. The estimated budget effects in these scenarios range from \$32 billion to \$63 billion. OMB uses the higher number, which is based on 1,027 failed thrifts and a "medium" loss rate, in the adjusted baseline and policy estimates.

Table 2

CHANGES TO THE ADMINISTRATION BASELINE DEFICIT  
(Fiscal years, billions of dollars)

	1990	1991	1992	1993	1994	1995
Total changes	97	131	132	96	67	90
Excluding the RTC	42	76	91	101	108	110
Changes to outlays						
RTC	55	55	41	-5	-42	-20
Net interest	6	21	31	35	39	43
Other	7	20	19	21	31	28
	68	96	92	51	28	51
Changes to receipts	-29	-35	-40	-45	-39	-40

Table 3

ECONOMIC ASSUMPTIONS OF THE ADMINISTRATION FOR 1990 AND 1991

	1990	1991
	-Percent change, Q4 to Q4-	
Real GNP		
July	2.2	2.9
January	2.6	3.3
CPI		
July	4.8	4.2
January	4.1	4.0
	-Percent, annual average-	
Three-month Treasury bill rate		
July	7.7	6.8
January	6.7	5.4
Ten-year Treasury note rate		
July	8.5	7.9
January	7.7	6.8
Corporate profits as a percent of GNP		
July	5.5	6.0
January	6.5	7.0

whole, however, the changes to the forecasts of real growth and inflation are relatively small and thus have only a modest effect on the overall deficit projection.<sup>3</sup>

Apart from the RTC, the latest estimates from the CBO are similar to those of the Administration. Its baseline deficit--excluding RTC spending--edges up to around \$160 billion in both FY1990 and FY1991, a bit above the actual deficits of the past few years. CBO's figures show RTC spending in FY1990 at only \$36 billion; this estimate was developed in June and now looks low in light of the sharp pickup in resolutions since late spring; its RTC estimate for FY1991--\$70 billion--is close to the Administration's.

Table 4

ADMINISTRATION DEFICIT-REDUCING PROPOSALS<sup>1</sup>  
(Change from baseline in billions of dollars,  
fiscal years)

	1991	1992	1993	1994	1995
Total	53	70	85	109	130
January recommendations	41	50	61	80	98
Additional June proposals	12	20	24	30	32
Receipts	14	12	4	7	6
Outlays					
Defense	7	13	21	30	37
Discretionary	5	7	10	13	16
Entitlements/mandatory					
Medicare	6	9	12	15	18
Other	11	15	18	21	23
User fees	6	6	6	6	6
Undistributed offsetting					
receipts	1	1	0	1	0
Net interest	2	7	12	18	23
	<u>39</u>	<u>58</u>	<u>80</u>	<u>102</u>	<u>124</u>

1. Consists of policy recommendations in the Administration's January budget (with minor reestimates) and additional proposals submitted to the Administration/Congressional Budget Summit on June 20.

3. OMB's July forecast anticipates a pickup in real activity in the second half of 1990, while prices are expected to rise less rapidly than in the first half. In the past few weeks, however, private forecasters generally have raised their inflation projections and have become more pessimistic about the outlook for real GNP.



The President's Deficit-Reducing Proposals

The Mid-Session Review also presents the outlook for the budget on the assumption that the deficit-reducing measures presented by the Administration to the Budget Summit on June 20 are enacted. As table 4 shows, these measures add \$12 billion to the proposals outlined in the January budget and bring the Administration's total package for 1991 to \$53 billion. Nonetheless, the resulting deficit--assuming full funding of the RTC--would still be more than \$100 billion above the GRH target.

The Administration's June proposals include \$7 billion of reductions in defense spending in FY1991. Recent events do not rule out the prospect of a cut of about that size. However, they clearly lessen the odds that significantly larger reductions--such as those proposed earlier by some members of the Congress--will be enacted this year.

GRH Accounting: RTC and the Size of a Possible Sequester

The ultimate size of a sequester will depend, of course, in part on how the Congress decides to modify the GRH calculations, as well as on spending and tax actions taken between now and mid-October.<sup>4</sup> In presenting its sequester calculations, the Administration assumes that RTC spending will be excluded from the baseline totals--in part because current law limits RTC spending and in part because many believe that RTC expenditures should be excluded from Gramm-Rudman-Hollings (GRH) sequester calculations. With this assumption, the baseline deficit will be \$169 billion--if, as seems likely, the food stamp program is reauthorized. The Administration will issue an initial sequester report on August 25 and a final report on October 15. If no deficit-reducing actions are taken and the GRH procedures are not modified before the final report is released, a sequester of roughly \$100 billion will be required.

The cuts would fall primarily on defense and on nondefense discretionary programs. Under the GRH law, Social Security and many other benefit programs, as well as net interest and outlays from commitments already in place, are exempt from the sequester; cutbacks also are limited in several nonexempt programs, notably Medicare, Stafford student loans, and veterans' medical care. Thus, the sequester would be concentrated on a relatively small portion of the budget. A sequester of \$100 billion, which would be split equally between defense and nondefense programs, would impose across-the-board cuts of 38 percent on affected nondefense programs. The President has exercised his option to exempt military personnel from the

---

4. The Gramm-Rudman-Hollings Act provides for the expedited consideration of a joint resolution suspending the act in the event that (1) the Department of Commerce reports real GNP growth of less than 1 percent at an annual rate during the immediately preceding two quarters or (2) either CBO or OMB projects that real GNP will decline for two consecutive quarters. A joint resolution must be passed by the Congress and signed by the President. However, a final sequestration order issued before the enactment of a joint resolution is not suspended.

sequester; as a result, cuts in the rest of the defense budget would reach 41 percent.

#### The Long-Run Budget Outlook

As tables 5 and 6 show, the Administration and CBO both expect the baseline budget to remain in substantial deficit through the mid-1990s. The Administration now projects the baseline deficit (excluding the RTC) to fall only to about \$100 billion in FY1995, in contrast to the small surplus shown for that year in the January budget. CBO, using less favorable economic assumptions (table 7), expects the deficit (excluding the RTC) to remain above \$150 billion through FY1995.

Table 5

ADMINISTRATION BUDGET PROJECTIONS  
(Fiscal years, billions of dollars)

	1990	1991	1992	1993	1994	1995
<u>Baseline</u> <sup>1</sup>						
Outlays	1,263	1,353	1,400	1,414	1,443	1,518
Receipts	1,044	1,122	1,195	1,279	1,363	1,441
Deficit	219	231	205	135	80	77
<u>Proposed</u>						
Outlays	1,264	1,312	1,340	1,332	1,339	1,392
Receipts	1,044	1,135	1,206	1,283	1,370	1,447
Deficit	220	176	134	49	-32	-55
<u>Memo</u>						
RTC net outlays	57	63	41	-5	-42	-20
Deficit excluding RTC:						
Baseline	161	169	164	141	121	97
Proposed	163	114	93	55	10	-35

1. Figures are for the "adjusted consolidated baseline budget."

Table 6

CBO BASELINE BUDGET PROJECTIONS  
(Fiscal years, billions of dollars)

	1990	1991	1992	1993	1994	1995
Outlays <sup>1</sup>	1,238	1,355	1,426	1,455	1,483	1,555
Receipts	1,044	1,123	1,188	1,260	1,337	1,417
Deficit <sup>1</sup>	195	232	239	194	146	138
<u>Memo</u>						
RTC net outlays	36	70	60	13	-30	-18
Deficit excluding RTC	159	162	179	182	177	157

1. Includes additional RTC spending needs as forecast by the CBO.

Table 7

## ECONOMIC ASSUMPTIONS OF THE ADMINISTRATION AND CBO

	Forecast		Projected			
	1990	1991	1992	1993	1994	1995
-----Percent change, calendar year average-----						
Real GNP						
Administration	2.0	2.8	3.2	3.2	3.1	3.0
CBO	2.0	2.5	2.6	2.6	2.6	2.6
GNP deflator						
Administration	4.2	4.2	4.0	3.7	3.4	3.1
CBO	4.1	4.0	3.9	3.8	3.8	3.8
CPI <sup>1</sup>						
Administration	4.8	4.1	4.0	3.7	3.4	3.0
CBO	4.8	4.2	4.2	4.0	4.0	4.0
-----Percent, calendar year average-----						
Unemployment rate						
Administration	5.4	5.6	5.5	5.4	5.3	5.2
CBO	5.3	5.4	5.4	5.5	5.5	5.5
Three-month Treasury bill rate						
Administration	7.7	6.8	5.8	5.1	4.8	4.4
CBO	7.6	6.9	6.7	6.2	5.6	5.4
Ten-year Treasury note rate						
Administration	8.5	7.9	7.0	6.1	5.8	5.4
CBO	8.5	7.8	7.4	7.2	6.9	6.8
Corporate profits as a percent of GNP						
Administration	5.5	6.0	6.5	6.5	6.7	6.8
CBO	5.3	5.1	5.1	5.2	5.2	5.2

1. Administration forecasts the CPI-W; CBO forecasts the CPI-U.

# **DOMESTIC FINANCIAL DEVELOPMENTS**

---

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

	1987	1989		1990		Change from:		
	2 Oct 16	March highs	Dec lows	FOMC Jul 3	Aug 14	Mar 89 highs	Dec 89 lows	FOMC Jul 3
<b>Short-term rates</b>								
Federal funds <sup>3</sup>	7.59	9.85	8.45	8.28	8.05	-1.80	-.40	-.23
<b>Treasury bills</b> <sup>4</sup>								
3-month	6.93	9.09	7.53	7.70	7.43	-1.66	-.10	-.27
6-month	7.58	9.11	7.29	7.59	7.33	-1.78	.04	-.26
1-year	7.74	9.05	7.11	7.45	7.18	-1.87	.07	-.27
<b>Commercial paper</b>								
1-month	7.94	10.05	8.51	8.22	7.98	-2.07	-.53	-.24
3-month	8.65	10.15	8.22	8.12	7.80	-2.35	-.42	-.32
<b>Large negotiable CDs</b> <sup>4</sup>								
1-month	7.92	10.07	8.52	8.23	7.93	-2.14	-.59	-.30
3-month	8.90	10.32	8.22	8.23	7.88	-2.44	-.34	-.35
6-month	9.12	10.08	8.01	8.25	7.87	-2.21	-.14	-.38
<b>Eurodollar deposits</b> <sup>5</sup>								
1-month	8.00	10.19	8.38	8.19	7.94	-2.25	-.44	-.25
3-month	9.06	10.50	8.25	8.19	7.88	-2.62	-.37	-.31
Bank prime rate	9.25	11.50	10.50	10.00	10.00	-1.50	-.50	.00
<b>Intermediate- and long-term rates</b>								
<b>U.S. Treasury (constant maturity)</b>								
3-year	9.52	9.88	7.69	8.28	8.08	-1.80	.39	-.20
10-year	10.23	9.53	7.77	8.40	8.66	-.87	.89	.26
30-year	10.24	9.31	7.83	8.40	8.78	-.53	.95	.38
<b>Municipal revenue</b> <sup>6</sup>								
(Bond Buyer)	9.59	7.95	7.28	7.48	7.51	-.44	.23	.03
Corporate--A utility recently offered <sup>7</sup>	11.50	10.47	9.29	9.92	10.16	-.31	.87	.24
<b>Home mortgage rates</b>								
S&L fixed-rate	11.58	11.22	9.69	10.15	10.08	-1.14	.39	-.07
S&L ARM, 1-yr.	8.45	9.31	8.34	8.45	8.39	-.92	.05	-.06
<b>Stock prices</b>								
			1989	1990		Percent change from:		
	Record highs	Date	Lows Jan 3	FOMC Jul 3	Aug 14	Record highs	1989 lows	FOMC Jul 3
Dow-Jones Industrial	2999.75	7/16/90	2144.64	2911.63	2747.77	-8.40	28.12	-5.63
NYSE Composite	201.13	7/16/90	154.98	196.61	186.10	-7.47	20.08	-5.35
AMEX Composite	397.03	10/10/89	305.24	360.67	339.94	-14.38	11.37	-5.75
NASDAQ (OTC)	485.73	10/9/89	378.56	461.76	410.33	-15.52	8.39	-11.14
Wilshire	3523.47	10/9/89	2718.59	3441.27	3223.69	-8.51	18.58	-6.32

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 for the maintenance period ending August 8, 1990.

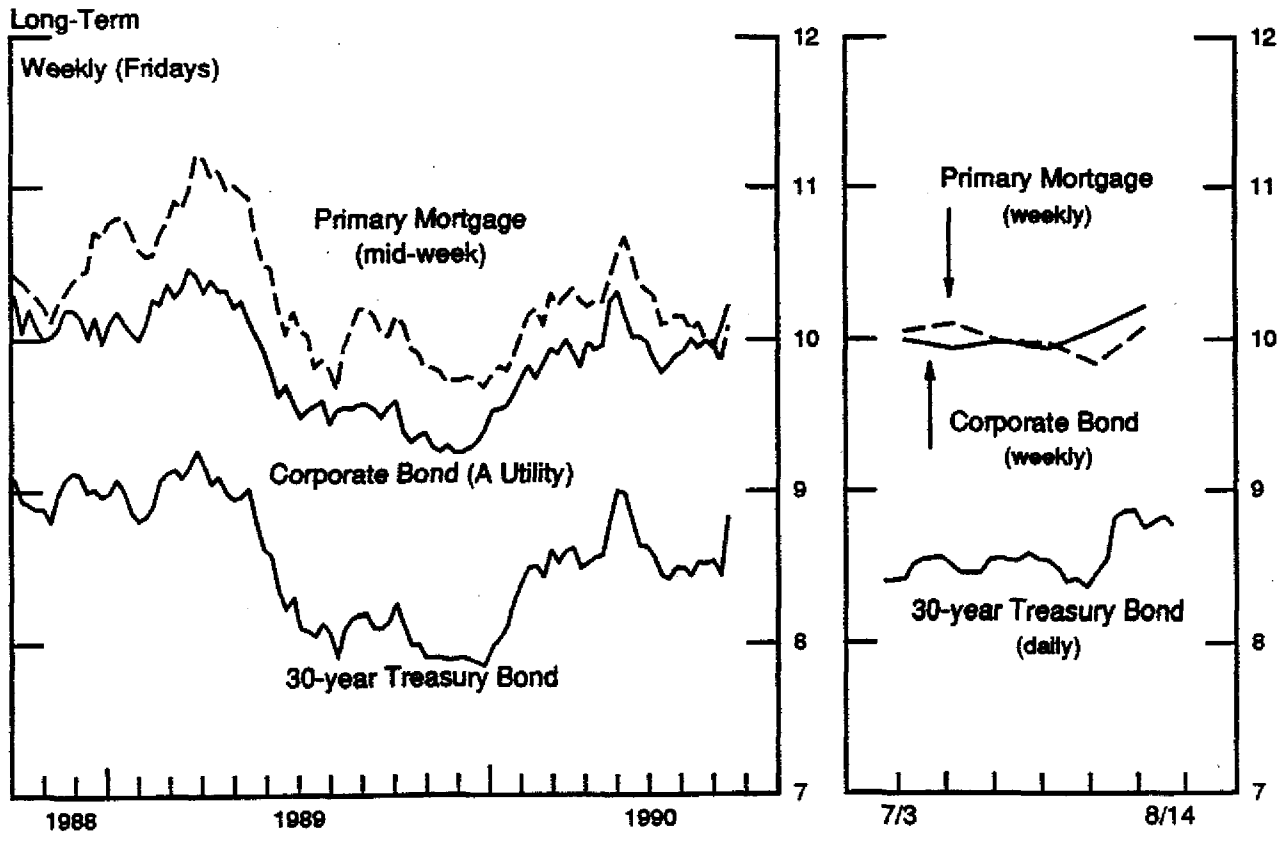
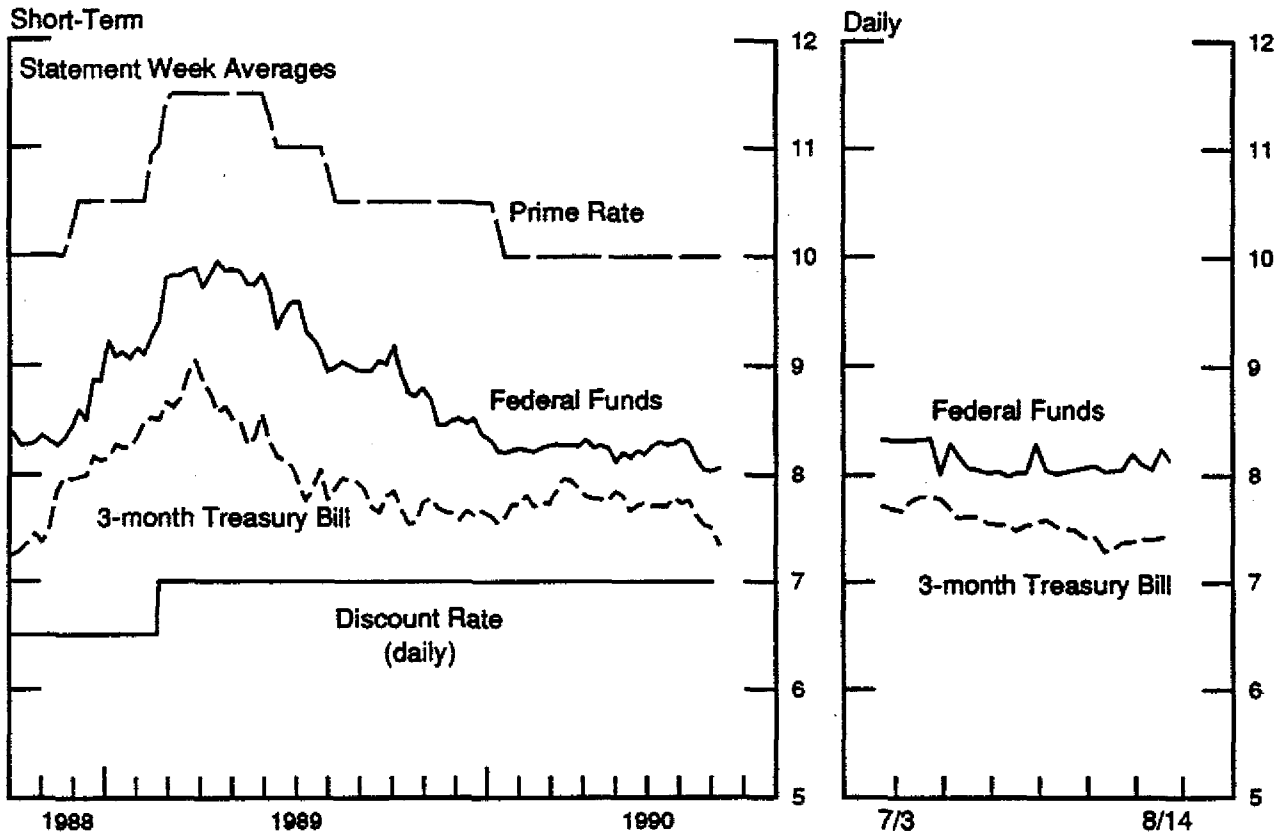
4/ Secondary market.

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 August 10, Wednesday weeks through August 1.

## DOMESTIC FINANCIAL DEVELOPMENTS

---

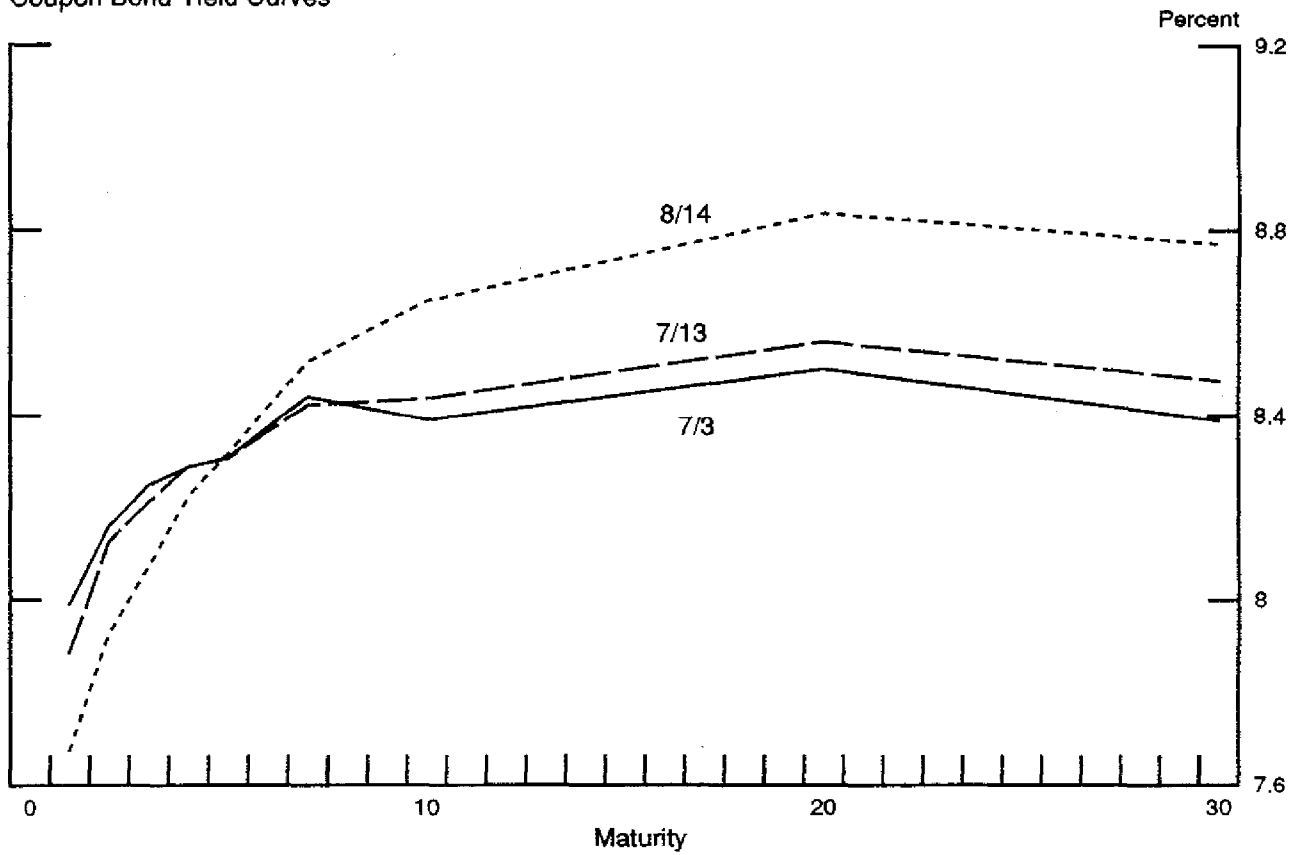
Financial markets experienced some notable turbulence as the intermeeting period unfolded, with investors responding first to a System easing move, next to soft economic data and finally to the Iraqi invasion of Kuwait. On July 13, the System acted to offset an apparent crimp in credit availability by easing reserve market conditions; short-term rates quickly incorporated the resulting 1/4 percent decline in the federal funds rate, and bond yields eased a bit. Bond yields backed up after a disappointing report on consumer prices, but rates fell across the maturity spectrum later in July, when the release of data on second-quarter GNP and revisions to GNP estimates for earlier quarters provided fresh evidence of a weak economy.

Market conditions changed dramatically in the wake of Iraq's invasion of Kuwait on August 2. Short-term rates dropped further, with Treasury bills benefiting from a "flight to quality" and from the perception that higher energy prices might tip the economy into recession. Bond yields surged, however, as investors reassessed the inflation outlook. In addition, hopes for a budget compromise faded as market participants perceived that the combination of a weaker economy and higher gasoline prices might make it more difficult for policymakers to reach agreement on steps to achieve significant deficit reductions. With the inflation outlook less favorable and more uncertain, the yield curve has steepened significantly (chart); implicit forward rates for three years and beyond have risen by 1/2 to 3/4 of a percentage point. On balance, the thirty-year bond rate is up nearly 40 basis points since the July FOMC meeting, while bill rates are down about 25 basis points.

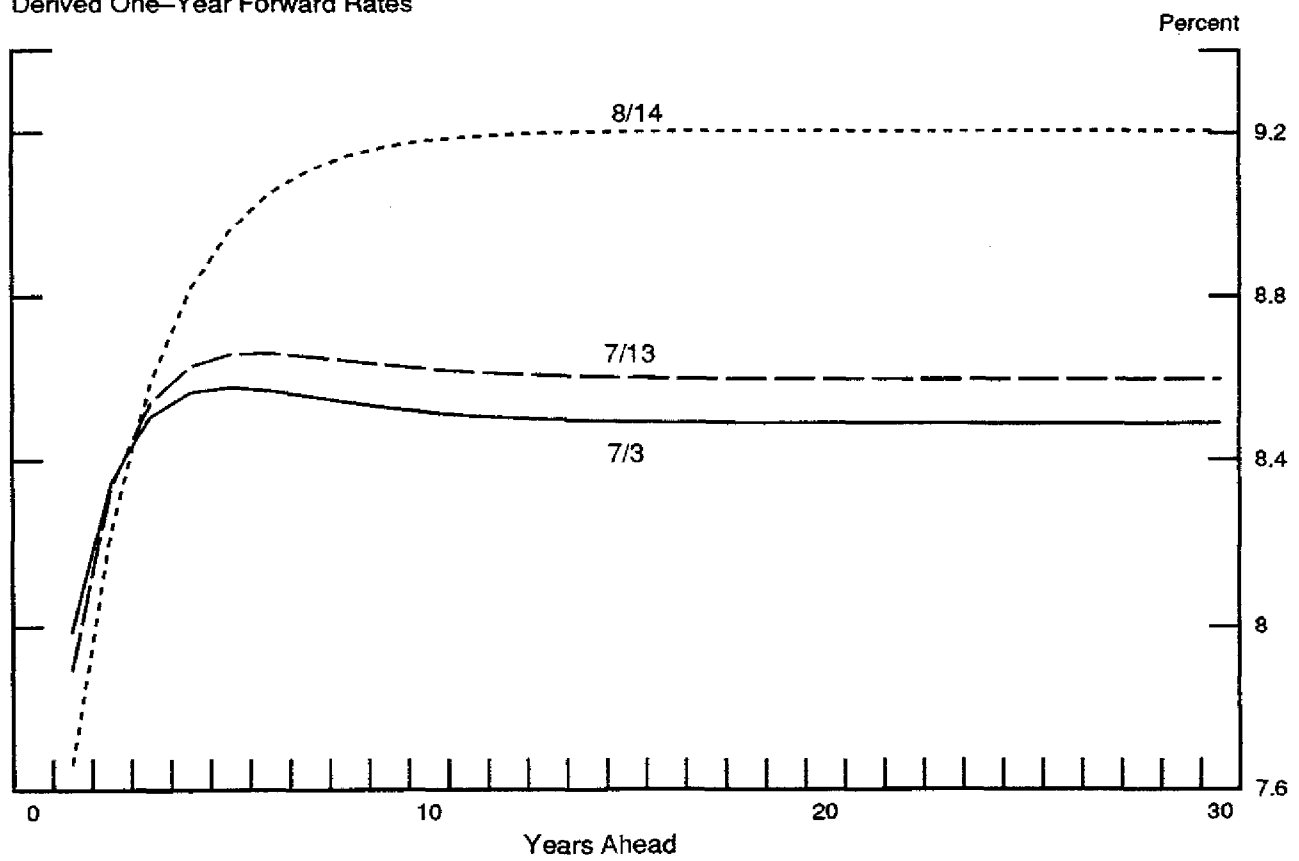


Long-Term Treasury Yields and Implied Forward Rates

Coupon Bond Yield Curves



Derived One-Year Forward Rates



After recording new highs early in the intermeeting period, equity prices began to retreat late in July in response to weak second-quarter earnings reports and economic data suggesting a torpid economy. Selling pressures intensified in the first week of August as the market concluded that the sharp rise in oil prices would depress future corporate earnings and prevent interest rates from falling. Price declines were quite steep at times, triggering price limits on stock index futures as well as program trading restraints in the cash markets. Equity prices managed to recover from their lows, but most major indexes remain about 5-1/2 percent lower than they were at the time of the July FOMC meeting.

M2 expanded at only a 1 percent rate last month, moving near the lower bound of its annual target range. Total core deposits remained quite weak as the restructuring of the thrift industry continued to weigh on the aggregates. M3 was again flat in July, as bank credit slowed and thrifts apparently continued to pare their balance sheets. The latest data suggest some strength in M2 in early August, including a boost in the second week of this month from the transfer of balances from stock and bond funds to money funds.

Private credit market borrowing apparently tailed off last month. Business loans and outstanding commercial paper of nonfinancial firms contracted in July, and bond issuance slumped after a surge in June. State and local governments cut back on their security offerings, while available data suggest that both consumer credit and mortgage credit were soft again last month. By contrast, the federal government has been borrowing heavily in the third quarter, largely driven by funding needs to close ailing thrifts.

## MONETARY AGGREGATES

(based on seasonally adjusted data unless otherwise noted)

	1989 <sup>1</sup>	1990 Q1	1990 Q2	1990 May	1990 Jun	1990 Jul pe	Growth Q4 89- Jul 90pe
-----Percent change at annual rates-----							
1. M1	0.6	4.8	3.6	-2.8	6.1	0	3½
2. M2	4.5	6.1	2.4	-2.6	2.0	1	3½
3. M3	3.3	2.6	0.3	-2.8	-0.1	0	1
							Levels bil. \$ Jun 90
-----Percent change at annual rates-----							
<u>Selected components</u>							
4. M1-A	0.4	4.2	1.6	-3.7	4.2	6	515.7
5. Currency	4.8	10.3	9.2	7.8	9.3	10	233.4
6. Demand deposits	-2.8	-0.9	-4.6	-13.8	0.0	2	274.6
7. Other checkable deposits	1.0	5.9	7.2	-0.8	9.9	-11	294.0
8. M2 minus M1 <sup>2</sup>	5.9	6.5	2.0	-2.6	0.6	1	2460.7
9. Overnight RPs and Eurodollars, NSA	-9.2	30.7	-10.8	45.9	-53.1	-12	77.8
10. General purpose and broker/dealer money market mutual fund shares	29.7	18.8	-1.0	-20.0	6.0	12	321.0
11. Commercial banks	7.5	8.5	10.4	13.3	14.1	13	1122.7
12. Savings deposits plus MMDAs <sup>3</sup>	-1.7	9.3	8.7	6.0	9.4	7	563.7
13. Small time deposits	19.0	7.8	12.1	20.8	18.7	20	559.4
14. Thrift institutions	-0.2	-1.7	-5.4	-13.1	-16.0	-12	938.0
15. Savings deposits plus MMDAs <sup>3</sup>	-9.3	2.8	1.5	-7.7	-7.7	-5	354.0
16. Small time deposits	5.8	-4.3	-9.5	-16.5	-21.0	-16	584.0
17. M3 minus M2 <sup>4</sup>	-1.4	-10.7	-7.9	-3.3	-8.8	-3	785.4
18. Large time deposits	4.2	-8.3	-10.6	-6.7	-6.5	-4	531.7
19. At commercial banks, net <sup>5</sup>	9.9	-1.6	-3.0	5.5	1.5	7	396.9
20. At thrift institutions	-7.8	-24.7	-30.4	-40.3	-29.5	-36	134.8
21. Institution-only money market mutual fund shares	17.1	10.2	11.5	5.6	0.0	17	107.3
22. Term RPs, NSA	-16.0	-39.8	0.9	3.9	20.6	-27	94.6
23. Term Eurodollars, NSA	-21.7	-51.2	-21.7	36.3	-58.1	-24	64.8
-----Average monthly change in billions of dollars-----							
<u>MEMORANDA:</u> <sup>6</sup>							
24. Managed liabilities at commercial banks (25+26)	5.9	2.2	-3.2	-0.3	-4.2	11	716.8
25. Large time deposits, gross	2.6	-2.3	-1.6	-0.5	-2.0	1	452.6
26. Nondeposit funds	3.3	4.5	-1.6	0.2	-2.2	10	264.2
27. Net due to related foreign institutions	0.2	3.3	-0.8	7.8	-9.7	2	14.8
28. Other <sup>7</sup>	3.1	1.2	-0.7	-7.7	7.6	8	249.5
29. U.S. government deposits at commercial banks <sup>8</sup>	-0.3	-0.6	0.4	-2.6	1.8	-6	20.4

1. Amounts shown are from fourth quarter to fourth quarter.

2. Nontransactions M2 is seasonally adjusted as a whole.

3. Commercial bank savings deposits excluding MMDAs grew during June and July at rates of 9.3 percent and 6 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during June and July at rates of -3.2 percent and -1 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.

pe - preliminary estimate

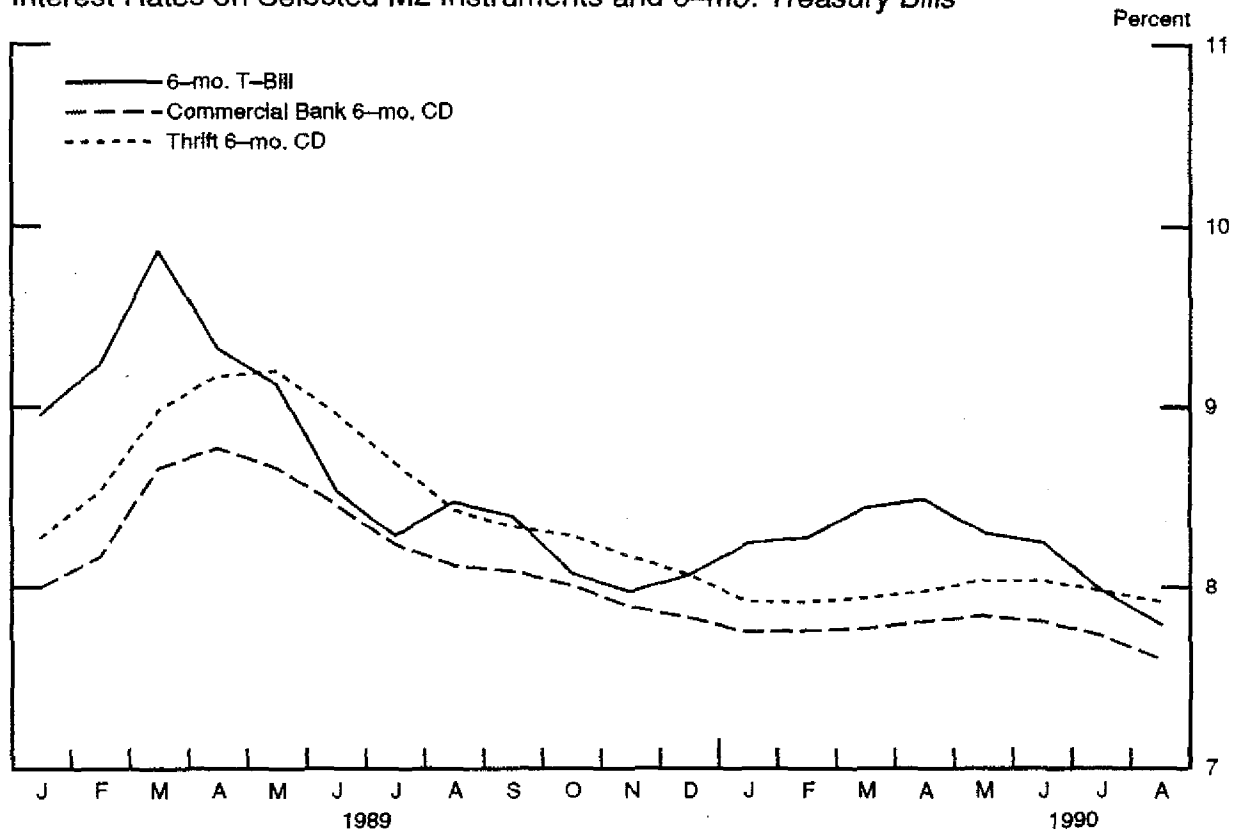
Monetary Aggregates and Bank Credit

Growth in M1 and M2 remained sluggish in July, continuing the trend of recent months. M1 was virtually unchanged in July and M2 expanded at only a 1 percent clip. The continued lethargic growth of these aggregates in July owes, in part, to an innovative funding strategy that pared 3-1/2 percentage points off M1 growth and 1 percentage point off M2 growth.

In early July, the subsidiary banks began to sweep funds out of NOW accounts each day and place them with a nonbank affiliate; the funds were then returned to the banks in the form of large time deposits, with lower reserve requirements. The maturities of the time deposit contracts were staggered so as to cover daily checks drawn against the OCDs. The transfer of funds from OCD accounts to large time accounts had no effect on M3, which grew at an annual rate of 1/4 percent in July, about in line with its recent behavior.

Growth of M2 in July continued to run well below staff econometric forecasts. These forecasts, based primarily on income and opportunity costs, began overpredicting M2 growth in the second quarter. Spreads between yields on six-month Treasury bills and CDs, shown in the accompanying chart, have narrowed in recent months, especially at thrifts, where higher relative rates may be symptomatic of the suspension of RTC efforts to replace high-cost thrift deposits. However, households typically respond with a lag to changes in the opportunity costs of holding retail deposits, and staff models suggest the rise and subsequent fall of deposit opportunity costs since late last year provided little net boost to M2 in July. The weakness in M2 in recent months has coincided with continued

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



strong demand in noncompetitive tenders for Treasury securities. The strength in noncompetitive tenders has been more than would normally be expected given prevailing rate spreads, perhaps signalling reduced demand for retail deposits in M2. Preliminary data for August show some rebound in M2, partly owing to narrower opportunity costs, but also to a surge in M2 money funds fueled by transfers from stock and bond funds.

M3 was flat in July, despite a pickup in institutional MMMFs, reflecting some slowing in bank credit and an apparent further retrenchment of thrifts. The continuing slide in M3 has placed it at the 1 percent lower limit of its new annual target range. The runoff of managed liabilities at thrifts accelerated somewhat in July, and abstracting from the effects of                    action, managed liability growth remained tepid at commercial banks. Weak credit demands, tight credit standards on some types of bank loans, and rapid inflows of deposits from thrifts have reduced banks' need for managed liabilities. So far this year, banks have funded 85 percent of their total credit growth with retail deposits, about double the proportion of recent years.

Bank credit growth in July continued to show the effects of restraint in the supply of credit and subdued demand, expanding at an annual rate of 5-1/2 percent. Much of the July increase in bank assets can be attributed to a jump in security loans at several large banks and to the transfer of real estate loans to banks by the RTC at the beginning of the month. Apart from the RTC real estate loan transfer and the continuing popularity of home equity lines, real estate credit was softer in July, reflecting the depressed residential and commercial real estate markets. Consumer loans continued to contract, largely because of an increased pace of

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

	1988:Q4	1990					Levels
	to 1989:Q4	Q1	Q2	May	June	July p	bil.\$ July p
----- Commercial Bank Credit -----							
1. Total loans and securities at banks	7.2	6.8	5.2	3.3	7.1	5.4	2669.9
2. Securities	3.9	16.8	9.3	3.4	15.7	2.9	614.6
3. U.S. government securities	9.7	24.6	15.1	9.4	24.5	5.5	436.7
4. Other securities	-6.9	-.2	-3.8	-10.6	-4.7	-4.0	177.9
5. Total loans	8.1	3.9	4.0	3.2	4.5	6.2	2055.3
6. Business loans	6.8	.6	5.2	-.6	6.1	-2.6	649.8
7. Real estate loans	12.9	10.1	10.0	12.5	9.4	11.0	801.0
8. Consumer loans	6.3	3.7	-1.4	4.4	-4.1	-4.8	376.4
9. Security loans	3.8	-18.2	-23.0	-42.2	13.4	126.3	39.9
10. Other loans	.6	-5.0	-9.0	-5.1	-15.8	15.5	188.2
----- Short- and Intermediate-Term Business Credit -----							
11. Business loans net of bankers acceptances	6.8	.1	5.0	-.8	5.6	-2.1	641.5
12. Loans at foreign branches <sup>2</sup>	-5.0	3.7	9.2	16.4	.0	21.6	22.6
13. Sum of lines 11 & 12	6.4	.3	5.1	.0	5.6	-1.4	664.1
14. Commercial paper issued by nonfinancial firms	31.2	24.5	9.3	-31.4	5.0	-13.2	144.0
15. Sum of lines 13 & 14	9.8	4.4	5.9	-5.8	5.5	-3.7	808.0
16. Bankers acceptances: U.S. trade related <sup>3,4</sup>	6.1	-19.8	-9.8	-15.1	23.0	n.a.	31.9 <sup>5</sup>
17. Line 15 plus bankers acceptances: U.S. trade related	9.7	3.4	5.2	-6.3	6.2	n.a.	842.3 <sup>5</sup>
18. Finance company loans to business <sup>3,6</sup>	10.6	4.7	15.4	11.9	25.9	n.a.	270.3 <sup>5</sup>
19. Total short- and intermediate-term business credit (sum of lines 17 & 18)	9.9	3.7	7.6	-1.8	10.8	n.a.	1112.6 <sup>5</sup>

1. Average of Wednesdays.

2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.

3. Based on average of data for current and preceding ends of month.

4. Consists of acceptances that finance U.S. imports, U.S. exports, and domestic shipment and storage of goods.

5. June data.

p--preliminary.

n.a.--not available

securitization. Securitization of consumer loans has been trending up for some time, as some banks have sought to reduce assets in order to meet the new risk-based capital standards. Even adjusting for securitizations, however, bank loans to consumers remained soft in July, likely owing to continued restraint in household credit demands.

Business loans contracted in July, with weakness especially pronounced at small banks and in the Northeast, Southeast, and Southwest. An August survey of senior loan officers at large banks revealed a further tightening of credit standards for business borrowers since the last survey in May, which had already pointed to some firming of standards for midsized and smaller firms. Over 40 percent of the respondents reported that they had applied tighter standards to applications from midsized firms for non-merger-related loans, while about one-third reported tighter standards for larger and smaller firms. Terms on credit extensions were also tightened, with a sizable minority of respondents reporting they had cut the maximum size of credit lines and increased their cost, raised spreads of loan rates over base rates, and imposed more stringent loan covenants and more extensive collateral requirements. The survey also addressed, for the first time, lending practices at U.S. agencies and branches of foreign banks. About 60 percent of these respondents reported that they had tightened standards for nonmerger credits to U.S. businesses during the last six months.

In response to the more cautious bank lending posture, businesses apparently have been seeking credit from other sources or applying for loan guarantees. For example, business loans at finance companies increased at a 26 percent annual rate in June and 15 percent in the second quarter, far



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

	1987	1988	1989	1990				
	Year	Year	Year	Q1	Q2 <sup>P</sup>	May <sup>P</sup>	June <sup>P</sup>	July <sup>P</sup>
Corporate securities - total <sup>1</sup>	24.12	22.39	19.80	16.89	23.30	24.64	29.87	16.94
Public offerings in U.S.	21.93	20.37	17.74	15.00	20.41	21.05	25.87	13.87
Stocks--total <sup>2</sup>	4.45	3.53	2.69	3.00	2.33	2.35	2.87	2.37
Nonfinancial	2.32	1.14	1.09	1.58	1.29	1.67	1.07	1.55
Utility	.57	.24	.29	.41	.38	.88	.06	.50
Industrial	1.75	.90	.80	1.18	.91	.79	1.01	1.05
Financial	2.12	2.39	1.60	1.42	1.04	.68	1.80	.82
Bonds--total <sup>1</sup>	17.48	16.84	15.05	12.00	18.08	18.70	23.00	11.50
Nonfinancial	6.58	6.17	6.22	3.77	6.62	5.20	9.75	3.60
Utility	2.02	1.78	1.75	1.22	2.30	2.15	3.60	1.05
Industrial	4.56	4.39	4.47	2.55	4.32	3.05	6.15	2.55
Financial <sup>3</sup>	10.90	10.67	8.83	8.23	11.46	13.50	13.25	7.90
By quality								
Aaa and Aa	3.30	2.73	3.28	2.64	3.62	4.95	3.35	4.50
A and Baa	5.22	5.50	5.65	4.27	8.28	6.60	12.30	3.75
Less than Baa	2.77	2.59	2.39	.17	.24	.40	.27	.18
No rating (or unknown)	.07	.04	.04	.00	.07	.00	.19	.00
Memo items:								
Equity-based bonds <sup>4</sup>	.87	.28	.52	.05	.88	.40	2.01	.11
Mortgage-backed bonds	5.19	4.72	1.67	1.64	2.90	4.50	1.60	.70
Other asset-backed	.93	1.26	2.02	3.28	2.97	2.25	5.29	2.37
Variable-rate notes	1.88	1.19	1.01	1.39	.25	.01	.04	.00
Bonds sold abroad - total	2.03	1.93	1.90	1.62	2.49	3.15	3.40	2.80
Nonfinancial	.94	.73	.48	.38	.64	.51	1.00	.45
Financial	1.09	1.20	1.42	1.24	1.85	2.64	2.40	2.35
Stocks sold abroad - total	.16	.09	.16	.27	.40	.44	.60	.27
Nonfinancial	.12	.08	.12	.10	.15	.31	.05	.12
Financial	.04	.01	.04	.17	.25	.13	.55	.15

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.

outstripping growth at banks. The Small Business Administration has recorded a pickup in the demand for its loan guarantees in recent months, suggesting that some small business borrowers may be coping with availability constraints by seeking credit enhancements.

#### Business Finance

Borrowing in the commercial paper and bond markets by nonfinancial firms paralleled the lagging growth in business credit at banks. Gross public bond issuance in July fell to its slowest pace of the year, and commercial paper also ran off. The fall in commercial paper outstanding may be due partly to the delayed effects of the June surge in bond issuance, when several firms saw the drop in long-term yields as an opportunity to substitute bonds for short-term debt.

Concerns about credit quality have continued to loom large in securities markets. Downgrades exceeded upgrades by more than 6 to 1 in dollar terms in the second quarter. Nationwide, commercial real estate difficulties and regional residential property problems have helped spur the downgradings of many banks. In the nonfinancial sector, downgrades were concentrated among speculative-grade issues.

Even more creditworthy borrowers have been subject to closer scrutiny by the market. For example, rate tiering in the A2/P2 commercial paper category has become more marked, with lower quality paper reportedly trading at rates up to 15 basis points higher than more desirable A2/P2 issues.<sup>1</sup> This has been due in part to increasing concern about possible defaults. The same concern led the SEC to propose a rule restricting money fund

---

1. Issuers of A2/P2 commercial paper have investment-grade long-term debt ratings ranging from A+ to BBB. Nearly 15 percent of total commercial paper outstanding falls in the A2/P2 category.

ownership of A2/P2 paper to 5 percent of total assets. Currently, money funds face no restrictions on total holdings of A2/P2 paper, although they may not hold lower-rated securities. Money funds have reportedly become selective in purchasing A2/P2 paper. However, because money fund holdings of A2/P2 paper appear to be relatively small, their reduced presence in the A2/P2 market should not by itself create funding problems for issuers. In the below-investment-grade bond market, there were some encouraging developments, including the steps announced by RJR to buy back some of its junk bonds and by Columbia Savings and Loan to sell its large junk portfolio. The spread between high-yield bonds and the 10-year Treasury note rate narrowed a bit as a result. Issuance of new junk bonds remained negligible throughout July.

Gross equity issuance by nonfinancial firms remained quite strong in July. Initial public offerings exceeded \$1 billion, the largest figure for the year, as many high-tech firms took advantage of the high level of stock prices in July to go public. However, the recent steep declines in stock prices chilled the new issue market, reportedly resulting in the postponement of several planned issues.

#### Thrift Industry Developments

First-quarter losses for nonintervened thrifts fell sharply from the last quarter of 1989, driven largely by reduced loan-loss provisions. However, loan-loss provisions tend to be larger at year-end, so the improvement in earnings may be illusory. Compared to the first quarter of 1989, provisions for loan losses were up slightly. Total assets declined about 1 percent during the quarter, contributing to a small improvement in the ratio of tangible capital to assets. Thrifts likely continued to shed

assets at a rapid pace in the second quarter, judging by the sizable runoffs of thrift liabilities.

Because complete data are not yet available, the overall performance of thrift earnings in the second quarter is hard to discern. Several California institutions have released second-quarter reports that indicated relatively healthy earnings, but the trend in loan-loss provisions among them is disturbing. Losses at Coast Savings, HomeFed, CalFed, and Great American Bank were driven mainly by large loan-loss provisions for loans on real estate in Arizona and Texas, but problems on California loans have begun to surface. As much as 37 percent of HomeFed's nonperforming assets are now in California, and CalFed cited a deterioration in its California loan portfolio as the main reason for its loss. H.F. Ahmanson, widely considered the healthiest thrift in the country, also experienced an increase in nonperforming loans on California real estate. While the California market is still considered strong relative to the rest of the nation, these increases in nonperforming loans and similar experiences at California banks have raised questions concerning the underlying strength of the state's real estate market.

#### Treasury and Sponsored Agency Financing

Staff projections put the third-quarter federal government deficit at about \$60 billion, bringing the total for the fiscal year to a record \$223 billion. RTC's third-quarter needs for working capital are estimated at \$34 billion, although its outlays to this point in the quarter amount to only about \$5 billion. The Treasury is expected to finance the deficit with a record \$68 billion of marketable borrowing in the third quarter, including \$32 billion in the bill market and \$36 billion in the coupon market. The

TREASURY AND AGENCY FINANCING<sup>1</sup>  
(Total for period; billions of dollars)

	1990				
	Q2	Q3 <sup>e</sup>	Jul. <sup>p</sup>	Aug. <sup>e</sup>	Sept. <sup>e</sup>
<u>Treasury financing</u>					
Total surplus/deficit (-)	-12.0	-60.1	-24.3	-55.7	19.9
Means of financing deficit:					
Net cash borrowing					
from the public	41.0	72.9	24.8	46.1	2.1
Marketable borrowings/ repayments (-)	32.6	67.7	21.1	46.0	0.6
Bills	.5	31.8	11.3	29.1	-8.6
Coupons	32.1	36.0	9.8	16.9	9.3
Nonmarketable <sup>2</sup>	8.3	5.2	3.7	.1	1.4
Decrease in the cash balance	-16.2	-3.8	9.8	2.5	-16.0
Memo: Cash balance at end of period	34.6	38.4	24.9	22.4	38.4
Other <sup>3</sup>	-12.8	-9.1	-10.3	7.2	-5.9
<u>Federally sponsored credit agencies, net cash borrowing<sup>4</sup></u>					
	2.5	--	--	--	--
FHLBs	-8.5	--	--	--	--
FHLMC	4.9	--	--	--	--
FNMA	1.1	--	--	--	--
Farm Credit Banks	.0	--	--	--	--
FAC	.0	--	--	--	--
SLMA	1.4	--	--	--	--
FICO	.0	.0	.0	.0	.0
REFCORP	3.5	5.0	5.0	.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.

e--staff estimate

p--preliminary

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

gross sizes of the weekly bill auctions have already crept up over the intermeeting period from an average of \$17.2 billion to \$18.4 billion, while the auction sizes of other issues have been boosted as much as \$1 billion. Results of the Treasury's August midquarter refunding were mixed, with the three- and ten-year note issues meeting a cool reception, while the thirty-year bond sold surprisingly well, contributing to a brief 12-basis-point rally in the market.

REFCORP returned to a thirty-year maturity in its July auction. The \$5 billion offering came at a 38-basis-point spread over the thirty-year Treasury bond, about 10 basis points higher than the spread for the original \$4-1/2 billion thirty-year REFCORP bonds auctioned in October 1989. Overall, however, spreads for the agency market remained tight as total agency debt outstanding has grown slowly. The total debt of government-sponsored enterprises increased only \$10 billion over the last four quarters, about \$25 billion lower than the pace in the preceding few years. Much of this slowdown is due to the decline in Home Loan Bank debt outstanding, which stemmed from paydowns of advances by thrifts.

In recent weeks, the Student Loan Marketing Association has suffered from its relationship to the troubled Higher Education Assistance Foundation (HEAF).<sup>2</sup> About \$2-1/2 billion of Sallie Mae's \$16 billion loan portfolio is guaranteed by HEAF, and Sallie Mae has extended about \$800 million in

---

2. HEAF is one of the largest of 47 state and nonprofit agencies that insure Guaranteed Student Loan Program loans, insuring about 10 percent of the \$50 billion in loans outstanding. In case of losses, the guarantor agencies have recourse to the Department of Education at a rate dependent upon the loss rate of the guarantor agency's loan portfolio. The higher the loss rate, the lower the reimbursement rate from the Department of Education on any nonperforming loans. HEAF's loss rate entitles it to only 80 percent reimbursement of its losses.

loans to HEAF and HEAF-related entities. However, Sallie Mae reportedly believes its risk of loss is minimal because its HEAF loans are fully collateralized, and the Department of Education has recently reaffirmed its backing of HEAF guarantees. The market, though, is still wary; spreads on Sallie Mae's debt have widened about 5 basis points, and its stock price is down 18 percent since HEAF's difficulties came to light.

Concerns about government-sponsored enterprises (GSEs) prompted the Treasury to submit a proposal at the ongoing budget summit negotiations that would require GSEs to obtain a triple-A debt rating by at least two nationally recognized rating agencies. The ratings are to be based solely on the GSEs' financial health without reliance on implicit federal guarantees or other advantages of agency status--a more stringent standard than was proposed in the Treasury's May GSE report. GSEs failing this test within a prescribed period would be subject to restrictions and oversight by the Treasury.

#### State and Local Government Finance

Gross issuance of long-term tax-exempt securities is estimated to have slackened in July from its strong June pace. Offerings to finance new capital expenditures and to refund outstanding debt were both off. Short-term volume, which had been boosted in June by New York State's heavy issuance, returned to a more normal level in July but may jump again in August as California recently announced plans to issue \$4.1 billion in short-term debt.

The credit quality of municipal issuers deteriorated further in the second quarter, with downgrades outpacing upgrades by three to one. The

downgrades were especially widespread among housing issues, owing to a decline in the ratings of banks providing credit support.

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

	1988	1989	1989	1990		1990		
	Year	Year	Q4	Q1	Q2	May	June <sup>P</sup>	July <sup>P</sup>
Total offerings <sup>1</sup>	11.73	11.90	12.78	8.85	14.62	13.41	21.32	10.26
Total tax-exempt	11.41	11.65	12.13	8.73	14.38	13.22	20.93	10.15
Long-term	9.54	9.47	10.76	7.63	11.41	12.03	13.63	7.57
Refundings <sup>2</sup>	2.90	2.47	2.35	1.45	1.58	1.55	2.65	.12
New capital	6.64	7.01	8.41	6.19	9.73	10.49	10.97	7.45
Short-term	1.87	2.17	1.37	1.10	2.97	1.19	7.30	2.58
Total taxable	.32	.25	.34	.12	.23	.19	.39	.11

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

2. Includes all refunding bonds, not just advance refundings.  
p--preliminary.

The Congress recently amended federal legislation to allow issuers of tax-exempt securities to invest a sizable proportion of proceeds in taxable securities for more than two years. As a result, tax-exempt entities undertaking construction projects have a much stronger incentive to issue tax-exempt bonds in advance of the projects' completion dates in order to earn arbitrage profits. California, the largest of these issuers, has already announced its plans to pursue this strategy, and other states are expected to follow suit.

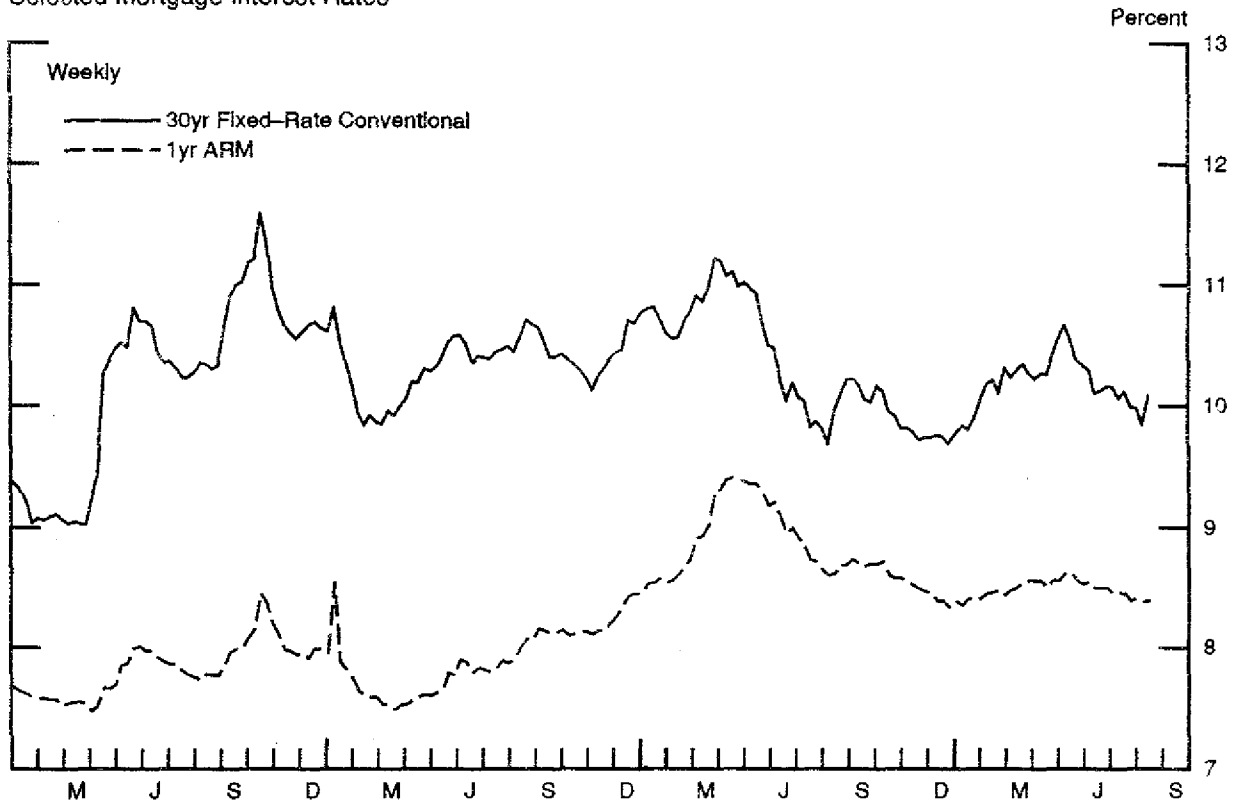
#### Mortgage Markets

Available indicators suggest that mortgage borrowing remained subdued in July. Growth of real estate loans at commercial banks decelerated after allowance for transfers of mortgage assets in thrift resolutions. Sharp

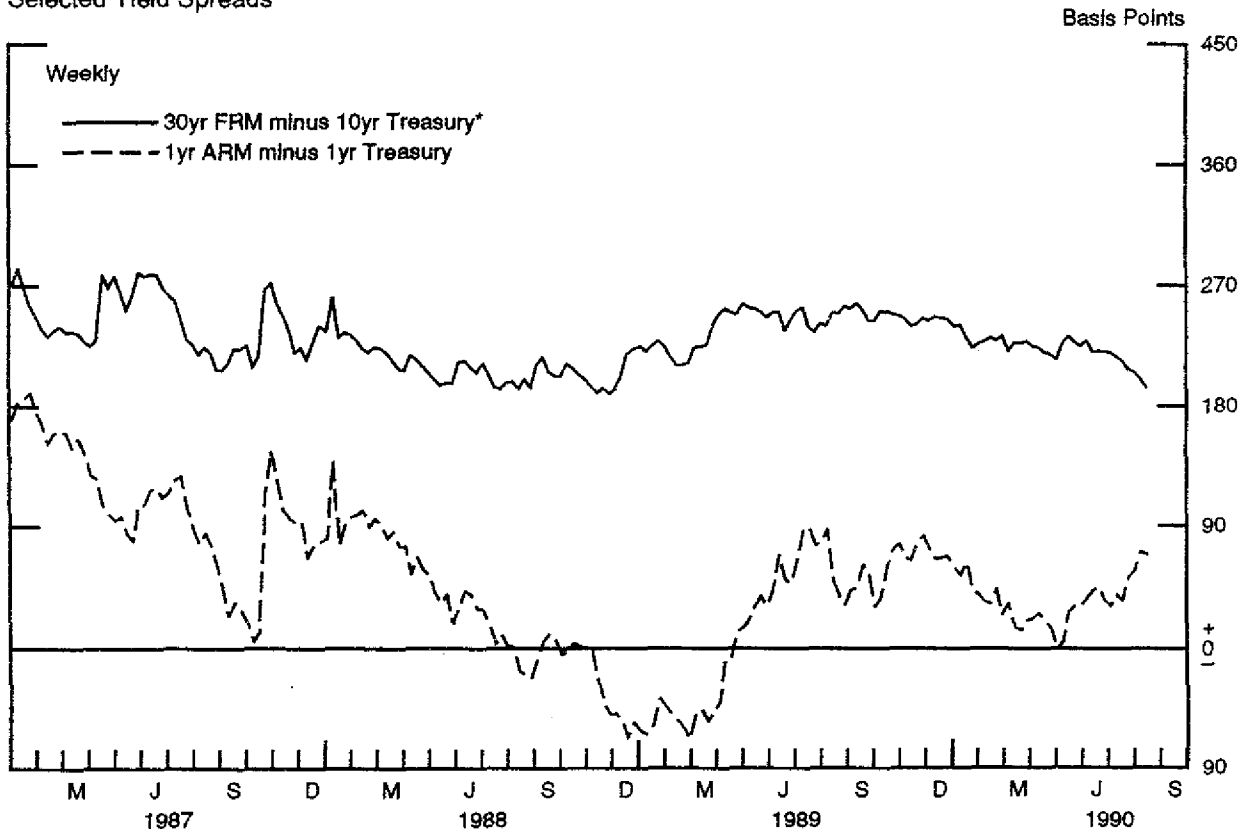


### Mortgage Markets

Selected Mortgage Interest Rates



Selected Yield Spreads



\*30yr FRM is bond-yield equivalent.

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

	Federally related pass-through securities			Multiclass securities				
	Total	Total	ARM-	Total	Private	FNMA	FHLMC	Agency
	(SA)	(NSA)	backed		issues <sup>1</sup>	REMICs <sup>2</sup>	REMICs	strips
1988	12.5	12.6	2.4	6.9	4.2	.9	1.2	.6
1989	16.8	16.7	2.6	8.1	1.4	3.1	3.2	.3
1988-Q4	14.6	14.5	2.6	8.0	4.3	1.2	1.8	.7
1989-Q1	15.9	13.7	3.1	6.6	2.5	1.2	2.5	.4
Q2	13.5	13.8	2.8	5.2	.6	2.4	2.1	.1
Q3	15.9	17.8	2.5	9.8	1.2	3.6	4.4	.5
Q4	21.7	21.6	2.2	10.7	1.2	5.2	4.0	.4
1990-Q1 r	23.2	19.8	1.4	11.3	1.6	5.0	3.8	.9
Q2 p	18.0	18.4	2.2	10.8	2.7	4.7	3.0	.4
1989-July	13.3	15.5	2.9	10.5	1.2	4.9	3.3	1.1
Aug.	15.7	17.2	2.3	9.7	1.5	3.3	4.6	.3
Sept.	18.7	20.7	2.2	9.1	1.0	2.7	5.2	.2
Oct.	19.4	19.3	1.7	10.1	1.1	5.1	3.9	.0
Nov.	23.2	21.6	1.5	12.1	.9	6.1	4.5	.7
Dec.	22.6	24.0	3.3	9.8	1.5	4.4	3.5	.5
1990-Jan.	25.3	20.7	0.8	11.1	2.2	3.9	4.2	.8
Feb.	21.8	19.0	1.0	7.5	0.9	3.5	2.6	.5
Mar. r	22.4	19.8	2.5	15.2	1.8	7.6	4.5	1.4
Apr. r	17.7	18.0	1.9	9.1	2.4	4.5	2.2	.0
May p	18.0	16.8	2.5	12.4	4.4	5.0	3.0	.0
June p	18.2	20.3	2.2	11.1	1.3	4.7	3.8	1.3
July p	n.a.	n.a.	n.a.	n.a.	0.1	6.7	n.a.	n.a.

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

CONSUMER CREDIT  
(Seasonally adjusted)

	Percent change (at annual rate)						Net change (billions of dollars)		Memo: Outstandings (billions of dollars)
	1988	1989 <sup>1</sup>	1990		1990		1990		1990
			Q1	Q2 <sup>P</sup>	May <sup>r</sup>	June <sup>P</sup>	May <sup>r</sup>	June <sup>P</sup>	June <sup>P</sup>
Total installment	8.9	5.5	2.1	2.5	6.1	.8	3.65	.46	724.9
Installment, excluding auto	10.3	8.6	3.4	7.5	10.2	5.6	3.65	2.05	437.6
Selected types									
Auto	7.0	1.3	.2	-4.9	-.0	-6.5	-.00	-1.58	287.3
Revolving	13.7	14.2	10.5	12.2	18.8	7.6	3.19	1.30	208.5
All other	7.6	4.2	-2.6	3.2	2.5	3.9	.47	.74	229.1
Memorandum:									
Total <sup>2</sup>	7.3	5.0	2.4	2.4	4.0	5.6	2.60	3.53	787.4

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				
				Feb.	Mar.	Apr.	May	June
At commercial banks <sup>1</sup>								
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. <sup>2</sup>								
New cars	10.73	12.60	12.62	12.67	12.31	12.21	12.23	12.58
Used cars	14.61	15.11	16.18	15.91	15.97	16.02	16.03	16.00

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.

declines in thrift liabilities continued last month, suggesting that thrifts further pared their mortgage assets.

Interest rates on fixed-rate mortgages have generally trended lower relative to Treasuries in recent months (chart), partly reflecting a sagging demand for credit in the housing sector. Issuance of fixed-rate mortgage-backed pass-throughs (table) has remained strong, however, as FRMs have accounted for about 70 percent of new mortgage production in recent months.

ARMs, meanwhile, accounted for 32 percent of all conventional home loans closed in June, up a bit from the May level. In contrast with fixed-rate mortgage pricing, spreads between ARM rates and short-term Treasuries widened slightly over the intermeeting period. ARM rates respond to short-term Treasury yields with a lag and yields on short-dated Treasuries dropped sharply in recent weeks, responding to the System easing in mid-July and the unsettling movements in equity and bond prices in early August. In addition, initial rate discounting of ARMs has moderated in recent months, probably because banks are concerned about the creditworthiness of loan applicants and perhaps because they feel less competitive pressure.

#### Consumer Installment Credit

Consumer installment credit grew less than 1 percent at an annual rate in June, holding its second-quarter growth to a 2-1/2 percent pace. This performance marked little increase over the first quarter, so that the first half of 1990 was the weakest two-quarter period since 1980.

Automobile credit accounted for most of the drag on installment credit growth, both in June and in the second quarter, reflecting the modest pace of retail sales at auto dealers over the same period. While the sales and credit series often diverge on a month-to-month basis, partly because of

RETAIL SALES OF AUTO DEALERS AND AUTOMOBILE CREDIT

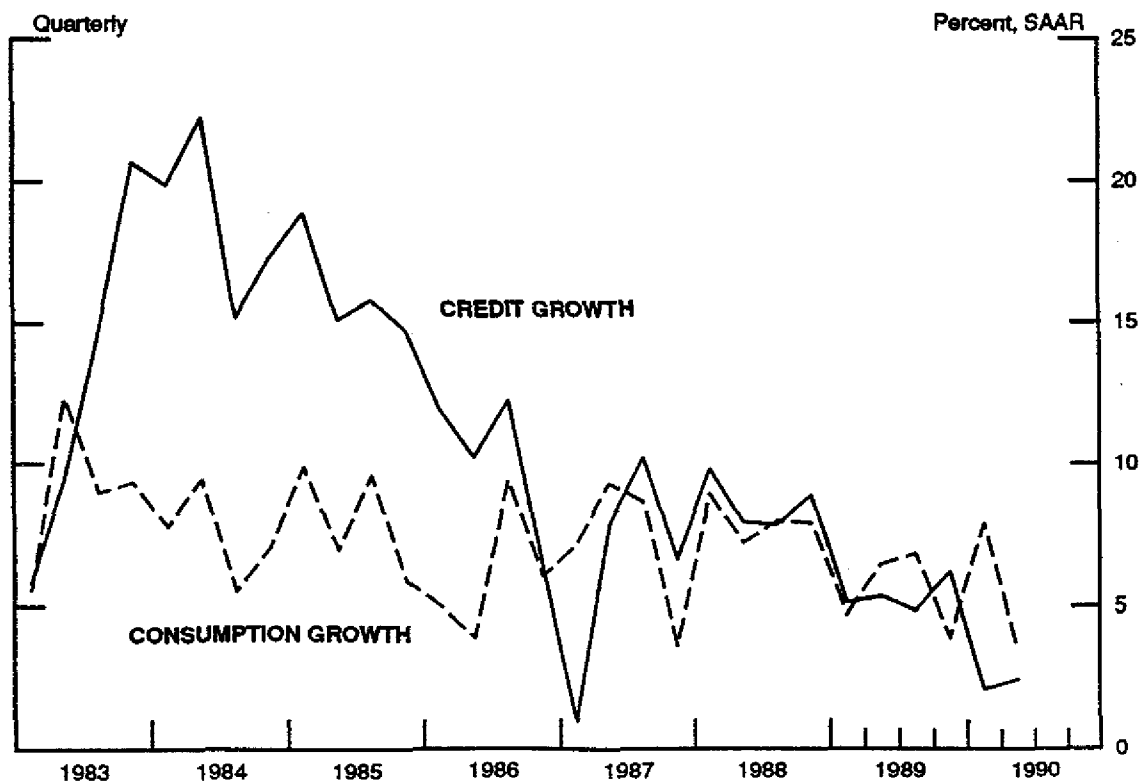
Period	Retail Sales, Auto Dealers			Automobile Credit		
	Billions of Dollars		Percentage	Billions of Dollars		Percentage
	Volume	Growth	Change	Outstanding	Growth	Change
1983	230.1	37.6	19.5	143.6	17.7	13.9
1984	273.4	43.4	18.9	173.6	30.0	20.9
1985	303.3	29.9	10.9	210.3	36.6	21.1
1986	326.3	22.9	7.6	247.4	37.1	17.6
1987	342.9	16.6	5.1	265.9	18.5	7.5
1988	371.6	28.7	8.4	284.3	18.8	7.1
1989	378.4	6.8	1.8	290.9	3.7 <sup>1</sup>	1.3

--seasonally adjusted, at annual rates--

1990-Q1	384.7	54.4	14.7	290.9	.6	0.2
-Q2 (p)	369.8	-59.6	-15.5	287.4	-14.3	-4.9

1. Adjusted for break in series in January, 1989.  
p--preliminary.

GROWTH IN CONSUMER INSTALLMENT CREDIT AND CONSUMPTION



lags between the recording of an auto sale and the booking of the related loan, they track fairly closely over a longer period. Last year, dealer sales slid to a 1-3/4 percent rate of growth, a pace at least two-thirds slower than in any of the previous six years. Auto credit experienced a similar slowdown, expanding only 1-1/4 percent during the year (see table). The story in 1990 is much the same. Sales have declined on balance over the first half of the year, and auto credit at midyear had contracted about 1 percent since year-end.

Revolving credit remained the strongest component of consumer credit, although June's 7-1/2 percent pace was less than half the rate recorded in May and well below that of recent years. Robust growth recorded in April and May kept revolving credit climbing at a 12 percent rate during the second quarter, up from 10-1/2 percent in the first.

The meager advance in consumer credit this year appears generally consistent with the pattern of consumer spending (see chart). In the early stages of an economic expansion, growth in consumer credit typically outstrips the growth in spending, then gravitates toward the spending path as the expansion matures. This pattern of initial fast growth in credit and subsequent moderation reflects two major factors. First, spending on durable goods, the element of consumption most closely related to consumer borrowing, is generally a higher proportion of total spending early in the expansion than it is later. Second, the stream of debt repayments is relatively small at the outset of an expansion, reflecting the lower levels of borrowing in the previous recession. As the expansion matures, repayments accelerate and serve as a larger offset to new borrowing, thereby slowing the growth of the debt stock.

The use of home equity lines of credit to finance consumer outlays has also damped the growth of consumer credit during the past few years, possibly trimming its rate of growth by 1 to 2 percentage points. At banks, borrowing against home equity lines through July of 1990 has been growing about 20 percent at an annual rate, bringing the total amount of home equity credit to \$55 billion at banks and possibly as much as \$100 billion at all lenders. Some banks have been tightening standards for granting home equity lines and offering less liberal terms, particularly in the Northeast where real estate values have weakened and delinquency rates have risen on home equity lines (see table). However, the pinch of tighter rules appears to have been relatively modest and the stricter guidelines are likely to exert little restraining effect on already existing accounts. Household surveys taken last year indicated that one in five line holders had not drawn against their lines at the time of the survey. Moreover, those who had tapped their lines had used only 40 percent of their lines on average. As a result, there appears to be ample scope for home equity credit to continue its recent rapid growth despite tighter lending standards.

DELINQUENCY RATES ON HOME EQUITY LINES OF CREDIT AT BANKS  
U.S. Total and Selected States  
(First quarter data, nsa)

State	1988	1989	1990
Connecticut	.96	1.30	2.25
Maine	.94	.97	1.90
Massachusetts	.59	.84	1.18
New Hampshire	.73	1.91	2.59
New York	1.12	1.71	1.69
Rhode Island	.55	.76	1.02
U.S. Total	.67	.67	.79

Note: Figures represent the number of loans delinquent as a percent of the number of accounts, as reported by the American Bankers Association.

# **INTERNATIONAL DEVELOPMENTS**

---



INTERNATIONAL DEVELOPMENTS

U.S. Merchandise Trade

The deficit on merchandise trade increased slightly in May to \$7.7 billion (seasonally adjusted, Census basis), from the revised \$7.3 billion deficit recorded in April. Increases in non-agricultural exports in May were more than offset by increases in imports of oil and non-oil products. Trade data for June will be released on August 17 and will be reported in the Greenbook supplement.

Oil imports increased slightly in May, as a surge in quantity was partly offset by a fall in prices. The increase in the quantity of imported oil resulted from further additions to oil stocks, since consumption was

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

	Exports			Imports			Balance
	Total	Ag.	Nonag.	Total	Oil (nsa)	Non-oil	
1989-Jan	28.4	3.2	25.2	37.4	3.5	33.9	-9.1
Feb	28.4	3.4	25.0	38.2	3.2	35.0	-9.8
Mar	30.8	3.9	26.9	39.9	3.7	36.2	-9.0
Apr	30.4	3.7	26.7	38.7	4.0	34.7	-8.3
May	30.7	3.5	27.2	41.0	4.7	36.3	-10.3
Jun	31.6	3.3	28.3	39.5	4.2	35.3	-8.0
Jul	29.9	3.3	26.6	39.0	4.3	34.7	-9.1
Aug	30.2	3.1	27.1	40.5	4.3	36.2	-10.3
Sep	30.1	3.3	26.8	38.9	4.0	34.9	-8.8
Oct	31.4	3.2	28.2	41.6	4.4	37.2	-10.2
Nov	30.6	3.4	27.2	40.5	4.4	36.1	-9.9
Dec	31.3	3.3	28.0	38.1	4.1	34.0	-6.8
1990-Jan	31.4	3.6	27.8	41.6	5.9	35.7	-10.2
Feb	31.6	3.4	28.2	38.7	4.7	34.0	-7.1
Mar	33.3	3.7	29.6	41.6	4.7	36.9	-8.4
Apr <sup>r</sup>	32.1	3.3	28.8	39.4	3.8	35.6	-7.3
May <sup>p</sup>	32.8	3.2	29.6	40.5	4.4	36.1	-7.7

r--revised

p--preliminary

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

about unchanged from the beginning of the year. The decline in oil prices during May continued the downward trend that began early in the year, reflecting strength in OPEC production. From May through early July, the spot price of West Texas Intermediate declined from \$18.24 to \$16.50 per barrel, with OPEC showing little inclination to limit the flow of oil.

OIL IMPORTS  
(BOP basis, value at annual rates, not seasonally adjusted)

	1989				1990			
	Q1	Q2	Q3	Q4	Q1	Apr/May	Apr-r	May-p
Value (Bil. \$)	43.52	54.08	52.69	53.29	62.43	50.08	46.94	53.21
Price (\$/BBL)	15.44	18.32	16.75	17.67	19.47	16.29	16.86	15.81
Quantity (mb/d)	7.83	8.11	8.55	8.20	8.90	8.40	7.73	9.05

p--preliminary.

Oil prices reversed their decline in the middle of July, when the Persian Gulf OPEC producers announced an informal production agreement that became a formal OPEC accord in late July. The agreement called for production restraint of 1 mb/d relative to July rates of crude production (23.2 mb/d); this brought the spot price of West Texas Intermediate close to \$19 per barrel by July 12th. The price increased a further \$2.50 per barrel in response to threats from Iraq and movement of Iraqi troops towards the border with Kuwait. Following the invasion of Kuwait, oil prices peaked at nearly \$30 per barrel on August 7. Over the past week, prices have settled at roughly \$26.50 per barrel as tensions in the Middle East continue.

The trade deficit continued to narrow in April/May, improving by roughly \$9 billion on a balance of payments basis from the first-quarter deficit. The improvement in the April/May balance relative to the first quarter was due entirely to the significant decline in the value of oil imports that more than offset lower agricultural exports. Declines in shipments of wheat, corn, soybeans, and cotton were responsible for the drop

in agricultural exports during April/May. A small decline in exports of nonagricultural products was about offset by a decline in imports of non-oil goods.

While there were essentially no changes in the composition of non-oil imports from the first quarter to April/May, there were some shifts across the categories of nonagricultural exports. Automotive exports increased

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	320.3	38.2	282.1	447.3	39.6	407.7	-127.0
1989	360.5	41.5	319.0	475.3	50.9	424.4	-114.9
<u>Quarters:</u>							
1988-1	306.0	35.7	270.2	440.0	39.9	400.0	-134.0
2	317.6	37.4	280.2	442.0	41.1	400.8	-124.4
3	322.0	40.5	281.6	445.2	39.5	405.6	-123.1
4	335.7	39.4	296.4	462.2	37.9	424.3	-126.5
1989-1	353.1	42.6	310.5	465.4	43.5	421.9	-112.4
2	364.4	42.7	321.7	477.3	54.1	423.3	-112.9
3	357.4	39.7	317.7	476.6	52.7	423.9	-119.2
4	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
A/M-e	380	40	340	477	50	427	-97

Source: U.S. Department of Commerce, Bureau of Economic Analysis.  
e -- FR staff estimate.

almost 10 percent, reflecting a rise in shipments not only to Canada but to other countries as well. Offsetting this were declines in exports of industrial supplies and capital goods, particularly computers and other machinery.

#### Import and Export Prices

As reported by the Bureau of Labor Statistics, prices of non-oil imports fell 2.1 percent in the second quarter, reflecting continued

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

	Year	1989			1990	
	1989	Q2	Q3	Q4	Q1	A/M-e
Agricultural Exports	41.5	42.7	39.7	40.9	43.8	40
Nonagricultural Exports	319.0	321.7	317.7	326.1	340.4	340
Industrial Supplies	90.6	94.0	90.5	89.0	94.0	93
Gold	2.5	3.0	2.6	2.1	2.4	3
Fuels	12.1	12.8	11.0	12.2	12.8	11
Other Ind. Supp.	76.0	78.2	76.9	74.7	78.8	79
Capital Goods	138.0	138.4	141.1	140.8	152.9	150
Aircraft & Parts	26.5	27.3	29.7	25.6	32.3	32
Computers & Parts	24.2	24.1	24.6	24.7	26.5	25
Other Machinery	87.3	87.0	86.8	90.5	94.1	93
Automotive Products	34.7	34.3	33.0	35.6	34.6	38
Canada	22.5	22.0	21.5	22.8	20.8	23
Other	12.2	12.2	11.5	12.9	13.8	15
Consumer Goods	35.4	35.0	35.0	38.0	40.7	42
Other Nonagric.	20.3	20.1	18.1	22.7	18.3	17
Oil Imports	50.9	54.1	52.7	53.3	62.4	50
Non-Oil Imports	424.4	423.3	423.9	428.6	427.2	427
Industrial Supplies	84.1	85.1	82.5	83.2	80.1	81
Gold	3.6	3.7	3.4	4.3	1.8	1
Other Fuels	3.2	3.2	3.1	3.7	2.9	3
Other Ind. Supp.	77.3	78.2	76.0	75.2	75.4	77
Capital Goods	113.1	114.0	113.1	116.5	115.5	115
Aircraft & Parts	9.5	10.2	9.2	9.0	9.3	10
Computers & Parts	21.5	20.9	22.5	23.4	23.0	23
Other Machinery	82.1	82.9	81.4	84.1	83.2	82
Automotive Products	86.0	84.5	85.4	83.0	84.0	84
Canada	22.5	29.1	29.1	29.6	27.7	30
Other	56.5	55.4	56.3	53.4	56.3	54
Consumer Goods	102.8	101.3	104.9	106.4	103.3	104
Foods	25.1	25.2	24.7	25.0	27.7	27
Other Non-oil	13.4	13.1	13.3	14.5	16.7	16

e--FR staff estimate.

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

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

	Year		Quarters			Months	
	1990-Q2	1989-Q2	1989	1990		1990	
			Q4	Q1	Q2	May	June
	(annual rates)					(monthly rates)	
- - - - - BLS Prices - - - - -							
<u>Imports, Total</u>	-0.7	5.2	3.7	-6.4	-0.5	-0.4	
Foods, Feeds, Bev.	0.8	7.3	11.5	2.2	-1.1	2.3	
Industrial Supplies	-6.3	8.6	-0.4	-18.1	-1.1	-2.0	
Ind Supp Ex Oil	-3.9	-2.2	-2.2	-3.8	-0.1*	-1.1*	
Capital Goods	2.4	2.8	9.1	-0.9	0.0	0.2	
Automotive Products	0.0	5.7	-0.3	-5.4	-1.1	0.6	
Consumer Goods	3.1	4.1	6.9	0.3	0.4	-0.8	
Memo:							
Oil	-11.7	35.8	3.3	-42.8	-3.3	-4.2	
Non-oil	0.4	2.9	3.8	-2.1	-0.3	-0.1	
<u>Exports, Total</u>	0.1	0.0	1.8	1.4	0.3	-0.2	
Foods, Feeds, Bev.	-7.2	-7.4	-3.3	5.7	2.7	-2.9	
Industrial Supplies	-2.2	-2.7	0.0	-1.7	-0.3	-0.1	
Capital Goods	2.9	2.2	4.1	2.2	0.0	0.4	
Automotive Products	2.8	4.8	1.8	1.4	0.1	0.2	
Consumer Goods	3.5	2.1	6.3	2.4	0.6	0.0	
Memo:							
Agricultural	-4.0	-4.9	-1.1	7.1	2.1	-1.9	
Nonagricultural	0.6	0.4	2.1	0.4	-0.1	0.1	
- - - - - Prices in the GNP Accounts - - - - -							
<u>Fixed-Weight</u>							
Imports, Total	-1.7	3.2	10.1	-9.9	--	--	
Oil	-12.5	20.9	48.2	-54.3	--	--	
Non-oil	0.0	0.7	4.9	0.0	--	--	
Exports, Total	0.0	-2.2	3.8	1.5	--	--	
Ag.	-4.0	-15.2	2.7	7.4	--	--	
Nonag.	0.8	0.6	4.1	0.4	--	--	
<u>Deflators</u>							
Imports, Total	-3.8	0.4	5.4	-8.0	--	--	
Oil	-12.6	20.9	48.2	-54.4	--	--	
Non-oil	-2.8	-3.7	2.8	-1.0	--	--	
Exports, Total	-1.3	-2.7	-0.6	4.2	--	--	
Ag.	-4.0	-15.2	2.7	7.4	--	--	
Nonag.	-0.9	-1.1	-1.2	4.0	--	--	

\*Not for publication.

declines in the prices of non-oil industrial supplies and automotive products. Prices of imported capital goods also dropped slightly. The small decline in non-oil import prices in the second quarter resulted partly in response to an appreciation of the dollar against the Japanese yen that was largely offset by depreciation against other currencies.

Prices for U.S. exports increased 1.4 percent in the second quarter, led by increases in agricultural prices. Prices of exported corn and soybean rose significantly, and cotton prices edged up slightly. For non-agricultural exports, increasing prices for capital goods, automotive products, and consumer goods were largely offset by a decline in prices of industrial supplies.

#### U.S. International Financial Transactions

Available data for the second quarter indicate that net private capital outflows exceeded net official inflows by almost \$4 billion. While these data do not include direct investment flows and are subject to revision, it is likely that recorded capital inflows for the quarter will be quite modest in relation to the current account deficit, resulting in a large positive statistical discrepancy. The statistical discrepancy in the first quarter was also very large and positive.

One partial explanation for the large positive statistical discrepancy this year is the rapid increase in currency held by foreigners. Reports from several large U.S. currency shippers indicate net currency shipments abroad totaled \$3-3/4 billion in 1989, about one-half of which occurred in December. In the first half of 1990, these banks report net shipments of \$6-3/4 billion. Since the Department of Commerce makes no attempt to estimate currency flows in the international transactions accounts, these outflows necessarily contribute to a positive statistical discrepancy.

Private net purchases of foreign securities by U.S. residents accelerated in May and June, bringing the total net purchases for the quarter to \$11-1/2 billion (line 2c of the Summary of U.S. International Transactions table). The pick-up from April was primarily in net purchases of foreign stocks. In May, stock purchases were concentrated in Japan, as U.S. residents rebuilt their portfolios after reducing them in March and April, coincident with the break in the Japanese stock market. In June, net purchases of foreign stocks were concentrated in the United Kingdom, although net purchases of Spanish stocks were almost \$1/2 billion. U.S. residents on net sold German stocks in May and June, reversing the sizable purchases in the first quarter.

Foreign net purchases of U.S. corporate bonds picked up in May and accelerated further in June (line 2a). This increase accompanied an increase in new issues in the domestic market and a surge in Euromarket offerings by U.S. firms. Private foreigners continued to sell U.S. stocks in May and June, bringing the net sales for the second quarter to \$3-1/4 billion.

Foreign purchases of Treasury obligations rebounded in May and rose further in June. Italian residents purchased more than \$2 billion in Treasuries in May. Japanese residents also registered large purchases of Treasuries in May (\$3-1/2 billion), but sold Treasuries in April and June; this pattern coincides with Treasury's refunding schedule for long-term bonds. For the second quarter as a whole, Japanese residents sold \$3-1/4 billion in Treasuries, accelerating the trend of net sales evident since the fourth quarter of 1989. Net purchases in June were concentrated in Mexico and the United Kingdom.

Official inflows (line 4) resumed in June as G-10 countries increased their assets in the United States by \$2 billion. Other European countries

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

	1988	1989	1989		1990		1990		
	Year	Year	Q3	Q4	Q1	Q2	Apr.	May	June
<b>Private Capital</b>									
<b>Banks</b>									
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	22.2	27.2	15.1	10.7	16.2	-4.6	0.5	7.3	-12.4
<b>Securities</b>									
2. Private securities transactions, net <sup>1</sup>	17.8	16.1	0.6	6.2	-6.8	-7.8	-2.9	-4.6	-0.4
a) foreign net purchases (+) of U.S. corporate bonds <sup>2</sup>	26.8	32.8	5.6	12.5	5.9	6.9	.8	1.8	4.3
b) foreign net purchases (+) of U.S. corporate stocks	0.4	7.6	5.1	-1.5	-3.2	-3.3	-1.0	-2.2	-0.1
c) U.S. net purchases (-) of foreign securities	-9.4	-24.3	-10.2	-4.8	-9.5	-11.5	-2.7	-4.3	-4.5
3. Foreign net purchases (+) of U.S. Treasury obligations	20.6	30.4	12.7	5.3	-0.7	3.0	-3.3	2.7	3.5
<b>Official Capital</b>									
4. Changes in foreign official reserves assets in U.S. (+ = increase)	40.2	8.5	13.4	-7.4	-7.8	5.1	3.3	-0.1	1.9
a) By area									
G-10 countries (incl. Switz.)	15.5	-5.0	6.1	-2.0	-6.3	*	-0.7	-1.3	2.0
OPEC	-3.4	10.1	4.6	-1.5	3.1	*	0.4	-0.5	0.1
All other countries	28.1	3.4	2.7	-3.9	-4.6	5.2	3.6	1.7	-0.2
b) By type									
U.S. Treasury securities	41.7	0.3	12.8	-7.3	-5.9	3.1	2.0	*	1.1
Other <sup>3</sup>	-1.6	8.2	0.6	-0.1	-1.9	2.0	1.3	-0.1	0.8
5. Changes in U.S. official reserve assets (+ = decrease)	-3.9	-25.3	-6.0	-3.2	-3.2	0.4	0.1	-0.4	0.6
<b>Other transactions (Quarterly data)<sup>4</sup></b>									
6. U.S. direct investment (-) abroad	-16.2	-31.7	-9.6	-8.8	-7.6	n.a.	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	58.4	72.2	12.4	21.5	7.6	n.a.	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow) <sup>5</sup>	-1.8	-9.8	-8.5	-3.7	4.3	n.a.	n.a.	n.a.	n.a.
9. U.S. current account balance	-128.9	-110.0	27.6	-26.7	-22.9	n.a.	n.a.	n.a.	n.a.
10. Statistical discrepancy	-8.4	22.4	-2.5	6.1	20.9	n.a.	n.a.	n.a.	n.a.
<b>MEMO:</b>									
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	n.a.	n.a.	n.a.	n.a.

1. These data have not been adjusted to exclude commissions on securities transactions and, therefore, do not match exactly the data on U.S. international transactions as published by the Department of Commerce.
  2. Includes all U.S. bonds other than Treasury obligations.
  3. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
  4. Seasonally adjusted.
  5. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking and official transactions not shown elsewhere. In addition, it includes amounts resulting from adjustments to the data made by the Department of Commerce and revisions to the data in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.
- \*--Less than \$50 million.
- NOTE: Details may not add to total because of rounding.



INTERNATIONAL BANKING DATA  
(Billions of dollars)

	1988	1989				1990				
	Dec.	Mar.	June	Sept.	Dec.	Mar.	Apr.	May	June	July
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	-4.9	-2.9	-3.9	-6.4	-5.5	-11.7	-9.9	-22.0	-11.0	-10.2
(a) U.S.-chartered banks	21.6	20.4	19.2	14.9	19.2	12.2	11.3	2.3	7.2	7.5
(b) Foreign-chartered banks	-26.5	-23.3	-23.1	-21.3	-24.7	-23.9	-21.2	-24.3	-18.3	-17.7
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	21.2	24.0	26.0	21.6	20.7	21.8	22.2	22.4	22.2	22.3
3. Eurodollar Holdings of U.S. Nonbank Residents <u>1/</u>	145.3	144.8	131.5	130.3	123.5	110.7	107.5	111.6	108.4	106.6

1. Includes term and overnight Eurodollars held by money market mutual funds. Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices. Line 2 is an average of daily data. Line 3 is an average of daily data for the overnight component and an average of Wednesday data for the term component.

also registered inflows, bringing the total net inflow from Europe to \$5-1/2 billion. Offsetting this was a \$4-1/2 billion decrease in official holdings by Taiwan

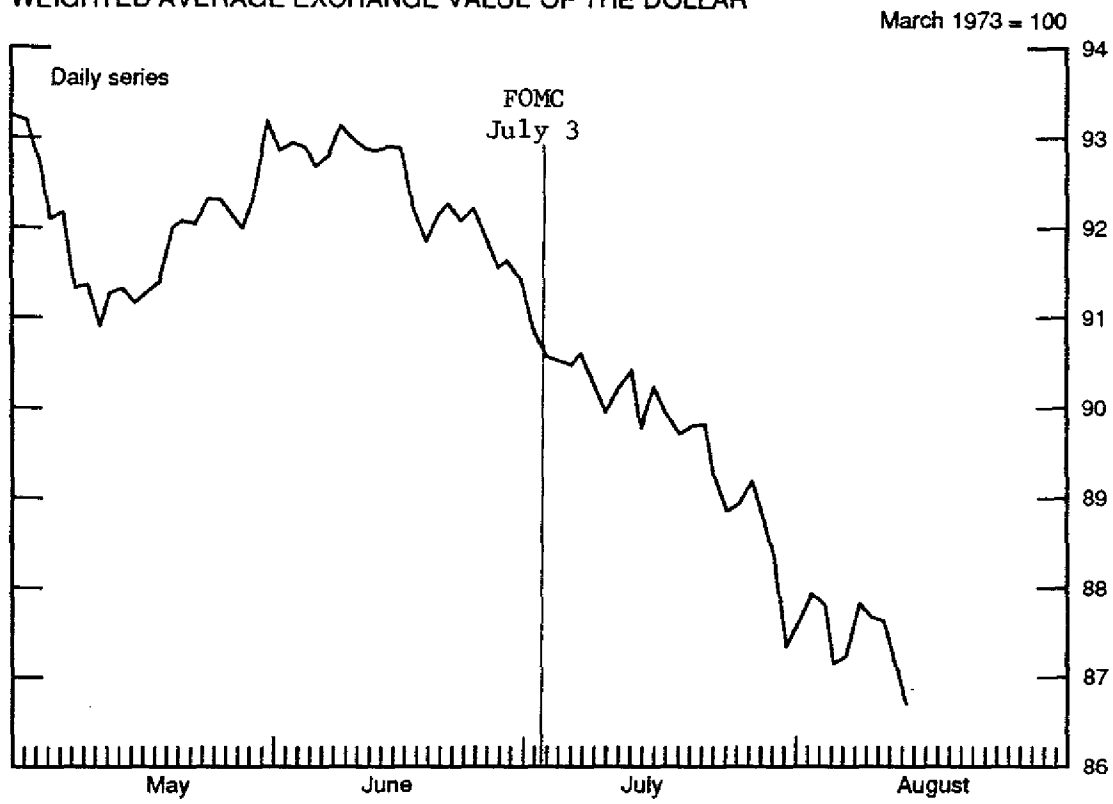
Banks reported net outflows of \$12-1/2 billion in June, reversing the inflow recorded in May and bringing the net reported outflow for the second quarter to \$4-1/2 billion (line 1). Most of the outflow in June was associated with an increase in net claims on foreign affiliates. While these end-of-quarter data are quite volatile and can be reversed in the first days of a new quarter, monthly average data for July (line 1 of the International Banking Data table) indicate that the level of net claims on own foreign offices rose further in July.

#### Foreign Exchange Markets

The weighted-average exchange value of the dollar, in terms of the other G-10 currencies, has declined nearly 5 percent since the July 3 FOMC meeting, as shown in the accompanying chart. The dollar declined 5-1/2 percent against the mark and 2-1/2 percent against the yen. Signs of weakness in the U.S. economy, the slight easing of U.S. monetary policy, and some tightening of conditions on foreign money markets combined to weaken the dollar. Late in the intermeeting period, the dollar received some temporary support from uncertainty generated by the Iraqi invasion of Kuwait. However, flight to the dollar as a safe haven does not seem to have been extensive.

Three-month interest rates rose 1/4 percentage point during the intermeeting period in both Germany and Japan, while declining by an equivalent amount in the United States. The Bank of Japan nudged up short-term market interest rates in response to perceived inflationary pressures stemming from strong Japanese economic activity and a tight Japanese labor

WEIGHTED AVERAGE EXCHANGE VALUE OF THE DOLLAR



market. In Germany, the call money rate remained near the 8 percent Lombard rate, where it has been since German monetary union in early July, as market participants speculated that the Bundesbank would decide to tighten at its next meeting on August 23.

As shown in the accompanying table, stock and bond prices declined sharply in most major countries following the Iraqi invasion of Kuwait and the subsequent \$5 per barrel increase in spot prices of oil (for a total increase of \$10 per barrel since early July). Japanese stock prices declined about 4-1/2 percent before the invasion and another 6-1/2 percent, on balance, after the invasion. The yield on the Japanese bellwether government bond rose about 60 basis points over the period, to almost 8 percent. German stock prices declined 9 percent, all since the invasion, while the German bond yield rose 25 basis points. The price of gold rose nearly \$40, with three-quarters of that coming after the Iraqi invasion.

. The U.S. Treasury purchased over \$400 million in the market

. Those dollar purchases enabled the Exchange Stabilization Fund to repurchase marks that had been warehoused with the System, leaving \$7 billion equivalent of marks outstanding.

The currency grid of the European Monetary System became fully extended during the intermeeting period, with the Spanish peseta nearly 6 percent above its central rate, and the Italian lira 2-1/4 percent above its central rate, against the bottom-most EMS currencies (variously the mark, the French franc, and the Dutch guilder).

## Selected Financial Markets Indicators

	<u>July 3</u>	<u>August 1</u>	<u>August 15</u>
Oil (WTI)	16.83	21.54	26.67
Gold	361.25	373.30	400.50
<u>Stock Indices</u> (7/3/90=100)			
Germany	100.0	100.3	91.1
Japan	100.0	95.6	89.4
United States	100.0	98.9	95.2
<u>Bond Yields</u>			
Germany	8.65	8.57	8.82
Japan	7.27	7.48	7.91
United States	8.40	8.29	8.74

---

Stock market indices used:

Germany: Frankfurter Allgemeine Zeitung index;

Japan: New Tokyo Stock Exchange index, first section;

United States: New York Stock Exchange composite index.

Bond yields are for 10-year bellwether bonds in Germany and Japan, and the 10-year Treasury note in the United States.

Sterling rose nearly 2 percent against the mark over the intermeeting period, benefiting from speculation that it may join the Exchange Rate Mechanism of the EMS in the near future and from official indications that U.K. monetary policy will remain tight until there is evidence of declining U.K. inflation.

#### Developments in Foreign Industrial Countries

Although indicators from the second quarter in Japan and Germany suggest a continued robust underlying rate of growth, real economic activity in the rest of the industrial countries has apparently slowed from the first quarter, with Canada particularly weak. Domestic demand, particularly consumer spending, has slackened somewhat with drops in retail sales in Canada and the United Kingdom.

Sluggish growth is reflected in a smaller trade deficits in France, Italy, and the United Kingdom. Compared with the first half of last year, the Canadian and German external trade positions were about the same, while the Japanese surpluses have narrowed.

Except in the United Kingdom, measures of inflation have slowed, although pressures from tight capacity utilization in France and Japan, relatively large wage increases in Canada and Italy, and issues related to credit and fiscal policy and currency unification in Germany may push inflation rates higher. Real exchange rate appreciation in Japan and France has tempered some of the upward pressure implied by increases in costs.

Individual Country Notes. In Japan, recent data suggest that the pace of real activity remained strong. Industrial production (s.a.) in the second quarter was 1.9 percent higher than in the first quarter, although growth in June declined from the 2.5 percent increase recorded in May. The capacity utilization rate (s.a.) rose 2.8 percent in May to its highest level in 16 years. Retail sales (s.a.) posted a 12-month increase of

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
			Q3	Q4	Q1	Q2	Feb.	Mar.	Apr.	May	June	
<b>Canada</b>												
GDP	3.1	2.9	.8	.6	.5	n.a.	*	*	*	*	*	2.2
IP	2.7	.4	-.2	-.4	-1.2	n.a.	-.2	.3	-.4	.2	n.a.	-1.6
<b>France</b>												
GDP	3.5	3.4	.5	.7	.7	n.a.	*	*	*	*	*	2.6
IP	4.6	2.8	-.1	-.1	-.3	n.a.	-1.7	.7	1.4	.3	n.a.	1.4
<b>Germany</b>												
GNP	3.0	3.7	-.1	1.0	3.3	n.a.	*	*	*	*	*	4.4
IP	4.0	4.6	2.2	.4	2.9	-.9	-.9	1.1	-3.5	3.2	.3	4.7
<b>Italy</b>												
GDP	3.5	3.0	.8	.5	.9	n.a.	*	*	*	*	*	3.1
IP	7.5	3.3	2.7	2.1	-2.3	n.a.	3.8	-.9	-.8	-2.5	n.a.	2.3
<b>Japan</b>												
GNP	5.1	4.8	2.9	.8	2.5	n.a.	*	*	*	*	*	5.6
IP	7.6	4.2	-.0	.7	.9	1.9	.3	1.7	-1.0	2.5	-.2	3.5
<b>United Kingdom</b>												
GDP	3.7	1.7	.9	.4	.7	n.a.	*	*	*	*	*	1.6
IP	2.5	.4	1.0	.1	-.1	2.1	-.6	2.0	.4	-.1	2.1	3.1
<b>United States</b>												
GNP	3.5	1.8	.4	.1	.4	.3	*	*	*	*	*	1.2
IP	4.5	1.1	-.3	.0	.2	.9	.9	.4	-.2	.6	.4	.8

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

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

	1988	1989	1989				1990		1990			
			Q1	Q2	Q3	Q4	Q1	Q2	Mar.	Apr.	May	June
<b>Canada</b>												
Trade	8.0	3.9	2.0	.9	.9	.2	1.1	n.a.	.3	.1	.8	n.a.
Current account	-8.4	-14.1	-2.6	-4.0	-3.5	-4.0	-4.3	n.a.	*	*	*	*
<b>France</b>												
Trade	-5.4	-6.9	-.8	-2.1	-2.0	-2.1	-.4	-2.0	-.2	-.8	-1.0	-.2
Current account	-3.4	-4.0	1.4	-1.2	-1.2	-3.0	.9	n.a.	*	*	*	*
<b>Germany</b>												
Trade (NSA)	72.9	71.6	19.4	17.7	17.8	16.6	22.4	16.7	8.5	4.5	7.3	4.9
Current account (NSA)	50.5	55.5	16.8	14.0	11.1	13.5	17.0	11.4	6.1	3.4	5.2	2.7
<b>Italy</b>												
Trade	-9.9	-12.3	-4.3	-3.4	-2.7	-1.9	-4.0	-2.0	-1.4	-.5	-1.9	.5
Current account (NSA)	-6.3	-10.6	-8.2	-1.1	.1	-1.5	n.a.	n.a.	*	*	*	*
<b>Japan</b>												
Trade	77.4	64.8	21.9	15.4	15.0	12.6	15.5	13.5	5.9	3.2	3.4	6.9
Current account 2	79.6	57.2	21.5	12.6	13.2	9.7	15.4	8.3	7.2	2.4	2.1	3.8
<b>United Kingdom</b>												
Trade	-37.0	-37.9	-10.5	-10.3	-10.2	-6.9	-9.0	-8.2	-3.4	-3.0	-2.6	-2.7
Current account	-26.0	-31.2	-7.4	-7.5	-9.6	-6.6	-7.8	-7.2	-3.0	-2.6	-2.2	-2.3
<b>United States</b>												
Trade 2	-127.0	-114.9	-28.1	-28.2	-29.8	-28.7	-26.4	n.a.	*	*	*	*
Current account	-128.9	-110.0	-27.1	-28.6	-27.6	-26.7	-22.9	n.a.	*	*	*	*

1. The current account includes goods, services, and private and official transfers. Asterisk indicates that monthly data are not available.

2. Annual data are subject to revisions and therefore may not be consistent with quarterly and/or monthly data.



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

	Q4/Q4 1988	Q4/Q4 1989	1989				1990		1990				Latest 3 months from year ago
			Q1	Q2	Q3	Q4	Q1	Q2	Apr.	May	June	July	
<b>Canada</b>													
CPI	4.1	5.2	1.2	1.7	1.4	.7	1.4	.9	.1	.5	.4	n.a.	4.6
WPI	3.7	.7	1.0	.3	-2.2	-.4	.6	n.a.	-.2	.3	n.a.	n.a.	.3
<b>France</b>													
CPI	3.0	3.6	.8	1.2	.7	-.8	.7	.9	.4	.2	.2	n.a.	3.1
WPI	7.2	1.2	2.4	.4	-5.5	-1.0	-5.5	n.a.	*	*	*	*	-1.6
<b>Germany</b>													
CPI	1.6	3.1	1.5	.9	.0	.6	1.1	.5	.2	.2	.1	.0	2.3
WPI	2.2	4.3	3.0	1.5	-6.6	.3	-3.3	.6	.3	.3	-.3	n.a.	.0
<b>Italy</b>													
CPI	5.2	6.6	2.0	1.7	1.0	1.8	1.6	1.2	.4	.3	.4	.4	5.7
WPI	n.a.	n.a.	n.a.	1.7	.0	2.5	2.1	n.a.	.2	-.4	n.a.	n.a.	4.5
<b>Japan</b>													
CPI	1.5	2.9	-.2	2.2	.1	.9	.4	1.2	.7	.6	-.6	.1	2.5
WPI	-1.4	3.7	.5	2.7	.8	-.3	.4	.8	.6	-.3	-.1	-.1	1.1
<b>United Kingdom</b>													
CPI	6.5	7.6	1.6	2.9	.9	2.0	1.8	4.7	3.0	.9	.4	n.a.	9.7
WPI	4.9	5.2	1.4	1.2	1.2	1.2	1.6	2.1	1.0	.6	.2	.3	6.3
<b>United States</b>													
CPI (SA)	4.3	4.6	1.3	1.5	.7	1.0	2.0	.9	.2	.2	.5	n.a.	4.6
WPI (SA)	3.4	4.9	2.0	1.6	.0	1.2	2.3	-.2	-.3	.3	.2	-.1	3.2

1. Asterisk indicates that monthly data are not available.

11.9 percent, rising 2.9 percent in June. Housing starts (s.a.) jumped 8.4 percent in May, the largest monthly increase since 1983. The unemployment rate (s.a.) remained close to its 10-year low of 2 percent, edging up only to 2.2 percent in June. The ratio of job offers to applicants (s.a.) rose to a 12-year peak of 1.41 in May.

Despite the growing evidence of strains on production capacity and in the labor market, recorded inflation rates have remained stable. Consumer prices in Tokyo (n.s.a.) increased 0.1 percent in July, while the 12-month change was only 2.6 percent. Wholesale prices (n.s.a.) declined by 0.1 percent in July and were up only 0.8 percent on a 12-month basis. Reflecting a stronger yen and lower oil prices, the wholesale price of imported goods declined by 6.1 percent over the May-July period, almost entirely reversing the 6.2 percent increase in import prices in March-April when the yen weakened.

Both the trade and the current account surpluses (s.a.) increased in June. Over the first half of the year, the cumulative current account surplus was \$47.4 billion (s.a.a.r.), little changed from the second half of last year, but substantially lower than in the first half of 1989.

Economic developments in West Germany have been dominated by the process of unification with East Germany. The Treaty implementing an economic and monetary union between the two Germanys went into effect on July 1 with the initial adjustment progressing relatively smoothly. Withdrawals of DM currency by East Germans were significantly below expectations, suggesting that the introduction of the DM in the GDR will not generate immediate inflationary pressures because of increased spending. However, the demand for short-term credit from state-owned enterprises in the GDR exceeded expectations with requests in August for credit guarantees more than double the DM 10 billion provided under the trust fund set up to

manage state-owned property. Fiscal deficits in the GDR will also be somewhat higher than had previously been expected, in part because the number of East Germans that are either unemployed or working part-time has expanded to more than 10 percent of the labor force.

Political developments generated considerable uncertainty in the first two weeks of August. It now appears likely that all-German elections will be held on December 2, but the timing of formal political unification remains under negotiation.

The growth of industrial production (s.a.) in West Germany moderated in the second quarter, increasing 1.6 percent (adjusting for a weather-related correction in construction) to a level 4.7 percent above where it was one year earlier; including construction, industrial production declined 0.9 percent. The June increase was only 0.3 percent after an increase of 3.2 percent in May. The unemployment rate remained at 7.3 in July, unchanged since February.

Inflation remains low. Consumer prices (n.s.a) were unchanged in July, and on a 12-month basis, consumer price inflation held at 2.4 percent in July after being 2.3 percent in April, May and June. Wholesale prices fell in June to a level below where they were one year ago. Producer prices fell in July and remained just 1.4 percent above year-earlier levels. Import prices fell 0.6 percent in April after falling 0.9 percent in May. June import prices were 5.4 percent below their year-earlier level.

M3 growth for 1990 (s.a.a.r.) was 4.3 percent through June, at the low end of the Bundesbank's 1990 target range of 4-6 percent, although when Euro-DM deposits are included, M3 growth has been more than 6 percent. An announcement of how the target for M3 growth in 1990 will be adjusted in light of monetary union is expected on August 23. Bundesbank officials have

indicated that the level of M3 will probably play a less important role in short-run monetary policy decisions.

West Germany's external surpluses (excluding transactions with East Germany) fell sharply in the second quarter as exports fell by about 5 percent. However, comparing the first half of 1990 to the same period in the previous year, West Germany's external surpluses are little changed.

Economic activity has slowed in France in comparison to the quick pace of 1989. Industrial production (measured on a 12-month basis) was 1.5 percent higher in May, compared with a 5.1 percent increase a year earlier.

French inflation has been moderate despite tight capacity utilization in part because the strength of the franc has intensified import competition. Consumer prices (n.s.a.) rose 0.2 percent in June although inflation has fallen from 3.6 percent on a twelve-month basis at the end of last year to 3.0 percent in June. The franc measured on a weighted-average basis appreciated 9.9 percent in the year to June. Despite the appreciation, the merchandise trade deficit has remained relatively stable.

Real economic activity in the United Kingdom has been sluggish. Retail sales in June fell 2.4 percent while manufacturing output declined 0.6 percent to a level 2.5 percent above its level a year ago. Although industrial production rose 2.1 percent in June, the increase was due entirely to deferred maintenance of North Sea oil platforms raising energy output above its normal seasonal level. Unemployment rose for the third month running, although the unemployment rate remained at 5.7 percent in June.

Consumer prices continued to rise rapidly. The overall 12-month rate of retail price inflation was 9.8 percent in June. Excluding mortgage interest payments and the poll tax, the "underlying" rate of inflation was 6.9 percent in May. Output prices for manufactured goods (n.s.a.) rose

0.3 percent in July to a level 6.1 percent above year-earlier levels. In May, the underlying annual rate of increase in average earnings remained at 9-3/4 percent.

Sluggish economic activity has narrowed the cumulative trade deficit for the first half of the year to \$17.2 billion compared with a \$20.8 billion deficit for the same period last year. The cumulative current account deficit remained about the same as last year (\$14.9 billion) as the invisibles surplus continued to erode. In recent weeks, the pound has strengthened as a result of rising oil prices and rumors that entry of sterling into the exchange rate mechanism of the EMS is imminent.

Recent data suggest some slowing of economic activity in Italy after somewhat stronger than expected first-quarter growth of GDP of 3.6 percent (s.a.a.r.). Industrial production (s.a.) declined 2.5 percent in May to a level only 0.7 percent above its level of a year earlier. For the first five months of the year, industrial production was up only 1.9 percent from the corresponding period of 1989.

The Italian consumer price index in July was 5.7 percent above its level a year earlier, little changed from the increase in June. Wholesale price and producer price increases in May of 3.9 and 3.6 percent, respectively, from their levels a year earlier were smaller than the April increases. However, in May the overall index of wages and salaries (n.s.a) increased sharply to a level almost 8 percent above its level a year earlier, reflecting the impact of recent public sector wage settlements. These are likely to contribute to inflationary pressures in the coming months.

Indicators from Canada for the second quarter point to a slower rate of growth following the first quarter when domestic demand rose by 1.8 percent compared with the fourth-quarter figure of 6.3 percent. Retail

sales (s.a.) fell 1.0 percent in May after dropping 1.4 percent in April and wholesale trade (s.a.) was off 1.6 percent in May after falling 0.9 percent in April. Housing remains a particularly weak sector with starts (s.a.) falling 7.3 percent in June to stand 5.8 percent below a year earlier. The number of consumer and corporate bankruptcies was more than 30 percent higher in the first half of 1990 than last year, and was even higher than in the 1982 recession year. The unemployment rate (s.a) rose in July to 7.8 percent from 7.5 percent in June.

First-quarter growth in real GDP (s.a.a.r) of 2.2 percent was sustained by a positive contribution of real net exports. Although Canada's current account deficit increased from \$4.0 billion in the fourth quarter to \$4.3 billion in the first quarter, this increase was more than accounted for by the forgiveness of developing country debt by the government of Canada. Canada's merchandise trade surplus increased almost \$500 million in May to \$808 million, as imports fell and exports rose modestly.

Inflation as measured by the consumer price index (n.s.a) continued to come down, in part as the impact of last summer's increase in excise taxes on the index wore off. In June, the year-over-year increase was 4.3 percent. More disturbing, however, was news that major wage settlements (s.a.) contained increases of 6.2 percent in the first quarter, up from the 5.3 percent rate over 1989 as a whole. Finance Minister Wilson recent warned that poor performance in holding unit labor costs down was harming Canada's international competitiveness.

#### Developments in East European Economies

Hungary, which has never rescheduled its \$21 billion of international debt, emerged from its recent bout of illiquidity in the international markets with substantial additional credits available -- a \$280 million bridge loan from the industrial countries arranged by the Bank for

International Settlements and the United States, a West German government guarantee of a DM 800 million 12-month revolving credit line from a consortium of banks led by Deutsche Bank, and a World Bank guarantee of the principal at maturity of a \$200 million Eurobond private placement by Hungary's State Development Institute.

Progress under the economic reform program is mixed. New cuts in subsidies moved relative prices towards market-clearing levels and restored the fiscal budget to its target range, but they caused inflation to surge well beyond the objective of 20 percent for the year as a whole. Efforts to remove enterprises from state control received a boost with the reopening of the Bourse and the successful floating of stock in the travel agency IBUSZ.

In July, the government of Poland moved from focussing on fighting inflation to revitalizing and restructuring the economy. Wage indexation will be eased (although not eliminated) and an emergency welfare program will aid the nearly one-third of Polish families worst hit by the lay-offs and price increases associated with the shock program. Recent data indicate that industrial sales by state firms (representing almost all of industrial sales) continued to decline in June, although the rate of decline has moderated. Based on 90-day notifications, unemployment is expected to rise substantially over the coming months from the rate of 5.2 percent registered in July. The government budget has been increasingly in surplus over the first half of 1990, but expenditures on revitalizing the economy and providing a social safety net are likely to take the budget into deficit for the second half year; a zero balance for the year as a whole is the aim.

Private sector development is proceeding apace with both a "small privatization program" -- that is sales or leasing of retail and small commercial facilities directly to individuals (8 percent of state retail shops have been so privatized this year) -- and a two-step privatization

process for handling larger state-owned enterprises; the first step transforms enterprises into joint-stock companies and the second step allows citizens to purchase shares with "privatization vouchers".

#### Economic Situation in Major Developing Countries

At the end of July, Mexico prepaid the \$674 million balance of the bridge loan received in March from the Federal Reserve System and the U.S. Treasury. Increased public confidence in Mexico's economic prospects has been reflected in rising international reserve levels and in a decline in interest rates and the short-term forward premium on the dollar. At the same time, however, the trade balance has deteriorated. In Brazil, economic activity and interest rates appear to have stabilized. Fiscal and monetary policy remain relatively tight, but the prospects for the additional reforms needed to sustain progress on the fiscal deficit remain uncertain. Argentina has continued to run fiscal surpluses and has registered progress in its privatization program. However, inflation has not declined as rapidly as anticipated, despite weak aggregate demand. Venezuela's fiscal position and the outlook for economic growth improved in August due to higher oil export revenues. Alberto Fujimori, inaugurated as Peru's new president on July 28, has announced severe economic adjustment measures in response to a rapidly deepening economic crisis.

Individual country notes. Mexico took advantage of rising international reserves to prepay, on July 31, the \$674 million balance of the bridge loan received in late March from the Federal Reserve System and the U.S. Treasury. The reserve gain from the end of March to the end of July is estimated to have been roughly \$3 billion. It reflects a strengthening of public confidence brought about by the implementation of the bank financing agreement in late March, by an announcement in May that the nationalized commercial banks are to be privatized, by the speedy passage of a



constitutional amendment that paves the way for bank privatization, by favorable first-quarter fiscal results, by a decision not to increase minimum wages when the anti-inflation pact was extended at the end of May, and by the general improvement in prospects for private investment associated with the structural adjustments carried out in recent years. In addition, the assurance that the exchange rate will not undergo a sharp depreciation for at least several more months, coupled with the high rates of return from investment in financial instruments in Mexico, is providing a strong incentive to move funds to Mexico.

The strengthening of public confidence is evident also in the reduction of the forward premium on the dollar to 6.3 percent on August 8 from 10.5 percent in March for 180-day contracts and in the narrowing of the spread between the free market and controlled exchange rates to 0.57 percent on August 8 from 1.4 percent on April 2.

Inflows of private capital have been accompanied by a fall in interest rates. At the August 7 Treasury auction, the rate for 28-day bills was about 30 percent, 17 percentage points lower than at the mid-March peak. This decline is likely to stimulate economic activity in the second half of 1990. The CPI rose by 1.8 percent in July, when it was 27 percent higher than a year earlier. This is the highest 12-month increase since February 1989. However, price inflation this year is largely the result of attempts to correct relative price distortions and restore price flexibility gradually in order to facilitate the elimination of price controls at a later date.

Mexico's trade balance deteriorated during the first half of 1990. In January-May, total exports were only about 3 percent higher than in the same period of 1989, but imports were nearly 16 percent higher, and in May Mexico recorded its first monthly trade deficit since September 1988. The rate of

growth of non-oil exports has fallen steadily for over two years, reflecting a slowing of real GDP growth in the industrial countries since 1988 and some deterioration in Mexico's international competitiveness. Moreover, the fall in world oil prices during the first half of 1990 depressed oil export earnings. Recent increases in these prices will provide some relief, but a further slowing of economic activity in the industrial countries would hurt the outlook for non-oil exports.

In Brazil, limited weekly employment data indicate that the economy appears to have stabilized in June and July after industrial production declined by about 4 percent between March and May. However, consumer prices rose 13 percent in July, compared with 10 percent in June. The government continues to run budget surpluses, and monetary policy has been relatively tight since June. In late July, President Collor vetoed a congressional proposal to index wages monthly and issued a provisional measure, which is subject to congressional approval, calling for wage adjustments to be made every six months. Brazil's trade surplus was \$1.17 billion in June. The accumulated surplus for the first half of 1990 was \$6.3 billion, compared with \$9.2 billion over the same period in 1989.

Financial markets have been relatively calm in recent weeks. Domestic short-term interest rates have remained stable at about 11 percent per month. The spread between the dollar exchange rate in the parallel and official markets has narrowed to about 16 percent, as the government has reportedly sold reserves to support the cruzeiro in the parallel market. Consultations are underway to prepare a possible IMF stand-by arrangement, and the Brazilian government is arranging to meet individually with its commercial bank creditors in late August and early September.

Argentina is continuing to run budget surpluses on a cash basis, but the inflation rate has not declined as rapidly as anticipated when its

stabilization program was launched five months ago. After rising from 13.6 percent in May to 13.9 percent in June, consumer price inflation registered 10.8 percent in July. These price increases in part reflect continued adjustments in public sector prices and "catch-up" increases in wage rates; they have occurred in spite of continued weakness in aggregate demand. Industrial production in June is estimated to have been roughly 12 percent below average monthly production in 1989 and 20 percent below the average in 1988. This weakness is attributable not only to reduced domestic demand, but also to depressed industrial exports stemming from the overvaluation of the free-floating Austral since March, a result of strong agricultural export revenues and short-term capital inflows.

Argentina has made progress in its privatization program in recent months. In late June, 60 percent of the shares in ENTEL, the state telephone company, were awarded to two foreign consortia for a total of \$5 billion in debt paper (at face value) and \$214 million in cash; Bell Atlantic, in association with Manufacturers Hanover, will operate ENTEL's northern operations, while Telefonica de Espana, with Citibank, will run operations in the southern part of the country. In mid-July, an 85-percent share in Aerolineas Argentinas, the state airline, was awarded to an investment group led by Spain's Iberia Airlines in exchange for \$2 billion (at face value) in debt paper, \$130 million in cash, and \$130 million financed over the next five years. It is expected that both companies will be handed over to their new owners within the next few months.

On August 9, the World Bank's Executive Board approved the release of the second \$150 million tranche of the Bank's \$300 million Second Trade Policy Loan to Argentina. This loan was approved initially in October 1988, but following disbursement of the first tranche, it was suspended in March 1989 due to Argentina's failure to implement macroeconomic reforms.

Venezuela's fiscal position improved this month. Until the recent oil crisis, Venezuela appeared unlikely to achieve its original goal of a zero fiscal deficit for 1990. Weak economic activity and lower oil export prices had depressed revenues, while outlays were boosted by a delayed realization of losses due to foreign exchange guarantees provided for private sector debts by the previous government. With the 1990 fiscal deficit threatening to reach 4 percent of GDP, the government has prepared (but has not yet implemented) measures to trim the deficit to about 2-1/2 percent of GDP. The recent rise in oil export prices, coupled with an expected temporary increase of crude oil production and exports of up to 500,000 barrels per day, could boost 1990 revenues by up to 3 percent of GDP, potentially restoring budget balance.

The Venezuelan authorities implemented long-delayed increases in the domestic prices of petroleum products in July. However, prices remain well below world market levels. The government's program to reform public enterprises has been moving forward very slowly. Last month, a bank controlling one percent of banking system assets became the second public enterprise to be put up for sale to private investors. A July shake-up of the Venezuelan cabinet reinforced the position of the members of the government who have argued for accelerated privatization.

Alberto Fujimori, Peru's new president, was inaugurated on July 28 in the midst of a rapidly deepening economic crisis. Fujimori inherited a record level of hyperinflation (running at a daily rate of 6 percent when he assumed office), a shortage of food (following a sharp dropoff in imports and the continuing impact of a severe drought), and declining international reserves. The new government has announced several elements of a stabilization program, including a 3,000 percent increase in domestic gasoline prices, and has asked foreign donors to support a "social emergency

program" designed to buffer the most exposed strata of society from the shock of long overdue macroeconomic adjustment.