Prefatory Note

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

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

---

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

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

Confidential (FR) Class II FOMC

December 16, 1981

RECENT DEVELOPMENTS

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

TABLE OF CONTENTS

TABLE OF CONTENTS (cont.)

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	Nov.	12-4-81	107.0	3.3	1.6	1.7
Unemployment rate (%) 1/	Nov.	12-4-81	8.4	8.0	7.2	7.5
Insured unemployment rate (%) 1/	Nov.	12-14-81	4.1	3.7	3.4	3.8
Nonfarm employment, payroll (mil.)	Nov.	12-4-81	91.6	-3.1	-1.5	.8
Manufacturing	Nov.	12-4-81	20.0	-11.2	-9.1	-.7
Nonmanufacturing	Nov.	12-4-81	71.5	-.8	.7	1.2
Private nonfarm:						
Average weekly hours (hr.) 1/	Nov.	12-4-81	35.1	35.0	35.2	35.3
Hourly earnings ($) 1/	Nov.	12-4-81	7.44	7.39	7.34	6.90
Manufacturing:						
Average weekly hours (hr.) 1/	Nov.	12-4-81	39.3	39.5	40.0	39.8
Unit labor cost (1967=100)	Oct.	11-30-81	215.5	11.2	12.2	7.8
Industrial production (1967=100)	Nov.	12-16-81	146.5	-24.9	-18.5	-1.8
Consumer goods	Nov.	12-16-81	144.7	-22.8	-13.1	-2.3
Business equipment	Nov.	12-16-81	178.2	-19.2	-13.4	2.5
Defense & space equipment	Nov.	12-16-81	104.6	6.9	7.0	4.3
Materials	Nov.	12-16-81	144.9	-32.2	-26.5	-3.5
Consumer prices all items (1967=100)	Oct.	11-24-81	280.0	4.3	9.5	10.1
All items, excluding food & energy	Oct.	11-24-81	265.6	5.0	10.2	10.9
Food	Oct.	11-24-81	279.4	3.4	8.2	5.7
Producer prices: (1967=100)						
Finished goods	Nov.	12-9-81	275.2	6.1	5.0	7.1
Intermediate materials, nonfood	Nov.	12-9-81	315.7	5.3	2.9	8.7
Crude foodstuffs & feedstuffs	Nov.	12-9-81	243.6	-25.6	-28.1	-14.0
Personal income ($ bil.) 2/	Nov.	11-18-81	2,476.7	7.0	9.6	10.8
				(Not at annual rates)		
Mfrs. new orders dur. goods ($ bil.)	Oct.	12-3-81	78.4	-9.1	-12.6	-5.9
Capital goods industries	Oct.	12-3-81	25.1	-15.1	-15.4	-1.9
Nondefense	Oct.	12-3-81	21.3	-7.4	-12.0	-1.4
Defense	Oct.	12-3-81	3.8	-41.9	-30.5	-4.4
Inventories to sales ratio: 1/						
Manufacturing and trade, total	Oct.	12-14-81	1.48	1.44	1.40	1.41
Manufacturing	Oct.	12-3-81	1.69	1.64	1.60	1.59
Trade	Oct.	12-14-81	1.30	1.25	1.23	1.24
Ratio: Mfrs.' durable goods inventories to unfilled orders 1/	Oct.	12-3-81	.597	.583	.571	.557
Retail sales, total ($ bil.)	Nov.	12-11-81	87.5	.8	-1.3	5.7
GAF 3/	Nov.	12-11-81	18.4	.2	-1.5	4.4
Auto sales, total (mil. units.) 2/	Nov.	12-3-81	7.7	6.9	-24.0	-15.6
Domestic models	Nov.	12-3-81	5.4	5.4	-32.1	-17.6
Foreign models	Nov.	12-3-81	2.3	10.9	6.1	-10.4
Plant & Equipment expen. ($ bil.)4/						
Total nonfarm business	1981	12-10-81	322.61	--	--	9.1
Manufacturing	1981	12-10-81	128.26	--	--	10.7
Nonmanufacturing	1981	12-10-81	194.35	--	--	8.1
Capital Appropriations, Mfg.	1981-Q3	12-2-81	26,843	-5.6	--	27.1
Housing starts, private (thous.) 2/	Oct.	11-18-81	.857	-6.8	-18.1	-43.6
Leading indicators (1967=100)	Oct.	11-30-81	128.1	-1.8	-4.5	-5.1

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

The deterioration in economic activity evident since late last summer has intensified and spread to most sectors of the economy. Industrial production declined more sharply in November than in previous months, and cutbacks in employment occurred in a wide range of industries. Activity in the ailing auto and housing sectors continued to weaken, and consumer confidence reached its lowest level since the 1980 recession. Weakness in demand spread to the cyclically sensitive capital goods sector; business equipment spending registered a precipitous decline in October. Demand has fallen more rapidly than production, and as a result there has been sizable and widespread accumulation of inventories. Although recent reports have revealed substantial price increases for some producer and consumer items, overall price increases are still moderating.

Industrial Production and Capacity Utilization

Industrial production fell 2.1 percent in November, the largest of four consecutive monthly declines. As in September and October, reductions in output were widespread among products and materials. Output of durable consumer goods dropped sharply; auto assemblies plummeted to an annual rate of 4.8 million units, and output of consumer trucks dropped 12 percent. Consumer nondurable goods output fell in November and remained below its third-quarter average.

Output of business equipment declined again in November, as the slump in economic activity spread to most of its components. Business vehicle production was particularly hard hit. The pace of business equipment output appears likely to continue declining in the near term;

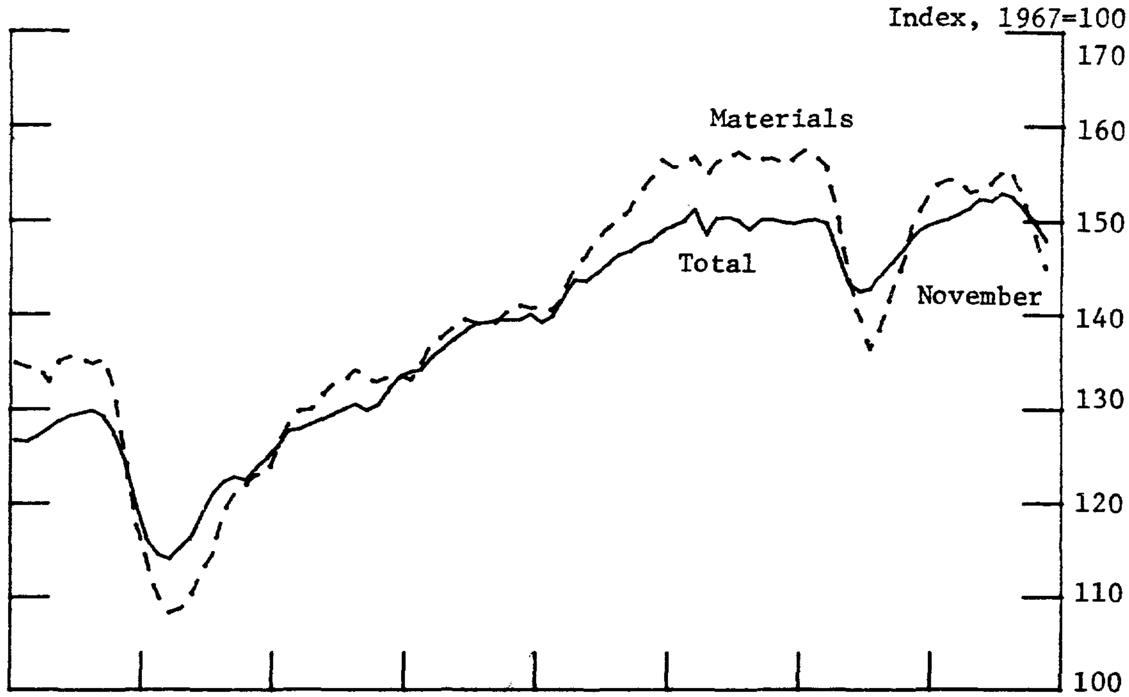
INDUSTRIAL PRODUCTION
(Percentage change from preceding period;
based on seasonally adjusted data)

	1981 Q1	1981 Q2	1981 Q3	1981 Sept.	1981 Oct.	1981 Nov.
	---annual rate---			---monthly rate---		
Total	8.4	1.9	1.5	-1.2	-1.4	-2.1
Final products	3.8	7.1	1.0	-.8	-.5	-1.5
Consumer goods	1.4	6.3	-1.2	-.9	-.5	-1.9
Durable	1.1	14.5	-9.0	-1.5	-2.6	-6.0
Nondurable	1.5	3.4	1.9	-.8	.4	-.4
Business equipment	9.1	9.4	3.8	-1.0	-.8	-1.6
Defense and space eq.	2.0	4.1	5.0	.7	.5	.6
Construction supplies	17.8	-7.4	-8.7	-3.1	-3.8	-2.1
Materials	13.4	-1.9	2.4	-1.8	-2.3	-2.7
Durable goods	19.6	3.7	1.1	-2.6	-2.9	-3.9
Nondurable goods	6.7	-1.7	-5.7	.1	-2.4	-2.0
Energy materials	8.6	-16.6	22.5	-2.7	-.5	-.5

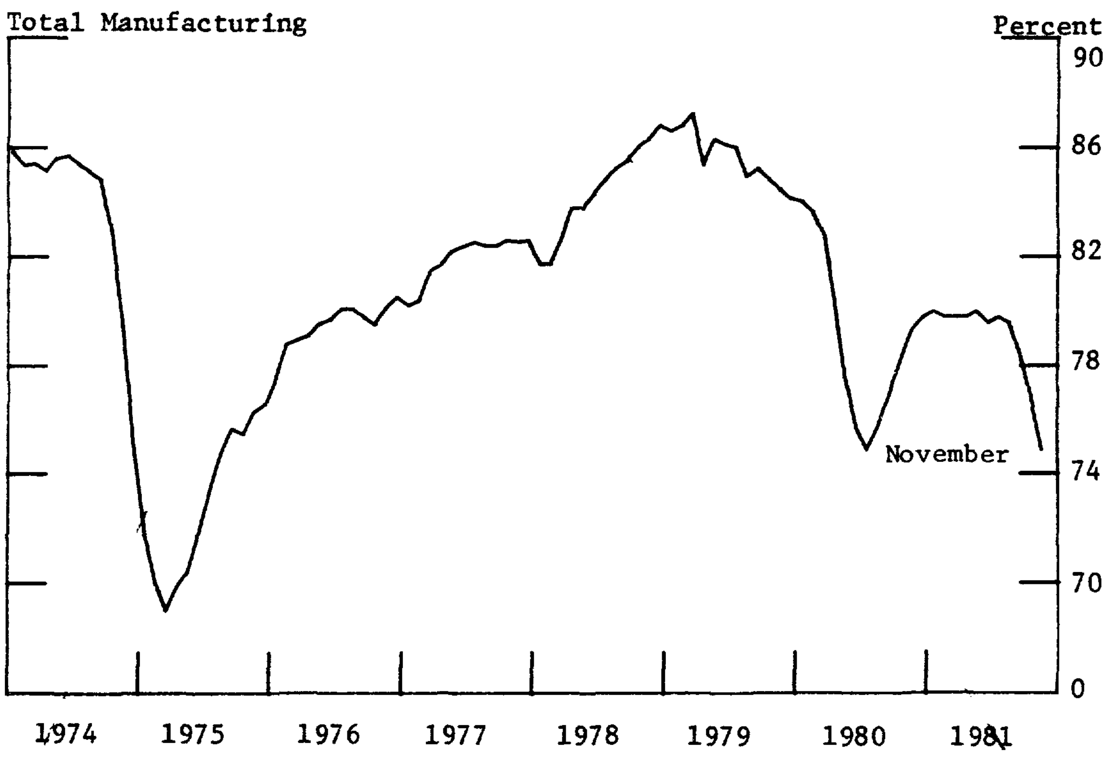
CAPACITY UTILIZATION RATES: MANUFACTURING AND MATERIALS
(Percent, seasonally adjusted)

	1978-80 High	1980 Low	1981 Q2	1981 Q3	1981 Oct.	1981 Nov.
Manufacturing industries	87.2	74.9	79.8	79.3	76.9	74.9
Primary processing	90.1	71.0	80.3	79.4	75.6	72.8
Advanced processing	86.2	77.2	79.6	79.2	77.5	76.0
Motor vehicles & pts.	94.5	51.0	65.5	60.4	55.0	50.5
Materials producers	88.8	73.8	81.2	81.2	78.0	75.8
Durable goods mats.	88.4	68.2	79.0	78.7	75.0	71.9
Raw steel	100.7	55.3	83.7	81.4	73.5	69.5
Nondurable goods mats.	91.6	77.5	85.3	83.3	80.7	78.7
Energy materials	88.8	82.7	81.1	85.0	82.6	82.1

INDUSTRIAL PRODUCTION



CAPACITY UTILIZATION



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

	1979	1980	1981 Q2	1981 Q3	1981 Sept.	1981 Oct.	1981 Nov.
	-Average monthly changes-						
Nonfarm payroll employment[2]	170	34	89	139	132	-235	-237
Strike adjusted	176	28	117	122	147	-250	-258
Manufacturing	-5	-58	78	24	-9	-269	-189
Durable	1	-47	60	11	-21	-203	-155
Nondurable	-6	-12	18	13	12	-66	-34
Construction	15	-12	-44	-4	-3	-12	-18
Trade	30	12	27	52	10	38	-84
Finance and services	84	79	76	83	119	1	42
Government	27	13	-55	-45	-12	27	0
Private nonfarm production workers	103	-9	110	159	148	-268	-262
Manufacturing production workers	-16	-67	57	12	-13	-263	-193
Total employment[3]	172	-42	-7	-41	-674	-53	-192
Nonagricultural	174	-48	-3	-56	-615	-79	-218

1. Average change from final month of preceding period to final month of period indicated. These figures are revised to reflect new seasonal factors and the 1980 benchmark to the establishment survey data.
2. Survey of establishments. Strike-adjusted data noted.
3. Survey of households.

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

	1979	1980	1981 Q2	1981 Q3	1981 Sept.	1981 Oct.	1981 Nov.
Total, 16 years and older	5.8	7.1	7.4	7.2	7.5	8.0	8.4
Teenagers	16.1	17.7	19.2	18.7	19.3	20.6	21.8
20-24 years old	9.0	11.5	12.4	11.7	12.1	12.8	13.0
Men, 25 years and older	3.3	4.7	4.8	4.8	5.0	5.5	5.8
Women, 25 years and older	4.8	5.5	5.7	5.7	5.9	6.1	6.4
White	5.1	6.3	6.5	6.2	6.5	6.9	7.4
Black and other	11.3	13.2	13.7	14.6	15.1	15.5	15.5
Fulltime workers	5.3	6.8	7.1	6.9	7.2	7.7	8.1
White collar	3.3	3.7	4.0	4.0	4.1	4.1	4.2
Blue collar	6.9	10.0	9.8	9.6	10.2	11.1	11.8

capital goods inventories have accumulated for several months, and recent commitments data suggest further weakening in capital goods spending. Output of construction supplies also weakened again--continuing the sizable declines in recent months.

Capacity utilization in manufacturing has fallen sharply since August and in November was about 75 percent, close to its July 1980 low. This operating rate is below levels reached in November 1970 and only 6 percentage points above the post-war record low reached in March 1975. Capacity utilization in the motor vehicles and parts sector slipped to nearly 50 percent, the lowest level since the General Motors strike in 1970.

Employment and Unemployment

Labor demand deteriorated further in November, and the unemployment rate increased to 8.4 percent, 1.2 percentage points higher than three months earlier. About three-fourths of the November rise in unemployment resulted from layoffs. The unemployment rate for men aged 25 and over climbed to 5.8 percent--just below the peak attained in 1975, reflecting large cutbacks in manufacturing jobs. Nonwhite unemployment remained at a record 15-1/2 percent.

As reported by the establishment survey, total nonfarm employment fell nearly 240,000, about the same as in October. Cutbacks were widespread; employment in the trade sector fell for the first time since the June 1980 trough. Retail stores were cautious about pre-Christmas hiring, and their employment declined 86,000 on a seasonally-adjusted basis. Two-thirds of the November reduction occurred in the cyclically sensitive durable goods sector, as production adjustments followed

PERSONAL INCOME
(Based on seasonally adjusted data)

	1979	1980	1981 Q2	1981 Q3	1981 August	1981 Sept.	1981 Oct.
	- - - - Percentage changes at annual rates[1] - - - -						
Total personal income	12.3	11.0	8.7	13.0	12.6	8.9	7.0
Wage and salary disbursements	10.8	9.0	6.8	8.7	12.4	6.2	4.8
Private	11.6	9.2	7.2	9.3	14.5	4.1	1.3
Disposable personal income							
Nominal	11.7	10.9	8.0	11.8	10.9	7.8	14.4
Real	2.0	.8	1.4	2.6	4.7	-2.3	n.a.
	- - - - - Changes in billions of dollars[2] - - - - -						
Total personal income	18.3	18.7	14.6	26.0	25.3	18.2	14.3
Wage and salary disbursements	10.3	9.8	7.0	11.4	15.4	7.9	5.9
Private	8.9	8.1	5.9	9.6	14.6	4.2	1.3
Manufacturing	2.0	2.3	3.1	1.9	3.0	-.3	-2.8
Other income	8.9	9.6	7.8	15.3	10.9	10.6	9.0
Transfer payments	2.8	4.1	1.5	5.8	.4	1.7	1.6
Less: Personal contributions for social insurance	.9	.8	.2	.7	.9	.2	.7
Memorandum:							
Personal saving rate[3]	5.2	5.6	5.4	5.1	5.1	5.4	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.

weak October sales and sizable accumulations of inventories. Large declines occurred in employment in the metals, machinery, and transportation equipment industries, and construction employment--already below last year's trough--fell another 18,000. The factory workweek declined 0.2 hours in November and was a full hour below the peak reached in May 1981.

Personal Income and Consumer Spending

Personal income growth slowed in October to an annual rate of only 7 percent. Reflecting the reduction in employee hours reported in October, private wage and salary disbursements rose at only a 1.3 percent annual rate; this compares with an increase of 10 percent recorded over the preceding twelve months. Government payrolls were boosted by the October 1 pay raise, and interest income continued to grow rapidly. Despite the small increase in October incomes, disposable personal income rose at a 14.4 percent annual rate because of the federal tax cut. With disposable income rising and consumer outlays falling, the saving rate jumped to 6-1/2 percent from September's 5-1/4 percent.

Consumer demand was weak in November. A rise in retail sales of 0.8 percent can be attributed to a slight increase in auto sales and a rise in the price of gasoline. Excluding sales of automotive products, gasoline, and nonconsumption items, spending at retail level was essentially unchanged for the third consecutive month. Sales of largely discretionary goods, such as general merchandise, apparel, and furniture and appliances, edged up only slightly after sizable reductions in the two preceding months. Sales of new domestic autos edged up slightly to

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

	1981						
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Total sales	4.9	-.4	2.3	1.4	.1	-2.1	.8
(Real)[1]	2.9	-1.7	.5	1.2	-.8	-2.4	n.a.
Total, less autos and nonconsumption items	3.5	1.0	1.1	.9	.3	-.1	.5
Total, exc. auto group, gasoline, and nonconsumption items	3.3	1.1	1.3	1.2	.0	.1	.2
GAF[2]	3.1	1.1	.6	2.8	-.9	-.7	.2
Durable goods	8.5	-4.1	5.2	2.5	-.2	-7.3	1.4
Automotive	10.0	-5.6	9.8	4.6	-.6	-9.7	1.7
Furniture & appliances	4.4	-2.6	.2	4.4	.6	-2.7	2.4
Nondurable goods	3.3	1.3	1.0	.9	.3	.3	.5
Apparel	5.1	-.5	2.3	1.0	.2	-1.6	.1
Food	2.1	2.3	2.2	2.0	-1.4	.9	.8
General merchandise[3]	1.8	3.2	.1	2.9	-1.9	.4	-.6
Gasoline	4.9	.1	-.1	-.7	2.4	-1.0	2.5

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)

	1981						
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Total	10.0	7.9	9.0	10.1	8.8	7.2	7.6
Foreign-made	2.7	2.3	2.1	2.1	2.0	2.0	2.3
U.S.-made	7.3	5.6	6.9	7.9	6.9	5.1	5.4
Small	3.9	2.9	3.5	4.1	3.5	2.6	2.8
Intermediate & standard	3.4	2.8	3.4	3.9	3.5	2.5	2.6

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

a rate of 5.4 million units a year, and foreign car sales were about the same as their rate over the last six months. In the first ten days of December, sales of new domestic autos eased back to a 5.2 million unit rate.

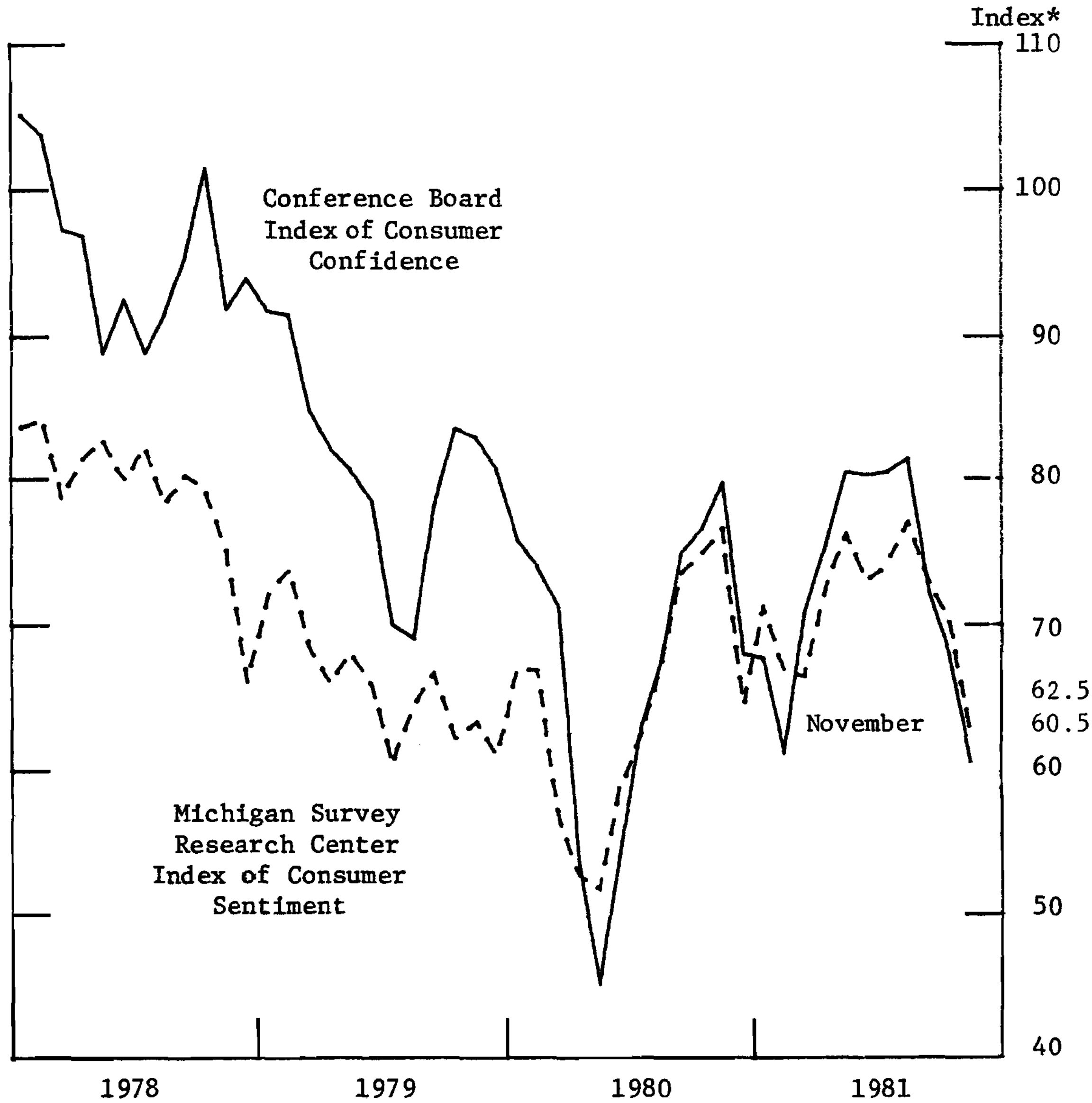
Consumers evidently have become more cautious about discretionary expenditures in recent months. According to both the University of Michigan and the Conference Board surveys, consumer confidence declined to its lowest level since mid-1980. Attitudes about the purchase of cars, houses, and large household durables were again very negative. Questions in the University of Michigan survey revealed widespread concern about high interest rates, high prices, and rising unemployment. The survey also reported that more respondents deferred major purchases because of high interest rates.

Business Fixed Investment

Capital spending fell sharply in October, reflecting the sustained weakness in demand and low capacity utilization rates. Shipments of nondefense capital goods--about 80 percent of producers' durable equipment in GNP--declined 3-1/2 percent. Machinery shipments were down 2-1/4 percent, and purchases of heavy weight trucks were reduced sharply. Construction expenditures for structures declined a bit further, but oil and gas well drilling rose substantially.

Data on fixed investment commitments in October suggested a further weakening of capital goods outlays. Contracts and orders for plant and equipment fell almost 4 percent in October, the eighth reduction this year and the fourth consecutive monthly decline. A decline of 7-1/2 percent in new orders for nondefense capital goods swamped a rise in the

CONSUMER ATTITUDES



* Michigan Survey Research Center Index of Consumer Sentiment (1966-Q1=100) and Conference Board Index of Consumer Confidence (1969-1970=100). Bases of indexes are derived from responses (favorable minus pessimistic) to five equally weighted questions. Questions in the two indexes are different. Beginning May 1981 the sample includes all types of households, prior to that families only.

value of construction contracts. Permits for nonresidential construction dropped almost 25 percent in October, offsetting a similar rise in the previous month.

In contrast to other indicators, the Commerce Department's survey of plant and equipment spending, taken in late October and November, reported that businesses were planning to increase expenditures for new plant and equipment at a 14 percent annual rate over the first half of 1982. This survey, however, has a history of considerably overstating actual expenditures during cyclical downturns. Two private surveys of plans for fixed capital expenditures suggest real outlays in 1982 will be no higher than in 1981.

Housing

High mortgage rates and low house sales continued to depress housing production in October. Total private housing starts fell to a seasonally adjusted 857,000 unit annual rate, the second lowest monthly rate since 1946. This weakness was concentrated in the single-family units, which plunged 25 percent to a new record low for this series. A rise in multifamily starts partially offset the decline in single-family units. A part of this increase represented the beginning of construction on HUD-subsidized rental units authorized near the close of the 1981 fiscal year.

Sales of both new and existing houses remained at low levels in October. Sales of new houses rose 15 percent, but they remained more than a third below last year's pace, while sales of existing houses dropped below the 2 million unit annual rate--the slowest pace since

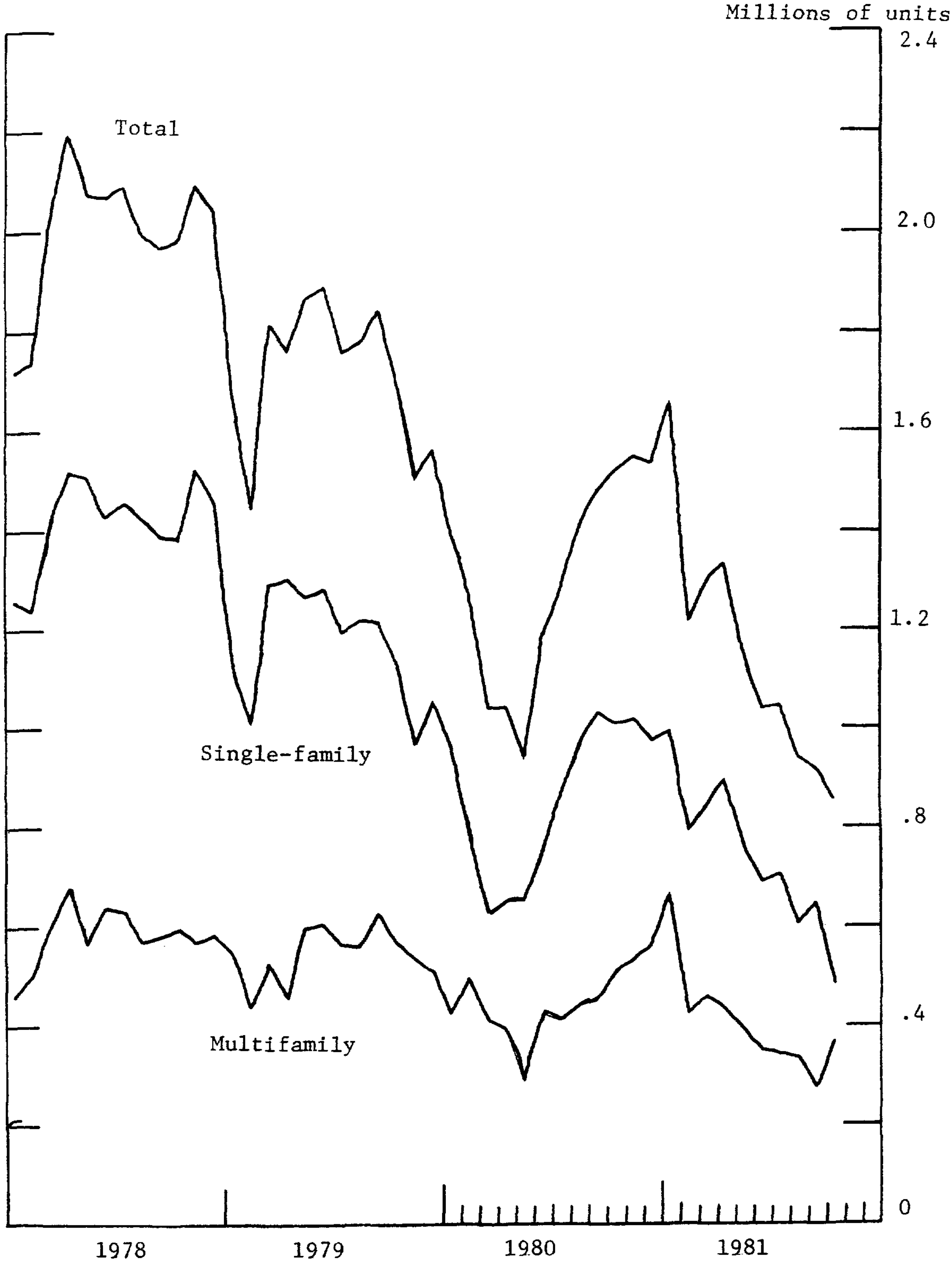
BUSINESS CAPITAL SPENDING INDICATORS
(Percentage change from preceding comparable period;
based on seasonally adjusted data)

	1981					
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Nondefense capital goods shipments						
Current dollars	1.4	3.2	.9	2.7	.1	-3.5
Addendum: Sales of heavy-weight trucks (thousands)	247	226	232	235	256	196
Nonresidential construction						
Current dollars	8.0	1.7	3.6	.6	.0	-.4
Addendum: Oil and gas well drilling (millions of feet)	24.7	30.1	26.7	25.1	25.6	36.6

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

	1981					
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Nondefense capital goods orders						
Current dollars	1.2	1.9	.2	2.0	-6.8	-7.4
Machinery						
Current dollars	1.1	3.1	.4	7.7	-2.1	-9.7
Addenda: Ratio of current dollar unfilled orders to shipments						
Total	6.32	6.10	6.00	6.01	5.94	6.05
Machinery	4.68	4.62	4.50	4.45	4.48	4.51
Nonresidential building permits						
Current dollars	10.1	.5	14.5	-18.4	24.1	-24.4

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



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

	1980	1981					
Type of unit	Annual	Q1	Q2	Q3	Aug.	Sept.	Oct.[1]
Total							
Permits	1.19	1.18	1.11	.88	.87	.85	.73
Starts	1.29	1.39	1.18	.97	.94	.92	.86
Single-family							
Permits	.71	.69	.64	.49	.49	.45	.40
Starts	.85	.87	.78	.65	.61	.65	.49
Sales							
New homes	.53	.51	.44	.36	.35	.31	.36
Existing homes	2.88	2.54	2.59	2.28	2.26	2.05	1.92
Multifamily							
Permits	.48	.49	.47	.38	.37	.40	.33
Starts	.44	.52	.39	.32	.34	.27	.37
Mobile home shipments	.22	.25	.26	.24	.23	.24	n.a.

1. Preliminary estimates.

early 1971. This depressed sales volume was accompanied by a continued deceleration in measured house price increases. Average prices for existing houses increased 4 percent at an annual rate over the first ten months of this year, considerably less than the 14 percent rise during 1980. Likewise, the rise in new house prices declined to a 5 percent annual rate from 12 percent last year.

While sales of new housing units have been low, production adjustments generally have prevented a significant buildup of unsold units. The end-of-period stock of unsold units declined in October for the sixth consecutive month to its lowest level in a decade. Accompanying this decline, however, was an increase in the ratio of completed unsold new units to all unsold units. The median number of months that completed units have remained unsold rose to 8.1 months, significantly above the high of 7.2 months reached in the 1974-75 recession.

Inventory Investment

Despite sizable production cutbacks, business inventories have continued to accumulate at a fairly rapid pace. In October, the book value of manufacturing and trade inventories rose at a $58 billion annual rate. Stock building by manufacturers moderated a little in October, but substantial buildups were reported by several major durable goods industries where in recent months shipments have been weak and orders declining.

In the trade sector, auto dealers' inventory positions improved a little in November. At the end of the month, dealers' new car stocks were reduced to a level equal to 86 days of supply, down from the 95 days one month earlier. Outside of autos, a further rise in general

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

	1979	1980	1981 Q1	Q2	Q3(r)	Aug.	Sept.(r)	Oct.(p)
Book Value Basis								
Total	49.0	31.0	41.1	35.0	55.6	52.3	68.1	57.9
Manufacturing	31.5	16.4	34.2	12.7	27.6	17.9	39.1	20.9
Durable	23.7	10.2	18.5	9.8	25.9	16.4	35.0	18.5
Nondurable	7.8	6.2	15.7	3.0	1.8	1.5	4.0	2.4
Wholesale	10.3	11.7	.0	6.7	8.3	17.0	17.7	22.8
Retail	7.2	2.9	6.8	15.6	19.6	17.4	11.3	14.2
Automotive	1.4	-2.3	-3.5	12.2	7.3	7.3	-.2	.3
Gen. Merchandise	1.1	1.4	3.1	2.6	5.5	2.6	8.1	8.8
Constant Dollar Basis								
Total	7.2	-2.5	-1.3	11.0	11.3	7.2	13.3	n.a.
Manufacturing	6.8	-1.0	4.6	.9	5.2	.4	9.0	n.a.
Wholesale	.4	.6	-1.6	3.2	1.2	7.2	3.3	n.a.
Retail	-.1	-2.2	-4.3	6.9	4.9	-.5	1.1	n.a.
Automotive	-.3	-1.2	-5.9	5.7	.0	-2.7	-3.6	n.a.

INVENTORIES RELATIVE TO SALES[1]

	1980 Cyclical Peak[2]	1981 Q1	Q2	Q3(r)	Aug.	Sept.(r)	Oct.(p)
Book Value Basis							
Total	1.53	1.39	1.41	1.44	1.42	1.44	1.48
Manufacturing	1.76	1.61	1.60	1.63	1.61	1.64	1.69
Durable	2.36	2.09	2.05	2.13	2.10	2.15	2.25
Nondurable	1.18	1.11	1.12	1.11	1.10	1.11	1.12
Wholesale	1.21	1.08	1.11	1.14	1.14	1.13	1.18
Retail	1.44	1.31	1.36	1.39	1.37	1.38	1.42
Automotive	2.01	1.47	1.77	1.72	1.69	1.70	1.88
Gen. Merchandise	2.28	2.22	2.21	2.34	2.24	2.35	2.41
Constant Dollar Basis							
Total	1.76	1.63	1.66	1.69	1.69	1.69	n.a.
Manufacturing	2.11	1.97	1.95	1.99	1.99	2.00	n.a.
Wholesale	1.45	1.33	1.40	1.42	1.43	1.41	n.a.
Retail	1.48	1.36	1.42	1.43	1.42	1.43	n.a.
Automotive	2.05	1.51	1.84	1.71	1.70	1.67	n.a.

1. Ratio of end-of-period inventories to average monthly sales for the period.
2. Highs are specific to each series and are not necessarily coincident.
(r) Revised estimates.
(p) Preliminary estimates.

merchandise stocks pushed their book-value inventory-to-sales ratio in October to 2.41, matching their previous cyclical high recorded in November 1974. Merchant wholesalers' inventories also increased sharply in October, with about four-fifths of the accumulation in durable stocks. Stocks of automotive products, electrical goods, and machinery rose substantially; distribution centers for steel and nonferrous metals also reported sizable buildups.

Federal Government

The federal unified budget deficit in September and October totaled $11.2 billion, essentially the same as in the comparable 1980 period. Growth of receipts slowed a little, particularly in October, as a result of the tax cut, a smaller increase in personal income, and an apparent decline in corporate profits. Outlays in September and October also increased at a slightly lower rate, reflecting budget cuts and special factors, such as an unusually large sale of Farmers Home Administration assets. In contrast, outlays by the Defense Department and interest payments on the rising government debt continued to mount.

Program budgets for fiscal year 1982 remain unsettled. Only three appropriation bills (pertaining to the legislative branch, energy and water, and the District of Columbia) have been passed by Congress and signed by the President. Six other bills, including appropriations for Defense and Agriculture, have been passed by Congress and are awaiting Presidential approval. So far this fiscal year, continuing resolutions have been providing funding for government programs. The latest resolution, which has been signed by the President, is for the period December 16 to March 31, 1982; it provides for appropriated nondefense programs that is about $4 billion below the administration's March 1982 budget. When signed into law, new appropriation bills will supersede the funding levels set by the continuing resolution.

State and Local Government

State and local government purchases of goods and services have continued to decline in real terms, reflecting sluggish tax revenue growth, reductions in federal support, and high costs of financing construction projects. Outlays were held below revenues in the third quarter, and the surplus net of social insurance contributions of $4.5 billion (in annual rate terms) was realized.

State and local government construction expenditures, postponable items and often financed by federal grants, fell 4 percent in real terms in October; these outlays so far this year have been well below last year's levels. The recent declines in the Dodge index of public construction contracts suggests that public construction expenditures are not likely to increase in the near term.

State and local government payroll employment was unchanged in November; so far this year 260,000 workers have been dropped from state and local payrolls, largely because of the phase-out of federally-funded CETA jobs. This contrasts with average annual employment growth of 3 percent in the 1970s. Currently, nearly 40 percent of state governments have hiring freezes in effect.

Prices

Recent price reports contain some further confirmation of easing inflationary pressures, although the moderation is by no means evident in all sectors. The consumer price index rose .4 percent in October, and in November producer prices for finished goods increased .5 percent.

In the food sector, declining commodity prices were passed on to the retail level in October, as the consumer price index for food rose just 0.3 percent. Apart from a short-lived summer spurt, food price increases have been small for most of this year. At the producer level, declines in crude food and in finished food prices continued in November.

Except for food, producer prices for finished goods increased sharply in November. Prices of both gasoline and natural gas surged, reversing the downward trend in consumer energy prices evident since late last spring. Capital equipment prices, which increased 0.9 percent in October, rose another 0.8 percent in November; these increases were substantially higher than those in the third quarter. Despite these recent increases in particular sectors, the general behavior of prices at the producer level has been relatively good. For the first eleven months of 1981, the producer price index increased at a 7.4 percent per year rate, well below the 11.8 percent rise in 1980.

Declines in homeownership costs and consumer energy prices held down the October rise in the overall consumer price index. Excluding food, energy, and homeownership, the index rose 0.7 percent, roughly in line with increases earlier this year, and substantially lower than the increases in 1980. Consumer food price increases have moderated in recent months and are expected to continue rising very slowly over the near term because prices for farm products fell in November for the fourth consecutive month. Energy prices turned up in October, as pump prices for gasoline failed to register their normal seasonal decline.

SELECTED MEASURES OF COMPENSATION, PRODUCTIVITY, AND COSTS (NONFARM BUSINESS SECTOR)
(Seasonally adjusted annual rates)

		1981					
	1980	Q1	Q2	Q3	Oct.	Nov.	1st three quarters
Wage rate measures:							
Hourly Earnings Index - production workers[1]							
Total private nonfarm	9.6	9.6	8.3	8.3	3.2	10.4	8.8
Manufacturing	10.9	9.3	9.7	8.5	4.5	5.6	9.2
Contract construction	7.6	9.2	4.9	8.9	11.1	5.5	7.6
Transportation and public utilities	9.4	9.4	11.0	6.8	3.5	11.5	9.0
Trade	8.8	9.6	7.1	8.0	-4.8	10.2	8.2
Services	9.5	9.8	8.5	8.8	6.5	14.4	9.0
Employment Cost Index, wages and salaries - all persons[2]							
Total	9.0	10.5	8.7	8.0	n.a.	n.a.	9.0
By Occupation:							
White collar	8.7	11.9	8.7	7.1	n.a.	n.a.	9.2
Blue collar	9.6	8.7	9.0	9.6	n.a.	n.a.	9.1
Service Workers	8.1	11.7	6.7	7.7	n.a.	n.a.	8.7
By Bargaining Status:							
Union	10.9	8.6	10.1	10.3	n.a.	n.a.	9.7
Nonunion	8.0	11.3	7.9	7.0	n.a.	n.a.	8.7
Compensation measures:							
Employment Cost Index, compensation rates - all persons[3]							
Total	9.8	15.2	7.8	8.2	n.a.	n.a.	10.4
Labor Productivity and Costs - all persons[1]							
Compensation per hour	10.1	11.6	9.6	9.3	n.a.	n.a.	10.2
Output per hour	.1	4.3	1.4	-1.6	n.a.	n.a.	1.2
Unit labor costs	9.9	7.0	8.1	11.1	n.a.	n.a.	8.8

1. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Quarterly changes are at compound rates; monthly changes are not compounded.
2. Percent change from final month of previous period, compounded. Seasonal adjustment by FRB staff.
3. Percent change from final month of previous period, compounded. Not seasonally adjusted; series was introduced in 1980-Q1.

Wages and Labor Costs

The hourly earnings index for production workers in the nonfarm business sector increased at an annual rate of 10-1/2 percent in November, following several months of relatively small increases. Despite this surge, the index has risen at an annual rate of 8.6 percent over the first 11 months of the year, as compared with a 9.6 percent rise during 1980. The rise in the manufacturing component of the index has declined considerably this year, while the advance in other components has moderated by only half a percentage point. Wage and salary increases for white collar workers, as reported in the employment cost index, were smaller in the third quarter than earlier in the year. However, because of a large bulge in the first quarter, white collar salaries have grown faster over the first three quarters of 1981 than they did in 1980.

Although wage inflation has declined a little so far this year, smaller pay increases have been offset by a large boost in social security taxes. Increases in hourly compensation in the nonfarm business sector eased to a 9.3 percent annual rate in the third quarter, making the rate of increase so far this year about the same as over 1980.

Labor productivity declined in the third quarter following a half year of increases above the recent trend rate of 0.7 percent per year. Because little of the rise in compensation has been offset by productivity gain, unit labor costs increased at an annual rate of 8-3/4 percent over the first three quarters of 1981, following a 1980 rise of about 10 percent.

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

	1981 Highs	1981 FOMC Nov. 17	1981 Intermtg. Lows	1981 Dec. 15	Change from: 1981 Highs	Change from: FOMC Nov.17	Change from: Intermtg. Low
Short-term rates							
Federal funds[2]	20.06	13.17	12.04	12.25p	-7.81	-.92	.21
Treasury bills							
3-month	17.01	10.63	9.94	10.89	-6.12	.26	.95
6-month	15.93	11.08	10.34	11.41	-4.52	.33	1.07
1-year	15.21	11.00	10.42	11.42	-3.79	.42	1.00
Commercial paper							
1-month	18.63	12.11	11.17	12.44	-6.19	.33	1.27
3-month	18.29	11.84	11.04	12.27	-6.02	.43	1.23
6-month	17.44	11.63	10.96	12.30	-5.14	.67	1.34
Large negotiable CDs[3]							
1-month	18.90	12.16	11.16	12.39	-6.51	.23	1.23
3-month	19.01	12.21	11.23	12.49	-6.52	.28	1.26
6-month	18.50	12.41	11.64	12.95	-5.55	.54	1.31
Eurodollar deposits[2]							
1-month	19.80	12.98	11.86	13.08	-6.72	.10	1.22
3-month	19.56	13.09	12.16	13.38	-6.18	.29	1.22
Bank prime rate	21.50	16.50-17	15.75	15.75	-5.75	-1.00	0
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	16.59	12.85	12.54	13.45	-3.14	.60	.91
10-year	15.84	13.18	12.92	13.55	-2.29	.37	.63
30-year	15.20	13.25	12.76	13.30	-1.90	.05	.54
Municipal (Bond Buyer)	13.21	11.43[4]	n.a.	12.89[4]	-.32	1.46	—
Corporate Aaa							
New issue	17.62	—	14.62	15.42p[5]	-2.20	—	.80
Recently offered	17.72	15.10	14.52	15.25e	-2.47	.15	.73
Primary conventional mortgages	18.63	18.02[6]	16.90	16.94[6]	-1.69	-1.08	.04

	1981 Highs	1981 FOMC Nov. 17	1981 Dec. 15	Percent change from: 1981 Highs	Percent change from: FOMC. Nov. 17
Stock Prices					
Dow-Jones Industrial	1,024.05	850.17	875.95	-14.5	3.0
NYSE Composite	79.14	70.39	71.35	-9.8	1.4
AMEX Composite	380.36	311.25	317.80	-16.4	2.1
NASDAQ (OTC)	223.47	197.68	195.16	-12.7	-1.3

1. One-day quotes except as noted.
2. Averages for statement week closest to date shown.
3. Secondary market.
p—Preliminary. n.a.—not applicable
4. One-day quotes for preceding Thursday.
5. Average for preceding week.
6. One-day quotes for preceding Friday.
e—Estimated.

The monetary aggregates grew rapidly in November and early December, paced by strength in several of the most liquid types of assets. M1-B accelerated markedly and, with a sharp increase in the nontransaction component of M2 as well, that broader aggregate expanded at its strongest pace of the year. M3 growth also picked up in November, as the surge in M2 more than offset an increased runoff of large time deposits.

Interest rates initially continued to fall after the November FOMC meeting, as bank reserve positions eased further and market participants focused on weak economic indicators. The rally faltered, however, owing to concern about the rise in the monetary aggregates and disappointment that the federal funds market had not eased still more. As anxiety mounted, the prospective volume of corporate, municipal and, especially, Treasury borrowing became more troubling; an administration estimate that the 1982 federal deficit will exceed $100 billion was particularly unsettling to market participants.

On balance, the federal funds rate is down a percentage point from its level at the time of the last FOMC meeting, as is the discount rate, but other short-term rates have risen 1/4 to 1/2 of a percentage point. Most bond yields are unchanged to 1/2 percentage point higher; yields on municipal bonds are up by 1-1/2 points. The yield curve has maintained a considerable upward slope at the short end, reflecting a prevailing expectation that interest rates will rise further in the months ahead--about 2 percentage points by year-end 1982 in the case of 3-month Treasury bills. Meanwhile, moving in lagged response to the earlier drop in bond

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

	1981						QIV '80 to Nov. '81
	Q1	Q2	Q3	Sept.	Oct.	Nov.	
	---- Percentage change at annual rates ----						
Money stock measures							
1. M1-A	-20.8	-5.3	-3.6	-7.9	2.3	3.3	-7.2
2. (Adjusted)[2]	(-1.7)	(5.1)	(-1.4)	(-4.9)	(2.5)	(8.0)	(1.2)
3. M1-B	4.9	8.7	0.3	-2.8	3.3	10.3	4.7
4. (Adjusted)[2]	(-0.8)	(5.3)	(-0.6)	(-3.7)	(3.1)	(8.2)	(1.9)
5. M2	8.3	10.6	7.1	6.5	8.1	16.4	9.6
6. M3	12.4	10.6	10.3	9.2	5.6	12.3	11.2
Selected components							
7. Currency	5.5	7.9	5.0	-1.0	3.0	5.9	5.5
8. Demand deposits	-32.9	-11.8	-8.0	-11.7	1.5	1.5	-13.0
9. Other checkable deposits	372.3	107.4	21.5	23.7	8.3	46.2	175.5
10. M2 minus M1-B (11+12+13+16)	9.4	11.3	9.4	9.5	9.6	18.4	11.2
11. Overnight RPs and Eurodollars, NSA[3]	0.0	58.9	13.9	-104.5	-121.0	25.5	3.4
12. Money market mutual fund shares, NSA	84.5	113.7	88.2	95.7	71.8	73.6	130.2
13. Commercial banks	6.0	4.2	6.7	6.5	10.6	15.5	7.3
14. savings deposits	-30.5	-11.9	-19.6	-22.4	-19.0	13.9	-16.9
15. small time deposits	30.2	13.4	21.0	20.1	24.7	16.3	23.4
16. Thrift institutions	3.5	- 0.3	-2.9	-0.2	1.4	6.1	0.6
17. savings deposits	-29.6	-12.6	-23.0	-22.0	-17.6	-3.4	-18.6
18. small time deposits	19.0	4.7	5.1	7.6	8.6	9.2	9.5
19. Large time deposits	39.6	10.3	25.3	13.4	-4.8	-16.1	19.5
20 at commercial banks, net[4]	40.6	10.1	27.3	11.7	-11.1	-23.3	18.8
21. at thrift institutions	34.7	11.2	15.1	24.3	26.2	18.6	22.8
22. Term RPs, NSA	18.1	12.2	43.6	93.4	-20.4	31.1	26.7
	—Average monthly change in billions of dollars--						
MEMORANDA:							
23. Managed liabilities at commercial banks (24+25)	4.3	9.0	6.6	0.5	-4.8	-2.5	5.3
24. Large time deposits, gross	5.1	7.5	7.0	2.8	-1.2	-3.3	5.3
25. Nondeposit funds	-0.8	1.5	-0.4	-2.3	-3.6	0.8	0.0
26. Net due to related foreign institutions, NSA	-1.6	0.7	1.1	-1.2	-4.5	-1.0	-0.5
27. Other[5]	0.7	0.9	-1.6	-1.1	0.9	1.9	0.5
28. U.S. government deposits at commercial banks[6]	1.1	-0.3	-0.7	-0.3	3.4	-0.5	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 77-1/2 percent of inflows into other checkable deposits--in excess of "trend"--was from demand deposits in January, and 72-1/2 percent in subsequent months.
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. Excludes retail RPs.
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. Changes since October 1980 are partially estimated.
6. Consists of Treasury demand deposits at commercial banks and Treasury note balances.

yields, the commitment rate for new conventional mortgages has declined more than a percentage point since mid-November.

Aggregate business borrowing increased in November, as a surge in issuance of corporate bonds more than offset a continued reduction in shorter-term borrowing. States and localities, too, increased their issuance of longer-term debt, and the federal government continued to borrow heavily to finance its deficit. Reduced consumer spending has been accompanied by slower growth of consumer installment debt, however, and mortgage formation remains depressed.

Monetary Aggregates and Bank Credit

M1-B, adjusted for shifts to NOW accounts, accelerated in November to an 8-1/4 percent annual rate as a result of a large rise in other checkable deposits and stronger currency growth. Despite the jump in November, however, shift-adjusted M1-B has expanded at less than a 2 percent annual rate thus far this year and therefore remains well below the Committee's target range for 1981. Growth of M2 soared in November to a 16-1/2 percent rate, reflecting strength in both its M1-B and nontransaction components. M2 has grown at a 9-1/2 percent annual rate since the fourth quarter of 1980, above the upper end of its target range.[1]

Given the inherent volatility of the aggregates, the November surge in money growth may represent simply statistical noise. However, it is possible to pinpoint some reasons why monetary growth might have picked up at this time. First, while the elasticities are uncertain, the decline in short-term interest rates since mid-summer has appreciably reduced the

1. A review of the growth of various measures of money and bank credit in 1981 appears in Appendix III-A.

opportunity cost of holding cash--perhaps enough to offset the effects of weaker income and spending on transactions demands for money.[1] Second, it would not be surprising if the public built up holdings of short-term, liquid assets in view of uncertainties about income and employment prospects and the possibility that interest rates might rebound substantially once again.[2]

Several categories of such liquid assets grew impressively in November, including other checkable deposits, savings deposits, money market mutual funds, overnight RPs, and Eurodollars. The increase in savings deposits broke a steady decline that began 14 months ago. Similar upticks in savings deposits have occurred in some other periods--such as mid-1980--when a "temporary parking" motive would seem likely to have been strong.

Inflows to money market mutual funds also have been encouraged by the fact that fund yields have declined more slowly than current market rates. Throughout November, the average yield on money fund shares was about 250 basis points above the coupon-equivalent rate on 3-month Treasury bills. Apart from the normal effects of accounting, the relative yield on fund shares has benefited from the lengthening of the average maturity of fund portfolios from the 25-day low reached in June of this year to 37 days. With the yield curve now upward sloping, this allows them to pay somewhat higher rates than they otherwise could.

---

1. With a lag, lower interest rates can also enhance monetary growth through an increase in compensating balance requirements as banks adjust their earnings credit rates on customer balances.
2. November's bulge in other checkable deposits is likely a result of such behavior rather than a shift of balances into newly opened NOW accounts. An informal survey conducted by the Reserve Banks suggested that the shift of balances to newly opened NOWs is drawing to an end. The survey also indicated an absence of a clear trend in pricing NOW accounts, although several districts reported some reductions in minimum balance requirements.

ESTIMATED INFLOWS TO MMCs, SSCs, ASCs, AND RETAIL RPs
(Month-end basis, $ billions)

	MMCs		SSCs		ASCs		Retail RPs	
	Thrifts	CBs	Thrifts	CBs	Thrifts	CBs	Thrifts	CBs
July	4.6	7.2	0.1	0.5	-	-	2.9	1.0
August	-0.5	7.1	8.0	2.6	-	-	1.9	1.0
September	-4.5	1.8	11.6	6.2	-	-	2.0	1.1
October	-14.9	-6.5	11.1	5.4	19.8	12.8	-2.1	0.4
November[p]	-6.0	-3.2	6.4	3.9	3.3	4.2	-0.3	0.2

p--preliminary.

On a monthly average basis, small-denomination time deposits continued to rise at a fairly brisk pace in November; however, there was a weakening of inflows in the latter part of October that carried through November. Small Savers Certificates (SSCs), which had paced the growth in small time deposits since the removal of the cap on their yields in August, slowed in November, perhaps reflecting the payment of lower-than-maximum rates by a growing number of institutions. Flows into All Savers Certificates (ASCs) fell off sharply during November following the surge that accompanied their introduction in October. In contrast, Money Market Certificate (MMC) runoffs moderated as fewer deposits were transferred to the other account categories; reportedly, almost all institutions are paying the ceiling on MMCs, which by virtue of a new averaging option now more closely follows yields on MMMFs.[1]

1. As of November 1, the ceiling interest rate for MMCs is the higher of the most recent auction average discount rate on six-month Treasury bills plus 25 basis points, and the average of the most recent four auction average rates on six-month bills plus 25 basis points, for bill rates above 9 percent.

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

	1981						Nov. 80 to Nov. 81[e]
	Q1	Q2	Q3	Sept.	Oct.	Nov.[e]	
	------ Commercial Bank Credit ------						
1. Total loans and investments at banks[2]	7.8	8.2	9.1	10.6	8.5	3.4	8.6
2. Investments	10.5	6.5	3.8	.4	9.1	-1.7	6.5
3. Treasury securities	14.8	15.7	-5.7	-18.1	-5.1	-38.9	2.5
4. Other securities	8.0	1.7	9.1	11.4	16.1	17.4	8.6
5. Total loans[2]	6.8	8.9	11.0	14.3	8.2	5.2	9.3
6. Business loans[2]	6.5	11.9	20.5	19.0	13.0	2.6	12.9
7. Security loans	27.3	53.2	-54.5	47.5	19.6	102.7	21.6
8. Real estate loans	9.5	7.2	8.5	9.2	6.5	5.6	8.5
9. Consumer loans	-1.4	-1.4	0.0	1.4	1.4	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)	13.7	15.8	26.6	26.9	n.a.	n.a.	n.a.
11. Business loans net of bankers acceptances	5.5	10.6	22.3	20.5	13.0	4.4	13.3
12. Commercial paper issued by nonfinancial firms[3]	29.6	42.4	61.5	87.0	7.0	50.7	44.0
13. Sum of lines 11 & 12	8.2	14.1	26.6	28.7	12.5	10.6	16.6
14. Line 13 plus loans at foreign branches[4]	11.3	14.0	28.4	30.2	16.3	14.4	18.6
15. Finance company loans to business[5]	8.5	19.3	14.7	1.5	3.0	n.a.	n.a.
16. Total bankers acceptances outstanding[5]	35.6	23.1	28.9	33.3	n.a.	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 ks.
Based on average of current and preceding ends of months.
n.a.—not available. e--estimated.

As noted above, the acceleration of M2 expansion more than offset a faster runoff of large time deposits, leading to a pickup of M3 growth in November. The decline in large time deposits was limited to commercial banks, since thrifts continued to issue these deposits at the appreciable pace of recent months. The drop at commercial banks likely was a result of stronger inflows to core deposits together with a weaker demand for bank credit. Other managed liabilities increased slightly as a reduction in borrowing from foreign offices was more than offset by an increase in other nondeposit funds.

Bank credit growth slowed markedly in November to a 3-1/2 percent annual rate, the weakest pace since March. Holdings of U.S. government securities fell sharply, while total loan growth slowed for the second consecutive month. The principal area of weakness in the loan category was business loans, which expanded at only a 2-1/2 percent annual rate, down from 13 percent in October. Real estate loans decelerated a bit in November but an advance in security loans accompanied a buildup of securities dealer positions.

Business Finance

Overall business borrowing appears to have picked up in November, and its composition changed appreciably, as longer-term financings surged while shorter-term borrowing dropped further. Public offerings of corporate notes and bonds soared to a record $8.2 billion, seasonally adjusted--four times its pace in October and more than twice as large as in any previous month this year. The step-up in volume was distributed about equally between offerings by industrial and financial corporations; utility issues continued at about the average pace of earlier months. Most of November's

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

	1981					
	Q1	Q2	Q3	Oct.p	Nov.p	Dec.f
	Seasonally adjusted					
Corporate; securities--total	5,942	6,886	4,176	3,850	10,325	6,600
Publicly offered bonds[1]	3,443	3,007	1,603	2,000	8,200	4,800
Privately placed bonds	523	843	759	700	700	700
Stocks	1,976	3,036	1,814	1,150	1,425	1,100
	Not seasonally adjusted					
Publicly offered bonds--Total[1]	3,038	3,597	1,676	2,150	6,700	3,500
By Industry						
Utility	1,125	1,275	960	1,395	1,250	--
Industrial	1,289	1,383	345	275	2,650	--
Financial	624	939	371	480	2,800	--
By quality[2]						
Aaa and Aa	914	1,246	685	610	3,675	--
A and Baa	1,728	1,663	627	1,325	2,200	--
Less than Baa[3]	396	688	364	215	825	--
Memo Items:						
Convertible bonds	439	491	150	155	330	--
Original discount bonds						
Par value	167	1,175	343	135	3,500	--
Gross proceeds	85	480	173	107	1,601	--
Stocks--total	1,889	2,850	1,681	1,400	1,300	1,300
By Industry						
Utility	499	1,012	711	500	700	--
Industrial	1,186	1,425	567	500	400	--
Financial	204	413	403	400	200	--

p--preliminary. f--forecast.
1. Total reflects gross proceeds rather than par value of original discount bonds.
2. Bonds categorized according to Moody's bond ratings.
3. Includes issues not rated by Moody's.

new issues were intermediate-term, straight debt offerings. Original issue discount bonds were very popular, with the proceeds of 12 such issues accounting for nearly one-fourth of total offerings. In early December, the pace of corporate bond offerings slowed in response to the increase in interest rates, but the volume for December as a whole may still approach $5 billion, seasonally adjusted.

Business loan growth at large banks and U.S. offices of foreign-related institutions slowed sharply in November. Other forms of short-term business borrowing, however, were more robust, reflecting the widening spread between the prime and market interest rates. For example, issuance of commercial paper picked up in November and loans to U.S. residents by foreign branches of U.S. banks rose substantially. Meanwhile, business loan growth moderated only slightly at small banks, possibly because of the lack of alternative sources of funds for many customers of those institutions.

Stock offerings totaled $1.4 billion in November, seasonally adjusted, up from October but still below the record pace of the first three quarters of the year. Share prices generally have increased slightly on average since the mid-November FOMC meeting; this continues the irregular advance that began in late September. Even so, the major composite indexes remain well below their summer peaks.

Although the recent declines in interest rates may provide some relief for business borrowers, available data indicate that firms remain under considerable stress in the current economic environment. Business failures rose to a near-term peak in October and remained quite high in November. Business bankruptcy filings also have been fluctuating at high

FEDERAL GOVERNMENT AND SPONSORED AGENCY FINANCING[1]
(Total for period; billions of dollars)

		1981			1982
	FY81	Nov.[e]	Dec.[e]	Q4[e]	Q1[f]
Treasury financing					
Combined surplus/deficit(-)	-78.9	-13.6	-21.0	-53.4	-27.2
Means of financing deficit:					
(1) Net cash borrowing from the public	79.4	10.8	15.0	36.2	33.7
Marketable borrowings/ repayments(-)	88.9	11.0	15.7	37.5	36.4
Bills	23.0	4.8	11.2	21.7	17.7
Coupons	65.9	6.2	4.5	15.8	18.7
Nonmarketables	-9.5	-.2	-.7	-1.3	-2.7
(2) Decrease in the cash balance	2.3	8.5	-2.6	8.3	.5
(3) Other means of finance[2]	-2.7	-5.7	8.5	8.9	-7.0
Federally sponsored credit agencies net cash borrowing[3]	37.5	-.3	1.5	3.8	4.0

e--estimated. f--forecast.
1. Numbers reported on a not seasonally adjusted, payment 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, Federal National Mortgage Association, and the Federal Farm Credit Banks System.

levels, with such filings in October only 6 percent below the historic record set in February. Furthermore, nearly three-fifths of the bankers contacted in the November Survey of Senior Loan Officer Opinion reported a deterioration in the financial condition of an above-normal proportion of customers to whom they had loans outstanding, and two-fifths reported a deterioration in the financial condition of new loan applicants.[1] Nevertheless, yield spreads between higher- and lower-rated issues of corporate bonds and commercial paper have not increased recently, although they remain relatively wide.

Government Finance

The Treasury borrowed heavily in November and early December to help finance a record fourth-quarter deficit of $53 billion (combined on- and off-budget), with about $12 billion of this due to an accelerated social security payment at the end of the quarter. To finance the deficit and a continued runoff in nonmarketable debt, the Treasury will borrow a record $38 billion in the market in the current quarter.[2] It will finance the remainder of the deficit by a reduction in its cash balance and through "other means of finance."[3] Marketable borrowing in the fourth quarter

1. For additional detail on these and other results of the survey, see Appendix III-B.
2. About half of the paydown in nonmarketable debt has been due to a continued redemption of savings bonds. To help stem net redemptions of savings bonds, the Treasury announced recently that it will seek permission from Congress to index interest payments on new and outstanding savings bonds (EE and the outstanding E bonds) to the market yield on 5-year Treasury securities. The Treasury proposes to set the rate on savings bonds equal to 85 percent of the average yield on 5-year Treasury issues prevailing over the previous six months, with the return being adjusted every six months.
3. The sharp rise in other means of finance in the current quarter reflects the accelerated social security payment at the end of December. Because many of these checks will not be cashed until January, they do not drain Treasury cash until that time, although they are included in December outlays.

should consist of $22 billion of bills and $16 billion in coupons. In the upcoming quarter, the Treasury is expected to borrow another $36 billion in the market to finance an estimated deficit of $27 billion and to offset a further runoff of nonmarketable debt as well as drains on other means of finance. It is expected that this borrowing will be about evenly split between bills and coupons.

Credit demands of federally sponsored credit agencies have continued to diminish with the agencies paying off, on net, about $300 million of debt in November. The redemption mainly reflected a paydown by the Federal Farm Credit Banks; their borrowing is expected to increase again in December. The Federal Home Loan Banks also paid down debt in November, as they made almost no net advances to thrifts. Borrowing by FNMA is estimated at $660 million in November, financing a similar amount of net mortgage purchases. Of this amount, about one-quarter came from sales of special one-year debentures tailored for investment of All Savers funds. In addition to this borrowing, FNMA issued $250 million of pass-through securities on December 2--the first phase of its new program for conventional mortgages. These securities are backed by a pool of low-rate seasoned conventional mortgages purchased by FNMA from S&Ls, banks, and other institutions. The agency guarantees the timely payment of both principal and interest on the securities. FNMA plans to expand its program to include guarantees of securities issued by others against pools of newly originated conventional mortgages.

Gross issuance of long-term municipal securities picked up in November, owing to a rebound in offerings of mortgage revenue bonds. The rebound was caused by several factors, including the decline in rates through mid-month and federal restrictions on annual volume totals for each state that have encouraged issuance of these bonds before year-end.

STATE AND LOCAL GOVERNMENT SECURITY OFFERINGS
(Monthly totals or monthly averages, billions of dollars)

	1980	1981				
	Year	H1	Q3	Oct.	Nov.[e]	Dec.[e]
	------------ Seasonally adjusted -----------					
Total	6.22	6.61	6.46	8.90	7.80	8.00
Long-term	4.03	3.79	3.69	3.30	4.80	3.90
Short-term	2.19	2.82	2.77	5.60	3.00	4.10
	---------- Not seasonally adjusted ---------					
Total	6.22	6.50	6.11	7.30	7.80	6.30
Long-term	4.03	3.87	3.34	3.50	5.00	3.50
Housing revenue bonds	1.28	.38	.24	.10	.90	.25
Short-term	2.19	2.64	2.77	3.80	2.80	2.80

e--estimate.

Municipal bond yields have risen appreciably over the intermeeting period, both absolutely and relative to those on taxable obligations, as the long-term tax-exempt market continues to suffer from a lack of demand by major institutional investors. The ratio of tax-exempt to taxable yields rose to an average 87 percent in November, and by the end of the month it had reached a 9-year high of 90 percent.

Mortgage Markets

Residential mortgage formation has weakened in recent months. Growth in real estate loans at commercial banks slowed to a 6 percent annual rate during October and November, about 2 percentage points below the third quarter's reduced rate of expansion. October data for S&Ls (the latest available) indicate that these institutions reduced their holdings of mortgages by $500 million (seasonally adjusted), one of the few declines recorded in this series in the postwar period. Moreover, the S&Ls continued to extend only a small volume of new commitments, and their outstanding commitments fell to the lowest level since June 1980.

S&Ls have experienced some improvement in the cost and availability of loanable funds of late, however. Consumer-type deposits have shown renewed growth, and the bigger institutions have continued to issue large CDs. These developments have permitted a paydown of FHLB advances and some rebuilding of liquidity.[1] With the improvement in liquidity and reduced earnings pressures, the strongest S&Ls reportedly have been able to issue CDs at a spread of 50 to 75 basis points over the commercial bank CD rate. This is a wider spread than the 25 to 50 basis-point norm of earlier years, but it is well below the 100 to 125 basis-point peak experienced a few months ago.

Recent declines in interest rates also may enhance loan demand a bit. In the primary market for long-term mortgage credit, the commitment rate on fixed-rate, level-payment home loans at sampled S&Ls averaged 16.94 percent in the week ended December 11, down from the peak of 18.63 percent in early October. To bring FHA/VA ceiling rates on fixed-rate level-payment home loans closer in line with market yields, they were lowered by administrative action to 15-1/2 percent from 16-1/2 percent, effective November 16.

Rates on adjustable rate mortgages currently are quoted at approximately 15-1/2 to 16 percent. The FHLBB has begun to collect information

1. The increase in the liquidity ratio of S&Ls reflects, in addition to deposit reflows, the transfer of funds from retail RPs to ASCs, since securities serving as collateral for an RP cannot be counted as part of liquidity for regulatory purposes.

on the proportion of conventional home mortgage loans closed that have adjustable rate features. The data for both October and November show that around 30 percent of all conventional loans closed had some such feature. In November, the proportion was almost 40 percent at S&Ls and over 50 percent at MSBs. Reflecting the slowness with which secondary markets for such instruments have developed, conventional mortgages originated by mortgage bankers remained almost entirely fixed-rate instruments in November.

Consumer Credit

Expansion of consumer installment credit slowed substantially to a 3-3/4 percent annual rate in October, mainly reflecting the sharp curtailment of automobile financing associated with the low level of new-car sales in that month. Revolving credit continued to expand moderately, but all other installment credit contracted. With retail sales sluggish in November and with a further slowdown likely in auto financing, November's overall growth in consumer installment debt probably was slight, at most. Indeed, early estimates suggest a second consecutive month of contraction in consumer loans at commercial banks in November, following four months of growth.

Partly as a result of the limited expansion in installment debt since the beginning of 1980, households in the aggregate appear to have improved some aspects of their financial positions. The ratio of installment debt repayments to disposable personal income declined during the third quarter to its lowest point of the past ten years. In addition, delinquency rates on installment loans have dropped sharply from cyclical peaks recorded in the third quarter of 1980. The American Bankers Association series for

CONSUMER INSTALLMENT CREDIT
(seasonally adjusted annual rates)

	1979	1980	1981 Q2	1981 Q3	1981 Sept.	1981 Oct.
	- - - - - -	- Percent	rate of	growth -	- - - - -	-
Change in outstandings -- total	14.0	0.5	7.1	9.6	10.5	3.7
By type:						
Automobile credit	14.5	0.0	1.0	18.8	22.5	9.3
Revolving credit	19.9	5.5	15.3	8.5	5.8	7.7
All other	12.1	-2.9	13.8	2.2	2.1	-2.9
	- - - - - -	- Billions	of dollars	- - - -	- - - -	-
Change in outstandings -- total	38.4	1.4	22.4	30.5	33.8	12.2
By type:						
Automobile credit	14.7	0.0	1.2	22.4	27.4	11.5
Revolving credit	8.6	2.9	8.8	5.0	3.5	4.7
All other	15.1	-1.5	12.4	3.1	2.9	-4.1
By major holder:						
Commercial banks	18.2	-8.4	1.0	3.0	1.5	-2.1
Finance companies	14.0	8.4	8.9	24.1	32.2	14.4
All other	6.2	1.4	12.5	4.1	0.2	-0.2
Extensions -- total	324.8	305.9	344.1	348.3	353.1	323.4
By type:						
Automobile credit	93.9	83.0	87.9	103.7	110.1	85.7
Revolving credit	120.2	129.6	147.7	146.0	148.0	146.5
All other	110.7	93.3	108.5	98.6	95.0	91.3
Liquidations -- total	286.4	304.5	321.7	317.8	319.3	311.3
Memo: Ratio of liquidations to disposable income (percent)	17.5	16.7	16.2	15.6	15.5	15.0

delinquencies on closed-end installment credit in the third quarter was near its lowest point since 1973, and the auto finance companies are reporting their lowest delinquency rates in nine years.

Series on mortgage delinquencies, in contrast, have risen steadily in 1981. At S&Ls, the proportion of mortgage loans delinquent 60 days or more reached 1.44 percent, seasonally adjusted, in October, about 50 basis points above the series low in 1979 and about 10 basis points below the previous high in 1975. In addition, the Mortgage Bankers Association series for delinquencies edged to a new high in the third quarter.[1]

Personal bankruptcies, meanwhile, have been holding at a high level, in part reflecting the liberalized asset exemptions established by federal law in late 1979 which made bankruptcy less onerous to debtors. After drifting down during the first half of this year, bankruptcies turned up in the third quarter to a level 2 percent above last year's third quarter.

1. Part of the divergence between the mortgage and consumer credit delinquency trends is attributable to the widely different maturity structures of the two types of debt. Consumer debt is of much shorter duration, so that adoption of stringent credit standards by lenders and belt-tightening efforts of households can more quickly redress problem loan situations.

Appendix III-A*

THE GROWTH OF MONEY AND BANK CREDIT IN 1981

With the year drawing to a close, it is possible to review in a preliminary way the 1981 behavior of the monetary aggregates and bank credit in relation to each other and to interest rates and economic activity. While a final appraisal must await at least the availability of additional and revised data on the aggregates and GNP, it is clear that there have been some significant departures from historical norms. These are symptomatic of fundamental changes in financial institutions and practices--changes that have been induced in large measure by high and volatile market interest rates against a backdrop of shifting regulatory controls on the terms at which banks and thrifts can offer deposits.

The following points may be emphasized:

- Demand for M1 has been extraordinarily weak, evidently because high interest rates have stimulated more intensive use of cash-economizing techniques.
- Demand for M2 probably has been a shade stronger than might have been anticipated given the actual behavior of income and interest rates, owing to spreading use of money market mutual funds (MMMFs), liberalization of deposit rate ceilings, and to a small extent the introduction of the All Savers Certificate (ASC)--factors offsetting the depressing impact of retail RPs.
- M3 growth has been quite rapid in 1981, partly because of a pattern of bank liability management that has favored issuance of large time deposits to help finance credit expansion.
- The growth of bank credit this year does not in itself appear unusual. The shortfall of bank credit growth relative to M3 expansion has been a reflection of the growing importance of MMMFs as intermediaries, diverting funds from depository institutions and funneling them to a large extent to the commercial paper market.

Shift-adjusted M1-B this year has been weaker than might be expected from past relationships of M1-B growth to nominal income and interest rates. In 1981, M1-B has expanded at an annual rate of only 2.0 percent (see Table 1)--the slowest growth for any year since the early 1960s and a bit more than a quarter of the rate posted for this aggregate in 1980, even after allowing for the shift into ATS and related accounts last year.[1] NOW accounts increased by a sizable $48-1/4 billion in 1981, bringing not-shift-adjusted M1-B growth to about 4-3/4 percent. About $12-1/4 billion of this increase is estimated to have shifted from interest-earning assets in M2.

---

* Prepared by Sherry S. Atkinson, Economist, Banking Section, Division of Research and Statistics.

1. Shift-adjusted M1-B in 1980 expanded at a 6-3/4 percent annual rate. Monetary growth rates for 1981 are calculated from the fourth quarter of 1980 to the fourth quarter of 1981 and utilize December projections.

Table 1

MONETARY AGGREGATES AND BANK CREDIT
(Q4 to Q4 averages, seasonally adjusted unless otherwise noted)

Year	M1-B	M2	M3	Bank credit	Non-trans-actions component of M2	MMMF assets (NSA)	Savings and small time deposits	Overnight RPs and Euro-dollars (NSA)	Large time deposit component of M3 *	Total term RPs (NSA)	Retail RPs (NSA)
	(Percent annual rates of change)				(Annual flows in billions of dollars)						
1978	8.2	8.3	11.2	13.3	80.2	5.9	69.7	4.6	48.9	6.0	0.2
1979	7.5	8.3	9.8	13.2	96.7	30.7	62.0	4.0	28.6	5.2	0.3
1980	7.3	9.6	10.2	8.0	118.7	36.5	76.4	5.9	28.4	6.0	0.6
1981[1]	1.9[2]	9.5	11.1	8.7	137.6	100.3	36.6	0.7	50.1	9.7	11.5

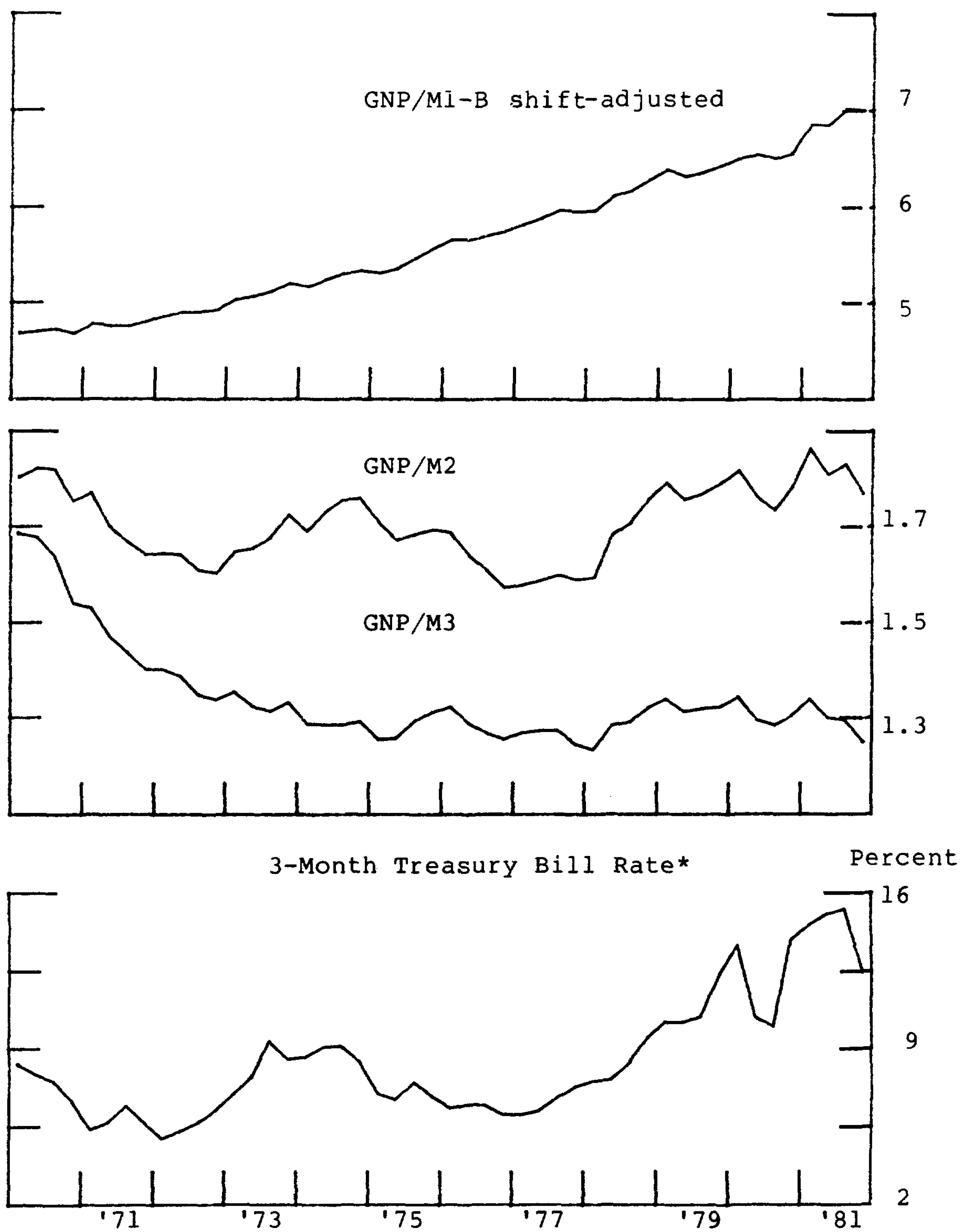
1. Monetary aggregates data for 1981 reflect December projections. Bank credit data are through November 1981.
2. Growth rate of M1-B adjusted for shifts into NOW accounts.
* Net of large-denomination time deposits held by MMMFs and thrift institutions.

This year's narrow money growth (shift-adjusted) has been roughly 6 percentage points weaker than would have been expected on the basis of standard demand-for-money relationships, such as the one in the Board's quarterly model. At the retail level, the introduction of NOW accounts nationwide may have stimulated a general reconsideration of alternative deposit and nondeposit instruments and thereby intensified the response to continued high interest rates this year. More generally, direct and indirect evidence suggests that the M1-B shortfall can be attributed in large measure to greater use of sophisticated cash management techniques, more of which seems to be in train. A variant of the Board's money demand equation--containing a variable measuring interest rate expectations over the intermediate run that is designed to capture the incentive to adopt new cash management methods--predicts the growth in narrow money quite accurately, on net, in 1981.

In past periods of rising interest rates, M2 velocity has risen, reflecting disintermediation (see chart). But the composition of M2 has changed drastically since 1978: its nontransactions component now contains a variety of attractive assets bearing market-related yields. While the velocity of M1-B has increased dramatically, the velocity of M2 appears to have decreased somewhat. Instruments that offer market-determined rates of return have continued to grow rapidly in 1981, insulating M2 from the damping effects of rising interest rates by encouraging investors to keep their funds in financial intermediaries. The growth of MMMFs has been particularly strong, accounting for almost three-quarters of the increase in the nontransactions component of M2. While available data do not permit accurate estimates, the shifting of funds to MMMFs may have lowered growth in M1-B somewhat. To a small extent, MMMFs may have been used as direct substitutes for demand deposits in making payments, but what is more likely the bigger effect, MMMFs have played a role in making it easier to economize on transactions balances. To the extent that MMMFs have attracted funds from the open market, the effect has been higher M2. The sizable inflows to institution-only MMMFs--which were likely diverted primarily from non-M2 assets--suggest that M2 has been boosted significantly by MMMF growth.

Small-denomination time and savings deposit flows in 1981 accounted for a much smaller proportion of the increase in the nontransactions component of M2 than in recent years. Net issuance of MMCs was only about a third of the 1980 flow as rates paid on MMCs exceeded those available on MMMFs for only two months during the year. In addition, SSC flows were quite weak until August when the ceiling rate on this instrument was uncapped. The October introduction of the ASC augmented deposit flows only moderately because most of the funds came from savings and other time deposits. ASCs are estimated to have boosted M2 growth in 1981 by less than .2 percentage points. Finally, outflows from savings deposits were much greater in 1981 than last year, even after adjusting for shifts into NOW accounts. Despite the weakness in deposit flows in 1981 relative to last year, overall deposit growth probably has been better maintained than past experience would have indicated--despite the MMMF competition--because of the deposit instruments with yields tied to market interest rates.

VELOCITIES OF M1-B (SHIFT-ADJUSTED),
M2 AND M3



* Quarterly average bill rates with the fourth quarter of 1981 plotted as the average to date.

The promotion of retail RPs on a substantial scale in 1981 offset some of the stimuli to M2 growth. The inclusion of retail RPs in M2 would have increased the annual growth rate of this aggregate about three-quarters of a percentage point; this may exaggerate the RP effect, however, since some funds may have been diverted from non-M2 assets. Overnight RPs and Eurodollar deposits contributed less to M2 expansion in 1981 than in earlier years, as the combined increase in these two components was quite small.

M3 this year has grown 11-1/4 percent--almost a full percentage point faster than in 1980 and 1-1/2 percentage points more than the growth of M2. The decrease in M3 velocity--estimated at just under 2 percent--is the largest over any four-quarter span since 1976. The growth of retail RPs probably has been an important factor in the divergence of M2 and M3 growth. In addition, however, large-denomination time deposits, which are the main additional instruments included in M3, have grown rapidly in 1981, reflecting the need for depository institutions to expand their managed liabilities to offset the weakness in core deposits. Commercial banks financed the excess of credit expansion over core deposit growth solely by issuing large CDs, continuing the pattern of bank liability management that emerged in mid-1980 (see Table 2). The increase in nondeposit funds was neglible, on net, as other borrowings--consisting primarily of RPs with nonbank lenders--were about equal in size to the volume of net Eurodollar lending to related offshore offices. Most of the drop in net Eurodollar borrowing has occurred at agencies and branches of foreign banks; these institutions have gained wider acceptance this year in domestic CD markets, encouraging them to reduce their borrowings from abroad. The cost of domestically issued CDs relative to borrowing in the Eurodollar interbank market has generally favored large CD issuance since the middle of last year, boosting expansion of M3.

Over the first eleven months of 1981, commercial bank credit grew on balance at an annual rate of 8-3/4 percent, 3/4 percentage points faster than last year. Most of the acceleration from 1980 was in business loans at U.S. offices. In addition, C&I loans to U.S. residents booked at foreign branches of U.S. banks--not included in the standard measure of bank credit--increased substantially more in 1981 than last year owing to the historically wide spread of the prime rate over the London Interbank Offer Rate. Security acquisitions at banks slowed markedly in 1981, with the bulk of the slowdown accounted for by U.S. government obligations.

The growing importance of MMMFs as intermediaries has loosened an already weak link between the movements of the monetary aggregates and bank credit. The fact that bank credit has grown considerably less rapidly than M3 may be said to reflect the fact that MMMFs have channeled the bulk of their large inflow of funds directly into commercial paper and other non-monetary assets.

Table 2

RELATIONSHIP OF CHANGES IN M3 AND BANK CREDIT
(billions of dollars)

		1980*	1981*
	M-3	180.7	217.4
-	MMMF assets (NSA)	36.4	99.9
-	Thrift liabilities	52.3	29.0
-	Other nonbank assets in M3	11.5	8.9
=	Commercial bank component of M3	80.5	79.6
+	Non-M3 sources of funds for banks	.5	25.7
=	Total bank sources of funds	81.0	105.3
	Core deposits	59.2	41.2
	Large time deposits (gross)	28.1	64.3
	Nondeposit sources	-6.8	0.2
	Net Eurodollar borrowing (NSA)	-22.9	-6.5
	Other borrowing	16.1	6.7
	Discrepancy	0.5	-0.4
-	Bank Credit	90.2	107.5
=	Discrepancy plus other assets less other liabilities[1]	-9.2	-2.2

* Data for 1980 reflect the Q4-1979 to Q4-1980 net dollar flows and for 1981 reflect the flows from Q4-1980 through November.

1. Includes such items as cash assets not included in M3, accrual accounts, net due from foreign branches, accrued expenses and capital accounts.

Appendix III-B*

SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES

According to the November 15th Senior Loan Officer Opinion Survey on Bank Lending Practices, 26 of the 60 respondents expected business loan demand to weaken over the next three months, while only 11 anticipated stronger demand. Growth of business loans had decelerated in each month since the August survey, and slack economic activity together with a pickup in bond issuance may have pointed toward further weakness in business loan demand.

Although the prime rate dropped by about 350 basis points between the August and November surveys, the spread of the prime rate over the more rapidly falling commercial paper rate widened substantially. Moreover, according to the survey, only a limited easing of other terms of bank lending to business occurred in the August-November period. About one-fourth of the survey panel relaxed their standards of creditworthiness to qualify for the prime rate, but nearly half as many made such criteria more stringent. Nearly one-fifth of the banks eased their standards for given spreads above prime, but almost as many tightened them. Over one-fourth of the panel reduced compensating balance or fee requirements for business loans, but a tenth increased them. In addition, although only a small number of survey participants reported a more restrictive stance on lending to new and nonlocal customers, they outnumbered slightly those who reported an easier stance.

One-fifth of respondents reported in November that over the previous three months they had become more willing to make installment loans to individuals. Such respondents outnumbered those who indicated reduced willingness for the first time since the August 1980 survey, which followed the termination of the special credit restraint program. Survey respondents failed to explain their greater willingness to make consumer loans, but it may reflect recent declines in market interest rates relative to usury ceilings.

In answers to supplemental questions, reports of adverse changes in the financial condition of business borrowers were somewhat more widespread in November than in August and were relatively common among very large respondents with domestic assets of $5 billion or more. Nearly three-fifths of respondents reported in November a deterioration over the previous three months in the financial condition of an above-normal proportion of customers to whom they had business loans outstanding.[1] Of these banks, about 60 percent indicated that they had reacted both by requesting additional collateral and by restructuring payment schedules, while most of the remainder had taken one or the other of these actions. Many banks specified that in restructuring payments they had reduced or

---

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

1. The corresponding figure was nearly 45 percent in August, when the panel was asked about changes in the financial condition of borrowers over the previous six months.

deferred interest or stretched out remittances of principal, but a few banks indicated that they had asked for accelerated repayment of some loans. When asked the industries in which the affected borrowers were concentrated, respondents who had observed an unusual deterioration in financial condition most often cited manufacturing--especially autos and related suppliers--and construction.[1] The next most frequently cited industry groups were agribusiness and transportation--specifically airline and truck operations. Retailing and financial services also received some mention.

About two-fifths of the survey panel--again, mainly very large banks--reported a decline over the previous three months in the average creditworthiness of applicants for new business loan extensions.[2] As in August, about 80 percent of those so reporting indicated that they had reacted by rejecting a higher proportion of applicants, while the remainder said that they had tailored loan agreements appropriately for borrowers in strained financial condition. The distribution of responses concerning the industries in which the deterioration in creditworthiness was concentrated was roughly the same for new loan applicants as for customers to whom respondents had business loans outstanding.

In November, about one-fifth of respondents reported increases over the previous three months in delinquency rates on residential mortgages and installment loans to individuals. This proportion was somewhat greater than that for August, when the panel was asked about changes in delinquency rates over the previous six months.[3] As in August, those respondents who reported increases in delinquencies indicated that they had reacted by intensifying their collection efforts, by repossessing collateral, and by restructuring payment schedules.

Over four-fifths of very large banks and two-fifths of other respondents indicated that diversion of business credit demand from long-term markets had been an important source of business loan demand at their banks over the previous three months. Of those so reporting, a plurality indicated that they were satisfying such demand by entering revolving credit agreements of several years' length, often with borrower options to convert remaining balances to term loans at the end of the revolving credit agreement. Such agreements guarantee the borrower a source of credit for the intermediate term, yet allow refunding of bank loans with the proceeds of bond and equity issues. About one-fourth of respondents who reported shifts of credit demands from long-term markets to their banks indicated simply that they were satisfying such demand with short-term loans, but they did not specify whether or not these were takedowns of revolvers. Another one-fourth reported long-term lending.

1. This question was not posed in August.
2. The corresponding figure for August was just under one-third.
3. In August, many panel members commented that delinquency rates actually had declined over the previous six months; such respondents equalled (mortgages) or exceeded (installment loans) in number those who reported increased delinquency rates. In November, very few respondents commented that delinquency rates had dropped.

SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES
AT SELECTED LARGE BANKS IN THE U.S.

(Status of policy on November 15, 1981 compared to three months earlier)
(Number of banks and percent of total banks answering question)
(By size of total domestic assets, in billions[1])

CORE QUESTIONS

	Much Stronger		Moderately Stronger		Essentially Unchanged		Moderately Easier		Much Easier		Total Banks Answering
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	
1. Strength of demand for commercial and industrial loans anticipated in next 3 months (after allowance for usual seasonal variation):											
All respondents	2	3.3	9	15.0	23	38.3	26	43.3	0	0.0	60
$5 and over	0	0.0	4	16.0	12	48.0	9	36.0	0	0.0	25
under $5	2	5.7	5	14.3	11	31.4	17	48.6	0	0.0	35

	Much Firmer		Moderately Firmer		Essentially Unchanged		Moderately Easier		Much Easier		
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	
2. Standards to qualify for prime rate:											
All respondents	0	0.0	7	11.7	37	61.7	15	25.0	1	1.7	60
$5 and over	0	0.0	4	16.0	16	64.0	5	20.0	0	0.0	25
under $5	0	0.0	3	8.6	21	60.0	10	28.6	1	2.9	35
3. Standards to qualify for spread above prime:											
All respondents	0	0.0	9	15.0	40	66.7	10	16.7	1	1.7	60
$5 and over	0	0.0	4	16.0	14	56.0	7	28.0	0	0.0	25
under $5	0	0.0	5	14.3	26	74.3	3	8.6	1	2.9	35
4. Stance on C&I lending to new and nonlocal customers											
All respondents	0	0.0	8	13.3	47	78.3	5	8.3	0	0.0	60
$5 and over	0	0.0	4	16.0	21	84.0	0	0.0	0	0.0	25
under $5	0	0.0	4	11.4	26	74.3	5	14.3	0	0.0	35
5. Compensating balance or fee requirments for C&I loans:											
All respondents	0	0.0	6	10.0	37	61.7	16	26.7	1	1.7	60
$5 and over	0	0.0	3	12.0	14	56.0	8	32.0	0	0.0	25
under $5	0	0.0	3	8.6	23	65.7	8	22.6	1	2.9	35

	Considerably Greater		Moderately Greater		Essentially Unchanged		Moderately Less		Much Less		
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	
6. Willingness to make installment loans to individuals:											
All respondents	1	1.7	11	18.6	42	71.2	3	5.1	2	3.4	59
$5 and over	0	0.0	5	20.8	17	70.8	2	8.3	0	0.0	24
under $5	1	2.9	6	17.1	25	71.4	1	2.9	2	5.7	35

SUPPLEMENTAL QUESTIONS

S With regard to commercial and industrial lending, has there been a deterioration over the last three months in the financial condition of an above-normal proportion of customers to whom your bank has loans outstanding? If so, how has your bank responded?

	No Unusual Deterioration		Additional Collateral		Restructure Payments		Collateral and Restructure		Other		Total Banks Answering
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	
All respondents	26	43.3	2	3.3	8	13.3	20	33.3	4	6.7	60
$5 and over	8	32.0	0	0.0	5	20.0	11	44.4	1	4.0	25
under $5	18	51.4	2	5.7	3	8.5	9	25.7	3	8.6	35

S.1.b In which industries has the deterioration been concentrated? (Asked only of those banks reporting above-normal deterioration in answer to question S.1.a).[2]

	Manufacturing		Construction		Transportation		Agribusiness		Retail		Finance		All		Total Industry Citations
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	
All respondents	20	30.8	16	24.6	7	10.8	9	13.8	5	7.7	4	6.2	4	6.2	65
$5 and over	11	34.4	7	21.9	5	15.6	5	15.6	1	3.1	2	6.3	1	3.1	32
under $5	9	27.3	9	27.3	2	6.1	4	12.1	4	12.1	2	6.1	3	9.1	33

S.2.a With regard to commercial and industrial lending, has there been a deterioration over the last three months in the average financial condition of applicants for new loan extensions from your bank? If so, how has your bank responded?

	No Unusual Deterioration		Increase Rejections		Design Loans Appropriately		Total Banks Answering
	Banks	Pct	Banks	Pct	Banks	Pct	
All respondents	37	61.7	19	31.7	4	6.7	60
$5 and over	12	48.0	11	44.4	2	8.0	25
under $5	25	71.4	8	22.9	2	5.8	35

S.2.b In which industries has the deterioration been concentrated? (Asked only of those banks reporting above-normal deterioration in answer to question S.1.b).[2]

	Manufacturing		Construction		Transportation		Agribusiness		Retail		Finance		All		Total Industry Citations
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	
All respondents	13	39.4	6	18.2	3	9.1	4	12.1	2	6.1	0	0.0	5	15.2	33
$5 and over	9	39.1	5	21.7	3	13.0	3	13.0	2	8.7	0	0.0	1	4.3	23
under $5	4	40.0	1	10.0	0	0.0	1	10.0	0	0.0	0	0.0	4	40.0	10

S. With regard to mortgage and installment loans to individuals, have there been increases over the last three months in the delinquency rates at your bank? If so, how has your bank responded?

	Delinquencies Not Up		Repossess Collateral		Restructure Payments		Repossess and Restructure		Collections		Total Banks Answering
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	
Mortgages											
All respondents	46	79.3	0	0.0	1	1.7	3	5.0	8	13.3	8
$5 and over	20	83.3	0	0.0	0	0.0	0	0.0	4	16.0	4
under $5	26	76.5	0	0.0	1	2.6	3	8.8	4	11.4	4
Installment Loans											
All respondents	45	77.6	2	3.3	2	3.3	9	15.0	0	0.0	58
$5 and over	17	70.8	2	8.3	0	0.0	5	20.8	0	0.0	24
under $5	28	82.4	0	0.0	2	5.9	4	11.8	0	0.0	34

S.4 In recent months, demand for business credit at banks apparently has been augmented by credit needs stemming from postponement of bond issues due to high long-term interest rates. Has this been an important source of business credit demand at your bank? If so, do such borrowers typically obtain relatively short interim financing--on the order or several months or less--or loans of greater duration, say several years?

	Not a Major Source of Demand		Takedowns of Intermediate-term Revolvers		Short-term		Long-term		All Types of Financing		Total Banks Answering
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	
All respondents	25	41.7	12	20.0	9	15.0	9	15.0	5	8.3	60
$5 and over	4	16.0	7	28.0	6	24.0	4	16.0	4	16.0	25
under $5	21	60.0	5	14.3	3	8.8	5	14.3	1	2.9	35

1. As of June 31, 1981, there were 25 banks having domestic assets of $5 billion or more. Their combined assets, in billions, totalled $463, compared to $562 for the entire panel and $1,584 for all insured commercial banks.
2. The number of times an industry was cited is shown under the heading "Banks". This number as a percent of total industry citations is shown under the heading "Pct". Both farming and forest products are included in agribusiness.

Foreign Exchange Markets

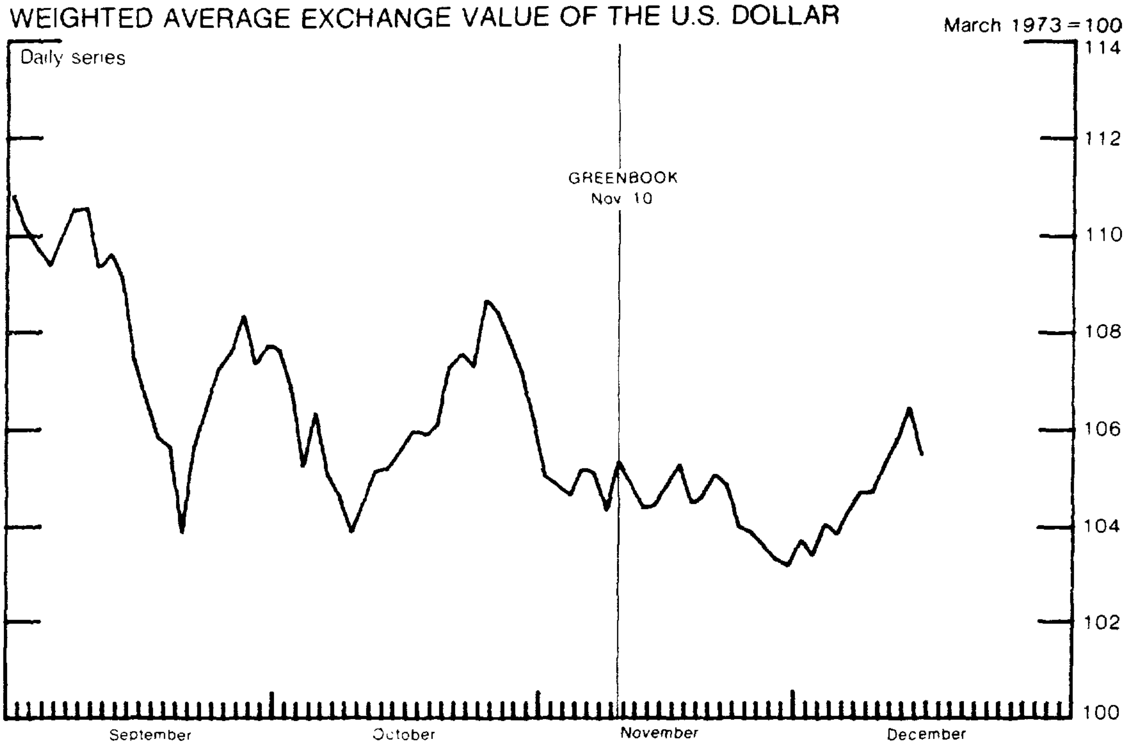
Since the last Greenbook the dollar's weighted-average value in exchange markets has fluctuated in a narrow range. As indicated in the top panel of the chart, near the end of November the dollar declined somewhat from its mid-month range, but in early December renewed strength was evident. At present the dollar's weighted-average value is about 0.8 percent higher than on November 10.

Against individual currencies the dollar's movements have been somewhat more pronounced, with gains of from 1-3/4 to 3-1/4 percent registered against most European currencies and a net depreciation of about 4-3/4 percent against the Japanese yen. Despite some fluctuations, the dollar's net changes against the Canadian dollar and the pound sterling were fairly small.

Market reactions to a downturn in U.S. interest rates and the release of various economic indicators, such as housing starts and unemployment figures, which underscored the weakness in U.S. activity, appear to have been the principal influences in the dollar's moderate decline late in November. Subsequently, in early December the Bundesbank lowered its lombard rate and the Bank of Japan cut its discount rate, and market rates fell slightly in several foreign centers. In addition, upward revisions in estimates of the U.S. budget deficit for 1982 and expectations of a large increase in the M2 money supply contributed to a backing up of U.S. interest rates and to the dollar's more buoyant tendency toward mid-month. The relatively favorable consumer price data released in late November may also have contributed to a downward

STRICTLY CONFIDENTIAL (FR)
CLASS II - FOMC

WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



revision in U.S. inflation expectations. Other factors having some influence on exchange-rate developments during this interval included perceptions of budget and political problems in Germany, the Polish situation, persistent problems with the formation of a government in Belgium and, toward the end of the period, threats of labor difficulties in the United Kingdom.

Early this week, following the declaration of martial law in Poland and accompanying uncertainty about what turn that situation would take next, the dollar briefly shot above the DM 2.35 level and also advanced sharply against other major currencies. Gold climbed into the $430 range. However, these gains were eroded quickly once exchange markets tranquilized.

In developments regarding the European Monetary System, the Danish krone has remained at or near the top of the EMS currency spread for the past five weeks, and last week the Dutch guilder and French franc likewise moved near the top. The German mark was close to its lower limit until recently, but subsequently was replaced by the Belgian franc, which came under speculative pressure while the Belgians struggled to form a new government. This considerable pressure kept the franc at its lower intervention floor

. On December 10 the Belgian National Bank raised both its discount and securities-advances' rates by 2 percentage points. After last weekend, reports that a Belgian government would be formed by former Prime Minister Martens brought the franc off its lower intervention floor. Shortly thereafter, the Belgian National Bank moved forcefully to drive up short-term interest rates to very high levels, and the franc catapulted to the top of the EMS currency spread, where it remained at mid-week,

. Despite these developments, there continue to be rumors of an eventual realignment of EMS central rates involving a Belgian franc devaluation.

Gold prices were near the $430 level at the time of the last Greenbook, and presently are around the $418 level.

On December 15 U.S. authorities repaid from balances the second installment of mark-denominated Carter notes, amounting to around $800 million equivalent at current exchange rates.

OPEC surpluses and investment flows. In the first half of 1981 the OPEC current-account surplus is estimated at $44 billion, almost the same as in the second half of 1980. (See table.) Oil exports of $138 billion in the first half of 1981 were as large as in the previous six months; although the volume of oil exports declined, the average OPEC official sales price for crude oil increased by almost 8 percent, to $34.74 per barrel, in the first half of this year. At the same time, the rate of growth of OPEC imports in dollar terms slowed markedly, in part reflecting the 13.3 percent rise in the exchange rate of the dollar compared with the second half of 1980. OPEC imports in the first half of 1981 rose only $2 billion (3 percent) from the previous six months, compared with 15 percent in the preceding half year and 30 percent in 1980 as a whole.

In contrast to the foregoing, the second half of 1981 is expected to show an abrupt decline in the OPEC current-account surplus, to the level of $18 billion. Weakening demand for oil is expected to bring oil exports down to $125 billion, $13 billion below the first-half level, the decrease being partly reflected in reduced volume and partly in lower prices. Concurrently, OPEC imports are projected to rise much more rapidly, to a level about $11 billion (15 percent) above that of the first half of the year and 24 percent higher than a year earlier, because of a smaller rise in the dollar and disappearance of certain factors depressing imports in the first half. For 1981 as a whole the OPEC current account surplus is projected at $62 billion. However, deficits will be incurred by Iraq (because of the war with Iran), Nigeria, and on a smaller scale by Iran and Algeria.

The pattern of new OPEC investments in the first six months of 1981 underwent several changes, the most striking being the much smaller share

ESTIMATES OF OPEC CURRENT ACCOUNT AND EXTERNAL INVESTMENTS
(Billions of dollars)

	1978	1979	1980	1980		1981	
	Year	Year	Year	1st H	2nd H	1st H	2nd H[p]
Current account							
1. Exports	141	214	294	148	146	147	134
(Oil)	(130)	(201)	(279)	(141)	(138)	(138)	(125)
(Non-oil)	(11)	(13)	(15)	(7)	(8)	(9)	(9)
2. Imports	100	101	133	62	71	73	84
3. Trade balance (1-2)	41	113	161	86	75	74	50
4. Net services and private transfers	-38	-42	-50	-24	-26	-26	-28
5. Public transfers	-3	-5	-7	-3	-4	-4	-4
6. Current account balance (3 + 4 + 5)	0	66	104	59	45	44	18
External investments							
7. In United States	.4	7.1	14.0	9.5	4.5	7.6	2.1[1]
a. Treas. bills & bank liabilities	-.1	8.3	.2	2.8	-2.5	-.2	-2.8[1]
b. Other securities	.1	-.1	12.9	6.1	6.7	8.2	4.9[1]
c. Other	.4	-1.2	.9	.6	.3	-.4	n.a.
8. In United Kingdom	.2	2.4	3.3	2.8	.5	.9	n.a.
9. In other industrial countries[2]	4.2	8.7	16.7	8.1	8.6	11.0	n.a.
a. Germany[3]	.6	.9	9.2	4.0	5.2	5.1	n.a.
b. Other	3.6	7.8	7.5	4.1	3.4	5.9	n.a.
10. In Eurocurrency market[4]	3.0	33.5	41.0	22.5	18.5	3.8	n.a.
11. Loans to developing countries	6.2	9.6	6.5	4.0	2.5	2.9	n.a.
12. IMF and IBRD	-.7	-1.6	1.4	.2	1.2	.6	n.a.
13. Gold purchases	.8	1.2	3.5	3.2	.3	.7	n.a.
14. Subtotal (7 thru 13)	-14.1	60.9	86.4	50.3	36.1	27.5	n.a.
15. Other investments plus net borrowings (6 minus 14)	-14.1	5.1	17.6	8.7	8.9	16.4	n.a.

1. Third quarter only.
2. Excluding bank deposits.
3. Long-term only.
p. Projected
4. Including domestic currency deposits outside the U.S. and U.K.

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

going into new Eurocurrency deposits than in earlier years. Additions to OPEC Eurocurrency deposits (together with domestic currency deposits in countries other than the United States and United Kingdom) amounted to only \$3.8 billion, down from \$18.5 billion in the preceding half-year. The flow into these deposits was equivalent to less than 10 percent of the OPEC current-account surplus, compared with an average of close to 40 percent in both 1980 and the entire period 1974-80. The percentage of the current-account surplus going into assets in the United Kingdom (excluding Eurocurrency deposits in that country) also dropped sharply in the first half of 1981 compared with 1980 as a whole.

Higher shares of total OPEC external investments in the first six months of this year were accounted for by flows to the United States and to other industrial countries. The inflow into the United States came to \$7.6 billion, equivalent to 17 percent of the current-account surplus compared with a 15 percent share in 1980 and only 9 percent in the second half of last year. Net purchases of U.S. securities other than Treasury bills increased to \$8.2 billion, a step-up of more than 25 percent compared with the average half-yearly rate in 1980. In the third quarter, the rate of OPEC investment flows to the United States tapered off and holdings of Treasury bills and bank deposits were drawn down, but the rate of flow into other U.S. securities rose further.

Industrial countries other than the United States and United Kingdom absorbed \$11 billion of OPEC investment flows (excluding additions to bank deposits) in the first half of 1981. This was equivalent to 25 percent of the current-account surplus, substantially higher than the 16 percent share taken by these countries in 1980. Long-term capital flows to

Germany, amounting to $5.1 billion, were about the same as in the last half of 1980 in dollar terms (while rising 35 percent in DM terms) and again were almost entirely borrowings by the German public sector.

U.S. International Transactions

The U.S. merchandise trade deficit increased sharply in October, returning to the high level recorded in August. For four months in a row the trade deficit has swung widely. However, the combined September-October deficit was about the same as the combined July-August deficit; both were larger than deficits recorded in the first two quarters of this year. Since the second quarter, the value of exports has declined while the value of imports (other than oil) has risen.

U. S. Merchandise Trade*

	1981 Q1	1981 Q2	1981 July-Aug.	1981 Sept.-Oct.	Sept.	Oct.
Value (Bil. $, SAAR)						
Exports	244.4	241.9	231.1	233.3	235.5	231.1
Agricultural	50.9	44.3	38.9	43.2	42.7	43.6
Nonagricultural	193.5	197.6	192.1	190.1	192.8	187.5
Imports	263.1	269.6	264.4	267.4	253.6	281.1
Petroleum	83.3	84.8	71.6	73.4	72.3	74.3
Nonpetroleum	179.8	184.8	192.8	194.1	181.4	206.8
Trade Balance	-18.7	-27.7	-33.3	-34.1	-18.0	-50.0
Volume (Bil. 72$, SAAR)						
Exports - Agricultural	19.5	17.5	16.2	18.7	18.3	19.1
- Nonagric.	73.2	73.3	69.9	68.0	69.6	66.4
Imports - Petroleum	6.3	6.2	5.6	5.8	5.7	5.9
- Nonpetrol.	67.8	70.7	74.8	76.3	71.6	80.9

*/ International Transactions and GNP basis.

Despite a slowing in U.S. economic activity in the third quarter, the value and volume of nonoil imports rose in both July-August and in September-October. The increase was fairly evenly spread among items in most major commodity categories -- particularly consumer goods, capital goods, and industrial supplies. The value of steel imports declined in September and October from the record August level, but remained high; much of the increase in steel imports during the last three months was from the European Community. The volume of foreign cars imported increased sharply in October from a low September level, but for September-October combined imports were about 8 percent below the July-August rate. July-August foreign car imports were at almost the same rate as during the first and second quarters but were about 15 percent less than last year's peak third-quarter rate.

Oil imports have increased slightly since July, but remain below the average rate for the first half of 1981. The low level of imports is due in part to a drawdown of inventories; the U.S. stock of crude oil and petroleum products (seasonally adjusted) continued to ease downward through November. The price of oil imports continued to decline through October, with the October average price about $3.80 per barrel below the peak April price. Trade data do not yet reflect price increases made by Saudi Arabia, Nigeria, Mexico, and North Sea producers in October (more than offsetting some price cuts by other exporters during the last two months) and oil import prices are expected to recover to about $34 per barrel by next spring.

1981 U.S. Oil Imports

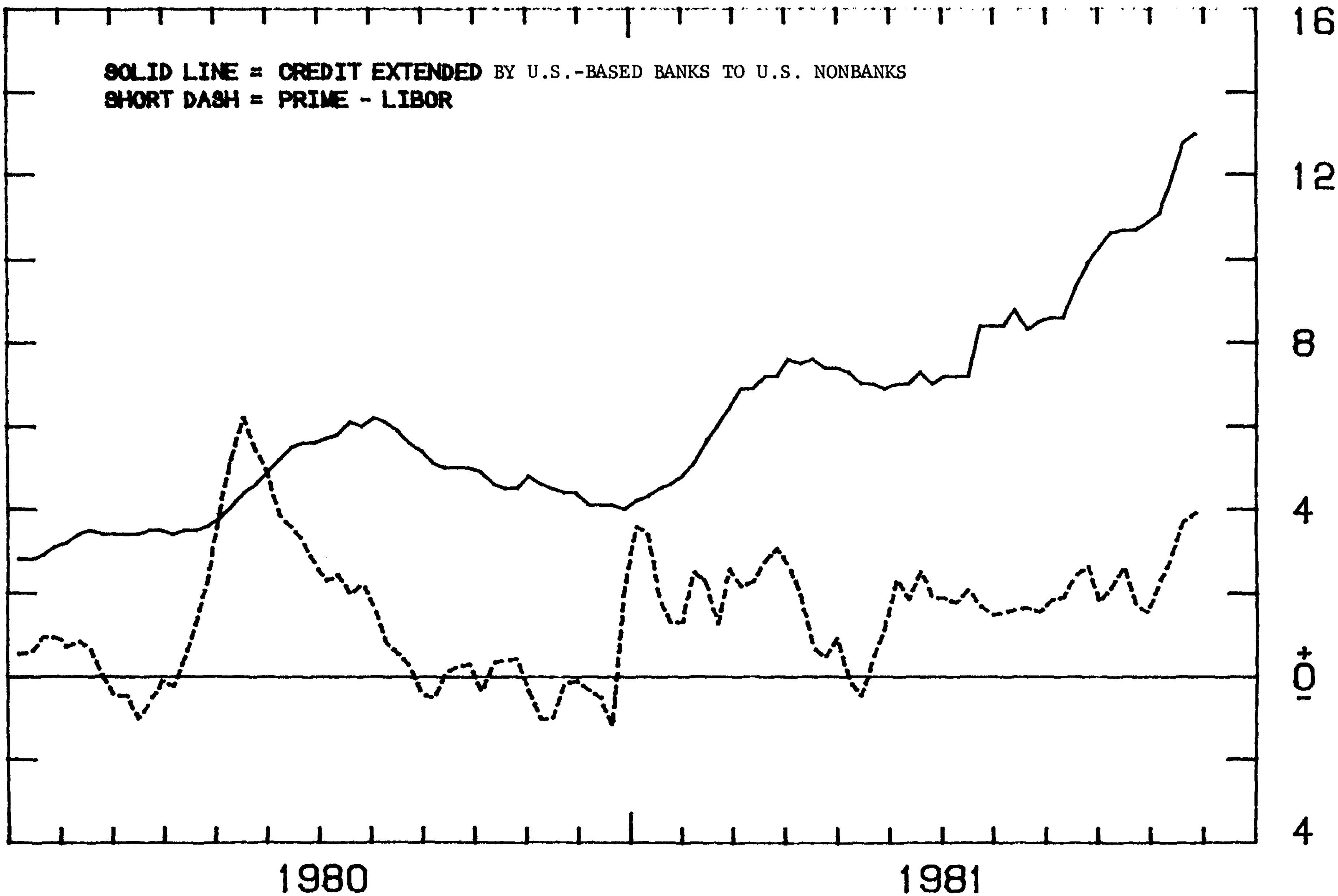
	1Q	2Q	July-Aug.	Sept.-Oct.	Sept.	Oct.
Volume (mbd,SA)	6.59	6.52	5.94	6.17	6.05	6.29
Price ($/BBL)	34.63	35.62	33.38	32.75	33.11	32.38
Value (Bil. $,SAAR)	83.3	84.8	71.6	73.4	72.3	74.3

Agricultural exports increased from the low July-August rate of $39 billion to a rate of $43 billion in September-October. Export prices continued the decline begun at the beginning of the year; from January to October average export prices fell 13 percent. The September-October upturn in exports resulted from a pick-up in the volume of shipments, particularly wheat and corn exports to the Soviet Union and soybean exports to Japan. The volume exported in September-October was almost as large as in the strong first quarter.

Nonagricultural exports have declined since the second quarter. From the second quarter through October the largest declines have been in civilian aircraft exports and in automotive exports to Canada. Industrial supplies and machinery exports (which together account for two-thirds of nonagricultural exports) ceased to expand and have begun to decline marginally; about 17 percent of these exports are shipped to Canada, 25 percent to the EC, and 8 percent each to Japan and Mexico.

International capital account transactions reflect the increasing integration of U.S. and offshore financial markets: U.S. nonbanks increased both their borrowing from and deposits in banks offshore and foreigners sharply increased their borrowing in the U.S. capital market. Credit extended to U.S. nonbanks by the foreign offices of U.S. banks has continued to rise during a period when the LIBOR-prime spread has favored LIBOR-pricing. (See chart.) Funding for such loans may have

CREDIT EXT. AND THE PRIME/LIBOR DIFFERENTIAL
(CREDIT EXT. IN BILLIONS OF $, PRIME/LIBOR IN % PTS.)



come from U.S. sources: net advances to foreign offices have risen since August (see line 1(b) of the table below) and deposits of bank holding companies at their foreign subsidiary banks have increased by about $3 billion between June and October, 1981. These flows probably reflect the relative attractiveness of funding through U.S. CD's and commercial paper compared to Eurodollar borrowing.

International Banking Data
(billions of dollars)

	1980	1981					
	Dec.	March	June	Aug.	Sept.	Oct.	Nov.
1. Banking Positions Vis-a-vis Own Foreign Offices 1/2/							
(a) All banks	7.2	3.0	5.0	8.9	7.5	3.0	1.8
(b) U.S.-based banks	-14.6	-16.9	-14.1	-10.0	-12.1	-15.1	-14.7
(c) Foreign-based banks	21.8	19.9	19.2	18.9	19.6	18.2	16.5
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. banks 2/	4.2	7.0	7.1	8.6	9.2	10.6	12.0
3. Eurodollar Holdings of U.S. Nonbank Residents 3/	60.8	66.3	76.8	84.4	86.8	n.a.	

1/ Net due to own foreign offices = (+).
2/ Daily averages.
3/ End of month.

Data on U.S. nonbanks' borrowing from the foreign offices of foreign banks are not available on a systematic basis. Although foreign and U.S.-based banks are not necessarily affected in identical ways by certain considerations (e.g. reserve requirements and taxes), one would expect that foreign banks would also book part of their LIBOR-based loans to U.S. residents offshore. Documents filed in connection with recent corporate takeover programs have confirmed this. Foreign banks were scheduled to provide $5.4 billion out of the total of $11 billion of syndicated bank facilities for Dupont, U.S. Steel, and Marathon Oil. Of 27 foreign banks involved in those facilities, 21 have indicated that they would book offshore those portions of the loans based on LIBOR. In addition, three foreign banks said even prime-based drawdowns would be booked abroad. As much as $4.2 billion of the foreign banks' share was subject to offshore booking. The recent declines in foreign-based banks' positions vis-a-vis their own foreign offices shown in line 1 (c) of the table above may be related to increased lending to U.S. nonbanks from foreign banks' overseas offices, funded in part by reductions in net advances to U.S. offices. Another source of funding may have been the proceeds of commercial paper issued in the United States by parent organizations of foreign banks.

Eurodollar holdings of U.S. nonbanks increased again in September. (See line 3 of table above.) Most of the expansion was in the form of negotiable CDs, the great bulk of which are issued by London branches of U.S. banks. Among the important holders of such London-branch instruments are money-market mutual funds (MMMF) and unit investment trusts (UIT), whose portfolios have recently contained upwards of 60 percent of the estimated total of all negotiable Eurodollar CD's held by U.S. nonbanks. Since mid-September, MMMF and UIT holdings of Eurodollar CD's have expanded by nearly $3 billion.

Foreign bond issues in the United States during the third and fourth quarters together appear likely to exceed placements during the first six months of 1981 by at least 20 percent, and for the year as a whole the total of such issues will approach a figure double the $3.5 billion offered in 1980. After U.S. interest rates began to decline, private Canadian borrowing in the U.S. capital market expanded from a monthly rate of about $325 million during the third quarter to a rate of over $500 million during October and November. Canadians were not the only borrowers to respond to lower long-term interest rates in the U.S. market during October and November. Other issuers of foreign securities increased their offerings from a third-quarter monthly rate of about $85 million to a rate of nearly $500 million a month during October and November.

Foreign official reserves assets in the United States declined in both September and October. Increases in OPEC holdings were more than offset by declines in holdings of the G-10 countries and Switzerland. These declines were associated with intervention sales of dollars. The reduction in official holdings in October was concentrated in assets other than U.S. Treasury securities. (See table on U.S. International Transactions.) Official holders appear to have responded to expected future declines in U.S. interest rates by shifting out of short-term investments and into Treasury obligations of more than one year's maturity. Partial data through late November, based on holdings at the FRBNY, indicate a further increase of over $2.5 billion in foreign official holdings of U.S. Treasury securities, of which somewhat under $1 billion was for the account of OPEC members.

Summary of U.S. International Transactions
(in billions of dollars)

	1980 Year	1981 Q-1	Q-2	Q-3	July	Aug.	Sept.	Oct.
Banks								
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow) 1/	-29.8	-11.8	-6.4	4.2	6.8	-1.9	-.6	-1.3
Securities								
2. Private securities transactions, net	2.5	1.9	1.7	.2	.1	.2	-.1	-.2
a) Foreign net purchases (+) of U.S. corp. bonds	1.2	.7	.6	.6	.3	.2	.1	.1
b) Foreign net purchases (+) of U.S. corp. stocks	4.3	1.7	2.6	.1	.1	--	--	-.1
c) U.S. net purchases (-) of foreign securities	-3.0	-.5	-1.4	-.5	-.3	--	-.2	-.2
3. Foreign net purchases (+) of U.S. Treasury obligations 2/	2.7	1.4	.7	-.8	-.5	.3	-.6	.3
Official								
4. Changes in foreign official reserve assets in U.S. (+ = increase)	14.9	5.5	-3.0	-5.5	-.1	-4.6	-.8	-1.9
a) By area								
G-10 countries and Switzerland	-2.5	1.9	-7.9	-5.6	-1.5	-2.8	-1.4	-3.0
OPEC	12.1	5.7	2.5	2.5	2.5	-1.6	1.7	1.6
All other countries	5.3	-2.1	2.4	-2.4	-1.1	-.2	-1.1	-.4
b) By type								
U.S. Treasury securities	9.7	7.2	-2.1	-4.6	-1.7	-1.7	-1.4	.1
Other 3/	5.2	-1.6	-.9	-.9	1.6	-3.0	.6	-2.0
5. Changes in U.S. official reserve assets (+ = decrease) 4/	-7.8	-3.7	.8	-.1	.7	-.4	-.5	-.5
Other transactions (Quarterly data)								
6. U.S. direct investment (-) abroad	-18.5	-1.6	-3.6	n.a.				
7. Foreign direct investment (+) in U.S.	10.9	2.5	2.9	n.a.				
8. Other capital flows (+ = inflow) 5/ 6/	-8.2	-10.2	.7	n.a.				
9. U.S. current account balance 6/	3.7	3.3	1.1	n.a.				
10. Statistical Discrepancy 6/	29.6	10.9	7.6	n.a.				
MEMO:								
U.S. merchandise trade balance -- part of line 9. (Balance of payments basis, seasonally adjusted)	-25.3	-4.7	-6.9	-7.1	-.9	-4.6	-1.5	-4.2

1/ Excludes liabilities to foreign official institutions.
2/ Includes U.S. Treasury notes publicly issued to private foreign residents.
3/ Includes deposits in banks, commercial paper, acceptances, & borrowing under repurchase agreements.
4/ Includes newly allocated SDR's of $1.1 billion in January 1979; $1.15 billion in January 1980; and $1.1 billion in January 1981.
5/ Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and allocations of SDRs, and other banking and official transactions not shown elsewhere.
6/ Includes seasonally adjusted components.

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

International Developments. The growth of real GNP in the major foreign industrial countries was weak in the third quarter. Even Japan's GNP grew at only half the rate of the second quarter. In France, where second-quarter growth had been unusually strong, the third-quarter rate was also much lower. In the United Kingdom GNP growth was positive in the third quarter after two years of decline, but the level of production remains depressed. Canada and Italy recorded sharp declines of GNP in the third quarter. Industrial production in Germany, where third-quarter seasonally adjusted GNP data are not yet available, remains flat. Unemployment in most countries has been rising more rapidly in recent months, reaching a level of nearly 10 million in West Europe. Especially high rates of unemployment were observed in Belgium, the United Kingdom and the Netherlands. Despite the general weakness of economic activity, consumer price inflation abroad has continued to rise in October and November at rates which were roughly equal to or higher than those in the third quarter. Japan's current account has moved further into surplus and Germany's deficit has continued to decline in recent months.

In response to the weakness of economic activity and aided by lower interest rates in the United States, official interest rates have been lowered in Germany, Japan, the Netherlands and Switzerland.

Individual Country Notes. In Japan, real GNP grew by 2.4 percent (s.a.a.r.) in the third quarter, after 4.8 percent growth in the second quarter. The slowdown of growth reflects weakness in all components of domestic demand, which actually declined by 0.8 percent. The growth of real net exports remained very strong in the third quarter, although somewhat reduced from the second quarter. In contrast to this generally

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

	1978	1979	1980	1980 Q1	1980 Q2	1980 Q3	1980 Q4	1981 Q1	1981 Q2	1981 Q3	1981 July	1981 Aug.	1981 Sept.	1981 Oct.
Canada: GNP	3.7	3.0	0.0	-0.9	-1.0	0.2	2.3	0.9	1.4	-1.0	*	*	*	*
IP	3.5	5.3	-2.0	-0.9	-2.5	0.0	2.2	1.0	2.6	-2.9	-2.5	-1.4	-1.0.	n.a.
France: GDP	4.0	3.7	1.5	0.2	-0.6	0.2	-0.1	-1.1	1.2	0.4	*	*	*	*
IP	1.9	4.7	-1.2	0.5	-2.2	0.0	-2.0	-4.1	-0.8	2.7	[1.6]		0.0	n.a.
Germany: GNP	3.6	4.5	1.7	1.9	-2.0	0.0	-0.4	0.4	-0.7	n.a.	*	*	*	*
IP	2.0	5.3	-0.1	0.9	-2.4	-1.5	-1.8	1.3	0.6	-0.6	1.9	-0.9	0.9	0.0
Italy: GDP	2.6	5.0	4.0	2.1	-0.9	-2.7	2.0	0.6	-1.2	-1.6	*	*	*	*
IP	1.9	6.6	5.6	4.4	-2.7	-7.6	5.3	0.7	-2.5	-5.1	0.6	-13.6	18.2	-2.5
Japan: GNP	6.0	5.9	5.5	1.8	0.8	1.5	0.5	1.1	1.2	0.6	*	*	*	*
IP	6.2	8.3	7.1	4.1	0.2	-2.3	1.6	1.7	-0.3	1.6	1.0	-2.6	3.8	1.7
United Kingdom: GDP	3.6	1.7	-2.1	-0.9	-1.5	-1.3	-0.4	-1.0	-0.6	0.3	*	*	*	*
IP	3.6	2.7	-6.6	-2.3	-3.0	-3.0	-2.5	-1.1	-0.8	1.0	-0.1	-0.1	1.2	1.7
United States: GNP	4.8	3.2	-0.2	0.8	-2.6	0.6	0.9	2.1	-0.4	0.2	*	*	*	*
IP	5.8	4.4	-3.6	0.1	-5.4	-1.5	4.5	2.0	0.5	0.4	0.7	-0.2	-1.2	-1.4

* GNP data are not published on monthly basis.

weak third quarter picture, industrial production made strong gains in September and October.

Consumer prices in the third quarter were slightly below their second-quarter level. This declining trend was reversed in October-November, with monthly CPI increases of about 0.3 percent, but wholesale prices declined in each of those months. Slower growth in dollar prices for imported materials (including oil) has been an important factor offsetting the effects of a weakening yen earlier this year.

The seasonally adjusted current account showed a $1.5 billion surplus in October, which brings the cumulative surplus for the first ten months of 1981 to $5.2 billion. The government announced in late November that it is considering advancing by two years, to 1982, the import tariff cuts scheduled to take place in 1983-1984 under the Tokyo Round. In addition, some other measures to open the Japanese markets to imports are under discussion. Effective December 11, the Bank of Japan lowered its official discount rate by 0.75 percentage points to 5.5 percent.

German industrial production in October was unchanged from its low September level. Economic activity thus remains at the low level to which it had fallen in the course of last year. Preliminary non-seasonally adjusted data indicate a small gain of third-quarter real GNP on the second quarter. The increase in the rate of unemployment, which had been moderate in the early phase of the prolonged current period of weak activity, has been accelerating since early this year. The previous post-war record of 5.2 percent (mid-year 1975) was passed

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

	1980			1981			1981				MEMO: Latest 3 Months from Year Ago
	Q2	Q3	Q4	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.	
Canada: CPI	2.8	2.8	2.8	3.2	3.1	3.0	0.7	0.7	1.0	n.a.	12.6
WPI	1.1	2.8	3.2	2.5	2.1	1.3	-1.6	3.1	n.a.	n.a.	9.5
France: CPI	3.1	3.2	2.8	3.0	3.3	3.9	1.2	1.1	1.2	0.9	14.1
WPI	0.8	0.6	3.4	1.5	4.5	4.3	1.1	0.9	0.5	n.a.	13.9
Germany: CPI	1.8	0.7	0.8	2.2	1.8	1.2	0.3	0.5	0.3	0.5	6.6
WPI	1.7	-0.2	0.7	3.9	2.3	2.1	1.3	0.9	0.3	0.5	11.2
Italy: CPI	3.9	4.2	5.3	5.2	4.4	2.8	0.7	1.4	2.0	1.7	18.4
WPI	3.6	2.2	3.8	5.0	5.1	3.5	1.2	1.3	1.2	n.a.	18.9
Japan: CPI	3.0	1.1	1.2	1.3	1.3	-0.1	-1.0	2.0	0.4	0.2	3.9
WPI	4.8	0.7	-0.7	-0.7	1.1	1.4	0.5	0.0	-0.1	-0.1	1.5
United Kingdom: CPI	5.8	2.2	1.9	2.4	4.9	1.7	0.7	0.6	0.9	n.a.	11.5
WPI	4.0	2.3	1.2	3.0	3.4	2.1	0.9	0.8	0.8	0.6	10.8
United States: CPI(SA)	3.1	1.9	3.1	2.6	1.8	2.9	0.8	1.2	0.4	n.a.	10.6
WPI(SA)	2.5	3.3	2.1	2.6	2.3	0.9	0.3	0.2	0.6	n.a.	7.6

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

	1979	1980	1980 Q1	1980 Q2	1980 Q3	1980 Q4	1981 Q1	1981 Q2	1981 Q3	1981 Aug.	1981 Sept.	1981 Oct.
Canada: Trade	3.4	6.7	1.4	0.9	2.0	2.4	1.4	0.8	0.6	0.3	0.1	0.6
Current Account	-4.2	-1.6	-0.8	-1.0	-0.2	0.3	-1.2	-1.8	-2.2	*	*	*
France: Trade[b]	-2.4	-14.2	-3.4	-3.5	-4.0	-3.2	-2.7	-2.1	-1.9	0.0	-0.9	1.1
Current Account[b]	1.1	-7.9	-2.6	-1.2	-2.1	-2.0	-2.4	-0.4	-1.9	*	*	*
Germany: Trade	12.3	4.9	1.7	1.2	1.1	0.9	0.2	3.1	3.1	0.4	1.0	n.a.
Current Account (NSA)	-5.3	-17.4	-2.9	-4.0	-7.1	-3.3	-4.4	-2.3	-3.3	-0.8	-0.9	1.3
Italy: Trade	-5.2	-22.6	-4.1	-4.4	-8.6	-5.5	-4.5	-4.8	-4.4	-1.4	-1.7	-0.6
Current Account (NSA)	5.5	-9.8	-4.4	-1.5	-1.0	-2.9	-5.8	2.3	n.a.	*	*	*
Japan: Trade[b]	1.8	2.1	-1.8	-0.9	1.4	2.9	3.4	5.4	6.3	2.2	2.5	2.6
Current Account[b]	-8.8	-10.7	-5.0	-4.1	-1.8	-0.2	-0.7	2.0	2.4	0.9	1.4	1.5
United Kingdom: Trade	-7.4	2.9	-0.9	-0.7	1.5	3.0	n.a.	n.a.	n.a.	n.a.	0.0	0.2
Current Account[b]	-3.0	6.6	0.2	-0.2	2.1	4.5	n.a.	n.a.	n.a.	n.a.	0.3	0.6
United States: Trade	-27.3	-25.3	-10.1	-6.7	-2.9	-5.6	-4.7	-6.9	-7.1	-4.6	-1.5	-4.2
Current Account	1.4	3.7	-2.1	-0.5	5.0	1.4	3.3	1.1	n.a.	*	*	*

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.

in May. Since then, the rate has risen to 6.5 percent (s.a.) in November, which amounts to 1-1/2 million unemployed.

The rate of inflation, as measured by the consumer price index, has been about 5 percent (annual rate) in the last three months including November. This rate, however, has been held down by seasonal factors. Seasonally adjusted, the annual rate in the three months to October was 7.7 percent. Wholesale prices in the three months to November rose at an annual rate of 7 percent. An important factor contributing to the inflation picture has been the steep rise of import prices (16 percent annual rate in the first three quarters this year), which reflect the weakness until recently of the D-mark exchange rate. The German current account was in surplus ($1.3 billion) in October for the first time since April 1979. The cumulative 1981 deficit through October was $8.7 billion (n.s.a.) compared to $16.1 billion last year.

On December 3 the Bundesbank announced its monetary target for 1982, 4-7 percent growth of Central Bank Money from the fourth quarter of this year to the fourth quarter of next year. The new target is thus unchanged from this year's target. The growth of Central Bank Money was below the bottom of this year's range in November. The Bundesbank also reduced its Special Lombard rate from 11 to 10.5 percent on December 3.

French GDP continued to grow in the third quarter of 1981; however, the over 1.5 percent (s.a.a.r.) growth was well below the nearly 5 percent growth which occurred in the second quarter. Third-quarter growth was supported almost exclusively by consumption growth of 4.5 percent. Whereas investment by private firms grew by 6 percent in 1980, there has been a decline of nearly 4.5 percent (a.r.) so far this year.

Unemployment has risen in France from over 1.5 million (s.a.) in January to over 1.8 million in November. The unemployment rate has risen from under seven percent to over eight percent in November.

Consumer price inflation during the last three months, including November, was over 13 percent (a.r.). The CPI for that period was over 14 percent above its level a year ago.

The current-account deficit for the first three quarters of this year was $4.7 billion compared to nearly $6 billion for the first three quarters last year.

French M2, although falling slightly in September, has grown at an annual rate of nearly 14.5 percent (s.a.) for the first three quarters of 1981. Interest rates in France have been falling steadily over the past two months. Credit controls seem to be less binding now than at any time during the year according to subjective evaluations by firms. In addition, the premium at which banks trade credit allocations among themselves, the "prime de desencadrement", which was above 6 percent in late September, was below 2 percent in mid-November.

The budget deficit in the 1982 draft budget, FF95 billion, is well above the FF30 billion in the 1981 draft budget and somewhat above a forecast FF70 billion deficit outturn for this year. Real government expenditure is planned to increase by over 26 percent compared with the original 1981 budget.

In the third quarter of 1981, preliminary data indicate that real GDP in the United Kingdom rose 1.2 percent (s.a.a.r.), the first quarterly increase in real GDP in the United Kingdom since the final quarter of

1979. Industrial production in the three-month period ending October 1981 was 7 percent (s.a.a.r.) above the level recorded in the preceding three-month period. Thus it appears that the prolonged decline in U.K. economic activity has come to an end. However, production is still at depressed levels and the unemployment rate continues to climb, reaching 11.4 percent in November. Between the fourth quarter of 1980 and the second quarter of 1981, output per person employed in the U.K. economy rose over 3-1/2 percent (s.a.a.r.), and in manufacturing it increased some 10 percent.

On December 2, 1981, Chancellor of the Exchequer Sir Geoffrey Howe announced some changes in the U.K. government's fiscal plans for FY1982-83, which will begin in April 1982. The net result is that the level of real government spending in FY1982-83 is now planned to be about the same as in the present fiscal year. (In his March budget message, Sir Geoffrey had originally announced the intention to cut real government spending by some 2 percent in FY1982-83.) In addition, the Chancellor announced an increase in the social security tax rate paid by employees, effective at the beginning of the next fiscal year. Sir Geoffrey did not present an estimate of the expected public sector borrowing requirement (PSBR) in FY1982-83 resulting from the announced fiscal measures. (This year's PSBR is still forecast to be £10-1/2 billion -- 4-1/4 percent of GDP.)

In <u>Canada</u>, real GNP fell roughly 4 percent (s.a.a.r.) in the third quarter of this year. Excluding inventory accumulation the decline in real GNP was 7.6 percent, representing the most severe decline since 1951. The sharp decline in real GNP during the third quarter was broadly based. Real consumption fell by 3.6 percent and real private investment fell 18.4 percent (s.a.a.r.). This decline in final demand played a major role in the more than $1 billion increase in inventory accumulation from about $642 million in the second quarter to roughly $1.7 billion in the third quarter.

Despite the third-quarter decline in real growth, inflation still remains high. In October the CPI index was about 12.7 percent higher than a year ago.

In the third quarter, the current-account deficit rose almost $500 million to $2.2 billion. The deficit for the first three quarters of this year was over $5 billion, compared with $1.6 billion for all of 1980.

In Italy economic activity remains weak. Real GDP fell by 6.4 percent (s.a.a.r.) in the third quarter after a 4.8 percent decline in the previous quarter. Both consumption and investment spending declined in real terms this year. At the beginning of the third quarter, the unemployment rate was 8.8 percent; based on the increase in unemployment benefits paid, the current rate is probably over 9 percent (over 2 million unemployed).

The inflation rate for consumer prices remains high; in November consumer prices rose by 1.7 percent to a level 18.2 percent above their year-earlier level. The weakness of the domestic economy has produced an improvement in the trade account: in the three month period ending in October, the trade deficit was about $3-3/4 billion compared with a deficit of $8-1/2 billion during the same period a year ago.

Talks between the government and the labor unions concerning the reform of the wage indexation system continue. In August, wages in industry were about 24 percent above their year-earlier level. During the same period, public sector wages grew by 35 percent.

In the Benelux countries further increases in unemployment indicate continued weakness of real activity. In Belgium unemployment in September reached 14.6 percent (n.s.a.) of the insured labor force, up almost 3 percentage points from the level of September 1980. Nevertheless, the National Bank of Belgium raised its official lending rates 2 percentage points on December 11 in response to continued pressure against the Belgian franc. In the Netherlands unemployment in October rose 0.4 percentage points to 9.9 percent (s.a.). This level represents a steady increase in the rate from its January 1981 level of 7.2 percent. The reduced level of domestic activity has helped to restrain import demand and led to a current account surplus of $1 billion (s.a.) for the first half of 1981 compared with a deficit of $2.4 billion for 1980 as a whole.