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CLASS III - FOMC

August 12, 1988

SUPPLEMENT  
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the  
Federal Open Market Committee

By the Staff  
Board of Governors  
of the Federal Reserve System

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THE DOMESTIC NONFINANCIAL ECONOMY

Retail Sales and Inventories

Retail spending on goods apparently moderated in July. Sales in the retail control category<sup>1</sup> edged up 0.2 percent during the month from May and June levels that were revised up substantially. Second-quarter growth in nominal control now is estimated to have run at about an 8 percent annual pace. However, price increases were sharp last quarter, and spending in real terms in the control category probably moved up at about a 1-1/2 percent annual rate. Overall, the July retail sales report implies an upward revision to BEA's preliminary estimate of real consumption spending during the second quarter of nearly 1 percentage point, or roughly \$5 billion.

In July, sales at food stores moved up 0.5 percent--about in line with expected food price increases. Sales at apparel stores posted a gain of 1.6 percent, and the estimate for sales in May was revised up. Nevertheless, even with apparel price increases expected to be small in July, real apparel spending likely retraced only a small part of its sharp second-quarter decline. Sales at general merchandise stores edged up only 0.2 percent in July, after two months of large gains. Purchases at furniture and appliance stores, which have been an area of strength in recent months, dropped back 1 percent.

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1. The retail control category excludes sales at automotive dealers, building material and supply stores, and gasoline stations.

The current market cost of retail inventories rose in June at a \$25 billion annual rate. The June increase brought the retailers' stock accumulation during the second quarter to \$22.4 billion, fairly close to the increase assumed by BEA when the preliminary GNP estimates for the second quarter were prepared.

Auto dealers' stocks, which dominated retail inventory changes in the preceding several months, accounted for only one-fourth of the accumulation in June. Outside of auto dealers, there was a fairly large (\$7.7 billion, annual rate) buildup at general merchandise stores, although because of declines in the preceding two months the accumulation of general merchandise stocks over the second quarter only amounted to \$2.3 billion annual rate--more moderate than the first-quarter pace. Elsewhere, apparel inventories posted a \$2.1 billion rise in June, but other types of retail stocks were little changed. Excluding autos, the ratio of inventories to sales edged up in June and remained near the recent high recorded in 1987-Q4 and 1988-Q1.

#### Producer prices

The producer price index for finished goods rose 0.5 percent in July, maintaining the somewhat faster rate of increase that has been evident in this price measure in recent months. Food prices rose less rapidly than in June, and energy prices were little changed. However, the prices of finished goods other than food and energy were up 0.6 percent, well above the average pace of recent months.

The index for finished foods was up 0.4 percent in July, after rising more than 1 percent in June. Although beef and pork prices fell sharply last month, increases were widespread for other foods, particularly poultry and eggs, fruits and vegetables, and cooking oils. To a large extent, both the declines in meat prices and the increases for other food products undoubtedly are reflecting the effects of drought. The prices of crude foods were up 1-1/2 percent in July; the biggest increases were for corn and turkeys.

In the energy sector, prices fell sharply for crude oil and for a number of refined products. However, prices were higher for gasoline, reflecting tightness in inventories in that market.

Excluding food and energy, a broadly based pickup was apparent among consumer nondurables, the prices of which rose 1.2 percent in July to a level about 5-1/2 percent above a year earlier. The prices of consumer durables were up 0.4 percent in July, the same as in June. Capital goods prices were little changed last month.

Intermediate materials prices (excluding food and energy) advanced 0.7 percent in July, a little faster than in the two previous months. This index, which includes the prices of a broad range of industrial inputs, has risen 7-1/4 percent over the past year. The PPI for crude materials excluding food and energy was up 1-1/2 percent, mainly because of a jump in the price of steel scrap.

Farm output

The Department of Agriculture's August 11 assessment of agricultural supply and demand conditions showed downward revisions in projected 1988 output of the major crops compared with the July 12 estimate. The August crop report is the first that is based extensively on samples taken in the field. Corn output now is expected to total 4.5 billion bushels, down from a projected 5.2 billion bushels in mid-July and a 1987 harvest of 7.1 billion bushels. The estimate for soybeans was marked down from 1.65 billion bushels in July to 1.47 billion bushels this month; last year, soybean production was 1.91 billion bushels. The projection for wheat was revised down slightly.

Overall, potential crop losses now appear slightly larger than the figures that were built into the August Greenbook, but not enough to appreciably affect the GNP forecast for coming quarters.

RETAIL SALES  
(Seasonally adjusted percentage change)

	1988		1988		
	Q1	Q2	May	June	July
Total sales	2.7	1.7	.8	.4	.5
Previous estimate <sup>1</sup>		1.4	.3	.5	
Total less auto dealers, nonconsumer stores, and gasoline stations	1.2	2.0	1.2	.6	.2
Previous estimate <sup>1</sup>		1.5	.5	.4	
GAF <sup>2</sup>	1.1	2.3	1.2	1.5	.2
Previous estimate <sup>1</sup>		2.0	.8	1.2	
Durable	4.9	1.8	.0	.6	.7
Motor vehicle dealers	6.0	.3	-.3	.2	2.2
Furniture and appliances	5.7	5.4	.8	1.9	-1.0
Other durable goods	1.2	2.2	-.2	2.0	-.3
Nondurable	.6	1.7	1.4	.3	.4
Apparel	-1.0	2.3	1.8	1.4	1.6
Food	1.2	2.4	2.2	-.2	.6
General merchandise <sup>3</sup>	-.2	.9	1.1	1.4	.2
Other nondurables	1.1	1.6	.8	-1.5	.6
<u>Memo: Motor vehicle sales<sup>4</sup></u>	15.6	15.6	15.8	15.9	15.4
Autos	10.8	10.8	10.7	11.1	10.4
Light trucks	4.8	4.8	5.1	4.8	5.0

1. Based on incomplete sample counts approximately one month ago.
2. General merchandise, apparel, furniture, and appliance stores.
3. General merchandise excludes mail order nonstores; mail order sales are also excluded in the GAF grouping.
4. Millions of units at an annual rate; FRB seasonals.

BUSINESS INVENTORIES  
(Change at annual rates in seasonally  
adjusted book value; billions of dollars)

	1987		1988		1988			
	Q3	Q4	Q1	Q2	Mar.	Apr.	May <sup>r</sup>	June <sup>p</sup>
Manufacturing and trade (Previous)	36.8	81.4	41.0	55.3	26.6	46.5	60.7 53.0	58.8
Manufacturing	20.2	27.9	23.6	20.9	11.9	16.2	28.6	17.9
Trade, total	16.6	53.4	17.4	34.5	14.7	30.3	32.1	40.9
Wholesale	1.8	23.8	26.5	12.1	13.2	21.6	-1.3	15.9
Retail	14.8	29.6	-9.1	22.4	1.5	8.7	33.5	25.0
Ex autos	9.2	15.3	12.5	10.2	18.3	.7	11.6	18.3
Durable	8.0	22.2	-17.3	15.4	-10.2	8.6	26.4	11.1
Auto	5.5	14.2	-21.6	12.2	-16.8	8.0	21.9	6.7
Nondurable	6.8	7.4	8.2	7.0	11.7	.1	7.1	13.8

Totals may not add because of rounding.

INVENTORY/SALES RATIOS

	1987		1988		1988			
	Q3	Q4	Q1	Q2	Mar.	Apr.	May <sup>r</sup>	June <sup>p</sup>
Manufacturing and trade	1.50	1.53	1.53	1.51	1.50	1.51	1.51	1.50
Manufacturing	1.62	1.60	1.62	1.58	1.58	1.59	1.58	1.56
Trade, total	1.41	1.46	1.45	1.46	1.44	1.45	1.45	1.44
Wholesale	1.23	1.27	1.31	1.30	1.29	1.30	1.30	1.28
Retail	1.59	1.65	1.60	1.62	1.58	1.59	1.60	1.61
Excluding auto	1.51	1.54	1.55	1.55	1.53	1.54	1.53	1.54

r--Revised.

p--Preliminary.

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

	Relative Importance Dec. 1987	1987 1987	1987		1988		1988	
			Q4	Q1	Q2	June	July	
			-Annual rate-			-Monthly rate-		
Finished goods	100.0	2.2	-1.9	2.7	4.6	.4	.5	
Consumer foods	25.9	-.2	-5.7	6.0	9.4	1.1	.4	
Consumer energy	9.6	11.2	-9.6	-18.5	4.8	-1.6	.0	
Other consumer goods	40.1	2.7	1.7	5.7	2.4	.3	.9	
Capital equipment	24.4	1.3	-.7	3.2	3.6	.4	.1	
Intermediate materials <sup>2</sup>	95.0	5.5	4.3	4.3	7.4	.6	.6	
Excluding energy	82.5	5.2	7.2	8.2	6.9	.5	.7	
Crude food materials	39.5	1.8	-4.8	17.7	30.5	4.2	1.5	
Crude energy	41.9	10.7	-15.2	-24.1	12.2	-1.0	-5.4	
Other crude materials	18.6	22.6	18.0	15.9	-7.0	.2	1.9	

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

2. Excludes materials for food manufacturing and animal feeds.

## THE FINANCIAL ECONOMY

Monetary Aggregates and Interest Rates

Based on more complete data, estimates of M2 and M3 growth during July were revised down to 3 and 5-1/2 percent annual rates, respectively. The adjustments largely reflect downward revisions to small time deposits, which lowered the growth rate of the nontransactions component of M2 to just 1 percent last month.

Since August 9, most market interest rates have moved up further and the federal funds rate has firmed to 8-1/8 percent. While increases in Treasury bill rates have been minor in recent days, private money market rates and yields on long-term Treasuries have risen another 10 to 20 basis points. On August 11, most major banks increased their prime rate by 1/2 percentage point, returning the spreads between the prime rate and key short-term rates to more normal levels.

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

	1987 <sup>1</sup>	1988 Q1	1988 Q2	1988 May	1988 Jun	1988 Jul p	Growth Q4 87- Jul 88p
-----Percent change at annual rates-----							
1. M1	6.2	3.8	6.3	0.2	9.8	9.1	5.8
2. M2	4.0	6.7	7.8	4.7	5.2	3.0	6.5
3. M3	5.4	7.0	7.1	4.4	6.3	5.4	6.7

	-----Percent change at annual rates-----						Levels bil. \$ Jul 88p
<u>Selected components</u>							
4. M1-A	2.8	1.4	3.9	-4.1	9.2	4.8	504.1
5. Currency	8.7	9.4	8.4	6.5	7.7	8.2	206.3
6. Demand deposits	-1.0	-4.4	1.0	-11.6	10.4	2.9	290.6
7. Other checkable deposits	13.6	8.3	10.6	8.0	11.0	17.1	278.3
8. M2 minus M1 <sup>2</sup>	3.3	7.7	8.4	6.2	3.7	0.9	2241.5
9. Overnight RPs and Eurodollars, NSA	4.1	-13.3	3.6	67.4	-13.3	-58.5	76.1
10. General purpose and broker/dealer money market mutual fund shares, NSA	5.8	19.3	4.5	-17.3	-15.0	3.1	230.4
11. Commercial banks	2.5	7.2	6.8	0.9	9.0	4.8	958.5
12. Savings deposits, SA, plus MMDAs, NSA <sup>3</sup>	1.8	2.8	3.2	-3.5	11.1	1.8	548.7
13. Small time deposits	3.5	13.7	11.7	6.9	6.2	8.6	409.7
14. Thrift institutions	3.5	8.7	9.1	6.5	3.0	0.6	972.0
15. Savings deposits, SA, plus MMDAs, NSA <sup>3</sup>	0.8	-7.3	2.3	0.9	4.8	1.8	404.0
16. Small time deposits	5.6	21.3	14.0	10.7	1.7	-0.2	568.0
17. M3 minus M2 <sup>4</sup>	10.8	7.9	4.2	3.3	10.3	14.5	793.6
18. Large time deposits	8.5	7.3	7.2	7.3	13.6	17.9	509.0
19. At commercial banks, net <sup>5</sup>	11.2	3.4	6.4	7.7	20.5	25.6	340.5
20. At thrift institutions	3.4	15.7	8.8	5.7	0.0	2.9	168.5
21. Institution-only money market mutual fund shares, NSA	3.0	44.0	-30.6	-24.8	-49.3	-20.9	84.8
22. Term RPs, NSA	29.9	3.4	8.9	33.3	-1.1	-5.4	110.5
23. Term Eurodollars, NSA	13.8	-24.3	19.4	31.1	23.7	20.7	94.4

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

MEMORANDA:<sup>6</sup>

24. Managed liabilities at commercial banks (25+26)	6.1	1.2	7.0	12.4	3.3	4.8	596.0
25. Large time deposits, gross	3.5	2.3	1.5	2.4	4.1	6.3	406.8
26. Nondeposit funds	2.6	-1.1	5.5	10.0	-0.8	-1.5	189.2
27. Net due to related foreign institutions, NSA	2.9	-6.1	4.0	7.8	-0.9	1.0	9.9
28. Other <sup>7</sup>	-0.3	5.1	1.4	2.1	0.1	-2.4	179.3
29. U.S. government deposits at commercial banks <sup>8</sup>	0.3	-0.4	-1.0	2.9	-2.7	-1.8	20.2

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 12.9 percent and 8.9 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during June and July at rates of 9 percent and 6.5 percent, respectively.

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

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

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

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

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

p - preliminary

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

	1986:Q4	1988					Levels
	to						bil.\$
	1987:Q4	Q1	Q2	May	June	July <sup>P</sup>	July <sup>P</sup>
----- Commercial Bank Credit -----							
1. Total loans and securities at banks	7.9	7.8	11.9	13.0	11.1	4.8	2353.3
2. Securities	5.0	5.4	8.9	5.1	10.6	-9.6	543.9
3. U.S. government securities	9.1	6.8	12.9	10.1	13.5	-17.2	344.8
4. Other securities	-1.3	2.9	2.0	-3.6	5.5	3.6	199.1
5. Total loans	8.8	8.6	12.9	15.4	11.2	9.2	1809.2
6. Business loans	7.5	2.7	16.7	17.6	14.3	12.5	600.6
7. Security loans	1.0	76.6	-12.1	22.0	-6.2	-21.8	37.9
8. Real estate loans	18.1	10.8	13.8	16.3	12.3	12.0	625.1
9. Consumer loans	4.9	10.4	7.2	5.3	5.3	3.9	341.7
10. Other loans	-2.3	5.4	13.2	21.9	11.9	5.9	204.0
----- Short- and Intermediate-Term Business Credit -----							
Business loans net of bankers acceptances	7.6	2.3	17.0	18.2	14.4	12.2	596.9
12. Loans at foreign branches <sup>2</sup>	-4.1	115.8	4.1	61.9	-35.3	-48.5	19.0
13. Sum of lines 11 & 12	7.2	5.2	16.6	20.0	12.5	10.2	615.9
14. Commercial paper issued by nonfinancial firms	-1.6	8.8	12.2	28.0	-7.8	-22.3	89.7
15. Sum of lines 13 & 14	6.0	5.7	16.0	20.9	10.0	6.0	705.6
16. Bankers acceptances: U.S. trade related <sup>3,4</sup>	13.3	-11.6	-9.5	-24.9	-10.9	n.a.	32.8 <sup>5</sup>
17. Line 15 plus bankers acceptances: U.S. trade related	6.3	4.9	14.8	18.5	9.0	n.a.	734.9 <sup>5</sup>
18. Finance company loans to business <sup>3</sup>	16.6	8.4	12.1	11.6	8.7	n.a.	221.2 <sup>5</sup>
19. Total short- and intermediate-term business credit (sum of lines 17 & 18)	8.4	5.6	14.2	17.2	8.9	n.a.	956.1 <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.

n.a.--not available

p--preliminary

SELECTED FINANCIAL MARKET QUOTATIONS 1/  
(percent)

	1987		1988			Change from:
	Jan-Feb lows	2/ Oct 16	Feb lows	FOMC Jun 30	Aug 11	FOMC Jun 30
<b>Short-term rates</b>						
Federal funds 3/	5.95	7.59	6.38	7.58	7.80	0.22
Treasury bills 4/						
3-month	5.30	6.93	5.59	6.56	7.01	0.45
6-month	5.31	7.58	5.77	6.71	7.44	0.73
1-year	5.35	7.74	6.10	6.98	7.66	0.68
Commercial paper						
1-month	5.81	7.94	6.41	7.62	8.13	0.51
3-month	5.73	8.65	6.45	7.61	8.30	0.69
Large negotiable CD's 4/						
1-month	5.85	7.92	6.44	7.57	8.08	0.51
3-month	5.80	8.90	6.49	7.65	8.35	0.70
6-month	5.78	9.12	6.55	7.77	8.69	0.92
Eurodollar deposits 5/						
1-month	6.00	7.79	6.60	7.65	8.01	0.36
3-month	6.00	8.69	6.69	7.69	8.29	0.60
Bank prime rate	7.50	9.25	8.50	9.00	10.00	1.00
<b>Intermediate- and long-term rates</b>						
U.S. Treasury (constant maturity)						
3-year	6.34	9.52	7.28	8.18	8.82	0.64
10-year	7.01	10.23	8.11	8.82	9.35	0.53
30-year	7.29	10.24	8.32	8.87	9.40	0.53
Municipal revenue 6/ (Bond Buyer index)	6.92	9.59	7.76	8.12	8.18	0.06
Corporate—A utility Recently offered	8.78	11.50	9.63	10.30	10.31	0.01
Home mortgage rates 7/						
Fixed-rate	9.10	11.58	9.84	10.39	10.44	0.05
ARM, 1-year	7.52	8.45	7.59	7.81	7.90	0.09
	1986	1987		1988		Percent change from:
	Year end	Record highs	Lows	FOMC Jun 30	Aug 11	FOMC Jun 30
<b>Stock prices</b>						
Dow-Jones Industrial	1895.95	2722.42	1738.74	2141.71	2039.30	-4.78
NYSE Composite	138.58	187.99	125.91	154.47	148.60	-3.80
AMEX Composite	263.27	365.01	231.90	309.25	296.74	-4.05
NASDAQ (OTC)	348.83	455.26	291.88	394.66	379.11	-3.94

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 except lows shown which are one-week averages ending Feb. 25 and Feb. 10, respectively. Last observation is average for maintenance period ending Aug. 10, 1988.

4/ Secondary market.

5/ Average for statement week closest to date shown.

6/ One-day quotes for Thursday.

7/ Quotes for week ending Friday closest to date shown  
e—estimate