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Confidential (FR) Class III FOMC

September 26, 1984

RECENT DEVELOPMENTS

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

TABLE OF CONTENTS

September 26, 1984

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	August	09-07-84	113.9	-4.7	-1.1	1.2
Unemployment rate (%) 1/	August	09-07-84	7.5	7.5	7.5	9.5
Insured unemployment rate (%) 1/	June	08-26-84	2.7	2.8	2.9	3.8
Nonfarm employment, payroll (mil.)	August	09-07-84	94.5	2.0	3.1	5.1
Manufacturing	August	09-07-84	19.7	1.8	3.5	6.1
Nonmanufacturing	August	09-07-84	74.8	2.1	3.0	4.8
Private nonfarm:						
Average weekly hours (hr.) 1/	August	09-07-84	35.2	35.2	35.3	35.0
Hourly earnings ($) 1/	August	09-07-84	8.35	8.35	8.29	8.00
Manufacturing:						
Average weekly hours (hr.) 1/	August	09-07-84	40.4	40.5	40.6	40.3
Unit labor cost (1967=100)	July	08-29-84	84.0	-11.3	-11.1	-8.3
Industrial production (1967=100)	August	09-14-84	166.2	2.9	8.4	9.5
Consumer goods	August	09-14-84	163.2	-5.1	3.7	4.4
Business equipment	August	09-14-84	186.1	13.0	21.8	18.8
Defense & space equipment	August	09-14-84	136.1	8.9	9.0	13.2
Materials	August	09-14-84	164.9	3.6	7.2	10.2
Consumer prices all items (1967=100)	August	09-21-84	312.4	5.4	3.6	4.2
All items, excluding food & energy	August	09-21-84	303.1	5.6	4.8	5.1
Food	August	09-21-84	304.1	7.5	4.3	4.3
Producer prices: (1967=100)						
Finished goods	August	09-14-84	291.9	-1.2	.5	2.0
Intermediate materials, nonfood	August	09-14-84	325.7	-1.5	1.1	2.4
Crude foodstuffs & feedstuffs	August	09-14-84	252.3	-21.0	-14.4	.2
Personal income ($ bil.) 2/	August	09-19-84	3,042.8	6.4	8.6	10.3
				(Not at annual rates)		
Mfgrs. new orders dur. goods ($ bil.)	August	09-25-84	100.5	-.9	-1.7	13.1
Capital goods industries	August	09-25-84	32.6	-5.7	-5.9	16.5
Nondefense	August	09-25-84	25.6	-6.3	-11.6	11.9
Defense	August	09-25-84	7.0	-3.1	23.1	37.0
Inventories to sales ratio: 1/						
Manufacturing and trade, total	July	09-17-84	1.34	1.32	1.33	1.35
Manufacturing	July	09-25-84	1.47	1.46	1.44	1.50
Trade	July	09-17-84	1.23	1.20	1.24	1.23
Ratio: Mfgrs.' durable goods inventories to unfilled orders 1/	August	09-25-8	.530	.529	.523	.563
Retail sales, total ($ bil.)	August	09-14-84	106.2	-.8	-1.9	8.1
GAF 3/	August	09-14-84	22.6	.5	-1.0	9.1
Auto sales, total (mil. units.) 2/	August	09-06-84	9.9	-8.0	-10.2	10.8
Domestic models	August	09-06-84	7.6	-10.3	-11.1	13.9
Foreign models	August	09-06-84	2.4	.5	-7.0	2.0
Plant and equipment expenditures 4/						
Total nonfarm business	1984	09-11-84	307.60	—	—	14.3
Manufacturing	1984	09-11-84	130.39	—	—	16.9
Nonmanufacturing	1984	09-11-84	177.21	—	—	12.4
Capital Appropriations, Mfg.	1984-Q2	09-04-84	37,092	38.3	—	77.7
Housing starts, private (thous.) 2/	August	09-19-84	1,537	-12.8	-14.3	-17.9
Leading indicators (1967=100)	July	08-29-84	165.3	-.8	-1.1	4.5

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

The pace of economic expansion slowed considerably during the third quarter as growth slackened in a number of sectors, even prior to the six-day auto strike in September. Industrial production rose only slightly in August and payroll employment decelerated. Consumption spending leveled off in July and August, housing starts dropped in both months, and growth in business capital spending moderated. In July, further import expansion pushed the trade deficit to a record figure. Producer prices fell in August, but consumer prices rose a little faster than in most recent months.

Industrial Production

Industrial production edged up an estimated 0.2 percent in August, after climbing 0.9 percent in both June and July. For consumer goods, output declined 0.4 percent in August, largely reflecting reduced assemblies of autos and lightweight trucks. Tight supplies of quality parts limited auto assemblies in August to an annual rate of 7.7 million units, down from the July rate of 7.9 million units; and the strike at selected G.M. plants contributed to a further reduction in September. Output of goods for the home, including appliances, and production of nondurable consumer goods also declined in August. In contrast, production of equipment for both business and defense continued to advance strongly last month, and output of construction supplies edged up.

With production gains moderating in August, capacity utilization in manufacturing was unchanged, following a sizable increase in July. At 82.8 percent, the August utilization rate was slightly higher than the 1967-82 average and 14 percentage points above the postwar low registered

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

	1984		1984		
	Q1	Q2	June	July	Aug.
	-----Annual rate-----		---Monthly rate--		
Total	11.5	8.5	.9	.9	.2
Final products	11.9	8.8	1.2	1.0	.2
Consumer goods	7.4	5.8	.6	.7	-.4
Durable	16.0	-1.7	1.2	.9	-1.0
Nondurable	4.1	8.9	.4	.7	-.2
Business equipment	19.1	13.1	2.4	1.8	1.1
Defense and space equipment	17.4	13.4	.7	.8	.7
Construction supplies	14.8	7.6	.9	.3	.2
Materials	12.3	8.7	.6	.9	.3
Durable goods	20.6	11.7	.9	1.3	.4
Nondurable goods	.5	6.7	-.2	.3	.5
Energy materials	10.9	3.7	.9	.5	-.2

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

	1978-80	1982	1967-82	1984		
	High	Low	Avg.	June	July	Aug.
Total industry	87.3	69.6	82.4	82.1	82.6	82.6
Manufacturing	87.5	68.8	81.8	82.1	82.8	82.8
Durable	89.4	64.8	80.5	81.7	82.8	82.7
Nondurable	87.2	73.8	83.9	82.7	82.9	82.8
Mining	90.4	69.6	86.5	76.4	78.0	77.7
Utilities[1]	86.8	79.0	88.6	85.4	84.3	84.5
Industrial materials	88.9	66.6	83.3	83.0	83.5	83.6
Metal materials	95.4	46.2	82.2	72.0	73.0	71.8
Paper materials	97.9	86.3	93.4	99.7	100.4	n.a.
Chemical materials	91.3	64.0	85.1	78.8	78.6	n.a.

1. The 1978-80 high is below the 1967-82 average because of the unusually slow growth in demand for electricity.

in late 1982. During August, substantial declines in operating rates for steel, aluminum, and auto assemblies were offset by increases for nonelectrical machinery, instruments, and petroleum refining.

Employment and Unemployment

Employment growth slowed during the third quarter, and the unemployment rate in August remained at 7-1/2 percent, the same as the average for the second quarter. Jobless rates were little changed during August for most demographic groups.

As measured by the establishment survey, the employment gains in July and August—averaging about 210,000 per month (strike-adjusted)—were only two-thirds as large as the average monthly increase during the first half of 1984. Much of the slowdown occurred in the manufacturing sector; factory job gains totaled only 29,000 in August, with increases in a few durable goods industries--particularly autos--partly offset by declines in a number of nondurable goods industries. In addition, the factory workweek edged down again to 40.4 hours, off from the cyclical high of 41.1 hours registered in April. By contrast, employment in the trade and services industries continued to expand at a healthy pace during August, although below the first-half rate. The reported employment growth in services would have been larger but for a since-settled strike of hospital workers that removed about 50,000 persons from the payrolls.

In the household survey, monthly changes in employment have been quite volatile in recent months, with exceptional gains early in the summer being reversed partly by sharp declines in July and August. Almost all of the August decline in employment took place among youths; because of a late

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

	1983	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 June	1984 July	1984 Aug.
	-Average monthly changes-							
Nonfarm payroll employment[2]	282	364	336	344	359	349	216	159
Strike adjusted	282	372	330	339	366	362	205	218
Manufacturing	92	102	148	108	54	59	82	29
Durable	70	79	114	82	46	54	57	54
Nondurable	22	23	34	25	8	5	25	-25
Construction	22	36	22	22	64	57	7	7
Trade	69	72	85	86	87	89	58	52
Finance and services	96	102	93	105	122	146	8	59
Total government	3	33	-22	1	7	-28	46	-5
Private nonfarm production workers	249	289	306	259	307	303	112	130
Manufacturing production workers	84	88	129	81	35	27	63	17
Total employment[3]	330	378	355	400	536	460	-353	-426
Nonagricultural	336	435	339	425	495	445	-294	-306

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	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 June	1984 July	1984 Aug.
Civilian, 16 years and older	9.6	9.4	8.5	7.9	7.5	7.1	7.5	7.5
Teenagers	22.4	22.4	20.6	19.6	18.7	17.6	18.3	18.4
20-24 years old	14.4	14.0	12.9	11.9	11.5	10.7	11.3	11.8
Men, 25 years and older	7.8	7.6	6.8	6.1	5.7	5.4	5.7	5.5
Women, 25 years and older	7.2	7.0	6.3	6.1	5.9	5.8	6.1	6.3
White	8.4	8.1	7.4	6.8	6.4	6.1	6.4	6.4
Black	19.5	19.4	17.9	16.5	15.9	15.0	16.9	16.0
Fulltime workers	9.5	9.3	8.3	7.6	7.2	6.7	7.2	7.2
Memo:								
Total national[1]	9.5	9.3	8.4	7.8	7.4	7.0	7.4	7.4

1. Includes resident Armed Forces as employed.

survey week, more young persons than usual may have left summer jobs in anticipation of returning to school.

Personal Income and Consumption

Personal income rose at a $16.1 billion annual rate in August, a gain that was about a third below the average increase during the first half of the year. The slowdown in income growth largely reflected the easing of labor demand, as nonlabor income continued its strong advance.

Nominal personal consumption expenditures were nearly flat in both July and August and, in real terms, probably declined somewhat following large real gains in the preceding three quarters. Continued growth in expenditures for services throughout the summer was offset by falloffs in spending at retail outlets for a wide range of consumer goods. Outlays for clothing and shoes dropped sharply this summer after a surge in the second quarter; spending for furniture and appliances, which had been exceptionally strong since the fall of 1982, also declined.

The easing of consumer spending also reflected a decline in new car sales. Crimped by a shortage of inventories, sales of domestic units dropped in August to a 7.6 million unit annual rate. The selling rate rebounded in the first 20 days of September, but the strike at G.M. probably depressed sales toward the end of the month. In July and August, sales of imported units remained close to 2.5 million units per year.

Despite the softness in consumer spending during July and August, the surveys from the Michigan Survey Research Center and the Conference

PERSONAL INCOME AND EXPENDITURES
(Based on seasonally adjusted data)

	1982	1983	1983 Q4	1984 Q1	1984 Q2	1984 June	1984 July	1984 Aug.
	- - Percentage changes at annual rates[1] - -							
Total Personal Income								
Nominal	5.3	7.5	11.0	12.4	9.1	11.2	8.1	6.4
Real[2]	.4	4.3	8.6	8.3	6.8	10.9	2.5	n.a.
Disposable Personal Income								
Nominal	6.1	8.5	10.7	12.7	8.6	9.9	7.6	6.2
Real	1.1	5.3	8.2	8.6	6.3	9.6	2.0	n.a.
Expenditures								
Nominal	8.2	9.0	9.2	8.6	10.2	4.0	.6	.6
Real	3.1	5.7	6.8	4.6	7.9	3.7	-4.9	n.a.
	- - Changes in billions of dollars[3] - -							
Total personal income	11.7	17.0	25.1	26.7	22.0	27.7	20.2	16.1
Wages and salaries	5.1	11.1	15.2	12.2	13.2	14.5	8.7	3.9
Private	3.3	9.5	13.5	9.7	11.8	13.0	7.0	1.9
Manufacturing	-.9	3.3	4.2	3.8	1.9	1.6	1.7	2.0
Other income	7.1	6.8	10.8	16.6	9.5	14.2	12.0	12.5
Disposable personal income	11.5	16.3	20.9	23.7	16.8	21.0	16.3	13.4
Expenditures	12.9	15.7	17.8	9.1	24.9	7.8	1.2	1.2
Durables	2.8	3.9	7.8	-.6	6.8	1.5	-6.9	-4.9
Motor vehicles and parts	2.0	2.4	5.5	-.9	3.5	-2.1	-1.1	-6.8
Furn. and household equip.	.6	1.1	2.0	.0	2.4	2.9	-4.1	.6
Nondurables	2.3	3.9	2.0	5.0	8.0	-.3	1.5	-4.8
Clothing and shoes	.5	1.0	2.1	.6	3.3	2.5	-4.1	-1.9
Gasoline and oil	-.5	.3	.0	.0	-.2	-2.0	-2.7	-.7
Services	7.9	7.9	8.0	4.7	10.0	6.4	6.7	10.9
Personal saving rate (percent)	6.2	5.0	5.3	6.1	5.7	5.6	6.1	6.5

1. Annual changes are measured from final quarter of preceding period to final quarter of period indicated. Changes for quarterly periods are compounded rates of change; monthly changes are not compounded.
2. Total personal income is deflated by the personal consumption expenditure deflator.
3. Average monthly changes are from the final month of the preceding period to the final month of period indicated; monthly figures are changes from the preceding month.

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

	1984 Q1	1984 Q2	Aug./Q2[4]	1984 June	July	Aug.
Total sales	3.5	2.9	-2.0	1.0	-2.0	-.8
(Real)[1]	2.7	3.0	—	1.2	-1.8	—
Total, less automotive, gasoline and nonconsumer stores	3.0	2.5	-.4	1.1	-1.3	.0
GAF[2]	3.2	3.9	-1.6	2.5	-3.8	.5
Durable	5.1	4.3	-3.8	2.0	-3.4	-2.2
Automotive group	5.7	4.6	-6.0	2.5	-4.1	-4.0
Furniture & appliances	3.5	3.8	.2	3.0	-2.6	1.4
Nondurable	2.7	2.1	-1.0	.4	-1.2	-.1
Apparel	2.4	6.3	-5.8	1.7	-4.3	-3.0
Food	2.2	2.3	-.5	.6	.8	-1.7
General merchandise[3]	3.4	3.0	-.6	2.6	-4.1	1.5
Gasoline stations	.3	1.4	-4.9	-3.2	-3.0	-.5

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

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

	1984 Q1	1984 Q2	1984 July	Aug.	Sept.
Total sales[1]	10.5	10.6	10.8	9.9	
Imports	2.3	2.4	2.4	2.4	
Domestic	8.2	8.2	8.4	7.6	8.5[2]
Domestic production	8.2	7.7	7.9	7.7	
Domestic inventories	1.49	1.41	1.30	1.39	
Days' supply[3]	56	53	48	57	

1. Components may not add to totals due to rounding.
2. First 20 days.
3. Quarterly days' supply are based on end of quarter stocks and average sales for the quarter.

Board indicate that consumer confidence remained high. The Michigan index of sentiment edged up during August to within 2 percentage points of the 20-year peak reported in March of this year. Much of the gain in August was attributable to more favorable evaluations of present and expected personal finances. The Conference Board index of consumer attitudes changed little in August and was 6.2 percentage points above a year earlier.

The moderate rise in nominal disposable income, coupled with almost no increase in personal consumption expenditures, resulted in a rise in the personal saving rate to 6-1/2 percent in August, up 0.8 percentage point from the second quarter.

Business Fixed Investment

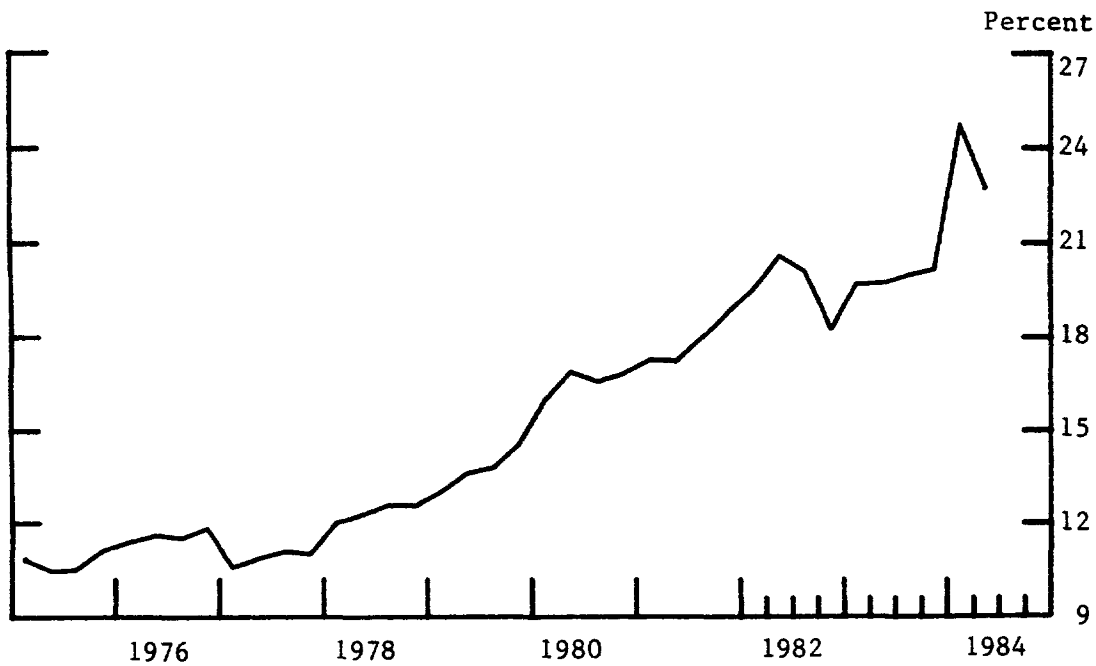
Growth in capital spending by business moderated this summer, following extremely large gains in both producers' durable equipment and nonresidential construction earlier this year. In the equipment sector, shipments of nondefense capital goods by domestic producers fell 0.4 percent in August, to a level 1 percent below the second quarter average; declines in August were concentrated in heavy industrial machinery. In contrast, purchases of equipment from abroad continued to climb. Imports of capital goods (excluding autos) surged 42 percent in July, when the U.S. trade balance in capital goods was negative for the first time in the postwar era. Largely because of the strength of the dollar, capital goods imports as a portion of domestic equipment investment already had risen from about 12 percent in 1978 to about 24 percent in the first half of this year.

Nominal construction expenditures rose 0.3 percent in July, after average monthly gains of 2-1/2 percent in the first six months of the year. Commercial construction, in particular office building, remained a source of

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

	1983	1984		1984		
	Q4	Q1	Q2	June	July	Aug.
Producers' durable equipment						
Nondefense capital goods						
Shipments	6.0	1.1	5.6	3.9	-4.4	-.4
Orders	6.9	5.2	4.9	-3.2	-2.6	-6.3
Unfilled orders	2.0	4.4	4.1	.9	1.1	0
Sales of heavy-weight trucks (thousands of units, A.R.)	199	232	269	295	293	265
Nonresidential structures						
Nonresidential construction	3.3	8.0	8.0	-.7	.3	n.a.
Commercial building	3.4	13.7	13.9	-.9	1.5	n.a.
Value of nonresidential building						
Permits	-2.1	16.0	.8	-10.9	.1	n.a.
Contracts	4.9	-9.8	19.7	-18.7	12.9	n.a.

RATIO OF NOMINAL CAPITAL GOODS IMPORTS TO BUSINESS EQUIPMENT SPENDING[1]



1. Based on N.I.P.A data. Autos are excluded from both imports and equipment spending.

strength; nominal expenditures for commercial structures rose 1.5 percent in July and have climbed more than 30 percent since last December.

On the whole, forward-looking indicators point to further gains in business spending in coming months. Although new orders of nondefense cpaital goods fell in July and August, the backlog of unfilled orders remained relatively high. Also, contracts and permits for new nonresidential building increased in July, and were running well above year-earlier levels. Finally, the Commerce Department's August survey reported that firms still plan to increase nominal spending on plant and equipment by about 14-1/2 percent in 1984 as a whole, which would be consistent with continued growth in capital spending in the second half.

Business Inventories

Businesses accumulated inventories at a brisk rate in July after a temporary lull in June. In constant dollars, total manufacturing and trade inventories rose at an annual rate of $23 billion in July, about the same as the average pace during the first half of the year. Despite large inventory increases since the beginning of the year, the overall inventory-sales ratio still appears low by historical standards. However, excess stocks in a few industries, including building materials and consumer durables, have caused some limited cutbacks in production.

Manufacturers continued their vigorous inventory expansion in July, as factory stocks rose at an annual rate of $11-1/2 billion in real terms after a $13-3/4 billion rate of buildup in the second quarter. Nonetheless, stocks in most industries remain lean in relation to sales, and manufacturers appear to be positioned for further inventory expansion. Since early spring, the bulk of the increase in factory stocks has occurred in capital goods industries.

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

	1984 Q1	1984 Q2	1984 May	1984 June[r]	1984 July[p]
Book value basis					
Total	73.7	56.3	62.2	7.1	52.9
Manufacturing	27.8	40.4	50.4	34.7	29.8
Wholesale trade	13.6	10.1	11.0	-8.5	26.8
Retail trade	32.3	5.8	.8	-19.1	-3.7
Automotive	10.5	-4.3	-12.7	-16.0	-9.1
Ex. auto	21.8	10.1	13.5	-3.1	5.4
Constant dollar basis					
Total	24.4	19.7	24.5	.0	22.9
Manufacturing	9.1	13.8	18.6	14.2	11.4
Wholesale trade	3.9	4.1	5.9	-6.1	10.5
Retail trade	11.4	1.7	.0	-8.1	1.1
Automotive	3.8	-3.0	-6.4	-7.4	-2.0
Ex. auto	7.7	4.7	6.4	-.7	3.1

r--revised estimates.
p--preliminary estimates.

INVENTORIES RELATIVE TO SALES[1]

	Cyclical Reference Points[2] 1981 Low	Cyclical Reference Points[2] 1982 High	1984 Q1	1984 Q2	1984 May	1984 June[r]	1984 July[p]
Book value basis							
Total	1.39	1.53	1.33	1.33	1.32	1.32	1.34
Manufacturing	1.60	1.77	1.44	1.47	1.45	1.46	1.47
Wholesale trade	1.06	1.28	1.11	1.09	1.09	1.08	1.11
Retail trade	1.36	1.44	1.37	1.34	1.36	1.33	1.35
Automotive	1.59	1.88	1.49	1.37	1.44	1.34	1.37
Ex. auto	1.29	1.36	1.34	1.33	1.34	1.33	1.35
Constant dollar basis							
Total	1.62	1.75	1.52	1.51	1.50	1.50	1.52
Manufacturing	1.91	2.11	1.73	1.76	1.74	1.75	1.78
Wholesale trade	1.34	1.52	1.33	1.30	1.30	1.29	1.31
Retail trade	1.34	1.44	1.34	1.31	1.32	1.30	1.32
Automotive	1.49	1.81	1.38	1.27	1.31	1.24	1.28
Ex. auto	1.28	1.37	1.33	1.33	1.33	1.32	1.33

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.

In the trade sector, non-auto inventories generally have been rising with some limited reports of overstocking recently. Auto stocks were drawn down in July, but the first deliveries of 1985 models in August enabled dealers to replenish their inventories a bit, achieving a 57-days' supply by the end of the month.

Housing Markets

Activity in housing markets weakened during the summer, as housing starts fell sharply in both July and August. Newly issued permits for residential units also declined. In the multifamily sector, starts declined in August; but, on balance, multifamily activity has remained surprisingly robust in recent months. The strength in multifamily construction this year apparently has continued to be concentrated in rental units; in the second quarter only 31 percent of multifamily starts were in condominium or cooperative structures. By contrast, such "for sale" units made up more than 40 percent of multifamily starts as recently as early 1982.

Starts of single-family units declined for the fourth consecutive month in August; since the first quarter, such activity has declined almost 30 percent. Home sales have fallen by lesser margins, as sales of both new and existing properties during the summer were off only 12 percent from their early-year peaks.

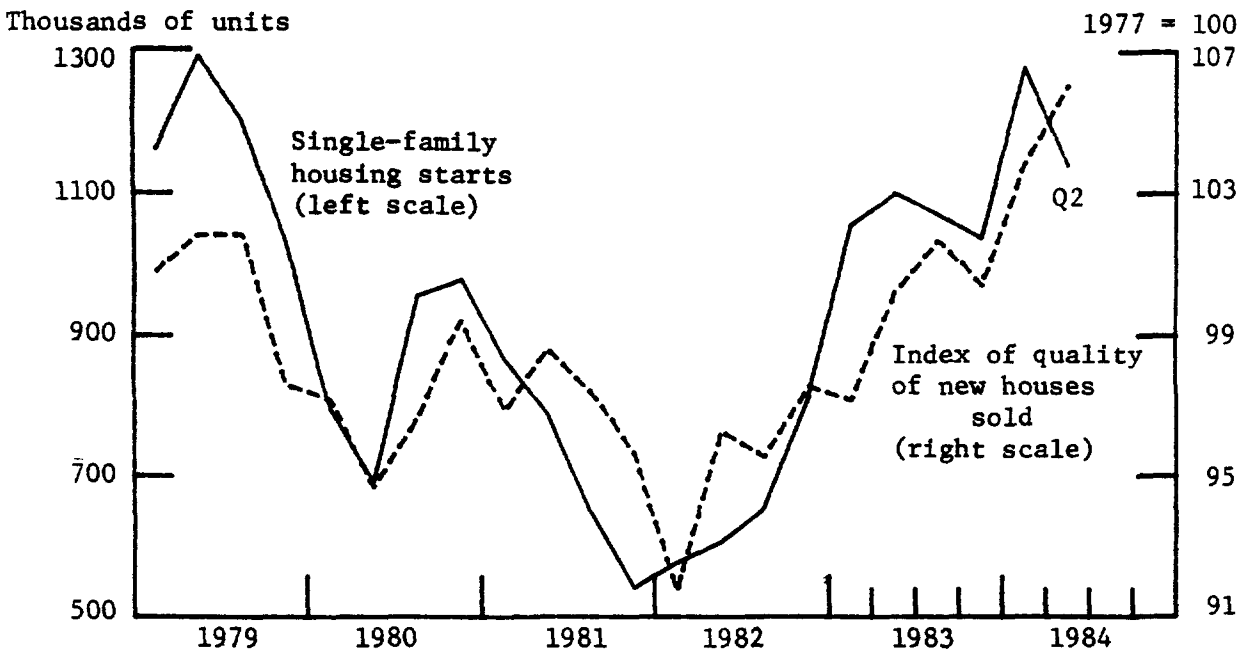
Despite some recent retrenchment, single-family markets have shown considerable resilience, given that nominal interest rates on fixed-rate mortgage loans have remained high by historical norms. This strength, reflecting the continued widespread use of mortgages with initial interest rates below those of traditional fixed-rate loans, has been apparent not only in the number of units started, but also in the size and amenities of

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

	1983		1984				
	Annual	Q4	Q1	Q2	June	July	Aug.[1]
All units							
Permits	1.61	1.63	1.81	1.76	1.77	1.57	1.51
Starts	1.70	1.70	1.97	1.90	1.88	1.76	1.54
Single-family units							
Permits	.90	.91	1.02	.93	.92	.82	.79
Starts	1.07	1.04	1.28	1.14	1.08	1.00	.90
Sales							
New homes	.62	.67	.69	.63	.63	.63	n.a.
Existing homes	2.72	2.76	2.94	3.04	2.96	2.77	2.72
Multifamily units							
Permits	.70	.72	.79	.83	.85	.74	.71
Starts	.64	.66	.69	.76	.79	.76	.63
Mobile home shipments	.30	.31	.30	.29	.30	.30	n.a.

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

SINGLE-FAMILY STARTS AND QUALITY INDEX OF NEW HOUSES SOLD



houses purchased. The two-year trend toward higher quality new houses continued through the second quarter of 1984, according to data recently released by the Census Bureau.

Federal Government

The federal government apparently had an unusually large budget deficit in August, but probably ran a surplus of between $15 to $20 billion in September. For fiscal year 1984 as a whole, the federal government deficit is apt to be in the neighborhood of $173 billion, about $20 billion less than in fiscal year 1983.

To date, only four of the 13 fiscal 1985 appropriation bills have been enacted. However, the chief barrier to progress--agreement on the size and the content of future defense spending increases--has been lifted and enactment of some the remaining appropriations bills is now expected before the early October adjournment. In addition, Congress is considering a continuing resolution to provide interim funding until the remaining appropriations are decided.

One element in the controversy about future defense appropriations has been the slower-than-anticipated growth in current outlays. Based on ten months of data, FY1984 national defense expenditures are likely to total less than $230 billion, nearly $10 billion below the figures projected last February by the administration and the CBO. A similar shortfall from anticipated spending levels occurred in fiscal 1983. A number of explanations have been suggested for the slower spending rate, including lower-than-expected costs and longer start-up times for new programs. Moreover, tighter quality control by the Department of Defense is believed to have reduced outlays for some big-ticket items. Despite the shortfalls from budget projections, monthly defense outlays are averaging more than 8 percent above year-earlier levels, and contract and orders data suggest such growth will continue for some time.

State and Local Government

Indicators point to continued increases in real spending by state and local governments. Employment has trended up all year and in July and August was at its highest level since the end of 1981. This year's payroll increases follow a period during which 40 states imposed hiring freezes or reduced their work forces. In July, construction outlays rose briskly, paced by sizable increases for roads and educational facilities. As their fiscal conditions have improved, several states have taken steps to reduce tax rates or to allow temporary tax hikes--mandated during the recession--to be cut back.

Exports and Imports

Imported goods continue to fill a growing share of domestic demand. Although the monthly pattern has been erratic, merchandise imports in real terms in the four-month period ending in July averaged 4 percent above the first-quarter pace. This increase in imports, encompassing a wide range of manufactured goods, reflects the strength of aggregate demand in the United States as well as the high exchange value of the dollar. Owing to the strength of imports, the trade deficit widened to a record level in July despite another monthly increase in the volume of nonagricultural exports, which in July reached their highest level since late 1981. The July improvement in exports was concentrated in industrial supplies, business machines, and automotive exports to Canada. (Further discussion of international economic developments is included in Part IV.)

Prices

Incoming price data, taken together, suggest that inflation is holding at about the pace seen earlier this year. Producer prices of finished goods edged down 0.1 percent in August after increasing 0.3 percent a month earlier. By contrast, the CPI increased 0.5 percent after a July advance of 0.3 percent.

Among producer goods, capital equipment prices rose 0.3 percent in August, close to the average rate for the year to date. Prices of intermediate materials less food and energy were little changed in August for the second month.

Food prices at the consumer level picked up in August, rising 0.6 percent after registering little net change over the previous five months. The August increase stemmed from a surge in fresh vegetable prices and from a price upturn for meats. However, it appears that the upward pressures evident in the August index may be short lived. The supply shortages that give rise to spurts in prices of fresh vegetables typically are reversed within a few months. Moreover, crude food prices fell sharply in the August PPI, and developments in commodity markets since mid-August suggest that the crude foods index may be down again in September.

Retail energy prices were little changed in August, as further declines in prices of gasoline and fuel oil were offset by increases for electricity and natural gas. Spot prices for both gasoline and fuel oil have firmed since mid-August, returning to their early-summer levels. Excluding food and energy items, consumer prices have risen at an annual rate of about 5 percent since the end of 1982. The August increase, which

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

	Relative Importance Dec. 1983	1982	1983	1983 Q4	1984 Q1	1984 Q2	1984 July	1984 Aug.
				—Annual rate—			—Monthly rate—	
Finished Goods	100.0	3.7	.6	1.1	5.7	.0	.3	-.1
Consumer foods	24.0	2.1	2.3	5.8	16.9	-8.5	1.4	-.1
Consumer energy	12.0	-.1	-9.2	-10.4	-8.1	9.6	-1.7	-2.5
Other consumer goods	41.9	5.3	1.9	1.5	4.5	1.3	.2	.4
Capital equipment	22.2	3.9	1.9	1.8	3.8	2.8	.2	.3
Intermediate materials[2]	94.8	.2	1.5	2.5	2.9	3.4	-.1	-.1
Exc. energy	79.5	.6	3.0	4.1	3.8	1.9	.0	.1
Crude food materials	52.8	1.5	8.0	12.1	12.5	-21.3	.4	-1.8
Crude energy	31.3	2.6	-4.6	-2.3	-1.6	4.2	.3	.7
Other crude materials	15.9	-7.6	15.5	2.4	-9.7	30.6	-1.6	-3.1

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

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

	Relative Importance Dec. 1983	1982	1983	1983 Q4	1984 Q1	1984 Q2	1984 July	1984 Aug.
				—Annual rate—			—Monthly rate—	
All items[2]	100.0	3.9	3.8	4.0	5.0	3.3	.3	.5
Food	18.7	3.1	2.6	4.3	9.0	-.7	.3	.6
Energy	11.9	1.3	-.5	-1.7	-1.4	.8	-.3	.1
All items less food and energy[3]	69.4	6.0	4.9	4.9	5.1	4.7	.4	.5
Commodities[3]	26.5	5.0	5.0	4.6	3.4	3.7	.2	.4
Services[3]	42.9	7.0	4.8	5.3	5.9	5.3	.6	.5
Memorandum:								
CPI-W[4]	100.0	3.9	3.3	2.6	2.3	2.7	.4	.9

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.

included a sharp hike in apparel prices, was somewhat higher--a monthly rate of 0.5 percent.

Wages and Labor Costs

Wage inflation, has remained moderate so far in the third quarter. The hourly earnings index, which covers wages paid to production and nonsupervisory workers, fell 0.2 percent in August, as decreases in the service-producing sectors reversed the gains posted in the preceding month. Over the past year, this measure of wage change has risen at a 3-1/4 percent annual rate.

Wage settlements in new collective bargaining agreements have been consistent with the general wage temperance. Pay cuts and wage freezes in new contracts are less evident than earlier in the year; but first-year adjustments in new settlements, according to data collected by the Bureau of National Affairs (a private publishing company), have averaged 3-3/4 percent since the beginning of the year, down from 4-1/2 percent in 1983 and 7 percent in 1982. More recently, tentative collective bargaining agreements were reached in the auto and mining industries. The settlement between the United Auto Workers and General Motors, provides for an initial wage rate increase averaging 2-1/4 percent and lump sum payments of around 2-1/4 percent of annual earnings in the second and third years in addition to COLAs; this would increase wage costs at G.M. roughly 20 percent over the next three years, assuming a 5 percent rate of inflation. In addition, the settlement provides for continued profit sharing and for a commitment by G.M. of about $1 billion for income support and retraining of workers affected by new technology and outsourcing. The mine workers settled for a moderate 10-1/4 percent wage increase spread over 40 months.

For the private nonfarm sector as a whole, hourly compensation--which includes fringe benefits and employer payroll taxes as well as wages--increased at a 3.7 percent annual rate in the second quarter. As a result of an upward revision in productivity growth to an annual rate of 4.7 percent, unit labor costs now are estimated to have fallen 0.9 percent (annual rate) in the second quarter. Hourly compensation rose 4 percent and unit labor costs 1.3 percent from a year earlier.

SELECTED MEASURES OF LABOR COSTS IN THE NONFARM BUSINESS SECTOR
(Percentage change at annual rates; based on seasonally adjusted data)

	1981	1982	1983	1983 Q4	1984 Q1	1984 Q2	1984 to date
Hourly earnings index, wages of production workers[1]							Dec. 1983-Aug. 1984
Total private nonfarm	8.3	6.1	3.9	4.1	3.5	3.2	2.7
Manufacturing	8.8	6.0	2.7	3.3	3.8	3.0	3.3
Contract construction	8.3	5.4	1.5	1.4	2.3	1.9	1.0
Transportation and public utilities	8.5	6.1	4.3	4.6	3.7	3.1	3.2
Trade	6.9	5.4	4.7	4.5	2.7	2.5	1.8
Services	9.1	7.0	4.9	5.1	3.3	4.9	3.0
Employment cost index, wages and salaries of all persons[2]							1983-Q4 to 1984-Q2
Total	8.8	6.3	5.0	5.0	4.2	4.1	4.2
By occupation:							
White collar	9.1	6.4	6.0	4.9	3.1	6.4	4.8
Blue collar	8.6	5.6	3.8	4.3	4.9	2.5	3.7
Service workers	8.3	8.5	4.6	11.4	5.2	1.8	3.4
Labor costs and productivity, all persons							1983-Q4 to 1984-Q2
Compensation per hour	8.8	7.2	3.9	4.1	6.1	3.7	4.9
Output per hour	.5	1.4	3.9	1.0	2.9	4.7	3.9
Unit labor costs	8.2	5.8	.0	3.0	3.1	-.9	1.1

1. Changes are from final quarter of preceding period to final quarter of period indicated. Quarterly changes at compound rates.
2. Seasonally adjusted by the Board staff.

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

	1981	1983	1984			Change from:	
	Cyclical peak	Cyclical low	FOMC July 17	FOMC Aug. 21	Sept. 25	FOMC July 17	FOMC Aug. 21
Short-term rates							
Federal funds[2]	20.06	8.42	11.21	11.77	10.88	-.33	-.89
Treasury bills							
3-month	17.01	7.55	10.18	10.42	10.29	.11	-.13
6-month	15.93	7.62	10.62	10.59	10.37	-.25	-.22
1-year	15.21	7.73	10.96	10.68	10.40	-.56	-.28
Commercial paper							
1-month	18.63	8.00	11.04	11.30	10.86	-.18	-.44
3-month	18.29	7.97	11.18	11.24	10.81	-.37	-.43
Large negotiable CDs[3]							
1-month	18.90	8.08	11.28	11.42	10.98	-.30	-.44
3-month	19.01	8.12	11.58	11.56	11.06	-.52	-.50
6-month	18.50	8.20	12.13	11.76	11.25	-.88	-.51
Eurodollar deposits[2]							
1-month	19.80	8.68	11.51	11.66	11.27	-.24	-.39
3-month	19.56	8.71	12.01	11.81	11.42	.59	-.39
Bank prime rate	21.50	10.50	13.00	13.00	13.00	--	--
Treasury bill futures							
Dec. 1984 contract	--	8.89	11.45	10.59	10.29	-1.16	-.30
Dec. 1985 contract	--	10.86	12.57	11.56	11.35	-1.22	-.21
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	16.59	9.33	13.12	12.44	12.34	-.78	-.10
10-year	15.84	10.12	13.37	12.62	12.56	-.81	-.06
30-year	15.21	10.27	13.18	12.35	12.34	-.84	-.01
Municipal revenue (Bond Buyer index)	14.24	9.21	10.88[4]	10.47[4]	10.47[4]	-.41	--
Corporate--A utility Recently offered	18.33*	11.64	14.85e	14.10e	13.83e	-1.02	-.27
Home mortgage rates							
S&L fixed-rate	18.63	12.55	14.68[5]	14.39[5]	14.29[5]	-.39	-.10
FNMA ARM, 1-yr.	N.A.	10.49	13.60[5]	13.25[5]	13.00[5]	-.60	-.25

	1982	1983	1984			Percent change from:	
	Lows	Highs	FOMC July 17	FOMC Aug. 21	Sept. 25	FOMC July 17	FOMC Aug. 21
Stock prices							
Dow-Jones Industrial	776.92	1287.20	1112.90	1239.73	1207.16	8.5	-2.6
NYSE Composite	58.80	99.63	87.76	96.30	95.47	8.8	-.9
AMEX Composite	118.65	249.03	193.64	209.78	214.20	10.6	2.1
NASDAQ (OTC)	159.14	328.91	233.50	253.33	250.01	7.1	-1.3

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.

Credit markets rallied further over the intermeeting period as incoming information indicated a moderation of economic activity in the third quarter and continued slow money growth. In addition, with the federal funds rate declining since the last FOMC meeting from the 11-3/4 percent to the 11 percent area, and adjustment plus seasonal borrowing from the discount window dropping below the $1 billion level where it had been since April, market participants have concluded that the System is seeking somewhat easier bank reserve conditions. Most other money market rates were off 15 to 50 basis points by late September, with rates on private paper down more than those on bills, implying some further narrowing of risk premiums. Rate declines generally were somewhat smaller at the longer end, where spreads between private and government rates also narrowed.

The monetary aggregates grew sluggishly in August. M1 edged up at a 1-3/4 percent annual rate, about offsetting the previous month's decline and leaving this aggregate just below the midpoint of its longer-run target range. M2 growth in August, at 4-1/2 percent, was little changed from the slow July rate, and this aggregate moved further below the midpoint of its range. Despite the slower expansion of M1 and M2 in recent months, available evidence suggests that velocity growth for these aggregates in the third quarter will fall short of increases posted earlier in the year. M3 growth fell to a 4-3/4 percent rate in August, about half its recent pace, as a change in funding patterns at thrift institutions and some slowing of loan demands at large banks contributed to a sharp deceleration in its large time

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

September 25, 198

	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 July	1984 Aug.	Growth from Q4 1983 to Aug. 1984
	------- Percentage change at annual rates ------						
1. M1	9.5	4.8	7.2	6.1	-1.3	1.8	5.9
2. M2	6.9	8.5	6.9	6.8	4.8	4.5	6.
3. M3	7.4	9.8	8.9	10.3	8.4	4.7	9.
							Levels in billions of dollars Aug. 1984
Selected components							
4. Currency	9.1	9.7	8.7	7.2	6.2	7.7	156.0
5. Demand deposits	4.0	-0.5	1.2	3.4	-5.3	-7.8	245.5
6. Other checkable deposits	21.2	9.6	15.9	9.9	-2.6	12.1	139.7
7. M2 minus M1[2]	6.1	9.7	6.8	7.1	6.7	5.3	1743.2
8. Overnight RPs and Eurodollars, NSA[3]	-8.1	23.4	19.3	-8.2	-2.1	34.1	57.9
9. General purpose and broker/dealer money market mutual fund shares, NSA	-13.1	-1.2	9.8	15.5	12.9	0.8	150.6
10. Commercial banks	12.2	12.4	5.4	6.7	7.1	5.8	746.7
11. Savings deposits, SA, plus MMDAs, NSA[4]	11.0	5.9	6.5	4.9	-5.5	-7.8	368.9
12. Small time deposits	13.7	19.3	4.4	8.6	20.0	19.4	377.8
13. Thrift institutions	7.3	7.3	6.4	6.2	8.7	6.5	798.5
14. Savings deposits, SA, plus MMDAs, NSA[4]	1.0	-7.0	-0.9	2.6	-15.5	-23.6	314.7
15. Small time deposits	12.3	18.8	11.8	8.9	25.6	26.6	483.7
16. M3 minus M2[5]	9.8	15.8	17.6	24.7	22.7	5.4	578.3
17. Large time deposits	11.9	15.7	24.8	31.5	31.7	8.6	391.9
18. At commercial banks, net[6]	-4.6	-0.4	10.0	24.2	25.5	2.8	255.6
19. At thrift institutions	63.5	58.1	59.0	46.4	42.7	20.6	136.3
20. Institution-only money market mutual fund shares, NSA	-17.8	16.6	10.9	6.8	8.5	2.8	42.7
21. Term RPs, NSA	15.2	50.0	18.4	42.5	-2.0	74.4	63.4
22. Term Eurodollars, NSA	-1.3	-4.4	5.7	0.4	-20.3	-27.6	85.1
	-- Average monthly change in billions of dollars --						
MEMORANDA:							
23. Managed liabilities at commercial banks (24+25)	-2.6	5.3	4.6	7.0	3.5	1.5	423.1
24. Large time deposits, gross	-2.0	0.1	2.0	7.9	2.9	-2.4	313.3
25. Nondeposit funds	-0.6	5.2	2.6	-0.9	0.6	3.9	109.8
26. Net due to related foreign institutions, NSA	1.3	3.2	1.9	0.9	-0.3	-1.4	-35.8
27. Other[7]	-2.0	2.1	0.6	-1.8	0.9	5.3	145.6
28. U.S. government deposits at commercial banks[8]	1.0	-1.2	1.2	-1.3	-1.2	1.0	12.7

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 seasonally adjusted. Commercial bank savings deposits excluding MMDAs declined during July and August at rates of 5.6 and 10.4 percent respectively. At thrift institutions, savings deposits excluding MMDAs decreased in July and August at rates of 8.1 and 12.3 percent respectively.
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.

deposit component. M3 in August was just above the 9 percent upper boundary of its target range. Data for early September indicate that a pickup in growth of all measures of the money stock is in train this month.

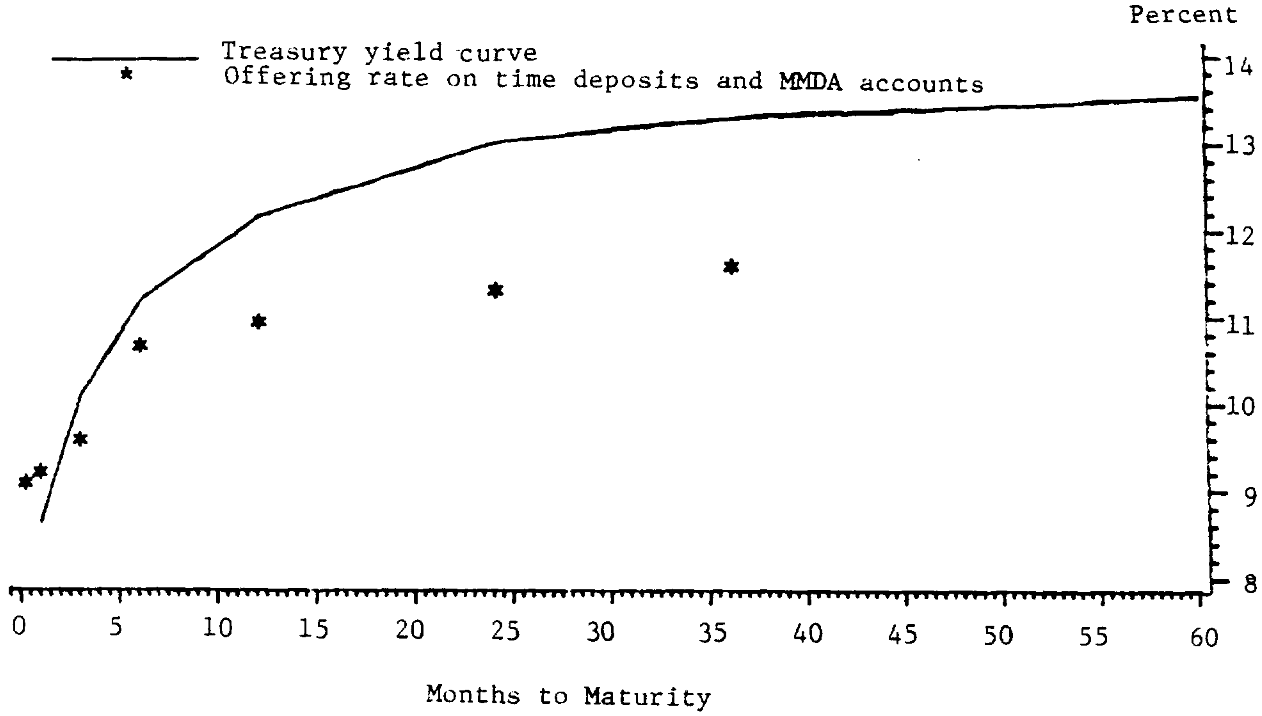
Private credit demands, although remaining robust, evidently slowed in August. Reduced consumer lending at commercial banks and weakness in retail sales suggest that consumer credit growth in August continued the downtrend that began in June. Growth in mortgage credit also may have moderated in August, judging from partial data and field reports. Reduced business borrowing appears to have been entirely accounted for by a drop in merger activity and to have been concentrated in the short-term area, as many firms turned to the bond markets in August. Despite the lessening in private credit demands, an acceleration of federal debt to its fastest growth rate in half a year brought expansion of the total domestic nonfinancial debt aggregate to nearly a 14 percent clip in August. Fragmentary evidence suggests that the debt aggregate will slow in September, however, with growth in federal debt falling sharply and private demands likely to moderate further.

Monetary Aggregates and Bank Credit

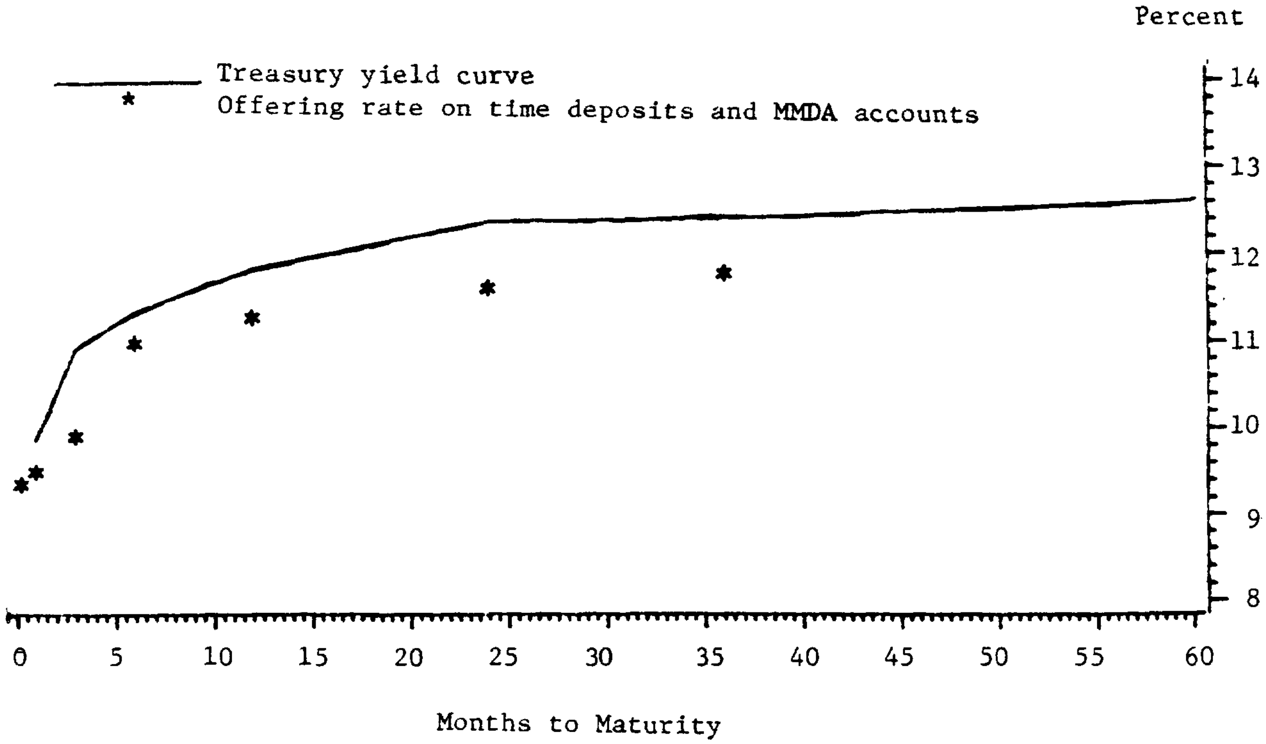
The July weakness in M1 extended into August, although data through early September clearly indicate some rebound. The August weakness was again concentrated in runoffs of demand deposits, which continued to be widespread among banks. Currency strengthened a bit last month, while other checkable deposits resumed expanding after the unusual contraction in July. The flatness in M1 in July and August may in part have represented an unwinding of the June surge in transactions deposits.

RELATIONSHIPS BETWEEN MARKET INTEREST RATES AND OFFERING RATES ON DEPOSITS AT COMMERCIAL BANKS

June 27, 1984



August 29, 1984



For the third quarter as a whole, though, available evidence points to about a 1-1/2 percent increase in M1 velocity at an annual rate, as the deceleration in M1 likely will fall well short of the slowing in nominal GNP growth. Nevertheless, velocity growth in the third quarter is again in line with the pace implied by the Board's quarterly econometric model.

M2 growth in recent months may well have been restrained by lagged responses to the earlier rise in interest rates and by a moderate growth in wealth. In August, a slowing of its nontransaction component offset the pickup in M1. Within nontransaction M2, general purpose and broker/dealer money market mutual funds, which had recorded considerable inflows in previous months, were virtually flat in August, despite a sizable rate advantage over MMDAs; the rally in the stock market reportedly encouraged some money fund customers to shift into equity funds. Declines in MMDAs continued, reaching $5-3/4 billion in August--the largest monthly drop since their introduction--while outflows from savings accounts accelerated. Only small time deposits, which expanded at a rate in excess of 20 percent for the second straight month, and overnight RPs exhibited strength last month.

The weakening of MMDAs and savings deposits and the strengthening of small time deposits in recent months are consistent with the structure of offering rates on deposits. As market interest rates increased on balance over the spring, offering rates on time accounts lagged, and spreads between market rates and offering rates widened, particularly for deposits with maturities of a year or more. Over the past several months, a flattening of the yield curve has brought about a considerable narrowing of spreads between market rates and offering rates for longer-

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

	1983	1984[2]					Levels in bil. of dollars
	Q4	Q1	Q2	June	July	Aug.	Aug.
	Commercial Bank Credit						
1. Total loans and securities at banks[3]	12.4	14.0	7.2	1.7	8.5	8.4	1678.4
2. Securities	10.8	4.4	-9.2	-16.8	1.7	10.6	434.4
3. Treasury securities	25.1	-2.3	-11.1	-28.4	7.3	13.1	184.8
4. Other securities	0.6	9.5	-7.9	-8.6	-2.4	9.7	249.6
5. Total loans[3]	12.9	17.5	13.1	8.2	11.0	7.6	1244.0
6. Business loans[3]	10.1	18.9	17.1	14.5	10.2	9.1	461.8
7. Security loans	60.8	-4.4	-38.5	-115.6	9.8	-112.2	22.3
8. Real estate loans	10.3	14.5	14.5	15.9	11.4	11.6	366.2
9. Consumer loans	22.1	21.5	21.6	21.0	21.2	14.0	251.2
	Short- and Intermediate-Term Business Credit						
10. Business loans net of bankers acceptances	10.3	18.2	17.3	15.6	9.1	9.6	451.8
11. Commercial paper issued by nonfinancial firms[4]	25.9	20.1	67.1	67.2	59.5	35.2	63.2
12. Sum of lines 10 & 11	11.8	18.4	22.5	21.4	14.6	12.6	515.0
13. Line 12 plus loans at foreign branches[5]	12.0	18.1	22.6	19.9	13.8	14.1	535.6
14. Total bankers acceptances outstanding[6]	18.9	-22.2	45.4	16.4	2.9	n.a.	n.a.
15. Line 13 plus total bankers acceptances outstanding	13.1	13.2	25.9	19.7	11.9	n.a.	n.a.
16. Finance company loans to business[6]	29.0	28.8	8.4	10.7	10.6	n.a.	n.a.
17. Total short- and intermediate-term business credit (sum of lines 15 and 16)	15.1	14.9	23.0	18.2	12.1	n.a.	n.a.

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.

term deposits, while the relative attractiveness of short-term deposits has deteriorated. With the yield curve for deposit offering rates steeply sloped at the very short end and offering rates on accounts of a year or longer now more in line with market rates, investors have been lengthening the maturities of their deposits.

The abrupt slowing of M3 growth in August primarily reflected a sharp reduction in CD issuance at both commercial banks and thrifts. Large time deposits, which had grown at rates between 25 and 40 percent over the first seven months of the year, slowed to an annual rate of 8-1/2 percent in August. Highly-publicized funding difficulties at a West Coast savings and loan association, which had tapped the national CD market in volume earlier in the year, contributed substantially to the slowdown in large time deposits at thrift institutions in August and apparent runoffs in September. The slowing in large time deposits at commercial banks in August likely was related to much diminished loan demands at large banks; a sizable runup in Treasury balances in September is restraining CDs this month. Continued runoffs of term Eurodollars also contributed to the weakness of M3 growth. By contrast, term RPs increased by $3-3/4 billion last month, as large banks financed a sizable addition of Treasury securities to their trading accounts.

Bank credit growth was unchanged in August at an 8-1/2 percent annual rate. Increased acquisitions of Treasury and other securities offset a deceleration in loan growth which, at 7-1/2 percent, was the slowest in almost a year. Business loans expanded by 9 percent, down a bit from the July rate, but only half the merger-boosted growth registered during the first half of the year. The slowdown in business lending

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

	1983	1984					
		Q1	Q2	June	July[p]	Aug.[p]	Sept.[f]
Corporate securities - total[1]	8.91	8.36	6.84	8.37	7.86	12.95	10.00
Public offerings in U.S.	8.21	6.92	5.78	7.26	7.20	10.75	7.00
Stocks--total[2]	4.30	2.17	1.94	2.22	.90	2.20	1.70
Nonfinancial	3.07	1.11	1.27	1.19	.60	1.30	1.00
Utility	.80	.22	.28	.29	.10	.40	.20
Industrial	2.27	.89	.99	.90	.50	.90	.80
Financial	1.23	1.06	.67	1.03	.30	.90	.70
Bonds--total[1]	3.91	4.75	3.84	5.04	6.30	8.55	5.30
By industry							
Nonfinancial	2.03	1.49	1.91	2.67	2.54	4.21	3.10
Utility	.95	.64	.46	.70	.72	.95	1.10
Industrial	1.08	.85	1.45	1.97	1.82	3.26	2.00
Financial	1.88	3.26	1.93	2.37	3.76	4.34	2.20
By quality[3]							
Aaa and Aa	1.13	.93	1.19	1.76	1.38	2.60	2.00
A and Baa	1.57	1.59	1.34	1.96	3.30	3.47	1.50
Less than Baa	.48	.61	.74	.48	.60	1.81	.9
No rating (or unknown)	.37	.36	.15	.10	.09	.23	
Memo items:							
Equity based bonds[4]	.75	.28	.34	.13	.08	.62	1.10
Mortgage-backed bonds	.38	1.26	.42	.74	.82	.32	.60
Floating rate or extendible notes	.46	.58	1.35	1.85	2.16	2.24	.70
Bonds sold abroad - total	.70	1.44	1.06	1.11	.66	2.20	3.00
Nonfinancial	.33	.86	.42	.38	.30	.55	1.50
Financial	.37	.58	.64	.73	.36	1.65	1.50

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.

during July and August was concentrated at large banks, where credit demands appear to have weakened.[1] Real estate lending remained below the first-half pace, while growth in consumer loans, which had been at annual rates above 20 percent in each of the past three quarters, slipped to a 14 percent rate. A large decline in volatile security loans also contributed to weakness in loan growth last month. Data for large banks in early September show a slight pickup in growth of their business loans from the very slow August rate but continuing moderation in growth of consumer and real estate loans.

Business Finance

Business loans at domestic banking offices and foreign branches of U.S. banks plus nonfinancial commercial paper expanded at a 14 percent annual rate in August, not much above the reduced pace of the previous month. Short- and intermediate-term business credit demands have expanded more slowly of late, despite a probable further widening in the gap between capital spending and internal sources of funds at nonfinancial corporations. Financing needed for large mergers has dropped off, while long-term financing picked up in August as conditions in bond and equity markets improved. Overall credit demands by businesses adjusted for merger effects appear to have risen in August. This pace seems likely to have been maintained in September as slightly stronger demand for business loans at large banks this month appear to have coincided with some slackening in commercial paper issuance and little change in bond offerings.

1. Recent developments in business lending at large banks are discussed in the appendix.

Nonfinancial firms issued nearly $5 billion of new bonds in domestic and foreign markets in August. Although firms continued to issue large volumes of variable rate and extendible notes last month, the average maturity of bond issues, which had been declining throughout the year, lengthened because of a step-up in issuance of 20-, 25-, and 30-year bonds. Most of the 20- and 25-year issues are convertible to common stock; the resurgence of these issues, a high proportion of which represents offerings by lower-rated firms, has accompanied generally high stock prices.

New offerings by U.S. firms in Euromarkets have been especially strong since the last FOMC meeting, following the promulgation of new Treasury rules for bearer bonds. So far, however, the repeal of the withholding tax has led few new firms to use Eurobond and other foreign bond markets, and the recent volume has been bolstered by issues that had been postponed owing to uncertainty about the new Treasury rules.[1]

The broad stock market indexes reached six-month highs during the intermeeting period, but subsequent declines have about reversed those gains. While new stock offerings have exceeded the anemic July volume, issuance in August and September rose only to around the average monthly rate of the first half of the year.

The current climate for initial public offerings (IPOs) is much poorer than last year as prices of over-the-counter stocks are still down considerably from their 1983 highs. A substantial number of IPOs continue to come to market, however. This year, the monthly rate has averaged 52 first offerings, down from last year, but much greater than

1. Investors remain nervous that the Treasury may reimpose a withholding tax or tighten disclosure requirements on foreign bond holders.

in earlier years. The almost complete absence of S&L issues since February is a major change from the prior year, reducing both the number of issuers and the average size of new issues.

Government Finance

Federal sector. The staff currently is expecting a combined deficit for the third quarter of about $37 billion, bringing the total for fiscal 1984 to around $185 billion. In addition, the Treasury is expected to let its cash balance rise over the quarter by $17 billion, which would leave its end-of-quarter level at more than $30 billion. Altogether, the Treasury will have borrowed about $54 billion, net, from the public during the third quarter. As in recent quarters, the Treasury is raising most of its new money, about $38 billion, in auctions of marketable coupon issues. Net bill financing accounts for the remaining $13 billion raised in marketable form.

As of late September, Treasury debt outstanding subject to the statutory limit was only $5 billion under its ceiling. According to staff estimates, this ceiling will be reached in late September or early October when the Treasury credits civilian and military pension funds. The Treasury has decided to postpone its usual end-of-quarter auctions, originally scheduled for late this month, out of concern that Congress may fail to lift the debt limit by then. When these auctions are held later in October, they may include one or two new instruments. In conjunction with its regular domestic 4-year note auction, the Treasury plans to auction simultaneously between $1 and $2 billion of 4-year notes targeted to foreign buyers. In contrast to the semiannual coupon that has been the standard domestically, the security for foreign sales will

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

	1984				
	Q2	Q3[f]	July	Aug.[p]	Sept.[f]
Treasury financing					
Combined surplus/deficit(-)	-28.3	-37.5	-18.1	-36.4	17.0
Means of financing deficit:					
Net cash borrowing from the public	31.2	53.7	24.2	25.8	3.7
Marketable borrowings/ repayments(-)	29.7	51.3	23.4	25.1	2.8
Bills	-7.0	13.4	4.1	13.0	-3.7
Coupons	36.7	37.9	19.3	12.1	6.5
Nonmarketable	1.5	2.4	.8	.7	.9
Decrease in the cash balance	.5	-17.2	-2.7	5.0	-19.5
Memo: Cash balance at end of period	13.6	30.8	16.3	11.3	30.8
Other[2]	-3.4	1.0	-3.4	5.6	-1.2
Federally sponsored credit agencies, net cash borrowing[3]	9.2	14.1	4.6	5.0	4.5
FHLB	6.2	9.7	3.2	3.5	3.0
FNMA	1.9	3.7	0.8	1.5	1.4
Farm Credit Banks	-.1	-.1	0.2	-.2	-.1
FHLMC	.5	.2	.0	.1	.1
SLMA	.7	.6	.4	.1	.1

p--preliminary. f--staff 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.

have an annual coupon, the practice in Euromarkets. Tenders for these new securities must include the identity of the registered owner, but need only to certify that the beneficial owner is neither a U.S. citizen nor a U.S. resident. Another financing innovation may be the offering of only five years of call protection on the 20-year bond regularly included in the end-of-quarter financing. Previous 20-year bonds have not been callable.

Borrowing by the federally sponsored credit agencies has swelled in the third quarter, owing primarily to heavy financing needs of the Federal Home Loan Banks. Advances by FHLBs to thrifts rose appreciably in August, largely reflecting the funding needs of a large West Coast S&L. In July, demands for advances by thrifts generally had eased as acquisitions of mortgage assets slowed. FNMA also has stepped up its borrowing in the third quarter.

Several agencies have been taking advantage of the large investor appetite for zero-coupon bonds. FNMA issued $6-3/4 billion of 35-year zero-coupon subordinated debentures early in September in order to raise $200 million; the issue, reportedly the first of its kind, yielded 10.08 percent. SLMA subsequently offered $5 billion of 38-year zero-coupon debentures at a yield of 9.70 percent, raising $125 million of new cash.

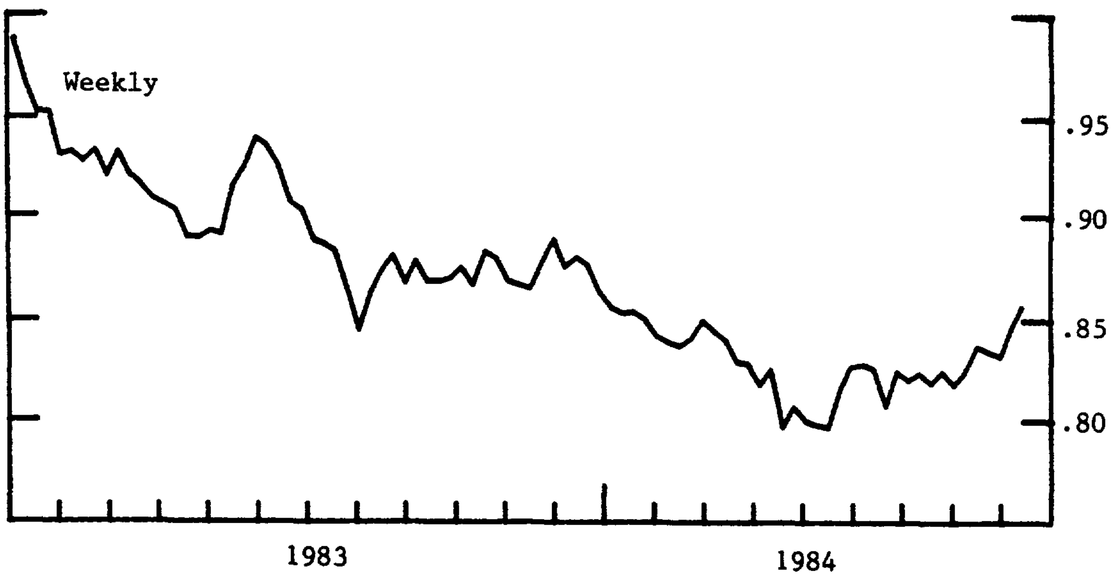
State and local sector. Strong activity in the long-term tax-exempt market has reflected the surge in issuance of private-purpose bonds that began in late June following legislative clarification. In July and August, seasonally adjusted monthly gross offerings of long-term debt averaged about $8 billion, compared with the $5-3/4 billion average monthly pace over the first half of the year. Single-family

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

	1983	1984 Q1	1984 Q2	July[e]	Aug.[e]	Sept.[f]
	Seasonally adjusted					
Total	10.39	9.43	9.02	9.80	10.60	9.90
Long-term	7.20	5.85	5.78	7.60	8.70	7.70
Short-term[1]	3.19	3.58	3.24	2.20	1.90[3]	2.20[3]
	Not seasonally adjusted					
Total	10.39	7.83	10.60	8.83	10.10	9.50
Long-term	7.20	5.05	6.41	6.63	8.00	7.20
Refundings	1.17	.80	.95	.89	.91	--
Total housing[2]	1.48	.48	.70	2.78	2.80	--
Short-term[1]	3.19	2.78	4.19	2.20	2.10[3]	2.30[3]

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.
3. Excludes HUD cancellations.

RATIO OF TAX-EXEMPT TO TAXABLE BOND YIELDS*



*Bond Buyer 30-year revenue bond index to 30-year Treasury bond yield.

mortgage revenue bonds accounted for about 40 percent of the volume in the most recent two months, as state and municipal housing authorities in all parts of the country responded to declining bond yields. Issuance of industrial development bonds similarly was strong in August, totaling $1.5 billion or more. In the short-term market, the volume of tax-exempt offerings has slackened a bit in recent months as HUD was forced to cancel planned sales of project notes pending clarification of certain financing restrictions set forth in the Deficit Reduction Act of 1984.

With issuance rising, tax-exempt rates have not declined with other long-term rates, and the ratio of tax-exempt to taxable yields has increased from levels earlier in the summer.

Mortgage Markets

Growth in residential mortgage debt outstanding has slackened in recent months, constrained by higher costs of credit. During August, debt expansion remained below the May high, judging from a continued reduced rate of net lending by commercial banks and a decrease in the volume of new issues of federally guaranteed mortgage pass-through securities (after adjustment for swaps). In July, expansion of the mortgage component of the domestic nonfinancial debt aggregate had already moderated a bit further to a seasonally adjusted annual rate of around 10 percent, compared with nearly 11 percent in June and 13-1/2 percent in May.

Commitment data also indicate a slowing in mortgage activity. S&Ls issued new commitments in July at a seasonally adjusted monthly rate of about $18-1/2 billion, somewhat above the upward-revised June volume but below the May peak. At federally insured associations,

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-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	19.5	66.1	10.6	8.4	2.2
June	18.1	66.9	10.7	7.9	2.8
July	18.6	66.9	8.5	7.9	0.6

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.

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
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	4892	2745	886	1261	1745
Q2	4020	2343	1133	545	1492
June	4692	2268	1844	580	2314
July r	5438	2325	1580	1533	2576
Aug. p	5824	2373	1589	1862	3342

p--preliminary.

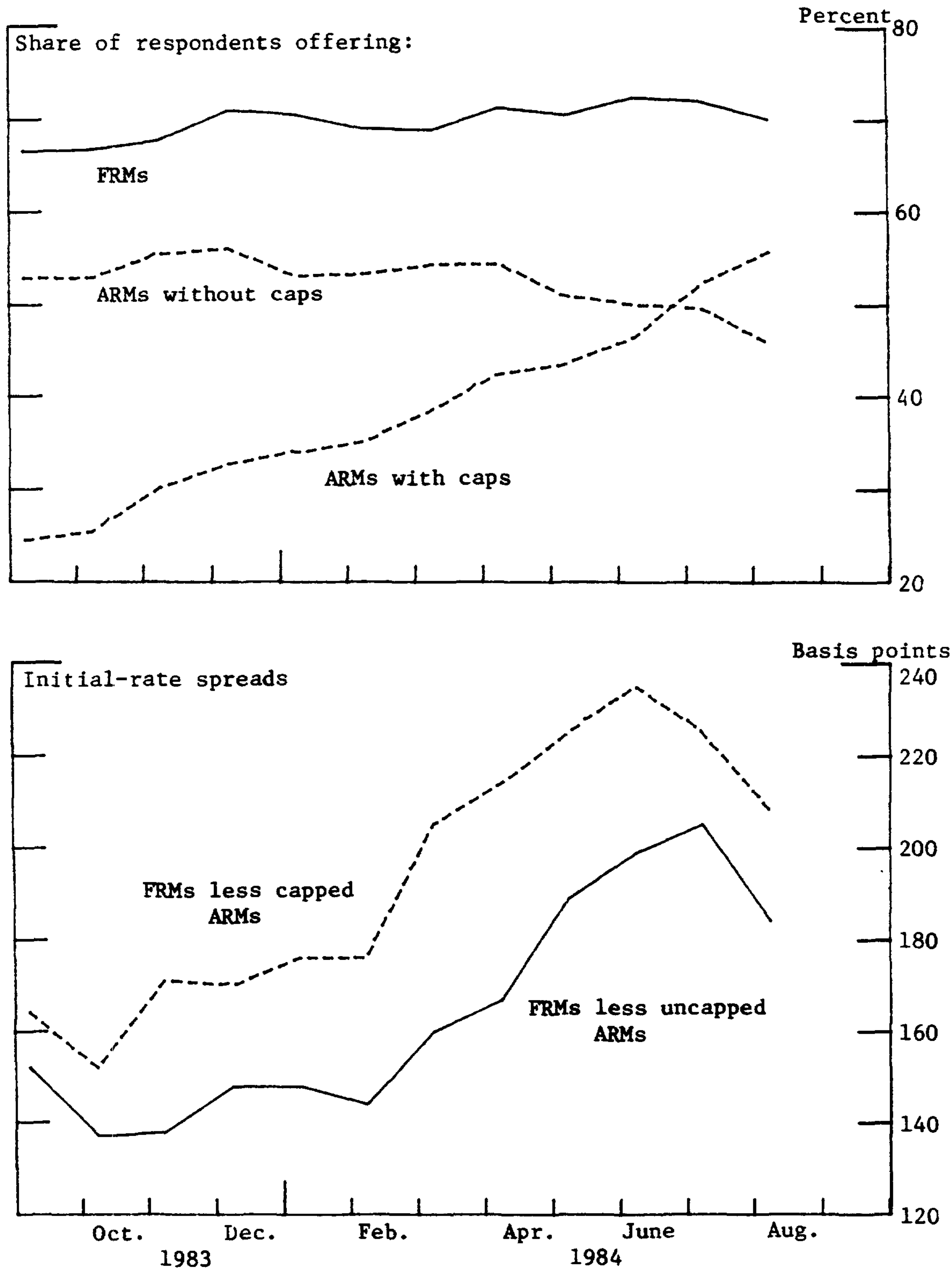
mortgage commitments outstanding rose only $70 million in July, the smallest monthly increase in two years. Although mortgage lending by S&Ls dropped less than in June, their net acquisitions of mortgage assets were off substantially in July as net takings of mortgage-backed securities fell sharply.

In early August, major institutional originators of conventional home loans were continuing to shift toward offering adjustable-rate mortgages (ARMs) with "caps" on lifetime rate increases, and away from ARMs lacking this kind of consumer protective feature (upper panel of chart on page III-18). As a share of the market, ARMs of all types again accounted for the bulk of lending on conventional home mortgages early last month, representing on average 68 percent of the total number of such loans closed. However, the initial rate advantage of ARMs over fixed-rate mortgages (FRMs) declined in early August (lower panel of chart), apparently due to a flattening of the yield curve during the latest months depicted in the chart.[1] FHA's new program for ARMs, launched at the end of July, has continued to work its way gradually into the primary market, despite the narrow scope of the secondary market that has developed so far for this special product. Initial offering rates generally have been about 100 basis points below rates on FHA-insured FRMs.

Most interest rates on home mortgage loans have drifted down 10

1. Initial costs of credit on uncapped ARMs have been running above contract interest rates on capped ARMS, as shown by the charted FHLBB series. This anomalous behavior probably reflects tradeoffs in other loan characteristics, such as the possibility that uncapped mortgages may feature longer time periods between adjustments in interest rates or in mortgage payments.

CONVENTIONAL HOME MORTGAGES



to 30 basis points further since the August FOMC meeting, but are still around 100 basis points or more above their lows of early this year. On FRMs in the primary market, contract rates on new commitments at S&Ls for conventional home mortgages--which typically lag secondary market yields--dipped around 10 basis points, averaging 14.29 percent on September 21. At a sample of large mortgage companies reporting to HUD, effective rates on conventional FRMs dropped more than 25 basis points. Yields on both ARMs and FRMs in the more sensitive secondary market also were lower by late September. On VA-guaranteed home loans, minimal discounts have evoked some market expectations of a cut in the current ceiling rate of 13-1/2 percent.

Consumer Credit

In light of the deceleration in consumer loans at commercial banks and the weakness in retail sales in August, growth in consumer installment credit apparently slowed further last month. To some extent, recent signs of slowing in consumer expenditures have been magnified by shortages of popular models of new cars. However, other components of retail sales that are typically financed by credit also were off in August.

The 19-3/4 percent annual rate of increase in installment credit outstanding in July, while down considerably from the unusually strong 30 percent pace in May, was still quite substantial by historical standards. Almost half the July gain was in automobile credit; revolving credit, which had risen strongly over the preceding six months, was off appreciably as retail sales weakened at department, furniture, and apparel stores.

According to the most recent Senior Loan Officer Opinion Survey,

CONSUMER INSTALLMENT CREDIT

	1983	1984 Q1	1984 Q2	1984 June	1984 July	1984 Aug.
	----- Percent rate of growth, SAAR -----					
Change in outstandings--total	11.3	17.4	24.1	22.2	19.8	n.a.
By type:						
Automobile credit	8.7	14.8	23.8	22.7	26.3	n.a.
Revolving credit	15.5	25.1	31.2	22.2	8.9	n.a.
All other[1]	10.1	16.3	21.3	21.9	19.5	n.a.
	------- Billions of dollars, SAAR ------					
Change in outstandings--total	48.3	67.8	97.9	93.9	85.3	n.a.
By type:						
Automobile credit	13.6	20.9	35.0	34.8	41.1	n.a.
Revolving credit	12.9	19.0	25.0	18.8	7.7	n.a.
All other[1]	21.7	27.9	37.9	40.3	36.5	n.a.
By major holder:						
Commercial banks	23.4	41.5	55.7	46.0	38.3	n.a.
Finance companies	5.0	0	9.2	16.2	16.8	n.a.
All other	19.9	26.3	33.0	31.6	30.1	n.a.
	-------- Annual percentage rate --------					
Interest rates						
At commercial banks[2]						
New cars, 48 mos.	13.92	13.32	13.53	n.a.	n.a.	14.08
Personal, 24 mos.	16.50	16.16	16.35	n.a.	n.a.	16.75
Credit cards	18.78	18.73	18.71	n.a.	n.a.	18.81
At auto finance companies[3]						
New cars	12.58	14.11	14.15	14.33	14.68	15.01
Used cars	18.74	17.55	17.61	17.64	17.77	17.99

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. Average rate for all loans of each type made during the period, regardless of maturity.
n.a.--not available.

commercial banks on balance somewhat increased their willingness to lend to consumers in the three months ending in August. Consumer lending rates at banks moved higher between early May and early August, with new-car loan rates up by 55 basis points and personal loan rates up by 40 basis points. The average rate on bank credit card plans also increased. Finance companies raised their rates on new-car loans in August by 33 basis points to 15.01 percent--the highest rate in almost two years, but nearly 300 basis points below the August 1982 peak. The increases in auto loan rates moved spreads over market yields toward a more typical range from the narrow differentials of earlier this year. The average maturity of new-car loans at finance companies lengthened further in August to 49.2 months, more than three months longer than a year earlier.

Even though consumer credit has surged in 1984, there is little evidence that credit quality has eroded significantly. The average delinquency rate on closed-end installment loans at commercial banks rose rather sharply during the second quarter, but was still historically low; the first-quarter figure was the lowest in 12 years. Auto loan delinquencies at finance companies remained at a near-record low. Moreover, personal bankruptcy filings dropped 6 percent in the second quarter and, for the first time since early 1980, were below the 70,000 case level.

APPENDIX A*

RECENT BUSINESS LOAN DEVELOPMENTS AT LARGE BANKS

Business loan growth at large weekly reporting banks slowed considerably over the three months ending in August. At small banks, by contrast, C&I loans accelerated slightly over this period. Information available from both the most recent Senior Loan Officer Opinion Survey on Bank Lending Practices (LPS) and the Survey of Terms of Bank Lending (STBL) suggests that the slowdown in business lending at large banks reflects reduced loan demand rather than a decreased willingness to make such loans.

As shown in Table 1, almost half of the LPS respondents at very large banks (those with assets exceeding $5 billion) reported a slowing in C&I loan growth over the past three months; at other banks, this share was about a third. Of the total of 25 banks reporting slower growth, almost 90 percent attributed it primarily to weaker loan demand. Only three respondents indicated that their loan growth slowed because they had become less willing to lend. Five other banks (all but one over $5 billion in assets) cited loan sales or the participating out of loans as the reason.

According to respondents, reduced loan demand over the last three months reflected several factors. Reduced merger activity, greater use of alternative funding sources, improved internal cash flow, and slower inventory accumulation were factors cited by about half of the respondents. A reduction in the pace of capital spending was cited less frequently. With regard to merger financing in August, respondents estimated that, on average, about 8-1/2 percent of their gross C&I loan extensions were made to finance mergers, acquisitions or leveraged buy-outs, down from nearly 19 percent during the first quarter of 1984.[1]

Data from the August STBL supports the LPS findings that banks on balance have not attempted to deflect demands for business credit to other lenders by raising the markup over their cost of funds. Indeed, spreads on money market priced business loans were narrower in August than in previous surveys. Informal interviews that Board staff conducted recently with corporate lending officers at several

* Prepared by Thomas F. Brady and Patrick Parkinson, Economists, Banking Section, Division of Research and Statistics.

1. Both of these averages are weighted by respondent's C&I loan outstanding. This decline appears consistent with other reports that merger-related credit demands have abated but inconsistent with replies to LPS question, 3b, to which more respondents reported that merger-related loan demand has trended up over the past six months than reported it had declined. However, without being able to quantify how much merger-related lending rose or fell at banks responding to question 3b, no quantitative comparison can be made.

large banks revealed that money market priced loans are made under two types of facilities, referred to by banks as "lines" and "commitments", respectively. Lines are relatively informal arrangements under which banks agree that on demand they will quote the firm a loan rate on a fixed-rate loan for a specific maturity (usually under a year) and an amount selected by the borrower, within specified limits. Banks generally set the price of such loans as a spread over a reference market rate for the same maturity as the requested loan, for example, the 30-day CD rate for a 30-day loan.[1] The borrower, however, simply receives an all-in rate on a take-it-or-leave-it basis. Because banks retain full flexibility with respect to pricing under such arrangements, they can widen or narrow their markup spreads to reduce or augment the quantity of these loans outstanding. According to market sources, virtually all large loans having maturities of under a month are made under such lines and are priced off market rates. As shown in Table 2, the STBL data reveal that, for large loans ($1 million and above) with maturities of a month and under, the average markup over the funding cost (taken as the federal funds rate) was lower in August than it has been in over a year, suggesting that banks may have been attempting to recoup some of the business being lost at that time to other markets.

Unlike lines, loan commitments always require fees which are paid on the amount of unused credit available under the arrangement. Commitments oblige banks to lend up to agreed upon amounts as long as borrowers meet the loan covenants included in the contract. Also in contrast to line arrangements, loans taken down under commitments are made at pre-established spreads over reference market rates. From a borrower's point of view, revolving credit arrangements are attractive because they provide some certainty about the pricing of future credit needs and guarantee the prompt availability of funds up to a stipulated amount. From the point of view of a bank, however, a commitment tends to reduce liquidity, since it obligates the bank to stand ready over an extended period to provide credit at rates fixed in relation to market rates when the bank's own future costs of funds relative to market rates, as well as its future ability to expand assets given equity constraints, are uncertain. The term of revolving loan commitments typically is for several years.

Loans available under revolvers have a number of pricing formulas. Typically, however, they provide for two basic options: funds can be drawn down at a rate tied to the bank's prime rate with no set maturity, or priced at the rates linked to a money market rate such as LIBOR or CD rates.[2] The latter type of loan has a fixed maturity selected by the borrower with a rate that reflects the maturity. Most loans that are priced in relation to money market rates have maturities of between a month and a year, frequently 30, 90 or 180 days. The bottom line of

1. Funding decisions are quite separate from lending decisions, however, and individual loans may or may not be matched-funded.
2. Some banks book loans priced off LIBOR at their foreign branches. Such loans are not included in the STBL data.

Table 2 shows that in August loans with a maturity of between a month and a year were made at an average spread over the cost of funding them (taken as the 90-day CD rate) that was low in comparison with earlier STBL surveys. These loans would include almost all domestically booked loans made under the money market options of revolving loan agreements as well as loans taken down under lines at these maturities. In sum, the STBL data for August suggest that banks responded to reduced loan demands by making price concessions where they had the flexibility to do so.

In addition to investigating recent growth of C&I loans, the LPS survey asked several questions about the reselling of C&I loans in secondary markets--a practice that press reports suggest has expanded in recent months. As noted above, loan sales do not appear to be an important explanation for the recent weakening of loan growth at large banks. Nevertheless, 54 percent of LPS respondents with assets over $5 billion and 36 percent of banks with assets between $1 and $5 billion had sold C&I loans out of their portfolios during the past three months. About 60 percent of respondents reported that loans were sold primarily to small or medium-sized domestic banks, while 40 percent indicated that other large domestic banks were also important buyers. Another 40 percent sold loans to their own or their holding company's subsidiaries while only 20 percent (all over $5 billion) sold them to foreign banks.

SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES
AT SELECTED LARGE BANKS IN THE U.S.
(Status of policy September 4, 1984 compared to three months earlier)
(Number of banks and percent of total banks answering question)
(By size of total domestic assets, in billions[1])

1a. Indicate your bank's willingness to make consumer installment loans now as compared to three months ago.

	Much More Banks	Much More Pct	Somewhat More Banks	Somewhat More Pct	About Unchanged Bank	About Unchanged Pct	Somewhat Less Banks	Somewhat Less Pct	Much Less Banks	Much Less Pct	Total Banks
All Respondents	1	(1.7)	10	(17.2)	47	(81.0)	0	0	0	0	58
$5 and over	0	(0.0)	7	(21.2)	26	(78.8)	0	0	0	0	33
Less than 5	1	(4.0)	3	(12.0)	21	(84.0)	0	0	0	0	25

1b. Indicate your expectations concerning the strength of demand for consumer installment loans in the next three months (abstracting from normal seasonal variation).

	Much Stronger Banks	Much Stronger Pct	Somewhat Stronger Banks	Somewhat Stronger Pct	About Unchanged Banks	About Unchanged Pct	Somewhat Weaker Banks	Somewhat Weaker Pct	Much Weaker Bank	Much Weaker Pct	Total Banks
All Respondents	0	(0)	19	(33.3)	32	(56.1)	6	(10.5)	0	0	57
$5 and over	0	(0)	9	(27.3)	20	(60.6)	4	(12.1)	0	0	33
Less than 5	0	(0)	10	(41.7)	12	(50.0)	2	(8.3)	0	0	24

2a. Has commercial and industrial loan growth at your bank (adjusted for normal seasonal variation) slowed in the past three months as compared to the prior three month period?

	Yes Banks	Yes Pct	No Banks	No Pct	Total Banks
All Respondents	25	(41.7)	35	(58.3)	60
$5 and over	17	(48.6)	18	(51.4)	35
Less than 5	8	(32.0)	17	(68.0)	25

If yes, would you attribute this slowing primarily to (more than one may apply):

	A decreased willingness to make loans Banks	Pct	Lessening of demand for loans Banks	Pct	Increased net loan charge-offs Banks	Pct	Increased sales of loans or participations Banks	Pct	Total Banks
All Respondents	3	(12.0)	22	(88.0)	1	(4.0)	5	(20.0)	25
$5 and over	1	(5.9)	15	(88.2)	1	(5.9)	4	(23.5)	17
Less than 5	2	(25.0)	7	(87.5)	0	(0.0)	1	(12.5)	8

2c. If you cited a lessening of demand for commercial and industrial loans, please indicate the primary reasons for this lower loan demand (more than one may apply).

	Less inventory accumulation Banks	Pct	Less capital spending Banks	Pct	Less merger and acquisition activity Banks	Pct	Firms using more internally generated funds Banks	Pct	Firms using more externally generated funds Banks	Pct	Total Banks
All Respondents	11	(50.0)	8	(36.4)	10	(45.5)	10	(45.5)	10	(45.5)	22
$5 and over	8	(53.3)	6	(40.0)	7	(46.7)	8	(53.3)	7	(46.7)	15
Less than 5	3	(42.9)	2	(28.6)	3	(42.9)	2	(28.6)	3	(42.9)	7

1. As of December 31, 1983, 35 of the surveyed banks had domestic assets of $5 billion or more. Combined assets for these institutions totalled $611 billion, compared to $690 billion for the entire panel and $2.02 trillion for all federally-insured commercial banks.

3a. What portion of commercial and industrial loans extended by your bank during the past month would you estimate was related to mergers, acquisitions, or leveraged buy-outs?

	0%		1-10%		11-20%		21-50%		51-100%		Average	Average	Tot.
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Percent	Percent[2]	Banks
All Respondents	12	(20.3)	40	(67.8)	2	(3.4)	6	(10.2)	0	(0.0)	6.7	8.3	59
$5 and over	7	(20.6)	24	(70.6)	1	(2.9)	3	(8.8)	0	(0.0)	6.8	8.5	34
Less than 5	5	(20.0)	16	(64.0)	1	(4.0)	3	(12.0)	0	(0.0)	6.7	6.1	25

3b. Has this share been trending up or down in the past six months?

	Up considerably		Up moderately		Unchanged		Down moderately		Down considerably		Total
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks
All Respondents	3	(5.0)	21	(35.0)	17	(28.3)	15	(25.0)	4	(6.7)	60
$5 and over	1	(2.9)	14	(40.0)	7	(20.0)	10	(28.6)	3	(8.6)	35
Less than 5	2	(8.0)	7	(28.0)	10	(40.0)	5	(20.0)	1	(4.0)	25

4a. During the past three months has your bank engaged in the resale of commercial and industrial loans (either whole loans or portions of loans) from its portfolio?

	Yes		No		Total
	Banks	Pct	Banks	Pct	Banks
All Respondents	28	(46.7)	32	(53.3)	60
$5 and over	19	(54.3)	16	(45.7)	35
Less than 5	9	(36.0)	16	(64.0)	25

4b. If yes, are these loans or participations sold primarily to (more than one may apply):

	Other large domestic banks		Small or medium-sized domestic banks		Foreign banks		Own subsidiaries or subsidiaries of its holding company		Unrelated non-banks		Total
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks
All Respondents	11	(39.3)	17	(60.7)	6	(21.4)	11	(39.3)	1	(3.6)	28
$5 and over	8	(42.1)	11	(57.9)	6	(31.6)	7	(36.8)	1	(5.3)	19
Less than 5	3	(33.3)	6	(66.7)	0	(0.0)	4	(44.4)	0	(0.0)	9

4c. In your view, how active is the secondary market for commercial and industrial loans or sub-participations in commercial and industrial loans?

	Very active		Somewhat active		Relatively inactive		Nonexistent		Don't know		Total
	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks	Pct	Banks
All Respondents	17	(28.3)	28	(46.7)	10	(16.7)	1	(1.7)	4	(6.8)	60
$5 and over	7	(20.0)	21	(60.0)	5	(14.3)	0	(0.0)	2	(5.9)	35
Less than 5	10	(40.0)	7	(28.0)	5	(20.0)	1	(4.0)	2	(8.0)	25

2. Reported percentage is weighted by amount of foreign and domestic C&I loans to U.S. addressees reported on the December 31, 1983 Report of Condition.

SPREAD OF AVERAGE LOAN RATES OVER MARKET RATES
ON LARGE LOANS AT 48 LARGE BANKS[1]
(Basis Points)

	1983				1984		
Maturity	Feb.	May	Aug.	Nov.	Feb.	May	Aug.
One Month or Less (Spread Over Federal Funds Rate)	68	64	59	60	61	55	52
One Month to One Year (Spread Over 90-Day CD Rate)	110	133	53	73	142	121	85

1. Rates on gross loans extended during the survey week. Large loans are those with denominations of $1 million or more.
Source: Survey of Terms of Bank Lending (STBL).

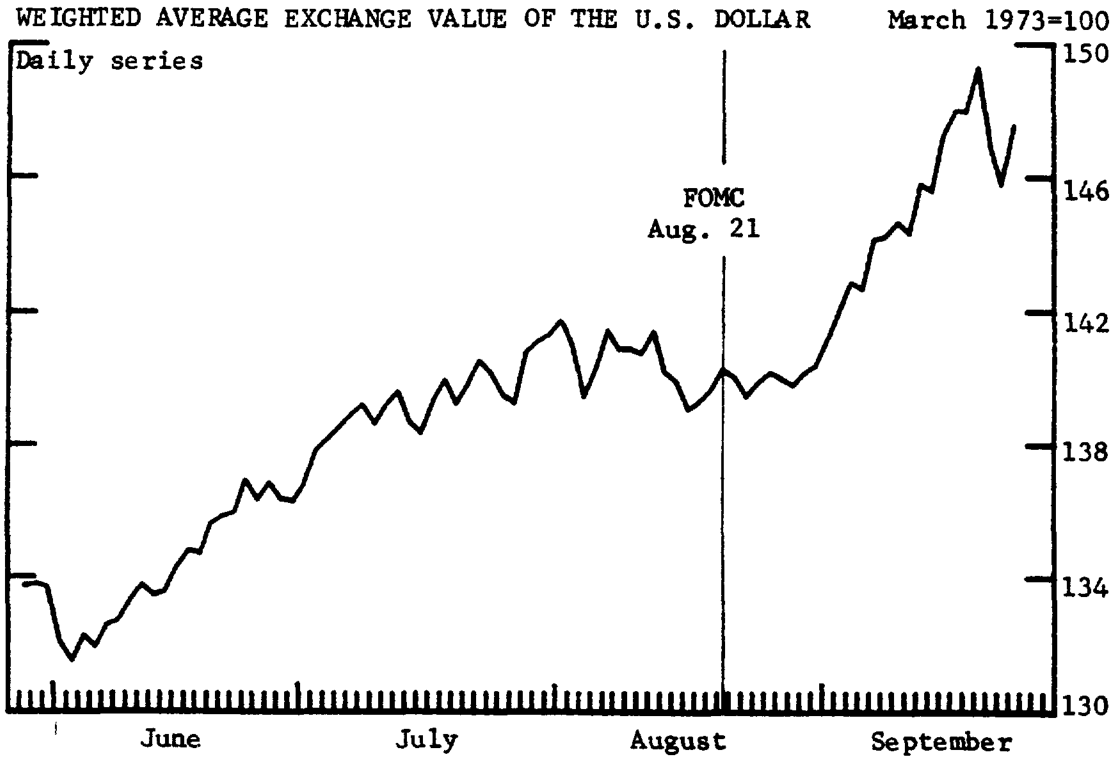
Foreign Exchange Markets

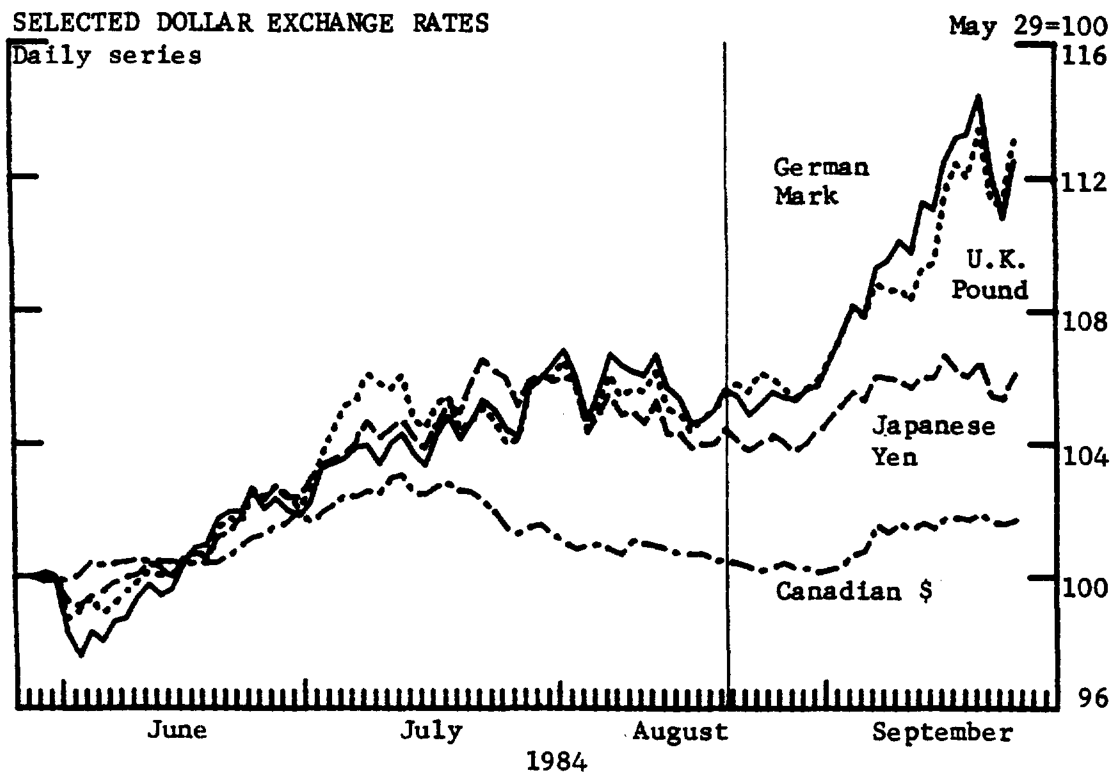
The weighted-average dollar rose seven percent between the last FOMC meeting and September 20. (See chart) The dollar's surge took place against a background of declining short-term U.S.-foreign interest rate differentials. The increased likelihood that the present Administration, which is seen as favorable toward business, would continue in office following the November election, probably had some upward impact on the dollar. But the magnitude of the dollar's rise is not obviously explainable in terms of movements in fundamental variables.

During the later part of the period the dollar seemed to be on a speculative path, where the exchange rate increased more than the growth in the currency's intrinsic value solely because market participants believed that the exchange rate would continue to rise. On Friday, September 21, the weighted-average dollar index rose two percent in the early morning to a record high of 150.6 (not shown on the chart), but then declined on news of a higher-than-expected CPI figure. The Bundesbank responded with very large and publicly announced dollar sales. This unanticipated government intervention provoked a dramatic slide in the dollar's value. The weighted-average index value declined four percent by Monday morning. During the remainder of the period the dollar edged upward . Over the period since the last FOMC meeting the dollar has risen about 5-3/4 percent.

On a bilateral basis the mark and pound depreciated by about 7 and 6-1/2 percent, respectively, against the dollar, while the yen and

Chart 1 9/26/84





Canadian dollar each declined by only about 1-1/2 percent. (See chart) The mark may be suffering from downward revisions in expected German GNP growth while the pound is hurt by continuing labor problems.

. The Desk bought $50 million equivalent of marks on September 7, $15 million equivalent on September 24, and $35 million equivalent on September 25. In other official actions, France reduced its money market intervention rate by 1/4 percentage point to 11 percent and Italy raised its discount rate by one percentage point to 16-1/2 percent. The European Currency Unit was restructured to bring the weights of its constituent currencies more in line with measures of relative economic activity. At the same time, the Greek drachma was introduced into the scheme with a small weight.

U.S. International Financial Transactions

Recorded net capital inflows for the first seven months of 1984 reveal only part of the financial counterpart of the U.S. current account deficit. (See the Summary Table on U.S. International Transactions.) While there were substantial net inflows to banks in the first quarter they were followed by a small net outflow over the next four months. Foreign official institutions have reduced their holdings of assets in the United States by several billion dollars thus far in 1984. On the other hand, private foreign net purchases of U.S. Treasury securities of over $10 billion through July are greater than for any previous year. Net foreign direct investment has also shown a sizeable inflow, partly reflecting a substantial inflow of funds raised in the Eurobond markets through the Netherlands Antilles finance affiliates of U.S. companies in the second quarter, and in part as a result of the attempted buy out of a partially owned petroleum company by its foreign parent.

The positive statistical discrepancy in the published U.S. International Transactions accounts totals nearly $20 billion for the first half of the year, although the total for the first quarter was recently revised downward substantially as a result of newly available data revealing a sharp increase in the net financial liabilities of U.S. nonbank residents to unaffiliated foreigners in the first quarter, a large portion of which was related to merger financing. (Data on nonbank claims and liabilities to foreigners for the second quarter will be released in December and could result in a substantial revision in the statistical discrepancy for the second quarter as well.)

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

	1982 Year	1983 Year	1983 Q4	1984 Q1	1984 Q2	1984 May	1984 June	1984 July
Private Capital								
Banks								
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	-39.5	15.3	11.4	13.0	-2.7	4.5	-6.7	-2.2
a) with own foreign offices	-8.9	8.1	8.7	*	*	-1.5	-1.3	-6.0
b) all other	-30.6	7.8	2.6	13.0	-2.7	6.0	-5.4	3.7
Securities								
2. Private securities transactions, net	-1.6	1.2	*	2.2	-0.2	-0.7	0.6	0.1
a) foreign net purchases (+) of U.S. corporate bonds	2.8	2.2	0.7	0.3	0.5	0.1	0.5	0.4
b) foreign net purchases (+) of U.S. corporate stocks	3.6	6.4	0.4	1.2	*	-0.2	-0.1	-0.5
c) U.S. net purchases (-) of foreign securities	-8.0	-7.4	-1.1	0.6	-0.8	-0.6	0.2	0.2
3. Foreign net purchases (+) of U.S. Treasury obligations 1/	6.5	8.3	1.7	1.4	6.6	2.5	1.5	2.4
Official Capital								
4. Changes in foreign official reserve assets in U.S. (+ = increase)	2.9	5.2	6.4	-3.0	-0.9	-3.4	2.0	0.6
a) By area								
G-10 countries (incl. Switz.)	-12.7	6.4	1.7	2.3	-0.8	-0.6	-1.3	-0.8
OPEC	6.9	-8.5	-1.5	-2.8	-2.4	-2.0	-0.5	1.8
All other countries	8.8	7.3	6.1	-2.5	2.3	-0.7	2.9	-0.4
b) By type								
U.S. Treasury securities	5.7	7.0	2.6	-0.2	-0.3	-2.5	2.0	-1.8
Other 2/	-2.7	-1.8	3.8	-2.7	-0.6	-0.9	*	2.4
5. Changes in U.S. official reserve assets (+ = decrease)	-5.0	-1.2	-1.0	-0.7	-0.6	-0.3	-0.1	-0.4
Other transactions (Quarterly data)								
6. U.S. direct investment (-) abroad	4.8	-4.9	-1.6	-3.5	1.9	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	14.9	11.3	2.3	2.4	7.7	n.a	n.a.	n.a.
8. Other capital flows (+ = inflow) 3/ 4/	-6.7	-2.9	-0.3	1.9	-0.7	n.a.	n.a.	n.a.
9. U.S. current account balance 4/	-9.2	-41.6	-17.2	-19.7	-24.4	n.a.	n.a.	n.a.
10. Statistical discrepancy 4/	32.9	9.3	-1.7	6.0	13.3	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	-19.4	-25.9	-25.7	-7.5	-7.5	-13.7

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.

Inflows from abroad to U.S. nonbank residents also highlight the growing importance of foreign-based banks to developments in U.S. financial markets. A rough idea of the magnitude of the increase in foreign banks' loans to U.S. nonbanks booked offshore can be deduced from the fact that while the financial liabilities of U.S. nonbank residents reported in the balance of payments data increased by $3.7 billion in the first quarter, credit extended to U.S. nonbanks by the offshore branches of U.S. banks increased by only $2 billion over the same period, when calculated on a month-end basis from Federal Reserve data.

Further evidence of the increasing presence of foreign banks in the U.S. credit markets can be seen in the commercial paper data, where the share of foreign banks' paper in total bank related paper outstanding has increased steadily from 9 percent in June of 1981 to 28 percent in August of 1984. These sales of commercial paper can be used to finance some of the offshore lending activity of foreign banks to U.S. nonbanks as well as to foreigners.

The role of foreign banks in the U.S. market may be further increased in the near term by other recent developments. The Eurocurrency reserve requirement has begun to bind at an increasing number of U.S. chartered banks, particularly large banks, thereby increasing the marginal cost to those U.S. banks of obtaining funds in the Euromarket and dampening their incentives to extend credit to U.S. nonbank residents. In addition, in the aftermath of the Continental Illinois crisis there was some evidence in the Euromarket of a narrowing of rate spreads between the liabilities of foreign banks and those of some U.S. banks.

In August, U.S. chartered banks appeared to continue to reduce their reliance on the commercial paper market as a source of funds. Bank holding companies simultaneously reduced their commercial paper outstanding and drew down deposits at their affiliated offices offshore. The reduction in the Eurodollar holdings of U.S. nonbank residents (line 5 of the International Banking Data table) is in part attributable to the reduced deposits offshore by U.S. bank holding companies. In order to offset this outflow of funds, the foreign offices of U.S. chartered banks continued to receive inflows from their head offices [line 3a]. This shift in the pattern of funding may reflect the response of the banks' head offices to a shift in investor preferences. Uncertainty surrounding the extent of government guarantees may have altered investor perceptions of the risk of holding liabilities of bank holding companies relative to the risk of holding the liabilities of the bank itself.

The net impact on foreign purchases of U.S. securities of the repeal of the 30 percent withholding tax on foreigners (passed by Congress at the end of June) does not appear to have been large to date. Private net foreign purchases of U.S. corporate and Treasury securities were substantial in July, but they were not out of line with recent months. However, a larger impact may become apparent in the data for the period following the clarification of withholding tax regulations by the U.S. Treasury, which took place in late August and early September. In the first part of September, there were large issues of Eurobonds through the domestic offices of U.S. corporations rather than through finance affiliates in the Netherlands Antilles.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1981	1982	1983				1984				
	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.	May	June	July	August 3/
1. Net Claims of U.S. Banking Offices (excluding IBFs) on Own Foreign Offices	7.8	32.9	49.2	43.6	44.1	39.3	35.3	28.7	32.2	27.6	30.3
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	2.1	4.4	8.1	6.8
3. Sum of lines 1 and 2 of which:	19.6	49.1	63.8	56.4	54.6	44.5	39.4	30.8	36.6	35.7	37.1
(a) U.S.-chartered banks	22.3	40.0	53.7	49.9	48.7	40.8	36.9	31.5	34.7	33.7	35.6
(b) Foreign-chartered banks	-2.6	9.1	10.0	6.5	5.9	3.6	2.5	-.7	1.9	2.0	1.5
4. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	13.2	15.8	16.9	17.3	17.3	18.7	18.5	20.0	19.9	19.7	20.6
5. Eurodollar Holdings of U.S. Nonbank Residents 2/	95.5	112.6	116.4	120.4	121.3	126.4	128.0	129.0	123.6	122.9	120.1

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 August 27.

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.

Foreign official institutions slightly increased their asset holdings in the United States in July. OPEC members increased their aggregate holdings by $1.8 billion, but this development may prove to have been only temporary: partial information for August and early September indicates that OPEC dollar holdings at the New York Federal Reserve Bank were drawn down again. G-10 countries' official holdings in the United States fell in July,

. Partial information indicates that G-10 holdings in the U.S. rose slightly in August and

.

U.S. Merchandise Trade

In July, the U.S. merchandise trade deficit was a record high. A strong increase in exports was overwhelmed by a surge in imports.

The rise in imports in July, from levels recorded in June, was spread across a wide range of manufactured goods -- particularly office machines and parts, semiconductors, clothing, footwear, passenger cars from Japan, automotive parts from Canada, steel and chemicals. Imports of agricultural commodities and petroleum also rose. In the April-July period, imports of nonoil items reached a 6 percent higher rate than in the already strong first quarter, with increases in most major commodity categories. The high exchange value of the dollar enhanced the price competitiveness of imports and domestic demand remained strong. By area, more than three-fourths of the rise in nonoil imports (April-July/Q1) was from industrial countries, especially Japan.

U.S. MERCHANDISE TRADE[1/]

	1983	1984	1983		1984		
	Year	7 mo.	Q3	Q4	Q1	Q2	July
Value (Bil. $, SAAR)							
Exports	200.3	218.3	201.7	207.3	215.7	218.4	225.7
Agricultural	36.6	38.8	37.2	39.2	41.2	37.1	36.9
Nonagricultural	163.6	179.5	164.5	168.1	174.5	181.3	188.8
Imports	261.3	330.2	271.8	284.9	319.2	321.3	389.9
Oil	53.8	58.3	63.7	57.1	55.4	59.6	63.3
Non-oil	207.5	271.9	208.1	227.8	263.8	261.7	326.6
Trade Balance	-61.1	-111.9	-70.0	-77.6	-103.5	-102.9	-164.2
Volume (Bil 72$, SAAR)							
Exports							
Agricultural	16.3	15.9	16.3	16.2	17.0	15.1	15.2
Nonagricultural	57.3	62.2	57.6	58.8	60.6	62.7	65.6
Imports							
Oil	4.9	5.4	5.8	5.2	5.1	5.5	5.8
Non-oil	81.9	104.7	82.1	89.1	102.3	100.3	125.3

1. International transactions and GNP basis.

Oil imports in July increased to just over 6 million barrels per day (mbd). For the April-July period, imports averaged 5.85 mbd, 8.3 percent higher than in the first quarter, as consumption and stock building strengthened (on a seasonally-adjusted basis). The average price of oil imports increased slightly in July, returning to the average for the second quarter. Spot market prices increased in August and September but remained well below official OPEC prices.

OIL IMPORTS

	1983	1983		1984			
	Year	Q3	Q4	Q1	Q2	June	July
Volume (mbd, SA)	5.20	6.17	5.53	5.40	5.76	5.84	6.11
Price ($/BBL)	28.42	28.29	28.30	28.05	28.26	28.18	28.27
Value (Bil. $, SAAR)	53.80	63.69	57.14	55.41	59.61	60.28	63.28

Exports in July reached the highest level recorded in several years. The July increase in exports largely comprised manufactured goods. Since the first quarter, nonagricultural exports have increased steadily, especially exports of industrial supplies (chemicals, fuels, metals) and business machines (computers and parts).

While agricultural exports in July were higher than the low June figure, shipments were still substantially below the rate recorded in the first quarter. During the summer months the Soviet Union purchased a relatively large quantity of grain from the United States after experiencing a very poor corn harvest. From July through mid-September they contracted for 12 million metric tons of corn and wheat, most of which is expected to be exported by March 1985. For the 12 months ending in June 1984, Soviet grain purchases totalled 10.7 million metric tons.

On Friday, September 28, merchandise trade data for August will be released by the Commerce Department.

U.S. Current Account

The U.S. current account deficit in the second quarter was $98 billion at an annual rate, only $5 billion smaller than the trade deficit. See the table below.

The current account deficit was nearly $20 billion (annual rate) larger than in the first quarter. Half of the change was accounted for by a swing to a large capital loss in net direct investment income receipts (line 7 in the table below); most of the capital loss related to the effect of the appreciation of the dollar on the valuation of the foreign-currency denominated claims and liabilities of U.S. direct investors abroad. There was also a decline in the dollar value of operating earnings on direct investments abroad, especially in Europe (line 8). The reduction in "other services" (line 11) largely resulted from a strong increase in U.S. expenditures on travel and passenger fares abroad.

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

	1983		1984		$ Changes	
	Year	Q4	Q1r	Q2	83-Q4 to 84-Q1	84-Q1 to 84-Q2
1. Current Account Balance	-41.6	-68.9	-78.7	-97.6	-9.8	-18.9
2. Trade balance	-61.1	-77.6	-103.4	-102.9	-25.8	0.5
3. Exports	200.3	207.3	215.7	218.4	8.4	2.7
4. Imports	-261.3	-284.9	-319.2	-321.3	-34.3	-2.1
5. Investment income, net	23.5	20.4	31.0	14.7	10.5	-16.3
6. Direct, net	14.0	11.7	23.6	8.1	11.9	-15.5
7. Capital losses(-) or gains(+)	-7.2	-9.2	0.2	-10.2	9.4	-10.4
8. Other D.I., net	21.2	20.9	23.4	18.3	2.5	-5.1
9. Portfolio, net	9.5	8.7	7.4	6.6	-1.3	-0.8
10. Military, net	0.5	-1.1	-1.5	-1.1	-0.4	0.4
11. Other services, net	4.2	1.7	3.8	0.1	2.1	-3.7
12. Unilateral transfers	-8.7	-12.3	-8.6	-8.4	3.7	0.2

Foreign Economic Developments. Of the major foreign industrial countries, only Japan is enjoying a robust recovery, with real GNP growth in each of the first two quarters being the highest since the 1970s. In Canada, real GNP grew at a 2.4 percent annual rate for the first half of 1984, suggesting a continued but moderated rate of economic expansion. Italian GDP also rose in the first half, growing at a 3 percent annual rate. As a result of strikes, first quarter gains in GNP growth were reversed in the second quarter in both Germany and the United Kingdom. German industrial production recovered to above (relatively low) pre-strike levels following the resolution of the metalworkers' strike in July. The British coal miners' strike, however, is unresolved. Economic activity in France remains weak. Although economic recovery is weakest in Europe, recent budget announcements by French, German, and Italian authorities suggest a continuation of fiscal restraint.

Inflation rates remain low or have continued to decline in the major industrial countries. In August, the year-over-year rise in German consumer prices fell to under 2 percent.

The Japanese trade balance surplus was $42 billion (s.a.a.r.) for the seven months through July. Much of the rise in Japan's trade surplus can be traced to the growth in its bilateral surplus with the United States. The external positions of Italy, Germany, and the United Kingdom have deteriorated relative to last year.

Individual Country Notes. In Japan, real GNP in the second quarter advanced by 6.7 percent (s.a.a.r.), somewhat below the upward revised rate in the previous quarter of 7.6 percent. Private consumption rose by only 1.2 percent (s.a.a.r.). Private plant and equipment investment

September 26, 1984

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

	Q4/Q4 1982	Q4/Q4 1983	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 APR.	1984 MAY	1984 JUNE	1984 JULY	1984 AUG.	LATEST 3 MONTHS FROM YEAR AGO+
CANADA												
GNP	-5.0	7.1	1.9	1.2	.7	.7	*	*	*	*	*	4.6
IP	-10.8	16.1	4.2	3.7	.6	.4	.2	.4	.4	N.A.	N.A.	9.0
FRANCE												
GDP	1.4	.6	-.1	.6	.9	-.3	*	*	*	*	*	1.2
IP	-1.8	1.8	.8	.0	1.3	-.8	-3.0	3.1	-1.5	N.A.	N.A.	1.3
GERMANY												
GNP	-1.6	2.9	-.1	1.3	1.5	-2.1	*	*	*	*	*	.6
IP	-5.4	5.9	.5	2.2	1.1	-5.0	-.9	2.1	-9.6	13.6	N.A.	-.2
ITALY												
GDP	-2.3	1.2	1.1	1.0	.8	.7	*	*	*	*	*	3.7
IP	-6.1	-1.0	1.8	1.4	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	-1.0
JAPAN												
GNP	3.8	3.6	1.5	.8	1.9	1.6	*	*	*	*	*	5.9
IP	-2.7	8.6	2.6	2.9	3.2	2.8	.8	2.4	.5	.3	N.A.	12.6
UNITED KINGDOM												
GDP	.7	4.6	.6	1.7	.9	-.9	*	*	*	*	*	2.3
IP	.1	4.8	1.9	1.3	.0	-2.7	-1.4	-1.1	.5	-.7	N.A.	-.5
UNITED STATES												
GNP	-1.5	6.3	1.7	1.5	2.4	1.7	*	*	*	*	*	7.5
IP	-7.5	15.0	5.1	2.5	2.7	2.1	.8	.4	.9	.9	.2	10.8

* DATA NOT AVAILABLE ON A MONTHLY OR QUARTERLY BASIS.

+ IF QUARTERLY DATA, LATEST QUARTER FROM YEAR AGO.

September 26, 1984

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

	Q4/Q4 1982	Q4/Q4 1983	1983 Q1	1983 Q2	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 MAY	1984 JUNE	1984 JULY	1984 AUG.	LATEST 3 MONTHS FROM YEAR AGO
CANADA													
CPI	9.7	4.6	.6	1.4	1.6	.9	1.2	.9	.2	.4	.6	.0	4.0
WPI	4.5	3.5	.7	1.5	.9	.4	1.6	1.2	.0	.1	.5	N.A.	3.9
FRANCE													
CPI	9.5	9.8	2.7	2.8	2.1	1.9	1.7	1.8	.5	.5	.7	.6	7.5
WPI	8.5	14.6	2.5	4.0	3.7	3.6	3.3	3.5	.1	.1	N.A.	N.A.	14.9
GERMANY													
CPI	4.7	2.7	.6	.5	1.0	.5	.9	.5	.1	.3	-.2	-.2	2.2
WPI	3.1	.9	-2.0	.8	.9	1.2	1.7	.8	-.2	.8	-.9	-1.4	3.3
ITALY													
CPI	16.6	12.8	3.6	2.9	2.3	3.5	2.9	2.1	.4	.6	.3	.3	10.6
WPI	12.4	9.1	1.6	1.6	2.3	3.3	3.2	2.2	.7	.3	.1	N.A.	11.3
JAPAN													
CPI	2.9	1.9	-.1	.9	-.2	1.4	.9	.6	.4	-1.0	.3	-.9	2.5
WPI	1.6	-3.3	-1.9	-1.0	.2	-.6	.1	-.1	.3	.0	.6	.0	-.1
UNITED KINGDOM													
CPI	6.2	5.1	.5	2.0	1.3	1.1	.6	2.0	.4	.3	-.1	1.0	4.8
WPI	6.5	5.6	1.4	2.0	.8	1.3	1.8	2.4	.4	.0	.2	.2	6.2
UNITED STATES													
CPI (SA)	4.4	3.2	-.0	1.1	1.0	1.1	1.2	.9	.2	.2	.3	.5	4.2
WPI (SA)	3.6	.9	-.4	.2	.6	.4	1.1	.4	.0	-.0	.3	-.1	2.2

September 26, 1984

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

	1982	1983	1983 Q1	1983 Q2	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 MAY	1984 JUNE	1984 JULY	1984 AUG.
CANADA												
TRADE	14.4	14.4	3.5	4.3	3.1	3.5	3.6	4.2	1.3	1.6	1.6	N.A.
CURRENT ACCOUNT	2.1	1.4	.5	1.1	-.2	.0	.0	.5	*	*	*	*
FRANCE												
TRADE 2/	-14.0	-5.9	-3.5	-1.7	-.6	-.2	-1.5	-1.1	.0	-.6	-.1	.4
CURRENT ACCOUNT 2/	-12.1	-4.2	-3.9	-.9	.3	.3	-.5	-1.0	*	*	*	*
GERMANY												
TRADE	20.9	16.4	5.1	4.1	3.7	3.4	4.3	3.2	1.5	.5	1.4	N.A.
CURRENT ACCOUNT (NSA)	3.5	4.1	2.1	.6	-2.3	3.7	.7	-.2	1.1	-1.2	-.1	-.5
ITALY												
TRADE	-12.8	-7.8	-3.0	-1.4	-2.1	-1.3	-2.5	N.A.	-1.2	N.A.	N.A.	N.A.
CURRENT ACCOUNT (NSA)	-5.7	.6	-1.9	1.1	1.5	-.1	-1.7	N.A.	*	*	*	*
JAPAN												
TRADE 2/	18.8	31.2	6.7	7.8	8.5	8.2	10.0	11.1	3.6	3.6	3.4	N.A.
CURRENT ACCOUNT	6.9	21.0	3.5	6.1	5.7	5.5	7.2	9.2	2.5	3.1	2.5	N.A.
UNITED KINGDOM												
TRADE	4.1	-.8	.3	-.7	-.4	-.0	-.1	-1.7	-.4	-.1	-.2	-.7
CURRENT ACCOUNT 2/	9.6	4.4	2.4	-.1	1.2	.9	1.2	-.6	-.0	.2	.1	-.4
UNITED STATES												
TRADE	-36.5	-61.1	-9.3	-14.9	-17.5	-19.4	-25.9	-25.7	-7.5	-7.5	-13.7	N.A.
CURRENT ACCOUNT	-9.2	-41.6	-2.9	-9.6	-11.8	-17.2	-19.7	-24.4	*	*	*	*

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.

* COM[illegible]BLE MONTHLY OR QUARTERLY CURRENT ACCOUNT DATA A[illegible]OT PUBLISHED.

continued to be strong (10.4 percent growth). Net exports contributed almost half of the growth of GNP. Other indicators point to a continued healthy expansion: in July, industrial production rose 0.3 percent (s.a.) to a level 12.8 percent above that of a year earlier, while retail sales, housing starts, and new construction orders (all s.a.) advanced strongly.

Inflation in recent months has remained low. Wholesale prices were flat in August and essentially unchanged from the year-earlier level. Consumer prices rose moderately in July to a level 2-1/2 percent above that of July 1983.

In the first seven months of this year the current account recorded a surplus of $32.5 billion (s.a.a.r.), while the trade surplus was $42 billion. The increase in the trade surplus over last year's is largely accounted for by the change in bilateral Japan-U.S. trade: the Japanese surplus vis-a-vis the United States rose from $18 billion in 1983 to more than $30 billion (a.r.) in the first seven months of this year.

Although preliminary budget requests by Japanese ministries for FY 1985 (beginning April 1, 1985) were only up by less than 1 percent from the FY 1984 budget, total general account expenditures (including debt servicing and transfers to local governments) increased by 8.2 percent. The Nakasone government hopes to reduce this increase and also to hold expenditures for the Fiscal Loan and Investment Program to their present level of $86 billion, instead of the 5 percent increase requested. In a movement towards the liberalization of money markets, banks have reached agreement on the outlines of short-term money market certificates (MMCs) bearing market determined rates of interest;

observers believe that the government will permit the banks to begin offering MMCs as early as January.

German real GNP fell 1-1/2 percent (seasonally and calendar adjusted) in the second quarter from the first quarter. The principal cause of this decline was the strike of the metalworkers and printers, which idled up to half a million workers for up to seven weeks, ending in early July. Industrial production, however, rebounded in July to a level above the pre-strike mark but no higher than that seen early this year. On average, production levels during the first seven months of this year exceeded year-earlier levels by about 3 percent. Leading indicators are mixed, with order data suggesting particular weakness in the construction industry. The rate of unemployment remains high in August at 9.3 percent (s.a.), essentially unchanged from the average over the last 20 months. Consumer prices declined in both July and August, bringing the August year-on-year rate to 1.7 percent.

The current account (n.s.a.) was in small deficit in August, leaving the cumulative result in near balance so far this year. Last year's comparable surplus was $0.6 billion. The decline in the current account surplus is primarily accounted for by a decline in the trade surplus.

On September 13 the Finance Minister presented his 1985 budget to the Bundestag. Government spending will increase by 2.4 percent over its projected 1984 level, which in turn is likely to be about 1 percent lower than planned. The federal budget deficit, now expected to be just below DM 30 billion (1.5 percent of GNP) in 1984, is projected to decline further to DM 24 billion in 1985.

In Canada, the economic expansion continued at a reduced pace from that experienced in 1983. Real GNP grew at an annual rate of 2.9 percent (s.a.) in the first half of 1984, down from the 7.1 percent (Q4/Q4) growth in 1983. Capital formation remains well below historical norms for this stage in the recovery. Real non-residential investment grew at an annual rate of less than 1 percent over the first half of 1984 after falling 9 percent over 1983. The unemployment rate rose slightly in August to 11.2 percent after falling in June and July; nevertheless, it remains unchanged from the rate recorded in January.

Inflation fell slightly over the first half of 1984, from a rate of 5.1 percent in the first quarter of 1984 over the first quarter last year to a rate of 4.6 percent in the second quarter over the same period last year. The rapid U.S. recovery continues to stimulate Canadian exports. The cumulative trade surplus (s.a.) through July stood at $9.3 billion, almost $0.5 billion ahead of the comparable total in 1983. However, continued growth in the service account deficit restrained the current account. For the first half of 1984 the cumulative surplus in the current account (s.a.) stood at about $0.5 billion compared with $1.5 billion over the year-earlier period.

Brian Mulroney and the Progressive Conservative Party swept to a decisive victory in Canada's parlimentary elections on September 4, capturing 211 of the 282 House of Commons seats. The Tories have yet to detail specific policy changes though they campaigned on the general themes of improved relations with the United States, a more favorable climate for foreign investment and business generally, and a restructuring of the national energy policy.

Economic activity in France has remained weak in recent months while inflation has continued to ease. Industrial production declined by 1.5 percent (s.a.) in June and was only 1.5 percent above its year-earlier level. The unemployment rate rose an additional 0.1 percentage point in August to 10.1 percent (s.a.). The 0.5 percent increase in consumer prices in August led to a further easing in the year-over-year consumer price inflation rate to 7.5 percent. The government has abandoned its earlier goal of reducing inflation to 5 percent by year-end and is now forecasting a 6.7 percent inflation rate by the end of 1984. The trade balance moved into surplus by $310 million (s.a.) in August.

On September 12 the cabinet approved the government's 1985 budget. In line with previous announcements, a policy of relative macroeconomic austerity will be retained. The goal will be to reduce slightly the size of the budget deficit to 3 percent of GDP. Expenditure growth is to be held to 6 percent (about in line with expected inflation.) Direct taxes are to be reduced by an amount equivalent to 1 percent of GDP, including an across-the-board 5 percent reduction in income taxes. About one-third of these direct tax reductions will be offset by higher gasoline taxes and other increases in government levies.

Real GNP in the United Kingdom fell 3.6 percent (s.a.a.r.) in the second quarter, reversing its first-quarter gain. Industrial production fell 0.7 percent (s.a.) in July, the sixth decline in the past seven months. This weakness is in part the result of the coal miners' strike which has been going on since mid-March. Although the production of coal has been substantially reduced, the effect of this strike on other industries has been limited. The dockworkers' union called for a national dock strike on August 24 in support of the miners but enough docks remained open to prevent a serious economic impact and agreement to end that strike was reached on September 18. Negotiations between the miners' union and the National Coal Board have recently collapsed again.

Retail prices rose 0.9 percent in August to a level 5 percent above that of a year earlier, a rate of inflation that has been unchanged since the start of the year. Much of the August increase in retail prices was the result of the 2-1/4 percent rise in mortgage rates in early July.

The U.K. trade and current accounts were both in deficit in August. The trade deficit widened to $2.7 billion for the first eight months in 1984, from $0.9 billion for the comparable period in 1983. The current account surplus for the first eight months in 1984 was only $0.3 billion, down $2.6 billion from the comparable period in 1983.

The Bank of England lowered its shortest-term intervention rate from 12 to 10-1/2 percent in four steps between August 8 and August 17. The Bank of England had increased its short-term intervention rates by nearly 3 percent in early July in response to exchange market pressures.

On September 4, the Bank of Italy authorities raised its discount rate to 16.5 percent from 15.5 percent. This move reversed a steady decline in the rate, which had been lowered twice during the first half of 1984. According to some observers, the Italian Treasury and the Bank of Italy want to impress upon Parliament the importance of reducing the public sector's deficit. Governor Ciampi has stated on several occasions that Italy's huge public sector deficit left no room for further cuts in the official bank rate. Recently, Treasury officials stated that credit is expanding too rapidly to be consistent with a continued reduction in inflation. On September 14 the government issued a draft budget for calendar 1985 showing a 4.2 percent nominal increase in the public sector's borrowing requirement.

Real GDP in Italy grew at a 3 percent annual rate for the first half of 1984. Inflation as measured by the consumer price index has remained encouragingly low; the rate for the year ending in July was 10.5 percent, the lowest level in more than a decade.

Italy's current account showed a noticeable deterioration in the first quarter of 1984. The trade balance deficit for the first half of 1984 was $3.3 billion, compared with a deficit of $2.2 billion for the first half of 1983.

Debt Situation in Selected Developing Countries

Argentina has reached an agreement with the IMF, but the country faces mounting financing requirements. Brazil's external situation continues to improve, but inflation remains high. Mexico and its bank creditors have agreed on a multi-year restructuring of public sector debt; inflation in Mexico continues to slow, and economic activity appears to have picked up in the third quarter. Venezuela has completed negotiations with its bank creditors on a multi-year debt rescheduling. Peru's fiscal and external payments situation has deteriorated sharply. The Philippines has submitted a letter of intent to the IMF, and if the necessary financing is available the program could go to the IMF Board for approval in November.

Argentina and the IMF reached agreement on the terms of an adjustment program on Sepember 25. It is uncertain when the program will go to the IMF Executive Board for approval because the Managing Director needs assurance that the necessary financing will be available, and the external financing requirements are large. Meanwhile, Argentina faces a shortage of liquidity immediately available to pay overdue interest on its public sector debt to banks. (About $900 million would be needed to eliminate all interest arrears through the end of September.) Argentina was scheduled to pay on September 15 the $750 million balance of the bridge loan that it obtained in December 1982, but this oft-postponed payment was not made (although interest on this loan is being paid). The banks rejected an Argentine request for a simple 90-day extension and the payment is now being rolled over on a day-to-day basis. Although Argentina has eliminated arrears on private sector import payments, total arrears have increased this year. At the end of August, they were about $800 million higher than at the end of 1983. Inflation remains a serious problem; in August the CPI was 650 percent higher than a year earlier.

Brazil registered a trade surplus of more than $8 billion during the first eight months of the year, compared with $4.3 billion over the first eight months of 1983, due largely to strong export growth. The current account deficit for the year is now expected to be $2.7 billion, substantially below the IMF projection of $5.3 billion. Prices increased by 10.6 percent in the month of August, a slight increase over the monthly rate recorded in July, but not significantly different from the average during the first seven months of the year. New regulations were recently passed to allow the Central Bank to achieve the revised growth target for the monetary base of 95 percent on an end-December to end-December basis. Negotiations with creditor banks are expected to begin in late October or early November. It is expected that the Brazilians will try to obtain a multi-year rescheduling of debt coming due between 1985 and 1990 in addition to $1 billion to $2 billion in new credits.

Mexico and its Bank Advisory Committee have agreed to restructure $48.7 billion of public sector debt to banks maturing in 1985-90 over 14 years, with a spread averaging 1-1/8 percent over LIBOR (or over a secondary market reserve-adjusted CD rate) and no rescheduling fee. Mexico is to make a prepayment of $1.0-$1.5 billion this year on the $5 billion "new money" loan of 1983 and the balance of this loan will be repaid on the schedule that applies to the 1984 "new money" loan, which is not being restructured. The agreement includes a formula whereby the IMF will monitor Mexican policies and performance during the period of the rescheduling in the form of enhanced Article IV consultations each year with mid-year reviews. Mexico's trade surplus in January-June was $7.3 billion, $500 million more than in the same period last year. The spread between the "free" market exchange rate in Mexico and the rate in U.S. markets has continued to narrow and was only about 0.5 percent on September 25. The annualized rate of increase in the CPI in the first eight months of 1984 was 63 percent, down from 91 percent in the same period of 1983. In June-August the annualized rate was 46.5 percent. As a result, the effective annual yield on short-term time deposits, which had remained virtually unchanged in nominal terms at 61.6 percent since early April, turned positive in real terms. Since mid-August, the nominal rates have been gradually reduced. There are some indications that economic activity may have begun to pick up slightly in the third quarter.

In late August, Venezuela and its creditor banks reconvened the negotiations on a multi-year rescheduling of Venezuela's public sector debt and reached agreement on September 21 on essentially the same terms as were agreed with Mexico—a spread of 1-1/8 over LIBOR and a maturity of 12-1/2 years. Final agreement is contingent on the Venezuelan government making significant progress in reducing private sector interest arrears, which total about $1 billion.

The fiscal and external payments situation of Peru has deteriorated sharply over the past two months. Government expenditures are far exceeding receipts, and external arrears of about $200 million on public sector debt have accumulated. About half of this amount is interest payments owed bank creditors, some of which are now more than 90 days overdue. The central bank has refused to finance the government's deficit and will not use the $1.4 billion in reserves that it holds to pay the arrears. Peru is out of compliance with its IMF program as a result of the fiscal deterioration, and a $45 million drawing has been suspended. Emergency measures to generate revenues are under consideration, but it is doubtful that the situation will be corrected quickly.

In early September, the Philippine authorities submitted a letter of intent to the IMF. The Philippines will be required to take certain prior actions before the Fund management approves the proposed stand-by arrangement, including measures to maintain reserve money (a type of monetary base) within a certain range, reduce budget expenditures, and raise government revenues. At a specified date, the peso will be floated freely, and the exchange taxes imposed earlier--such as the stabilization tax on exports and the excise tax on foreign exchange--will be abolished. Prime Minister Virata and Central Bank Governor Fernandez are to meet with the head of the Bank Advisory Committee to resolve the problem of the deposits in Manila that Citibank froze last October. The bankers are insisting on a resolution of that problem before they go ahead with new loans and rescheduling. The Managing Director of the IMF wants an assurance that the proposed stabilization package can be financed before he gives his final approval. He will also need indications of financial support from official creditors. If this support is forthcoming, the IMF Board could consider the program in early November.