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Confidential (FR) Class II FOMC

March 25, 1981

RECENT DEVELOPMENTS

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

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SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest data			Percent change from		
	Period	Release date	Data	Preceding period	Three periods earlier	Year earlier
					(At annual rate)	
Civilian labor force	Feb.	3-6-81	105.7	1.6	1.5	1.4
Unemployment rate (%) 1/	Feb.	3-6-81	7.3	7.4	7.5	6.2
Insured unemployment rate (%) 1/	Jan.	2-6-81	3.4	3.5	4.1	3.2
Nonfarm employment, payroll (mil.)	Feb.	3-6-81	91.6	.7	2.6	.4
Manufacturing	Feb.	3-6-81	20.4	1.2	1.7	-2.8
Nonmanufacturing	Feb.	3-6-81	71.2	.5	2.8	1.4
Private nonfarm:						
Average weekly hours (hr.) 1/	Feb.	3-6-81	35.2	35.5	35.4	35.5
Hourly earnings ($) 1/	Feb.	3-6-81	7.03	7.02	6.91	6.45
Manufacturing:						
Average weekly hours (hr.) 1/	Feb.	3-6-81	39.8	40.4	39.9	40.1
Unit labor cost (1967=100)	Jan.	2-27-81	202.6	12.6	5.4	10.8
Industrial production (1967=100)	Feb.	3-17-81	150.8	-5.5	3.7	-1.2
Consumer goods	Feb.	3-17-81	146.5	-7.3	-4.1	-1.3
Business equipment	Feb.	3-17-81	177.7	-4.0	7.3	1.0
Defense & space equipment	Feb.	3-17-81	101.2	2.4	5.6	4.1
Materials	Feb.	3-17-81	153.3	-3.9	7.4	-2.0
Consumer prices all items (1967=100)	Feb.	3-24-81	263.9	11.5	10.7	11.3
All items, excluding food & energy	Feb.	3-24-81	247.3	5.4	8.6	10.7
Food	Feb.	3-24-81	270.6	3.6	4.5	10.5
Producer prices: (1967=100)						
Finished goods	Feb.	3-6-81	261.9	10.2	8.7	10.4
Intermediate materials, nonfood	Feb.	3-6-81	299.8	7.2	14.5	9.6
Crude foodstuffs & feedstuffs	Feb.	3-6-81	263.8	-40.0	-27.5	5.4
Personal income ($ bil.) 2/	Feb.	3-17-81	2,313.7	7.8	9.9	10.9
					(Not at annual rates)	
Mfrs. new orders dur. goods ($ bil.)	Feb.	3-20-81	81.7	.4	.8	.8
Capital goods industries	Feb.	3-20-81	26.6	-7.3	1.1	5.6
Nondefense	Feb.	3-20-81	21.0	-14.5	-4.1	-2.4
Defense	Feb.	3-20-81	5.6	34.6	26.8	53.4
Inventories to sales ratio: 1/						
Manufacturing and trade, total	Jan.	3-17-81	1.36	1.37	1.39	1.38
Manufacturing	Jan.	3-4-81	1.54	1.53	1.55	1.53
Trade	Jan.	3-17-81	1.19	1.22	1.25	1.24
Ratio: Mfrs.' durable goods inventories to unfilled orders 1/	Jan.	3-4-81	.588	.579	.581	.568
Retail sales, total ($ bil.)	Feb.	3-17-81	86.6	1.1	4.7	9.8
GAF 3/	Feb.	3-17-81	18.1	.9	3.0	8.9
Auto sales, total (mil. units.) 2/	Feb.	3-4-81	10.3	10.0	13.2	-2.6
Domestic models	Feb.	3-4-81	7.3	6.6	12.3	-4.2
Foreign models	Feb.	3-4-81	2.9	19.9	15.5	2.0
Plant & Equipment expen. ($ bil.) 4/						
Total nonfarm business	1981	3-12-81	325.72	--	--	10.2
Manufacturing	1981	3-12-81	129.85	--	--	12.1
Nonmanufacturing	1981	3-12-81	195.87	--	--	8.9
Capital Appropriations, Mfg.	1980-Q4	3-9-81	25,661	6.2	--	12.2
Housing starts, private (thous.) 2/	Feb.	3-17-81	1,218	-24.6	-21.4	-4.3
Leading indicators (1967=100)	Jan.	2-27-81	135.8	-.4	-.2	.8

1/ Actual data used in lieu of percent changes for earlier periods.
2/ At annual rate.
3/ Excludes mail order houses.
4/ Planned-Commerce March 1981 Survey.

Economic growth slowed in February after marked advances in activity over the preceding six months. Industrial production declined, employment and income gains moderated, and housing starts fell sharply. However, consumer spending grew rapidly and business investment remained fairly strong in the early part of the year. Overall inflation continued high despite some easing in food prices.

Industrial Production and Employment

Industrial production declined 0.5 percent in February following successively smaller increases in each of the three previous months. Sharp declines occurred in production of construction supplies, trucks, and household appliances. On the other hand, automobile assemblies rose 7 percent, and reports indicate that they have risen further in March. Declines in auto output in December and January had played a significant role in the slowing of the rise in the overall index. Production of energy materials rose in February, mainly due to stockpiling of coal in anticipation of a possible strike in late March. Reflecting the drop in factory output, the index of capacity utilization for manufacturing declined 0.7 percentage point in February.

The drop in output in February was accompanied by some slackening in labor demand. Nonfarm payroll employment grew only 50,000--the smallest monthly gain since employment began rising after the July trough. Hiring at trade and service establishments continued to increase at its recent pace, but these gains were largely offset by a drop in construction jobs and a further slowing in the growth of manufacturing employment. Additionally, the factory workweek fell more

INDUSTRIAL PRODUCTION
(Percentage change from previous period;
based on seasonally adjusted data)

	1980			1981	
	Q3	Q4	Dec.	Jan.	Feb.
	---annual rate--		-----monthly rate-----		
Total	-6.7	21.2	1.0	.4	-.5
Final products	-1.7	12.3	.5	.1	-.5
Consumer goods	-.8	12.9	-.2	-.2	-.6
Durable	-3.6	39.6	-1.3	-2.0	-.9
Nondurable	.5	4.9	.2	.4	-.5
Business equipment	-3.9	11.0	1.7	.5	-.3
Defense and space equipment	.0	10.7	.9	.3	.2
Construction supplies	-1.8	32.5	1.3	1.5	-2.6
Materials	-15.3	34.1	1.3	.9	-.3
Durable Goods	-23.5	48.2	1.2	1.2	-.9
Nondurable Goods	-9.5	38.1	2.6	.3	-.1
Energy materials	-1.2	-1.2	-1.0	1.2	.8

CAPACITY UTILIZATION RATES: MANUFACTURERS AND MATERIALS PRODUCERS
(Percent, seasonally adjusted)

	1979-80	1980	1980		1981	
	High	Low	Q3	Q4	Jan.	Feb.
Manufacturing industries	87.2	74.9	75.7	79.2	80.0	79.3
Primary processing	89.2	70.9	72.9	79.3	80.8	79.8
Advanced processing	86.2	77.1	77.3	79.1	79.7	79.0
Motor vehicles & parts	92.2	51.0	53.0	61.4	57.6	56.9
Materials producers	88.6	73.7	74.9	80.0	81.7	81.2
Durable goods mats.	87.6	68.0	69.2	75.8	78.0	77.2
Raw Steel	94.7	55.3	59.9	85.0	86.7	85.7
Nondurable goods mats.	90.9	76.8	79.2	85.0	86.2	85.9
Energy materials	88.3	83.1	85.0	84.4	85.2	85.8

than 1/2 hour in February, after recovering to about its prerecession level in January, and the construction workweek plunged 2-1/2 hours. Particularly sharp reductions in hours in some industries--notably transportation equipment and construction--were partially attributable to severe weather conditions in the Midwest and Southeast during the reference week for the employment surveys. Cutbacks also occurred among industries located primarily outside the affected regions.

The overall unemployment rate in February was 7.3 percent, about the same as the rates that have prevailed since last May. Joblessness among blue collar workers, which had been moving lower during the preceding six months, was about unchanged in February. The household survey reported a 230,000 increase in total employment in February. In both January and February, job gains in the household survey outpaced those in the establishment survey; in contrast, over the second half of 1980 employment gains in the household report fell short of the rise in the establishment measure.

Personal Income and Consumer Spending

Personal income rose at an 8 percent annual rate in February, down from the 12-3/4 percent rate over the preceding four months. Holding down income growth in February was the reduction in the factory workweek, which limited gains in private wages and salaries. The slowdown in wage and salary growth was partly offset by a leveling off in social insurance contributions after the payroll tax increase on January 1. Real disposable personal income in February apparently was little changed from January at a level only about 1-1/2 percent (annual rate) above the fourth quarter average--well below the growth rate recorded over the second half of 1980.

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

	1979	1980	1980			1981	
			Q2	Q3	Q4	Jan.	Feb.
	- - - - Average monthly changes - - - -						
Nonfarm payroll employment[2]	176	37	-366	112	247	374	51
Strike adjusted	182	31	-390	135	220	363	47
Manufacturing	1	-56	-308	10	89	38	20
Durable	4	-46	-253	3	68	32	6
Nondurable	-3	-10	-55	7	21	6	14
Construction	20	-9	-50	8	35	100	-108
Trade	40	16	-50	54	6	144	110
Finance and services	74	74	36	84	86	87	39
Private nonfarm production workers	112	-5	-387	133	179	327	22
Manufacturing production workers	-11	-63	-306	14	73	31	34
Total employment[3]	172	-42	-283	133	34	414	231
Nonagricultural	174	-48	-248	78	36	406	352

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

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

	1979	1980	1980			1981	
			Q2	Q3	Q4	Jan.	Feb.
Total, 16 years and older	5.8	7.1	7.3	7.5	7.5	7.4	7.3
Teenagers	16.1	17.8	17.9	18.4	18.3	19.0	19.3
20-24 years old	9.0	11.5	12.0	12.1	12.1	11.9	11.8
Men, 25 years and older	3.3	4.8	5.0	5.4	5.0	4.9	4.8
Women, 25 years and older	4.8	5.5	5.5	5.6	5.9	5.8	5.6
White	5.1	6.3	6.5	6.7	6.6	6.7	6.6
Black and other	11.3	13.2	13.2	13.9	14.1	12.9	13.1
Fulltime workers	5.3	6.9	7.0	7.3	7.3	7.1	7.1
White collar	3.3	3.7	3.7	3.7	3.8	3.9	3.7
Blue collar	6.9	10.0	10.5	11.1	10.7	10.2	10.1

Gains in consumer spending in early 1981 outpaced income growth. Retail sales rose 1.1 percent in February, following a sharp 2.7 percent increase in January. A large portion of these increases was due to a burst in spending at automotive dealerships, but even excluding automobiles and nonconsumption items, sales grew at a brisk clip. Much of the strength in sales in the nonautomotive area during January and February was in the largely discretionary types of spending associated with stores in the GAF grouping. Sales by these stores also had increased markedly in the second half of last year.

Auto sales rose sharply in the first part of the year. Total unit purchases, which had been around a 9 million rate since last July, surged to a 10.3 million pace in February. The substantial gains in sales of domestic models--to a 9 million unit rate from about mid-February through mid-March--have been in large part related to the price concessions offered by all major domestic producers and likely have come at the expense of future purchases. Prior to the introduction of the price rebates, sales of 1981-model cars had been at about 6-3/4 million unit annual rate. The improvement in sales, along with low rates of production, succeeded in paring car dealers' inventories; by the end of February domestic auto stocks were 1.29 million units--the lowest level since November 1970. These stocks represented 54 days' sales at the relatively brisk February rate, the lowest days' supply in more than two years. Sales of imported cars also rose substantially in February, possibly reflecting some apprehensions by consumers of future import quotas.

PERSONAL INCOME
(Based on seasonally adjusted data)

	1979	1980	1980 Q3	1980 Q4	1981 Jan.	1981 Feb.
	- - Percentage changes at annual rates[1] - -					
Total personal income	12.3	11.0	13.4	14.3	11.7	7.8
Wage and salary disbursements	10.8	9.0	6.6	17.8	17.6	5.9
Private	11.6	9.2	6.9	18.3	20.5	6.1
Disposable personal income						
Nominal	11.7	10.9	13.3	12.8	10.3	8.2
Real	2.0	.8	4.1	2.9	3.2	n.a.
	- - Changes in billions of dollars[2] - -					
Total personal income	18.3	18.7	26.2	23.6	22.2	15.0
Wage and salary disbursements	10.3	9.8	11.2	18.1	20.7	7.0
Private	8.9	8.1	10.2	14.8	19.6	5.9
Manufacturing	2.0	2.3	3.9	5.8	5.6	2.4
Other income	8.9	9.6	16.0	6.4	11.4	8.0
Transfer payments	2.8	4.1	9.6	.4	3.5	-.2
Less: Personal contributions for social insurance	.9	.8	1.0	.9	9.9	.1
Memorandum:						
Personal saving rate[3]	5.3	5.6	6.1	5.1	4.4	n.a.

1. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Changes for quarterly periods are compounded rates of change; monthly changes are not compounded.
2. Average monthly changes are from the final month of the preceding period to the final month of period indicated; monthly figures are changes from the preceding month.
3. Monthly saving rate equals the centered three-month moving average of personal saving as a percentage of the centered three-month moving average of disposable personal income.

RETAIL SALES
(Percent change from previous period;
based on seasonally adjusted data)

	1980				1981	
	Q2	Q3	Q4	Dec.	Jan.	Feb.
Total sales	-2.5	4.2	3.3	.8	2.7	1.1
(Real)[1]	-4.6	1.9	.8	.2	2.1	--
Total, less auto and nonconsumption items	.6	2.6	3.3	1.3	2.1	1.1
GAF[2]	-1.2	3.0	3.3	.5	1.6	.9
Durable goods	-9.7	8.1	3.4	-.1	4.6	1.1
Auto	-13.4	12.5	1.6	-1.2	4.4	2.4
Furniture & appliances	-3.4	4.0	3.1	.4	5.7	-.3
Nondurable goods	1.0	2.5	3.2	1.2	1.9	1.0
Apparel	.4	2.7	1.4	.3	3.9	.3
Food	2.0	3.4	2.6	1.5	-.3	.8
General merchandise[3]	-1.0	2.8	4.1	.7	-.8	1.6
Gasoline	5.1	2.0	2.5	1.9	3.6	3.0

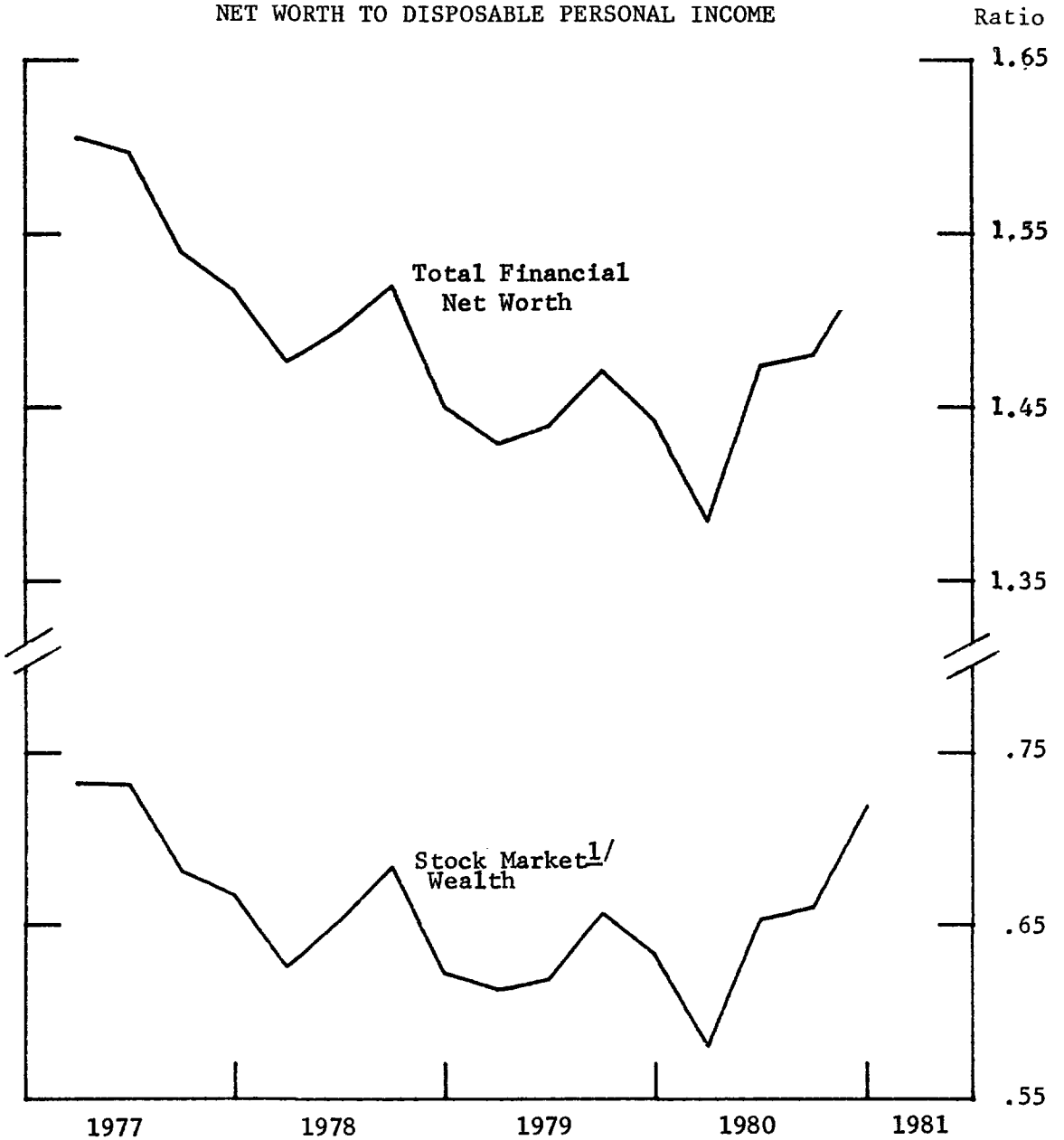
1. BCD series 59. Data are available approximately 3 weeks following the retail sales release.
2. General merchandise, apparel, and furniture and appliance stores.
3. General merchandise excludes mail-order nonstores; mail-order sales are also excluded in the GAF composite sales summary.

AUTO SALES
(Millions of units; seasonally adjusted annual rates)

	1980			1981		
	Q2	Q3	Q4	Jan.	Feb.	Mar.
Total	7.7	8.8	9.0	9.3	10.3	n.a.
Foreign-made	2.1	2.3	2.5	2.4	2.9	n.a.
U.S.-made	5.5	6.5	6.6	6.9	7.3	9.4[1]
Small	2.8	3.2	3.3	3.5	3.9	n.a.
Intermediate & standard	2,7	3.3	3.3	3.4	3.4	n.a.

Note: Components may not add to totals due to rounding.
1. First 20 days of month.

RATIO OF END OF QUARTER CONSUMER FINANCIAL
NET WORTH TO DISPOSABLE PERSONAL INCOME



1/ Includes stock market holdings of private pension fund and life insurance reserves.

The recent strong gains in consumption have resulted in the personal saving rate falling more than 2 percentage points from the 6.1 percent level of 1980-Q3. To some extent spending has been supported by gains in household wealth; financial wealth to income increased markedly from the first to the fourth quarters of 1980 as a result of the substantial rise in the stock market.

Residential Construction

Housing activity, which held firm from September through January despite further increases in interest rates, weakened significantly in February. Following four months above a 1-1/2 million unit rate, housing starts dropped to a 1.22 million unit rate in February--the lowest since last June. Starts of single-family units fell 22 percent in February, while multifamily starts plunged 30 percent. The former had declined slightly since last September, and the latter had been trending up since the middle of last year. Residential building permits declined in February for the third straight month.

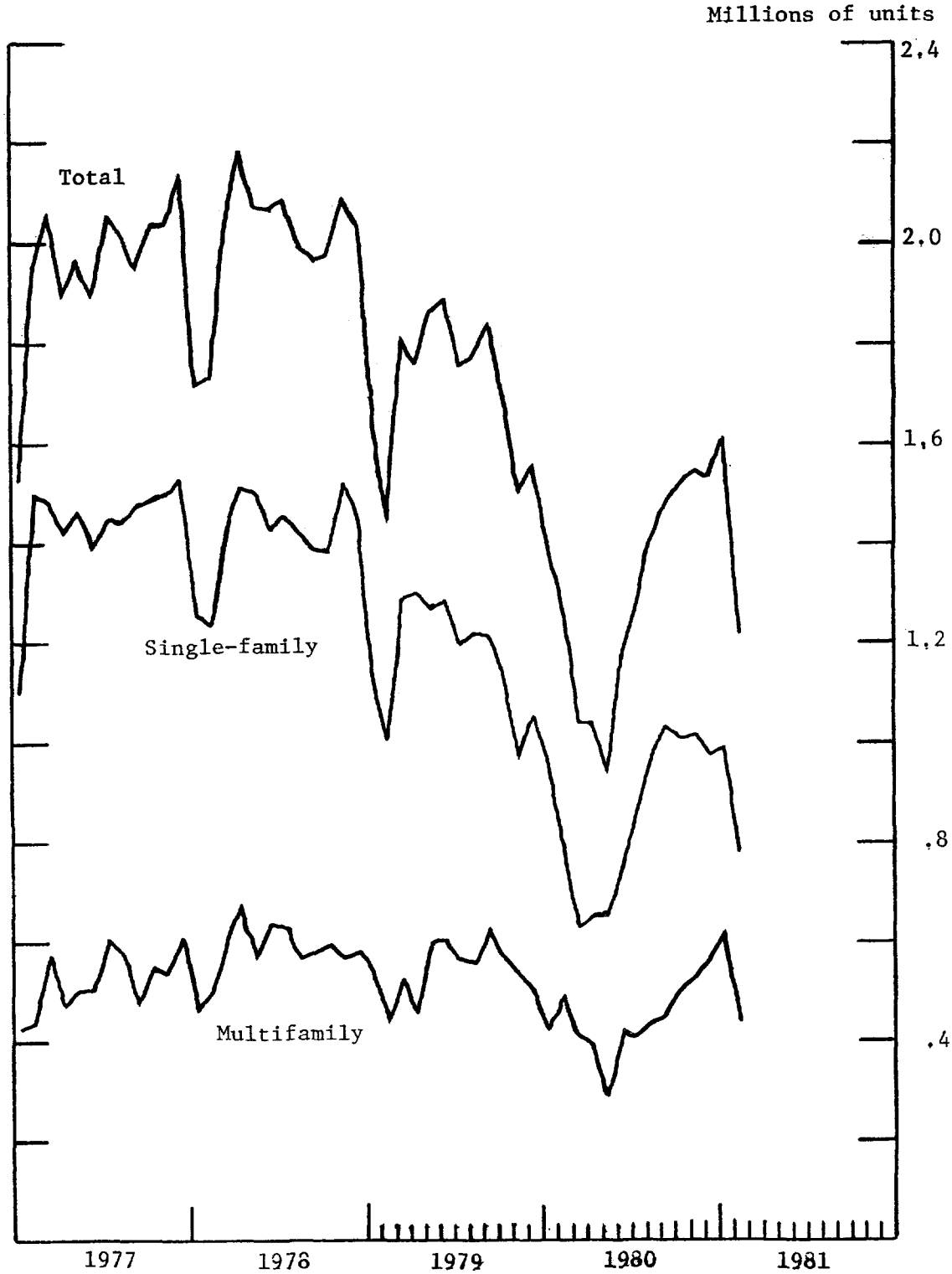
The weakness in new building activity reflects in part declining levels of home sales. Sales of new and existing houses dropped in January for the fourth consecutive month to a level about one-fifth below the recent September peak. Purchases of existing homes fell to a 2.5 million unit annual rate--a level only slightly above their depressed pace during the second quarter of last year. New home sales dropped 6.5 percent in January. On a year-over-year basis, increases in average transaction prices for houses were the smallest in several months--prices of new houses were 10 percent higher and those for

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

	1980					1981	
	Annual	Q2	Q3	Q4	Dec.	Jan.	Feb.[1]
All units							
Permits	1.17	.90	1.39	1.31	1.24	1.23	1.14
Starts	1.29	1.06	1.39	1.54	1.54	1.62	1.22
Single-family units							
Permits	.70	.53	.85	.79	.74	.72	.67
Starts	.85	.69	.96	1.00	.97	.99	.78
Sales							
New homes	.53	.45	.60	.55	.53	.49	n.a.
Existing homes	2.88	2.46	3.06	3.00	2.91	2.54	n.a.
Multifamily units							
Permits	.47	.37	.54	.52	.49	.51	.47
Starts	.44	.37	.43	.53	.56	.62	.44
Mobile home shipments	.22	.18	.22	.25	.26	.23	n.a.

1. Preliminary estimates.
n.a.--not available.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



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

	1980				1981	
	Q2	Q3	Q4	Dec.	Jan.	Feb.
Nondefense capital goods shipments						
Current dollars	-2.5	2.1	3.4	-.4	3.1	-1.3
Constant dollars[1]	-3.1	2.4	.5	-1.9	1.4	n.a.
Addenda: Sales of heavy-weight trucks (thousands)	240	290	230	240	280	230
Nonresidential construction						
Current dollars	-2.0	-4.8	1.8	4.6	3.7	n.a.
Constant dollars	-4.7	-7.0	.3	3.6	3.5	n.a.
Addenda: Oil and gas well drilling (millions of feet)	21.5	25.6	27.2	28.3	21.5	25.0

1. FRB staff estimate

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

	1980				1981	
	Q2	Q3	Q4	Dec.	Jan.	Feb.
Nondefense capital goods orders						
Current dollars	-9.2	.2	3.7	-.8	13.1	-14.5
Constant dollars	-9.7	.6	.8	-2.3	11.3[1]	n.a.
Machinery						
Current dollars	-13.0	8.9	6.0	2.1	9.2	-6.1
Constant dollars[1]	-13.5	9.3	3.0	.5	7.4	n.a.
Addenda: Ratio of current dollar unfilled orders to shipments						
Total	6.57	6.37	6.10	6.11	6.02	6.05
Machinery	4.34	4.21	4.16	4.07	3.99	3 98
Contracts for nonresidential plant						
Current dollars	-31.4	55.0	26.5	-12.3	-41.6	n.a.
Constant dollars	-37.5	62.4	24.4	-12.8	-41.3	n.a.

1. FRB staff estimate.

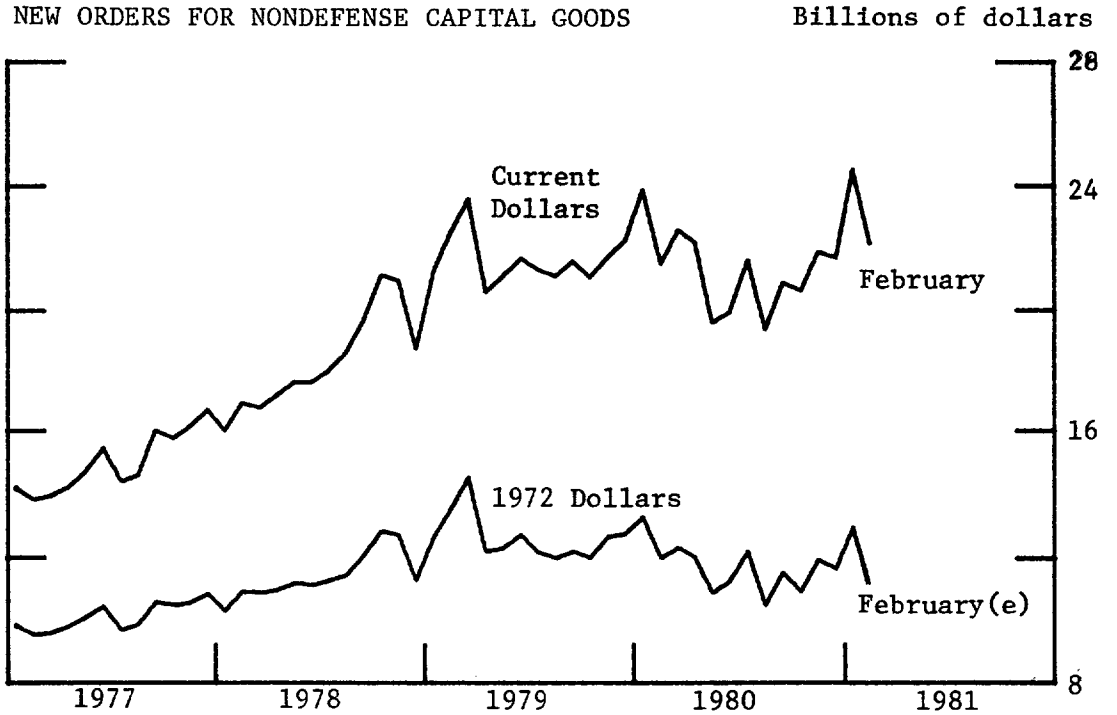
existing houses 12 percent higher. The CPI measure of home prices showed a sharp drop in early 1981; but because this series is based on the limited sample of FHA-insured homes, its movements are not necessarily representative of overall changes in house prices.

Business Fixed Investment

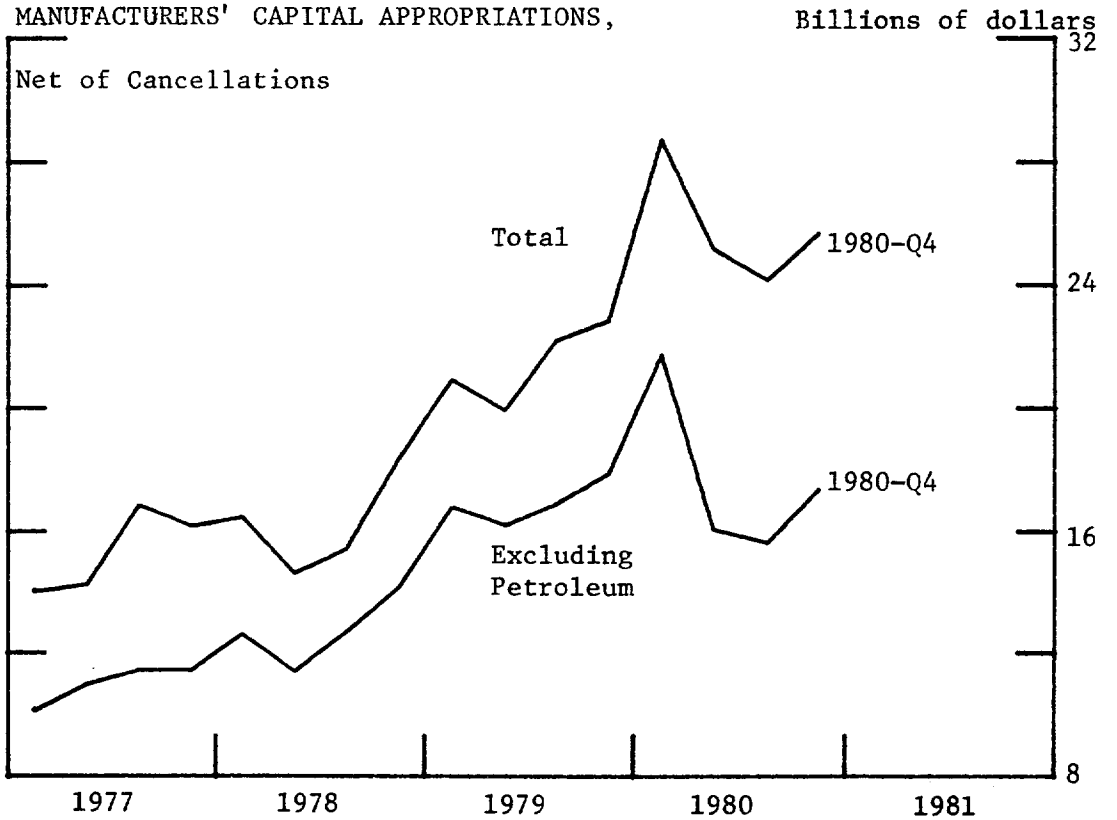
Capital spending, on balance, rose substantially in early 1981. In the structures category, real outlays for construction rose 3.5 percent in January, following a similar increase in December, while oil well drilling in the first two months of the year was somewhat below the high level at the end of 1980. In the equipment area, shipments of nondefense capital goods in real terms in January and February appear to have been little changed from the fourth quarter pace, but business purchases of automobiles increased substantially, and sales of heavy-weigt trucks rose slightly from the extremely low levels of last fall.

Commitments data do not appear to support continued strength in investment outlays. Constant-dollar new orders for nondefense capital goods, which were basically unchanged in the second half of last year, fell an estimated 15 percent in February, following January's 11.3 percent increase. The vigorous construction activity of December and January may reflect a catchup of projects deferred in the spring and summer of 1980 by financial conditions and overall economic weakness rather than an upsurge in demand. Contracts for private nonresidential plant trended up through November of last year but they were still below their level a year earlier.

NEW ORDERS FOR NONDEFENSE CAPITAL GOODS



MANUFACTURERS' CAPITAL APPROPRIATIONS,
Net of Cancellations



SURVEYS OF PLANT AND EQUIPMENT EXPENDITURES
(Percent change from preceding year)

		Planned for 1981		
		Commerce Department 1		McGraw-Hill 2
	1980	Dec. 1980	Feb. 1981	Fall 1980
All Business	9.3	10.8	10.2	11.9
Manufacturing	17.4	14.1	12.1	14.6
Durables	15.4	13.3	12.8	4.7
Nondurables	19.5	14.9	11.4	23.8
Nonmanufacturing	4.7	8.7	8.9	9.4
Mining	18.7	18.8	17.5	13.0
Transportation	-2.1	8.2	6.5	5.4
Utilities	4.4	8.7	8.0	8.6
Trade and Services	3.2	6.8	6.3	11.8[3]
Communications and other	6.2	9.5	13.4	8.5[4]

1. Results are adjusted for systematic bias. Without this adjustment, the Commerce results would have been 8.6 percent in December and 8.6 percent in February.
2. The McGraw-Hill survey is not strictly comparable to the Commerce reports because of coverage differences.
3. Contains commercial businesses only.
4. Contains the communication industry only.

RECENT ERROR HISTORY OF THE FEBRUARY COMMERCE SURVEY
(Percent change from preceding year)

Year	Anticipated Change	Actual Change	Error[1]
1970	10.0	6.1	3.9
1971	6.1	2.8	3.3
1972	12.7	10.8	1.9
1973	14.0	14.5	-.5
1974	11.4	14.0	-2.6
1975	1.9	.5	1.4
1976	8.1	8.7	-.6
1977	12.2	15.5	-3.3
1978	12.4	16.7	-4.3
1979	12.6	17.0	-4.4
1980	12.0	9.3	2.7

1. Anticipated less actual percent change.

CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Billions of dollars at annual rates)

	1979	1980 H1	1980 Q3	1980 Q4	1980 Nov.	1980 Dec.	1981 Jan.
Book Value Basis							
Total	46.4	40.0	30.1	8.8	17.4	-14.6	53.1
Manufacturing	29.9	30.7	-.1	3.5	14.6	4.8	47.0
Wholesale	9.1	7.4	17.9	8.2	8.2	2.5	-1.3
Retail	7.3	1.8	12.3	-2.9	-5.3	-21.9	7.4
Constant Dollar Basis							
Total	7.2	-1.4	-1.9	-5.1	-2.7	-13.6	1.4
Manufacturing	6.8	2.5	-5.2	-3.6	-1.5	-1.2	7.1
Wholesale	.4	.2	1.9	.3	1.9	-2.3	-2.3
Retail	-.1	-4.1	1.3	-1.8	-3.1	-10.1	-3.4

Details may not add to total due to rounding.

INVENTORIES RELATIVE TO SALES

	1979	1980 H1	1980 Q3	1980 Q4	1980 Nov.	1980 Dec.	1981 Jan.
Book Value Basis							
Total	1.42	1.47	1.46	1.38	1.39	1.37	1.36
Manufacturing	1.52	1.66	1.64	1.55	1.55	1.53	1.54
Wholesale	1.17	1.20	1.19	1.12	1.12	1.11	1.08
Retail	1.46	1.41	1.40	1.35	1.36	1.34	1.31
Constant Dollar Basis							
Total	1.64	1.70	1.72	1.66	1.67	1.66	1.65
Manufacturing	1.89	2.01	2.04	1.97	1.96	1.96	1.97
Wholesale	1.40	1.43	1.45	1.39	1.41	1.38	1.38
Retail	1.41	1.42	1.44	1.41	1.43	1.41	1.37

Longer-term indicators of investment demand suggest a modest advance in real capital spending over the balance of this year. Following sizable declines in the spring and summer, capital appropriations net of cancellations of large manufacturers increased 6.2 percent in the fourth quarter. Most of this rise was in the cyclically sensitive durable goods sector. The Commerce Department survey of capital spending plans, taken in January and February, reports that businesses plan to increase outlays an average of 10.2 percent in 1981. If this rise were realized it would leave constant-dollar outlays for 1981 as a whole little changed from their 1980 level, but would imply some real growth during the course of this year. It is possible that these relatively strong longer-term plans, like similar readings reported early last year, were made assuming more favorable financial conditions than are likely to prevail.

Inventory Investment

Inventories were liquidated over the second half of 1980. In January, however, constant-dollar stocks rose slightly. This increase occurred in the manufacturing sector, where it was concentrated in materials and work-in-process stocks; the finished goods inventories fell $2.5 billion. This distribution suggests that the rise in manufacturers' stocks apparently reflected planned increases rather than an unexpected weakness in sales. Durable goods stocks accounted for three-fourths of manufacturers' accumulation; sizable run-ups occurred in the aircraft, electrical machinery, and steel industries, where increases in orders were fairly substantial through the end of 1980.

In the trade sector, the book value of wholesale stocks fell at a $1.3 billion rate in January, while retail stocks grew at a $7.4 billion pace after a substantial liquidation in December. The overall accumulation of inventories in January was more than offset by strong sales gains, and the stock-sales ratio for all manufacturing and trade continued the downtrend that started last June.

Government Sector

The federal unified budget deficit in the current quarter now is estimated to be about $31-1/2 billion on the basis of January and February data. This is about $7-1/2 billion more than earlier projections, and is due primarily to higher CCC outlays than previously estimated and to less-than-anticipated revenues from the windfall profits tax as well as unexpectedly low receipts from the implementation of accelerated personal and corporate tax payment schedules. The revenue shortfall appears unrelated to underlying economic developments and is not likely to be reversed later.

The administration's budget revisions submitted to Congress on March 10 supersede the description of budget proposals presented to the Congress in President Reagan's February 18 address. For fiscal year 1982, the administration proposes total Federal outlays (unified budget) of $695 billion, and with assumed receipts of $650 billion, a deficit of $45 billion. In comparison with FY 1982 budget proposed by the Carter Administration in January, the Reagan Administration is proposing $4-1/2 billion additional defense outlays (net of outlay reductions assumed by the Reagan Administration from the Carter budget), more than $15 billion less in direct payments to individuals, and about $30

billion less in other nondefense spending exclusive of interest. Tighter restrictions are also proposed on federal credit activities. Major revenue proposals include a 10 percent reduction in personal income tax rates effective July 1, 1981, and further reductions to take place on January 1 of 1982, 1983, and 1984. Business tax cut proposals include a modified version of the 10-5-3 depreciation proposal widely discussed last year year. The budget proposals are discussed in more detail in Appendix II-A.

Recent data suggest some slowing in state and local government activity. Employment in this sector has been little changed since September 1980, as nineteen state governments have imposed hiring freezes. Moreover, in mid-February, the federal government froze CETA hiring. Partially offsetting the flattening of growth in employment, state and local construction spending rose 15.6 percent in real terms from November to January. This rebound came on the heels of prolonged weakness through most of 1980 and left real construction spending in January some 7 percent below its year-earlier level.

Wages and prices

During 1980 the rapid rise in wage rates sustained upward cost pressure on prices, and recent data indicate a continuation of large wage increases in early 1981. The hourly earnings index--a measure of wage trends for production and nonsupervisory workers in the private nonfarm economy--rose at only a 6-1/2 percent annual rate in February, following a 10-3/4 percent rate rise in January. The February level of the index remained 9-1/2 percent above a year earlier.

HOURLY EARNINGS INDEX[1]
(Percent change at annual rates;
based on seasonally adjusted data)[2]

	Feb. 80-Feb. 79	Feb. 81-Feb. 80	1980 H1	1980 H2	1981 Jan.	1981 Feb.
Total private nonfarm	8.2	9.5	9.7	9.7	10.6	6.4
Manufacturing	9.1	10.3	11.2	10.8	8.4	4.4
Durable	9.1	10.8	12.1	11.4	9.3	3.0
Nondurable	9.0	9.4	9.8	9.8	6.9	7.0
Contract construction	6.0	7.1	6.9	7.9	11.8	-7.3
Transportation and public utilities	8.8	9.4	8.4	10.5	7.7	5.0
Total trade	7.9	8.6	9.1	8.5	15.2	6.4
Services	7.9	10.2	9.3	9.7	8.4	13.7

1. Excludes the effect of interindustry shifts in employment and fluctuations in overtime pay in manufacturing.
2. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Changes for quarterly and half-year periods are at compound rates; monthly changes are not compounded.

EMPLOYMENT COST INDEX
(Percent change from December
of preceding year to December of year indicated)

	1977	1978	1979	1980
Total private nonfarm	7.0	7.7	8.7	9.0
By industry				
Manufacturing	7.8	8.3	8.6	9.4
Transportation and public utilities	9.2	7.6	9.4	11.1
Trade	6.6	8.3	7.9	7.8
Services	5.3	6.7	8.5	8.7
By occupational group				
White-collar workers	6.5	7.2	8.6	8.7
Blue-collar workers	7.7	8.2	9.0	9.6
Service workers	6.4	8.7	7.2	8.1
By bargaining status				
Union	7.6	8.0	9.0	10.9
Nonunion	6.6	7.6	8.5	8.0

Higher rates of joblessness over the past year appear to have had some--albeit small--restraining influence on wage demands. Data from the more comprehensive employment cost index show that wage and salary rates for nonunion workers rose 8 percent in the twelve months ended in December--a deceleration of 1/2 percentage point from the preceding year. Recently, Chrysler workers have agreed to forgo further cost-of-living adjustments and scheduled wage increases for the duration of their current contracts, which expire in September 1982. In the past this type of extraordinary development generally appears to have been limited to cases of acutely troubled companies. Despite the difficulties faced by the domestic auto industry as a whole, the UAW recently declined to reopen contracts with Ford and GM. Most recently, the United Mine Workers and the Bituminous Coal Operators Association reached a tentative agreement on a contract calling for a 36 percent increase in wages and benefits over the next three years--about the same as in their last contract.

Prices continued to rise rapidly on average in early 1981, as relief in some areas--particularly food and housing--was countered by the impact of recent OPEC price hikes and domestic oil decontrol. The rate of increase in the consumer price index decelerated to an 8-3/4 percent annual rate in January, but rebounded to an 11-1/2 percent rate in February as the effects of complete decontrol of domestic petroleum began to reach the retail level. Meanwhile, increases in the producer price index for finished goods remained near the rates in the last half of 1980. However, a decline in sensitive materials prices that began in December has provided some sign of relief in cost pressures at the producer level.

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

	Relative importance[2] Dec. 1980	1979	1980	1980 Q3	1980 Q4	1981 Jan.	1981 Feb.
Finished goods	100.0	12.8	11.7	13.5	7.8	10.3	10.2
Consumer foods	23.0	7.4	7.3	31.0	3.6	.5	-6.7
Consumer nonfood	56.6	17.5	14.0	7.6	8.5	14.0	16.1
Energy	12.0	58.0	27.7	3.6	14.5	32.3	42.8
Exc. energy	44.7	9.7	10.2	8.9	6.7	9.4	8.2
Capital equipment	20.3	8.8	11.4	9.9	11.4	11.5	13.3
Intermediate materials[3]	93.6	16.7	12.3	7.8	12.6	15.5	7.2
Exc. food and energy	77.4	12.8	10.0	6.9	11.0	10.7	2.7
Crude food materials	58.2	10.6	8.6	73.9	-4.1	-12.6	-40.0
Crude nonfood	41.8	26.1	16.7	32.3	17.6	-9.8	138.4
Exc. energy	15.6	15.1	7.5	54.8	15.1	-69.2	-41.3

1. Changes are from final month of preceding period to final month of period indicated.
2. Relative importance weights are on a stage of processing basis.
3. Excludes materials for food manufacturing and animal feeds.

RECENT CHANGES IN CONSUMER PRICES[1]
(Percentage change at annual rates; based on seasonally adjusted data)[2]

	Relative importance Dec. 1980	1979	1980	1980 Q3	1980 Q4	1981 Jan.	1981 Feb.
All items	100.0	13.3	12.4	7.8	13.2	8.8	11.5
Food	17.3	10.2	10.2	19.7	13.1	-1.8	3.6
Energy[3]	10.8	37.4	18.1	2.5	.3	36.6	61.0
All items less food and energy[3]	71.8	11.3	12.1	5.8	14.4	6.9	5.4
Homeownership	25.8	19.8	16.5	-3.5	23.1	5.7	.4
All items less food, energy and homeownership[4]	49.6	7.5	9.9	10.7	9.8	6.0	9.7
Used cars	3.0	2.2	18.3	39.0	62.3	14.6	6.5
Other commodities[4]	20.5	6.6	8.1	10.0	4.0	5.0	7.4
Other services[4]	26.1	8.8	10.3	9.4	8.5	10.2	9.6

1. Based on index for all urban consumers.
2. Changes are from final month of preceding period to final month of period indicated.
3. Energy items: gasoline and motor oil, fuel oil and coal, gas and electricity.
4. Reconstructed series; includes home maintenance and repairs (relative importance weight of 2.7), also a component of homeownership costs.

Food price increases so far in 1981 have been far less than expected, but the moderation mainly appears to reflect temporary developments. At the consumer level, food prices edged down in January and rose only a little in February, following several months of rapid increases. At the producer level, prices for finished consumer foods and crude foodstuffs both have declined sharply over the first two months of the year. To a large extent, the slowing in food prices has been concentrated in the livestock and poultry sectors where marketings have been relatively high. However, with livestock producers now reporting losses, current levels of output are not likely to be maintained. Moreover, inflation rates generally continue to be high for other food items.

The OPEC price increases of late 1980 and the lifting of crude oil price controls on January 28 have led to a surge in energy prices. At the retail level, energy prices jumped more than 3 percent in January (not at an annual rate), and 5 percent in February, when the effects of decontrol began to show up at the consumer level. The run-up in energy costs, however, may be short-lived, as stocks are ample and recent private surveys indicate that retail fuel price increases were moderating in early March.

The January and February declines in the CPI index for home prices partially offset the effect on the index of further increases in mortgage interest rates and consequently held down increases in homeownership costs. The mortgage rate component is expected to continue to rise over

the next several months, since the contract rate implicit in the CPI index is still well below the current level of commitment rates.

The increase in consumer prices for items other than food, energy, and homeownership in February was about the same as in the closing months of 1980, despite substantially smaller rises in used car prices than during the preceding two quarters. In addition, new car prices were again unchanged as price hikes posted in early January were subsequently balanced by a wide range of rebate programs and price discounts.

APPENDIX II-A

THE PRESIDENT'S MARCH 10 BUDGET REVISIONS*

Introduction. On March 10, the Administration formally submitted to Congress its revisions of the January budget which had been submitted by the outgoing Administration. This submission contains budget estimates which supersede the preliminary estmates in the "Program for Economic Recovery" reported on February 18. It re-affirms, however, the proposed budget deficit of $45 billion for fiscal year 1982 originally proposed by President Reagan. Table 1 summarizes the principal features of the new budget.

President Reagan's Outlay Proposals

The Administration's program calls for a substantial slowing in the growth of federal spending and a significant shift in the budget's priorities. As indicated in Table 1, the President has proposed over $6 billion in defense program initiatives in fiscal year 1982 (above the $6.6 billion in new defense proposals requested in the January budget); in addition a special military pay raise of 5.3 percent is estimated to raise outlays in FY1982 by $1.9 billion. Net of savings the total increase in defense outlays is $4.4 billion above the January budget. These increases are offset by $46 billion in net proposed reductions in spending for nondefense programs (this amount was raised from the February 18 proposal in order to offset subsequent upward re-estimates and adjustments to program costs). The major features of the proposed spending cuts are as follows:

- eligibility requirements are tightened in many entitlement programs (foodstamps, trade adjustment assistance, medicaid, and secondary social security benefits). See Table 2 for details.

- numerous programs are reduced or terminated, including public service jobs, impact aid, foreign aid and federal support for the arts.

- categorical grants--especially for education, health, and social services--are consolidated into a few block grants. Direct federal subsidies are reduced for synfuels development and Export-Import Bank activities.

- public construction projects--wastes treatment, highways and mass transit--are stretched-out into future years.

- Federal personnel costs are reduced through employment cuts and pay reforms.

It should be noted that the increase in defense outlays over earlier proposals for fiscal years 1981 and 1982 does not fully reflect the increase in military spending embodied in the administration's new budget. As illustrated in Table 3, the growth of budget authority for the Defense Department is expected to rise from the 14% rate registered in fiscal year 1980 to over 25% in fiscal year 1982. In real terms,

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* Prepared by Susan Leper, Senior Economist, Government Finance Section, Division of Research and Statistics.

Table 1
President Reagan's Budget Proposals
(fiscal years, billions of dollars)

	1981	1982	1983	1984
Outlays	655.2	695.3	732.0	770.2
Additional defense program 1/	(+2.0)	(+6.2)	(+20.7)	(+27.0)
Outlay savings 2/ 3/	(-4.8)	(-47.4)	(-29.8)	(-44.2)
Revenues	600.3	650.3	709.1	770.7
Personal income tax cut	(-6.4)	(-44.2)	(-81.4)	(-118.1)
Depreciation reform	(2.5)	(-9.7)	(-18.6)	(-30.0)
User charges and other changes	(+3.9)	(+3.1)	(+3.0)	(+3.2)
Surplus(+) or deficit(-)	-54.9	-45.0 4/	-22.8	+0.5

1/ Above January budget; January budget already included $6.6 billion of increased defense outlays above current servies.
2/ Net of small amounts of nondefense outlay increases ($1.2 billion in FY1982); includes some savings in defense.
3/ Includes some outlay savings already proposed in the January budget ($8.2 billion in FY1982).
4/ For fiscal 1982, the net proposed reduction in outlays from current services is $34.6 billion and the net reduction in revenues is $51.3 billion, resulting in a net increase in the deficit of $16.7 billion from current services (without taking into account second round effects).

Source: Fiscal Year 1982 Budget Revisions, Office of Management and Budget, March 1981.

Table 2

The Reagan Administration's Proposed Spending Reductions
(Fiscal years; billions of dollars)

	Item	1982
1]	Entitlement Revisions; Tighten Eligibility Requirements (subtotal)	8.6
	Foodstamps	2.3
	Secondary Social Security Benefits	2.3
	AFDC	0.7
	Medicaid	1.0
	Subsidized Housing	0.2
	Trade Adjustment Assistance	1.2
	Federal Retirement (annual indexation)	0.5
	Black Lung	0.4
2]	Program Reductions or Terminations (subtotal)	5.4
	Public Service Jobs	3.6
	Impact Aid	0.5
	Foreign Aid	0.4
	National Endowment for the Arts	.2
	NASA	2.5
	Youth Conservation Corps	.2
3]	Grant Consolidation (subtotal)	2.9
	Education Programs	1.1
	Health and Social Service	1.8
4]	Cuts in Federal Subsidies	3.0
	Economic and Regional Development	0.4
	Synfuels	1.2
	Mass Transit	0.4
	Export-Import Bank	0.4
	Postal Service	0.6
5]	Federal Pay Reforms and Personnel Cuts	1.4
	Federal Comparability Standards	0.1
	Other (Defense)	1.3
6]	Other 1/	27.3
7]	Grand Total of Budget Spending Cuts	$48.6

1/ Specified in detail is Fiscal Year 1982 Budget Revisions; includes additional spending cuts in previous five categories.

Table 3
MILITARY SPENDING IN THE REAGAN BUDGET[1]/
(Fiscal year, billions of dollars)

Fiscal Years	Budget Authority	Percent Change	Nominal Outlays	Percent Change
1977	108.4		97.5	
1978	115.3	6.4	103.0	5.6
1979	125.0	8.4	115.0	11.7
1980	142.6	14.1	132.8	15.5
1981	177.1	20.7	158.6	19.4
1982	221.8	25.2	184.8	16.5
1983	254.5	14.7	221.1	19.6

1/ Department of Defense - Military Spending.

the President is calling for a 7 percent increase in military outlays for the coming fiscal year.

Overall the pace of Federal spending in nominal terms is expected to moderate from fiscal year 1981's 13% rate to 6% in fiscal 1982. In real terms, this moderation translates into a 2.8% drop in federal spending in the coming fiscal year. As a result of the slower growth in spending, the share of GNP devoted to outlays is estimated in the revised budget to drop from the current 23 percent to 21.8 percent in fiscal year 1982. The ratio for FY1982 was estimated to be 23 percent in the January budget.

President Reagan's Revenue Proposals

The tax portion of the President's program proposes sizable cuts in personal taxes, phased in over a three year period, and a phased-in reduction in asset depreciation lives which will cut business taxes substantially. A small portion of the revenue losses from these tax cuts will be offset by new user charges. Under current law, federal receipts are estimated to rise from 20.3 % of GNP in 1980 to 23.5% in 1985. The tax cut package is estimated in the revised budget to reduce this percentage to 19.3% in 1985 (Table 4).

For individuals, marginal tax rates will be reduced 5 percent in calendar 1981,[1/] 15 percent in calendar 1982, 25 percent in calendar 1983 and 30 percent thereafter, from the current 14 to 70 percent range (Table 5) The President's proposal, thus, is similar to the "Roth-Kemp" program of across the board cuts in marginal tax rates of 10 percent per year for the next 3 years starting on July 1, 1981. However, the President's proposal does not call for indexing the tax system for inflation after the third year.

For business firms, the President's program proposes an "Accelerated Cost Recovery System" (ACRS) which is a modified 10-5-3 program of accelerated depreciation allowances. Most new investment in machinery and equipment would be placed in one of two asset classes:

- 3 year class. Automobiles, light trucks, and equipment used in research and development activities would be depreciated on an accelerated 3 year schedule.

- 5 year class. All other machinery and equipment, except for some long-lived public utility property would be depreciated on an accelerated 5 year schedule.

1/ Withholding rates would be cut 10 percent on July 1, 1981, so the full year's effect of the 5 percent cut in tax rates would be felt in the second half of the year. In all subsequent years, withholding tables would be adjusted January 1 so that withholdings and tax liabilities would be adjusted on the same schedule.

Table 4
THE TAX REDUCTION PROGRAM
(fiscal years; billions of dollars)

	1980 (actual)	1981	1982	1983	1984	1985
Receipts on a current services basis	520.0	608.8	701.6	806.2	915.5	1,032.0
Personal tax cuts		-6.4	-44.2	-81.4	-118.1	-141.5
Accelerated cost recovery system		-2.5	-9.7	-18.6	-30.0	-44.2
Proposed user charges		0.2	2.1	2.4	2.7	3.1
Other Proposals 1/			0.5	0.6	0.6	0.6
Receipts after proposed tax changes	520.0	600.3	650.3	709.1	770.7	849.9
Percent of GNP:						
Current law receipts	20.3	21.4	22.0	22.4	22.9	23.5
After proposed tax changes	20.3	21.1	20.4	19.7	19.3	19.3

1/ These proposals include an increase in railroad retirement payroll taxes and increases passport and visa fees.

ource: Fiscal Year 1982 Budget Revisions, March 1981.

Table 5

PHASE-IN FEATURES OF THE TAX CUT PROGRAM
(calendar years)

	1980 (present law)	1981	1982	1983	1984	1985
Personal Tax Cut						
Percentage reduction in marginal tax rates		5	15	25	30	30
Range of marginal tax rates (percent)	14-70	13-66	12-60	11-53	10-50	10-50
Revenue loss (fiscal years, billions of dollars)		6.4	44.2	81.4	118.1	141.5
Memo:						
Maximum capital gains tax rate (percent) 1/	28	26.4	24	21.2	20.0	20.0
Maximum tax rate on "earned income" (percent)	50	50	50	50	50	50
Accelerated Cost Recovery System						
3-year class (asset life in years)	3.5 2/	3	3	3	3	3
5-year class "	10.2 3/	9	8	7	6	5
10-year class "	32.5 4/	18	16	14	12	10
15-year class "	"	18	16	15	15	15
18-year class "	"	18	18	18	18	18
Revenue loss (fiscal years, billions of dollars)		2.5	9.7	18.6	30.0	44.2

1/ There are no explicit capital gains tax law changes in the President's package. These rates are reduced, since the capital gains tax rate is 40% of the personal income tax rate.
2/ Estimate of "best allowable" recovery period for cars and light trucks under current law.
3/ Estimate of "best allowable" recovery period for other machinery and equipment under current law.
4/ Estimate of "best allowable" recovery period for buildings under current law.

Real estate and factories would be placed in one of the following 3 asset classes.

- 10 year class. Factory buildings, retail stores, and warehouses used by their owners would be depreciated on an accelerated 10-year schedule. Public utility property for which present guideline lives exceed 18 years is also included in this class.

- 15 year class. Nonresidential structures not included in the 10-year class and low income rental housing would be depreciated over 15 years on a straight-line schedule.

- 18 year class. Other residential rental structures would be depreciated on a straight-line schedule over an 18-year period.

The full 10 percent investment tax credit would apply to machinery and equipment in the 5 year class and the public utility equipment included in the 10-year class (factories, stores, and warehouses in the 10-year class would not receive any credit, consistent with current law). A 6 percent credit would be received for assets in the 3-year class. Under current law assets with a life of less than 3 years receive no credit, a 3-1/3 percent credit is received for assets with a useful life between 3 and 5 years, a 6-2/3 percent credit is received by assets with a life between 5 and 7 years, and the full 10 percent credit is received by assets whose life exceeds 7 years.

The proposed reduction in asset lives would be phased in over a 3 to 5 year period. Assets in the 5 year class could be assigned a useful life as long as 9 years if acquired in 1981. The maximum life assignable to new investments in this class would then be reduced to 5 years over the next 4 years. New investment in the 10-year class would have an 18 year life in 1981. The recovery period for new investments in this class would be reduced annually in 2 year increments until a 10 year useful life is established for new assets acquired in 1985 and thereafter. Similarly, recovery periods in the 15 year class are phased in over 3 years, beginning at 18 years in 1981 and reaching 15 years in 1983.

The tax program also includes new user fees to reduce or eliminate subsidies to airport and airway users, inland waterway users, and boat and yacht users; passport and visa fees and railroad retirement taxes are also to be increased. These changes, together with a reform of Federal employee injury compensation and administrative speed-up in payment of alcohol and tobacco excise taxes, are expected to raise $3.1 billion in FY1982 and $3.0 billion in FY1983.

President Reagan's Credit Budget Proposals

The administration is proposing substantial reductions in the size and scope of the Federal credit budget. These reductions will affect both

on-budget and off-budget loan transactions. The total of direct loan obligations and loan guarantee commitments is estimated to be $13.6 billion below the January budget for FY1981 and $21.0 billion lower in FY1982 as shown in Table 6. Some of the important features of the new credit budget are as follows:

- Federal Financing Bank operations are to be reformed in a way that will diminish the borrowing ability of several agencies such as the Rural Electrification Administration and Farmers Home Administration.

- The largest reductions in direct loan obligations are for rural and agricultural development programs of the Rural Electrification Administration and the Farmers Home Administration. Sizable reductions will also effect programs in the Export-Import Bank that subsidize exports.

- In an effort to reduce subsidies to middle and upper income families, loan guarantee commitments for the Federal Housing Administration mortgage insurance program will be reduced by $4.8 billion in 1981 and $9 billion in 1982. Government National Mortgage Association guarantees of mortgage-backed securities will be reduced by $8 billion in both 1981 and 1982, and the GNMA tandem mortgage assistance program will gradually be terminated.

- Significant reductions are proposed in the Guaranteed Student Loan program by more directly targeting these loans to needy students. The amount of the loans will be further limited through the curtailment of their purchase on the secondary market by the Student Loan Marketing Association, which will no longer have access to borrowing from the FFB.

Comparison of Economic Assumptions and Budget Projections

The economic outlook presented with President Reagan's budget proposals differs significantly from the Carter Administration's earlier forecast and from the current Congressional Budget Office (CBO) forecast. The projection of the Reagan Administration differs from the other forecasts in expecting faster growth in real GNP and lower unemployment and interest rates in 1982.

Table 7 shows that the Reagan administration now forecasts a 1.4 percent increase in real GNP between the fourth quarter of 1980 and the fourth quarter of 1981, only slightly less than the 1.7 percent rise forecast by the Carter Administration. A lull in economic activity is expected in the second quarter of 1980 by the Reagan Adminitration. As a result, unemployment rises in mid-year. The subsequent economic recovery forecast by the Reagan Administration is expected, however, to result in a 7.7 percent unemployment rate in the fourth quarter of 1981.

Table 6
CREDIT BUDGET TOTALS
(Billions of dollars)

	FY 1981 Estimate			FY 1982 Estimate		
	January	Revised	Change	January	Revised	Change
New Direct Loan Obligations:						
On-budget	42.1	38.6	-3.5	34.1	32.9	-1.2
Off-budget	32.2	32.6	0.4	26.1	22.7	-3.4
Less new FFB purchases of loan assets	-16.6	-16.2	0.4	-8.2	-6.2	2.0
Total Net Direct Loan Obligations	57.6	55.0	-2.6	52.0	49.4	-2.6
New Primary Loan Guarantee Commitments a/	96.2b/	85.2	-11.0	96.9b/	78.5	-18.4
Total Credit Budget	153.8	140.2	-13.6	148.9	127.9	-21.0

a/ Primary loan guarantee commitments are gross commitments less secondary guarantees and guaranteed loans held as direct loans by government accounts.

e loan guarantee commitment totals published in the January budget have been increased .1 billion in 1981 and $4.5 billion in 1982 to correct technical errors.

Source: Fiscal Year 1982 Budget Revisions, March 1981.

Table 7
COMPARISON OF ECONOMIC ASSUMPTIONS
(Calender years)

	1981		1982	
	Reagan Admin.	Carter Admin.	Reagan Admin.	Carter Admin.
Gross National Product				
current dollars:				
Amount ($ billions)	2920	2928	3293	3312
Percent change (fourth quarter over fourth quarter	11.0	12.3	13.3	12.6
constant dollars:				
Amount ($ billions)	1497	1493	1559	1545
Percent change (fourth quarter over fourth quarter)	1.4	1.7	5.2	3.5
Prices (percent change)				
GNP deflator (fourth quarter over fourth quarter)	9.5	10.4	7.7	8.8
CPI (fourth quarter over fourth quarter)	10.5	12.6	7.2	9.6
Unemployment rate (percent)				
Yearly average	7.8	7.8	7.2	7.5
Fourth quarter	7.7	7.7	7.7	7.4
Interest rate, 91-day Treas.	11.1	13.5	8.9	11.0

CBO's economic forecast (assuming the Administration budget policies) has been published in the form of calendar year averages. Their forecast of key economic variables which affect budget estimates is as follows:

	1981	1982
Gross National Product		
Nominal, percent change (year to year)	11.8	11.9
Real, percent change (year to year)	1.3	2.5
Prices, percent change (year to year)		
GNP deflator	10.3	9.2
CPI	11.3	9.5
Unemployment rate (percent, annual average)	7.8	7.9
Interest rate (Treasury bills, percent, annual average)	12.6	13.7

In 1982, the Reagan administration expects that real GNP will rise by 5.2 percent and that unemployment will fall further to 7.0 percent by the final quarter of the year. This contrasts with much slower growth of real GNP in the Carter and CBO forecasts. Inflation (as measured by the GNP deflator) is expected by the Reagan administration to slow to 7.7 percent during 1982; the three-month Treasury bill rate in the Reagan forecast is assumed to fall from 11.1 percent in 1981 to 8.9 percent in 1982.

The Congressional Budget Office reports that their economic assumptins imply $13.5 billion higher outlays than are estimated by the Administration. In addition, technical re-estimates of the President's budget imply $12.8 billion higher outlays in FY1982, apart from the effect of economic assumptions; defense spending is estimated to be $5.1 billion higher.

DOMESTIC FINANCIAL DEVELOPMENTS

III-T-1
SELECTED DOMESTIC FINANCIAL DATA

Indicator	Latest data		Net Change from:		
	Period	Level	Month ago	Three months ago	Year ago
	$ billions		Percent at annual rates		
Monetary and credit aggregates[1]					
Total reserves	February	39.6	-14.7	-4.7	-5.9
Nonborrowed reserves	February	38.3	-12.4	3.0	7.1
Money supply					
M-1A	February	366.0	-21.9	-23.1	-2.0
M-1B	February	417.2	3.2	2.1	6.6
M-2	February	1692.1	7.7	5.1	9.3
M-3	February	1993.2	8.8	9.7	10.4
CB Gross Time and savings deposits	February	756.2	12.0	16.4	12.0
Total Thrift deposits (S&Ls + MSBs) + Credit Unions) Total	February	718.5	-1.2	2.7	7.6
Bank credit	February	1265.7	8.3	12.4	8.4

		Latest data		Net Change from:		
		Period	Percent or index	Month ago	Three months ago	Year ago
Market yields and stock prices						
Federal funds	wk. endg.	3/18/81	14.13	-1.68	-5.70	-2.11
Treasury bill (90 day)	" "	3/18/81	13.06	-2.16	-3.67	-1.74
Commercial paper (90-119 day)	" "	3/18/81	13.64	-2.43	-6.10	-3.46
New utility issue Aaa	" "	3/20/81	--	--	--	--
Municipal bonds (Bond Buyer) 1 day	1 day	3/19/81	9.81	- .41	- .75	.61
FNMA auction yield (FHA/VA)		3/16/81	15.39	- .20	.47	- .34
Dividend price ratio (common stocks)	wk. endg.	3/18/81	4.84	- .16	.06	.56
NYSE index (12/31/65=50)	end of day	3/16/81	77.19	3.97	2.32	13.24

	Net Change or Gross Offerings				
	Period	Latest data	Year ago	Year to date 1980	Year to date 1979
Credit demands					
Mortgage debt outstanding (major holders)[1 2]	December	7.1	5.9	66.7	97.0
				1981	1980
Business loans at commercial banks[1]	February	1.6	4.9	6.3	10.3
Consumer instalment credit outstaninding[1]	January	0.9	2.7	0.9	2.7
Corporate bonds (public offerings)	February	2.6e	1.4	5.6e	3.9
Municipal long-term bonds (gross offerings)	February	2.8e	2.4	5.5e	5.5
Federally sponsored agcy. (net borrowing)	February	-0.1e	1.5	1.2e	3.8
U.S. Treasury (net cash borrowing)	February	13.7e	2.1	20.5e	7.3

Seasonally adjusted.
Includes comm'l banks, S&Ls, MSBs, life ins. cos, FNMA and GNMA.
- Estimated.

The narrow monetary aggregates, adjusted to remove the effects of shifts into NOW accounts, appear to be growing briskly in March. However, this follows very sluggish performance over the preceding few months and leaves the average for the first quarter as a whole exceptionally weak relative to the rapid growth of nominal GNP. M-2 expansion also is estimated to be accelerating in March, reflecting not only the pickup in M-1B but also the continued upsurge in money market mutual fund assets and a strengthening in small time and savings deposits.

Given the weakness of the narrow monetary aggregates on average during the intermeeting period, demands for additional reserves fell short of the amounts provided through open market operations. Borrowing at the discount window diminished, and the federal funds rate eased by about 4 percentage points between early February and mid-March. In recent days, depository institutions have experienced some firming of their reserve positions, and money market rates have turned upward. Short-term rates generally are now 2 to 4 percentage points below their early February levels.

Market rates have been rather volatile in recent weeks, apparently reflecting uncertainties regarding the monetary statistics, fiscal policy, and the economic outlook. The concerns of investors about prospective developments have perhaps been manifested most clearly in the long-term markets, where rates have responded much less markedly than they did last spring to the easing of money markets. Indeed, bond yields are little changed on balance over the intermeeting period, and mortgage rates in the primary market have risen since early February.

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

	1980		1981		Change from:	
	Mid June* Low	Dec. High	FOMC Feb. 3	Mar. 24	Dec. High	FOMC Feb. 3
Short-term rates						
Federal funds[2]	8.99	19.83	17.19	13.28p	-6.55	-3.91
Treasury bills						
3-month	6.18	17.14	14.85	12.84	-4.30	-2.01
6-month	6.60	15.74	13.90	12.44	-3.30	-1.46
1-year	7.00	14.06	12.92	12.04	-2.02	-.88
Commercial paper						
1-month	7.98	20.77	16.86	13.09	-7.68	-3.77
3-month	7.78	19.88	15.98	13.05	-6.83	-2.93
6-month	7.59	18.58	14.92	12.87	-5.71	-2.05
Large negotiable CDs[3]						
1-month	7.96	21.29	16.71	13.34	-7.95	-3.37
3-month	7.90	20.90	16.50	13.67	-7.23	-2.83
6-month	7.66	19.19	15.93	13.92	-5.27	-2.01
Eurodollar deposit[2]						
1-month	8.88	22.54	17.56	13.95p	-8.59	-3.61
3-month	8.99	21.36	17.23	14.27p	-7.09	-2.96
Bank prime rate	12.00	21.50	19.50	17.50	-4.00	-2.00
Intermediate- and long-term rates						
U.S. Treasury (constant maturity)						
3-year	8.56	14.41	13.48	13.57	-.84	.09
10-year	9.47	13.57	12.98	13.30	-.27	.32
30-year	9.49	13.17	12.61	12.84	-.33	.23
Municipal (Bond Buyer)	7.44	10.56	9.91[4]	9.81[4]	-.75	-.10
Corporate Aaa						
New issue	10.53	14.51	14.06[5]	--[5]	--	--
Recently offered	10.79	15.03	14.08[6]	13.99p[6]	-1.04	-.09
Primary conventional mortgages	12.35	14.95	15.07[6]	15.40[6]	.45	.33

	Mid-Oct. High	Mar.-Apr. Low	FOMC Feb. 3	Mar.24	Percent change from: Mar-Apr Low	Feb.3
Stock Prices						
Dow-Jones Industrial	972.44	759.13	941.38	996.13	+31	+6
NYSE Composite	77.24	55.30	73.46	77.52	+40	+5
AMEX Composite	363.33	215.69	335.87	356.07	+65	+6
NASDAQ (OTC)	199.43	124.09	193.56	207.70	+67	+7

1. One-day quotes except as noted.
2. Averages for statement week closest to date shown.
3. Secondary market.
4. One-day quotes for preceding Thursday.
5. Averages for preceding week.
6. One-day quotes for preceding Fri
* Most lows occurred on or around June 13.

The prime rate has, as usual, lagged declines in market rates, and this has contributed to a redirection of short-term business credit flows from banks to other sources. Business loans at all banks moderated in February, and at large banks a contraction of these loans last month has been extended into early March. Growth of nonfinancial commercial paper, meanwhile, has remained robust. Public bond offerings have picked up, but stock issuance has declined from the extraordinary pace of the final quarter of 1980, and overall, the flow of long-term funds to nonfinancial corporations appears to have increased less since the beginning of the year than short-term borrowing has fallen. The government sector has continued to place heavy demands on credit markets. State and local government borrowing has been moderated by reduced issuance of housing bonds, but the Treasury has been obliged to cover a quarterly budget deficit of $36 billion. Mortgage market activity evidently has been slowing, despite reports of growing reliance on nontraditional financing.

Monetary Aggregates and Bank Credit

The narrow monetary aggregates continue to be affected by substantial--albeit diminishing--inflows to interest-bearing transactions accounts. Information from depository institutions and households suggests that the proportion of funds flowing into new NOW accounts from demand deposits declined from about 80 percent in January to around 75 percent in February and March.[1] M-1A and M-1B--adjusted to remove the distorting effects of shifts to NOW accounts--are estimated to have rebounded in March to annual growth rates of just under 11 percent, after declining in February.

1. Evidence on the sources of funds flowing into NOW accounts and on the terms under which NOW accounts are being offered at commercial banks and thrifts is presented in Appendix III-A.

MONETARY AGGREGATES
(Based on seasonally adjusted data unless otherwise noted)[1]

	1980		1981				Mar. '80 to Mar. '81[e]
	Q3	Q4	Q1[e]	Jan.	Feb.	Mar.[e]	
	---- Percentage change at annual rates ----						
Money stock measures							
1. M-1A	11.5	8.1	-18.9	-37.4	-21.9	-1.0	-1.9
2. (Adjusted)[2]			(-.5)	(2.5)	(-3.1)	(10.9)	
3. M-1B	14.6	10.8	5.3	12.2	3.2	14.4	7.9
4. (Adjusted)[2]			(.5)	(2.9)	(-2.3)	(10.8)	
5. M-2	16.0	9.1	7.3	5.7	7.7	18.9	10.6
6. M-3	13.0	11.6	10.9	12.7	8.8	11.7	11.0
Selected components							
7. Currency	11.3	9.2	5.2	2.1	7.2	6.1	8.3
8. Demand deposits	11.5	7.7	-29.3	-54.5	-34.7	-5.3	-6.2
9. Other checkable deposits, NSA	75.5	54.9	359.2	717.3	218.9	124.2	207.1
10. M-2 minus M-1B (11+12+13+16)	16.4	8.5	8.0	3.5	9.2	20.3	11.5
11. Overnight RPs and Eurodollars, NSA[3]	135.6	15.4	4.9	18.7	-29.4	79.2	28.9
12. Money market mutual fund shares, NSA	75.7	-15.5	82.9	77.6	174.0	161.0	72.1
13. Commercial banks	11.3	10.8	5.0	1.0	0.7	10.2	9.5
14. savings deposits	27.5	1.7	-34.4	-54.9	-29.1	-6.2	-5.8
15. small time deposits	0.7	17.1	31.2	36.3	17.8	19.9	20.2
16. Thrift institutions	9.5	9.5	1.6	-3.7	-2.7	5.5	6.3
17. savings deposits	28.1	-3.1	-37.3	-46.2	-34.2	-23.5	-9.6
18. small time deposits	1.1	15.7	19.9	15.4	10.4	17.3	14.2
19. Large time deposits	-11.6	25.3	35.3	52.3	20.9	-24.2	12.4
20 at commercial banks, net[4]	-16.3	20.7	35.4	55.7	20.7	-28.1	8.9
21. at thrift institutions	14.6	47.7	36.8	36.0	21.5	-2.6	32.8
22. Term RPs, NSA	47.8	41.5	13.3	69.0	-24.9	-63.5	23.9
	--Average monthly change in billions of dollars--						
MEMORANDA:							
23. Managed liabilities at commercial banks (24+25)	-0.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
24. Large time deposits, gross	0.4	6.2	5.1	10.7	7.2	-2.5	3.0
25. Nondeposit funds	-0.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
26. Net due to related foreign institutions, NSA	-1.9	-0.7	n.a.	1.6	-0.1	n.a.	n.a.
27. Other[5]	1.3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
28. U.S. government deposits at commercial banks[6]	1.3	-1.7	0.6	0.4	-0.2	1.6	0.2

1. Quarterly growth rates are computed on a quarterly average basis.
2. Figures in parentheses have been adjusted to remove the distorting effects since the beginning of 1981 of shifts of funds out of demand deposits and other accounts into NOW accounts. Based on a variety of evidence, it is estimated that 80 percent of inflows into other checkable deposits--in excess of "trend"--was from demand deposits in January, and 75 percent in February and March.
3. Overnight and continuing contract RPs issued to the nonbank public by commercial banks, net of amounts held by money market mutual funds, plus overnight Eurodollar deposits issued by Caribbean branches of U.S. member banks to U.S. nonbank customers.
4. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
5. Consists of borrowings 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 borrowings from the Federal Reserve), loans sold to affiliates, loan RPs, and other minor items.
6. Consists of Treasury demand deposits at commercial banks and Treasury note balances.
n.a.--Not available. e--estimated.

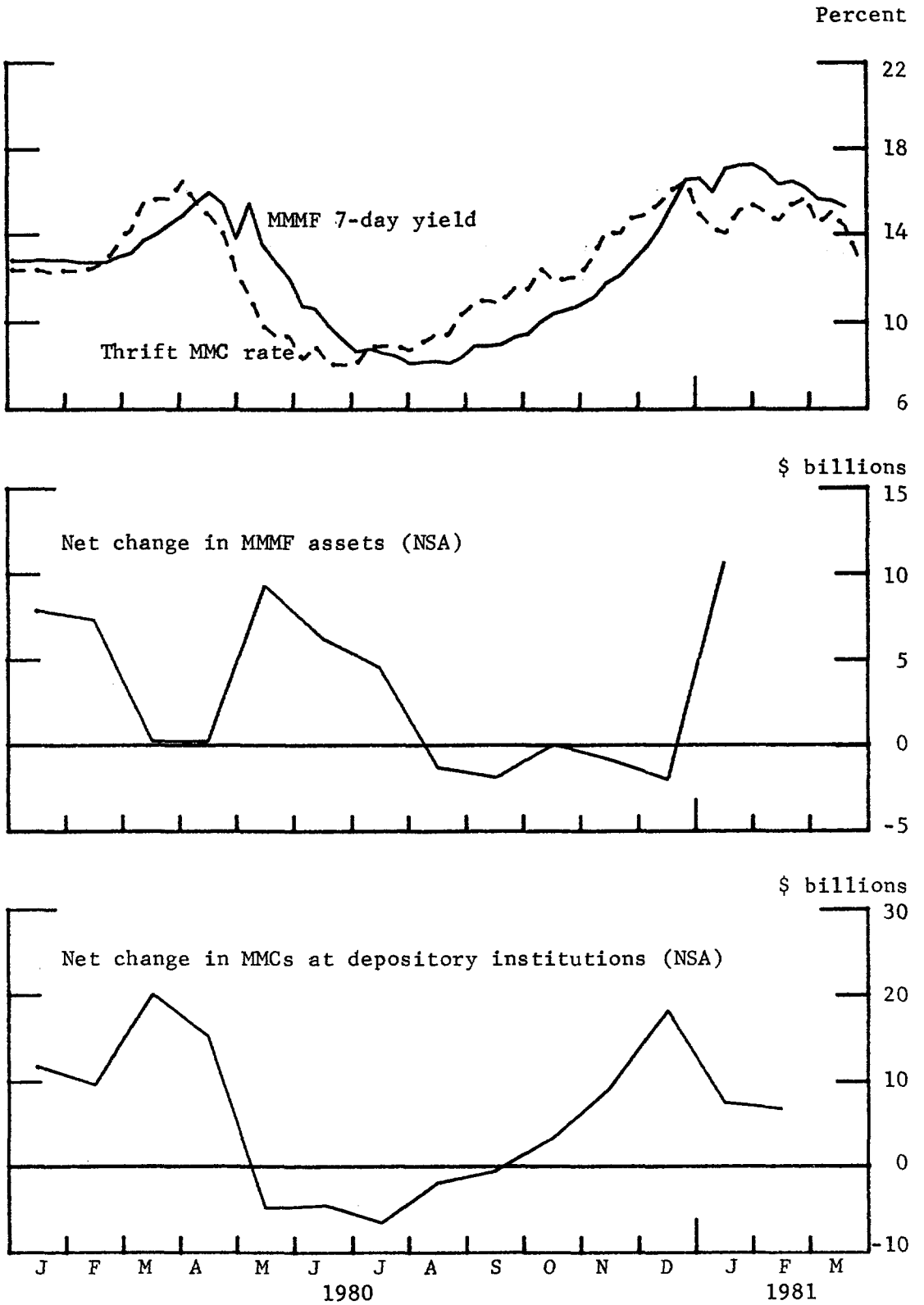
In the first quarter the adjusted narrow aggregates were about unchanged from their average levels in the fourth quarter. Part of the sluggishness may have been a lagged response to increased interest rates in late 1980, but growth in the narrow aggregates has been much weaker than would be expected on the basis of historical relationships among narrow money, income, and interest rates. The standard money demand equation in the Board's econometric model and a variant designed to capture incentives for adoption of new cash management techniques both overpredict growth in adjusted narrow money in the first quarter by more than 6 percent at an annual rate. As in other periods of apparent substantial downward shift in money demand, weakness in demand deposits has accounted for most of the shortfall. However, currency growth also has been weak in the first quarter.

M-2 expansion also picked up in March, posting an estimated 19 percent annual rate of growth, after expanding at a 7-3/4 percent pace in February. For the entire first quarter, M-2 growth is calculated at a 7-1/4 percent annual rate, implying a rise in M-2 velocity that is also sizable by historical standards.

Growth in the nontransactions component of M-2 increased markedly in February and March, as the runoff in savings deposits slowed both months and in March growth in small time deposits showed renewed strength.[1] However, the recent strength in M-2 reflects, in large part, the rapid increase in money market mutual fund shares. MMMFs experienced record

1. Adjusted for shifts to NOW accounts, the estimated runoff in the savings components of M-2 would be 11-1/4 percent in March; 25-1/4 percent in February; and 40-1/2 percent in January.

RELATIVE INTEREST RATES AND FLOWS FOR MMMFs AND MMCs



gains of about $11-1/2 billion in February (month-average basis), and inflows are likely to be even larger in March.

It is difficult to assess from what sources the funds that have been swelling MMMFs have been diverted. Noncompetitive tenders at Treasury auctions have slackened, savings bond redemptions are up sharply, and some reports indicate that funds may be flowing from the stock market. Nevertheless, it is fairly clear that much of the inflow into MMMFs would otherwise have been held in savings and small time accounts at depository institutions. The publicly-quoted yields on MMMFs have exceeded the effective rates offered on 6-month MMCs since December.[1] Coincident with this development were the record inflows at MMMFs and weakened consumer deposit flows at commercial banks and thrifts (see chart on page III-6). Most of the recent MMMF asset growth was at broker/dealer and general purpose funds that sell shares to individuals. Moreover, there has been a substantial increase in the number of shareholder accounts in recent months.

M-3 expansion is estimated to have accelerated in March after slowing in February, as faster M-2 growth more than offset declines in large time deposits at both banks and thrift institutions. (The decline in large time deposits was larger on a net than on a gross basis because MMMFs made sizable acquisitions of these instruments.) In part, the weakness of large time deposits may reflect a dropoff in earning asset expansion at both banks and thrifts, as well as market responses to the operating

1. These rates are not directly comparable, although depositors may well regard them as so. The yield on MMMFs reflects recent experience rather than prospective returns. In contrast, rates quoted for MMCs are guaranteed for the life of the instrument.

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

	1980				1981		Feb. '80 to Feb. '81
	Q2	Q3	Q4	Dec.	Jan.	Feb.	
	Commercial Bank Credit						
1. Total loans and investments at banks[2]	-4.1	12.9	14.6	12.8	15.7	8.3	8.4
2. Investments	11.8	20.7	11.9	7.4	19.2	9.8	14.5
3. Treasury securities	13.1	39.1	11.1	2.2	31.4	18.0	21.2
4. Other securities	11.4	11.5	12.3	10.2	13.5	5.0	11.2
5. Total loans[2]	-9.4	10.2	15.7	14.9	14.3	7.6	6.3
6. Business loans[2]	-9.3	15.3	21.1	15.3	17.3	5.8	9.7
7. Security loans	-17.1	-10.2	60.1	64.7	75.0	-32.1	4.0
8. Real estate loans	1.8	4.6	11.0	11.6	6.4	11.9	6.9
9. Consumer loans	-16.9	-7.6	-0.2	2.7	-2.1	n.a.	n.a.
	Short- and Intermediate-Term Business Credit						
10. Total short- and intermediate-term business credit (sum of lines 14, 15 and 16)	2.6	8.8	14.7	11.7	15.5	n.a.	n.a.
11. Business loans net of bankers acceptances	-10.7	14.3	24.2	19.1	15.1	5.2	10.0
12. Commercial paper issued by nonfinancial firms[3]	62.6	-19.3	-3.0	18.7	36.8	23.8	20.2
13. Sum of lines 11 & 12	-2.9	10.1	21.1	19.1	17.4	7.3	11.0
14. Line 13 plus loans at foreign branches[4]	-0.6	9.6	19.6	18.2	18.6	11.1	11.6
15. Finance company loans to business[5]	-2.3	-4.6	14.6	22.4	22.0	n.a.	n.a.
16. Total bankers acceptances outstanding[5]	31.5	21.0	-15.7	-42.9	-13.3	n.a.	n.a.

1. Average of Wednesdays for domestic chartered banks and average of current and preceding ends of months for foreign-related institutions.
2. Loans include outstanding amounts of loans reported as sold outright to a bank's own foreign branches, unconsolidated nonbank affiliates of the bank, the bank's holding company (if not a bank), and unconsolidated nonbank subsidiaries of the holding company.
3. Average of Wednesdays.
4. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestic-chartered banks.
5. Based on average of current and preceding ends of months.
n.a.--not available.

losses and eroding net worth of the latter institutions. The issuance of large CDs by insured S&Ls fell from $2.4 billion in December to only about $500 million in both January and February.[1] The estimated growth of M-3 in March also was moderated by a decline in term RPs.

Bank credit in February expanded at an 8-1/4 percent annual rate--about one-half the January pace. Some of the deceleration reflected reduced acquisition of investments and a decline in security loans. Judging from data for large banks, consumer lending may have contracted further in February. In contrast, real estate lending at commercial banks rebounded sharply from its January slowdown.

Business lending--excluding acceptances--decelerated sharply in February, reflecting a contraction at large banks. (Data for weekly reporting banks suggest that the weakness has continued into March.) At least two "special factors" contributed to the deceleration: loans to U.S. resident firms by foreign branches of domestically-chartered banks increased $1.2 billion in February, and Ford Motor Company utilized funds borrowed by its foreign subsidiaries in Eurodollar markets to reduce U.S. bank loans. In any event, the February Senior Loan Officer Opinion Survey did suggest a weakening in loan demand. The Survey also indicated that banks had eased their qualifying criteria and compensating balance requirements (see Appendix III-B). Moreover, as the spread of the prime rate over market rates widened, the relative importance of below-prime lending increased sharply. According to the Survey of Terms of Bank Lending,

1. Thrift institutions also have faced difficulties in the commercial paper market. The commercial paper ratings of nine large S&Ls have been downgraded in March, and the market was said to be unreceptive to all but the highest-rated issuers.

GROSS OFFERINGS OF CORPORATE SECURITIES
(Monthly totals or monthly averages; in millions of dollars)

	1980		1981			
	Year	Q4	Q1[p]	Jan.[p]	Feb.[p]	Mar.[f]
		------- Seasonally adjusted ------				
Corporate securities--total	6,074	4,946	5,833	6,200	5,400	5,900
Publicly offered bonds	3,462	2,209	3,633	3,600	3,600	3,700
Privately placed bonds	915	616	700	700	700	700
Stocks	1,697	2,121	1,500	1,900	1,100	1,500
		---- Not seasonally adjusted ----				
Publicly offered bonds--total	3,462	1,960	3,200	3,000	2,600	4,000
By quality[1]						
Aaa and Aa	1,666	702	--	890	455	--
Less than Aa[2]	1,796	1,258	--	2,110	2,145	--
By type of borrower						
Utility[3]	1,304	949	--	1,070	810	--
Industrial	1,323	456	--	1,630	1,400	--
Financial	835	555	--	300	390	--
Memo: convertible bonds	390	433	--	299	605	--
Stocks--total	1,697	2,358	1,433	1,600	1,200	1,500
By type of issuer						
Utility	606	619	--	550	550	--
Industrial	833	1,281	--	900	450	--
Financial	258	458	--	150	200	--

p--preliminary. f--forecast.
1. Bonds categorized according to Moody's bond ratings.
2. Includes issues not rated by Moody's.
3. Includes equipment trust certificates.

more than 70 percent of gross short-term loans at 48 large banks was extended at interest rates below prime during the February survey week. This compares with about 20 percent in the November Survey, when market rates and the prime were in closer alignment. The increase in below-prime lending in February was especially noticeable at large New York City banks, many of whose customers might be expected to have access to commercial paper and Eurodollar markets.

Business Finance

A great deal of the below-prime lending by banks is for very short periods--often overnight--and represents a means of competing with the commercial paper market while maintaining higher margins on loans to smaller or less credit worthy customers. However, below-prime lending has not prevented a sizable shift to the paper market. The growth of nonfinancial commercial paper slowed somewhat in February, but the increase was still the second largest since last June. Moreover, figures for early March show a reacceleration of growth. The combined growth of nonfinancial commercial paper and business loans at banks has fallen off substantially from the rapid pace of previous months.

The volume of publicly-offered corporate bonds has been sizable thus far in 1981, particularly when compared with late 1980 when rates were at similarly high levels. Gross offerings are estimated to have averaged about $3.6 billion per month, seasonally adjusted, during the current quarter. This pace was slightly greater than the record monthly average set in 1980 and 50 percent higher than in the fourth quarter. The pickup in issuance has reflected increased borrowing by industrial firms. With interest rates remaining high, there has been a continued

COMMITMENT ACTIVITY AND POLICY LOANS
AT LIFE INSURANCE COMPANIES
(Seasonally adjusted monthly rates; millions of dollars)

	New Commitments		Net Policy
	Corporate Bonds	Mortgages	Loans
1973	617	959	182
1974	542	578	221
1975	817	469	134
1976	1,302	764	115
1977	1,433	1,391	142
1978	1,208	1,788	215
1979	1,018	1,855	389
1980	594	741	555
1980: Q1	715	733	715
Q2	477	430	805
Q3	579	912	328
Q4	606	909	374
1980: Oct.	743	1,066	291
Nov.	587	823	248
Dec.	487	837	583
1981: Jan.	n.a.	n.a.	631[e]

e--estimated. n.a.--not available.

emphasis on relatively short maturities, and many issuers have used convertible debentures.[1]

Private placements of corporate bonds are estimated to have remained sluggish, as life insurance companies--the principal suppliers of such funds--have been confronted with renewed liquidity pressures. With interest rates at very high levels, policy loans rose sharply in December and are estimated to have increased further in January (see table on page III-12). Insurers reportedly also are reluctant to acquire long-term, fixed-rate assets in an environment of great uncertainty about future interest rates. New commitments by life insurance companies to purchase corporate bonds edged up in the fourth quarter, but remained quite weak by historical standards. Commitments outstanding at the end of 1980 were more than 50 percent below a year earlier.

In the stock market, most major price indexes have risen 6 to 7 percent since the February FOMC meeting. Market analysts attributed much of the gain to an increase in takeover activity and to the drop in short-term interest rates. New equity offerings, although dropping off from the extraordinary rate of late 1980, have continued strong. The average monthly pace of new offerings in the current quarter is estimated at $1.4 billion (seasonally adjusted)--just below the record pace in 1980.

1. Another interesting adaptation to current high rates has been the issuance of a few deep discount bonds. Investors apparently will accept a comparatively low yield for this type of security. The discount provides a type of call protection, and the below-market coupon gives greater certainty of total yield. On the other hand, much of the cash return is realized only at maturity.

FEDERAL GOVERNMENT AND SPONSORED AGENCY FINANCING[1]
(Billions of dollars)

	1980		1981			
	Q3	Q4	Q1[f]	Jan.	Feb.[e]	Mar.[f]
Treasury financing						
Combined surplus/deficit(-)	-20.9	-35.8	-36.1	-8.4	-16.8	-10.9
Net marketable borrowings/ repayments(-)	27.5	28.9	37.0	8.2	14.2	14.6
Bills	14.6	15.8	18.5	4.3	8.5	5.7
Coupons	12.9	13.1	18.5	3.9	5.7	8.9
Nonmarketable borrowings/ repayments(-)	-0.6	-1.3	-2.9	-1.4	-0.5	-1.0
Other means of finance[2]	0.9	-0.5	3.5	3.2	-0.7	1.0
Change in cash balance	6.9	-8.7	1.5	1.6	-3.8	3.7
Federally sponsored credit agencies net cash borrowings[3]	2.2	8.9	2.5	1.3	-0.1	1.3

f--forecast. e--estimated.
1. Numbers reported on a not seasonally adjusted, payments basis.
2. Includes checks issued less checks paid, accrued items and other transactions.
3. Includes debt of Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, and the Federal Farm Credit Bank System.

STATE AND LOCAL GOVERNMENT SECURITY OFFERINGS
(Monthly averages; billions of dollars)

	1980		1981			
	Year	Q4	Q1[e]	Jan.[e]	Feb.[e]	Mar.[f]
		------- Seasonally adjusted -------				
Total		6.05	5.10	4.80	5.70	4.90
Long-term		3.60	3.00	2.55	3.20	3.30
Short-term		2.45	2.10	2.25	2.50	1.60
		----- Not seasonally adjusted -----				
Total	6.12	5.33	4.70	4.20	4.90	5.00
Long-term	3.94	3.57	3.00	2.50	2.80	3.60
Housing bonds	1.07	1.08	.23	.08	.37	.25
Short-term	2.18	1.76	1.70	1.70	2.10	1.40

e--estimate. f--forecast.

Government Finance

During the first quarter, the Treasury faced an exceptionally large deficit and experienced $3 billion in redemptions of savings bonds--the largest runoff since the opening months of 1980. These financing needs were met by issuing $37 billion (not seasonally adjusted) of marketable debt, split about evenly between bills and coupon issues. The Treasury obtained nearly $12 billion in the regular weekly and monthly bill auctions and raised $7 billion in cash management issues. The remainder of the funds came from a variety of short- and intermediate-term notes and long-term bonds.

Borrowing by federally-sponsored credit agencies is estimated at $2.5 billion for the first quarter, with the Federal Farm Credit Banks raising $2 billion. Federal Home Loan Banks also borrowed heavily throughout the quarter with the proceeds being used to maintain System liquidity--now over $5 billion. (FHLB advances to S&Ls have increased steeply on a seasonally adjusted basis since the beginning of the year, but are little changed on an unadjusted basis.) The Federal National Mortgage Association is estimated to have run off about $100 million of debt in March, following a reduction of $850 million during the preceding two months. This decline reflects a lack of mortgage purchases by FNMA this quarter as well as a reduction in its liquidity.

Gross long-term debt issuance by state and local governments was only somewhat reduced during the first three months of 1981, despite a sharp drop-off in sales of mortgage revenue bonds. On a seasonally adjusted basis, state and local bond volume in March is estimated to be $3-1/4 billion--up slightly from February. This pace was just $400 million

less than the monthly average in the fourth quarter of last year when housing bonds accounted for an unusually large proportion of total issuance. New York City reentered the short-term market in February with a borrowing package that included $100 million of tax anticipation notes backed by its own property taxes; this was the first such unassisted offering by New York City since 1974. This sale was followed in March by a $75 million serial bond offering.

The increased volatility and generally higher level of interest rates during the last year has led to new financing methods in municipal bond markets. Two of these techniques are designed to protect investors against increases in rates: floating-rate bonds—of which about $270 million have been issued since May of last year--and the tender option security, which was introduced in December. Tender option issues enable the purchasers to put the bonds back to the issuer at par; about $500 million of single-family mortgage revenue bonds were sold by this method in February and March.[1] In addition, a long-term issue with warrants to purchase additional bonds at a fixed interest rate was marketed early this year by the Municipal Assistance Corporation for New York City; this technique affords the investor some protection against interest rate declines.

Mortgage Markets

Interest rates on fixed-rate home mortgages have stabilized in the primary market, after rising about 40 basis points in the weeks immediately

1. The bondholder can tender the bonds to the issuer at par plus interest on the fifth anniversary and each anniversary thereafter, until the bonds either mature or are called. The obligation to purchase these tender-option bonds is supported by a bank's irrevocable letter of credit that remains in force so long as the issuer does not default on the original bonds.

following the last FOMC meeting. The national average contract interest rate on new commitments for 30-year, 80-percent, fixed-rate loans at a sample of S&Ls has remained at 15.40 percent since March 6. The return on fixed-rate home mortgages has risen relative to yields on bonds; the gross yield spread over the Board's Aaa utility bond index reached 140 basis points in mid-March--the widest margin since early 1980. Field reports suggest that average initial interest rates on renegotiable-rate mortgages also have risen, on balance, during the intermeeting period.

Secondary market yields on 13-1/2 percent level-payment FHA/VA home loans rose further through early March, and deepening discounts became a major deterrent to originations. The ceiling rate on these loans was raised by HUD to 14 percent on March 9, reducing discounts by about 3 points. GNMA security prices have changed little on balance since then, and discounts on forward delivery GNMA issues reflecting the new ceiling rate averaged just over 5 points on March 23.

The high mortgage rates, in part, have reflected concern among traditional lenders about future mortgage prices and costs of funds.[1] And, lenders who raise funds at the short end of the market have continued to seek adjustable rate instruments that would provide returns responsive to changing market conditions. However, offerings of adjustable-rate loans apparently have been discouraged by uncertainties regarding pending federal regulations, limited secondary markets, and provisions of some state laws.[2]

1. Fixed-rate long-term conventional home mortgages were not available at about a fourth of all major lenders in early February. At that time, 74 percent of respondents indicated that they were offering 30-year, 80-percent loans--somewhat above the depressed 68 percent February 1980 level but well below the high several years earlier.
2. On March 23 the Controller of the Currency issued final regulations allowing rates on adjustable-rate mortgages made by national banks to increase by as much as 2 percentage points each year.

PRIMARY MARKET FOR CONVENTIONAL HOME MORTGAGES

Period	Fixed-rate loans at S&Ls: Average rate for 80 percent loans (percent)	Fixed-rate loans at S&Ls: Basis point change from month or week earlier	Fixed-rate loans at S&Ls: Spread over corporates[1] (basis points)	RRMs at major lenders[2]: Average rate for loans of 80 percent or less (percent)
1980--High	16.35	--	385	n.a.
Low	12.18	--	-20	n.a.
1981--High	15.40	--	141	14.75
Low	14.80	--	45	14.36
1981--Jan.	14.90	9	82	14.39
Feb.	15.13	23	28	14.57
Feb. 6	15.00	7	70	14.41
13	15.03	3	45	14.60
20	15.20	17	63	14.61
27	15.30	10	45	14.66
Mar. 6	15.40	10	87	14.64
13	15.40	0	122	14.75
20	15.40	0	141 p	14.79

1. Average mortgage rate on new commitments minus average yield on recently offered Aaa utility bonds.
2. New commitments for renegotiable rate mortgages made pursuant to FHLBB regulations (FNMA field report estimates.)

SECONDARY HOME MORTGAGE MARKET ACTIVITY

Period	FNMA auctions of forward purchase commitments[1]: Conventional: Amount ($ millions) Offered	Conventional: Amount ($ millions) Accepted	Conventional: Yield to FNMA (percent)	Government underwritten: Amount ($ millions) Offered	Government underwritten: Amount ($ millions) Accepted	Government underwritten: Yield to FNMA (percent)	Yield on GNMA-guaranteed mortgage-backed securities for immediate delivery[2]
1980--High	426	133	17.51	644	324	15.93	14.41
Low	29	20	12.76	97	52	12.28	10.79
1981--High	76	51	15.38	147	58	15.88	14.46
Low	12	11	14.83	58	35	14.84	13.18
1981--Feb. 2	33	28	14.83	74	40	14.88	13.76
9	--	--	--	--	--	--	14.08
17	76	51	15.26	80	47	15.59	14.41
23	--	--	--	--	--	--	14.26
Mar. 2	57	32	15.38	58	35	15.88	14.46
9	--	--	--	--	--	--	14.17
16	47	30	15.19	51	34	15.39	13.96
23	--	--	--	--	--	--	14.23

1. Effective January 19, 1981, successful bidders receive 4-month commitments on which the yield is fixed for only 2 months; if a commitment is not used within 2 months, its yield is reset to the average yield determined in the then-most-recent auction. Auction yields are gross, before deduction of 38 basis points for mortgage servicing.
2. Average net yields to investors assuming prepayment in 12 years on pools of 30-year FHA-VA mortgages typically carrying the prevailing ceiling rate on such loans.

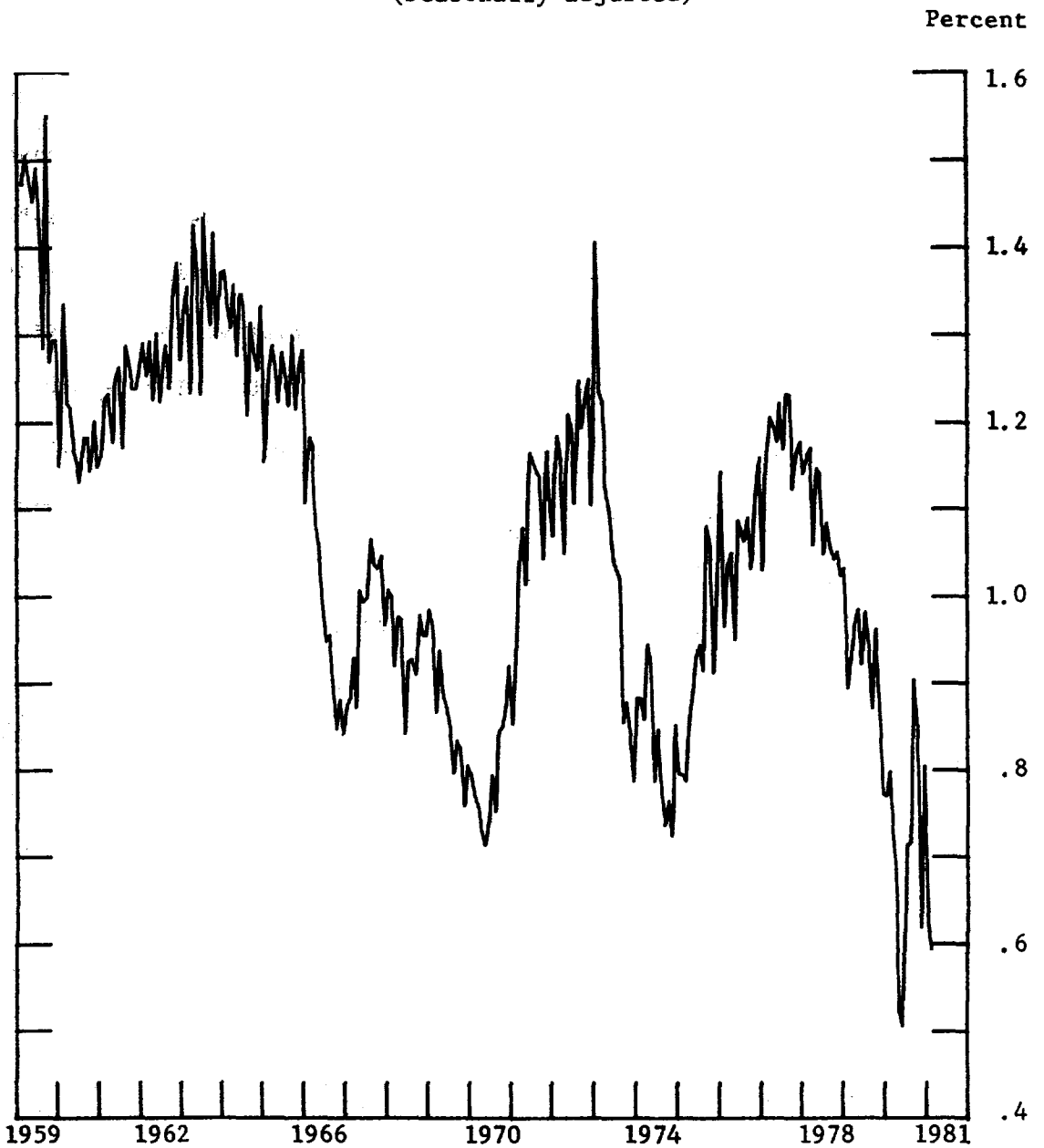
Credit on existing homes is increasingly being supplied at below-market rates in many transactions through assumptions of outstanding mortgages, wrap-around loans, and seller take-backs of second mortgages. The broader use of these techniques has reduced the flow of prepayments of principal on portfolios of older loans. These factors--along with lower home sales--helped decrease flows from amortization and prepayments at S&Ls in February to one of the lowest levels relative to mortgage holdings in more than two decades (see chart on page III-20). The reduced payoff rate on mortgage portfolios, in turn, has limited S&L opportunities to improve earnings by reinvesting the proceeds of repayments at current market yields.

Faced with generally weak inflows of funds and continuing financial uncertainties, S&Ls cut back new mortgage commitments further in February to the lowest volume since last May. New loans closed also declined as did the net increase in mortgage holdings, and the backlog of mortgage commitments outstanding edged down for the third consecutive month to a level 7 percent below last September's high.

Consumer Credit

Consumer installment credit outstanding increased at a 3-1/2 percent annual rate in January, extending the moderate recovery in such borrowing into its sixth month. Installment credit expanded at most types of lenders, with finance companies--led by the subsidiaries of the auto makers--recording a 17 percent rate of growth. In contrast, consumer receivables at commercial banks contracted in January, with the weakness concentrated in automobile credit. Bank installment credit has contracted steadily for almost a year, but the January decline was the largest since last July.

REPAYMENT RATES ON MORTGAGES HELD BY INSURED S&Ls*
(Seasonally adjusted)



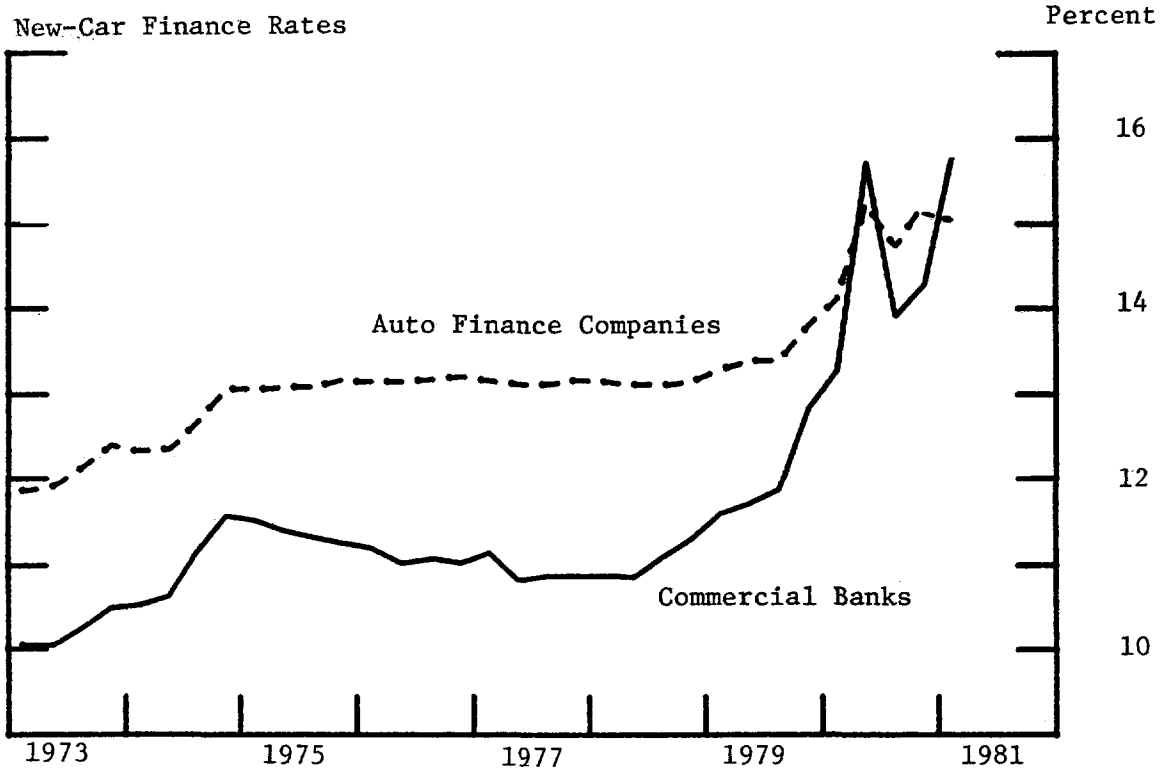
*Amortization and prepayments divided by mortgage loans outstanding.

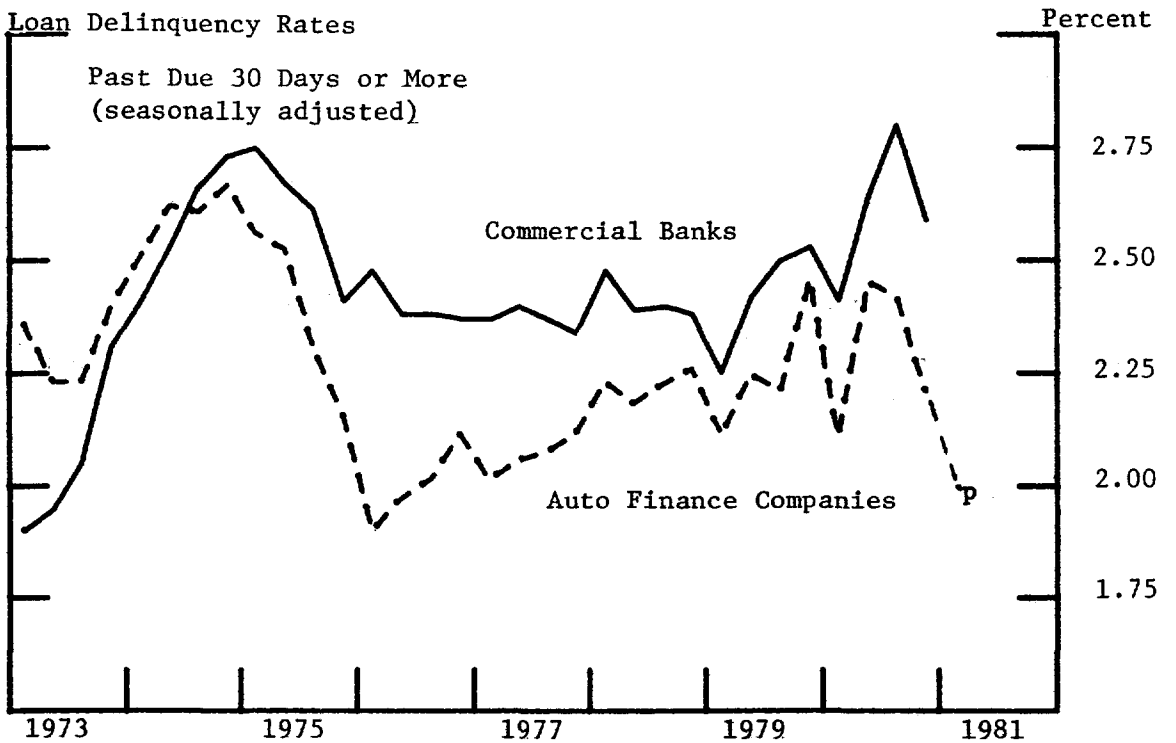
CONSUMER INSTALLMENT CREDIT[1]

	1979	1980	1980 Q3	1980 Q4	1980 Dec.	1981 Jan.
Total						
Change in outstandings						
Billions of dollars	38.4	1.4	1.4	12.6	19.4	10.4
Percent	14.0	0.5	0.5	4.2	6.3	3.4
Extensions						
Billions of dollars	324.8	305.9	309.0	322.0	325.8	324.7
Bank share (percent)	47.6	43.7	42.6	43.3	42.3	38.4
Liquidations						
Billions of dollars	286.4	304.5	307.6	309.4	306.4	314.3
Ratio to disposable income (percent)	17.5	16.7	16.7	16.3	16.0	16.3
Automobile credit						
Change in outstandings						
Billions of dollars	14.7	0.0	-1.1	3.0	3.6	-0.8
Percent	14.5	0.0	-1.0	2.6	3.1	-0.7
Extensions						
Billions of dollars	93.9	83.0	83.9	87.6	86.8	86.8
Revolving credit						
Change in outstandings						
Billions of dollars	8.6	2.9	3.2	4.6	7.4	6.7
Percent	19.9	5.5	5.9	8.4	13.4	11.9
Extensions						
Billions of dollars	120.2	129.6	130.1	134.8	139.4	137.8

1. Quarterly and monthly dollar figures and related percent changes are at seasonally adjusted annual rates.

CONSUMER CREDIT





p - preliminary. January-February average.

The retrenchment at banks evidently continued in February, as net declines were reported among the large weekly reporting institutions.

The continued weakness of consumer credit at commercial banks has reflected, in part, an increased reluctance to make such loans. In the February Senior Loan Officer Opinion Survey, nearly 20 percent of the respondents had become less willing to make consumer loans than last November. The weakness of bank consumer lending also may reflect upward movements of finance rates at these institutions. Average new-car loan rates at banks rose from 14.3 percent in November to 15.8 percent in February--a high for the series.[1] (See chart on page III-22.) In contrast, new-car rates at auto finance companies edged down slightly between November and February, as rate policies at captive finance companies apparently continue to reflect support for their parent organizations. This pattern continued a general shift toward relatively higher rates on auto financing at banks that has developed during the last two years.

Lenders have persisted in their efforts to enhance the return on consumer credit. In the face of high money costs, additional banks have imposed annual cardholder fees, and many have raised finance rates where statutes allow. Several Philadelphia banks and a major bank in Maryland are moving their credit card operations to Delaware, where a revised state law now permits user fees on card accounts and has eliminated ceilings on finance rates. Montgomery Ward also announced in early March that it was tightening credit standards and increasing its minimum monthly payment requirement.

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1. Removal of statutory rate ceilings on consumer loans in New York state on December 1 resulted in some sharp rate increases among New York banks. Such increases accounted for only about 20 of the 150 basis points increase in the national average, however.

Delinquency rates on consumer installment credit dropped in the fourth quarter at commercial banks and (through February) at auto finance companies. Although personal bankruptcy statistics have been volatile on a monthly basis, filings in January were well below their October peak.

APPENDIX A*

NOW ACCOUNT DEVELOPMENTS IN EARLY 1981

Heavy promotional activity beginning last year at depository institutions contributed to rapid shifts of funds to interest-bearing "other checkable deposits" (OCD) following the introduction of nationwide NOW accounts on December 31, 1980. OCD surged by more than $16 billion in January on a month average basis, with the bulk of the expansion occurring in the first two weeks of the month. Adjustment by the public to the new account has proceeded more moderately since mid-January; OCD expanded nearly $8 billion in February and a projected $5-1/4 billion in March.[1] Commercial banks have accounted for about 85 percent of the growth in OCD since year-end.

Knowledge of the sources of funds flowing into NOW accounts is critical to interpreting movements in the narrow monetary aggregates. Because such information cannot be obtained on a precise basis using only reported deposit data, the staff has relied on information from a variety of sources. The available evidence suggests that roughly four-fifths of net inflows to new NOW/ATS accounts in January was shifted or diverted from demand deposits and nearly all of the remainder came from savings deposits. The fraction from demand deposits is thought to have fallen to about three-fourths in February and March.[2]

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* Prepared by John R. Williams, Economist, Banking Section, Division of Research and Statistics.

1. Despite higher reserve requirements on NOWs than on ATS, the relative simplicity and public awareness of NOWs apparently makes them far more marketable. By early March, the net increase in OCD consisted of a nearly $32 billion increase in NOWs and about a $4-1/2 billion contraction in outstanding ATS accounts. The higher reserve requirement cost of NOWs reflects a provision of the Monetary Control Act of 1980 that any new types of accounts authorized after April 1, 1980 would immediately be subject to full reserve requirements, rather than to a phase-in of such requirements. The difference in the cost of investable funds obtained through ATS accounts relative to NOWs due to unequal treatment for reserve requirements is 43 basis points for member banks and 65 basis points for nonmember institutions.

2. To calculate adjusted M-1A each month, the assumed fraction from demand deposits is applied to the net increase in OCD (less its estimated $200 million per month trend growth) and the resultant value is added cumulatively to observed M-1A. To calculate adjusted M-1B, the assumed fraction from other sources (one minus the fraction from demand deposits) is applied to the net increase in OCD in excess of trend and the resultant value is subtracted from observed M-1B.

Staff estimates of the sources of OCD have been based principally on results of informal samplings of commercial banks conducted this year on January 14, January 31, and March 11 by the Reserve Banks and on a similar survey of S&Ls conducted on January 31 by the Federal Home Loan Bank Board. Nine commercial banks in each Federal Reserve district (three with total deposits of $1 billion and above, three with total deposits of $250 million to $1 billion, three with total deposits less than $250 million) were asked to estimate the sources of recent inflows to new NOW accounts. Although the sample is far too small to permit precise estimates, the mean response of the 30 banks outside the Northeast in each size class, weighted by the volume of NOW accounts in each size class, provides a rough approximation. The two January surveys suggested that just over 80 percent of net funds flowing to new NOW/ATS accounts at commercial banks in January would have been held in demand deposits in the absence of NOWs. The S&L respondents indicated that in January roughly 60 percent of inflows to new NOW accounts originated outside these institutions, suggesting that perhaps about 50 percent came from demand deposits.[1] Applying these rough estimates to the NOW market shares held by commercial banks and thrifts yields an overall estimate in the range of 75 to 80 percent from demand deposits for January.

A fraction in this range is confirmed by two other unrelated approaches. First, interviews of about 700 households were conducted in mid-February by the Survey Research Center of the University of Michigan. Depositors that had opened a new interest-bearing transaction account since NOWs were authorized nationwide estimated on average that between 76 and 80 percent of the initial balances used to get the account started would otherwise have been in demand deposits. Second, econometric methods, utilizing cross-section regressions of reported deposit flows, suggest that nearly 80 percent of new OCD in January came from demand deposits.

Recently available data from the mid-March Reserve Bank survey of commercial banks suggest a slight decline at sample commercial banks in the proportion of inflows to new OCD accounts estimated to come from

1. Lacking further evidence, the latter figure assumes that roughly four-fifths of funds from outside S&Ls were shifted or diverted from demand deposits.

demand deposits during the period from February 1 to March 11. However, the average survey response was still close to 80 percent.[1]

The fraction of inflows to new NOW accounts thus far in 1981 estimated to come from demand deposits is a bit higher than would have been expected on the basis of historical experience with NOW accounts in the Northeast and with ATS accounts nationwide.[2] In part, this appears to reflect the marketing strategies adopted by institutions outside the Northeast. Commercial banks typically have required high minimum balances--usually $1000 or more to avoid service charges--apparently to discourage shifting by small depositors while retaining the large depositors who evidently have tended to react most rapidly to the advent of NOWs. In contrast, at S&Ls minimum balance requirements for charge-free accounts seldom exceed $500, apparently reflecting an attempt to overcome the inertia of customers to retain transaction accounts at commerical banks. The minimum balance requirements at banks, which are larger than in the Northeast, apparently have discouraged shifting by smaller depositors who would have to consolidate transaction and non-transaction accounts. Thus, much of the early shifting to NOW accounts

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1. To monitor developments in the remainder of 1981, another informal survey of commercial banks will be conducted by Reserve Banks in April and similar formal surveys of about 400 banks will be conducted quarterly beginning in May. In addition, results of another informal survey of S&Ls by the FHLBB in March will be available by the end of March. The FHLBB has expressed a willingness to repeat their informal surveys of S&Ls later in 1981 as needed. Also, the household interviews conducted by the Survey Research Center are being repeated in March and April at another sample of 700 households and may be conducted again in some later months during the year, with results available around the ends of each such month. Finally, the econometric analysis of deposit flows will be repeated as subsequent data become available.

Each of the commercial bank and S&L surveys also provides data on the number of NOW accounts. Monitoring growth in the number of accounts over the course of the year will provide a further indication of the progress of the public's adjustment to this new account.

2. A variety of evidence suggests that roughly two-thirds of NOW/ATS balances prior to 1981 were shifted or diverted from commercial bank demand deposits. Such evidence includes: (1) results of surveys of sources of ATS balances at commercial banks conducted in late 1978 and late 1980; (2) behavior in the 1970s of household demand deposits in Massachusetts--the only individual state for which such data are available--compared to the national average; and (3) relationships among observed turnover rates, minimum balance requirements, and account sizes for various kinds of household transaction accounts.

apparently was done promptly in January by large demand deposit customers--who easily satisfied minimum balance requirements without transferring funds from savings or other accounts--producing the high proportion from demand deposits. Supporting evidence of this development can be found in the average size of NOW accounts, which was nearly $5,000 at commercial banks in January and $1,300 at S&Ls; the commercial bank average is much higher than in New England.[1] Moreover, nearly half of the sampled commercial banks outside the Northeast allow customers to satisfy minimum balance requirements by holding funds in accounts other than NOWs, compared to only about 10 percent in the Northeast. On average, such banks estimated that about a third of their customers utilize this option; thus, even small depositors at commercial banks may avoid transfers of savings to NOWs.

At present, the staff expects that a slowly declining proportion of new NOW growth will come from demand deposits as the current year progresses. The expectation is based in part on the slight drop in this fraction apparent in the March survey of commercial banks. It also reflects the likelihood that a further decline towards the two-thirds figure assumed for shifts to OCD prior to 1981 will occur as NOW accounts are opened by smaller depositors, who are more apt to consolidate demand deposits and savings deposits in a NOW account. Indeed, the share of the NOW market held by S&Ls may rise at the same time. These judgments will be reviewed throughout the year as new evidence becomes available.

1. Among the large customers shifting to NOWs at the earliest opportunity in January were sole proprietorships, labor unions, trade associations, pension funds, and other non-household entities. Roughly 13 percent of NOW balances outside the Northeast are held by other than individuals, compared to only 6 percent in New England. Although eligibility requirements for NOW accounts are not substantively different from when these accounts were first authorized in New England, publicity regarding those eligible has heightened since passage of the Monetary Control Act. The higher proportion of NOWs held by non-household entities outside New England may reflect greater awareness by those eligible, as well as the higher minimum balance requirements.

APPENDIX B*

SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES

One-third of the 118 respondents to the February 15th Senior Loan Officer Opinion Survey on Bank Lending Practices reported that business loan demand had fallen over the previous three months.[1] About one-fourth of the respondents anticipated a decline in business loan demand over the next three months. At the time of the survey, the prime rate was nearly 350 basis points above its mid-November level, and the spread of the prime rate over the commercial paper rate was substantially wider than in November. The reported weakness in business loan demand may have reflected some shifting of substantially weaker business demand for short-term credit from banks to the commercial paper market, where financing activity picked up sharply between surveys. It appears also to have reflected some substitution of long-term, bond-market financing for bank loans.

Although respondents indicated essentially unchanged willingness to make business loans, the number of banks reporting an easing exceeded the number reporting a firming of nonprice terms on business loans. The juxtaposition of unchanged willingness to lend and easing of nonprice terms would be consistent with an attempt by some banks to sustain their flow of bookings in the face of moderating demands for business loans. Evidence of an easing of nonprice terms included reduction in compensating balance requirements by about one-fifth of survey respondents.[2] In addition, somewhat smaller proportion of

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* Prepared by Warren T. Trepeta, Economist, Banking Section, Division of Research and Statistics.

1. This proportion appears small in light of the dramatic drop in the growth rate of business loans at domestic offices of large commercial banks between November and February. However, the survey does not specify precisely the meaning of "loan demand", which some respondents may interpret to include the demand for lines of credit. Unused commercial and industrial loan commitments at large banks rose sharply relative to loans made under commitment in the November-January period. In addition, some respondents may include in domestic office loan demand those demands expressed at domestic offices but satisfied through bookings at foreign branches. The weakness in business loan growth at large banks in the first two months of 1981 in part reflects booking of about $2 billion of loans to U.S. firms at foreign branches of domestically chartered banks.

2. When market interest rates increase, as they did on balance between the November and February surveys, banks' earnings per dollar of compensating balances also rise and the quantity of balances needed to compensate banks for a given quantity of credit services declines. Consequently, during and after a rise in interest rates, banks might be expected to ease compensating balance requirements on new and renegotiated loan commitments and takedowns. The easing reported in the February survey could be either such a response to higher interest rates or a continuation of the reported trend toward substitution of explicit fees for compensating balances, as well as an attempt by banks to pursue moderating loan demands.

respondents indicated that in the November-February period they had relaxed standards to qualify for the prime rate or for a given spread above prime. Respondents reported an essentially unchanged stance on lending to new and nonlocal customers, as well as to established and local customers.

Although respondents' willingness to make short-term, fixed-rate loans remained unchanged on balance between November and February, it apparently was low, given that respondents generally had reported reduced willingness to make such loans since February 1978. Meanwhile, a substantial minority of banks continues to report reduced willingness to offer fixed rates on long-term loans, probably because they remain uncertain about long-run interest rate trends.

As in November, the number of respondents indicating reduced willingness to make both consumer installment loans and residential mortgages exceeded the number reporting increased willingness. Several respondents indicated in supplementary comments that their reluctance to make such loans stemmed from the fact that these loans bear fixed rates or, in the case of variable-rate mortgages, from state government or consumer resistance to a range of variation in rates satisfactory to the banks.

In February, respondents' willingness to make most other types of loans was about unchanged from November. As in November, a substantial minority of banks indicated an increased willingness to lend only in the case of participation loans originated by correspondent banks.

TABLE 1

SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES
AT SELECTED LARGE BANKS IN THE U.S.
(STATUS OF POLICY ON FEBRUARY 15, 1981 COMPARED TO THREE MONTHS EARLIER)
(NUMBER OF BANKS & PERCENT OF TOTAL BANKS ANSWERING QUESTION)

LOAN DEMAND	MUCH STRONGER		MODERATELY STRONGER		ESSENTIALLY UNCHANGED		MODERATELY EASIER		MUCH EASIER		TOTAL BANKS ANSWERIN
STRENGTH OF DEMAND FOR COMMERCIAL AND INDUSTRIAL LOANS (AFTER ALLOWANCE FOR BANKS USUAL SEASONAL VARIATION):	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	
1. COMPARED TO THREE MONTHS EARLIER	0	0.0	14	11.9	62	52.6	40	33.9	2	1.7	118
2. ANTICIPATED DEMAND IN NEXT 3 MONTHS	0	0.0	11	9.4	80	67.8	27	22.9	0	0.0	118
INTEREST RATE POLICY	MUCH FIRMER		MODERATELY FIRMER		ESSENTIALLY UNCHANGED		MODERATELY EASIER		MUCH EASIER		
STANDARDS OF CREDIT WORTHINESS:	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	
3. TO QUALIFY FOR PRIME RATE	0	0.0	2	1.7	104	88.2	12	10.2	0	0.0	118
4. TO QUALIFY FOR SPREAD ABOVE PRIME	0	0.0	3	2.6	97	82.3	18	15.3	0	0.0	118
	CONSIDERABLY GREATER		MODERATELY GREATER		ESSENTIALLY UNCHANGED		MODERATELY LESS		MUCH LESS		
WILLINGNESS TO MAKE FIXED RATE LOANS:	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	
5. SHORT-TERM (UNDER ONE YEAR)	0	0.0	10	8.5	96	81.4	9	7.7	3	2.6	118
6. LONG-TERM (ONE YEAR OR LONGER)	0	0.0	3	2.6	80	67.8	22	18.7	13	11.1	118
CREDIT AVAILABILITY AND NONPRICE TERMS	MUCH FIRMER		MODERATELY FIRMER		ESSENTIALLY UNCHANGED		MODERATELY EASIER		MUCH EASIER		
REVIEWING CREDIT LINES OR LOAN APPLICATIONS FOR:	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	
7. ESTABLISHED CUSTOMERS	0	0.0	1	0.9	111	94.1	6	5.1	0	0.0	118
8. NEW CUSTOMERS	1	0.9	3	2.6	106	89.9	8	6.8	0	0.0	118
9. LOCAL SERVICE AREA CUSTOMERS	0	0.0	2	1.8	109	93.2	6	5.2	0	0.0	117
10. NONLOCAL SERVICE AREA CUSTOMERS	1	0.9	3	2.6	109	93.2	4	3.5	0	0.0	117
COMPENSATING BALANCE REQUIREMENTS FOR:											
11. COMMERCIAL & INDUSTRIAL LOANS	0	0.0	3	2.6	91	77.2	24	20.4	0	0.0	118
12. LOANS TO FINANCE COMPANIES	1	0.9	4	3.4	104	88.2	9	7.7	0	0.0	118
	CONSIDERABLY GREATER		MODERATELY GREATER		ESSENTIALLY UNCHANGED		MODERATELY LESS		MUCH LESS		
WILLINGNESS TO MAKE OTHER TYPES OF LOANS:	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	
13. SECURED CONSTRUCTION & LAND DVLPMNT	0	0.0	6	5.1	93	78.9	18	15.3	1	0.9	118
SECURED REAL ESTATE LOANS:											
14. 1-4 FAMILY RESIDENTIAL PROPERTIES	0	0.0	3	2.6	91	77.8	21	18.0	2	1.8	117
15. MULTI-FAMILY RESIDENTIAL PROPERTY	0	0.0	2	1.8	96	84.3	15	13.2	1	0.9	114
16. COMMERCIAL & INDUSTRIAL PROPERTY	0	0.0	6	5.1	102	86.5	9	7.7	1	0.9	118
17. INSTALLMENT LOANS TO INDIVIDUALS	0	0.0	8	6.9	87	74.4	17	14.6	5	4.3	117
COMMERCIAL AND INDUSTRIAL LOANS OF:											
18. 1-5 YEARS MATURITY	0	0.0	8	6.8	107	90.7	2	1.7	1	0.9	118
19. OVER 5 YEARS MATURITY	0	0.0	4	3.4	105	89.0	7	6.0	2	1.7	118
20. LOANS TO FINANCE COMPANIES	0	0.0	3	2.6	106	89.9	7	6.0	2	1.7	118
21. LOANS TO SECURITIES BROKERS & DEALERS	0	0.0	7	6.0	104	88.9	5	4.3	1	0.9	117
22. PARTICIPATION LOANS WITH CORRESPONDENT BANKS	0	0.0	16	13.6	101	85.6	1	0.9	0	0.0	118

TABLE 2

COMPARISON OF QUARTERLY CHANGES IN BANK LENDING PRACTICES AT BANKS GROUPED BY SIZE OF TOTAL DOMESTIC ASSETS
(STATUS OF POLICY ON FEBRUARY 15, 1981 COMPARED TO THREE MONTHS EARLIER)
(NUMBER OF BANKS ANSWERING EACH QUESTION AS PERCENT OF TOTAL NUMBER OF BANKS ANSWERING QUESTION)

SIZE OF BANK -- TOTAL DOMESTIC ASSETS IN BILLIONS 1/

LOAN DEMAND	MUCH STRONGER		MODERATELY STRONGER		ESSENTIALLY UNCHANGED		MODERATELY WEAKER		MUCH WEAKER		TOTAL	
STRENGTH OF DEMAND FOR COMMERCIAL AND INDUSTRIAL LOANS (AFTER ALLOWANCE FOR BANKS USUAL SEASONAL VARIATION):	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5
1. COMPARED TO THREE MONTHS EARLIER	0	0	22	9	52	53	26	36	0	2	100	100
2. ANTICIPATED DEMAND IN NEXT 3 MONTHS	0	0	7	10	78	65	15	25	0	0	100	100

INTEREST RATE POLICY	MUCH FIRMER		MODERATELY FIRMER		ESSENTIALLY UNCHANGED		MODERATELY EASIER		MUCH EASIER		TOTAL	
STANDARDS OF CREDIT WORTHINESS:	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5
3. TO QUALIFY FOR PRIME RATE	0	0	0	2	96	86	4	12	0	0	100	100
4. TO QUALIFY FOR SPREAD ABOVE PRIME	0	0	0	3	93	79	7	18	0	0	100	100

	CONSIDERABLY GREATER		MODERATELY GREATER		ESSENTIALLY UNCHANGED		MODERATELY LESS		CONSIDERABLY LESS		TOTAL	
WILLINGNESS TO MAKE FIXED RATE LOANS:	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5
5. SHORT-TERM (UNDER ONE YEAR)	0	0	7	9	85	80	7	8	0	3	100	100
6. LONG-TERM (ONE YEAR OR LONGER)	0	0	4	2	74	66	15	20	7	12	100	100

CREDIT AVAILABILITY AND NONPRICE TERMS	MUCH FIRMER		MODERATELY FIRMER		ESSENTIALLY UNCHANGED		MODERATELY EASIER		MUCH EASIER		TOTAL	
REVIEWING CREDIT LINES OR LOAN APPLICATIONS FOR:	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5
7. ESTABLISHED CUSTOMERS	0	0	0	1	100	92	0	7	0	0	100	[illegible]
8. NEW CUSTOMERS	0	1	0	3	96	88	4	8	0	0	100	100
9. LOCAL SERVICE AREA CUSTOMERS	0	0	0	2	96	92	4	5	0	0	100	100
10. NONLOCAL SERVICE AREA CUSTOMERS	0	1	0	3	100	91	0	4	0	0	100	100
COMPENSATING BALANCE REQUIREMENTS FOR:												
11. COMMERCIAL & INDUSTRIAL LOANS	0	0	4	2	85	75	11	23	0	0	100	100
12. LOANS TO FINANCE COMPANIES	0	1	4	3	96	86	0	10	0	0	100	100

	CONSIDERABLY GREATER		MODERATELY GREATER		ESSENTIALLY UNCHANGED		MODERATELY LESS		CONSIDERABLY LESS		TOTAL	
WILLINGNESS TO MAKE OTHER TYPES OF LOANS:	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5	$5 & OVER	UNDER $5
13. SECURED CONSTRUCTION & LAND DVLPMNT	0	0	4	5	78	79	19	14	0	1	100	100
SECURED REAL ESTATE LOANS:												
14. 1-4 FAMILY RESIDENTIAL PROPERTIES	0	0	4	2	77	78	15	19	4	1	100	100
15. MULTI-FAMILY RESIDENTIAL PROPERTY	0	0	0	2	87	83	12	13	0	1	100	100
16. COMMERCIAL & INDUSTRIAL PROPERTY	0	0	0	7	89	86	11	7	0	1	100	100
17. INSTALLMENT LOANS TO INDIVIDUALS	0	0	8	7	69	76	15	14	8	3	100	100
COMMERCIAL AND INDUSTRIAL LOANS OF:												
18. 1-5 YEARS MATURITY	0	0	0	9	96	89	4	1	0	1	100	100
19. OVER 5 YEARS MATURITY	0	0	0	4	96	87	4	7	0	2	100	100
20. LOANS TO FINANCE COMPANIES	0	0	4	2	81	92	15	3	0	2	100	100
21. LOANS TO SECURITIES BROKERS & DEALERS	0	0	4	7	93	88	4	4	0	1	100	[illegible]
22. PARTICIPATION LOANS WITH CORRESPONDENT BANKS	0	0	7	15	89	85	4	0	0	0	100	

1/ AS OF SEPT. 30, 1978 , THERE WERE 21 BANKS HAVING DOMESTIC ASSETS OF $5 BILLION OR MORE. THEIR COMBINED DOMESTIC ASSETS, IN BILLIONS, TOTALLED $325, COMPARED TO $511 FOR THE ENTIRE PANEL OF REPORTING BANKS AND $1198 FOR ALL INSURED COMMERCIAL BANKS.

INTERNATIONAL DEVELOPMENTS

Foreign Exchange Markets

The exchange value of the dollar has fluctuated widely since the last Greenbook, and on balance the dollar's weighted-average value has climbed by 2-3/4 percent. This is illustrated in the top panel of the chart on the following page. Against individual foreign currencies the dollar's performance in the past eight weeks has been mixed. Against the German mark the dollar has appreciated by 3/4 percent on balance, while against the Swiss and French francs and the Japanese yen the dollar has risen by 2 to 3 percent. Its appreciation against the pound sterling exceeded 6 percent during the same period.

From late January through about mid-February the dollar's weighted-average value climbed by about 6 percentage points, almost attaining 100 on the March 1973 base of this index. Major factors in this appreciation were favorable exchange-market perceptions of U.S. oil decontrol -- announced in late January -- and reactions to fiscal policy initiatives of the new U.S. administration. Periodic reaffirmations of U.S. monetary policy intentions, continuing tensions in the Polish situation, expectations of an MLR cut in the United Kingdom and mounting concern about the German mark likewise played roles in the dollar's buoyancy.

Since mid-February the dollar has tended to ease back somewhat, in line with the narrowing differential between interest-rates on dollar assets and foreign rates depicted in the bottom panel of the chart. Key U.S. money market rates have drifted down, while at the

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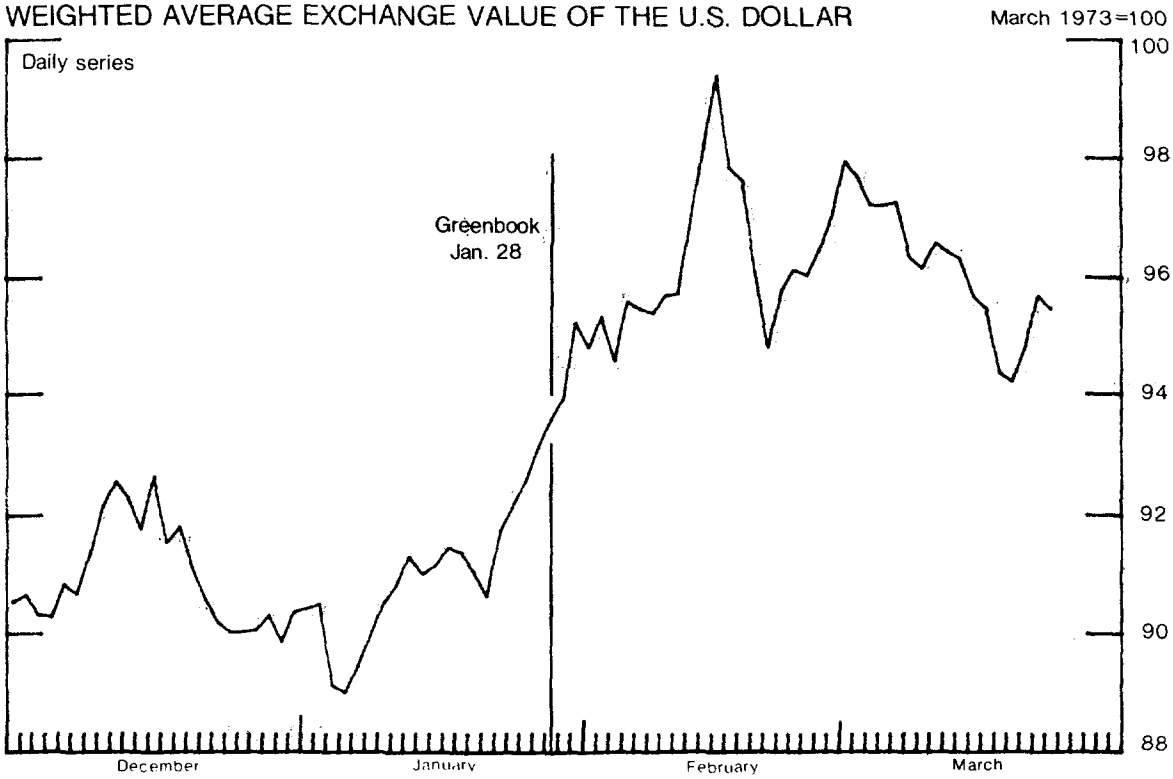
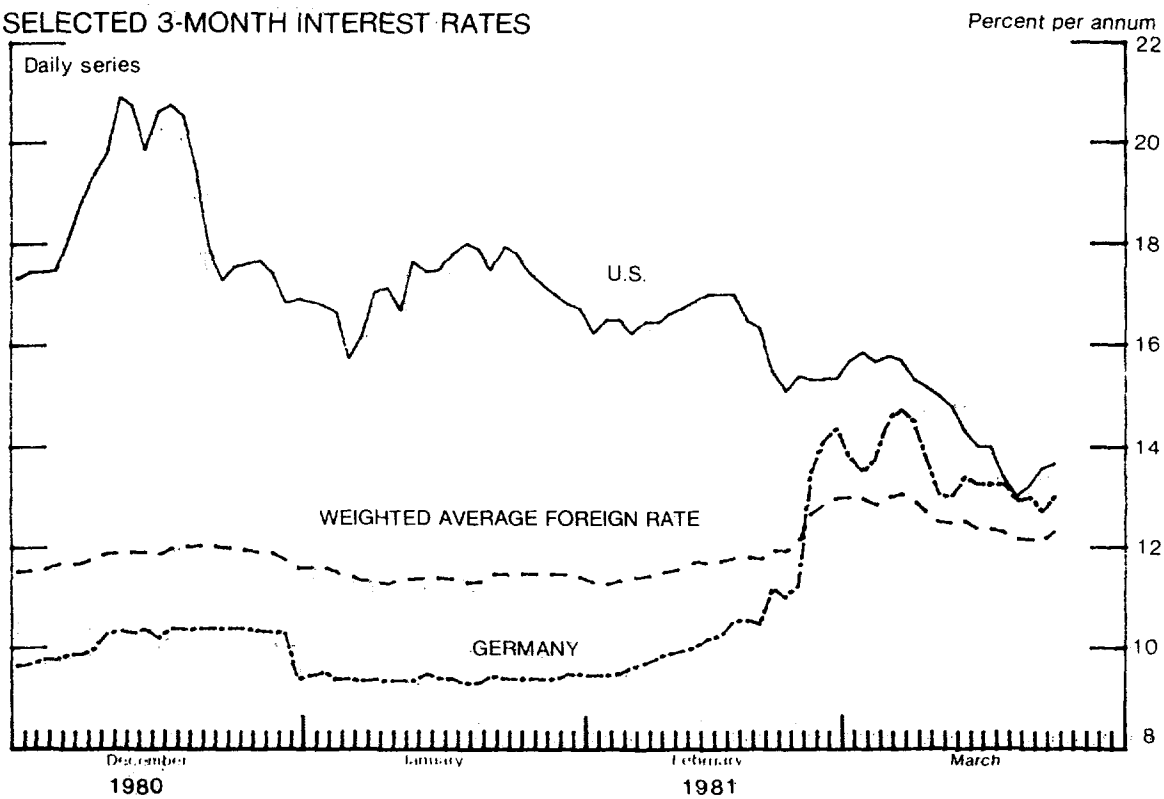
WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



SELECTED 3-MONTH INTEREST RATES



same time foreign interest rates have risen. On February 19 the Bundesbank's Central Council suspended its regular Lombard facility (for the first time since 1973), substituting instead a special, overnight Lombard window. This window has generally remained open since late February, but at a rate of 12 percent, or 3 percentage points higher than charges on the old facility. German interbank rates have moved up correspondingly. The dollar gradually gave up its earlier gains against the German mark following the Bundesbank's actions. Decreases in the Bank of England's MLR and in the Japanese discount rate had been widely anticipated, and exchange markets have shown little reaction to these initiatives. (See discussion on foreign economic developments, below, for details on these and other monetary policy actions.)

Gold prices fell from an initial level around $525 at the time of the last Greenbook to as low as $460 in early March, but subsequently have climbed again to around $530. This recent upward move is reported to be mostly in response to declines in dollar interest rates and heightened Polish tensions.

During the past several weeks the Italian lira has been particularly weak within the EMS arrangement, reflecting concerns about Italy's large external deficit and high inflation rate. On March 22 the central rate of the lira was formally devalued by 6 percent against the other EMS currencies, bringing its existing market rate to about 1 percent above its new central rate with the German mark. (Unlike the currencies in the narrow-margins agreement, the lira is permitted a 6 percent range of fluctuation against other EMS

currencies.) The Bank of Italy also increased its discount rate and increased banks' reserve requirements. Nonetheless, since the weekend the lira has been subjected to further downward pressure, and it has depreciated to about 1/2 percent below its new central rate with the mark.

The extended period of weakness exhibited by the German mark within the EMS narrow margins arrangement came to an end in late February with the sudden rise in German interest rates. In fact, the mark has moved to the top of the narrow band and is presently slightly above the French franc and almost 2-1/4 percent (the maximum allowable) above the Belgian franc.

The magnitude of U.S. intervention has declined sharply during the period, and for the last several weeks the Desk has essentially been out of the mark. However, for the whole period since the last Greenbook, the Desk purchased $1.2 billion equivalent of foreign

currencies, virtually all in German marks, but also including $20 million equivalent of Swiss francs. All the Desk acquisitions were shared equally between the System and Treasury. In addition, during February the System made several small investments of Swiss franc holdings in Swiss government money market certificates.

As of yesterday afternoon, the System's open position in foreign currencies remained at $3.2 billion equivalent, with unrealized losses on this position coming to $112.0 million.

Foreign lending by U.S. banks. Claims on foreigners held by the domestic offices and foreign branches of U.S.-chartered banks increased by somewhat less in the second half of 1980 than in the period a year earlier, following a sharp pickup in such foreign lending in the first half of the year. However, the slowing in the second half mainly involved lending to the industrial countries. Lending to the non-OPEC developing countries, by contrast, continued to increase strongly. For 1980 as a whole, lending both to that group and to the industrial countries was substantially greater than in 1979. (See table.)

Total claims on foreigners rose $24 billion in the second half of 1980, about $4 billion less than in the comparable period of 1979. (Because of seasonality in the data the most appropriate comparisons are between corresponding periods of each year.) In 1980 lending to most G-10 countries, which is largely interbank placements, slackened. Among the smaller industrial countries, lending to Spain declined sharply from a year earlier, and there was no further lending to Denmark. For South Africa repayments again exceeded new loans; outstanding claims on South Africa have fallen by $1.3 billion in the three years 1978-80, to $1.1 billion outstanding in December 1980.

Because lending to industrial countries had been very buoyant in the first half of the year, for the full year 1980 lending to both the G-10 and the smaller countries was substantially greater than the year before. Among the smaller industrial countries the principal increase was to Spain, on which claims rose $0.5 billion last year after no rise in 1979. With respect to other areas, lending to the OPEC countries, which had already fallen to a low level in 1979, became slightly negative

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

Claims on	Increase: Year 1976-78 avge.	Increase: Year 1979	Increase: Year 1980	Increase: 2nd Half 1979	Increase: 2nd Half 1980	Outstanding Dec. 1980
Total, all countries	37.0	37.5	48.3	28.2	23.9	352.1
G-10 and Switzerland	14.9	13.6	23.3	13.1	7.4	161.7
Smaller industrial countries	3.1	.5	1.3	1.7	.9	21.2
OPEC countries	5.6	.2	-.1	.2	1.9	22.8
Eastern Europe	1.1	.4	.2	.6	.3	7.5
Non-OPEC developing countries	6.2	10.2	14.1	6.9	9.5	76.9
of which:						
Brazil	2.4	.3	1.0	.1	.9	16.2
Mexico	.6	1.2	3.9	1.3	2.3	15.9
Argentina	.4	2.0	2.9	1.5	2.3	7.9
Korea	.6	1.6	1.6	.5	0	7.1
Philippines	.4	1.4	.8	.5	.4	5.0
Taiwan	.4	.5	.8	.1	.4	4.2
Chile	.4	.9	1.0	.7	.8	3.5
Others	1.0	2.2	2.1	2.2	2.4	17.1
Offshore banking centers	3.9	9.5	6.7	3.4	3.2	47.1
Miscellaneous and unallocated	1.7	2.6	3.4	1.8	.8	15.1

in 1980 as a whole (despite some rise in the second half). Although claims on Venezuela, Ecuador, and the African oil-exporting countries each increased $0.2-0.4 billion last year, these increases were offset by decreases in claims on Middle East oil exporters. Lending to Eastern Europe of $0.2 billion in 1980 was one-half of the 1979 figure. In this group, claims on Poland rose $60 million (compared with $220 million in 1979), and amounted to $1.74 billion at year-end.

U.S. bank lending to the non-OPEC developing countries came to $9.5 billion in the second half of 1980 and $14 billion in 1980 as a whole. Both these amounts were nearly 40 percent greater than the comparable 1979 amounts, and the full-year figure represented more than a doubling of the 1976-78 average annual volume. Lending to Brazil, Mexico, Argentina, and Taiwan increased sharply, both in the second half and in the full year. Lending to Korea halted in the second half, and therefore showed no full-year increase despite the surge in the first half. The only major borrower in this group to which lending dropped off for the year as a whole was the Philippines. Although lending to Brazil rose sharply in the second half of 1980, for the year it was much below its 1976-78 annual average and was greatly exceeded by lending to Mexico, Argentina (now the third largest debtor to U.S. banks among non-OPEC developing countries) and Korea.

The U.S. banks' willingness to step up their lending to the non-OPEC developing countries contrasts with the actions of non-U.S. banks. BIS statistics indicate that lending to these countries by non-U.S. banks in the first three quarters of 1980 amounted to about $15-1/2 billion, down 15 percent from $18-1/2 billion a year earlier.

The forms of bank lending to developing countries changed during 1980. For U.S. and non-U.S. bank lending taken together, lending to the non-OPEC developing countries in the form of syndicated medium-term Eurocredits declined more than 30 percent last year, while other forms of lending increased.

U.S. International Transactions

The U.S. merchandise trade deficit increased in January to $35 billion annual rate on an international accounts basis. Monthly trade deficits, which have risen steadily since last summer, increased significantly between October 1980 and January 1981 as the value of imports rose sharply. The strength of imports in those months largely reflected the pick-up in U.S. economic activity -- 4 percent real GNP growth was recorded in 4Q80. During the same months the value of exports, other than agricultural commodities, pretty much leveled off and the volume shipped fell continuing declines begun when foreign economic activity fell during the spring and summer.

	1980						1981
	Q1	Q2	Q3	Oct.	Nov.	Dec.	Jan.
Value* (Bil. $, SAAR)							
Exports	218.4	218.4	224.7	227.5	221.6	227.5	236.0
Agricultural	41.2	38.6	43.5	41.3	43.2	48.2	50.1
Nonagricultural	177.2	179.8	181.2	186.2	178.4	179.3	185.9
Imports	261.8	248.4	236.2	243.0	247.0	257.9	270.8
Petroleum	86.3	83.8	68.9	75.0	73.6	81.4	86.1
Nonpetroleum	175.5	164.6	167.2	168.0	173.4	176.5	184.7
Trade Balance	-43.4	-30.0	-11.4	-15.6	-25.4	-30.3	-34.8
Volume* (Bil. 72$, SAAR)							
Exports - Agricultural	18.0	17.6	18.7	16.8	17.0	18.7	n.a.
- Nonagric.	74.4	74.3	72.5	73.2	68.3	68.3	n.a.
Imports - Petroleum	8.1	7.2	5.7	6.2	6.0	6.4	n.a.
- Nonpetroleum	72.0	66.1	65.5	65.0	66.9	68.1	n.a.

*/ International Transactions Basis.

The merchandise trade data used in the International Transactions account are virtually the same as the trade data used in the GNP account. The only difference is that gold transactions are excluded from GNP data but are included in International Transactions data. In 1980 gold exports amounted to $4.0 billion, and gold imports excluded from GNP data amounted to $3.9 billion.

The volume of oil imports rose 10 percent between October 1980 and January 1981 primarily as a result of rising U.S. economic activity. In addition, the U.S. Government began to add to the Strategic Petroleum Reserves during these months after a 15 month hiatus. The decline of private stocks (particularly refined products) that occurred during the latter part of 1980 appears to have halted in early 1981. Prices of imported oil increased 6 percent between October and January; the rises through January reflect only part of the OPEC price rise announced at year-end.

	Oil Imports						
	1Q80	2Q80	3Q80	Oct. 80	Nov. 80	Dec. 80	Jan. 81
Volume (mbd, SA)	8.4	7.4	6.0	6.4	6.4	6.6	7.0
Price ($/BBL)	28.06	30.85	31.38	31.73	32.05	32.88	33.52
Value (Bil. $ SAAR)	86.3	83.8	68.9	75.0	73.6	81.4	86.1

The increase in nonoil imports, while spread fairly widely among commodity categories, was strongest for industrial supplies and consumer goods. Automotive imports from Japan and Europe also increased notably in January, more than reversing the sharp December downturn. Foreign car sales continued at about the fourth-quarter rate through January but rose sharply in February. Dealer inventories of new cars began to be drawn down in January.

Virtually all of the increase in exports from October to January was in agricultural exports, particularly wheat and soybeans. Agricultural export prices in January increased only modestly from December levels, despite a drop in commodity futures prices that began in November. Non-agricultural exports were about the same level in January as in October

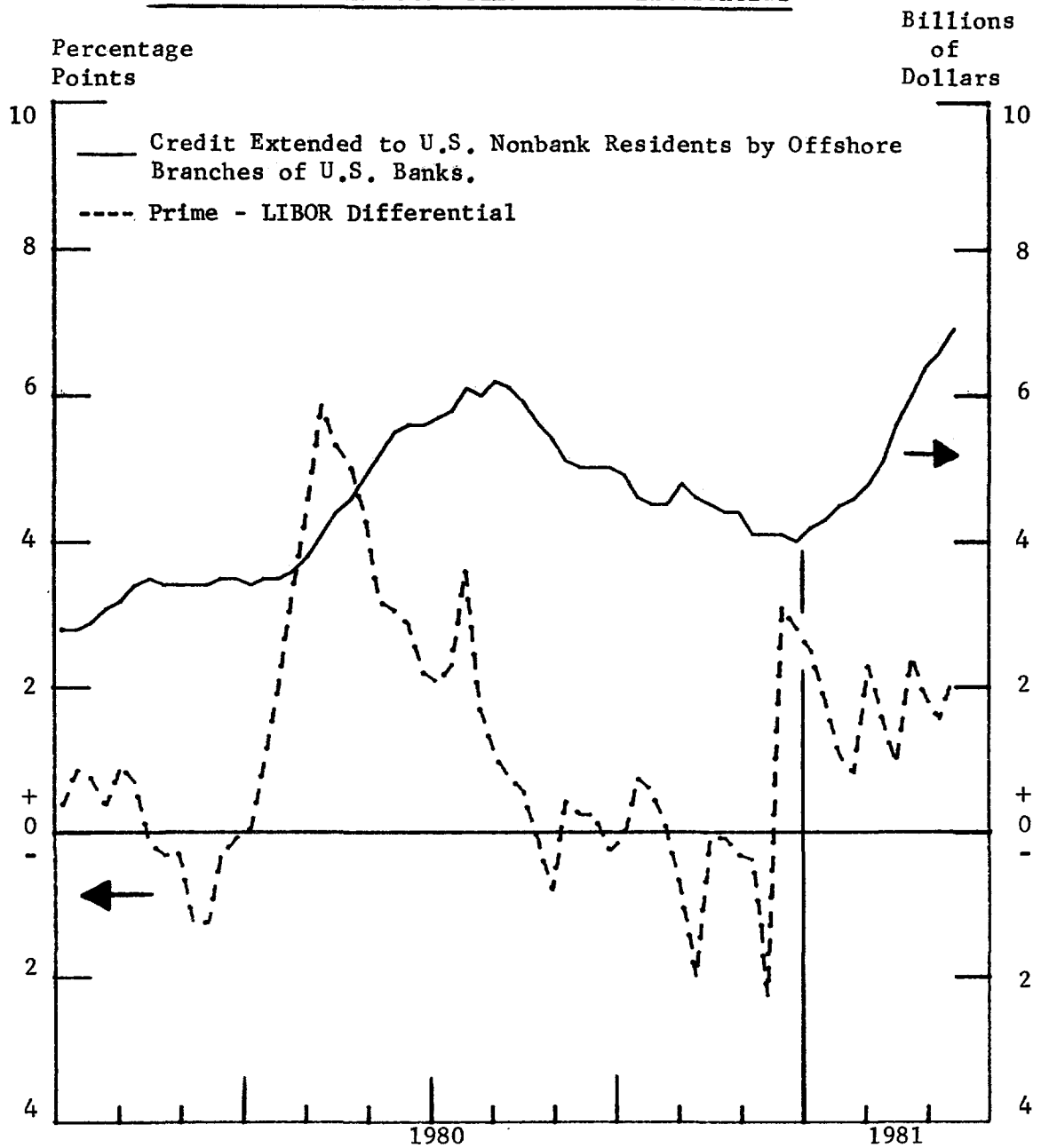
with declines in the intervening months; this pattern was followed by both industrial supplies and machinery exports (which together account for two-thirds of U.S. nonagricultural exports). In January the value of civilian aircraft exports fell sharply.

NOTE: Beginning with the January 1981 data, the Department of Commerce is including the foreign trade of the U.S. Virgin Islands, a major oil-refining center, in its monthly trade press release (Census basis data). This change does not affect trade data on an international accounts basis or in the GNP account since such transactions have always been included there.

Bank-reported capital flows. During January and February U.S. non-bank residents obtained a large amount of credit from offshore banks. As shown in the chart below, outstanding credit extended directly to residents by branches of U.S. banks increased about $2.5 billion during that period (a further increase of $0.5 billion was recorded in early March). In addition, Ford Motor Co. borrowed more than $1.2 billion from banks in West Germany and the United Kingdom through its subsidiaries in those countries. This growth in credit from abroad is a significant offset to the weakness in business loans of domestic banking offices since the beginning of the year. See the "Domestic Financial Developments" section of the Greenbook for a discussion of impact of such activity on measures of bank credit.

The surge in branch loans appears to reflect the spread of alternatives to prime-based pricing of business loans. Surveys of terms of lending at domestic offices of 48 large banks reveal that the percentage of gross loan extensions made at rates below prime increased from about 20 percent in November to 70 percent in February, a period during which market rates fell below prime. One alternative to prime-based pricing is

Branch Loans and the Prime-LIBOR Differential



Data on credit extended to U.S. nonbank residents by offshore branches of U.S. banks were obtained from required reserve reports (FR 2950). Data on the prime rate and LIBOR were obtained from Salomon Brothers' International Bond Market Roundup.

pricing based on the London Interbank Offer Rate (LIBOR). Many large corporations have the option of borrowing at a LIBOR-based rate rather than prime. The chart above indicates that in late December LIBOR fell below prime. Since the beginning of the year the differential has averaged about 170 basis points. Prime-based loans are generally booked at domestic offices. LIBOR-based loans, on the other hand, can be booked either onshore or offshore. Tax practices in certain states, however, provide strong incentives to book loans at offshore shell branches. In New York if a loan is booked at a shell branch rather than the head office, a considerable portion of the income on the loan is not subject to New York State taxation. To a lesser extent tax practices in California and Illinois also provide incentives for banks to book loans offshore. Banks headquartered in these three states accounted for nearly all of the surge in branch loans.

It does not appear that the surge in loans to U.S. residents from offshore branches of U.S. banks can be accounted for by the change in the Eurocurrency reserve requirement which was implemented in December 1980. The change allowed U.S. banks to net advances to their own foreign branches against branch loans to U.S. residents and sales of assets to branches in computing required reserves on Eurocurrency liabilities. If the reserve requirement had effectively discouraged branch loans to residents, allowing this type of netting could have been expected to result in an increase in such loans, accompanied by an increase in net advances to branches. This has not been the case. In fact, the bulk of the increase in such loans was reported by banks which did not report increases in net advances to their own foreign branches.

Holdings of official reserve assets in the United States by the G-10 countries and Switzerland increased about $1.5 billion in January. Partial data, based on holdings at the FRBNY, indicate an additional inflow of about $1.7 billion in February.

OPEC reserve holdings in the United States decreased by $0.2 billion in January.

. In February, OPEC holdings at the FRBNY rose $2.6 billion as one OPEC country purchased $3.0 billion in Treasury notes and bills.

U.S. official reserve assets increased by a total of about $2.9 billion in January and February, chiefly as a result of intervention purchases of German marks.

U.S. current account. Last week the Commerce Department released current-account data for the fourth quarter and year 1980. The U.S. current account was in surplus by $2.7 billion at an annual rate in 4Q80, which was considerably smaller than the third-quarter surplus. Most of the quarter-to-quarter change resulted from an increase in the trade deficit. Partly offsetting the decline in trade was an increase in net investment income receipts. This net increase was a result of reduced payments to foreigners; receipts from abroad declined, largely reflecting lower petroleum profits.

U.S. Current Account
(in billions of dollars, SAAR)

			1980				$ changes	
	1979	1980	Q1	Q2	Q3	Q4	year/year	3Q/4Q
Current Account, net	-0.7	0.1	-10.5	-9.8	18.0	2.7	0.8	-15.2
Trade balance	-29.4	-27.4	-43.4	-30.0	-11.4	-24.6	2.0	-13.1
Other transactions, net	28.7	27.5	32.9	20.2	29.4	27.3	-1.2	-2.1
Invest. Income, net	32.5	32.5	40.2	24.4	32.2	33.3	0	1.1
Direct, net	31.8	28.2	39.2	19.0	26.3	28.3	-3.6	2.0
Other, net	0.7	4.3	1.0	5.4	5.9	5.0	3.6	-0.9
Military, net	-1.3	-3.3	-3.7	-4.0	-2.5	-3.0	-2.0	-0.5
Other services, net	3.1	5.2	3.6	5.1	5.8	6.3	2.1	0.5
Unilateral transfers	-5.7	-7.0	-7.2	-5.3	-6.1	-9.2	-1.3	-3.1

U.S. INTERNATIONAL TRANSACTIONS
IN MILLIONS OF DOLLARS; RECEIPTS, OR INCREASE IN LIABILITIES

	1979 YEAR	1980 YEAR	1980 QI	1980 QII	1980 QIII	1980 QIV	1980 NOV.	1980 DEC.	1981 JAN.
1. CHANGE IN NET FOREIGN POSITIONS OF BANKING OFFICES IN U.S. (EXCL. LIAB. TO FOREIGN OFF. INST.)	14744	-29781	8685	-22906	-11788	-3772	-964	-6656	5862
THROUGH INTERBANK TRANSACTIONS WITH									
A. OWN OFFICES IN FOREIGN COUNTRIES	20617	-12707	6616	-18135	-2407	1219	2213	-4346	2374
B. UNAFFILIATED BANKING OFFICES IN FOR. COUNTRIES	3798	-6166	2938	-2115	-4653	-2336	-2762	-803	2834
THROUGH NONBANK TRANSACTIONS									
A. CLAIMS ON NONBANKS IN FOREIGN COUNTRIES (INC.,-)	-11996	-11921	-351	-3590	-4213	-3766	-1457	-1468	504
B. LIABILITIES TO PRIVATE NONBANKS IN FOREIGN COUNTRIES (INC. CUSTODY LIAB.)	2324	1013	-517	934	-515	1111	1042	-40	150
2. PRIVATE SECURITIES TRANSACTIONS, NET - EXCL. U.S. TREAS	-3349	2329	1671	-807	-565	2031	1355	739	519
A. FOREIGN NET PURCHASES OF U.S. CORP. BONDS	256	1221	440	213	203	366	161	138	157
B. FOREIGN NET PURCHASES OF U.S. CORP. STOCKS	1037	4182	1997	346	37	1801	975	396	562
C. U.S. NET PURCHASES(-) OF FOREIGN SECURITIES	-4641	-3074	-766	-1367	-805	-135	219	206	-200
3. FOREIGN NET PURCHASES OF U.S. TREASURY OBLIGATIONS 1/	4821	2676	3301	-1264	-254	894	145	504	-30
4. CHANGE IN FOREIGN OFFICIAL RESERVE ASSETS IN U.S. (INCREASE+)	-13,108	14,831	-7,382	7,051	7,748	7,413	5,812	1,116	-1,610
BY AREA									
A. G-10 COUNTRIES AND SWITZERLAND	-21,151	2,511	-10,686	1,272	1,381	5,526	5,458	-125	1,468
B. OPEC	6,540	12,025	3,275	4,200	3,932	617	991	-314	-159
C. ALL OTHER COUNTRIES	1,502	5,315	30	1,579	2,436	1,270	-637	1,554	-2,920
BY TYPE									
D. U.S. TREASURY SECURITIES 2/	-21,636	9,681	-5,356	4,358	3,769	6,914	5,013	206	1,169
E. OTHER 3/	8,528	5,150	2,026	2,693	3,979	499	799	910	-2,779
5. CHANGE IN U.S. RESERVE ASSETS (INCREASE-) 4/	-306	-7,800	-2,535	-452	-1,051	-3,762	-1,706	-1,083	-1,560
6. TRADE BALANCE 5/	-29,386	-27,354	-10,848	-7,503	-2,858	-6,145	-2,148	-2,624	-2,901
7. ALL OTHER TRANSACTIONS AND STATISTICAL DISCREPANCY	-26,584	45,099	7,108	25,881	8,768	3,341	-2,494	8,004	-280
MEMO:									
BIL. $ SEASONALLY ADJ. ANNUAL RATES									
MERCHANDISE TRADE BALANCE	-29.4	-27.4	-43.4	-30.0	-11.4	-24.6	-25.8	-31.5	-34.8
CURRENT ACCOUNT BALANCE	-0.7	0.1	-10.5	-9.8	18.0	2.7	n.a.	n.a.	n.a.

1/ INCLUDES U.S. TREASURY NOTES PUBLICLY ISSUED TO PRIVATE FOREIGN RESIDENTS.
2/ INCLUDES NON-MARKETABLE AND MARKETABLE SECURITIES.
3/ INCLUDES DEPOSITS IN BANKS, COMMERCIAL PAPER, ACCEPTANCES, & BORROWING UNDER REPURCHASE AGREEMENTS.
4/ INCLUDES NEWLY ALLOCATED SDR OF $1,139 MILLION IN JANUARY 1979, 1,152 MILLION IN JANUARY 1980, AND 1,093 MILLION IN JANUARY 1981.
5/ INTERNATIONAL ACCOUNTS BASIS, SEASONALLY ADJUSTED.

Economic activity remains weak in the major European countries and to some extent in Japan. Industrial production fell in December and January in the United Kingdom and Italy and, on balance, in Germany and France. This followed fourth quarter declines in real GNP in those countries (except Italy, where data are not yet available). Real GNP data for Japan show a decrease in the growth rate in the fourth quarter to about 2 percent (s.a.a.r.). In contrast, real growth for the same period in Canada recovered sharply to 8 percent (s.a.a.r.).

The rate of price inflation in recent months in Japan remained moderate while, except for the January/February WPI data, inflation has been declining in the United Kingdom since mid-1980. In the other major foreign countries inflation in the past two months remained high (Canada and Italy) or even rose further (Germany, France and Switzerland).

The current account moved into surplus in Canada in the fourth quarter of 1980 and remained in substantial surplus in the United Kingdom in January-February. The trade deficits of France and Italy declined in recent months. In sharp contrast, the traditional German trade surplus virtually disappeared in January and the German current-account deficit was exceptionally large at $2.5 billion. The Japanese current-account deficit increased somewhat in February, but is still quite low relative to levels reached in the first half of 1980.

Several of the major foreign industrial countries recently announced policy changes. In Japan authorities announced a decrease in the discount rate and other measures to expand domestic demand. Elsewhere policy moves were generally restricitive. In the United Kingdom and Canada the policy actions included new lower targets for the growth of money. Italian

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

		1978	1979	1980	1979 Q2	1979 Q3	1979 Q4	1980 Q1	1980 Q2	1980 Q3	1980 Q4	1980 Oct.	1980 Nov.	1980 Dec.	1981 Jan.
Canada:	GNP	3.4	2.6	0.1	-0.2	1.1	0.5	-0.6	-1.1	0.4	2.0	*	*	*	*
	IP	5.3	2.1	-1.5	-0.1	1.8	-0.5	-0.6	-2.5	-0.1	2.3	0.4	0.3	0.2	-0.9.
France:	GDP	3.7	3.4	1.5	0.5	2.1	0.4	0.6	-0.9	0.5	-0.2	*	*	*	*
	IP	1.9	4.7	-1.0	1.3	3.8	-2.2	0.5	-2.2	0.8	-2.7	1.6	-3.8	5.6	-6.8
Germany:	GNP	3.6	4.5	1.8	2.2	0.8	0.5	2.1	-1.9	0.0	-0.7	*	*	*	*
	IP	2.3	5.2	0.2	3.4	1.6	0.3	1.6	-2.4	-2.2	-1.3	1.7	-1.6	-2.2	1.8
Italy:	GDP	2.6	5.0	n.a.	-0.6	1.2	3.9	2.0	-0.9	-2.5	n.a.	*	*	*	*
	IP	1.9	6.5	5.8	-2.6	1.4	8.5	4.2	-2.7	-7.6	5.3	1.3	4.2	-6.0	-1.2
Japan:	GNP	6.0	5.9	5.5	1.7	1.7	1.1	1.8	0.8	1.5	0.6	*	*	*	*
	IP	6.2	8.3	7.1	2.2	2.0	2.6	4.1	0.2	-2.3	1.6	0.8	-1.5	2.3	0.6
United Kingdom:	GDP	3.1	1.5	n.a.	3.4	-2.1	1.2	-0.5	-1.6	-1.7	n.a.	*	*	*	*
	IP	3.6	2.7	-6.8	4.0	-1.9	0.0	-2.3	-3.1	-3.4	-2.6	-0.6	-0.1	-0.9	-1.3
United States:	GNP	4.8	3.2	-0.2	-0.4	1.0	0.2	0.8	-2.6	0.6	0.9	*	*	*	*
	IP	5.8	4.4	-3.6	-0.3	0.2	-0.1	0.0	-5.2	-1.7	4.9	1.9	1.7	1.0	0.4

* GNP data are not published on monthly basis.

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

	1979		1980				1980			1981		MEMO: Latest 3 Months from Year Ago
	Q3	Q4	Q1	Q2	Q3	Q4	Oct.	Nov.	Dec.	Jan.	Feb.	
Canada: CPI	2.0	2.3	2.2	2.8	2.8	2.8	0.9	1.2	0.6	1.3	1.0	11.8
WPI	2.7	3.6	4.9	1.4	2.5	3.1	1.4	0.8	0.2	n.a.	n.a.	12.4
France: CPI	3.2	2.8	3.8	3.1	3.2	2.8	1.1	0.7	0.9	1.2	n.a.	13.3
WPI	2.8	1.9	3.1	0.8	0.6	3.6	2.5	0.2	0.6	1.4	n.a.	8.1
Germany: CPI	1.2	0.9	1.9	1.8	0.7	0.8	0.2	0.6	0.6	0.8	0.7	5.6
WPI	1.7	1.1	3.9	1.7	-0.2	0.7	0.3	1.4	1.4	0.9	1.3	6.1
Italy: CPI	3.5	5.6	6.5	3.9	4.3	5.3	1.7	2.1	1.2	1.9	1.8	20.3
WPI	4.3	5.6	6.6	3.6	2.3	3.8	0.7	2.2	1.4	1.6	n.a.	16.7
Japan: CPI	0.9	1.9	2.0	3.0	1.1	1.2	0.4	0.1	-0.5	1.3	0.4	6.9
WPI	4.9	4.3	6.4	4.8	0.7	-0.7	-0.7	0.1	-0.2	-0.5	-0.2	6.7
United Kingdom: CPI	6.7	2.8	4.7	5.8	2.2	1.9	0.6	0.8	0.5	0.6	0.9	13.5
WPI	5.0	3.0	5.3	4.0	2.3	1.2	0.4	0.3	0.3	1.4	1.0	11.5
United States: CPI(SA)	3.3	3.4	3.9	3.1	1.9	3.1	1.0	1.1	1.0	0.7	1.0	11.8
WPI(SA)	2.9	3.7	3.9	2.5	3.3	2.0	0.9	0.5	0.5	0.9	0.8	11.0

TRADE AND CURRENT-ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES[a]
(Billions of U.S. dollars; seasonally adjusted)

			1979				1980				1980	1981	
	1979	1980	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Dec.	Jan.	Feb.
Canada: Trade	3.4	6.9	0.6	0.6	0.9	1.3	1.5	1.1	1.8	2.5	0.6	0.6	n.a.
Current Account	-4.2	-1.3	-1.2	-1.3	-0.9	-0.8	-0.7	-0.9	-0.1	0.4	*	*	*
France: Trade[b]	-2.4	-14.2	0.3	-0.4	-1.4	-1.3	-3.5	-3.6	-3.9	-3.1	-0.9	-1.3	-0.7
Current Account[b]	1.1	- 7.3	0.5	0.4	0.6	-0.4	-2.4	-1.2	-1.9	-1.6	*	*	*
Germany: Trade	12.2	5.1	4.3	4.0	2.3	1.6	1.7	1.3	1.2	0.9	0.2	0.1	n.a.
Current Account (NSA)	-5.6	-15.6	1.6	-1.6	-4.7	-0.8	-3.2	-3.7	-6.9	-1.9	-0.3	-2.5	n.a.
Italy: Trade	-5.3	-22.8	-0.1	-0.4	-1.5	-3.3	-4.1	-4.2	-9.3	-5.2	-0.9	-1.8	n.a.
Current Account (NSA)	5.1	n.a.	1.3	2.3	3.0	-1.5	-2.5	-1.9	n.a.	n.a.	*	*	*
Japan: Trade[b]	1.8	2.1	2.5	1.9	-1.0	-1.6	-1.9	-0.9	1.6	2.8	1.2	1.3	1.1
Current Account	-8.8	-10.8	0.1	-0.7	-3.9	-4.2	-5.1	-4.1	-1.6	0.4	0.0	0.0	-0.4
United Kingdom: Trade	-7.1	2.3	-3.2	-1.1	-1.1	-1.7	-1.4	-0.7	1.5	3.0	0.8	1.8	0.7
Current Account[b]	-3.5	6.5	-1.9	-0.5	0.1	-1.3	-0.2	-0.2	2.1	4.5	1.3	2.5	1.4
United States: Trade	-29.4	-27.4	-5.1	-8.1	-7.1	-9.2	-10.8	-7.5	-2.9	-6.1	-2.6	-2.9	n.a.
Current Account	-0.7	0.1	1.4	-1.5	1.1	-1.7	-2.6	-2.4	4.5	0.7p	*	*	*

a The current account includes goods, services, and private and official transfers.
b Quarterly data are subject to revision and are not consistent with annual data.
* Comparable monthly current account data are not published.
p preliminary.

authorities raised the discount rate and increased reserve requirements on incremental deposits. In Germany the Lombard rate was effectively raised by closing the normal Lombard facility and opening a new special facility. In addition central bank rates were increased in France, the Netherlands, Belgium (twice) and Switzerland (twice) during February and March.

In Japan recently-released GNP statistics confirm that real growth slowed significantly in the fourth quarter to only 2 percent (s.a.a.r.), due in large part to continued softness in private consumption expenditure. Private fixed investment and real exports remained relatively brisk, although growing resistance in Japan's overseas markets contributed to slower export expansion than earlier in 1980. Downward adjustments of inventory levels appear to be taking longer than expected.

In the face of this sluggishness in demand, as well as a continued easing of price pressures, the Japanese authorities in early March announced a package of measures designed to stimulate the economy -- including a one percentage point cut in the discount rate to 6.25 percent and reductions in reserve requirements. The package also includes an acceleration of public-works expenditure, measures to promote housing, and special favorable financing for industrial plant exports.

Still air -
A tethered kite flutters
and climbs higher still;
February Japan! Jiyū jin, XX Century

Prices have continued the moderating trend seen in recent months. In February, the Japanese WPI fell by 0.2 percent, and consumer prices moved upward in line with the 5-6 percent annual rate of increase of

recent quarters.

The current-account deficit widened slightly in February to $400 million (s.a.) following a small deficit of $30 million in January. Export growth was offset primarily by a deterioration of the services and transfers account to a record $1-1.2 billion deficit. The latter reflects, in large part, interest payments on the swelling stock of Japanese liabilities held abroad.

On March 10 the U.K. government presented its budget for the fiscal year beginning in April. Selected excise taxes were raised substantially; a one-time special tax on banks' non-interest-bearing deposit liabilities was imposed (a kind of windfall-profits tax); and the personal income tax schedule was deliberately not adjusted for inflation (by virtue of action by Parliament overriding existing law). Real government spending will be essentially unchanged in FY1981-82 from FY1980-81 levels, and the public sector borrowing requirement is forecast to decrease by £ 3 billion to £ 10.5 billion (4-1/4 percent of GDP). The Bank of England's Minimum Lending Rate was lowered from 14 to 12 percent and a new target for sterling M3 of 6-10 percent annual growth from February 1981 to April 1982 was set. The previous target was 7-11 percent for 1980-81 but was substantially exceeded.

Real activity in the United Kingdom continues to fall, but there are some preliminary indications from data on employment vacancies that decline may be nearing its end. Based on preliminary data, real GNP declined 1 percent (s.a.) in the fourth quarter of 1980 while the unemployment rate rose from 8.8 in December to 9.9 in March. The U.K. inflation rate has fallen substantially during the recession. In the

six months to February 1981 consumer prices increased only 8.5 percent (a.r.) in contrast to the 23 percent (a.r.) increase in the 6-month period ending June 1980. However, so far this year, both CPI and WPI have been accelerating somewhat. The current account continues to reflect the reduced level of domestic activity. In the first two months of the year the surplus was nearly $4 billion.

The pace of economic activity in Germany remains low. The seasonally adjusted rate of unemployment in February was 4.6 percent, compared with a year-earlier rate of 3.6 percent. The overall order volume rose slightly in January, due to a 6.5 percent increase in orders from abroad.

Consumer price inflation accelerated in the first two months of this year to an annual rate of 9 percent, compared with 5.5 percent annual rate in the fourth quarter of last year. As the annual wage negotiations are moving closer to their (mostly April) deadlines, only one major industry has settled. This settlement, a contract for construction workers with a 4 percent wage increase, is not considered pace-setting because of above average unemployment in that industry. Negotiations with the key metal workers' union are deadlocked and warning strikes by 120,000 workers in several Volkswagen plants have taken place.

The current account recorded another large deficit in January. At $2.5 billion, this is among the largest monthly deficits on record. The January trade balance also showed a deficit, $0.5 billion (equivalent to $0.1 billion s.a.).

In a major move to stop the depreciation of the D-mark, the Bundesbank closed its regular Lombard credit facility and eliminated the last remaining controls on capital imports on February 19. Lombard credit

has been available only overnight under a special Lombard facility. This facility was opened and closed several times in late February, resulting in considerable fluctuation of money market rates, but has remained open since March 31; the call money rate has remained close to the special Lombard rate of 12 percent. Prior to February 19, the Lombard rate had been 9 percent.

In Canada, real GNP rose 8 percent (s.a.a.r.) in the fourth quarter. This increase was primarily the result of a sharp rise in real merchandise exports of almost 9 percent. In February the unemployment rate fell to 7.2 percent from 7.3 percent in January. This is the lowest rate since December 1979 and represents the second consecutive monthly decline.

Consumer price inflation for the three-month period ending in February was almost 12 percent (a.r.) slightly higher than the rate for three months.

In the fourth quarter of 1980, the current account rose by $520 million to a surplus of $410 million. This sharp swing into surplus was primarily the result of a 10 percent increase in the value of exports which outpaced a 6.5 percent rise in imports.

On February 13, the Bank of Canada announced a reduction in its target range for M1 growth from 5-9 to 4-8 percent; the new base is the average level of M1 for three months centered on September 1980. On March 1, the Province of Alberta put into effect the first stage of oil production cutbacks in response to the Trudeau Government's National Energy Program a program which raises federal taxes on oil revenues and retards the rate at which domestic oil prices are allowed to reach

world market prices.

French real GNP declined slightly in the fourth quarter of 1980. Consumer prices rose over 13 percent in 1980 (December to December) and accelerated from a year-end slowdown to about the same rate in January. Wholesale price inflation increased to over 13 percent in the last quarter of 1980 and first month of 1981. The continued rapid pace of price increase is due to previous oil price rises and associated administered price increases. The trade deficit in the three months ending February was $2.9 billion, a decrease from the $3.6 billion rate of the previous three months.

French M2 growth from December 1979 to December 1980 was 9.6 percent, below the target (upper limit) of 11 percent set for that year. The target has been lowered to 10 percent for this year. The French raised their money market intervention rate from 10.75 to 12 percent in several steps the last ten days of February in response, at least in part, to interest rate increases in other countries.

In Italy industrial production, which has oscillated sharply since last spring, fell in December-January. Despite the latest two month's data, an end to the decline in real activity is suggested by the most recent business surveys, which indicate a less pessimistic outlook. The inflation rate has shown little sign of abating; consumer prices rose 1.9 percent in January, following a quarterly rent adjustment and a large jump in electricity and fuel prices, and a further 1.8 percent in February. The trade deficit narrowed in November-January to a monthly average of $1.4 billion, compared with a monthly average deficit of $3 billion in July-October.

In early February the Bank of Italy announced measures to tighten the limits on the expansion of bank credit by ending the exemption for small loans and foreign currency lendings. On March 22, in conjunction with the lira's devaluation in the EMS, the Italian authorities raised the discount rate from 16.5 to 19 percent and increased reserve requirements on incremental deposits from 15.75 to 20 percent. These measures were taken because of the persistance of high inflation and weakness of the lira.

In Switzerland inflation accelerated sharply in January and February. The consumer price index rose at an average annual rate of 12 percent in those two months, thereby raising the year-over-year inflation rate to 6 percent for February. In response to the higher domestic inflation and to higher interest rates abroad, the Swiss National Bank raised its discount rate to 3.5 percent on February 3 and to 4.0 percent on February 19.