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July 11, 1984

RECENT DEVELOPMENTS

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

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SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest data			Percent change from		
	Period	Release date	Data	Preceding period	Three periods earlier	Year earlier
				(At annual rates)		
Civilian labor force	June	07-06-84	113.9	.8	3.4	1.8
Unemployment rate (%) 1/	June	07-06-84	7.1	7.5	7.8	10.0
Insured unemployment rate (%) 1/	Apr.	06-21-84	2.8	2.9	3.1	4.4
Nonfarm employment, payroll (mil.)	June	07-06-84	94.0	3.9	4.1	4.6
Manufacturing	June	07-06-84	19.6	3.7	3.4	6.7
Nonmanufacturing	June	07-06-84	74.4	3.9	4.3	4.0
Private nonfarm:						
Average weekly hours (hr.) 1/	June	07-06-84	35.3	35.3	35.3	35.0
Hourly earnings ($) 1/	June	07-06-84	8.31	8.28	8.25	8.01
Manufacturing:						
Average weekly hours (hr.) 1/	June	07-06-84	40.6	40.6	40.7	40.1
Unit labor cost (1967=100)	May	06-29-84	87.8	-9.5	-7.6	-6.8
Industrial production (1967=100)	May	06-15-84	163.2	5.2	8.0	13.0
Consumer goods	May	06-15-84	161.7	.0	5.8	7.5
Business equipment	May	06-15-84	175.4	11.0	8.1	18.8
Defense & space equipment	May	06-15-84	133.8	9.9	13.3	13.8
Materials	May	06-15-84	163.1	5.9	9.3	15.1
Consumer prices all items (1967=100)	May	06-22-84	309.6	2.3	3.5	4.2
All items, excluding food & energy	May	06-22-84	299.5	4.0	5.0	5.2
Food	May	06-22-84	300.9	-3.2	-1.7	3.0
Producer prices: (1967=100)						
Finished goods	May	06-15-84	291.5	-.4	1.8	2.6
Intermediate materials, nonfood	May	06-15-84	324.8	3.7	3.5	3.4
Crude foodstuffs & feedstuffs	May	06-15-84	261.7	-32.6	.6	4.3
Personal income ($ bil.) 2/	May	06-19-84	2,978.8	7.2	6.9	9.5
				(Not at annual rates)		
Mfgrs. new orders dur. goods ($ bil.)	May	07-02-84	102.0	3.8	-.3	22.5
Capital goods industries	May	07-02-84	34.3	6.9	.1	28.9
Nondefense	May	07-02-84	5.7	-8.6	-21.7	18.8
Defense	May	07-02-84	28.6	10.6	6.0	31.1
Inventories to sales ratio: 1/						
Manufacturing and trade, total	Apr.	07-10-84	1.33	1.33	1.29	1.43
Manufacturing	May	07-02-84	1.45	1.44	1.43	1.55
Trade	Apr.	07-10-84	1.24	1.24	1.18	1.29
Ratio: Mfgrs.' durable goods inventories to unfilled orders 1/	May	07-02-84	.524	.523	.526	.581
Retail sales, total ($ bil.)	May	06-13-84	107.3	.2	1.7	10.3
GAF 3/	May	06-13-84	22.8	.1	2.7	11.3
Auto sales, total (mil. units.) 2/	June	07-05-84	10.3	-6.5	4.4	6.3
Domestic models	June	07-05-84	7.9	-7.2	1.2	10.1
Foreign models	June	07-05-84	2.4	-3.9	16.1	-4.3
Plant and equipment expenditures 4/						
Total nonfarm business	1984	06-11-84	308.98	—	—	14.8
Manufacturing	1984	06-11-84	128.76	—	—	15.5
Nonmanufacturing	1984	06-11-84	180.22	—	—	14.3
Capital Appropriations, Mfg.	1984-Q1	06-06-84	25,915	20.3	--	43.0
Housing starts, private (thous.) 2/	May	06-19-84	1,782	-10.5	-21.2	.2
Leading indicators (1967=100)	May	06-29-84	168.2	-.1	.7	8.9

1. Actual data used in lieu of percent changes for earlier periods.
2. At annual rates.
3. Excludes mail order houses.
4. Planned-Commerce April and May 1984 Survey.

Economic activity continued to be robust during the second quarter. Consumer spending and investment in plant and equipment were particularly strong, and there were additional large advances in business inventories. Substantial employment increases reduced the unemployment rate to the lowest level in more than four years. In contrast, housing activity weakened somewhat. With imports boosted by the further advances in domestic demand, the trade deficit widened. Wage and price increases remained small.

Industrial Production

After increasing about one percent in April, the pace of industrial production slowed to about half that rate in both May and June. The level of industrial output in June is estimated to be about 1/2 to 3/4 percent higher than in the month earlier with most industrial groupings contributing to the advance. In particular, output of business equipment and defense products apparently continued to show sizable gains (to be released July 13).

Capacity utilization in manufacturing edged up in both May and June, bringing the cumulative rise since January to about 2 percentage points. At around 82 percent in June, this was the highest rate since March 1980 and about equal to the 1967-1982 average. As a result of the overall moderate utilization rate and the availability of imports at competitive prices, purchasing managers report few items in short supply.

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

		1983		1984		1984		
	1983	Q3	Q4	Q1	Q2	Apr.	May	June
	- - - - - - Average monthly changes - - - - - -							
Nonfarm payroll employment[2]	282	364	336	344	320	391	269	301
Strike adjusted	282	372	330	339	327	378	291	312
Manufacturing	92	102	148	108	55	64	39	61
Durable	70	79	114	82	51	38	46	68
Nondurable	22	23	34	25	4	26	-7	-7
Construction	22	36	22	22	71	95	42	75
Trade	69	72	85	88	72	81	67	69
Finance and services	96	102	93	105	113	98	106	134
Total government	3	33	-22	1	-12	30	-7	-60
Private nonfarm production workers	249	289	306	259	278	357	201	277
Manufacturing production workers	84	88	129	81	42	55	18	53
Total employment[3]	330	378	355	400	536	262	886	460
Nonagricultural	336	435	339	425	495	150	890	445

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

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

		1983		1984		1984		
	1983	Q3	Q4	Q1	Q2	Apr.	May	June
Civilian, 16 years and older	9.6	9.4	8.5	7.9	7.5	7.8	7.5	7.1
Teenagers	22.4	22.4	20.6	19.6	18.7	19.4	19.0	17.6
20-24 years old	14.5	14.0	12.9	11.9	11.5	12.2	11.5	10.7
Men, 25 years and older	7.8	7.6	6.8	6.1	5.7	5.9	5.7	5.4
Women, 25 years and older	7.2	7.0	6.3	6.1	5.9	6.0	5.8	5.8
White	8.4	8.1	7.4	6.8	6.4	6.7	6.4	6.1
Black	19.5	19.4	17.9	16.5	15.9	16.8	15.8	15.0
Fulltime workers	9.5	9.3	8.3	7.6	7.2	7.6	7.2	6.7
Memo:								
Total national[1]	9.5	9.3	8.4	7.8	7.4	7.7	7.4	7.0

1. Includes resident Armed Forces as employed.

Employment and Unemployment

Substantial employment gains were reported in June by both the payroll and household surveys. The civilian unemployment rate fell 0.4 percentage point to 7.1 percent, the lowest level in more than four years.

Nonfarm payroll employment rose 300,000 with gains widespread by industry. In manufacturing, employment in durable goods was up 68,000 with further sharp gains reported in the machinery and equipment industries; however, in recent months, increases in employment in nondurable goods have dwindled. The factory workweek was unchanged at 40.6 hours--a high level for this stage of the business cycle. Employment in services rose 130,000 for the largest advance during this recovery.

As measured by the household survey, employment rose 460,000 in June following an exceptionally large increase in May, and unemployment rates fell for most major demographic groups. Many of the new jobholders were adults; however, more teenagers than usual also found jobs in June.

Personal Income and Consumption

Personal income rose at a little more than a 7 percent annual rate in May, about the same pace as in the two preceding months and during 1983. Gains in the first quarter had been at an exceptionally strong 13.5 percent annual rate, in part because of substantial additions to farm income from the PIK program.

Consumer spending in May continued to show strength, not only because growth in real income was well-maintained, but also because consumers appear quite willing to use installment credit. Unit auto sales were particularly strong in May at an 11 million unit annual rate.

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

	1983	1984				
	Q4	Q1	May/Q1[4]	Mar.	Apr.	May
Total sales	2.9	3.5	1.9	-1.5	3.1	.2
(Real)[1]	2.5	3.0	1.6	-1.9	3.2	.0
Total, less automotive, gasoline and nonconsumer stores	1.6	3.0	1.5	-.3	2.4	-.1
GAF[2]	3.3	3.2	3.0	-1.6	4.2	.1
Durable	6.8	5.1	2.6	-4.3	5.7	.2
Automotive group	9.4	5.7	3.2	-6.7	7.3	.8
Furniture & appliances	3.4	3.5	1.7	.3	5.3	-2.6
Nondurable	1.0	2.7	1.5	.0	1.8	.2
Apparel	4.2	2.4	7.3	1.0	4.3	1.9
Food	.1	2.2	1.4	.8	1.7	-.5
General merchandise[3]	2.9	3.4	1.8	-3.2	3.7	.5
Gasoline stations	-.7	.3	1.4	1.9	-.5	.9

1. BCD series 59. Data are available approximately 3 weeks following the retail sales release.
2. General merchandise, apparel, furniture and appliance stores.
3. General merchandise excludes mail-order nonstores.
4. May divided by first quarter level.

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

	1983	1984				
	Q4	Q1	Q2	Apr.	May	June
Total sales	9.9	10.5	10.6	10.3	11.0	10.4
Imports	2.7	2.3	2.3	2.1	2.5	2.4
Domestic	7.3	8.2	8.2	8.2	8.5	8.0
Small	3.2	3.7	3.7	3.7	3.9	3.7
Intermediate & standard	4.1	4.5	4.5	4.6	4.7	4.3
Domestic production	7.6	8.2	7.7	7.7	7.6	7.8
Small	3.8	3.9	3.8	3.8	3.8	3.7
Intermediate & standard	3.8	4.2	3.9	3.9	3.8	4.1

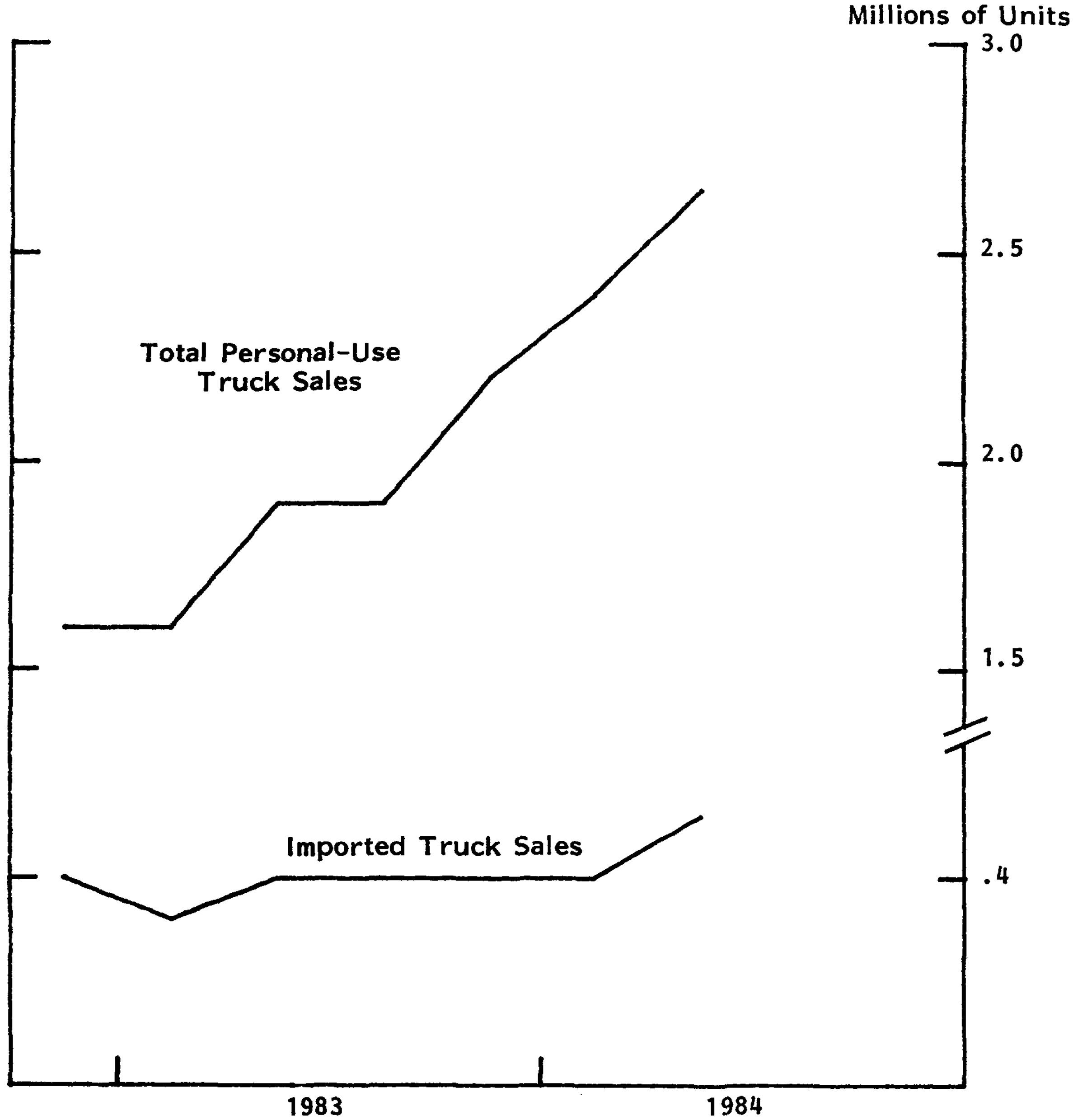
Note--Components may not add to totals due to rounding.

PERSONAL INCOME AND EXPENDITURES
(Based on seasonally adjusted data)

	1983	1984		1984		
	Q4	Q1	May	Mar.	Apr.	May
	--Percent change from previous quarter[1]--			--Percent change from previous month[1]--		
Total personal income						
Nominal	11.1	13.5		6.4	7.1	7.2
Real[2]	8.1	9.4		2.0	5.4	--
Disposable personal income						
Nominal	11.0	14.1		7.2	6.9	6.3
Real[2]	8.0	10.0		2.4	5.2	--
Personal saving rate (percent)	5.2	5.9		6.6	5.7	5.2
	--Changes in billions of dollars from previous quarter--			--Changes in billions of dollars from previous month--		
Total expenditures	49.8	55.3		5.4	36.1	24.5
Durables	15.8	16.5		-2.0	7.1	13.6
New autos	4.2	6.3		-2.7	-.6	7.9
Personal-use trucks	2.5	.7		3.2	1.6	.4
Furniture & appliances	4.7	4.2		-.2	3.9	.5
Nondurables	10.2	18.2		-2.2	20.2	4.0
Food	4.2	9.3		-4.3	13.4	-.2
Apparel	5.5	3.4		-2.1	4.8	4.3
Services	23.8	20.6		9.6	8.8	6.9

1. Changes from previous quarter are at compound rates; monthly changes are not compounded.
2. Personal income is deflated by the implicit deflator for personal consumption expenditures.

SALES OF PERSONAL-USE TYPE TRUCKS



Estimated on the basis of information on imports and the share of industrial production devoted to light-duty trucks.

In June, however, sales receded to a 10.4 million unit rate, about equal to the average for the first six months of 1984; this was the best half-year rate since early 1979. If it were not for shortages of many popular cars, sales might have been higher. Personal-use type trucks, moreover, are becoming an increasingly important component of consumer demand for vehicles. These light trucks sold at an estimated 2.7 million unit rate in May, compared to a first-quarter selling rate of about 2.5 million units, and a 2 million unit rate in mid-1983.

Nominal outlays for all consumer durable goods in May were up more than 20 percent at an annual rate from the first-quarter average, according to the monthly consumption estimates underlying the National Income and Product Accounts.[1] In addition to the sustained high level of purchases of motor vehicles, spending for furniture and appliances showed a gain of more than 12 percent at an annual rate in May from the first-quarter average. Spending for nondurable goods also remained robust in May, up 9 percent (annual rate) from the first quarter; a sizable share of this advance was attributable to higher spending for clothing and shoes. Spending for food was slightly lower over the month, but the easing of food prices tends to imply an upgrading in food budgets and therefore, probably an increase in real outlays for food. Spending for consumer services in May increased less than usual, in part because of the end of the spring cold snap and lower outlays for utilities.

1. BEA estimates consumption expenditures for goods other than automobiles and gasoline from the monthly retail sales reports.

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 Conference Board sample includes all types of households, prior to that families only.

With expenditures rising more strongly than disposable personal income, the saving rate for May is estimated to have dropped to 5.2 percent; this is off from 5.9 percent in the first quarter when farm income was boosted by PIK payments. The historically low rate is consistent with the high levels of consumer confidence that continued to be reported by both the Michigan Survey Research Center and the Conference Board. Answers to several questions in the Michigan Survey suggest that consumers have attempted to "buy in advance" of higher interest rates.

Business Fixed Investment

Real business fixed investment in the second quarter appears to have grown very rapidly--perhaps faster than the 16 percent annual rate now reported for the first quarter. Recent surveys of capital spending intentions, as well as data on new commitments, signal that a strong expansion is likely to continue.

Shipments of nondefense capital goods increased sharply in May after falling in April; the level in May was 5 percent (not an annual rate) above the first quarter. Increases were widespread among types of goods. Other components of current spending, including imports of capital goods and purchases of cars and trucks, also have been rising in recent months, although less rapidly than in the first quarter. New orders for nondefense capital goods point to further gains in equipment spending in the months ahead. In April and May orders were about 3-1/2 percent above the first quarter; the gain during the first quarter was 5 percent.

Nonresidential construction expenditures rose 4-1/2 percent in May, boosting building activity to a level more than 10 percent above the

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

	1983	1984			
	Q4	Q1	Mar.	Apr.	May
Producers' durable equipment					
Nondefense capital goods					
Shipments	6.0	1.1	4.5	-1.7	3.8
Excluding aircraft & parts	6.1	2.2	6.2	-2.6	4.0
Orders	6.9	5.2	-.6	-3.6	10.6
Excluding aircraft & parts	5.4	4.2	5.7	-5.8	11.0
Unfilled orders	2.0	4.4	1.3	.8	2.2
Excluding aircraft & parts	1.9	3.6	1.3	.3	2.2
Addendum:					
Sales of heavy-weight trucks (thousands of units, annual rate)	199	232	232	302	211
Nonresidential structures					
Nonresidential construction put in place	3.3	8.0	2.5	2.9	4.6
Nonresidential building contracts	4.4	-9.8	-5.0	20.1	25.1

first-quarter average. Most of the advance was concentrated in commercial construction, with both office buildings and other commercial units registering substantial gains. Industrial building has begun to pick up in recent months, and in the wake of the AT&T breakup construction outlays by telephone and telegraph companies also have risen. Recent data on contracts and permits for new nonresidential building indicate continued growth, particularly in the commercial construction area.

The latest survey of business spending plans taken by the Commerce Department found businesses planning an overall increase in nominal spending of about 15 percent for the year as a whole; however, in light of the current high level of spending, this survey figure implies relatively moderate spending gains in the second half of 1984. The spring surveys taken by McGraw-Hill and Merrill-Lynch indicated somewhat larger gains than the Commerce survey.

Business Inventories

Accumulation of business inventories has continued at a rapid pace since early this year, but the increases have been approximately matched by final demand and inventory-sales ratios remain low. In April, manufacturers and trade establishments added to their stocks at an annual rate of $32.4 billion in 1972 prices; the accumulation followed an already strong growth of $20.5 billion (annual rate) in the first quarter. Partial data in May show that inventory investment continued to be strong; in book value terms, factory inventories rose at an annual rate of nearly $50 billion, and wholesale trade stocks were up at a $8.3 billion rate.

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

	1983	1984				
	Q4	Q1	Feb.	Mar.[r]	Apr.[p]	May[p]
Book value basis						
Total	29.4	73.7	109.8	66.6	97.2	n.a.
Manufacturing	5.0	27.8	38.3	39.7	36.2	49.3
Wholesale trade	9.6	13.6	14.5	12.8	27.7	8.3
Retail trade	14.8	32.3	57.0	14.1	35.8	n.a.
Automotive	8.7	10.5	25.8	1.6	15.6	n.a.
Ex. Auto	6.1	21.8	31.3	12.5	20.2	n.a.
Constant dollar basis						
Total	9.4	20.5	40.7	14.8	32.4	n.a.
Manufacturing	-.5	6.9	12.9	14.0	9.5	n.a.
Wholesale trade	3.6	2.9	4.3	.5	10.8	n.a.
Retail trade	6.3	10.7	23.6	.3	12.1	n.a.
Automotive	4.1	2.8	10.7	-3.1	4.0	n.a.
Ex. Auto	2.3	7.9	12.8	3.3	8.1	n.a.

INVENTORIES RELATIVE TO SALES[1]

	Cyclical Reference Points[2]		1983	1984				
	1981 Low	1982 High	Q4	Q1	Feb.	Mar.[r]	Apr.[p]	May[p]
Book value basis								
Total	1.39	1.53	1.32	1.33	1.32	1.33	1.33	n.a.
Manufacturing	1.60	1.77	1.43	1.44	1.43	1.42	1.44	1.45
Wholesale trade	1.06	1.28	1.12	1.11	1.11	1.11	1.11	1.08
Retail trade	1.36	1.44	1.34	1.37	1.35	1.39	1.37	n.a.
Automotive	1.59	1.88	1.44	1.49	1.45	1.56	1.51	n.a.
Ex. Auto	1.29	1.35	1.31	1.34	1.33	1.34	1.34	n.a.
Constant dollar basis								
Total	1.62	1.76	1.55	1.54	1.54	1.54	1.55	n.a.
Manufacturing	1.92	2.14	1.75	1.73	1.72	1.72	1.75	n.a.
Wholesale trade	1.35	1.56	1.39	1.36	1.37	1.36	1.37	n.a.
Retail trade	1.33	1.45	1.36	1.38	1.38	1.40	1.39	n.a.
Automotive	1.44	1.79	1.40	1.37	1.37	1.43	1.42	n.a.
Ex. Auto	1.27	1.38	1.35	1.39	1.38	1.40	1.38	n.a.

1. Ratio of end-of-period inventories to average monthly sales for the period.
2. Highs and lows are specific to each series and are not necessarily coincident.
r--revised estimates.
p--preliminary estimates.

Much of the recent investment in factory stocks has occurred at producers of durable goods, especially capital goods industries such as machinery and some types of transportation equipment. By stage of processing, the stocking of raw materials and supplies apparently picked up again in May, after showing only small increases in March and April.

Auto stocks for certain popular models continue to be lean, reflecting strong sales and production capacity constraints. Although dealers held a 54 days' supply of domestic cars at the end of June--only slightly below their preferred level of 55-60 days--inventories of numerous General Motors models were in the 25 to 35 day range.

Housing Markets

The housing market has begun to show signs of reduced activity. In May, private housing starts dropped to an annual rate of 1.78 million units. The May level of starts was about 10 percent below the average for the first four months of the year when weather conditions generated a volatile monthly pattern. In addition, newly-issued residential building permits edged down in May to a level 3 percent below the average for the first four months of the year. Because abnormal weather conditions affect starts more than permits, the rate of starts relative to permit issuance has fluctuated considerably this year. In May, however this relationship appeared to be within its historical range.

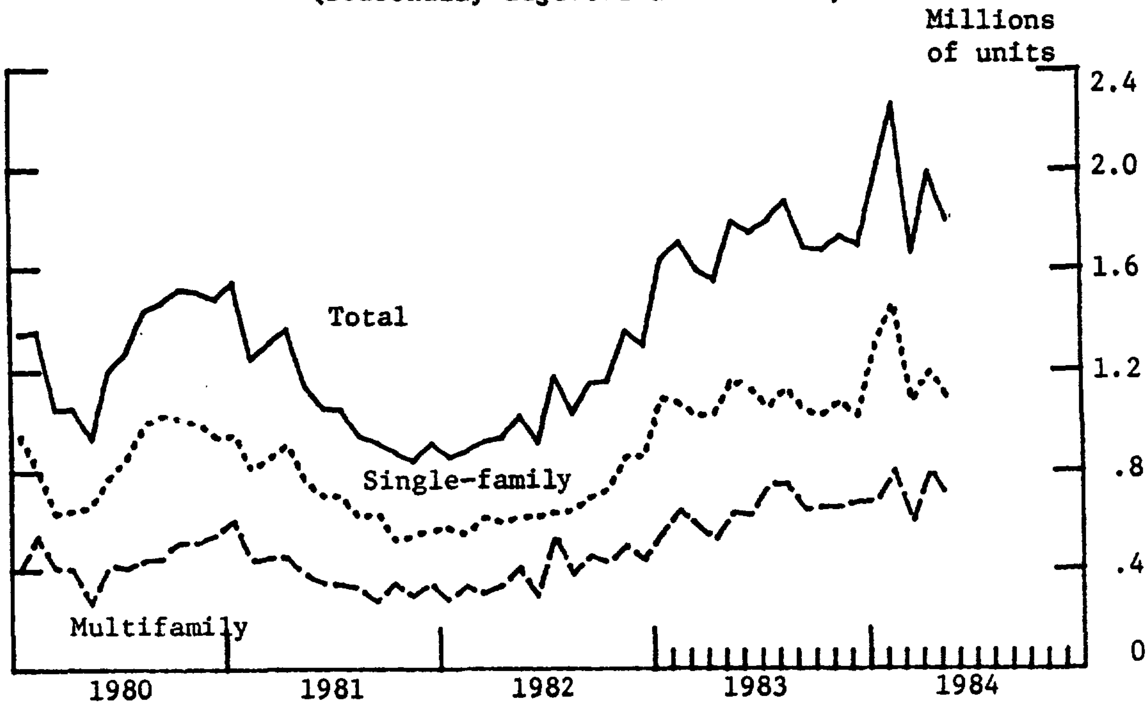
The decline in homebuilding has been most apparent in the single family sector; those starts in May were off 15 percent from the first-quarter average. In contrast, multifamily starts continue to hover around 700,000 units. However, market conditions are mixed, as field reports from the South

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

	1983 Annual	1983 Q4	1984 Q1	1984 Mar.	1984 Apr.	1984 May[1]
All units						
Permits	1.61	1.63	1.81	1.73	1.76	1.74
Starts	1.70	1.70	1.97	1.66	1.99	1.78
Single-family units						
Permits	.90	.91	1.02	.97	.96	.90
Starts	1.07	1.04	1.28	1.07	1.19	1.09
Sales						
New homes	.62	.67	.69	.68	.64	.61
Existing homes	2.72	2.76	2.94	3.02	3.09	3.05
Multifamily units						
Permits	.70	.72	.79	.75	.80	.84
Starts	.64	.66	.69	.59	.80	.69
Mobile home shipments	.30	.31	.30	.29	.29	n.a.

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

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



indicate some softness in both the condominium and the rental markets, while recent national data show no general weakening.

With costs of new mortgage credit moving up considerably since early this year, sales of new single-family homes have dropped for three successive months. The decline in new home sales produced a rapid buildup in the inventory of unsold new homes. Nevertheless, the inventory/sales ratio--equal to a 7 months' supply--was still not high by historical standards. Sales of existing homes, after posting five consecutive monthly increases, edged down 1 percent in May.

House prices have continued to rise at annual rates in the 5 to 9 percent range, although for new homes most of the gain apparently reflects quality improvements. Before adjustment for upgrading, the median price of new homes sold in May was up 9 percent from a year earlier; for existing home sales, the rise was 6 percent.

Federal Government Budget

The $11.5 billion unified federal government budget surplus in April was followed by a $33 billion deficit in May. The budget typically shows relatively high receipts in April that are attributable to payments of individual income taxes, but the surplus was unexpectedly large this year because of slower than usual processing of tax refunds and lower defense spending than projected by the administration. These patterns were reversed in May as a catchup in individual tax refunds reduced net revenues and defense spending increased more in line with spending plans for the fiscal year. In addition, unusually large outlays by the Federal Deposit Insurance Corporation--reflecting in part the infusion of capital into Continental Illinois Bank--contributed to the May deficit.

FEDERAL DEFICIT FOR THE 1984 FISCAL YEAR TO DATE
COMPARED TO PREVIOUS YEARS
(By month, dollar amounts in billions)

Month	Cumulative Deficits			Cumulative Monthly Deficit as a Percentage of the Fiscal Year Total Deficit		
	FY1982	FY1983	FY1984	FY1982	FY1983	FY1984[1]
October	18.1	26.2	25.1	.16	.13	.14
November	28.7	50.3	46.7	.26	.26	.26
December	48.2	68.3	63.3	.44	.35	.36
January	38.9	77.8	68.8	.35	.40	.39
February	53.7	103.2	89.2	.49	.53	.50
March	71.9	129.2	117.8	.65	.66	.66
April	62.2	132.5	106.3	.56	.68	.60
May	81.1	161.8	140.2	.73	.83	.79
Fiscal Year Total	110.7	195.5	177.8[p]			

1. Fiscal year total for FY1984 is the latest offical administration projection.

p Administration projection, Current Budget Estimates, April 1984

The cumulative FY1984 federal deficit totaled $140 billion through May. This amounts to almost 80 percent of the deficit projected by the administration for the entire fiscal year. As the table shows, this percentage is well within the range that has been recorded for this ratio by the end of May in the last two fiscal years.

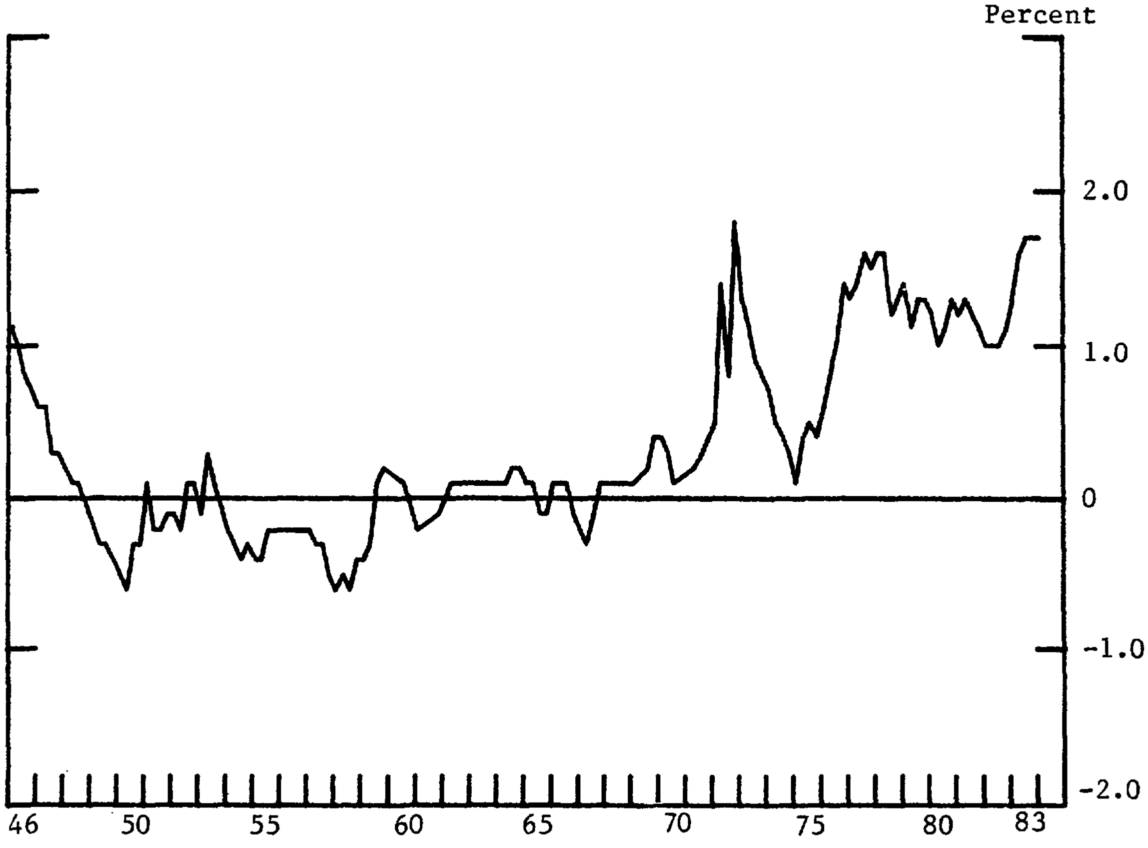
In action on the FY1985 budget, the Congress has passed the Deficit Reduction Act of 1984, which will increase taxes and cut spending by $63 billion over the next three years. The administration has stated that the President will sign this bill. About $50 billion in revenue will be raised from various small provisions that defer previously enacted tax cuts, raise excise taxes, place restrictions on some tax shelter activities, and broaden the tax base. The bulk of the savings in outlays arise from a freeze on physicians' fees and an increase in supplementary premiums in the medicare program. (The major provisions of the bill are summarized in Appendix II-A.)

This legislation represents between one-third and one-half of the total deficit-reduction program approved in separate "downpayment" versions by the Senate and House. The bulk of the remaining cuts must come from reductions in discretionary defense and nondefense spending now being negotiated by House and Senate budget conferees.

State and Local Government Sector

Activity in the state and local sector continued to advance during the spring, after a 3.0 percent rise in real terms at an annual rate in the first quarter. In May, real outlays for construction stood nearly 1 percent above the first quarter, and employment during the second quarter as a whole edged up from the first quarter. The surpluses of

STATE AND LOCAL GOVERNMENT BALANCE*
AS A PERCENT OF GNP



*--Includes operating and capital balance plus surplus of social insurance funds.

Source: National Income and Product Accounts.

state and local governments rose further in the first quarter to the highest level in nominal terms on record, reflecting increases in both the social insurance trusts and holdings in the operating and capital budgets. The total surplus in three consecutive quarters has been 1.7 percent of GNP; there has been only one quarter during the post-war period--the fourth quarter of 1972--when this ratio was either matched or exceeded.

Exports and Imports

For April and May combined, the merchandise trade deficit was a record $110 billion at an annual rate. Imports grew faster than exports reflecting the strength of demand in the United States, the slower rate of recovery in trading-partner countries, and the effects of the persistent high level of the exchange value of the dollar. Imports in the April and May period were at a moderately higher rate than in the already strong first quarter. Manufactured goods, which accounted for much of the large first-quarter increase, advanced further. Prices, as measured by the unit value index of nonoil imports, increased by 5 percent at an annual rate in April and May compared with increases of 3-1/2 percent at annual rate in the previous two quarters. Oil imports also rose somewhat in both volume and price. The value of merchandise exports in April and May was slightly higher than in the first quarter. A decline in agricultural exports was more than offset by an increase in nonagricultural shipments; nonagricultural exports in April and May were at the highest level recorded since the first quarter of 1982. (A more complete discussion of international economic developments is included in Part IV.)

Prices

Recent price reports were more favorable than expected. The consumer price index rose only 0.2 percent in May after a 0.5 percent increase in April; producer prices of finished goods were unchanged in both months. Although declines in food prices account for much of the slowdown, inflation rates for other goods and services remained quite moderate. At the consumer level, food prices fell 0.3 percent in May after two months of little change. Prices came down sharply for meats, poultry, and fresh vegetables, reversing much of the weather-related runup early this year. Although meat supplies were higher than anticipated, significant reductions in pork production are still expected in coming months.

Retail energy prices had picked up in April, in part because of unseasonably cold weather, but posted only small increases in May. Despite uncertainty about the Mid-East situation, spot prices in June were lower for both fuel oil and gasoline.

Excluding food and energy items, the CPI rose 0.5 percent in April and only 0.3 percent in May. This is similar to the average annual pace of 5 percent that has prevailed since the end of 1982; over this same time horizon prices of commodities other than used cars have been rising at an average annual rate of 2-1/4 percent.

At the producer level, increases in prices for capital equipment were relatively small in April and May, with the level of the index less than 3 percent above a year earlier. Prices of intermediate materials less food and energy were up only 0.1 percent in both months. Price

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

	Relative Importance Dec. 1983	1983	1983 Q4	1984 Q1	1984 Apr.	1984 May
			--Annual rate--		--Monthly rate--	
All items[2]	100.0	3.8	4.0	5.0	.5	.2
Food	18.7	2.6	4.3	9.0	.0	-.3
Energy	11.9	-.5	-1.7	-1.4	.7	.2
All items less food and energy[3]	69.4	4.9	4.9	5.1	.5	.3
Commodities[3]	26.5	5.0	4.6	3.4	.6	.2
Services[3]	42.9	4.8	5.3	5.9	.5	.4
Memorandum:						
CPI-W[4]	100.0	3.3	2.6	2.3	.2	.3

1. Changes are from final month of preceding period to final month of period indicated.
2. Official index for all urban consumers, based on a rental equivalence measure for owner-occupied housing after December 1982.
3. Data not strictly comparable. Before 1983, they are based on unofficial series that exclude the major components of homeownership; beginning in 1983, data include a rental equivalence measure of homeowners costs.
4. Index for urban wage earners and clerical workers.

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

	Relative Importance Dec. 1983	1983	1983 Q4	1984 Q1	1984 Apr.	1984 May
			--Annual rate--		--Monthly rate--	
Finished Goods	100.0	.6	1.1	6.0	.0	.0
Consumer foods	24.0	2.3	5.8	17.4	-.6	-1.2
Consumer energy	12.0	-9.2	-10.4	-7.2	.7	1.5
Other consumer goods	41.8	1.9	1.5	4.7	-.1	.1
Capital equipment	22.2	1.9	1.8	4.3	.3	.2
Intermediate materials[2]	94.8	1.5	2.5	2.6	.1	.3
Exc. energy	79.3	3.0	4.1	3.5	.1	.1
Crude food materials	52.8	8.0	12.1	13.7	-1.2	-2.7
Crude energy	31.3	-4.6	-2.3	-1.3	.4	.4
Other crude materials	15.9	15.5	2.4	-9.2	2.9	2.6

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

increases for products of industries with strong demand--such as paper, electronic components, and electric motors and generators--were largely offset by declines in a variety of other industries.

Wages and Labor Costs

Wage increases for production workers have remained quite low this year. The hourly earning index, which covers wages paid to about four-fifths of the workers on private nonfarm payrolls, rose at a 3 percent annual rate over the first six months of 1984, down from the 4 percent rate recorded in 1983. Despite a reduction in the prevalence of new wage concessions in collective bargaining agreements in manufacturing, wage changes have remained quite moderate. Small cost-of-living adjustments are one factor. In construction, pay cuts and freezes continue to occur under pressure from nonunion competition.

HOURLY EARNINGS INDEX[1]
(Percentage change; based on seasonally adjusted data)[2]

		1983		1984		1984		
	1983	Q3	Q4	Q1	Q2	Apr.	May	June
		--Annual rate--				--Monthly rate--		
Total private nonfarm	3.9	2.8	4.1	3.5	2.9	.5	-.2	.3
Manufacturing	2.7	2.1	3.3	3.8	2.8	.2	.2	.2
Durable	2.1	1.7	2.6	3.8	2.7	.2	.1	.2
Nondurable	3.9	2.9	4.4	3.6	3.1	.2	.3	.1
Contract construction	1.5	-.5	1.4	2.3	1.6	.2	.2	.1
Transportation and public utilities	4.3	2.2	4.6	3.7	2.9	.3	-.1	.3
Total trade	4.7	4.1	4.5	2.7	2.3	.6	-.3	.2
Services	4.9	4.1	5.1	3.3	4.6	.9	-.6	.7

1. Excludes the effect of interindustry shifts in employment and fluctuations in overtime hours in manufacturing.
2. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Quarterly changes are compounded annual rates.

APPENDIX A*

THE DEFICIT REDUCTION ACT OF 1984

The Deficit Reduction Act of 1984, which increases taxes by $50 billion and cuts entitlement-related spending by $13 billion over the 1984 through 1987 period, was passed by the Congress on June 29. The President is expected to sign the bill.

This legislation represents about one-half of the deficit reduction program included in the Senate passed version of the First Congressional Budget Resolution and about 40 percent of the House passed version. The remaining portions of the Senate and House deficit reduction packages consist of cuts in discretionary defense and nondefense spending and savings in debt service outlays attributable to reduced debt levels. Differences between the House and Senate version of the budget resolution--primarily in the size of the defense spending cuts--were not resolved by the budget conferees before Congress recessed for July 4 and the Democratic Party convention. The discretionary spending cuts are to be implemented in the regular annual appropriations process, which is not due to be completed until September 10.

The revenue portion of the Deficit Reduction Act, which is summarized in the table, consists of a large number of provisions that individually have small revenue impacts. However, several of the provisions can be usefully grouped into two broad categories. The category accounting for the largest receipts gains involves a freeze on changes in certain tax code provisions that would have expired or were scheduled to be liberalized under current law. A second major grouping involves changes to some of the trust, partnership and accounting provisions of the tax code that allowed individuals and organizations to shelter income from taxation by accelerating expenses, deferring income, or shifting taxable income to entities with relatively low tax rates.

Major revenue raising items in the freeze category, which accounts for about one-third of the revenue gain from the bill, include:

- Postponement of the effective date of a set of liberalized leasing rules known as finance leasing. These provisions, which became effective January 1, 1984, are retroactively repealed and are now scheduled to become effective January 1, 1988. In general, a lease arrangement must have economic substance aside from the tax benefits it generates in order to be classified as lease for tax purposes. Under the finance leasing rules that become effective in 1988 the fact that property is readily useable only by the lessee, or that the lessee has an option to purchase the property at a fixed price will not be taken into account in determining the economic substance of the transaction.

* Prepared by Wolf Ramm, Economist, Government Finance Section, Division of Research and Statistics.

- Postponement of increases in the amount of personal property that a business may elect to expense. Under prior law the maximum amount of qualifying property that could be expensed in the year in which the property is placed in service was $5,000. This limit was scheduled to increase to $7,500 in 1984 and $10,000 in 1986. These limits are now rescheduled to increase in 1988 and 1990.

- Repeal of the net interest exclusion under which individuals would have been allowed to exclude 15 percent of their interest income--up to a maximum of $3,000 on individual returns and $6,000 on joint returns--from taxable income beginning in 1985.

- Extension of the 3 percent telephone excise tax through 1987. This tax had been scheduled to expire after 1985.

- An increase of $2 per gallon in the tax on distilled spirits; this tax has declined sharply in real terms since first enacted.

Provisions that would limit the ability of individuals to shelter income from taxation account for another 20 percent of the revenue from the bill. Major revenue raising items include:

- Accounting rule changes which restrict--for tax payers using the accrual method of accounting--the accrual of expenses before all economic events establishing the expense liability have occurred. This provision has significant revenue effects since some tax shelters have offered current deductions for expense liabilities that are to be paid far in the future.

- Rules that impute income or rental income to the seller or lessor in transactions where payments are deferred and market interest rates (or rentals in the case of leases) are not charged. In the past, under a deferred payment transaction elements of interest or rent could be included in the final payment of a transaction; allowing the seller to deduct current interest expenses while deferring the income arising out of the transaction.

- The trust and partnership provisions include a limitation on the establishment of multiple trusts for the same beneficiary for the purpose of taking advantage of the graduated tax rate schedule; restrictions on the use of partnerships to change the timing of income, gains, losses and tax deductions; and limitations on tax exempt exchanges of property within a partnership.

Other areas in which the bill will result in relatively large revenue gains are:

- Corporate taxes are increased by limits on some tax preferences and eliminating the graduated tax rate structure for larger corporations.

- The sale of the tax benefits of accelerated depreciation by tax exempt entities such as state and local governments--through sale and leaseback arrangements--is restricted.

- The period over which certain real property may be depreciated is increased from 15 years to 18 years. This provision is not expected to have a sizable impact on building incentives.

- Income averaging formulas were modified making it harder to qualify for income averaging and reducing the benefits from averaging. The use of income averaging had increased rapidly in recent years due to inflation induced increases in wages and salaries. This relatively large revenue raiser primarily effects individuals.

- The tax treatment of pension and other employee benefit plans was tightened in a number of respects.

Also included in the bill were a number of provisions that reduced receipts:

- The rules governing the taxation of life insurance companies and products were rewritten replacing, in part, provisions that had expired at the end of 1983. The rules are designed to assure the uniform treatment of different forms of life insurance companies such as mutual and stock companies; and to discourage the use of life insurance as a short-term tax favored investment tool.

- Authority, which had expired at the end of 1983, for states and localities to issue mortgage revenue bonds for owner occupied residences was renewed. The existing state volume ceilings--the greater of 9 percent of average area qualifying mortgage originations during the last three years or $200 million--were retained. However some of the cap can be traded for "mortgage credit certificates," which will allow some buyers to claim a nonrefundable credit on their own tax returns. The act states that it is the intent of Congress to make this assistance available to lower income families.

- The jobs and earned income tax credits were increased.

- The holding period for long-term capital gains was reduced from one year to six months. This provision has a relatively small projected revenue impact reflecting, in part, the expectation of increased trading in financial assets.

- The 30 percent withholding tax on interest paid to foreign investors was repealed.

The outlay portion of the Deficit Reduction Act, also summarized in the table, will reduce spending by about $13 billion over the 1984 to 1987 period. The largest cuts are in the medicare and medicaid programs primarily from a 15 month freeze on physicians' fees under medicare and an increase in supplemental medicare insurance premiums. Other provisions would accelerate the collection of federal non-tax receipts and step up federal debt collection efforts as recommended by the Grace Commission, increase premium rates for federal credit union deposit insurance, limit veterans benefits, restrict farm disaster loans, and defer by one day--for an accounting gain of $1.4 billion in FY1985--the payment of military retirement benefits.

BUDGET IMPACT OF SELECTED REVENUE AND OUTLAY PROVISIONS[1]
(Fiscal years, unified budget, billions of dollars)

Provision	1984	1985	1986	1987	1984-1987
Tax Freeze:					
Postponement of finance leasing rules	.1	.3	.9	1.4	2.7
Expensing of personal property	.2	.4	.4	.4	1.4
Repeal of interest exclusion		1.0	2.9	3.1	7.0
Extension of telephone tax			1.2	2.0	3.2
Increase in liquor tax		.1	.3	.5	1.0
Other freeze items		.5	.3	.5	1.3
Sub-total of freeze provisions	.3	2.3	6.0	7.9	16.6
Partnership, Trust and Accounting Changes:					
Limits on premature expense accruals	.1	.4	.5	.5	1.6
Accrual of interest and rents in deferred payment transactions		.5	1.2	1.9	3.6
Other accounting changes	.2	.5	.5	.5	1.7
Trust and partnership provisions	.1	.5	1.1	1.6	3.3
Sub-total of partnership, trust and accounting provisions	.3	2.0	3.4	4.5	10.2
Corporate Provisions	.1	.9	1.4	1.6	3.9
Tax Exempt Entity Leasing	.3	.8	1.6	2.8	5.5
Depreciation of Real Property	.1	.3	.8	1.5	2.6
Income Averaging	.1	2.0	1.9	2.1	6.1
Pension and Employee Benefit Plans		.5	.9	1.1	2.5
Selected Provisions Resulting in Revenue Loss:					
Life insurance	-.1	-.3	-.4	-.5	-1.2
Jobs and earned income credits		-.2	-.8	-.7	-1.6
Capital gains			-.3	-.3	-.5
All Other Revenue Provisions		2.3	2.1	2.5	7.8
Total of Revenue Provisions	1.1	10.6	16.6	22.5	50.9
Spending Provisions:					
Medicare	.1	1.4	2.3	3.1	6.8
Grace Commission recommendations			1.5	1.7	3.2
All other spending provisions		2.7		.3	3.1
Total of Spending Provisions	.1	4.1	3.8	5.1	13.1
Total Deficit Reduction	1.2	14.7	20.4	27.6	64.0

1. Changes reducing the deficit (revenue increases and outlay reductions) are shown with a positive sign.
SOURCE: Joint Committee on Taxation and Congressional Budget Office.
NOTE: Detail may not sum to totals due to rounding.

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

	1981 Cyclical peak	1983 Cyclical low	1984 FOMC Jan. 30	1984 FOMC May 22	1984 July 10	Change from: FOMC Jan. 30	Change from: FOMC May 22
Short-term rates							
Federal funds[2]	20.06	8.42	9.41	9.75	11.26	1.85	1.51
Treasury bills							
3-month	17.01	7.55	8.89	10.04	10.09	1.20	.05
6-month	15.93	7.62	8.97	10.50	10.54	.57	.04
1-year	15.21	7.73	9.00	10.70	10.94	1.94	.24
Commercial paper							
1-month	18.63	8.00	9.14	10.16	11.16	2.02	1.00
3-month	18.29	7.97	9.13	10.52	11.28	2.15	.76
Large negotiable CDs[3]							
1-month	18.90	8.08	9.23	10.47	11.35	2.12	.88
3-month	19.01	8.12	9.31	11.10	11.64	2.33	.54
6-month	18.50	8.20	9.43	11.80	12.17	2.75	.38
Eurodollar deposits[2]							
1-month	19.80	8.68	9.53	10.73	11.63	2.10	.90
3-month	19.56	8.71	9.70	11.58	12.18	2.47	.59
Bank prime rate	21.50	10.50	11.00	12.50	13.00	2.00	.50
Treasury bill futures							
Sept 1984 contract	--	8.71	9.57	11.29	10.77	1.20	-.52
Dec. 1985 contract	--	10.86	10.79	12.68	12.70	1.91	.02
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	16.59	9.33	10.88	12.86	13.24	2.36	.38
10-year	15.84	10.12	11.66	13.52	13.53	1.87	.01
30-year	15.21	10.27	11.74	13.53	13.28	1.54	-.25
Municipal revenue (Bond Buyer index)	14.24	9.21	9.95[4]	10.82[4]	11.11[4]	1.16	.29
Corporate--A utility Recently offered	18.33*	11.64	12.90e	14.90e	15.05e	2.15	.15
Home mortgage rates							
S&L fixed-rate	18.63	12.55	13.29[5]	14.04[5]	14.66[5]	1.37	.62
FNMA ARM, 1-yr.	N.A.	10.49	11.40[5]	13.00[5]	13.70[5]	2.30	.70

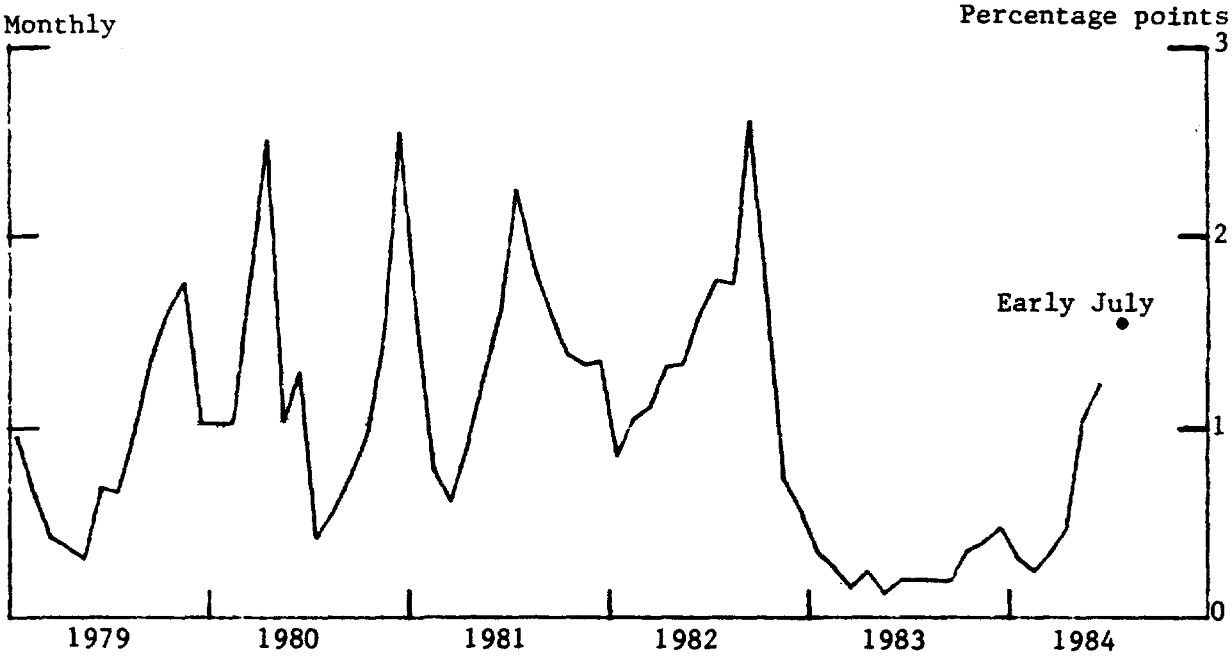
	1982 Lows	1983 Highs	1984 FOMC Jan. 30	1984 FOMC May 22	1984 July 10	Percent change from: FOMC Jan. 30	Percent change from: FOMC May 22
Stock prices							
Dow-Jones Industrial	776.92	1287.20	1221.52	1116.62	1126.88	-7.7	.9
NYSE Composite	58.80	99.63	94.12	88.43	88.19	-6.3	-.3
AMEX Composite	118.65	249.03	217.53	202.68	196.49	-9.7	-3.1
NASDAQ (OTC)	159.14	328.91	269.23	240.80	236.25	-12.2	-1.9

1. One-day quotes except as noted.
2. Averages for statement week closest to date shown.
3. Secondary market.
*September average.
4. One-day quotes for preceding Thursday.
5. One-day quotes for preceding Friday.
e--estimated. p--preliminary.

Financial markets have been rather turbulent during the past two months, as incoming data have provided a good many surprises about the course of the economy and as tensions have persisted in the banking system. Low inflation figures have been a constructive factor for the markets, but indications of continued rapid growth in real activity have intensified concerns about prospective money and credit demand pressures and about possible Federal Reserve tightening actions. In this environment, investors are demanding a large liquidity premium to extend beyond the shortest maturities.

Federal funds traded around 10-1/2 percent until mid-June when pressures associated first with corporate tax payments and later with the quarter-end statement date helped to push the rate above 11 percent. More recently, the funds market has remained relatively tight, perhaps reflecting expectations of firmer System policy and some caution in reserve management by large banks, who may wish to avoid borrowing at the discount window at this time. Despite the heavy demands on short-term credit markets, Treasury bill rates are about unchanged on balance since the May FOMC meeting. A net paydown of bills, to remain below the public debt ceiling, has contributed to the stability of bill rates, but there has also been something of a flight to quality. Heightened concerns about the exposure of the banking system to loan losses, which were underscored by Continental Bank's liquidity problems and rumors about other banks, helped to boost prime CD and commercial paper rates by 50 to 100 basis points over the intermeeting period. There have been reports of tiering and other resistance to U.S. bank borrowers in the Euro CD and interbank markets, and, in the domestic CD

YIELD SPREAD: CD LESS TREASURY BILL*
(3-Month)



*Rates converted to investment yield basis to provide comparability.

and commercial paper markets, certain money center banks have been paying premium rates compared with other issuers. The prime rate was raised to 13 percent from 12-1/2 percent on June 25, reflecting the higher cost of funds to major banks. Although private long-term bond yields have increased little on balance from May FOMC meeting levels, interest rates posted in the primary market for new home mortgages are up more than one-half percentage point.

Credit demands have continued to swell, reflecting burgeoning private domestic spending in the first half of the year and the continuing large federal deficit. The aggregate debt of private domestic nonfinancial sectors has expanded at double-digit rates since late last year; in the second quarter this measure is estimated to have increased at an annual rate of 13 percent, following a first-quarter increase of about 12 percent. Business borrowing, particularly in the short-term area, has continued sizable, owing in part to mergers but also reflecting growing external financing needs associated with investment in inventories and fixed capital. Household demands for consumer credit and home mortgages remained strong through May, a period too early to reveal any restraining impact from the upturn in rates on such loans. Uncertainty about the outcome of congressional debate over issuance of mortgage revenue bonds and IDBs restrained the volume of borrowing in the tax-exempt market through June; with new legislation now expected to be signed into law, the market could be flooded with tax-exempt issues over the summer months.

Against the backdrop of robust economic growth, M1 rebounded in May and posted another large increase in June; it stood in the upper part of its annual target range at midyear. M2 has continued to track a little below the 7-1/2 percent midpoint of its 1984 target range, but heavy issuance of large CDs by commercial banks and S&Ls--to meet strong loan demand--has held M3 growth above its annual target.

Monetary Aggregates and Bank Credit[1]

The recorded growth rates of M1 in April and May apparently were distorted, at least in part, by seasonal adjustment factors that did not capture adequately the patterns of tax payments and refunds; this was particularly evident for other checkable deposits, which declined in April, but subsequently surged and accounted for much of the growth in M1 during

1. A retrospective on the behavior of the aggregates in the first half of 1984 is presented in Appendix A.

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

	1983 Q3	1983 Q4	1984 Q1	1984 Q2**	1984 May	1984 June**	Growth from Q4 1983 to June 1984**
	------- Percentage change at annual rates ------						
1. M1	9.5	4.8	7.2	6.0	12.6	12	7½
2. M2	6.9	8.5	7.0	7.0	8.8	7	7
3. M3	7.4	9.9	9.0	10.0	10.7	8	9½
							Levels in billion of dollars May 1984
Selected components							
4. Currency	9.1	9.8	8.7	7.0	8.7	10	152.9
5. Demand deposits	4.0	-0.5	1.2	3.5	-0.5	16	245.2
6. Other checkable deposits	21.2	9.6	16.2	9.5	41.4	7	137.8
7. M2 minus M1[2]	6.1	9.7	6.9	7.0	7.6	6	1718.3
8. Overnight RPs and Eurodollars, NSA[3]	-8.1	23.4	19.3	-7.0	39.7	-53	59.3
9. General purpose and broker/dealer money market mutual fund shares, NSA	-13.1	-1.2	9.8	16.0	4.1	19	146.6
10. Commercial banks	12.2	12.4	5.5	6.5	4.9	9	732.9
11. Savings deposits, SA, plus MMDAs, NSA[4]	11.0	5.9	6.5	5.0	-4.8	1	372.5
12. Small time deposits	13.7	19.3	4.4	8.5	15.2	16	360.4
13. Thrift institutions	7.3	7.3	6.4	6.5	6.6	7	784.5
14. Savings deposits, SA, plus MMDAs, NSA[4]	1.0	-7.0	-0.9	2.0	-1.8	-9	327.3
15. Small time deposits	12.3	18.8	11.8	9.5	12.7	19	457.2
16. M3 minus M2[5]	9.8	16.0	17.9	23.5	18.2	12	556.5
17. Large time deposits	11.9	15.7	24.8	30.5	38.5	35	367.0
18. At commercial banks, net[6]	-4.6	-0.4	10.0	23.5	36.6	28	243.5
19. At thrift institutions	63.5	58.1	58.6	45.5	40.2	52	123.4
20. Institution-only money market mutual fund shares, NSA	-17.8	16.6	11.0	7.0	5.7	9	42.0
21. Term RPs, NSA	15.2	50.0	18.4	38.0	28.1	-57	61.2
22. Term Eurodollars, NSA	-1.7	-3.1	7.1	1.0	-12.6	-69	94.1
	-- Average monthly change in billions of dollars --						
MEMORANDA:							
23. Managed liabilities at commercial banks (24+25)	-2.6	5.3	4.6	5.5	15.5	-1	419.6
24. Large time deposits, gross	-2.0	0.1	2.0	8.0	10.5	10	302.8
25. Nondeposit funds	-0.6	5.2	2.6	-2.5	5.0	-11	116.8
26. Net due to related foreign institutions, NSA	1.3	3.2	2.0	2.0	5.3	-6	-28.4
27. Other[7]	-2.0	2.1	0.6	-4.5	-0.2	-5	145.2
28. U.S. government deposits at commercial banks[8]	1.0	-1.2	1.2	-1.5	-3.7	1	12.2

1. Quarterly growth rates are computed on a quarterly average basis. Dollar amounts shown under memoranda for quarterly changes are calculated on an end-month-of-quarter basis.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Overnight and continuing contract RPs issued to the nonbank public by commercial banks plus overnight Eurodollar deposits issued by branches of U.S. banks to U.S. nonbank customers, both net of amounts held by money market mutual funds. Excludes retail RPs, which are in the small time deposit component.
4. Growth rates are for savings deposits, seasonally adjusted, plus money market deposit accounts (MMDAs), not seasonall adjusted. Commercial bank savings deposits excluding MMDAs declined during May and June at rates of 3.7 and 1.0 percent respectively. At thrift institutions, savings deposits excluding MMDAs increased in May at a rate of 1.4 percent and decreased in June at a rate of 3.0 percent.
5. The non-M2 component of M3 is seasonally adjusted as a whole.
6. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.
7. 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 and unaffiliated foreign banks), loans sold to affiliates, loan RPs and other minor items. Data are partially estimated.
8. Consists of Treasury demand deposits at commercial banks and Treasury note balances.
** Based on nearly complete data for June. Monthly growth rates are rounded to the nearest full percentage point, quarterly rates are rounded to the nearest one-half percentage point, and Q4 to June rates are rounded to the nearest one-quarter percentage point.

May. The continued strength in M1 in June, however, which brought the quarterly average gain to 6 percent at an annual rate, appears to reflect the underlying growth in demand for transactions balances to support rising spending. The growth of desired cash balances presumably has been tempered by the rising trend in interest rates, thereby lifting the growth of income velocity; the velocity of M1 has risen at an average annual rate of about 4-1/2 percent over the past two quarters, broadly consistent with the predictions of the Board's quarterly model of money demand.

M2 growth strengthened in May, but in June returned to its subdued pace of earlier in the year, as a sharp drop in overnight RPs, which accompanied a large cutback in Treasury securities held in trading accounts at commercial banks, restrained expansion in its nontransactions component. Among other nontransactions components of M2, growth in small time deposits accelerated further in June. The slower pace through April was perhaps associated with inflows to IRA and Keogh accounts; these accounts have been increasing markedly in importance in the past few years, and their impact on M2 probably is not anticipated fully by current seasonal factors. Inflows to small time deposits at both commercial banks and thrift institutions have been strong recently even though rates on these accounts generally have lagged behind those on Treasury instruments and money market mutual funds, as market rates have risen.

M3 growth was similar in May to the brisk April pace, but slackened in June, with the slowing of M2 and sharp declines of term Eurodollars and RPs. Large time deposits accelerated on average in May and June as issuance by commercial banks surged, while growth of large time deposits at thrifts continued around the elevated pace of recent months. The strength in large

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

	1983 Q4	1984[2] Q1	Q2	Apr.	May	June p	Levels in bil. of dollars June p
	Commercial Bank Credit						
1. Total loans and securities at banks[3]	12.8	14.2	7.5	5.6	14.9	1.9	1657.7
2. Securities	10.8	4.4	-7.7	-10.1	1.9	-15.1	431.4
3. Treasury securities	25.1	-1.9	-8.1	-7.7	9.7	-26.3	183.3
4. Other securities	0.6	9.2	-7.4	-11.8	-3.8	-6.7	248.1
5. Total loans[3]	13.5	17.8	13.0	11.4	19.3	8.0	1226.3
6. Business loans[3]	10.6	18.9	16.6	8.5	27.7	12.9	455.2
7. Security loans	60.8	0.0	-33.7	-17.6	26.8	-109.1	25.0
8. Real estate loans	11.4	13.4	14.5	13.2	14.0	15.9	359.3
9. Consumer loans	23.1	21.3	22.1	20.2	21.9	23.0	244.2
	Short- and Intermediate-Term Business Credit						
10. Business loans net of bankers acceptances	10.8	18.2	16.9	8.2	27.5	14.3	445.7
11. Commercial paper issued by non-financial firms[4]	25.9	20.1	67.1	88.6	35.7	67.1	58.5
12. Sum of lines 10 & 11	12.3	18.4	22.0	16.6	28.2	20.0	504.2
13. Line 12 plus loans at foreign branches[5]	12.4	18.2	22.1	17.9	29.2	18.1	524.1
14. Finance company loans to business[6]	29.0	28.8	n.a.	7.2	n.a.	n.a.	n.a.
15. Total bankers acceptances outstanding[6]	18.9	-22.2	n.a.	54.1	61.2	n.a.	n.a.
16. Total short- and intermediate-term business credit (sum of lines 13, 14 and 15)	15.5	14.9	n.a.	20.2	n.a.	n.a.	n.a.

p--preliminary
n.a.--not available.
1. Average of Wednesdays for domestically chartered banks and average of current and preceding ends of months for foreign-related institutions.
2. Growth rates beginning 1984 have been estimated after adjusting for major changes in reporting panels and definitions that caused breaks in series at the beginning of January. Data should be regarded as highly preliminary.
3. 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.
4. Average of Wednesdays.
5. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
6. Based on average of current and preceding ends of month.

time deposits reflects credit demand that has outstripped growth in core deposits; it also reflects, at commercial banks, a substantial runoff in government deposits in May and, in June, a shift to funding foreign branch assets in the U.S. market.[1] Term RPs declined in June, perhaps reflecting a shortage of collateral; commercial bank holdings of Treasury securities were off sharply in June. Thrifts increased their reliance on nondeposit sources of funds in May and June to augment sizable deposit inflows, as FHLBB advances showed their largest increases of the year.

After surging to a 15 percent growth rate in May, commercial bank credit slowed abruptly in June, reflecting a substantial runoff of securities, particularly of Treasuries, and a marked slowing in total loan growth. The weakening in total loans was accounted for largely by declines in the security and unclassified loan categories. Business loans slowed somewhat in June from May's pace, which was boosted substantially by merger-related lending to large oil companies; a portion of these loans was paid down in June. In addition, lending to businesses in June likely was damped by the shift this year of the June corporate profits make-up payment to March. Nonetheless, the merger-adjusted growth of business loans appears off only only a bit from the roughly 20 percent pace in May.[2] Consumer and real

1. Commercial banks advanced $6-1/4 billion abroad in June, after raising more than $14 billion from their foreign offices over the first five months of the year. Evidently this reflected, at least in part, funding difficulties in the Eurodollar market as indicated by the large decline in term Eurodollars held by U.S. residents. This weakness in the Euromarket may have been masked in May as bank holding companies deposited substantial amounts in their foreign branches, financed by commercial paper issuance in the U.S.

2. Respondents to the Senior Loan Officer Opinion Survey on Bank Lending Practices taken in mid-June indicated some tightening of their lending practices. One-third of the respondents reported that they had become more restrictive in their lending for leveraged buy-outs. Most of the respondents who indicated a tightening of lending practices reported that they did so by applying higher standards of creditworthiness.

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

	1983	1984 Q1	Q2p	Apr.	Mayp	Junep	Julyf
Corporate securities - total[1]	8.91	8.36	6.54	7.80	4.80	7.00	5.70
Public offerings in U.S.	8.21	6.92	5.45	6.04	4.50	5.80	4.70
Stocks—total[2]	4.30	2.17	1.63	1.78	1.50	1.60	1.70
Nonfinancial	3.07	1.11	1.15	1.24	1.20	1.00	—
Utility	.80	.22	.35	.34	.30	.40	—
Industrial	2.27	.89	.80	.90	.90	.60	—
Financial	1.23	1.06	.48	.54	.30	.60	—
Bonds—total[1]	3.91	4.75	3.82	4.26	3.00	4.20	3.00
By industry							
Nonfinancial	2.03	1.49	1.88	2.35	1.49	1.80	—
Utility	.95	.64	.45	.56	.10	.70	—
Industrial	1.08	.85	1.43	1.79	1.39	1.10	—
Financial	1.88	3.26	1.94	1.91	1.51	2.40	—
By quality[3]							
Aaa and Aa	1.13	.93	1.18	1.36	1.34	.85	—
A and Baa	1.57	1.59	1.28	1.24	.64	1.96	—
Less than Baa	.48	.61	.72	1.23	.53	.39	—
No rating (or unknown)	.37	.36	.13	.12	.18	.10	—
Memo items:							
Equity based bonds[4]	.75	.28	.38	.76	.12	.26	—
Mortgage-backed bonds	.38	1.26	.52	.31	.20	.70	—
Floating rate or extendible notes	.46	.58	1.35	1.35	.84	1.85	—
Bonds sold abroad - total	.70	1.44	1.09	1.76	.30	1.20	1.00
Nonfinancial	.33	.86	.38	.69	.18	.27	—
Financial	.37	.58	.71	1.07	.12	.93	—

p—preliminary. f—forecast.
1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. Includes equity issues associated with debt/equity swaps.
3. Bonds categorized according to Moody's bond ratings. Excludes mortgage-backed bonds.
4. Includes bonds convertible into equity and bonds with warrants attached where the warrants entitle the holder to purchase equity in the future.

estate loans continued to expand at a brisk pace.

Business Finance

Business needs to finance inventories and fixed capital outlays have been outstripping the flow of internal funds this year, causing the financing gap to widen from $36 billion in the first quarter to about $57 billion in the second quarter; this gap was negative on average in 1982 and 1983. Borrowing by businesses has continued to be concentrated in short- and intermediate-term maturities, partly reflecting the rapid buildup of inventories, but also apparently the attractiveness of short-term relative to long-term credit costs.

The sum of business loans at commercial banks (excluding holding of bankers acceptances but including loans to U.S. residents at their foreign branches) and nonfinancial commercial paper increased at a 22 percent annual rate in the second quarter, following a first-quarter rise of 18 percent. Financing of mergers and buyouts has had a marked impact on short-term credit flows, with large oil-company deals alone accounting for at least one-third of this year's growth. Nevertheless, business credit has expanded substantially even after adjusting for merger activity.

In the second quarter, the volume of funds raised by nonfinancial businesses in long-term markets continued at close to the first quarter's moderate pace. In contrast to last year when equity offerings accounted for more than one-half of the gross volume of long-term public financing, the depressed stock market has reduced that share to about one-third so far this year. An increasing number of bond issues sold by nonfinancial firms were departures from the traditional long-term fixed-rate issue: floating rate notes, extendible maturity notes, or intermediate-term Euros.

The Deficit Reduction Act of 1984, which was passed by the Congress, provides for the repeal of the 30 percent withholding tax on interest payments to foreigners and may reduce somewhat the rate differential between the U.S. and Eurobond markets. The Eurobond market is still likely to be attractive to foreign investors who prefer the anonymity of bearer bonds--U.S. corporations can still issue bearer bonds in the Euromarket under the new law--or who are familiar with European distribution channels. Nevertheless, the extent to which this financing mechanism remains viable will depend partly on whether the Treasury relaxes existing regulations for a 20 percent backup witholding tax--it is expected to do so--and whether it decides to issue bearer bonds targeted at foreign investors. Generally, market analysts remain unconvinced that the Euromarket will be much affected.

Corporate bond yields have risen only 15 basis points since the May FOMC. The yield spread between A-rated utility and Treasury bonds has widened to more than 150 basis points, compared with levels of around 100 basis points at the beginning of the year. Quality spreads among private issues have changed much less, however, suggesting that a sizable part of the widening of the corporate-Treasury yield spread since January reflects differences in call protection associated with higher interest rates. Stock prices in general are below their May FOMC levels, and the broad indexes at least 10 percent below their 1984 highs reached early in January.

Government Finance

Federal sector. In May, the Treasury's deficit rose abruptly, reflecting hefty tax refunds as well as a reassertion of the underlying upward trend in outlays and a slowing of the cyclical rebound in receipts.

Treasury financing was disrupted, however, by a delay in raising the debt ceiling and, as a result, the $35.3 billion combined deficit was financed principally by a $30 billion decline in the cash balance.

The inflows of June tax payments greatly narrowed the federal deficit last month, and moderate net issuance of marketable debt restored the cash balance to an end-of-quarter level of $13.6 billion. Congress raised the debt limit on June 29 by $53 billion to $1,573 billion; this action is expected to accommodate the Treasury's needs through August.

The staff currently is projecting a third-quarter combined deficit of about $41 billion and the Treasury's cash balance is expected to increase by about $7 billion. So far in the current quarter, net marketable borrowing has amounted to about $16-1/2 billion. The Treasury will likely meet most of its remaining financing requirements in auctions of coupon issues.

Net cash borrowing by federally sponsored credit agencies is estimated to have totaled $4-3/4 billion in the second quarter, compared with $5-1/2 billion in the first quarter. Borrowing by the Federal Home Loan Banks picked up considerably to finance a substantial increase in advances. Reflecting portfolio purchases of mortgages, FNMA also was active in debt markets in the second quarter.[1] Borrowing by the Farm Credit System remained quite light, owing to depressed conditions in the agricultural sector.

1. FNMA recently issued a $6 billion, 30-year zero-coupon debenture that raised about $200 million of new cash. This was the largest offering ever of zero-coupon securities by any issuer and is estimated to have saved FNMA about 150 basis points relative to the likely pricing of a regular coupon issue, owing in part to the enthusiastic reception of zero-coupon issues in foreign markets, especially Japan.

TREASURY AND AGENCY FINANCING[1]
(Total for period; billions of dollars)

	1984				
	Q2p	Q3f	May	Junep	Julyf
Treasury financing					
Combined surplus/deficit(-)	-28.3	-41.2	-35.3	-3.8	-18.8
Means of financing deficit:					
Net cash borrowing from the public	31.2	52.8	8.6	5.6	23.2
Marketable borrowings/ repayments(-)	29.7	50.5	7.9	5.2	22.4
Bills	-7.0	12.0	-3.1	-.9	4.1
Coupons	36.7	36.3	11.0	6.1	18.3
Nonmarketable	1.5	2.5	.7	.4	.8
Decrease in the cash balance	.5	-7.1	30.0	-5.4	-7.3
Memo: Cash balance at end of period	13.6	22.7	8.2	13.6	20.9
Other[2]	-3.4	-4.5	-3.3	3.6	2.9
Federally sponsored credit agencies, net cash borrowing[3]	4.8	4.8	2.5	1.7	1.3
FHLB	1.9	2.1	.8	.8	.7
FNMA	1.8	1.5	1.2	.5	.5
Farm Credit Banks	.1	.2	.0	.1	.0
FHLMC	.5	.7	.4	.1	.1
SLMA	.5	.3	.1	.2	.0

p--preliminary. f--forecast.
1. Data reported on a not seasonally adjusted, payment basis.
2. Includes checks issued less checks paid, accrued items and other transactions.
3. Excludes mortgage pass-through securities issued by FNMA and FHLMC.

State and local sector. Activity in the long-term tax-exempt market was subdued during the first half of 1984, at least by comparison with the past two years. In June, gross bond offerings totaled $5.2 billion on a seasonally adjusted basis, in line with the pace of the first five months of the year but substantially below last year's $7 billion average monthly figure.

There was little issuance of single-family mortgage revenue bonds and industrial development bonds (IDBs) in the first half. The Deficit Reduction Act of 1984 extends the authority of state and local governments to issue mortgage bonds through 1987 and places volume caps on the sale of IDBs and student loan bonds.[1] As a result, offerings of such revenue bonds are expected to swell this summer, perhaps by as much as $7 billion in the next few months, according to market sources. Since late June, nearly $2 billion of new owner-occupied housing issues have come to to market--with delivery contingent on the signing of the new law.

Yields on municipal bonds have fluctuated considerably over the intermeeting period; on balance, they have changed little since the May FOMC meeting. The market appears to have been anticipating a surge in housing and IDB issues upon passage of the tax legislation, but rates on housing issues nonetheless jumped with the outpouring of new issues in early July.

Mortgage Markets

In the primary mortgage market, the contract interest rate for new commitments on conventional 80 percent fixed-rate home loans at a sample of S&Ls climbed during the intermeeting period by about 5/8 percentage point

1. The volume caps on these bonds total $200 million for each state or $150 per resident, whichever is higher. These caps do not include projects that were previously approved, as long as the bonds are issued this year.

GROSS OFFERINGS OF SECURITIES BY STATE AND LOCAL GOVERNMENTS
(Monthly totals or monthly averages; billions of dollars)

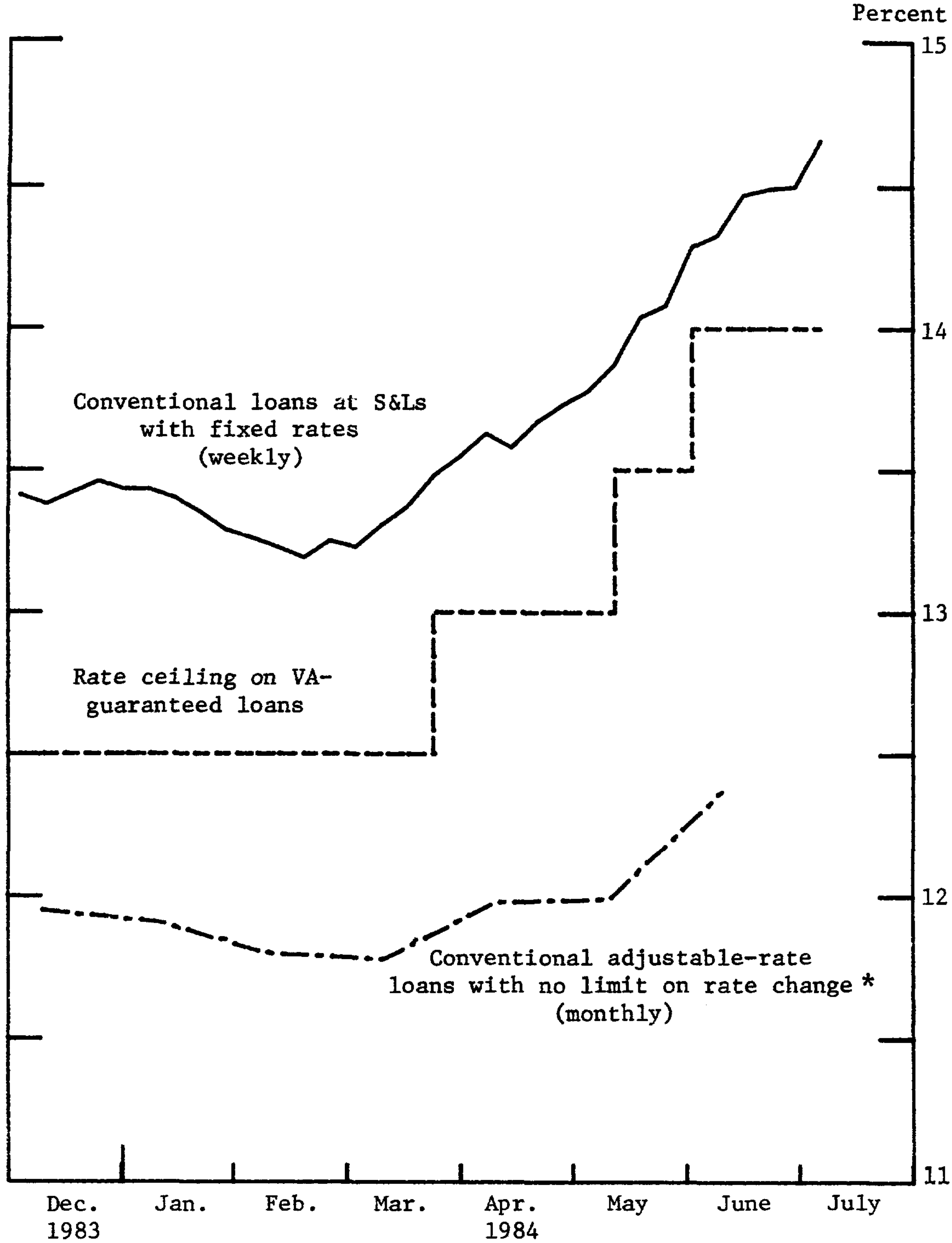
			1984				
	1982	1983	Q1	Q2[e]	May[e]	June[e]	July[f]
	Seasonally adjusted						
Total	10.29	10.39	9.35	7.89	8.20	7.90	10.3
Long-term	6.58	7.20	5.80	4.99	5.40	5.20	8.1
Short-term[1]	3.71	3.19	3.55	2.90	2.80	2.70	2.2
	Not seasonally adjusted						
Total	10.29	10.39	7.77	9.45	7.70	8.90	9.2
Long-term	6.58	7.20	5.01	5.55	5.50	5.90	7.0
Refunding	.36	1.17	.79	.55	.36	.50	--
Total housing[2]	1.24	1.48	.44	.27	.11	.57	--
Short-term[1]	3.71	3.19	2.76	3.90	2.20	3.00	2.2

e--estimate. f--forecast.
1. These figures do not include tax-exempt commercial paper.
2. Primarily mortgage revenue bonds for home ownership and multifamily rental structures.

to more than 14-5/8 percent in early July, but still remained below secondary market yields. At large mortgage companies, the effective rate for FHA-insured level payment loans has moved irregularly higher since late May to above 15 percent as of July 6, and the ceiling rate on VA-guaranteed loans was raised on May 29 to 14 percent from 13-1/2 percent. Commitment rates for conventional adjustable-rate mortgages (ARMs) at major originators also have increased; in early June, the average initial contract rate on ARMs without rate caps, which rose for the third straight month, still was about 190 basis points below the rate on fixed-rate loans.[1]

1. HUD recently announced plans to insure ARMs on certain 1- to 4-family properties and 1-family condominiums, effective July 30. Interest rates on FHA-insured ARMs would adjust annually, with limits on interest rate changes of 1 percent in any 12-month period and 5 percent during the life of the loan; negative amortization would not be permitted.

CONTRACT RATE FOR NEW COMMITMENTS ON HOME MORTGAGES
IN THE PRIMARY MARKET



*The adjustable-rate series for major originators includes initial-year discounts, but is not standardized for any given rate-adjustment period.

MORTGAGE ACTIVITY AT FEDERALLY INSURED SAVINGS AND LOAN ASSOCIATIONS[1]
(Billions of dollars, seasonally adjusted)

	Mortgage commitments		Net change in mortgage assets		
	New	Outstanding[2]	Total	Mortgage loans	Mortgage-backed securities
	(1)	(2)	(3)	(4)	(5)
1983-Jan.	10.5	31.9	2.2	0.2	2.0
Feb.	11.8	34.7	5.5	2.4	3.2
Mar.	12.3	37.4	5.2	1.4	3.9
Apr.	11.9	39.9	4.0	2.7	1.2
May	12.9	42.3	4.0	2.1	1.9
June	14.6	44.4	6.7	3.8	3.0
July	16.2	46.6	8.2	5.5	2.7
Aug.	15.3	48.5	8.8	5.6	3.2
Sept.	15.8	49.8	8.0	5.5	2.5
Oct.	14.0	51.0	6.4	3.7	2.7
Nov.	15.2	53.8	6.5	5.6	1.0
Dec.	15.0	56.5	6.0	5.7	0.3
1984-Jan.	17.2	58.0	5.8	4.9	0.9
Feb.	18.1	60.4	6.1	6.0	0.1
Mar.	17.0	62.8	10.0	5.9	4.1
Apr.	16.8	63.0	10.0	7.5	2.6
May p	19.2	65.3	10.5	8.4	2.1

1. Insured S&Ls account for approximately 98 percent of the assets of all operating S&Ls. Net changes in mortgage assets reflect adjustments to account for conversions of S&Ls to savings banks.
2. End of month. Includes loans in process.
p--Preliminary.

NEW ISSUES OF FEDERALLY GUARANTEED MORTGAGE PASS-THROUGH SECURITIES
(Monthly averages, millions of dollars, n.s.a.)

Period	All issues	GNMAs	FHLMCs	FNMAs	Memo: FNMA and FHLMC swap issues
1982-Q3	4772	1305	2249	1218	3149
Q4	6653	1779	2727	2147	3795
1983-Q1	7122	3841	1955	1326	2204
Q2	7368	4753	1392	1223	1880
Q3	7619	4835	1544	1240	2115
Q4	5733	3403	1673	657	1954
1984-Q1	4893	2745	887	1261	1744
Q2	4128	2458	1132	539	1491
1984 Mar.	5761	2488	868	2405	2938
Apr.	3205	1981	723	502	914
May	4163	2779	832	552	1249
June	5017	2613	1842	562	2309

In the secondary mortgage market, yields on GNMA-guaranteed securities backed by current-coupon mortgages have increased about 1/2 percentage point since the May FOMC; at the higher VA ceiling rate, average price discounts recently have been in a moderate range. Meanwhile, FNMA has boosted its required yield on one-year adjustable-rate mortgages by around 5/8 percentage point since late May, following the rise in 1-year Treasury yields to which rates on these loans are linked with a lag.

In early June, ARMs comprised a record 65 percent of all conventional first mortgage loans closed by major originators. Altogether, ARMs recently have constituted as much as one-half of the volume of all newly made home mortgages, including government underwritten loans.

Federally insured S&Ls--which accounted for two-fifths of institutional originations of home mortgages last year--issued a record $19 billion of new commitments on all types of mortgages during May. Mortgage commitments outstanding increased $2.3 billion to a new high of more than $65 billion, representing something less than 3-1/2 months of the current volume of mortgage originations and purchases combined, a low figure by recent standards. The strength in S&L commitment activity may have partly reflected efforts by borrowers to tie down initial rates before costs of credit moved up further. Net lending on mortgages at S&Ls advanced in May to a new record, and net acquisitions of mortgage-backed securities were substantial.

New issues of federally guaranteed pass-through securities--typically backed by pools of fixed-rate loans--picked up moderately further in June, but remained constrained by the large volume of ARMs originated in recent

CONSUMER INSTALLMENT CREDIT

	1982	1983	1983 Q4	1984 Q1	1984 Mar.	1984 Apr.
	----- Percent rate of growth, SAAR ------					
Change in outstandings--total	4.3	11.4	16.8	17.4	17.6	19.0
By type:						
Automobile credit	3.5	9.3	12.9	14.8	2.7	17.6
Revolving credit	8.4	15.5	24.5	25.1	46.0	27.9
All other[1]	3.3	11.4	16.8	16.3	17.6	16.0
	------- Billions of dollars, SAAR -------					
Change in outstandings--total	14.2	39.8	62.8	67.8	70.4	76.9
By type:						
Automobile credit	4.4	12.1	17.8	20.9	3.9	25.9
Revolving credit	5.1	10.1	17.4	19.0	35.5	22.4
All other[1]	4.8	17.6	27.6	27.9	31.0	28.6
By major holder:						
Commercial banks	3.8	19.5	38.1	41.5	41.1	48.2
Finance companies	4.7	4.1	1.1	-0.0	-2.3	-4.2
All other	5.7	16.2	23.6	26.3	31.7	32.9
	-------- Annual percentage rate --------					
Interest rates						
At commercial banks[2]						
New cars, 48 mos.[3]	16.83	13.92	13.46	13.32	n.a.	13.53[5]
Personal, 24 mos.	18.65	16.68	16.39	16.16	n.a.	16.35[5]
Credit cards	18.51	18.78	18.75	18.73	n.a.	18.71[5]
At auto finance companies[4]						
New cars	16.15	12.58	13.65	14.11	14.05	14.06
Used cars	20.75	18.74	18.12	17.55	17.52	17.59

1. Includes primarily personal cash loans, home improvement loans, and sales finance contracts for non-automotive consumer durable goods.
2. Average of "most common" rates charged, on loans of specified type and maturity, during the first week in the middle month of each quarter.
3. Data for 1982 are for new-car loans at a 36-month maturity.
4. Average rate for all loans of each type made during the period, regardless of maturity.
5. Data are for May 1984.
n.a.--not available.

months. Among the three sponsored agencies, only FNMA has so far been involved in issues of pass-through securities representing shares in pools of adjustable-rate mortgages; however, the outstanding balance on these securities constitutes less than 1 percent of pass-through issues outstanding under FNMA, GNMA, or FHLMC programs.[1] Regulations permitting a GNMA-guaranteed pass-through security collateralized by pools of FHA-insured ARMs are scheduled to become effective July 30.

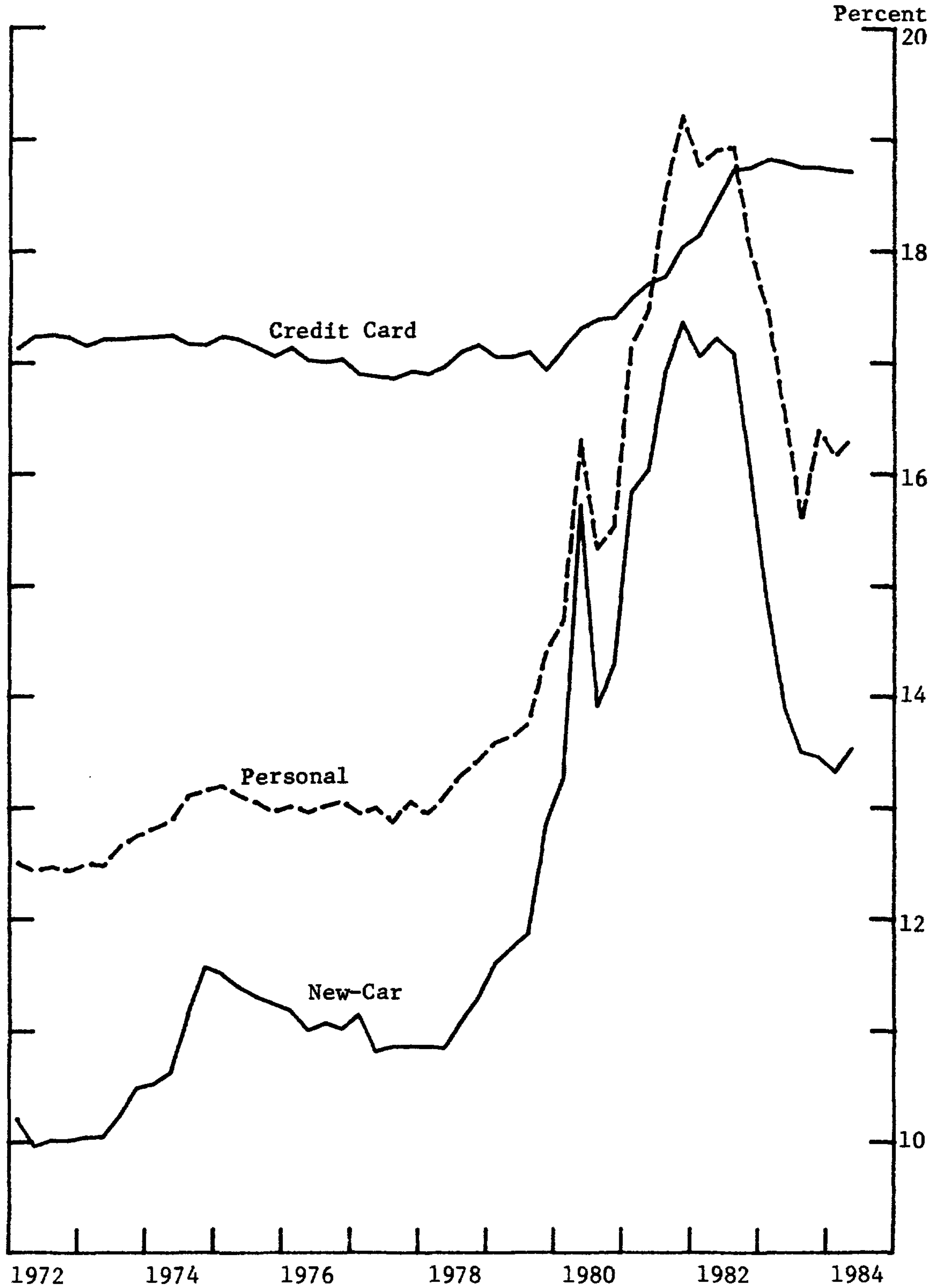
Consumer Credit

Reflecting brisk retail sales, consumer installment credit expanded at a rapid 19 percent annual rate in April and, according to available data, probably exceeded that pace in May. Revolving credit--primarily on credit cards--increased sharply in April and apparently again in May, and the growth of auto credit rebounded from its weak March pace. Expansion of installment credit at banks continued to be exceptionally strong. Around mid-June, several bank contacts indicated that they had become more willing to make consumer loans than earlier in the spring; none reported a reduced willingness to lend. Commercial bank loan data suggest that the strength in growth of consumer credit was extended into June.

Even with the rapid growth in installment borrowing this year, the ratio of debt outstanding to disposable personal income has retraced only one-third of the decline from its September 1979 peak to the October 1982 low, owing to the postwar record lull in the rate of debt expansion between

1. The Deficit Reduction Act of 1984, awaiting the President's action, would make FHLMC subject to federal income taxation, under terms comparable with those already applicable to FNMA. The legislation, among other things, also would reduce tax incentives for sellers of principal residences priced at more than $250,000 to take back low-rate mortgages from buyers. Neither action seems likely to have a significant effect on the mortgage market.

CONSUMER INTEREST RATES AT COMMERCIAL BANKS



1980 and 1982. Moreover, delinquency rates on consumer loans, which have declined steadily from their 1980 cyclical highs, fell further in the first quarter to a decade low.

Interest rates on consumer loans, which ordinarily lag changes in market rates, began to rise in the second quarter. Early last year, rates on new-car loans at commercial banks stood 4 to 5 percentage points above comparable-maturity Treasury yields, but that margin had dwindled to less than one percentage point by May of this year. More recently, an informal poll around the end of June indicated that three-fourths of the respondents had raised automobile and personal loan rates since early May, usually by about one percentage point.[1] Interest rates for new-car loans at automobile finance companies, after drifting lower during the early spring, edged up by 15 basis points in May to 14.21 percent.

1. A one percentage point increase in the interest rate on a 48-month automobile loan of $10,000 would boost the monthly payment by about $5, or by roughly 2 percent.

APPENDIX A*

MONETARY AND CREDIT GROWTH IN THE FIRST HALF OF 1984

Nominal GNP growth in the first half of 1984 was brisk--outstripping the rate projected for the year in the February monetary policy report to the Congress--and expansion of money and credit aggregates was, on balance, strong relative to the FOMC's ranges. Through June, M1 had risen at a 7-1/2 percent annual rate from its fourth-quarter 1983 base level, placing this measure near the upper end of its 1984 range. Expansion in M2 through June was just below the midpoint of its range, evidently restrained in part by the growing use of IRA/Keogh accounts. At the same time, growth of M3 exceeded its range; very rapid growth in credit demand at depositories, combined with moderate core deposit inflows, resulted in heavy issuance of large CDs. Similarly, total debt of domestic nonfinancial sectors expanded at a 13 percent rate as private credit demands strengthened further and the Treasury continued to borrow heavily.

Rising interest rates tended to restrain M1 growth over the first half of the year, contributing to an increase in velocity of about 4-1/2 percent at an annual rate, somewhat faster than the average for comparable periods of past postwar expansions. In contrast to previous cycles, however, M1 velocity has still not returned to its earlier peak level, reached in 1981, as recent gains have not offset the unprecedented declines in 1982 and early 1983. M1 growth in the first two quarters of 1984 was in line with predictions of econometric models of money demand.

Expansion in M1 continued to be concentrated in its OCD component, although the contribution of OCD diminished from the outsized proportions of the past few years: data on numbers of accounts suggest that the shifting by households out of demand deposits into interest-bearing checking accounts has abated. Within the OCD component, Super NOWs grew at about a 20 percent annual rate, nearly twice the rate of other OCDs; the difference likely reflected some continuing movement from regular NOWs to Super NOWs, as well as an increase in rates paid on Super NOWs during the period. Demand deposits grew sluggishly over the first half of the year, with much of the increase occurring in June, while currency expansion remained fairly rapid in an environment of strong spending growth.

For the most part, disturbances to the monetary aggregates arising from institutional changes in the financial system were minimal compared with those of 1983, especially those that occurred early in that year. An exception was the ongoing adjustment to the expanded availability of IRA/Keogh accounts, which attracted M2-type funds and may have reduced

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* Prepared by Deborah Danker, Economist, Banking Section, Division of Research and Statistics.

the growth of M2 by as much as 1 percentage point during the first half of the year. M2 growth was supported initially by growth in MMDAs and later by a pickup in small time deposits, while savings deposit balances continued to run off. Because M2 grew steadily, at 7 percent in each of the first two quarters, the pattern of velocity growth reflected uneven GNP expansion. In the first quarter, velocity rose at a 6-1/4 percent rate, but then slowed to a 2-1/2 percent rate in the second. These unexpectedly large gains extended the rise that began in the second quarter of 1983. Recent increases in M2 velocity may be in part attributable to a lessening of precautionary motives for holding M2-type balances as the economic expansion has proceeded; during the recession, M2 balances rose sharply relative to GNP. In addition, M2 growth may have been restrained by higher market rates--coupled with lags in deposit offering rates--and by the comparatively slow growth of household wealth.

The relatively modest increase in core deposits apparent in the M2 figures contrasted with the strong growth in credit which exceeded even the rapid growth of nominal GNP over this period. Depository institutions participated fully in this strong credit expansion and in fact increased their share of credit extended to the private nonfinancial sector, while reducing their share of Treasury issues. To finance their lending, depositories stepped up their issuance of managed liabilities, including large CDs. As a consequence, M3 growth--at a 9-1/2 percent pace through June--was above its target range and the margin between M2 and M3 growth rates widened. Large time deposits at commercial banks showed a marked turnaround and grew at an almost 20 percent rate through June, in contrast to the 16-1/2 percent decline experienced last year (when MMDAs boosted deposit inflows and loan demand was not as strong). At the same time, large time deposits at thrifts continued to climb at about the 50 percent annual rate posted during 1983. In addition to managed liabilities included in M3, depository institutions raised other funds, principally about $9 billion of FHLBB advances to thrifts and about $13 billion brought in from foreign offices of commercial banks over the period. This latter pattern was expected in light of the huge external financing requirement associated with the widening U.S. current account deficit, and was one of the reasons that an increase in M3 velocity--counter to its long-term trend--had been anticipated.

Bank credit accelerated in the first half of 1984 with strong growth in all major categories of loans--business, real estate and consumer. Indeed, business loans accelerated to almost a 20 percent annual rate as long-term financing in the bond and stock markets remained relatively light while the corporate sector's financing gap widened. In large part, though, the rise in business loans reflected an upswing in merger and acquisition activity: excluding the large oil company merger financings alone would reduce business loan growth to a 12 percent rate, and there were many other bank-financed deals whose cumulative magnitude likely was considerable. By late spring there were some indications that loan activity may have slowed; senior loan officers at a number of large commercial banks indicated that lending policies--especially with regard to financing mergers and leveraged buyouts--had been tightened in the wake of the financial market tensions that intensified in early May.

Domestic nonfinancial sector debt rose at a 13 percent annual rate through mid-1984, as increasing private sector credit demands combined with continued strong growth in the federal government component of the debt aggregate. The step-up in merger activity boosted private borrowing; mergers and buyouts are estimated to have accounted for a little more than 1 percentage point of the growth in the debt aggregate during the first half of 1984. The counterpart to the merger loans was a massive net liquidation of outstanding corporate equity shares.

Growth Rates of Money and Credit Aggregates*
(percent changes at seasonally adjusted annual rates)

	1983 (Q4 to Q4)	1984 Q1	1984 Q2	June 1984 (from Q4 1983)
M1	10.0	7.2	6	7-1/2
Demand Deposits	2.4	1.2	3-1/2	3-1/2
OCD	27.7	16.2	9-1/2	14
Currency	10.4	8.7	7	8-1/4
M2	12.1	7.0	7	7
Nontransactions	12.8	6.9	7	7
M3	9.7	9.0	10	9-1/2
Non-M2	0.3	17.8	23-1/2	20-1/2
Large time deposits	-3.5	24.8	30-1/2	30-1/2
Bank Credit	10.3	14.0	10-1/2	11-1/2
Debt	10.8	12.5	13	13
Federal	21.6	14.7	14	14-3/4
Other	8.0	11.9	13	12-1/2
Nominal GNP	10.5	13.9	9.8	n.a.

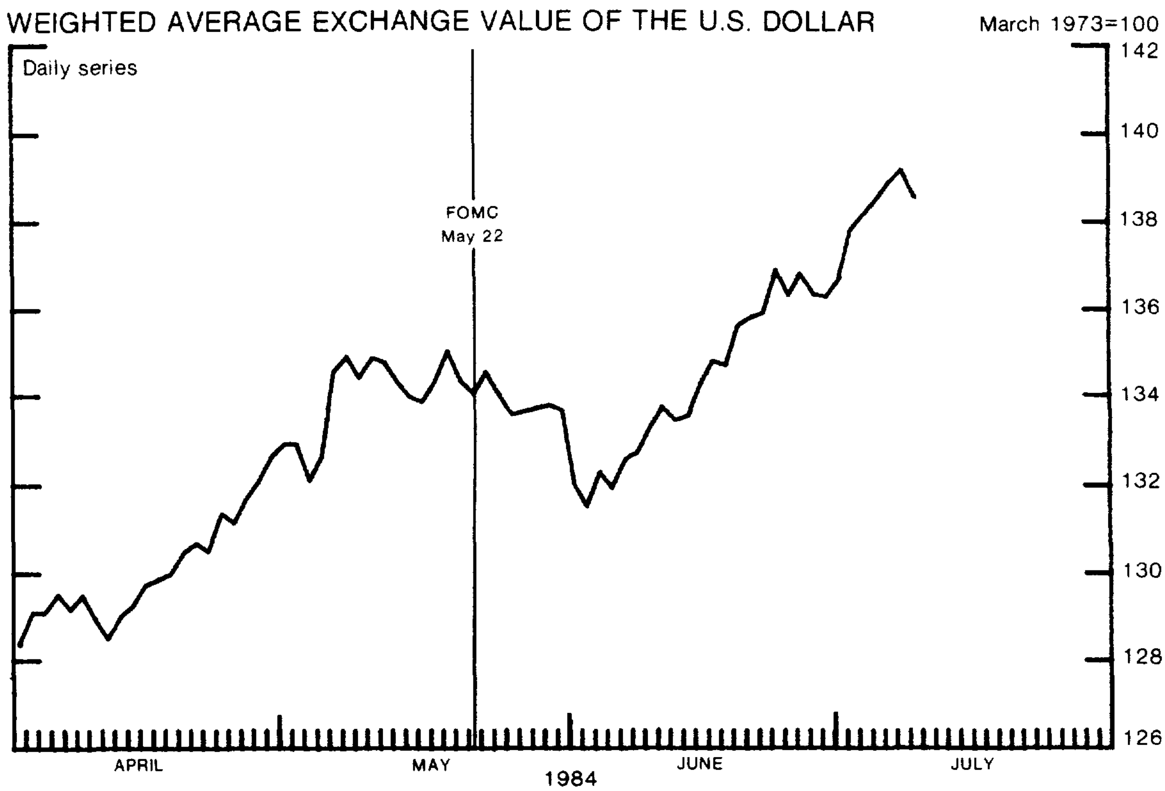
n.a.--not applicable
* Based on nearly complete data for June. Quarterly growth rates are rounded to the nearest one-half percentage point, and Q4 to June rates are rounded to the nearest one-quarter percentage point.

Foreign Exchange Markets

From the time of the last FOMC meeting through early June, the weighted-average dollar depreciated 2 percent. It then rose 5-1/2 percent for a net appreciation of over 3-1/2 percent for the reporting period. The dollar's initial weakening was probably due to two factors. First, some weaker-than-expected U.S. economic statistics led market participants to revise downward their expectations of U.S. growth. Second, concern over Continental Illinois and the apparent worsening of the international debt situation led to increased beliefs that the Federal Reserve would not tighten monetary policy. The strengthening of the dollar in June and early July, which brought it above its mid-January peak, was in association with a widening of the differentials between U.S. and foreign interest rates following the announcement of some stronger-than-expected economic statistics.

On a bilateral basis the mark came under particular pressure, depreciating 3-3/4 percent on balance over the period against the dollar

. The weakness of the mark was related to the metalworkers strike in West Germany. On June 27 a compromise settlement ended the strike, but the terms were not interpreted positively by the market. The mark has depreciated on average against the other major currencies since the settlement was announced.


WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR
March 1973=100
Daily series
FOMC
May 22
142
140
138
136
134
132
130
128
126
APRIL
MAY
JUNE
JULY
1984

The pound has depreciated 5 percent against the dollar since the last FOMC meeting, reaching a record low on both a bilateral and weighted-average basis. The major factors responsible were the continuation of the coal miners' strike and a softening of spot oil prices. On both July 6 and July 11 major U.K. banks raised their base lending rates and the Bank of England increased its short-term money market dealing rates. The second increase exerted at least temporary upward pressure on the pound.

The Canadian dollar, which traded in a very narrow range against the U.S. dollar through 1983 began to depreciate markedly in March and has depreciated 3 percent since the last FOMC meeting.

. The weakness of the Canadian currency is probably related to the slowing of the growth of the Canadian economy and the resulting perception that Canadian policy markers will be reluctant to continue to allow Canadian interest rates to rise with U.S. rates. Since the last FOMC, however, Canadian short-term rates have risen more than U.S. rates.

On May 24 rumors that some large U.S. banks were having difficulty obtaining funds in the interbank market led to disorderly conditions in which the dollar dropped rapidly. The Desk sold $135 million equivalent of marks, half from the Federal Reserve's account and half from the Treasury's account.

U.S. banks' foreign lending in first quarter. In the first quarter of 1984, U.S.-chartered banks increased their claims on non-OPEC developing countries by $1.3 billion, while decreasing their claims on all other groups by a total of $4.6 billion.

The increase in claims on non-OPEC developing countries principally reflected increases of $2 billion in claims on Brazil and of $0.5 billion in claims on the Philippines. The $2 billion increase in claims on Brazil resulted in part from Brazilian drawings of $3 billion, in March, on the $6.5 billion bank loan signed just before the drawings; the U.S. banks' share in these drawing was about $1.2 billion. In addition to these transactions, claims on local borrowers by U.S. bank branches domiciled in Brazil rose $0.3 billion equivalent (all in cruzeiros). It is possible that trade credits to Brazil also rose, but aggregate informtion is not available in this detail.

The $0.5 billion rise in claims on the Philippines partly resulted from an increase of $0.3 billion in claims held by U.S. bank branches in Manila. Most of this new lending was in Philippine pesos. The remaining $0.2 billion increase may have resulted from some restoration of short-term trade credits, which U.S. banks had cut back in 1983.

The changes in claims on the other more important developing countries were mostly decreases, the largest being a drop of $0.5 billion in claims on Mexico. A part of this decline appears to have stemmed from repayments by Mexico in March of private-sector debts to suppliers that originally came due between August 1982 and early 1984; about $0.2

TABLE 1. CLAIMS ON FOREIGNERS OF U.S.-CHARTERED BANKS
(Billions of dollars)

Claims on:	Change (no sign = increase) 1982 Year	1983 Year	1983 Q1	1983 Q2	1983 Q3	1983 Q4	1984 Q1	Outstanding 3/31/84
Total, all countries	23.5	-4.6	2.4	-3.7	-9.1	5.8	-3.3	430.8
Non-OPEC developing countries	10.8	3.5	0.6	0.6	0.8	1.5	1.3	111.9
OPEC countries	2.6	1.5	1.1	-0.2	-1.1	1.7	-0.4	28.5
Eastern Europe	-1.6	-0.9	-0.5	..	-0.4	..	-0.4	4.9
Smaller developed countries	5.3	2.2	0.3	0.4	-0.2	1.7	-0.4	35.5
G-10 countries and Switzerland	4.2	-12.5	2.5	-5.3	-8.6	-1.1	-2.2	165.0
Offshore banking centers	3.1	2.4	-0.6	1.5	-0.1	1.7	-0.3	68.9
Miscellaneous	-0.9	-0.9	-1.1	-0.7	0.7	0.2	-0.8	16.2

TABLE 2. CLAIMS OF U.S.-CHARTERED BANKS ON NON-OPEC DEVELOPING COUNRIES
(Billions of dollars)

Claims on:	Change (no sign = increase) 1982 Year	1983 Year	1983 Q1	1983 Q2	1983 Q3	1983 Q4	1984 Q1	Outstanding 3/31/84
Latin America	7.7	2.3	0.4	0.2	1.2	0.4	1.5	76.1
Argentina	-0.5	0.6	0.1	0.4	0.1	..	..	9.5
Brazil	3.8	..	0.2	-0.5	0.3	..	2.0	24.9
Chile	0.5	0.1	-0.3	-0.2	0.4	0.2	..	6.4
Colombia	0.5	0.1	-0.2	0.3	..	..	-0.1	3.1
Mexico	2.9	1.5	0.6	0.1	0.6	0.2	-0.5	25.5
Peru	0.6	-0.2	-0.2	0.2	-0.2	..	-0.1	2.3
Others	-0.1	0.2	0.2	0.1	-0.1	..	-0.2	4.4
Asia and Africa	3.1	0.2	0.2	0.4	-0.4	1.1	-0.2	35.8
Korea	1.5	0.4	..	-0.1	..	0.5	-0.2	11.1
Philippines	0.3	-0.1	0.3	-0.2	-0.2	..	0.5	6.7
Taiwan	0.2	..	-0.2	..	0.1	0.1	-0.3	5.0
Others	1.1	0.9	..	0.7	-0.3	0.5	-0.2	13.0
Total	10.8	3.5	0.6	0.6	0.8	1.5	1.3	111.9

billion was paid off in late 1983 and at least another $0.2 billion in the first quarter of 1984. Some of these debts were probably in bank portfolios.

Claims on the G-10 countries declined $2.2 billion. This was the fourth consecutive quarterly reduction in these claims, which at the end of March were more than $17 billion less than a year earlier. Most of this drop has been in interbank placements.

Claims on OPEC countries and the smaller developed countries each declined $0.4 billion in the first quarter; in the latest twelve months claims on the former were unchanged while claims on the latter rose $1.5 billion. Claims on Eastern Europe fell $0.4 billion in the first quarter and $0.8 billion in the latest twelve months.

U.S. International Financial Transactions

Since the last Greenbook, information has become available on direct investment flows during the first quarter (see lines 6 and 7 of the Summary table on the next page). Foreign direct investment in the United States tapered off somewhat during the first quarter to $1.9 billion. U.S. direct investment abroad was a net outflow of $3.2 billion during the quarter, following a downward-revised outflow of $4.9 billion during the whole of 1983. The first-quarter net outflow of $3.2 billion was inclusive of a $1.1 billion inflow of funds to U.S. corporations from their Netherlands Antilles finance affiliates. Further inflows from these affiliates are likely in the second quarter, given that U.S. corporations sold a total of $4.3 billion in the Eurobond market during the first quarter (some late in the quarter) and $3.3 billion in the second quarter.

Following the repeal of the withholding tax on interest payments to foreign holders of bonds issued in the United States, funds raised directly or indirectly from nonbanks abroad by U.S. corporations are likely to appear in the balance of payments accounts more predominantly as foreign net purchases of U.S. corporate securities, rather than as direct investment inflows through Netherlands Antilles finance affiliates. More generally, the repeal of the withholding tax, other things equal, should reduce the share of the U.S. net capital inflow that is intermediated by U.S. banking offices, and should increase the share that results from foreign nonbank purchases of U.S. corporate and Treasury securities.

The quantitative significance of these effects is difficult to predict. Those who believe the effects will be small argue that most

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

	1982 Year	1983 Year	1983 Q3	1983 Q4	1984 Q1	1984 Mar.	1984 Apr.	1984 May
Private Capital								
Banks								
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	-39.5	16.7	12.3	12.2	11.7	4.7	-0.2	4.5
a) with own foreign offices	-8.9	8.9	10.7	9.1	-0.8	1.0	2.7	-2.1
b) all other	-30.6	7.8	1.6	3.2	12.5	3.7	-2.9	6.7
Securities								
2. Private securities transactions, net	-1.6	1.0	0.3	0.2	1.9	0.8	-0.1	-0.5
a) foreign net purchases (+) of U.S. corporate bonds	2.8	2.2	0.5	0.7	0.4	0.1	-0.1	0.3
b) foreign net purchases (+) of U.S. corporate stocks	3.6	6.4	1.3	0.4	1.2	0.7	0.4	-0.2
c) U.S. net purchases (-) of foreign securities	-8.0	-7.6	-1.5	-0.9	0.2	*	-0.4	-0.6
3. Foreign net purchases (+) of U.S. Treasury obligations 1/	6.5	8.3	0.8	1.7	1.4	-3.2	2.5	2.6
Official Capital								
4. Changes in foreign official reserve assets in U.S. (+ = increase)	2.9	5.1	-2.8	6.4	-2.9	-1.9	0.4	-4.1
a) By area								
G-10 countries (incl. Switz.)	-12.7	6.4	0.9	1.7	2.4	-0.7	1.2	-1.1
OPEC	6.9	-8.5	-2.0	-1.5	-2.7	-1.0	-0.9	-2.3
All other countries	8.8	7.3	-1.7	6.1	-2.6	-0.2	0.1	-0.7
b) By type								
U.S. Treasury securities	5.7	7.0	-0.6	2.6	-0.2	-1.9	0.1	-3.1
Other 2/	-2.7	-1.8	-2.2	3.8	-2.7	*	0.3	-1.0
5. Changes in U.S. official reserve assets (+ = decrease)	-5.0	-1.2	0.5	-1.0	-0.7	*	-0.1	-0.3
Other transactions (Quarterly data)								
6. U.S. direct investment (-) abroad	4.8	-4.9	-3.9	-1.6	-3.2	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	14.9	11.3	3.3	2.3	1.9	n.a.	n.a	n.a.
8. Other capital flows (+ = inflow) 3/ 4/	-6.7	-4.0	-0.2	-1.3	-4.2	n.a.	n.a.	n.a.
9. U.S. current account balance 4/	-9.2	-41.6	-11.8	-17.2	-19.4	n.a.	n.a.	n.a.
10. Statistical discrepancy 4/	32.9	9.3	1.5	-1.7	13.5	n.a.	n.a.	n.a.
MEMO:								
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-36.5	-61.1	-17.5	-19.4	-25.6	-9.3	-10.7	-7.6

1. Includes U.S. Treasury notes publicly issued to private foreign residents.
2. Includes deposits in banks, commercial paper, acceptances, & borrowing under repurchase agreements.
3. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking and official transactions not shown elsewhere.
4. Includes seasonal adjustment for quarterly data.
* Less than $50 million.

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

foreign investors have been able all along to purchase U.S. securities that were exempt from the withholding tax -- e.g., Treasury bills or commercial paper with maturities of six months or less, as well as any securities purchased through addresses in the United Kingdom, Germany, the Netherlands, Luxembourg and the Scandinavian countries (which were exempt under various tax treaties). Those who believe the effects will be substantial argue that the repeal of the withholding tax will significantly increase the attractiveness of longer-term U.S. Treasury debt to some groups of foreigners (e.g., Japanese pension funds) and is likely to catalyze the marketing of U.S. Treasury securities in foreign countries; in addition, it is contended that some U.S. corporations have refrained from raising funds through Netherlands Antilles affiliates because of legal uncertainties about the withholding tax exemption, and that these corporations can now raise funds directly from foreigners with no legal uncertainties. It should be noted, as well, that future sales of U.S. securities to foreigners could be magnified if the Department of the Treasury decides to offer bearer issues in the Euromarket, as it is currently considering. Moreover, the attractiveness of U.S. bearer securities to "foreigners" depends on whether the Treasury chooses to amend a requirement that a 20 percent "back-up withholding tax" be applied on interest payments to investors who have foreign addresses but do not disclose their identities to U.S. tax authorities.

The balance of payments data for April and May show continuing net inflows reported by U.S. banking offices (line 1 of the Summary table) and relatively small amounts of private foreign net purchases of U.S.

corporate bonds and stocks (lines 2a and 2b). Private foreign net purchases of U.S. Treasury obligations (line 3) amounted to nearly $6-1/2 billion during the first five months of the year, including net purchases of about $4 billion by the World Bank. Based on conversations with staff at the World Bank, it is our understanding that the World Bank's holdings of Treasury securities were relatively low at the beginning of 1984 and are unlikely to expand much further this year.

Data on foreign official capital flows for April and May (line 4 of the Summary table) show a continuing decline of more than $3 billion in OPEC reserve holdings in the United States; preliminary data indicate that OPEC holdings at the Federal Reserve Bank of New York rose by $1.2 billion in June. Official reserve holdings of the G-10 countries showed counterbalancing changes in April and May,

. Preliminary June data indicate a drop of $1.6 billion in G-10 holdings at the New York Reserve Bank,

.

A continuing net inflow of funds through U.S. banking offices in April and May is also evident from the International Banking Data table. Data for the first 25 days of June, however, show a sizable net outflow from U.S. banking offices to their own foreign offices and IBFs. To some extent this increased funding of foreign offices may be related to concerns about the quality of bank credit, prompted in part by the problems at Continental Illinois; but more than one-third of the net

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1981	1982	1983				1984			
	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.	Apr.	May	June 3/
1. Net Claims of U.S. Banking Offices (excluding IBFs) on Own Foreign Offices	8.2	33.7	49.2	43.7	42.3	38.8	34.0	30.8	27.6	31.6
2. Net Claims of U.S. Banking Offices on Own IBFs 1/	11.8	16.2	14.6	12.8	10.5	5.2	4.1	4.2	2.1	4.4
3. Sum of lines 1 and 2 of which:	20.0	49.9	63.8	56.5	52.8	44.0	38.1	35.0	29.7	36.0
(a) U.S.-chartered banks	23.6	40.3	53.7	50.0	47.1	40.4	35.8	34.0	30.5	34.1
(b) Foreign-chartered banks	-3.6	9.6	10.0	6.5	5.7	3.6	2.4	1.0	-0.8	1.9
4. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	13.2	15.7	16.4	16.8	16.8	18.6	18.6	19.5	20.3	20.2
5. Eurodollar Holdings of U.S. Nonbank Residents 2/	95.5	112.6	116.4	120.4	121.3	126.4	128.0	128.6	130.0	125.6

1. Corresponds to net claims of international banking facilities (IBFs) on all foreign residents, including all banks whether related or not, and all nonbanks.
2. Includes term and overnight Eurodollars held by money market mutual funds.
3. Through June 25.

Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an estimate constructed as the residual of line 3 minus line 2. Line 2 is data for the last Wednesday of the month for the sample of monthly IBF reporters. Line 3 is an average of daily data reported to the Federal Reserve by U.S. banking offices. Line 4 is an average of daily data. Line 5 is the month-end value for data through September 1983. For dates after September 1983, the overnight portion is an average of daily data and the term portion is an average of Wednesday data.

outflow in June was accounted for by foreign chartered banks, and much of the remainder was accounted for by small and medium-sized U.S. chartered banks. The outflow from the large U.S.-chartered banks to their own foreign branches coincided with a sharp runoff in Eurodollar deposits at the branches held by U.S. nonbanks (including bank holding companies); see line 5 of the table.

U.S. Merchandise Trade

The U.S. merchandise trade deficit in May was substantially smaller than the record April rate, and was smaller than the first-quarter average, as imports declined sharply from unusually high levels. For April-May combined, however, the trade deficit was about $7 billion larger at an annual rate than for the first quarter.

Despite the sharp drop in May, imports in April-May on average were slightly higher than the strong first-quarter rate, reflecting the strength of U.S. economic activity and the price competitiveness of foreign-made goods. The increase in imports for April-May was about evenly divided between oil and nonoil items. Manufactured goods, which accounted for much of the first-quarter increase, rose further in April-May. Among the items of continued strength for the two-month period were capital goods and automotive products from Europe and Canada;

U.S. MERCHANDISE TRADE[1/]

	1983	1983		1984			
	Year	Q3	Q4	Q1	A/M	Apr.	May
Value (Bil. $, SAAR)							
Exports	200.3	201.7	207.3	216.7	218.2	215.7	220.8
Agricultural	36.6	37.2	39.2	41.1	38.6	38.1	39.1
Nonagricultural	163.6	164.5	168.1	175.5	179.6	177.5	181.6
Imports	261.3	271.8	284.9	319.2	327.8	343.7	311.9
Oil	53.8	63.7	57.1	55.4	59.2	64.3	54.2
Non-oil	207.5	208.1	227.8	263.8	268.6	279.4	257.8
Trade Balance	-61.1	-70.0	-77.6	-102.6	-109.6	-128.0	-91.2
Volume (Bil 72$, SAAR)							
Exports							
Agricultural	16.3	16.3	16.2	17.0	15.8	15.7	15.9
Nonagricultural	57.3	57.6	58.8	60.9	62.1	61.4	62.9
Imports							
Oil	4.9	5.8	5.2	5.1	5.4	5.9	5.0
Non-oil	81.9	82.1	89.1	102.5	102.8	107.2	98.5

1. International transactions and GNP basis.

imports of passenger cars from Japan picked up in May from the relatively low first-quarter rate as the new quota-year began on April 1. Steel imports, on the other hand, declined in both April and May to average slightly less than the first-quarter rate. By area, since the fourth quarter of last year, nonoil imports have increased faster from industrial countries than from developing countries. Even excluding automotive imports from Canada, nonoil imports rose 20 percent from industrial countries and about 12 percent from developing countries.

Oil accounted for a little less than half of the April-May increase in imports from the first-quarter rate. The volume imported in April-May averaged 5.7 million barrels per day (mbd) compared with 5.4 mbd in the first quarter (seasonally adjusted). Most of the increase was in response to rising U.S. demand. There were only minimal reactions to the hostilities in the Persian Gulf; U.S. inventories increased somewhat but spot prices actually declined from May until early July. The average import price in both April and May was about 25 cents per barrel higher than in the fourth quarter.

OIL IMPORTS

	1983	1983		1984			
	Year	Q3	Q4	Q1	A/M	Apr.	May
Volume (mbd, SA)	5.20	6.17	5.53	5.40	5.72	6.20	5.23
Price ($/BBL)	28.42	28.29	28.30	28.05	28.30	28.32	28.28
Value (Bil. $, SAAR)	53.80	63.69	57.14	55.41	59.23	64.30	54.16

Exports in April-May combined were slightly above the first-quarter rate. A decline in agricultural shipments (particularly soybeans and animal feed) was offset by increased exports of nonagricultural items (especially business machines, but also such items as chemicals, petroleum products, and coal). The value of nonagricultural exports in April-May reached its highest level since the first quarter of 1982.

Most of the rise in nonagricultural exports in recent quarters has been in machinery and automotive products to industrial countries, particularly Canada and Western Europe, as economic activity in those countries began to pick up. While part of the increase to Canada was automotive products ultimately destined for sale in the United States, 80 percent of the rise since the first quarter of 1982 was in non-automotive products. Nonagricultural exports to developing countries have increased to a lesser extent; shipments to Mexico have increased gradually and steadily from the low end-1982 level, but exports to other areas have been fairly flat.

U.S. Current Account

The U.S. current account deficit was a record $78 billion (annual rate) in the first quarter, $9 billion larger than in the fourth quarter (revised) of last year.

Changes in several components of the current account, between the fourth and first quarters, combined to partially offset the increase in the trade deficit. Recorded net investment income receipts rose, but virtually all of the large increase was accounted for by a swing, in net direct investment income receipts, from a large net capital loss to a small capital gain (see the table below). Net direct investment income receipts, before capital gains or losses, were little changed from the fourth to the first quarter. Net portfolio income receipts declined slightly in the first quarter, largely reflecting an increase in interest payments to foreigners.

U.S. CURRENT ACCOUNT
(billions of dollars, SAAR)

	1983			1984	$ Changes		
	Year	Q3	Q4	Q1	82Q4 to 83Q4	83Q3 to 83Q4	83Q4 to 84Q1
1. Current Account Balance	-41.6	-47.4	-68.9	-77.6	-43.6	-21.5	-8.8
2. Trade balance	-61.1	-70.0	-77.6	-102.6	-32.7	-7.6	-24.
3. Exports	200.3	201.7	207.3	216.7	13.2	5.6	9
4. Imports	-261.3	-271.8	-284.9	-319.2	-45.9	-13.2	-34.3
5. Investment income, net	23.5	28.7	20.5	30.5	-3.2	-8.2	10.0
6. Direct, net	14.0	18.7	11.7	22.9	-4.4	-7.0	11.2
7. Capital losses(-) or gains(+)	-7.2	-5.1	-9.2	1.3	-5.4	-4.0	10.4
8. Other D.I., net	21.2	23.8	20.9	21.7	1.0	-3.0	0.8
9. Portfolio, net	9.5	10.0	8.7	7.6	1.2	-1.2	-1.2
10. Military, net	0.5	-0.2	-1.1	-1.1	-0.7	-0.9	0
11. Other services, net	4.1	2.7	1.7	4.2	-4.3	-1.0	2.4
12. Unilateral transfers	-8.7	-8.6	-12.3	-8.6	-2.7	-3.8	3.7
Memo Item:							
13. Statistical Discrepancy in the BOP account (not an annual rate)	9.3	1.5	-1.7	13.5	3.3	-3.2	15.3

The rise in "other services" in the first quarter was primarily an increase in net travel receipts (a small rise in foreign travel in the United States and a small decline in U.S. travel abroad). Unilateral transfers returned to more usual levels following a very strong fourth quarter (when Israel drew its entire fiscal-year appropriation).

The size of the statistical discrepancy in the first quarter suggests that the United States is once again receiving substantial capital inflows that are not being reported.

<u>Foreign Economic Developments</u>. While a strong economic recovery seems to have taken firm hold in Japan, the pace of economic activity in other major foreign industrial countries has been uneven and, in some cases, quite sluggish. There have been modest gains in industrial production in Italy, and the Canadian economy has continued to move ahead -- although less rapidly than in 1983. In the United Kingdom and Germany, however, recent activity has been slowed partly by labor disputes. Activity in France also continues to be weak, and the unemployment rate remains at record or near-record levels in all three countries. In contrast to developments in Europe, real growth in Japan in the first quarter exceeded 7 percent, (s.a.a.r.), and recent industrial production data indicate that expansion has continued.

Prices continue to advance at a moderate rate in most of the major industrial countries. Inflation rates have decelerated in recent months in Italy, Canada, and France, and inflation has remained about unchanged in the United Kingdom and Germany. The CPI fell sharply in Japan in June, offsetting some acceleration earlier in the year.

Despite the relative weakness of the European economies, no significant improving trend in their external accounts has been evident this year. In both the United Kingdom and France, trade deficits narrowed in May, but both countries still have large deficits for the year so far. The German current account recorded a $1 billion surplus (n.s.a.) in May, but the cumulative surplus is still well below that of the same period last year. The Italian trade deficit widened in the first quarter. In contrast, the Japanese trade and current accounts have continued to record large surpluses in spite of the domestic economy's

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REAL GNP AND INDUSTRIAL PRODUCTION IN MAJOR INDUSTRIAL COUNTRIES
(PERCENTAGE CHANGE FROM PREVIOUS PERIOD, SEASONALLY ADJUSTED)

	Q4/Q4 1982	Q4/Q4 1983	1983 Q2	1983 Q3	1983 Q4	1984 Q1	1984 JAN.	1984 FEB.	1984 MAR.	1984 APR.	1984 MAY	LATEST 3 MONTHS FROM YEAR AGO+
CANADA												
GNP	-5.0	7.1	1.8	1.9	1.2	.8	*	*	*	*	*	5.8
IP	-11.8	16.7	3.1	4.3	3.1	.9	1.7	-2.8	.5	.7	N.A.	10.8
FRANCE												
GDP	1.4	.7	.4	-.1	.7	.4	*	*	*	*	*	1.4
IP	-1.8	1.8	1.0	.8	.0	1.3	.8	-.8	1.5	-3.0	N.A.	2.3
GERMANY												
GNP	-1.6	2.9	1.2	-.1	1.3	1.2	*	*	*	*	*	3.7
IP	-5.4	5.9	2.2	.5	2.2	1.1	.9	1.0	-3.8	-.9	.5	2.5
ITALY												
GDP	-2.3	1.2	-1.6	1.1	1.0	N.A.	*	*	*	*	*	1.2
IP	-6.1	-1.0	-4.7	1.8	1.4	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	-1.0
JAPAN												
GNP	3.8	12.4	1.1	1.5	9.3	-6.1	*	*	*	*	*	5.3
IP	-2.7	8.5	1.6	3.3	2.5	3.3	.7	2.7	-1.1	.8	1.8	11.2
UNITED KINGDOM												
GDP	1.6	3.6	-.5	.6	1.7	.9	*	*	*	*	*	2.7
IP	.1	4.9	.0	2.0	1.4	.1	.4	-1.6	-.9	-.2	N.A.	2.6
UNITED STATES												
GNP	-1.7	6.2	2.3	1.9	1.2	2.3	*	*	*	*	*	8.0
IP	-7.5	15.0	4.3	5.1	2.5	2.7	1.5	.9	.5	1.1	.4	13.9

* DATA NOT AVAILABLE ON A MONTHLY OR QUARTERLY BASIS.

+ IF QUARTERLY DATA, LATEST QUARTER FROM YEAR AGO.

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CONSUMER AND WHOLESALE PRICES IN MAJOR INDUSTRIAL COUNTRIES
(PERCENTAGE CHANGE FROM PREVIOUS PERIOD)

	Q4/Q4	Q4/Q4	1983				1984		1984				LATEST 3 MONTHS
	1982	1983	Q1	Q2	Q3	Q4	Q1	Q2	MAR.	APR.	MAY	JUNE	FROM YEAR AGO
CANADA													
CPI	9.7	4.6	.6	1.4	1.6	.9	1.2	N.A.	.2	.2	.2	N.A.	4.8
WPI	4.5	3.5	.7	1.5	.9	.4	1.6	N.A.	.7	.5	.1	N.A.	4.4
FRANCE													
CPI	9.5	9.8	2.7	2.8	2.1	1.9	1.7	N.A.	.7	.6	.5	N.A.	8.1
WPI	8.5	14.6	2.5	4.0	3.7	3.6	3.3	N.A.	.7	N.A.	N.A.	N.A.	15.5
GERMANY													
CPI	4.7	2.6	.5	.6	1.0	.5	1.0	.5	.1	.2	.1	.4	3.0
WPI	3.1	.9	-2.0	.8	.9	1.2	1.7	N.A.	.1	.4	-.2	N.A.	5.0
ITALY													
CPI	16.6	12.8	3.6	2.9	2.3	3.5	2.8	2.1	.7	.7	.6	.6	11.2
WPI	12.4	9.1	1.6	1.6	2.3	3.3	3.2	N.A.	.7	.8	N.A.	N.A.	11.2
JAPAN													
CPI	1.3	1.9	-.1	.9	2.1	1.3	.7	2.1	.0	.4	.4	-1.0	2.7
WPI	-.6	-3.3	-1.9	-1.0	.2	-.6	.1	N.A.	-.4	-.1	.3	N.A.	-.7
UNITED KINGDOM													
CPI	6.2	5.1	.5	2.0	1.3	1.1	.6	N.A.	.3	1.3	.4	N.A.	5.2
WPI	6.5	5.5	1.4	2.0	.8	1.3	1.9	2.3	1.0	1.2	.3	.2	6.3
UNITED STATES													
CPI (SA)	4.4	3.2	-.0	1.1	1.0	1.1	1.2	N.A.	.2	.5	.2	N.A.	4.5
WPI (SA)	3.6	.9	-.4	.2	.6	.4	1.1	N.A.	.5	.0	-.0	N.A.	2.8

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TRADE AND CURRENT ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES 1/
(BILLIONS OF U.S. DOLLARS; SEASONALLY ADJUSTED)

	1982	1983	1982 Q4	1983 Q1	1983 Q2	1983 Q3	1983 Q4	1984 Q1	1984 FEB.	1984 MAR.	1984 APR.	1984 MAY
CANADA												
TRADE	14.8	14.4	4.1	3.5	4.3	3.1	3.5	3.6	.9	1.1	1.3	1.3
CURRENT ACCOUNT	2.1	1.4	.6	.5	1.1	-.2	.0	-.1	*	*	*	*
FRANCE												
TRADE 2/	-14.0	-5.9	-2.9	-3.5	-1.7	-.6	-.2	-1.5	-.6	-.3	-.5	.0
CURRENT ACCOUNT 2/	-12.1	-4.2	-2.4	-3.9	-.9	.3	.3	-1.3	*	*	*	*
GERMANY												
TRADE	20.9	16.4	5.0	5.1	4.1	3.7	3.4	4.3	1.7	1.3	1.1	N.A.
CURRENT ACCOUNT (NSA)	3.5	4.0	4.9	2.2	.7	-2.3	3.4	.7	.2	.7	-.2	1.0
ITALY												
TRADE	-12.8	-7.8	-2.6	-3.0	-1.4	-2.1	-1.3	-2.5	-.4	-1.6	-.8	N.A.
CURRENT ACCOUNT (NSA)	-5.8	.5	-.7	-2.0	.6	1.0	.9	N.A.	*	*	*	*
JAPAN												
TRADE 2/	18.8	31.5	4.0	6.5	8.1	8.8	8.1	10.0	3.1	3.3	3.9	3.6
CURRENT ACCOUNT	6.9	21.0	1.6	3.5	6.0	6.1	5.5	7.2	1.9	2.4	3.6	2.5
UNITED KINGDOM												
TRADE	4.1	-.8	1.8	.3	-.7	-.4	-.0	-.1	.7	-.3	-1.2	-.4
CURRENT ACCOUNT 2/	9.6	4.4	3.6	2.4	-.1	1.2	.9	1.2	1.1	.1	-.8	-.1
UNITED STATES												
TRADE	-36.5	-61.1	-11.2	-9.3	-14.9	-17.5	-19.4	-25.6	-7.5	-9.3	-10.7	-7.6
CURRENT ACCOUNT	-9.2	-41.6	-6.3	-2.9	-9.6	-11.8	-17.2	-19.4	*	*	*	*

1/ THE CURRENT ACCOUNT INCLUDES GOODS, SERVICES AND PRIVATE AND OFFICIAL TRANSFERS.
2/ QUARTERLY DATA ARE SUBJECT TO REVISION AND ARE NOT CONSISTENT WITH ANNUAL DATA.

* COMPARABLE MONTHLY OR QUARTERLY CURRENT ACCOUNT DATA ARE NOT PUBLISHED.

strong performance. The cumulative trade surplus through May has already reached \$17-1/2 billion (s.a.).

In recent weeks, central bank lending rates were raised in several countries including Germany, Sweden, and the United Kingdom.

In Japan, first-quarter GNP figures confirm earlier indications of a vigorous recovery. Real GNP advanced at a 7.2 percent rate (s.a.a.r.) in the first-quarter -- the largest quarterly increase in six years and more than double the rate of growth in the fourth quarter. Growth was divided about equally between domestic and external components. Private consumption, which had been lagging recently, accelerated to a 4.5 percent (s.a.a.r.) rate of growth, and private plant and equipment investment continued to be strong (12.5 percent growth, s.a.a.r.). In the external sector, exports continued to move ahead briskly, while imports showed a marked deceleration. Other indicators -- including the industrial production index which increased strongly in April and May -- suggest that activity is continuing on a strong upward course.

Wholesale prices in Japan have moved within a narrow range in recent months. A 0.3 percent increase in May partly offset declines in the previous two months and left the WPI at the same level as at the end of 1983. Despite a fall in June by almost 1 percent, the CPI increased at an average annual rate of about 3 percent in the second quarter. The current account surplus contracted in May by over \$1 billion (s.a.) from April's record \$3-1/2 billion level. The cumulative current account surplus for the first five months has already surpassed \$13 billion, and the trade surplus \$17-1/2 billion.

In late May, the U.S. Treasury and Japanese Ministry of Finance announced agreement on a set of measures designed to liberalize Japanese financial markets and internationalize the yen including:

-- relaxation of restrictions on Euro-yen bonds and yen-CDs;

-- permission for foreign banks to enter the trust banking business in Japan;

-- permission for foreign banks to deal in Japanese government securities; and

-- commitments to establish a yen-denominated bankers acceptance market and to liberalize some deposit rates in Japan.

In Germany, GNP decelerated slightly in the first quarter to just under 5 percent (s.a.a.r.), but the deceleration was more abrupt if adjustments are made for calendar irregularities. The seven-week metalworkers' strike, which had shut down the automobile industry, ended in the first week of July. The strike settlement covers the period to October 1986, and provides for both a 3.3 percent increase in wages from July 1984 to March 1985 and a one-time bonus payment of about $100. From April 1985 to October 1986, the average contractual work-week will be reduced from 40 to 38-1/2 hours, and hourly wages will increase by 2.2 percent. The settlement also gives employers greater flexibility in tailoring working hours to the requirements of individual plants and production processes.

Although the strike contributed to recent weakness of economic activity in Germany, the pace of recovery had slowed even before the strike. Industrial production fell almost 4 percent (s.a.) in March and had not recovered by May. Data on the volume of incoming orders also showed weakness in March and April. The rate of unemployment, after briefly dipping under 9 percent early this year, returned to 9.3 percent (s.a.) in June, a level which is only slightly below that of its most recent peak.

Consumer prices increased at an annual rate of about 2-1/2 percent during the three months to June, when the CPI was less than 3 percent above last year's level. The current account showed a surplus in May of $1 billion (n.s.a.). The surplus of $1.3 billion so far this year compares with last year's $2.8 billion figure for the corresponding five-month period.

On June 28, the Bundesbank raised its discount rate by 50 basis points in a technical adjustment that did not affect market rates. The German cabinet has proposed a tax-cut package of approximately DM 20 billion (0.8 percent of 1983 GNP) to take effect in 1986 and beyond. In an apparent shift from earlier plans, it was announced that the tax cut is no longer intended to be partly offset by increases in indirect taxes.

In Canada, the slowing of the rate of economic expansion that was evident at the end of 1983 continued through the first quarter. Real GNP grew at rates of 4.8 and 3.2 percent (s.a.a.r.) in the fourth quarter of 1983 and the first quarter of this year, respectively -- down considerably from average growth of almost 8 percent in the first three quarters of 1983. A major source of strength in Canada continues to be the stimulus to its export sector provided by recovery in the United States, particularly in the automotive sector. In June, the unemployment rate declined by 0.5 percentage points to 11.2 percent (s.a.) after rising steadily since December.

Consumer price inflation has continued to slow. In April and May, prices rose at an annual rate of about 3 percent compared with a 4 percent rate in the previous two quarters and 6 percent in the two quarters previous to that. During the first five months of this year, Canada registered an accumulated trade surplus of $6.2 billion (s.a.), virtually the same figure as that recorded during the comparable period in 1983. The volume of exports increased by almost 9 percent in the first quarter, two-thirds of which was in the automotive sector. Nevertheless, a large service account deficit produced a first-quarter current account deficit of about $100 million (s.a.).

In June, John Turner, a Toronto lawyer and former Finance Minister in the early years of the Trudeau regime, became the new leader of the Liberal Party and Prime Minister. New Federal elections are constitutionally mandated to be held by February 1985, but they may be called as early as August. At the end of June, the Canadian Parliament approved a bill doubling the statutory ceiling on the foreign bank share of domestic banking assets from 8 to 16 percent.

Economic activity in France has remained weak in recent months. Industrial production declined by 3 percent (s.a.) in April, more than reversing the rise of the previous month and lowering the year-over-year increase in industrial production to 0.8 percent. Real GDP in the first quarter advanced by only 1.5 percent (s.a.a.r.). Unemployment in May was unchanged at 9.8 percent (s.a.) following six consecutive monthly increases that raised the unemployment rate by a full percentage point. The inflation rate has continued to ease slightly. Consumer prices in

May increased by 0.5 percent, lowering the year-over-year inflation rate to 7.7 percent.

The French trade deficit vanished in May after monthly deficits in the first four months of the year that averaged more than $500 million (s.a.). The current account recorded a deficit of $1.3 billion (s.a.) in the first quarter, compared with a $300 million surplus in the previous quarter.

In the United Kingdom real GDP expanded by 3.5 percent (s.a.a.r.) during the first quarter, reflecting the continuation of the recovery that began in the second half of 1981. However, industrial production declined in April for the third consecutive month. The April fall was at least in part the result of the coal miners' strike which has been going on since mid-March. The negotiations between the miners' union and the National Coal Board, which broke down shortly after they began in mid-June, are about to resume, but resolution of the strike does not appear imminent. During the strike so far, the production of coal has been substantially reduced, but the effects on other industries remain limited. In May, retail prices rose to a level 5.1 percent above that of a year earlier, a rate of inflation that has been about unchanged since the start of the year.

The U.K. trade and current accounts were in deficit in April and May, following near balance (s.a.) in the trade account and a $1.2 billion surplus in the current account during the first quarter. The combined $1.6 billion trade deficit and the $0.9 billion current account deficit in April and May are thought to result in part from the effects of the coal strike.

On July 6, the major London clearing banks announced increases in base lending rates from 9.25 to 10 percent. At the same time, the Bank of England raised some of its short-term money-market intervention rates. These increases failed to bring an end to downward pressure on the pound, and on July 11 Bank of England intervention rates and clearing bank base rates were raised again to 12 percent.

In the first four months of this year, industrial production in Italy was about 2 percent (n.s.a.) above the level for the same period in 1983. Other indicators, such as data on orders and consumer surveys, point to a continuation of economic expansion. Consumer price inflation continues to moderate. In June, consumer prices were 11 percent above their year-earlier level, representing a deceleration of over 4 percentage points from the corresponding period ending in June 1983.

On June 8, the Craxi government won Parliamentary approval of its modified incomes policy. The new law set limits on the scala mobile adjustments, but only for the first 7 months of this year. The law also holds increases in certain administered prices to 10 percent. Treasury Minister Goria is expected to announce soon new fiscal measures designed to bring current spending of the general government sector (including social security expenditures) exclusive of interest payments into line with current revenues. In 1983, the current budget deficit was 6.2 percent of GDP, compared with an overall budget deficit of 12.2 percent of GDP.

The Swedish Central Bank announced a 1 percentage point increase in its discount rate (to 9.5 percent) on June 28. The penalty rate, which is levied on borrowings that exceed a certain level and has more importance for daily market rates, was increased by 2 percent to 13.5 percent. The Swedish government announced on the same day that it was lifting the general price freeze that it had imposed in April, although the freeze on rents and dividend payments will be retained. The government's inflation goal for 1985 remained unchanged at 3 percent, and Swedish unions and employers' organizations recently agreed to keep 1985 wage increases within the government's goal of 5 percent -- a figure that is based on the 3 percent inflation goal.

Debt Situation in Selected Developing Countries

Argentina continues to negotiate with the IMF and has eliminated interest arrears through early April. Mexico, Brazil, Chile and Peru so far are operating successfully under IMF programs, but compliance for the latter three may become more difficult later this year. Colombia continues to lose reserves, and its largest bank is seeking reschedulings. Mexico's bank creditors are willing to negotiate a multi-year rescheduling. Venezuela's bank creditors may agree to a rescheduling without a formal IMF program if private sector interest arrears are reduced. The Philippines has taken some--though insufficient--steps toward an IMF program.

Argentina has sent a letter to the Managing Director of the IMF, outlining its planned adjustment program. The letter does not contain the usual paragraphs specifying quantitative performance criteria and fails to reconcile apparently conflicting objectives. The major areas of disagreement are the budget, interest rate policy, exchange rate policy, and wage policy. On June 20, Argentina made a $100 million payment to its foreign bank creditors to eliminate interest arrears substantially through January 24. On June 29, Argentina and the banks announced an arrangement whereby Argentina eliminated interest arrears through early April by using an additional $225 million of its reserves and drawing on a new $125 million short-term credit from the 11 banks that constitute the working committee for Argentina. The new credit is for 45 days, with the understanding that a 45-day extension would be granted if Argentina and the IMF reach agreement on an adjustment program by mid-August; it is secured by Argentine deposits at the Federal

Reserve Bank of New York. The $100 million short-term credit that the same banks provided on March 30, when interest arrears were eliminated through the fourth quarter of 1983, was rolled over for 90 days. The repayment of $300 million borrowed from Brazil, Colombia, Mexico, and Venezuela as part of the March 30 arrangement fell due on June 28 and was postponed for 30 days. The U.S. Treasury's conditional commitment to lend Argentina $300 million as a bridge to the IMF credit, to be used to repay the four countries, has lapsed, but the Treasury said that it would consider an Argentine request for such a loan once Argentina and the IMF agree on a letter of intent acceptable to the Managing Director.

Brazil registered a trade surplus of over $5.9 billion during the first six months of the year, compared with $2.9 billion over the first six months of 1983, due largely to strong growth in exports. It is likely that Brazil will exceed its $9 billion trade surplus target for the year. Inflation was slightly over 229 percent for the twelve month period ending in June compared with 211 percent over the twelve months of 1983. Strong export growth has led to a pickup of economic activity and real GDP is expected to grow 2 percent this year. Although complete information is not yet available on Brazil's compliance with second quarter IMF performance criteria, it appears that Brazil may have trouble achieving the nominal public sector borrowing requirement, given greater than expected inflation and the recent large net placements of government securities.

Colombia's international reserves continue to decline. At the end of April, reserves excluding gold were about $1 billion, much of them not liquid, down $900 million since the end of 1983. Gold holdings have also declined, reflecting sales in international markets. Colombia faces a prospective $2-1/2 billion current account deficit this year, maturing medium- and long-term debts of about $700 million, and short-term obligations of nearly $3-1/2 billion. The financial difficulties experienced by some important Colombian banks are continuing to constrain their access to foreign financing. Nearly 15 percent of the total assets of the domestic financial system are estimated to be nonperforming. Colombia's largest commercial bank is seeking rescheduling of about $500 million in short-term external debts and another $160 million used to finance a public sector entity that is now unable to pay. The government recently announced a plan to promote restructuring of private sector external debts over 6 years with 3 years' grace. Creditor participation is voluntary. Because of the recession, the government is reluctant to tighten fiscal and monetary policy in order to reduce the external deficit and is instead relying on direct import restrictions.

On June 29, banks made the first disbursement under Mexico's $3.8 billion new money loan. On July 9, Mexico and its Bank Advisory Committee began negotiations on a multi-year rescheduling of public sector debt. The decline in economic activity appeared to have run its course in the first quarter, when industrial production was only 0.8 percent lower than in the same period last year. The annualized rate of increase in the CPI in the first six months of 1984 was about 70 percent, down from 99 percent in the same period of 1983. A 20 percent increase in the minimum wage was announced on June 6. Together with the 30 percent increase which took effect on January 1, this brings the minimum wage to 56 percent above the December level. The trade surplus for January-April was about $5 billion, $400 million more than in the same period of 1983. The first-quarter current account surplus was about $2 billion, about $800 million higher than in the first quarter of 1983. The spread between the "free" market exchange rate and the rate in U.S. markets narrowed to about 5 percent at mid-June, and was fluctuating around 7 percent in early July.

Chile received $390 million of its $780 million credit from banks on June 29. Two other tranches of $195 million each will be contingent on compliance with Chile's IMF program. The authorities hope that this credit will close the foreign exchange gap, but their projections have been based on an average 1984 copper price of 71 cents per pound, and world prices recently have been below 65 cents. (One cent on the copper price is worth about $27 million to Chile at an annual rate.) Inflation, at about 20 percent so far this year, is on target, but unemployment has been edged up over the past few months. The government hopes to activate a clause in the IMF program allowing for somewhat larger fiscal deficit to stimulate private sector activity.

Peru reached agreement with its Paris Club creditors on June 5 on a rescheduling of debt falling due from May 1984 through July 1985. The fiscal deficit for the year now appears likely to exceed the 4.1 percent stipulated by the IMF program.

At the end of June, Venezuela and its creditor banks renewed discussions on rescheduling $14-1/2 billion of public sector debt. Under a series of moratorium agreements with banks, public sector principal payments have been rolled over since March 1983. The current moratorium expires July 31. Banks are likely to agree to a rescheduling in the absence of a formal IMF program based on an IMF "endorsement" of the Venezuelan adjustment program. The IMF completed Article IV consultations with Venezuela on June 18 and has stated that the adjustment program is on the right track; the main disagreements concern the estimated size of the 1984 budget deficit, the timetable for establishing a unified exchange rate, and some questions regarding the flexibility of administration of price controls and private sector employment guidelines. The Fund and Venezuela agree that the current account is likely to be in surplus in 1983. Banks are not likely to reschedule public sector debt until private sector interest arrears, currently estimated at more than $1 billion, are cleared up. Venezuela does not plan to ask for any new money from banks in 1984.

The Philippines has taken various measures to prepare the way for a new IMF stabilization program. In early June the peso was devalued from 14 to 18 to the dollar, but very little trading has taken place at the new rate. The black market rate has been about 23 pesos to the dollar. Other actions taken included an increase in the import surcharge, cuts in government budget expenditures, restrictions on borrowings by government corporations, and a 30 percent tax on export proceeds. The measures taken fall short of those considered necessary as a basis of an IMF program, but were deemed sufficient to justify the resumption of serious negotiations. A Fund mission was sent to Manila in early July. Interest rates in the interbank market have fluctuated between 37 and 65 percent. In May, consumer prices were 42 percent higher than a year earlier.