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Confidential (FR) Class III FOMC

March 20, 1985

RECENT DEVELOPMENTS

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

DOMESTIC FINANCIAL DEVELOPMENTS—continued

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INTERNATIONAL DEVELOPMENTS IV

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SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest data			Percent change from		
	Period	Release date	Data	Preceding period	Three periods earlier	Year earlier
				(At annual rates)		
Civilian labor force	Feb.	03-08-85	115.1	2.2	3.5	2.1
Unemployment rate (%)[1]	Feb.	03-08-85	7.3	7.4	7.1	7.8
Insured unemployment rate (%)[1]	Nov.	02-14-85	2.8	2.8	2.7	3.3
Nonfarm employment, payroll (mil.)	Feb.	03-08-85	96.1	1.5	2.6	3.5
Manufacturing	Feb.	03-08-85	19.7	-4.7	.2	1.8
Nonmanufacturing	Feb.	03-08-85	76.4	3.1	3.2	4.0
Private nonfarm:						
Average weekly hours (hr.)[1]	Feb.	03-08-85	35.0	35.2	35.2	35.3
Hourly earnings ($)[1]	Feb.	03-08-85	8.49	8.45	8.42	8.23
Manufacturing:						
Average weekly hours (hr.)[1]	Feb.	03-08-85	40.0	40.6	40.5	40.9
Unit labor cost (1967=100)	Jan.	03-01-85	82.7	-7.2	-3.4	-8.2
Industrial production (1967=100)	Feb.	03-15-85	164.7	-5.8	-.2	2.9
Consumer goods	Feb.	03-15-85	161.9	7.4	-1.7	1.6
Business equipment	Feb.	03-15-85	188.8	-4.4	.8	9.8
Defense & space equipment	Feb.	03-15-85	147.0	9.0	13.5	13.5
Materials	Feb.	03-15-85	159.9	-7.5	-1.2	.3
Consumer prices all items (1967=100)	Jan.	02-26-85	316.6	2.3	2.5	3.5
All items, excluding food & energy	Jan.	02-26-85	308.2	4.7	3.7	4.5
Food	Jan.	02-26-85	307.7	2.0	3.0	2.6
Producer prices: (1967=100)						
Finished goods	Feb.	03-15-85	292.1	-1.2	.1	.7
Intermediate materials, nonfood	Feb.	03-15-85	324.7	-5.9	-2.2	.7
Crude foodstuffs & feedstuffs	Feb.	03-15-85	250.4	-24.0	-16.2	-3.7
Personal income ($ bil.)[2]	Feb.	03-20-85	3,141.2	3.9	5.6	7.4
				(Not at annual rates)		
Mfgrs. new orders dur. goods ($ bil.)	Jan.	03-05-85	103.9	1.8	8.1	4.4
Capital goods industries	Jan.	03-05-85	32.7	-7.1	7.8	3.0
Nondefense	Jan.	03-05-85	23.1	-13.2	-8.9	-7.9
Defense	Jan.	03-05-85	9.5	11.7	94.2	44.4
Inventories to sales ratio:[1]						
Manufacturing and trade, total	Jan.	03-14-85	1.37	1.35	1.37	1.29
Manufacturing	Jan.	03-14-85	1.48	1.46	1.50	1.41
Trade	Jan.	03-14-85	1.27	1.26	1.26	1.18
Ratio: Mfgrs.' durable goods inventories to unfilled orders[1]	Jan.	03-05-85	.554	.553	.553	.530
Retail sales, total ($ bil.)	Feb.	03-13-85	112.1	1.4	1.6	6.3
GAF[3]	Feb.	03-13-85	23.8	3.6	.1	7.4
Auto sales, total (mil. units.)[2]	Feb.	03-05-85	11.0	-1.2	10.2	3.7
Domestic models	Feb.	03-05-85	8.6	1.0	19.0	2.0
Foreign models	Feb.	03-05-85	2.4	-8.2	-12.8	10.1
Capital Appropriations, Mfg.	1984-Q4	03-11-85	28,984	5.0	—	19.5
Housing starts, private (thous.)[2]	Feb.	03-19-85	1,638	-11.0	2.4	-25.8
Leading indicators (1967=100)	Jan.	03-01-85	166.7	1.7	1.6	1.3

1. Actual data used in lieu of percent changes for earlier periods.
2. At annual rates.
3. Excludes mail order houses.

Economic activity appears to have expanded at a moderate rate in early 1985. Growth in domestic spending was quite strong, but a good deal of the increased demand for goods was met by imports rather than domestic production. Consumer spending rose substantially in February, and housing market activity on average has picked up a bit. Trends in business investment have been mixed; spending on new equipment has been sluggish, while nonresidential construction remains robust. Recent price reports continued to be favorable.

Employment and Unemployment

Nonfarm payroll employment rose a moderate 120,000 in February, after four months of very strong growth. Retail trade and services posted further strong job gains, but manufacturing employment fell 75,000. About one-third of the decline in factory jobs occurred in the auto industry; the significance of this decline is questionable given that assemblies were back to a very high level in early March. Even so, many other manufacturers, including those in the lumber, machinery, textiles, and apparel industries, also reported job cutbacks. In addition, the factory workweek fell six-tenths of a hour, in large part owing to unusually harsh weather during the survey reference week. Bad weather probably hindered construction activity as well and may explain the drop of 50,000 in construction employment.

The civilian unemployment rate edged down to 7.3 percent in February. After falling rapidly over the first year and a half of the expansion, the jobless rate has fluctuated in the 7.2 to 7.5 percent range since last spring. Most of the job gains over the past several months occurred among adult women and teenagers; yet, because stong demand has drawn additional

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

	1983	1984	1984 Q3	1984 Q4	1984 Dec.	1985 Jan.	1985 Feb.
	-Average monthly changes-						
Nonfarm payroll employment[2]	282	305	224	291	184	312	119
Strike adjusted	282	307	216	304	211	270	118
Manufacturing	92	55	-4	62	83	4	-77
Durable	70	47	15	46	58	6	-55
Nondurable	22	8	-19	16	25	-2	-22
Construction	22	31	10	28	61	75	-52
Trade	69	87	61	112	0	110	114
Finance and services	96	97	63	100	89	147	130
Total government	3	16	72	-15	-63	-27	4
Total employment[3]	331	270	1	293	341	118	294
Nonagricultural	338	266	17	271	290	183	274

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

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

	1983	1984	1984 Q3	1984 Q4	1984 Dec.	1985 Jan.	1985 Feb.
Civilian, 16 years and older	9.6	7.5	7.4	7.2	7.2	7.4	7.3
Teenagers	22.4	18.9	18.6	18.4	18.8	18.9	18.4
20-24 years old	14.5	11.4	11.4	10.9	10.9	10.9	11.2
Men, 25 years and older	7.8	5.7	5.5	5.4	5.4	5.5	5.4
Women, 25 years and older	7.2	6.0	6.0	5.8	5.6	6.1	5.9
White	8.4	6.5	6.4	6.2	6.2	6.4	6.2
Black	19.5	15.9	15.8	15.1	15.0	14.9	16.3
Fulltime workers	9.5	7.2	7.1	7.0	6.9	7.1	7.1
Memo:							
Total national[1]	9.5	7.4	7.3	7.1	7.1	7.3	7.2

1. Includes resident Armed Forces as employed.

women and youth into the labor market, their unemployment rates have remained relatively flat.

Industrial Production and Capacity Utilization

Industrial production declined 0.5 percent in February, and output gains during the three preceding months were smaller than previously estimated. The overall industrial production index now is no higher than it was in mid-1984. The sluggishness in production during the past half year, reflects a continued substitution of imports for domestically produced goods and ongoing corrections of inventory imbalances in some industries.

Production cutbacks in February—attributable only in part to bad weather—were widespread among products and materials. The output of consumer goods declined 0.6 percent, while production of business equipment dropped for a second consecutive month. Automobile assemblies—at an 8.2 million unit annual rate—fell short of planned schedules after reaching an 8.6 million unit rate in January. Meanwhile, capacity utilization rates generally have dropped back since last summer. In February, the operating rate for total industry fell to 80.7 percent compared with its recent high of 82.7 percent in July 1984.

Personal Income and Consumption

Personal income grew $15 billion per month on average during the first two months of 1985, the same as the fourth-quarter pace. Income growth in January was boosted substantially by annual cost-of-living adjustments to government benefit programs, other factors affecting transfer payments, and pay raises for federal civilian and military personnel. Meanwhile, growth in private wages and salaries, which represent roughly half of

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

	1984 Q3	1984 Q4	1984 Dec.	1985 Jan.	1985 Feb.
	-----Annual rate-----		--Monthly rate--		
Total	6.3	-2.1	.1	.3	-.5
Final products	8.9	2.8	.5	.1	-.3
Consumer goods	1.4	-1.0	-.1	.2	-.6
Durable	-1.0	-3.6	-.1	-.1	-.8
Nondurable	2.4	.1	.0	.3	-.5
Business equipment	23.1	4.5	.8	-.2	-.4
Defense and space equipment	13.1	16.3	1.8	.8	.8
Construction supplies	.9	-6.9	.1	-.2	-.9
Materials	3.3	-7.6	-.3	.6	-.6
Durable goods	6.7	-5.8	-.6	.7	-.8
Nondurable goods	-1.8	-8.7	-.7	.1	-1.0
Energy materials	2.4	-11.2	1.0	1.5	.2

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

	1978-80 High	1982 Low	1967-82 Avg.	1984 Dec.	1985 Jan.	1985 Feb.
Total industry	87.3	69.6	82.4	81.3	81.4	80.7
Manufacturing	87.5	68.8	81.8	81.5	81.4	80.8
Durable	89.4	64.8	80.5	82.2	82.0	81.4
Nondurable	87.2	73.8	83.9	80.8	80.6	80.1
Mining	90.4	69.6	86.5	74.8	75.3	73.5
Utilities[1]	86.8	79.0	88.6	83.5	84.6	84.4
Industrial materials	88.9	66.6	83.3	80.4	80.7	80.1
Metal materials	95.4	46.2	82.2	65.0	65.6	67.1
Paper materials	97.9	86.3	93.4	98.1	97.7	n.a.
Chemical materials	91.3	64.0	85.1	74.5	74.8	n.a.

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

total personal income, slowed noticeably. Part of the recent slowdown in wages and salaries was attributable to weakness in manufacturing payrolls, reflecting the contraction in employment since December.

Nominal personal consumption expenditures rose at about a 9 percent annual rate in the first two months of the year, compared with 6 percent in the fourth quarter. In January, outlays for services rose sharply, apparently because unusually cold weather raised electricity and natural gas consumption, while spending on goods other than autos declined. In February, spending on goods posted a strong gain, as almost all major types of stores reported higher sales. Excluding sales of autos, nonconsumer items, and gasoline, retail outlays in February were 2.1 percent above the fourth-quarter average.

Consumer spending on new cars remained strong through early March. Total auto sales averaged about 11 million units at an annual rate in January and February--the highest level of sales over a two-month period since the first half of 1979. Sales of domestic models have averaged around 8-1/2 million units at an annual rate thus far in the first quarter, about a million units above the fourth-quarter pace. Demand for foreign cars also remains strong, but limited supplies of Japanese cars have curtailed sales lately. With the quota year drawing to a close on March 31, Japanese producers have slowed deliveries to the U.S. in order to stay within their export restraints.

Recent survey readings of consumer confidence were close to the high levels reported earlier in the expansion. In surveys taken during both January and February, respondents expressed greater interest in buying automobiles and household durable goods than they did late last year.

PERSONAL INCOME AND EXPENDITURES
(Based on seasonally adjusted data)

	1983	1984	1984 Q3	1984 Q4	1984 Dec.	1985 Jan.	1985 Feb.
	- - Percentage changes at annual rates - -[1]						
Total Personal Income							
Nominal	7.5	9.2	8.7	6.6	5.5	7.4	4.0
Real[2]	4.3	5.8	4.2	4.1	7.7	-.7	n.a.
Disposable Personal Income							
Nominal	8.5	8.9	8.4	6.0	4.0	8.5	3.2
Real[2]	5.3	5.6	3.9	3.5	6.1	.6	n.a.
Expenditures							
Nominal	9.0	7.5	5.0	6.1	9.8	9.0	9.0
Real[2]	5.7	4.2	.7	3.6	12.0	1.0	n.a.
	- - Changes in billions of dollars - -[3]						
Total personal income	17.0	21.0	20.6	14.5	14.3	19.1	10.3
Wages and salaries	11.1	11.4	8.3	11.9	17.7	8.1	8.5
Private	9.5	9.6	6.5	10.5	16.0	3.3	6.2
Manufacturing	3.3	2.6	1.2	3.3	4.3	1.4	-1.1
Other income	6.8	10.6	12.9	3.3	-2.3	20.5	2.4
Disposable personal income	16.3	17.2	18.2	9.9	8.8	18.8	7.1
Expenditures	15.7	14.1	11.9	10.6	19.6	18.2	18.2
Durables	3.9	2.4	-2.9	6.1	12.1	-2.4	.7
Nondurables	3.9	4.3	4.0	.2	7.6	3.5	11.0
Services	7.9	7.5	10.9	4.4	.0	17.0	6.6
Personal saving rate (percent)	5.1	6.1	6.3	6.2	5.7	5.7	5.2

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.
e—staff estimate

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

	1984		Feb.	1984	1985	
	Q3	Q4	Q4	Dec.	Jan.	Feb.
Total sales	-.9	2.1	2.2	-.3	.5	1.4
(Real)[1]	-1.3	1.7	n.a.	-.2	.3	n.a.
Total, less automotive, gasoline and nonconsumer stores	.5	1.3	2.1	-.1	-.5	2.1
GAF[2]	-.6	3.4	.8	1.0	-4.3	3.6
Durable	-2.4	4.8	2.8	-.2	1.4	.9
Automotive group[3]	-4.4	5.9	4.6	-.9	4.1	.4
Furniture & appliances	1.4	5.2	.5	1.9	-3.4	2.3
Nondurable	.0	.7	1.9	-.4	.0	1.7
Apparel	-3.2	2.9	-2.3	.0	-6.7	2.9
Food	1.0	.0	2.2	-1.6	2.7	.4
General merchandise[4]	-.3	2.9	2.2	1.0	-3.8	4.3
Gasoline stations	-3.4	.7	-.7	-2.4	1.1	-.2

1. BCD series 59. Data are available approximately three weeks following the retail sales release.
2. General merchandise, apparel, furniture and appliance stores.
3. Sales of the automotive group frequently differ from sales of new cars on a unit basis because of broader coverage (e.g. parts, used cars, and servicing), seasonal factors, and sampling.
4. General merchandise excludes mail-order nonstores.

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

	1984		1985		
	Q3	Q4	Jan.	Feb.	Mar.[3]
Total sales[1]	10.3	10.3	11.2	11.0	n.a.
Imports	2.4	2.8	2.6	2.4	n.a.
Domestic	7.9	7.5	8.5	8.6	8.3
Small	3.7	3.5	4.1	4.2	n.a.
Intermediate & standard	4.2	4.0	4.4	4.4	n.a.
Domestic production	7.5	7.7	8.6	8.2	8.5e
Small	3.6	3.6	4.0	4.0	n.a.
Intermediate & standard	3.9	4.1	4.6	4.2	n.a.
Domestic inventories	1.32	1.44	1.51	1.52	n.a.
Days' supply[2]	51	59	54	54	n.a.

1. Components may not add to totals due to rounding.
2. Quarterly days' supply are based on end of quarter stocks and average sales for the quarter.
3. First 10-days.
e—estimated.
n.a.—not available.

According to the Michigan survey, the more favorable buying plans were due to lower prices and interest rates. In response to special questions pertaining to the Administration's tax reform plans, most households thought that, if proposed tax reforms were passed, the changes would have little impact on their own personal finances.

Business Fixed Investment

Spending for business equipment has turned sluggish lately, after rising rapidly earlier in the expansion. Growth in expenditures on producers' durable equipment in real terms slowed to just a 2 percent annual rate in the fourth quarter, and more recent indicators of demand for domestically produced equipment show considerable weakness. Shipments of nondefense capital goods by domestic producers plunged 10.4 percent in January, with declines reported for nearly every category of equipment. To some extent, this weakness was counterbalanced by higher demand for equipment produced abroad. In addition, business purchases of motor vehicles remained quite strong.

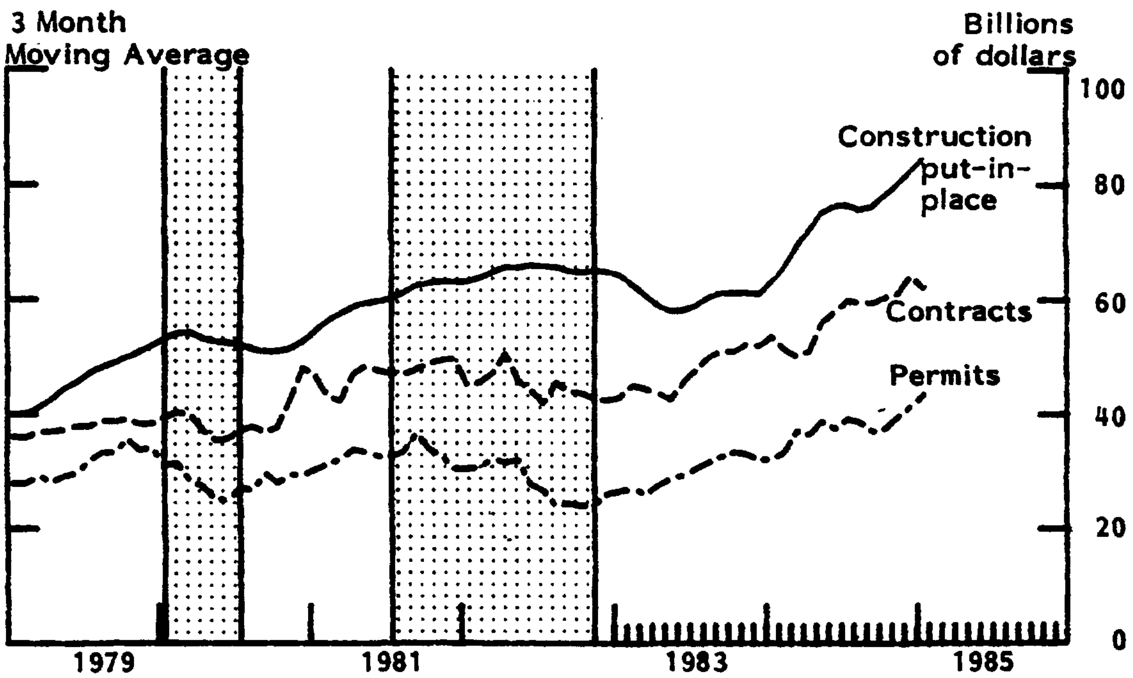
In contrast with equipment spending, construction spending still is growing at a robust pace. Outlays for nonresidential construction expanded 2.7 percent in January, continuing the brisk growth shown in the fourth quarter. Office and other commercial building activity remained especially strong, although some weakness is still evident in the public utility and institutional sectors.

Like the evidence on current spending, indicators of future business spending also are mixed. New orders for nondefense capital goods received by domestic producers fell 13 percent in January, after showing no growth

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

	1984				1985	
	Q3	Q4	Nov.	Dec.	Jan.	Feb.
Producers' durable equipment						
Nondefense capital goods						
Shipments	2.7	3.6	2.8	5.1	10.4	n.a.
Orders	-1.1	-3.5	6.9	-1.9	-13.2	n.a.
Unfilled orders	1.7	-2.5	-.1	-1.5	-1.9	n.a.
Imports of capital goods excluding autos	23.1	-17.9	1.0	-3.9	22.1	n.a.
Exports of capital goods excluding autos	1.4	2.3	-8.5	12.1	.0	n.a.
Sales of heavy-weight trucks (thousands of units, A.R.)	252	316	345	348	299	316
Nonresidential structures						
Nonresidential construction	1.3	4.9	1.3	2.5	2.7	n.a.
Commercial building	1.9	10.9	2.1	3.9	5.0	n.a.

NONRESIDENTIAL CONSTRUCTION, CONTRACTS, AND PERMITS[1]



1. Source: F.W. Dodge and Census.

over the second half of 1984. Orders for office and computing equipment were exceptionally low for the second month in a row, and there were widespread declines among other equipment categories. Although these data suggest weakness in domestic production of capital goods in the near term, the longer-term outlook for total investment spending--including purchases of foreign and domestically produced equipment as well as construction expenditures--remains more favorable. The value of new construction commitments was still trending upward around the turn of the year (chart). And, more generally, surveys of anticipated spending on plant and equipment, the latest of which is the February McGraw-Hill survey, point to an increase in nominal outlays of about 10 percent in 1985, with especially large gains in manufacturing.

Business Inventories

Investment in business inventories remained moderate in early 1985. The book value of stocks at all manufacturing and trade establishments increased at a $26 billion annual rate in January, roughly the same as in the fourth quarter but considerably slower than the rapid rates maintained over the first three quarters of 1984. The more moderate inventory investment in recent months reflects not only the need for some businesses to reduce overhangs that first emerged last fall, but also continued caution toward inventory investment fostered by high carrying costs and competitive pressures.

Recent changes in inventories varied considerably across industries. In the manufacturing sector, the book value of stocks fell in January for a third month in a row, largely in response to earlier weakness in orders and shipments. At the retail trade level, however, the book value of inventories increased substantially in January for a second consecutive month. Roughly two-thirds of the January accumulation occurred at auto dealers, as car manufacturers stepped up assemblies and shipments to dealers in an effort to alleviate tight supplies of some models. At general merchandise stores, where stocks had been burdensome late last year, retailers managed to pare their inventories in January, apparently through heavy discounting. Moreover, the strong increase in retail sales reported in February probably also helped to bring stocks and sales into better alignment.

Housing

Housing activity strengthened somewhat in early 1985. Housing starts jumped sharply in January and then settled back to a 1.64 million unit rate in February (chart). Issuance of residential building permits, which tends to be less volatile than the starts series, corroborates the recent pickup in construction activity: permit issuance during the January-February period averaged 5 percent above the fourth-quarter pace.

Housing starts for multifamily units were particularly volatile in the winter months, with all of January's sharp increase being reversed in February. When averaged over this two-month period, multifamily starts were 16 percent above the fourth-quarter pace. In light of several adverse influences on multifamily construction, including the highest average vacancy rate for rental housing in 10 years, a large number of units in the production pipeline, and uncertainty about potential tax law changes, the January level appeared unsustainable.

In the single-family market, sales of existing homes posted their third consecutive monthly gain in January, while new home sales rose 3

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

	1984 Q2	1984 Q3	1984 Q4	1984 Nov.	1984 Dec.[r]	1985 Jan.[p]
Book value basis:						
Total	56.3	54.4	23.4	14.5	15.0	25.9
Manufacturing	40.4	30.8	.9	-7.1	-5.0	-6.3
Wholesale trade	10.1	16.8	4.1	15.3	-9.1	9.7
Retail trade	5.8	6.7	18.3	6.4	29.1	22.5
Automotive	-4.3	1.8	10.2	10.2	13.2	16.0
Ex. auto	10.1	4.9	8.1	-3.8	16.0	6.5
Constant dollar basis:						
Total	19.7	24.3	11.6	8.7	7.2	—
Manufacturing	13.8	13.0	.3	-2.0	-1.2	—
Wholesale	4.1	8.8	3.7	8.5	-.6	—
Retail	1.7	2.5	7.6	2.1	8.9	—
Automotive	-3.0	.4	5.6	5.7	5.1	—
Ex. auto	4.7	2.1	2.0	-3.5	3.8	—

INVENTORIES RELATIVE TO SALES[1]

	Cyclical Reference Points[2] 81 low	Cyclical Reference Points[2] 82 high	1984 Q2	1984 Q3	1984 Q4	1984 Nov.	1984 Dec.[r]	1985 Jan.[p]
Book value basis:								
Total	1.39	1.53	1.33	1.36	1.37	1.36	1.35	1.37
Manufacturing	1.60	1.77	1.47	1.49	1.48	1.49	1.46	1.48
Wholesale	1.06	1.28	1.09	1.14	1.15	1.16	1.14	1.15
Retail	1.36	1.43	1.34	1.37	1.38	1.35	1.38	1.39
Automotive	1.59	1.88	1.37	1.46	1.49	1.43	1.49	1.49
Ex. auto	1.29	1.35	1.33	1.35	1.35	1.33	1.35	1.36
Constant dollar basis:								
Total	1.62	1.75	1.51	1.55	1.55	1.55	1.53	—
Manufacturing	1.91	2.11	1.76	1.79	1.78	1.78	1.76	—
Wholesale	1.34	1.52	1.30	1.36	1.37	1.37	1.36	—
Retail	1.34	1.44	1.31	1.34	1.36	1.35	1.34	—
Automotive	1.49	1.81	1.27	1.32	1.41	1.39	1.37	—
Ex. auto	1.28	1.37	1.33	1.34	1.34	1.34	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.

percent after a relatively sluggish initial response to the declines in mortgage interest rates recorded during the last half of 1984 and in early 1985. With the improvement in sales, single-family starts generally have trended higher since last October; in February, these starts were at a 1.12 million unit annual rate, or 7 percent above the fourth-quarter level.

House prices have continued to rise at approximately the rates observed over the past year. Controlling for changes in quality and regional mix, new home prices in the fourth quarter were about 5 percent above a year earlier. Price behavior in specific markets, however, has varied considerably from these national averages. For example, very large increases in median prices for existing houses were reported in New York City and Boston over the past year, while prices were flat or down in some metropolitan areas in California, Texas, and the Midwest.

State and Local Sector

Real outlays for goods and services by state and local governments showed virtually no growth in the fourth quarter of 1984 and apparently remained sluggish during the first two months of this year. In January, real outlays for construction continued to trend lower, as has been the case since the third quarter of 1984. And, through February, employment had dropped from its fourth-quarter level.

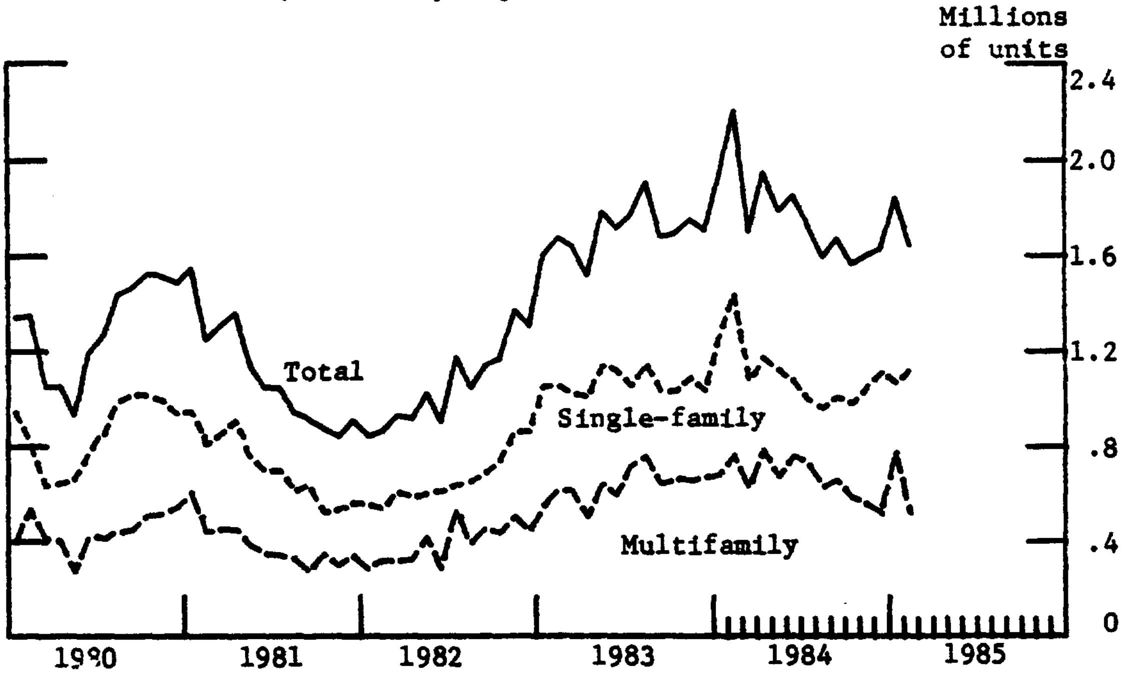
On the whole, the state and local sector still is enjoying a sizable operating surplus, and some states are contemplating decreases in tax rates, especially personal income tax rates. In particular, cuts are expected in Minnesota, Wisconsin, and New York, where effective income tax

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

	1984	1984				1985	
	Annual	Q2	Q3	Q4	Dec.	Jan.	Feb.[1]
All units							
Permits	1.67	1.80	1.53	1.56	1.63	1.68	1.60
Starts	1.75	1.86	1.66	1.60	1.63	1.84	1.64
Single-family units							
Permits	.92	.96	.85	.84	.85	.92	.94
Starts	1.08	1.12	.99	1.05	1.11	1.07	1.12
Sales							
New homes	.64	.63	.61	.62	.60	.62	n.a.
Existing homes	2.87	2.97	2.76	2.81	2.87	3.00	n.a.
Multifamily units							
Permits	.75	.84	.68	.72	.78	.75	.66
Starts	.67	.74	.67	.55	.52	.78	.52
Mobile home shipments	.30	.29	.30	.29	.28	.27	n.a.

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

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



rates are high. However, concerns about possible reductions in federal aid to states and localities may damp enthusiasm for tax cuts.

Federal Government

The federal government recorded a deficit of $6-1/2 billion (unified basis) in January, about $1 billion more than during the same month a year earlier. Over the first four months of fiscal 1985, the deficit totaled $79 billion and continued to run about $10 billion larger than it was during the comparable period of fiscal 1984.

On the outlay side, a cost-of-living adjustment in social security and federal retirement programs, along with general pay increases for federal civilian and military personnel, boosted January outlays about $1 billion ($12 billion at an annual rate). On the spending side, indexation of tax rates effective January 1 is estimated to have reduced liabilities on personal taxes at a $9 billion annual rate, while a hike in social security tax rates added about $6 billion (annual rate) to personal tax burdens. January and preliminary February data also show that income tax returns were being processed at a slower pace than in recent years.

In Congress, the Senate Budget Committee has completed markup on the First Budget Resolution for FY1986. The Committee's decisions call for a slowing in the growth of defense spending, a "freeze" on many domestic programs including social security COLAs and on federal pay and pensions, and a reduction in spending for a number of other domestic programs, but no tax increases. According to the Committee's estimates, these actions would reduce their baseline deficit by about $55 billion in FY1986 and approximately $100 billion by FY1988. The House Budget Committee is expected to take the budget within the next few weeks.

Exports and Imports

The U.S. merchandise trade deficit widened substantially in January, to $21 billion at an annual rate, after declining to a $92 billion annual rate in the fourth quarter. An increase in nonoil imports accounted for most of the deterioration in the trade account, as imports of capital goods, passenger cars from Europe, and consumer goods were up sharply. Although monthly figures on nonoil imports tend to be volatile, their high level continued to reflect the effects of the rising dollar and strong U.S. demand. Oil imports, in contrast, have declined steadily in recent months in both price and quantity. The volume of oil imported in January was 4.8 million barrels per day compared with an average of 5.8 million barrels per day in the October-November period; the average price of imported oil dropped 55 cents per barrel between November and January. Nonagricultural exports in January remained at their somewhat improved December level. However, agricultural shipments abroad, which had benefited from a surge in exports to Russia in the fourth quarter, dropped back. (Further discussion of international economic developments is included in Section IV).

Prices

Price reports have continued to be favorable early this year. The consumer price index rose 0.2 percent in January, while the producer price index for finished goods was unchanged in January and then fell 0.1 percent in February.

Price weakness in petroleum markets was again a factor in holding down the inflation rate early this year. The energy component of the CPI was off 0.8 percent in January, the largest monthly decline in almost two years, as gasoline and fuel oil prices fell markedly.

Retail food prices rose 0.2 percent in January, as lower prices for livestock products partially offset increases in other categories. At the producer level, prices for both finished and crude foods declined for a second month in a row in February, despite sharp weather-related increases for fresh fruits and vegetables. Further price reductions for meats and most livestock contributed to the overall declines in the PPI food indexes.

Outside the food and energy sectors, consumer prices rose somewhat faster in January than during the fourth quarter. This acceleration occurred exclusively in the commodities component and was attributable to large price increases for cigarettes and used cars. In contrast, prices of nonenergy services rose at the same pace as in the two preceding months and less than the average monthly rate during 1984.

Capital equipment prices picked up in January and February, largely reflecting higher manufacturers' prices for cars and light trucks. Nevertheless, the PPI index for capital equipment still is only 2-1/4 percent above its level a year ago. At earlier stages of processing, the index for intermediate materials less food and energy continued to be relatively flat, and prices of crude nonfood nonenergy materials fell substantially further.

<u>Wages and Labor Costs</u>

Wage inflation in the private economy leveled off in late 1984 and early 1985. The hourly earnings index for production and nonsupervisory workers rose 0.6 percent in February, after a decline the month before.

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

	Relative Importance Dec. 1984	1983	1984	1984 H1	1984 Q3	1984 Q4	1984 Dec.	1985 Jan.
				—Annual rate—			—Monthly rate—	
All items[2]	100.0	3.8	4.0	4.3	4.5	3.0	.3	.2
Food	18.7	2.6	3.8	3.8	3.9	3.7	.4	.2
Energy	11.5	-.5	.2	.8	.1	-.7	-.2	-.8
All items less food and energy	69.8	4.9	4.7	5.0	5.3	3.5	.3	.4
Commodities	26.3	5.0	3.1	3.8	3.8	.9	.2	.5
Services	43.5	4.8	5.6	5.6	6.2	5.0	.4	.4
Memorandum:								
CPI-W[3]	100.0	3.3	3.5	2.6	7.5	1.6	.3	.2

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. Index for urban wage earners and clerical workers, based on a rental equivalence measure for owner-occupied housing after December 1984.

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

	Relative Importance Dec. 1984	1983	1984	1984 H1	1984 Q3	1984 Q4	1985 Jan.	1985 Feb.
				—Annual rate—			—Monthly rate—	
Finished Goods	100.0	.6	1.8	2.8	.0	1.8	.0	-.1
Consumer foods	24.4	2.3	3.8	3.3	4.5	4.5	-.6	-.1
Consumer energy	11.5	-9.2	-4.1	-.2	-19.7	5.7	-2.4	-2.5
Other consumer goods	42.4	1.8	2.2	3.1	2.5	.0	.6	.3
Capital equipment	21.6	1.9	2.1	3.1	2.3	.0	.4	.5
Intermediate materials[2]	95.1	1.4	1.7	3.5	-1.1	1.1	.0	-.5
Exc. energy	80.1	3.0	2.0	3.0	.9	1.3	.0	-.2
Crude food materials	53.0	8.0	-.9	-6.2	-1.7	12.0	-2.4	-2.0
Crude energy	31.7	-4.6	-1.0	1.1	1.0	-7.0	-2.2	-.4
Other crude materials	15.4	15.5	-3.3	7.4	-15.3	-10.7	-1.4	-4.3

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

Although volatile on a monthly basis, the 12-month change in this wage measure has fluctuated around the 3 percent mark since last autumn. Average wage adjustments in manufacturing have risen somewhat more in recent months than they did earlier in the recovery when many union workers negotiated new contracts with initial wage cuts and freezes. Some of the step up lately may be attributable to the reduced incidence of cuts and freeze in the manufacturing sector, as profits generally have improved. Meanwhile, changes in the wage indexes for services and transportation and public utilities have been quite moderate, on average, over the past several months.

Productivity in the nonfarm business sector rose nearly 3 percent at an annual rate during the fourth quarter of 1984 after a 1 percent decline in the preceding quarter. Over the four quarters of the year, productivity was up 2-1/2 percent, compared with the strong, cyclical rebound of nearly 4 percent in 1983. Rising productivity coupled with a moderate increase in hourly compensation held the increase in unit labor costs to less than 2 percent last year.

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

	1983	1984	1984 Q3	1984 Q4	1984 Dec.	1985 Jan.	1985 Feb.
			—Annual rate—		—Monthly rate—		
Total private nonfarm	3.9	3.1	2.7	2.9	.6	-.2	.6
Manufacturing	2.7	3.3	3.1	3.2	.4	.5	.4
Durable	2.1	3.0	2.8	2.7	.5	.6	.4
Nondurable	3.9	3.7	3.8	4.0	.2	.3	.4
Contract construction	1.5	.9	-.7	.3	.6	.2	.9
Transportation and public utilities	4.3	3.0	2.7	2.4	.7	-.3	.5
Total trade	4.7	2.6	2.0	3.0	.5	-.5	.4
Services	4.9	4.0	3.9	3.7	1.1	-1.0	.8

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

III-T-1
SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

	1982/1983	1984		1985		Change from:	
	Cyclical low	Highs	FOMC Dec. 18	FOMC Feb. 13	Mar. 19	1984 highs	FOMC Dec. 13
Short-term rates							
Federal funds[2]	8.46	11.63	8.34	8.52	8.58	-3.05	.06
Treasury bills							
3-month	7.08	10.67	7.81	8.24	8.55	-2.12	.31
6-month	7.62	10.77	7.98	8.30	9.02	-1.75	.72
1-year	7.73	11.13	8.30	8.49	9.21	-1.92	.72
Commercial paper							
1-month	8.00	11.42	8.06	8.47	8.80	-2.62	.33
3-month	7.97	11.35	8.13	8.56	8.95	-2.40	.39
Large negotiable CDs[3]							
1-month	8.08	11.52	8.18	8.51	8.84	-2.68	.33
3-month	8.13	11.79	8.29	8.70	9.13	-2.66	.43
6-month	8.20	12.30	8.47	9.05	9.75	-2.55	.70
Eurodollar deposits[4]							
1-month	8.68	11.89	8.53	8.60	8.84	-3.05	.24
3-month	8.71	12.20	8.79	9.04	9.34	-2.86	.30
Bank prime rate	10.50	13.00	11.25	10.50	10.50	-2.50	--
Treasury bill futures							
June 1985 contract	10.11	12.82	8.66	8.77	9.25	-3.57	.48
Dec. 1985 contract	10.86	13.20	9.43	9.64	10.08	-3.12	.44
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	9.33	13.49	10.24	10.44	11.19	-2.30	.75
10-year	10.12	13.99	11.29	11.39	11.99	-2.00	.60
30-year	10.27	13.94	11.35	11.31	11.93	-2.01	.62
Municipal revenue (Bond Buyer index)	9.21	11.44	10.44[5]	9.96[5]	10.25[5]	-1.19	.29
Corporate--A utility Recently offered	11.64	15.30	12.80e	12.65e	13.24e	-2.06	.59
Home mortgage rates							
S&L fixed-rate	12.55	14.68	13.18[6]	12.90	13.20[6]	-1.48	.30
S&L ARM, 1-yr.	n.a.	12.31	11.07[6]	10.59	10.87[6]	-1.44	.28

	1982	1983	1984	1985		Percent change from:	
	Lows	Highs	FOMC Dec. 18	FOMC Feb. 13	Mar. 19	FOMC Dec. 18	FOMC Feb. 13
Stock prices							
Dow-Jones Industrial	776.92	1287.20	1211.57	1297.92	1271.09	4.9	-2.1
NYSE Composite	58.80	99.63	96.78	106.08	103.91	7.4	-2.0
AMEX Composite	118.65	249.03	204.00	231.22	224.64	10.1	-2.8
NASDAQ (OTC)	159.14	328.91	243.44	288.32	278.85	14.5	-3.3

1. One-day quotes except as noted.
2. Averages for two-week reserve maintenance period closest to date shown. Last observation is for maintenance period ended March 13, 1985.
3. Secondary market.
4. Averages for statement week closest to date shown.
5. One-day quotes for preceding Thursday.
6. One-day quotes for preceding Friday.
e--estimated.

M1 growth strengthened in February, probably still boosted by previous declines in interest rates, bringing this aggregate near the upper parallel band associated with its 1985 target range. Growth of the broader monetary aggregates, on the other hand, slowed in February, as spreads between market interest rates and rates on retail deposits and money funds widened.

Since the FOMC meeting in mid-February, federal funds have traded primarily between 8-1/2 and 8-3/4 percent, somewhat above the prevailing level earlier in the year. Other market interest rates rose more markedly during February, as the strength of M1, combined with indications of tautness in reserve markets, apparently aroused concerns that System policy had become or was about to become less accommodative. More recently, these interest rates have fluctuated in response to incoming data on the strength of economic activity, which have given mixed signals. On balance, yields on Treasury securities have risen throughout the maturity spectrum since the February FOMC meeting, by 30 to 75 basis points, and the yield curve has remained quite steep. Yields on corporate obligations generally have increased in line with those on Treasury securities, while yields on tax-exempt securities have risen less. New commitment rates for conventional home mortgages, after declining in early February, have begun to rise as well.

The collapse in early March of E.S.M. Government Securities, a non-primary, monthly-reporting dealer, and the subsequent closing of privately insured savings and loan associations in Ohio appear not to have significantly affected domestic financial markets. Apart from the privately insured S&Ls in Ohio, depository institutions apparently have not encountered

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

	1984 Q2	1984 Q3	1984 Q4	1984 Dec.	1985 Jan.	1985 Feb.	Growth from Q4 1984 to Feb. 1985
	------- Percentage change at annual rates ------						
1. M1	6.5	4.5	3.2	10.2	9.0	13.9	11.3
2. M2	7.1	6.8	9.0	13.1	13.8	10.6	12.7
3. M3	10.5	9.5	11.0	14.4	10.5	8.1	11.1
							Levels in billions of dollars Feb. 1985
Selected components							
4. Currency	7.5	7.3	5.1	6.1	5.3	9.0	160.6
5. Demand deposits	3.3	0.3	-1.0	8.8	2.4	12.0	251.6
6. Other checkable deposits	11.3	9.0	8.5	16.7	24.7	22.6	151.7
7. M2 minus M1[2]	7.2	7.6	10.8	14.1	15.4	9.5	1850.7
8. Overnight RPs and Eurodollars, NSA[3]	0.7	2.8	2.1	-10.3	110.4	129.7	69.7
9. General purpose and broker/dealer money market mutual fund shares, NSA	15.5	10.9	28.3	42.2	32.2	23.0	175.5
10. Commercial banks	9.0	4.9	8.6	17.7	15.0	9.0	792.3
11. Savings deposits, SA, plus MMDAs, NSA[4]	5.1	-3.6	10.6	28.0	38.2	25.7	410.7
12. Small time deposits	13.1	13.4	6.9	7.8	-8.1	-8.4	381.7
13. Thrift institutions	8.7	4.7	7.3	9.4	7.7	6.5	821.6
14. Savings deposits, SA, plus MMDAs, NSA[4]	2.3	-12.5	-4.1	6.5	23.7	25.9	327.1
15. Small time deposits	13.4	17.0	14.8	11.4	-2.9	-5.6	494.6
16. M3 minus M2[5]	24.9	20.3	18.9	19.0	-2.3	-1.2	622.1
17. Large time deposits	30.4	25.7	18.8	16.3	1.7	6.9	419.8
18. At commercial banks, net[6]	21.8	19.3	12.2	3.6	-9.1	9.6	264.5
19. At thrift institutions	48.1	38.1	31.3	39.0	20.5	2.3	155.3
20. Institution-only money market mutual fund shares, NSA	8.1	9.7	97.4	90.6	44.0	-51.7	62.2
21. Term RPs, NSA	54.2	33.4	39.6	-17.0	-84.4	18.5	65.8
22. Term Eurodollars, NSA	7.1	-22.1	-23.0	19.0	30.3	5.9	81.5
	-- Average monthly change in billions of dollars --						
MEMORANDA:							
23. Managed liabilities at commercial banks (24+25)	7.1	4.2	4.2	-0.6	-7.4	11.5	438.5
24. Large time deposits, gross	6.9	1.8	3.5	2.8	1.0	0.6	325.4
25. Nondeposit funds	0.2	2.4	0.7	-3.4	-6.4	10.9	113.1
26. Net due to related foreign institutions, NSA	1.0	-0.4	1.0	1.1	-4.5	3.0	-33.5
27. Other[7]	-0.9	2.8	-0.4	-4.5	-1.8	7.9	146.6
28. U.S. government deposits at commercial banks[8]	-0.7	0.6	0.0	-1.2	-1.4	-1.7	13.0

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 January and February 1985 at rates of 9.8 and 2.0 percent respectively, At thrift institutions, savings deposits excluding MMDAs increased in January and February 1985 at rates of 7.2 and 7.9 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.

liquidity problems. Some Treasury bill rates dropped sharply after the announcement of the closing of the Ohio thrifts, but on balance yield spreads between bank CDs and Treasury bills and between federal funds and RPs have widened only marginally.

Borrowing by nonfinancial sectors in the first two months of the year seems to have moderated relative to the fourth quarter of 1984. Business credit demands appear to have fallen off considerably from the strong fourth-quarter pace, despite a likely widening of the financing gap in the first quarter and continued net retirements of equity. In addition, offerings of tax-exempt bonds have declined by one-third from the record volume brought to market in the fourth quarter. And although the Treasury continues to place very large demands on financial markets, its borrowing too has been significantly below the fourth-quarter level. Only in the household sector does the growth of aggregate credit demands appear to have remained close to the late-1984 pace.

Monetary Aggregates and Bank Credit

M1 growth surged in February to a 14 percent annual rate, with all of its components contributing to this strength. Inflows to Super NOW accounts remained substantial, probably boosted by the January reduction in regulatory minimum balance requirements; however, this does not appear to have had a significant effect on M1 growth, as the primary source of Super NOW inflows seems to have been ordinary NOW accounts. The continued strength of M1 in recent months points toward a decline in velocity in the first quarter as a whole, which probably is at least in part a lagged reaction to the drop in interest rates over the fall and early winter.

In contrast to M1, growth in the broader aggregates moderated in February. M2 decelerated to a 10-1/2 percent pace, as growth in MMDAs and M2-type money funds slowed and runoffs of small time deposits quickened. The weakening of these components likely reflects changing yield relationships. When market rates declined last fall and early winter, yields on money funds, MMDAs, and small time deposits responded sluggishly, resulting in strong inflows into these accounts, particularly to MMDAs and money funds, whose yields became most favorable relative to market counterparts. However, a further downward adjustment of these yields, followed by the recent upturn in market rates, has tended to reverse this trend. The slowdown in M2 growth in February was tempered by a record increase in overnight RPs and a rare increase in savings deposits. The surge in RPs financed substantial acquisitions of Treasury securities by bank security dealers.

M3 growth slowed to an 8 percent annual pace in February, as the level of its non-M2 component contracted a bit for the second straight month. The February decline was concentrated in institution-only money funds, which registered outflows following the restoration of a positive spread between market rates and money fund yields. In addition, growth of large time deposits at thrift institutions virtually ceased, owing both to slower asset growth and increased reliance on Federal Home Loan Bank (FHLB) advances. Asset growth of FSLIC-insured institutions apparently is being restrained by the implementation of new capital requirements for these institutions by the Federal Home Loan Bank Board.[1] Outstanding FHLB advances increased $2-1/2 billion in February, perhaps reflecting an effort by some thrifts to lengthen maturities of managed liabilities; the average maturity of advances in recent months generally has exceeded 13 months. In contrast to thrift institutions, commercial banks resumed issuance of large time deposits and term RPs in February after runoffs of these liabilities in January, as core deposit growth slowed while credit growth picked up.

Credit growth at commercial banks in February increased to a 13 percent annual rate, more than double the January pace. Strength was evident in both the security and loan components. Heavy acquisitions of U.S. government securities more than offset a runoff in holdings of other securities. The pickup in loan growth was accounted for by business loans and real estate loans. To a large degree, the strength in business loans appears to have reflected an increase in the share of business loans booked at domestic offices rather than at foreign branches, as the spread between the prime and LIBOR narrowed by about 100 basis points in February. Nonetheless, the sum of business loans at domestic offices plus foreign branch loans grew at a 6-1/2 percent rate in February, somewhat faster than the average rate in the previous two months. Growth in consumer loans slowed for the second straight month.

1. On January 1, FSLIC-insured institutions became subject to new incremental requirements on minimum net worth, the size of which are based on their rate of growth. In addition, those institutions with assets exceeding $100 million now must have regulatory approval to grow in excess of a 25 percent annual rate over two consecutive quarters. In January, total assets of FSLIC-insured institutions were virtually unchanged, compared with a monthly average increase of over $12 billion in the fourth quarter of 1984.

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

	1984 Q2	1984 Q3	1984 Q4	1984 Dec.	1985 Jan.	1985 Feb.p	Levels in bil. of dollars Feb.p
	Commercial Bank Credit						
1. Total loans and securities at banks	9.2	9.5	9.8	9.6	6.2	13.1	1742.2
2. Securities	-9.8	6.6	0.5	-1.2	6.3	12.8	406.8
3. U.S. government securities	-11.2	6.8	3.4	3.7	-1.4	24.9	265.3
4. Other securities	-7.3	6.3	-4.8	-10.2	20.5	-9.3	141.5
5. Total loans	15.7	10.5	12.7	12.9	6.1	13.3	1334.4
6. Business loans	18.5	7.5	7.7	2.3	1.5	13.6	474.2
7. Security loans	-13.6	4.2	36.1	47.7	19.1	-11.3	31.6
8. Real estate loans	13.8	11.4	11.6	11.6	7.7	13.7	381.9
9. Consumer loans	21.5	14.2	16.2	20.9	16.7	15.1	257.8
	Short- and Intermediate-Term Business Credit						
10. Business loans net of bankers acceptances	18.4	7.9	7.8	4.1	2.1	10.6	469.8
11. Loans at foreign branches[2]	21.5	8.2	26.0	40.8	45.1	-76.0	20.7
12. Sum of lines 10 & 11	18.7	7.8	8.7	5.7	3.9	6.6	490.5
13. Commercial paper issued by nonfinancial firms[3]	64.8	46.8	51.2	23.4	-41.0	37.3	72.9
14. Sums of lines 12 & 13	23.3	12.2	13.7	8.0	-1.9	10.5	563.4
15. Total bankers acceptances outstanding[4]	47.0	-16.1	-32.0	-28.2	-49.8	n.a.	71.6 (Jan.)
16. Line 14 plus total bankers acceptances outstanding	26.4	8.3	7.7	3.6	-7.6	n.a.	630.1 (Jan.)
17. Finance company loans to business[4,5]	15.2	9.8	23.2	25.8	32.5	n.a.	136.5 (Jan.)
18. Total short- and intermediate-term business credit (sum of lines 16 & 17)	24.5	8.5	10.3	7.4	-0.6	n.a.	766.6 (Jan.)

n.a.--not available. p--preliminary.
1. Average of Wednesdays for domestically chartered banks and average of current and preceding ends of months for foreign-related institutions.
2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
3. Average of Wednesdays.
4. Based on average of current and preceding ends of month.
5. Reporting panel change in January, 1985 increased reported acceptances $2.1 billion. Growth rates have been adjusted to eliminate this break in series.

The rebound in business lending by commercial banks was accompanied by a resumption of heavy commercial paper issuance in February after the sharp runoff in January. After contracting in January, the sum of bank loans and commercial paper expanded at about a 10-1/2 percent annual rate in February, still somewhat below the fourth-quarter pace.

Business Finance

Overall credit demands of nonfinancial firms strengthened in February from January's sluggish pace, as the surge in borrowing from banks and in the commercial paper market more than offset a decline in bond issuance. New issues by nonfinancial firms in the domestic bond market were essentially unchanged from the previous month, but Eurobond offerings dropped back after a bulge in January.

Taking the first two months of the year together, the volume of funds raised in financial markets by nonfinancial corporations appears to have fallen off considerably from the fourth-quarter pace, despite a likely widening of the financing gap in the current quarter. Borrowing from banks and in the commercial paper market grew at only one-third the rate of the fourth quarter, while in long-term markets total bond offerings--here and abroad--by nonfinancial firms were only about two-thirds the average monthly volume in the fourth quarter. Meanwhile, net retirements of equity--reflecting mergers and other financial restructurings--have continued sizable. A $4-1/2 billion swap of debt for common stock and a $1/2 billion repurchase of shares from the Pickens group by Phillips Petroleum are expected to take place in late March.

Total bond offerings by U.S. corporations--financial and nonfinancial--declined sharply in February from the strong January pace. Eurobond

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

	1984			1985			
	Year	Q3	Q4	Q1f	Jan.p	Feb.p	Mar.f
Corporate securities - total[1]	9.88	11.00	13.19	11.85	12.23	8.62	14.70
Public offerings in U.S.	8.00	8.77	10.40	8.78	7.15	6.00	13.20
Stocks--total[2]	1.89	1.64	1.79	1.93	1.40	2.20	2.20
Nonfinancial	1.08	.84	1.11	--	.90	1.30	--
Utility	.22	.17	.20	--	.30	.50	--
Industrial	.86	.66	.90	--	.60	.80	--
Financial	.81	.80	.69	--	.50	.90	--
Bonds--total[1]	6.11	7.13	8.61	6.85	5.75	3.80	11.00
By industry							
Nonfinancial	2.80	3.30	4.48	--	2.45	2.50	--
Utility	.87	.88	1.51	--	1.00	.50	--
Industrial	1.93	2.42	2.97	--	1.45	2.00	--
Financial	3.31	3.83	4.13	--	3.30	1.30	--
By quality[3]							
Aaa and Aa	1.85	2.23	3.01	--	1.50	.20	--
A and Baa	2.11	2.79	2.63	--	3.50	2.40	--
Less than Baa	1.06	1.19	1.71	--	.45	.40	--
No rating (or unknown)	.28	.32	.28	--	.20	.15	--
Memo items:							
Equity based bonds[4]	.62	.57	1.30	--	.60	.15	--
Mortgage-backed bonds	.81	.60	.98	--	.10	.65	--
Variable rate notes	.72	1.29	.51	--	.35	.08	--
Bonds sold abroad - total	1.88	2.23	2.79	3.07	5.08	2.62	1.50
Nonfinancial	.84	.97	1.08	--	1.86	.97	--
Financial	1.04	1.26	1.71	--	3.22	1.66	--

p--preliminary. f--staff 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.

volume dropped by half, and total bond issuance by financial firms fell by more than half. Offerings in the Eurobond market last month apparently were held down by a large buildup of unsold issues at underwriters following the very aggressive pricing of a record volume of offerings in January. Bank holding companies accounted for much of the reduction in total bond issuance by financial corporations, as a number of institutions approached regulatory limits on the amount of mandatory convertible debt that can be counted as primary capital for purposes of regulatory minimum capital guidelines.[1] Total bond issuance by U.S. corporations is expected to balloon in March, bolstered by the Phillips restructuring; apart from this transaction, bond offerings thus far in March are running close to the pace in February.

Several stock price indexes reached record highs in early February, before weakening with the backup in market interest rates, and equity issuance picked up a bit. Even so, equity issuance through the first two months of the year remained at around the lackluster average pace of 1984, despite the strong performance, on balance, of stock prices thus far in 1985.

<u>Government Finance</u>

<u>Federal sector</u>. The staff is now projecting a combined (on- and off-budget) deficit of $60 billion for the first quarter. The first-quarter deficit has been reduced by as much as $5 billion by a slower-than-normal pace of tax refunds, attributed to problems with new IRS computer systems. The Treasury is expected to meet its financing requirements by borrowing

1. A more extensive discussion of activity in the Eurobond markets in February appears in the International Developments section of the Greenbook.

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

	1984	1985			
	Q4	Jan.	Feb.p	Mar.f	Q1f
Treasury financing					
Combined surplus/deficit(-)	-71.5	-8.0	-24.7	-27.6	-60.3
Means of financing deficit:					
Net cash borrowing from the public	64.2	12.7	16.3	10.8	39.8
Marketable borrowings/ repayments(-)	60.2	11.9	15.1	9.8	36.8
Bills	17.6	.1	2.2	2.5	4.8
Coupons	42.6	11.8	12.9	7.3	32.0
Nonmarketable	4.0	.8	1.2	1.0	3.0
Decrease in the cash balance	12.8	-8.9	9.3	7.7	8.1
Memo: Cash balance at end of period	17.6	26.5	17.2	9.5	9.5
Other[2]	-5.5	4.2	-.9	9.1	12.4
Federally sponsored credit agencies, net cash borrowing[3]	3.4	-.4	.5	2.0	2.1
FHLB	-.1	-.8	.1	1.2	.5
FNMA	3.6	.9	1.0	1.0	2.9
Farm Credit Banks	-1.9	-.6	-.6	-.7	-1.9
FHLMC	1.3	-.1	.1	.4	.4
SLMA	.5	.2	-.1	.1	.2

f--staff forecast. p--preliminary.
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.

about $40 billion, net, from the public and by reducing its cash balance by about $8 billion, leaving an end-of-quarter balance of $9-1/2 billion. Continuing the pattern of recent quarters, the Treasury will raise the bulk of its new money in auctions of marketable coupons. Bill financing is expected to total only $5 billion, with a cash management bill that the Treasury had expected to be needed in March now likely to be deferred until early April.

Borrowing by the federally sponsored credit agencies is declining in the first quarter from the already low level in the final quarter of last year. Federal Home Loan Banks are borrowing relatively small amounts in the current quarter, as advances to thrifts have been financed largely by drawing down liquid assets. The FHLBs continue to hold a relatively large volume of liquid assets and thus are not expected to tap the financial markets for new funds in the near term. Borrowing by the Federal National Mortgage Association moderated in the first quarter, but remains sizable. FNMA's rapid growth reflects, in part, an effort to reduce the rate sensitivity of its portfolio by adding adjustable-rate mortgages.

The Farm Credit Banks will reduce their outstanding debt in the first quarter by the same amount as in the preceding quarter. Borrowing by these institutions generally has been weak since 1982, but the recent cutback in debt has been the sharpest over this period and coincides with a decline in the demand for loans by the agricultural sector. With heavy debt burdens and declining land values, farmers have been increasing their outstanding debt only slightly.

Thus far, the stress in the farm sector has had a limited effect on the financial condition of the Farm Credit System. A few of the local cooperative associations that lend directly to farmers have been liquidated and three of the 37 Farm Credit Banks have reported financial difficulty.[1] However, the losses of these three banks can be covered by the others in the System. For 1984, the System recently reported aggregate net income of $442 million, compared with $543 million in 1983, and its capital position is strong. Recent issues of securities by the System have not carried additional risk premiums. There have been reports that some investors are attempting to pare their holdings of these securities, but the paydown of debt by the System apparently has been sufficient to offset the selling pressure from those investors liquidating their holdings.

State and local sector. Issuance of tax-exempt bonds increased in February to $9.5 billion but seems to be dropping back this month to about the comparatively low $6.7 billion pace of January. Not only have offerings of long-term tax-exempts remained well below the record volume in the fourth quarter, but offerings of short-term tax-exempt notes also have remained light. Interest rates on tax-exempt bonds have increased substantially after reaching their lowest level since the spring of 1983 during the third week of January.

The supply of new tax-exempt issues in February was augmented by a surge of refunding bonds. Many states sold general obligation bonds for this purpose and two publicly owned utilities brought large refunding issues to the market. The total volume of refundings was nearly $2 billion, its highest level since the spring of 1983.

1. The Farm Credit System issues debt on behalf of 37 Farm Credit Banks. These banks then distribute these funds to local cooperatives that lend directly to farmers.

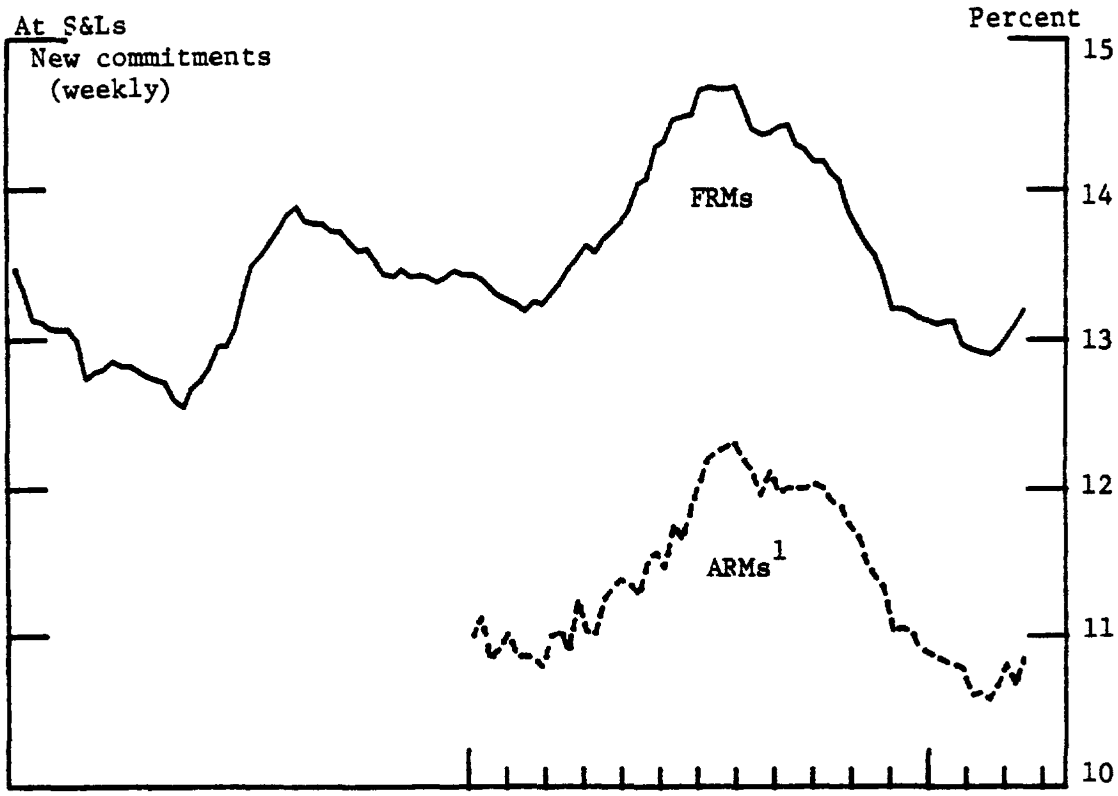
GROSS OFFERINGS OF TAX-EXEMPT SECURITIES
(Monthly totals or monthly averages; billions of dollars)

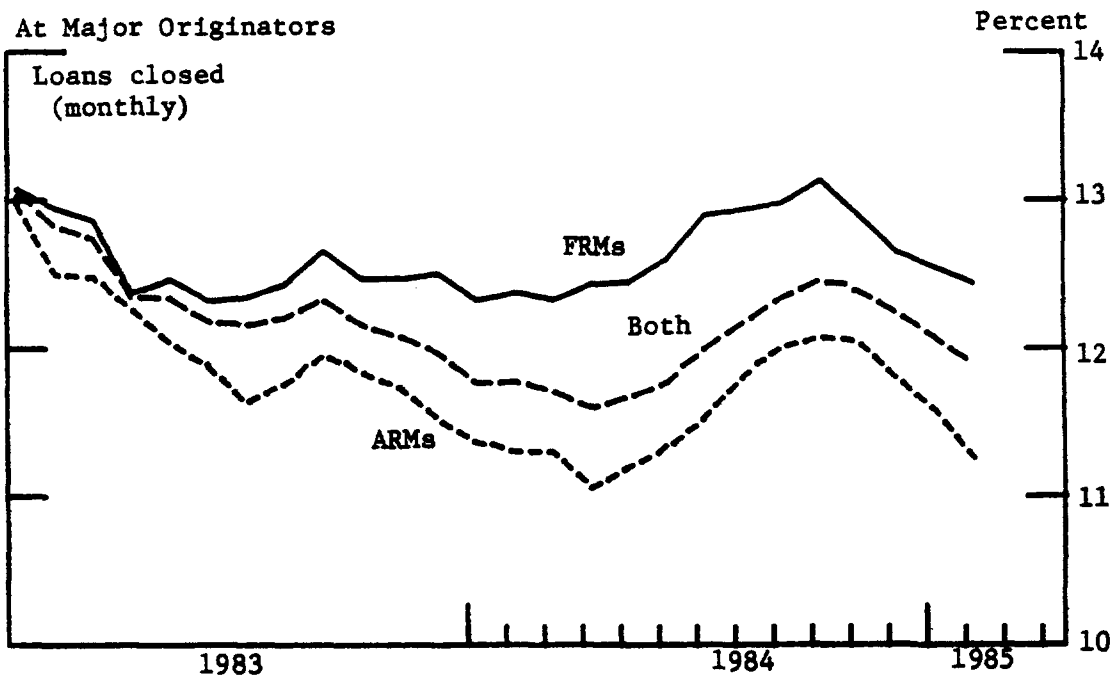
	1983	1984	1984 Q3	1984 Q4[e]	1985 Jan.[e]	1985 Feb.[e]	1985 March[f]
	Seasonally adjusted						
Total	10.39	10.45	11.87	14.09	7.60	10.40	7.60
Long-term	7.20	8.75	10.00	12.83	6.70	9.50	6.80
Short-term[1]	3.19	1.70	1.87	1.26	.90	.90	.80
	Not seasonally adjusted						
Total	10.39	10.45	11.03	15.18	6.20	8.10	7.70
Long-term	7.20	8.75	9.08	14.06	5.50	7.40	7.00
Refundings[2]	1.17	1.01	.78	1.29	.70	1.87	--
Single-family housing[3]	.92	1.08	2.69	1.25	.07	.03	--
Short-term[1]	3.19	1.70	1.95	1.12	.70	.70	.70

e--estimate. f--staff forecast.
1. These figures do not include tax-exempt commercial paper.
2. Includes all refunding bonds, not just advance refundings.
3. Data from the Department of Housing and Urban Development.

On the demand side, households and mutual funds have continued to be the major investors in tax-exempt bonds. There is some evidence of increased participation by commercial banks, primarily in shorter-term markets, but property/casualty companies, once heavy participants in the municipal market, have remained inactive, given record underwriting losses. Individuals' demand for municipal securities has been supported by the increasing use of guarantees of various types. In 1984, about 21 percent of long-term municipal securities was protected with private insurance, compared with 15 percent in 1983, and less than 4 percent as recently as 1980. Until 1983, AMBAC Indemnity Corporation and the Municipal Bond Insurance Association provided most of the insurance for tax-exempt bonds, but more recently two new firms have entered the market.

CONTRACT INTEREST RATES ON
CONVENTIONAL HOME MORTGAGES





1. One-year ARMs at S&Ls offering both FRMs and ARMs with the same number of discount points. Data unavailable prior to 1984.

Mortgage Markets

Rates on new commitments for home mortgages have turned up since the last FOMC meeting in both the primary and the secondary markets. At S&Ls, contract interest rates for conventional fixed-rate mortgages (FRMs) averaged 13.20 percent by mid-March, up 30 basis points from the latest low in mid-February but still about 150 basis points below last July's high. Initial contract rates on one-year adjustable-rate mortgages (ARMs) at the same institutions have increased on balance by a similar amount.

Through early February, closing rates on both FRMs and ARMs had continued to move down, but the cumulative declines in closing rates since last autumn had been much smaller than cumulative declines in rates on new commitments. For FRMs and ARMs combined, average contract rates at closing were off by only 57 basis points from last October's high. In part, the downtrend in the average closing rate on all conventional loans has been moderated by a shift in the composition of lending toward FRMs and away from ARMs that carry lower initial rates.[1] Of all conventional mortgages closed in early February, 46 percent carried adjustable-rate features--sharply below last October's near-record high of 64 percent and the lowest proportion since late 1983.

Available evidence on demands for new mortgage credit early this year has been mixed. Net borrowing from commercial banks on all types of real estate picked up sharply in February from the reduced January pace, but on

1. Deep discounting of ARM interest rates in the initial period--offered as a promotional incentive--has apparently diminished considerably since last fall, judging from staff estimates based on FHLBB data through early February.

MORTGAGE ACTIVITY AT FSLIC-INSURED INSTITUTIONS
(Billions of dollars, seasonally adjusted)

	Mortgage commitments		Net change in mortgage assets[1]		
	New	Outstanding[2]	*Total*	Mortgage *loans*	Mortgage-backed *securities*
	(1)	(2)	(3)	(4)	(5)
1984-May	20.1	70.3	10.9	8.4	2.5
June	18.8	71.3	10.9	8.3	2.6
July	18.1	72.3	8.8	8.2	.6
Aug.	16.6	71.4	9.0	6.6	2.5
Sept.	15.9	70.5	6.4	5.9	.5
Oct.	16.9	69.2	5.5	5.2	.3
Nov.	16.9	69.2	4.5	5.9	-1.4
Dec.	17.5	69.6	3.4	2.8	.6
1985-Jan.	16.8	68.7	3.9	4.3	-.5

1. Data are adjusted to account for structural changes through mergers, acquisitions, liquidations, terminations, or de novo institutions.
2. End of month. Includes loans in process.

NEW ISSUES OF FEDERALLY GUARANTEED MORTGAGE PASS-THROUGH SECURITIES
(Monthly averages, billions of dollars, not seasonally adjusted)

Period	Total	GNMAs	FHLMCs	FNMAs	Memo: FNMA and FHLMC swap issues
1983-Q1	7.1	3.8	2.0	1.3	2.2
Q2	7.4	4.8	1.4	1.2	1.9
Q3	7.6	4.8	1.5	1.2	2.1
Q4	5.7	3.4	1.7	.7	2.0
1984-Q1	4.9	2.7	.9	1.3	1.6
Q2	4.0	2.3	1.1	.5	1.5
Q3	5.1	2.2	1.4	1.5	2.7
Q4	6.0	2.0	2.7	1.2	3.5
Aug.	5.8	2.4	1.6	1.9	3.3
Sept.	4.2	1.9	1.1	1.1	2.1
Oct.	6.2	2.5	2.6	1.1	3.4
Nov.	4.7	1.4	2.0	1.2	2.7
Dec.	7.0	2.1	3.7	1.3	4.4
1985-Jan. r	5.4	2.7	1.9	.9	2.1
Feb. p	6.9	2.7	2.4	1.8	3.3

p--preliminary. r--revised.

balance real estate lending during those two months was in line with that in the fourth quarter. Moreover, the surge in real estate loans in February occurred at large banks, where home mortgages historically have accounted for less than half of total real estate loans.

At FSLIC-insured institutions--the largest mortgage originator group--new mortgage loans closed (for both construction and permanent financing) increased in January at slightly above the fourth-quarter average rate; however, with loan retirements at an all-time high, the volume of net lending remained below its late-1984 average pace. The industry also ran off holdings of mortgage-backed securities. Meanwhile, new commitments dropped in January to the lowest volume since last September, reflecting a large cutback in purchase commitments that more than offset a small increase in origination commitments. With originations higher and purchases unchanged, mortgage loan commitments outstanding declined to the lowest level since last spring. Issuance of federally guaranteed mortgage-backed securities strengthened during February as swap volume picked up to near its fourth-quarter average.

Consumer Credit

Growth of consumer credit in the first two months of the year appears to have remained substantial, associated with continued strength in sales of autos and other consumer goods, as well as a further downward drift, at least through early February, in consumer finance rates. According to the revised series, outstanding consumer installment debt increased at a 19 percent annual rate in January, up a bit from the 18-1/2 percent December pace. Consumer loan growth at commercial banks slowed in February, but may have been restrained by the introduction of concessionary financing for

CONSUMER INSTALLMENT CREDIT*

	1983	1984	1984 Q3	1984 Q4	1984 Nov.	1984 Dec.	1985 Jan.
	-------- Percent rate of growth, SAAR --------						
Change in outstandings--total	14.7	20.0	17.5	15.8	16.6	18.4	19.2
By type:							
Automobile credit	13.4	20.6	17.9	16.5	18.3	19.0	20.1
Revolving credit	17.7	23.9	16.2	20.1	21.1	18.5	24.7
All other[1]	14.0	17.5	17.8	12.9	12.6	17.4	12.2
	-------- Billions of dollars, SAAR --------						
Change in outstandings--total	48.7	76.8	72.9	68.7	73.0	81.8	86.7
By type:							
Automobile credit	16.9	29.5	28.2	27.3	30.6	32.2	34.6
Revolving credit	12.4	19.6	14.1	18.2	19.4	17.3	23.5
All other[1]	19.5	27.7	30.5	23.2	23.0	28.9	28.5
By major holder:							
Commercial banks	19.5	40.4	28.8	33.1	29.8	36.3	45.6
Finance companies	9.3	9.3	19.3	4.0	9.3	14.4	10.8
All other	20.0	27.1	24.8	31.6	33.8	31.1	30.3
	-------- Annual percentage rate --------						
Interest rates							
At commercial banks[2]							
New cars, 48 mos.	13.92	13.71	14.08	13.91	13.91	n.a.	n.a.
Personal, 24 mos.	16.68	16.47	16.75	16.63	16.63	n.a.	n.a.
Credit cards	18.78	18.77	18.81	18.82	18.82	n.a.	n.a.
At auto finance companies[3]							
New cars	12.58	14.62	14.95	15.22	15.24	15.24	15.11
Used cars	18.74	17.84	17.93	18.28	18.30	18.34	17.88

1. Includes primarily personal cash loans, home improvement loans, mobile home 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.
* Installment credit data reflect benchmark and seasonal revisions from 1980 forward.

certain automobile loans at the captive finance companies. Growth of installment credit in January was especially brisk in the automotive and revolving credit categories.

Costs of most types of consumer credit continued to drift down through early February. At commercial banks, the most common rate on 48-month new auto loans dropped 54 basis points between early November and early February, reaching 13.37 percent. Rates on closed-end personal consumer credit also declined by about 40 basis points over the three-month period, but rates on bank credit card plans continued to edge up to a record 18.85 percent. Rate concessions on small cars offered by AMC, Chrysler, and Ford dealers are scheduled to remain in effect until various dates from the end of March through the end of April.

Household Financial Positions

The increase in net consumer installment debt in January brought the debt-to-income ratio to 17-1/4 percent, up from about 14-1/2 percent in late 1982, but still below the late 1979 peak of 17-3/4 percent. Nevertheless, the debt burden suggested by this measure does not appear to be excessive, judging from other indications such as personal bankruptcies and delinquencies on such debt. Personal bankruptcy filings have shown no tendency to increase for the last year and a half and are substantially under the highs partly induced by the 1980 statutory changes. The percent of installment loans 30 days or more past due at both commercial banks and finance companies increased at the end of last year, but it remained well below the highs reached in 1980 and below the average levels of the 1970s; indeed, the finance company rate remained near its historic low achieved last year.

On longer-term home mortgage debt, though, the most recent data suggest that delinquency rates stand at historic highs. According to the Mortgage Bankers Association, the delinquency rate on all mortgages 60 days or more past due edged up to a record 1.88 percent in the fourth quarter. In January, the corresponding rate at savings and loan associations also increased, to a record 2.38 percent. The runup in mortgage delinquencies appears to be due, in part, to the sharp slowing in the rate of increase of home prices since the last recession. In addition, trade sources suggest that delinquencies have been increasing on ARMs that had been made with substantial first-year interest rate discounts.

Foreign Exchange Markets

The trade-weighted average value of the dollar has declined about 3/4 percent on balance since the last FOMC meeting. The dollar was very strong early in the intermeeting period, but it dropped back sharply late in the period amid shifting assessments of the strength of U.S. economic activity and the stance of U.S. monetary policy. The exceptional volatility of exchange-rate movements also has reflected varying market concern about possible concerted intervention against the dollar,

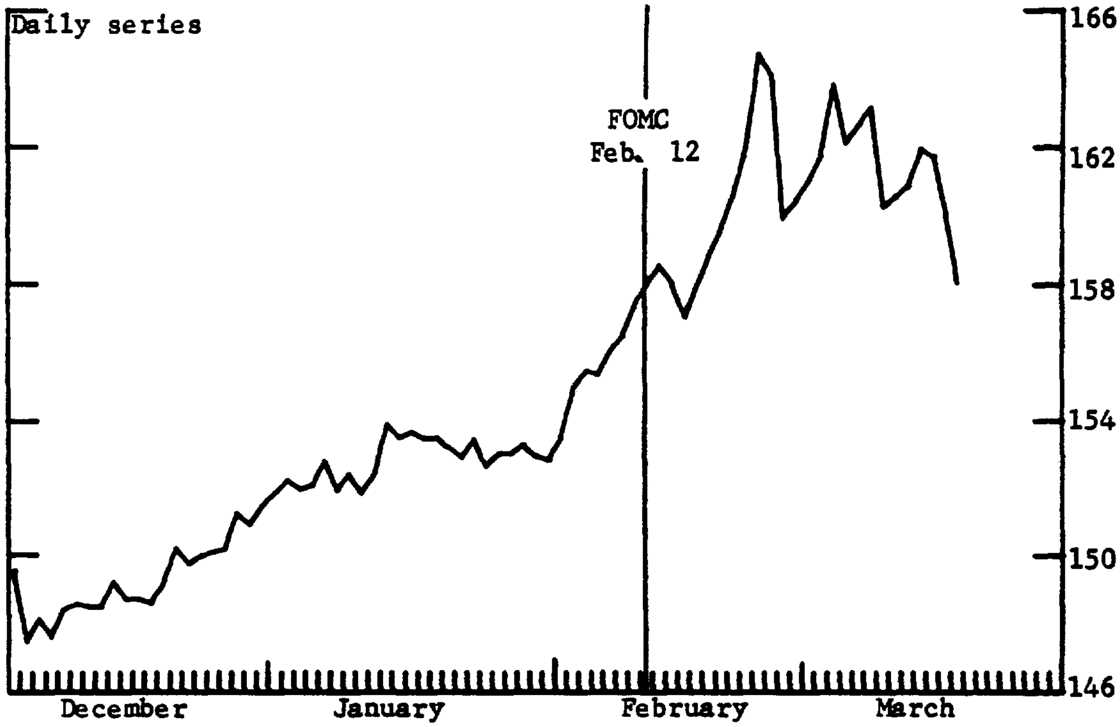
.

The dollar appreciated 5 percent over the first two weeks of the intermeeting period, boosted by unexpectedly strong data on U.S. economic activity, together with a market perception that the Federal Reserve might have begun to tighten reserve conditions, while the Bundesbank continued to supply liquidity to the German interbank market at terms and in volume viewed as generous. Another factor cited in the dollar's advance was President Reagan's criticism of artificial attempts to depress the dollar, which reportedly alleviated market concern that the United States might participate vigorously in coordinated intervention efforts.

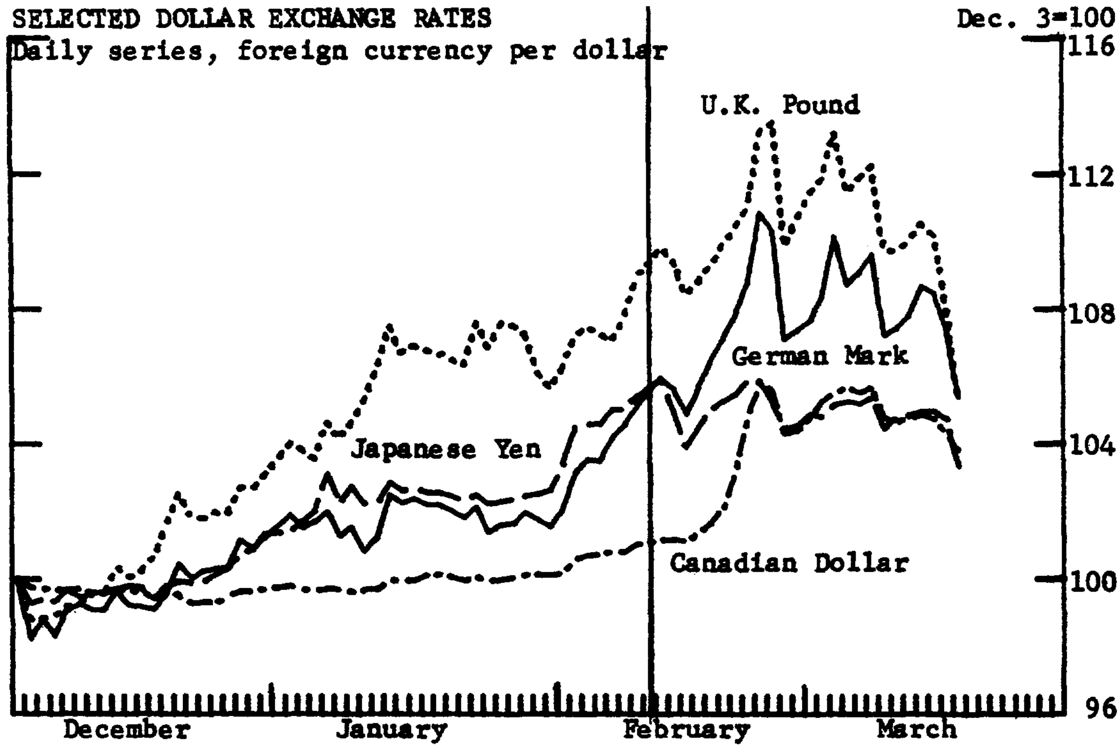
The dollar eased somewhat on Tuesday, February 26. ,

Chart 1 3/19/85

WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR March 1973=100



SELECTED DOLLAR EXCHANGE RATES Dec. 3=100



. Over the next two days, additional favorable data on the U.S. economy helped the dollar rebound from Wednesday's low

. In addition, the Desk purchased $257.5 million equivalent of marks over three days,

. Desk activity was noted in the market, but was perceived as moderate. Including an operation in mid-February, the Desk's dollar sales for the intermeeting period totalled $322.5 million divided equally between the accounts of the System and the Treasury, with $306.1 million sold for marks and $16.4 million for sterling.

Over the remainder of the intermeeting period,

, the dollar quickly recovered almost to its late-February peak, but trading conditions continued to be volatile with market participants wary of central bank action. The dollar subsequently weakened as new data on U.S. economic activity disappointed market expectations, and as some market participants conjectured that problems at state-insured thrift institutions in Ohio might induce the Federal Reserve to maintain an easier stance than it otherwise would. The dollar's slide turned into a steep drop as an increasing number of participants expressed the view that fundamental imbalances in the U.S. economy might at last be bringing a long-expected reversal of the dollar's protracted rise.

As illustrated in the bottom panel of the chart, the dollar has depreciated 2-1/4 percent against the yen and nearly 5 percent vis-a-vis sterling over the intermeeting period. Sterling, notably, benefitted from high U.K. interest rates, from a firming of spot prices for Britain's North Sea oil, and from the ending of the year-long strike by British coal miners. The pound recovered 4 percent on a trade-weighted basis. Its recovery contributed to an easing of sterling interest rates late in the period. Major U.K. banks cut their base lending rates 1/2 percentage point to 13-1/2 percent, and the Bank of England made similar reductions in its money-market dealing rates.

The Canadian currency has depreciated sharply against the dollar, dropping 2-1/2 percent on balance since the last FOMC meeting. The Canadian dollar's recent weakness reflects several factors: a market perception that political conflict in Canada may inhibit fiscal retrenchment and reform of regulations governing foreign investment; an anticipated slowing of economic growth; and a belief that with unemployment still high and capital formation weak, Canadian authorities might resist increases in interest rates despite exchange-rate pressures. Nonetheless, short-term Canadian interest rates have risen steeply, and major Canadian banks recently raised their prime rates 1/4 percentage point to 11-1/2 percent.

Notable among the EMS currencies is the Italian lira, which has depreciated 2-1/2 percent against the dollar and has dropped from near the top of the EMS to the bottom. Italy's trade deficit, which established a record in 1984 and remained large in January, reportedly has engendered speculation that the lira's parities against other EMS currencies may have to be adjusted downward. It is unclear why expectations of a realignment should have materialized so abruptly.

U.S. banks' foreign lending in the fourth quarter. U.S.-chartered banks' gross claims on foreigners declined a slight $2 billion in the fourth quarter. The changes in claims on the various country groups were all less than $1 billion except for a $2.5 billion (7 percent) drop in claims on smaller developed countries. Claims on non-OPEC developing countries again showed little movement. In this group, claims on Brazil were unchanged and claims on Mexico fell $0.3 billion even though U.S. banks disbursed about $300 million to Brazil and $350 million to Mexico when those countries drew further on bank term loans signed in the spring of 1984.

1984 was a year of sharp contraction in U.S. banks' claims on foreigners that was motivated primarily by the banks' desire to improve capital/asset ratios through a reduction in interbank placements as well as by a decline in the relative attractiveness of lending to developing countries and Eastern Europe. The decrease for the year of nearly $30 billion (7 percent) followed a year of virtually no net change in 1983, of moderate (6 percent) expansion in 1982, and of growth in the years 1976-81 averaging 17 percent annually. Of the 1984 decline, $11-12 billion can be accounted for by the valuation effect of the higher foreign exchange value of the dollar on the foreign branches' non-dollar claims. The dollar rose 12 percent, on a weighted average multilateral trade basis, from December 1983 to December 1984. About two-thirds of the nominal decrease in the dollar value of total claims in 1984 occurred in the third quarter, when the dollar appreciated by eight percent. After adjustment for exchange rate changes, almost all the decline in total claims was in interbank placements.

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

Claims on:	Change (no sign = increase) 1983 Year	1984 Year	1984 Q1	1984 Q2	1984 Q3	1984 Q4	Outstanding 12/31/84
Total, all countries	-1.4	-29.7	-3.1	-5.0	-19.5	-2.1	407.6
Non-OPEC developing countries	4.5	0.7	0.5	0.6	-0.8	0.4	112.3
OPEC countries	1.5	-3.3	-0.3	-1.9	-1.7	-0.6	25.6
Eastern Europe	-0.9	-0.8	-0.4	..	-0.4	..	4.5
Smaller developed countries	2.4	-2.3	-0.4	1.4	0.8	-2.5	33.8
G-10 countries	-11.7	-20.5	-1.9	-8.5	-9.5	-0.6	147.5
Offshore banking centers	3.7	-3.7	..	2.5	-6.5	0.3	66.8
Miscellaneous	-0.9	0.2	-0.7	1.0	..	-0.1	17.2

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

Claims on:	Change (no sign = increase) 1983 Year	1984 Year	1984 Q1	1984 Q2	1984 Q3	1984 Q4	Outstanding 12/31/84
Latin America	2.6	1.9	1.6	0.1	1.0	-0.8	76.8
Argentina	0.6	-0.8	..	-0.3	-0.1	-0.4	8.7
Brazil	0.2	3.2	2.0	0.3	0.9	..	26.3
Chile	0.1	0.6	0.1	0.2	0.4	-0.1	7.0
Colombia	0.1	-0.3	-0.1	-0.1	-0.1	..	2.9
Mexico	1.6	-0.3	-0.5	0.4	0.1	-0.3	25.8
Peru	-0.2	-0.2	-0.1	..	-0.1	..	2.2
Others	0.2	-0.3	0.2	-0.4	-0.1	..	3.9
Asia and Africa	1.9	-1.2	-1.1	0.5	-1.8	1.2	46.2
Korea	0.4	-0.6	-0.2	0.1	-0.9	0.4	10.7
Philippines	-0.1	-0.2	0.5	-0.4	-0.4	0.1	6.0
Taiwan	..	-0.2	-0.4	0.4	-0.1	-0.1	5.1
Others	1.6	-0.2	-1.0	0.4	-0.4	0.8	24.4
Total	4.5	0.7	0.5	0.6	-0.8	0.4	112.3

More than $20 billion of the 1984 reduction in claims was on the G-10 countries, and consisted largely of cut-backs in interbank placements. Small declines were shown in claims on most other groups, while claims on non-OPEC developing countries were essentially unchanged. As shown in Table 2, for almost all the principal borrowers in this group the change for the year was small and negative. The main exception was Brazil. U.S. bank claims on Brazil rose $3.2 billion, of which about $1.9 billion reflected disbursement of the U.S. banks' share (about 40 percent) of Brazilian drawings on the $6.5 billion new money loan from the banks signed in March. Claims on Mexico declined slightly despite disbursements of the U.S. banks' share of about $1.1 billion under the $3.8 billion new money loan signed in April; the decline appears to have reflected repayments of debts of private Mexican borrowers and perhaps some write-offs of by banks private-sector debts.

U.S. INTERNATIONAL FINANCIAL TRANSACTIONS

Large net capital inflows through several channels were recorded in 1984. (See the Summary table of U.S. International Transactions.) Substantial inflows of capital included unprecedented net foreign private purchases of U.S. Treasury securities, sizeable net foreign private purchases of U.S. corporate bonds, and large net inflows reported by banks.

Foreign net purchases of U.S. Treasury securities totaled more than $22 billion in 1984. One development which contributed to the large foreign net purchases of U.S. Treasury securities was the Treasury's introduction in October and December of two $1 billion issues of securities targeted for purchase by foreigners. At the time of the first issue in October the price of the foreign targeted instrument was above that of the domestic companion issue. Later quotations in the secondary market, however, indicate this premium has declined and even reversed. While this development may signal that market participants do not place great value on the degree of anonymity provided by the foreign targeted issue it may also derive from other differences between the two securities, in particular differences in the size of the secondary markets. An investor may demand a higher yield on the foreign targeted issue to compensate for the relatively greater uncertainty associated with disposition of the foreign targeted security prior to its maturity.

While the foreign targeted issue may offer a higher yield to compensate for secondary market asymmetries, the extent of the yield differential is limited by the provision that a foreign targeted issue

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

	1983 Year	1984 Year	1984 Q1	Q2	Q3	Q4	Nov.	Dec.	Jan.
Private Capital									
Banks									
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	13.3	20.6	13.8	-0.8	8.8	-2.7	6.3	-6.9	13.4
a) with own foreign offices	6.8	-6.1	1.0	1.4	-4.6	-3.8	2.6	-6.1	1.0
b) all other	6.6	26.7	12.8	-0.7	13.4	1.1	3.8	-0.8	12.5
Securities									
2. Private securities transactions, net	1.6	8.2	2.1	-0.3	0.3	6.1	2.0	1.9	1.7
a) foreign net purchases (+) of U.S. corporate bonds	2.2	13.7	0.4	0.6	2.6	10.1	2.4	3.7	3.0
b) foreign net purchases (+) of U.S. corporate stocks	6.4	-0.8	1.0	-0.1	-1.0	-0.8	0.1	-0.4	-0.7
c) U.S. net purchases (-) of foreign securities	-7.0	-4.6	0.7	-0.8	-1.3	-3.2	-0.4	-1.3	-0.5
3. Foreign net purchases (+) of U.S. Treasury obligations 1/	8.3	22.5	1.3	6.5	5.1	9.5	2.2	4.6	0.5
Official Capital									
4. Changes in foreign official reserve assets in U.S. (+ = increase)	5.2	2.7	-3.1	-0.8	-0.7	7.0	2.0	2.4	-[illegible]
a) By area									
G-10 countries (incl. Switz.)	6.4	3.0	2.3	-0.7	-0.8	2.2	1.8	-1.0	0.1
OPEC	-8.5	-5.3	-2.8	-2.4	-0.7	0.5	-2.6	3.0	-0.5
All other countries	7.3	5.0	-2.5	2.4	0.8	4.2	2.8	0.3	-3.7
b) By type									
U.S. Treasury securities	7.0	4.7	-0.2	-0.3	-0.6	5.8	3.2	2.3	-0.8
Other 2/	-1.7	-2.0	-2.7	-0.5	-0.1	1.1	-1.1	*	-3.3
5. Changes in U.S. official reserve assets (+ = decrease)	-1.2	-2.7	-0.7	-0.6	-0.8	-1.1	-0.4	-0.5	0.4
Other transactions (Quarterly data)									
6. U.S. direct investment (-) abroad	-4.9	-6.0	-3.5	2.1	1.9	-6.6	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	11.3	21.2	2.4	8.8	5.3	4.7	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow) 3/ 4/	-1.3	5.1	1.4	6.5	-0.1	-0.2	n.a.	n.a.	n.a.
9. U.S. current account balance 4/	-41.6	-101.6	-19.7	-24.7	-33.6	-23.7	n.a.	n.a.	n.a.
10. Statistical discrepancy 4/	9.3	30.0	6.0	3.3	13.8	7.0	n.a.	n.a.	n.a.
MEMO:									
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-61.1	-107.4	-25.8	-25.8	-32.9	-22.9	-8.6	-6.4	-10.1

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

may be converted into its domestic companion at any time beyond 45 days after the date of auction. The Treasury reports that approximately 25 percent of the foreign targeted securities which have been issued have subsequently been converted into the domestic companion securities. This development may in turn increase the relative uncertainty of dealing in the secondary market for foreign targeted securities as the total stock of these securities outstanding diminishes.

Foreign net purchases of U.S. corporate bonds totaled $13.7 billion in 1984, sharply higher than in 1983 [line 2a]. Much of the increase occurred in the fourth quarter of 1984 when a $10.1 billion net inflow was recorded. Legislation to repeal the withholding tax on interest payments to foreigners at mid-year and the clarification of the TEFRA (Tax Equity and Fiscal Responsibility Act of 1982) regulations in late August resulted in a shift in location for the issue of Eurobonds by U.S. corporations from the Netherlands Antilles to the United States. Previously, the proceeds of Eurobond sales, when repatriated to the United States, were recorded as a reduction in U.S. direct investment abroad, (line 6) rather than as foreign net purchases of U.S. corporate securities.

Eurobond issuance by U.S. corporations was strong through January of 1985, but there are some signs of a slowdown in activity. Several forces may combine to diminish the issuance of Eurobonds. First, increased underwriting competition in recent months appears to have eroded profit margins and there has been a large buildup of underwriters' inventories. In the absence of expectations that interest rates will fall many underwriters may be reluctant to participate vigorously. Second, in recent months, many large U.S. bank holding companies have issued large amounts of mandatory convertible securities in the Euromarkets to augment their primary capital, but several of the large bank holding companies have reached, or are approaching, the limit on the amounts raised in this manner that can be counted as capital for regulatory purposes. Finally, the decision of the Japanese government to eliminate the foreign withholding tax on European bond issues by Japanese companies as of April 1, removes an incentive for U.S. and Japanese firms to issue yen and dollar bonds, respectively, in the Euromarkets and then swap the payments obligations.

Turning now to other capital flows, banking offices in the United States recorded a large net inflow in January, more than offsetting the outflow at the end of 1984. Foreign official holdings in the U.S. fell by $4.1 billion in January of 1985, in part due to a $1.0 billion decline in the holdings of Latin American countries. Partial data from FRBNY for February indicates that official reserve assets in the United States fell substantially .

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1981	1982	1983	1984				1985	
	Dec.	Dec.	Dec.	Mar.	June	Sept.	Dec.	Jan.	Feb.
1. Net Claims of U.S. Banking Offices (excluding IBFs) on Own Foreign Offices	7.8	32.9	39.3	35.3	32.2	30.2	25.4	29.9	25.5
2. Net Claims of U.S. Banking Offices on Own IBFs 1/	11.8	16.2	5.2	4.1	4.4	6.3	7.8	7.9	8.9
3. Sum of lines 1 and 2 of which:	19.6	49.1	44.5	39.4	36.6	36.3	33.3	37.8	34.4
(a) U.S.-chartered banks	22.3	40.0	40.8	36.9	34.7	35.7	32.1	35.6	32.5
(b) Foreign-chartered banks	-2.6	9.1	3.7	2.5	1.9	.6	1.2	2.2	1.8
4. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	13.2	15.8	18.7	18.5	19.9	20.2	20.7	20.7	20.6
5. Eurodollar Holdings of U.S. Nonbank Residents 2/	95.5	112.6	124.2	126.5	124.3	122.7	117.4	117.3	117.5

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. Include terms and overnight Eurodollars held by money market mutual funds.

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.

U.S. Merchandise Trade

In January, the U.S. merchandise trade deficit increased from a relatively low December rate; exports (other than agricultural shipments) continued at relatively strong December levels, and imports (other than oil) turned up after several low months.

The strength of nonagricultural exports in January, as in December, was primarily in machinery (particularly office machines and other electronic items) and in passenger car exports to Canada. Industrial supplies contributed a smaller part of the recent strength. Agricultural exports in January, especially wheat and soybeans, dropped off from rates recorded in the fourth quarter; fourth-quarter shipments had benefited from a surge in exports of grain to the U.S.S.R.

U.S. MERCHANDISE TRADE[1/]

	Years		1984				
	1983	1984	Q1-r	Q2-r	Q3-r	Q4	Jan.
Value (Bil. $, SAAR)							
Exports	200.3	220.3	215.7	218.2	222.5	225.0	227.6
Agricultural	36.6	38.4	41.4	37.2	36.3	38.7	36.4
Nonagricultural	163.6	181.9	174.3	180.9	186.2	186.3	191.1
Imports	261.3	327.8	318.9	321.4	354.2	316.6	348.5
Oil	53.8	57.3	55.4	59.6	57.8	56.4	48.0
Nonoil	207.5	270.5	263.5	261.8	296.4	260.2	300.6
Trade Balance	-61.1	-107.4	-103.3	-103.2	-131.8	-91.5	-120.9
Volume (Bil 72$, SAAR)							
Exports							
Agricultural	16.3	16.3	17.1	15.2	15.4	17.5	n.a.
Nonagricultural	57.3	63.0	60.5	62.5	64.6	64.4	n.a.
Imports							
Oil	4.9	5.3	5.1	5.5	5.4	5.3	n.a.
Nonoil	81.9	103.8	102.1	100.3	113.2	99.5	n.a.

r/ Revised.
1/ International transactions and GNP basis.

The rise in imports in January followed a decline in December. Month-to-month movements in nonoil imports are very erratic. However, by averaging monthly developments, it appears that following a strong surge in imports in the middle of the year (April through September), imports eased in the fourth quarter, as did U.S. domestic demand. In January, nonoil imports increased from relatively low fourth-quarter rates. The rise in nonoil imports in January appears to have been generally in capital goods (particularly office machines and other electronic equipment), in passenger cars from Europe, and some industrial supplies such as steel and textiles.

Oil imports have declined steadily in recent months in both price and volume. The volume of oil imported in January was 4.8 million barrels per day compared with 5.1 mbd in December and an average of 5.8 mbd in the October-November period; between November and January, the average price of imported oil dropped by about 55 cents per barrel.

OIL IMPORTS

	Years		1984				
	1983	1984	Q1	Q2	Q3	Q4	Jan.
Volume (mbd, SA)	5.20	5.60	5.40	5.76	5.66	5.59	4.84
Price ($/BBL)	28.42	27.95	28.05	28.26	27.91	27.59	27.19
Value (Bil. $, SAAR)	53.80	57.31	55.40	59.61	57.84	56.38	47.99

March 19, 1985

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

	1983	1984	1984 Q1r	1984 Q2r	1984 Q3r	1984 Q4	$ Changes Q4-Q3	$ Changes Yr84-Yr83
1. Trade Balance	-61.0	-107.4	-103.3	-103.2	-131.8	-91.5	40.3	-46.4
2. Exports	200.3	220.3	215.7	218.2	222.5	225.0	2.5	20.1
3. Imports	261.3	327.8	318.9	321.4	354.2	316.6	-37.6	66.4
4. Investment income, net	23.5	18.1	31.0	13.8	11.5	16.2	4.6	-5.4
5. Direct investment, net	14.0	12.4	23.6	7.5	6.2	12.1	5.9	-1.7
6. Capital gains or losses 1/	-7.2	-8.0	0.2	-11.8	-15.1	-5.2	9.9	-0.8
7. Other D.I. income	21.2	20.4	23.4	19.3	21.3	17.3	-4.0	-0.9
8. Portfolio income net	9.5	5.8	7.3	6.4	5.3	4.1	-1.2	-3.7
9. Military, net	0.5	-1.6	-1.5	-1.6	-1.3	-2.2	-0.9	-2.2
10. Other services, net	4.1	0.5	3.7	0.8	-1.4	-1.1	0.3	-3.6
11. Unilateral transfers	-8.7	-11.2	-8.6	-8.6	-11.4	-16.1	-4.7	-2.5
12. Current Account Balance	-41.6	-101.6	-78.7	-98.8	-134.4	-94.7	39.7	-60.1
13. Excluding capital gains or losses	-34.4	-93.6	-78.9	-87.0	-119.3	-89.5	29.8	-59.3
Memo:								
Statistical discrepancy	9.3	30.0	23.8	13.2	55.0	28.0	-27.0	20.7

1/ Gains or losses on foreign-currency denominated assets owing to their revaluation at current exchange rates, and other valuation adjustments. Plus = gains; minus = losses.

U.S. Current Account in 1984

For the year 1984, the U.S. current account balance was in deficit by $102 billion; this compares with a deficit of $42 billion for the year earlier. About three-fourths of the increase in the deficit was attributable to merchandise trade -- imports expanded faster than exports rose. In addition, net investment income receipts were reduced in 1984, largely a result of interest payments on liabilities to foreigners increasing faster than interest receipts from U.S. claims on foreigners; net direct investment income receipts were also somewhat less in 1984 than in 1983. A reduction in exports of military goods and services, increased U.S. payments for other services (travel abroad, transportation costs, etc.), and increased unilateral transfers (importantly government grants) also contributed to the widening of the current account deficit in 1984.

Foreign Economic Developments. Economic activity in the major foreign industrial countries has continued to expand, but only Japan has experienced robust growth. Growth in Japan accelerated markedly in the fourth quarter of 1984, in large part owing to increases in net exports and spending on plant and equipment. Growth of real gross national product in the fourth quarter slowed in Germany, France, and Canada. Industrial production has declined in recent months in Japan and Continental Europe, while it remained relatively unchanged in the Canada and and rose in the United Kingdom. The unusually cold winter in Europe may have contributed somewhat to the recent decline in output.

Unemployment remains at historically high rates in all countries, with recent data indicating slightly higher unemployment in Germany, France, the United Kingdom, and Italy than at the beginning of 1984. Unemployment has been slightly lower than a year ago only in Japan and Canada. Inflation abroad remains low, although there is some indication that further reductions in some countries' rates may be difficult to achieve this year.

Record trade and current account surpluses were registered by Japan and Canada in 1984, while the United Kingdom's trade deficit narrowed in the most recent data. Germany continued to be in surplus on current account in January, and France's trade deficit in 1984 was much less than in 1983. Italy experienced an increase in its trade deficit in January.

March 20, 1985

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

	Q4/Q4 1983	Q4/Q4 1984	1984 Q1	1984 Q2	1984 Q3	1984 Q4	1984 OCT.	1984 NOV.	1984 DEC.	1985 JAN.	1985 FEB.	LATEST 3 MONTHS FROM YEAR AGO+
CANADA												
GNP	7.1	3.7	.7	.8	1.6	.6	*	*	*	*	*	3.7
IP	16.1	5.1	.2	1.5	3.2	.2	.5	1.5	.5	N.A.	N.A.	5.1
FRANCE												
GDP	.8	1.9	1.1	-.4	.8	.3	*	*	*	*	*	1.9
IP	1.8	1.0	1.5	-1.3	2.8	-2.0	2.3	-1.5	-2.3	-1.6	N.A.	-2.0
GERMANY												
GNP	3.0	2.9	1.2	-2.0	2.2	1.5	*	*	*	*	*	2.9
IP	6.0	3.9	.6	-4.7	5.6	2.5	3.6	-.4	.4	-2.0	N.A.	2.4
ITALY												
GDP	1.2	N.A.	.8	.7	1.1	N.A.	*	*	*	*	*	3.2
IP	1.7	1.6	1.0	.5	1.9	-1.8	-2.5	-1.0	.4	N.A.	N.A.	1.6
JAPAN												
GNP	3.9	6.3	1.4	1.8	.6	2.3	*	*	*	*	*	6.3
IP	8.6	10.7	3.2	2.8	1.5	2.8	3.3	.3	-.7	-.2	N.A.	9.5
UNITED KINGDOM												
GDP	4.0	N.A.	.8	-.8	.6	N.A.	*	*	*	*	*	1.8
IP	5.3	-.0	.6	-2.1	.3	1.2	.1	.4	.5	1.3	N.A.	-.1
UNITED STATES												
GNP	6.3	5.9	2.4	1.7	.4	1.2	*	*	*	*	*	5.9
IP	15.0	5.9	2.7	2.1	1.6	-.5	-.4	.2	.1	.3	-.5	4.3

* DATA NOT AVAILABLE ON A MONTHLY OR QUARTERLY BASIS.

+ IF QUARTERLY DATA, LATEST QUARTER FROM YEAR AGO.

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

	Q4/Q4 1983	Q4/Q4 1984	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 Q3	1984 Q4	1984 NOV.	1984 DEC.	1985 JAN.	1985 FEB.	LATEST 3 MONTHS FROM YEAR AGO
CANADA													
CPI	4.6	3.7	1.6	.9	1.2	.9	.9	.7	.6	.1	.4	.6	3.7
WPI	3.5	3.6	.9	.4	1.6	1.2	.5	.3	.4	.2	.5	N.A.	3.6
FRANCE													
CPI	9.8	6.8	2.1	1.9	1.7	1.8	1.7	1.4	.3	.2	.5	.5	6.5
WPI	14.6	10.5	3.7	3.6	3.4	2.9	2.1	1.7	.3	.0	.5	N.A.	9.2
GERMANY													
CPI	2.7	2.0	1.0	.5	.9	.5	.0	.7	.1	.1	.7	.4	2.1
WPI	.9	1.0	.9	1.2	1.7	.8	-1.4	.0	-.6	.1	.6	1.3	.5
ITALY													
CPI	12.8	8.8	2.3	3.5	2.9	2.1	1.2	2.2	.6	.7	1.0	1.0	8.6
WPI	9.1	8.8	2.3	3.3	3.2	2.2	1.2	1.9	.2	.2	1.4	N.A.	8.4
JAPAN													
CPI	1.9	2.4	-.2	1.4	.9	.6	-.2	1.2	-.4	.2	1.0	-.7	2.6
WPI	-3.3	.5	.2	-.6	.1	-.1	.8	-.3	-.2	.1	.3	.3	.6
UNITED KINGDOM													
CPI	5.1	4.8	1.3	1.1	.6	2.0	.9	1.2	.3	-.1	.4	N.A.	4.8
WPI	5.6	6.0	.8	1.3	1.8	2.3	.6	1.3	.3	.4	.7	.5	6.1
UNITED STATES													
CPI (SA)	3.2	4.1	1.0	1.0	1.3	.9	.9	.9	.2	.3	.2	N.A.	3.8
WPI (SA)	.8	1.7	.6	.3	1.2	.4	.0	.1	.3	.2	-.0	-.1	1.2

March 20, 1985

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

	1983	1984	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 Q3	1984 Q4	1984 OCT.	1984 NOV.	1984 DEC.	1985 JAN.
CANADA												
TRADE	14.4	16.1	3.1	3.5	3.5	4.1	4.1	4.4	1.9	1.4	1.1	1.1
CURRENT ACCOUNT	1.4	1.6	-.2	.0	.0	.5	.5	.6	*	*	*	*
FRANCE												
TRADE 2/	-5.9	-2.6	-.6	-.2	-1.5	-1.1	.4	-.3	-.4	.1	-.1	-.4
CURRENT ACCOUNT 2/	-4.9	-.1	.1	.2	-.7	-.4	.9	.1	*	*	*	*
GERMANY												
TRADE	16.4	18.8	3.7	3.4	4.3	3.2	5.0	6.3	2.2	2.1	1.9	N.A.
CURRENT ACCOUNT (NSA)	4.1	6.0	-2.3	3.7	.7	-.2	-.6	6.0	2.0	2.0	2.1	.2
ITALY												
TRADE	-7.8	-10.5	-2.1	-1.3	-2.5	-3.0	-1.6	-3.4	-1.0	-2.3	-.1	-1.3
CURRENT ACCOUNT (NSA)	.6	N.A.	1.5	-.1	-1.7	-1.0	N.A.	N.A.	*	*	*	*
JAPAN												
TRADE 2/	31.2	44.5	8.5	8.2	10.0	11.1	10.1	13.2	4.0	5.2	4.0	4.9
CURRENT ACCOUNT	21.0	35.0	5.7	5.5	7.2	9.2	7.4	11.5	3.4	4.3	3.8	4.2
UNITED KINGDOM												
TRADE	-.8	-5.7	-.4	-.0	-.2	-1.8	-2.1	-1.6	-1.0	-.2	-.4	-.1
CURRENT ACCOUNT 2/	4.4	1.3	1.2	.9	.6	.9	-.7	.5	.1	.3	.1	.4
UNITED STATES												
TRADE	-61.1	-107.6	-17.5	-19.4	-25.8	-25.8	-32.9	-22.9	-7.9	-8.6	-6.4	-10.1
CURRENT ACCOUNT	-41.6	-101.6	-11.8	-17.2	-19.7	-24.7	-33.6	-23.7	*	*	*	*

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

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

Individual Country Notes. In Japan, real GNP last year rose by 6.3 percent on a Q4/Q4 basis, the highest rate of growth since 1972. Domestic demand rose by 3.8 percent, compared with a 2.5 percent increase in 1983. Real growth in the fourth quarter accelerated to 9-1/2 percent (s.a.a.r.) from a downward revised 2-1/2 percent in the third quarter. A large part of the acceleration in the fourth quarter can be attributed to the external sector. Exports rose, while imports slowed from the advanced pace of the third quarter. More recent indicators of activity are mixed. Industrial production declined in December and January after a total increase of 3-1/2 percent during October and November. On the other hand, an Economic Planning Agency survey in December shows strong investment plans for the first half of this year by major corporations. Also, department store sales and sales of passenger cars point to stronger consumer spending.

Inflation in Japan remains low. The Tokyo consumer price index in the first two months of this year was about 2-1/2 percent above that of a year earlier. Large surpluses continue to be seen in the external accounts. In the three-month period ending in January, the trade and current accounts showed record surpluses of $56 billion and $49 billion (s.a.a.r.), respectively.

In the face of such large external surpluses, the Japanese government has become increasingly concerned about foreign perceptions that its policies are protectionist. The United States, for one, is seeking to make the Japanese market more open. Sector specific trade talks are being held in the areas of telecommunications, forest products, electronics, and pharamaceuticals and medical equipment. The first area is the most urgent as the Japanese government is now drafting regulations and technical standards in association with the April 1 deregulation of the telecommunications industry. There is concern that these regulations will be drafted so as to inhibit foreign competition. There is also reason to believe that the Japanese will show some restraint on promoting exports. In particular, after the elimination of the voluntary export restraints on automobiles, many observers expect that the Japanese government will attempt to regulate the increase in such exports to the United States.

Real gross national product in Germany grew by 2.9 percent from the fourth quarter of 1983 to that of 1984. Growth decelerated at the end of 1984. Industrial production in Germany fell 2 percent in January to a level only slightly higher than in January 1984. Unusually severe winter weather, which depressed construction activity in particular, was an important factor in this setback. However, the volume of orders continued to grow in January, suggesting that the lull in production activity may have been temporary. The seasonally adjusted rate of unemployment was unchanged at 9.2 percent in February.

Although the consumer price index rose only 2.3 percent in the twelve months preceding February, it accelerated in January and February to an annual rate of increase of about 6 percent (n.s.a.), in part reflecting seasonal factors. Import prices have been rising rapidly with the recent strength of the dollar against the mark.

Wholesale and producers prices in January are also showing some acceleration.

The current account showed a small surplus in the month of January. German exports to the United States and Canada rose by 42 percent in 1984, whereas imports rose by 13 percent. North America's share of total German exports rose from 8 percent in 1983 to 10.5 percent in 1984. The increase in exports to North America in 1984 amounts to about 1-1/4 percent of German nominal gross national product.

By the third week in March, short-term market interest rates were once again above the Lombard rate, which had been raised to 6 percent on February 1 for the stated purpose of keeping that rate above market rates. The Bundesbank's infusions of liquidity necessary to keep market rates low in February and early March were probably inconsistent with the Central Bank Money target for 1985. Central Bank Money growth for January was well above the 5 percent upper limit of the target.

Economic activity in France has remained weak in recent months. Industrial production declined by 3.9 percent (s.a.) in total in December and January and was 4.5 percent below its level of a year ago. Real growth of gross domestic product in the fourth quarter fell to 1.4 percent (s.a.a.r.), and the increase from the fourth quarter of 1983 was only 1.9 percent. The unemployment rate rose a further 0.1 percentage point in January to 10.6 percent (s.a.).

Consumer prices increased by 0.5 percent (n.s.a.) in February as the year-over-year inflation rate declined further to 6.4 percent. The government announced that public sector wage increases would be limited to 3-1/2 percent in 1985, in line with the government's inflation target of 4-1/2 percent.

The targeted monetary aggregate M2R declined for the second consecutive month in November, reducing its growth rate in 1984 to only 4.2 percent (s.a.a.r.), below the lower bound of its 5-1/2 percent to 6-1/2 percent target range for 1984.

The trade deficit in January was $400 million (s.a.) after a $60 million deficit in December. For 1984 as a whole, trade was in deficit by $2.6 billion, less than half the $5.9 billion deficit of the previous year.

According to provisional data, real gross domestic product (output measure) in the United Kingdom grew 4.2 percent (s.a.a.r.) in the fourth quarter to achieve a growth rate of 2.1 percent on a Q4/Q4 basis. Despite the depressing influence of the coal miners' strike, the industrial production index rose 1.3 percent (s.a.) in January to reach the highest level since January 1980. The year long strike ended on March 4, 1985, when the National Union of Mineworkers voted to return to work without reaching agreement with the National Coal Board over the closure of loss-making pits. At the time of the vote, over half the miners were ignoring the strike call. Although some union leaders have threatened to wage some sort of unspecified "guerilla warfare" until the issues leading to the strike are resolved, the credibility of this threat is uncertain. A resumption of normal coal production would add an estimated 1 percent to measured gross domestic product this year.

The unemployment rate rose slightly to 13 percent (s.a.) in February. The retail price index in January was 5 percent above its year-earlier level, an annual rate of increase similar to that prevailing for most of 1984. The monthly trade deficit narrowed from $400 million (s.a.) in December to $90 million (s.a.) in January as a result of lower imports. After being in near balance in 1984, the monthly current account in January was in surplus by $360 million (s.a.).

The U.K. government budget proposals for fiscal year 1985/86 have just been presented to Parliament. The new targets for money growth during the fourteen months from February 1985 to April 1986 are: sterling M3, 5 to 9 percent (a.r.); and M0 (the monetary base), 3 to 7 percent (a.r.). These ranges are slight reductions from the 1984/85 targets; through January, sterling M3 is just above the top of its current target range, while M0 is near the middle. Only slight changes have been proposed for taxes and expenditures. The tax measures include increases in the real value of personal exemption amounts, higher excise taxes for some goods (for example beer, wine, and cigarettes), and some extension of the indexing provisions that apply to capital gains. As of October 1985, employment tax reforms will lower the effective rate levied on low incomes and raise that on the high incomes. The net effect of the measures is forecast to be a public sector borrowing requirement (PSBR) of £7 billion (2 percent of GDP). Expenditure overruns and expenses associated with the prolonged strike by coal miners resulted in the PSBR for this fiscal year rising to £10.5 billion (3-1/4 percent of GDP).

Following the release of the budget message, Bank of England official money market dealing rates were cut by one-half percentage point. At the same time, major London clearing banks announced reductions in their base lending rates from 14 to 13.5 percent.

Canadian gross national product increased at an annual rate of 2.4 percent in the fourth quarter of 1984, slower than the third quarter increase. On a Q4/Q4 basis, growth was 3.7 percent. Almost 95 percent of the increase in gross national product was accounted for by increases in consumption expenditure and a record trade surplus. Total real investment expenditure increased slightly and by year end was 13 percent below the peak average quarterly pace reached in 1981. The unemployment rate in February was in 11.0 percent up from December's 10.8 percent. The unemployment rate has been at or above 11 percent for 29 of the last 31 months.

Inflation continued to be moderate. Consumer prices were 3.7 percent higher in January than they had been a year earlier. In addition, the industry selling price index was only 3.3 percent higher than a year earlier, compared with an annual rise of 3.6 percent in December. The trade surplus in 1984 was a record $16.1 billion, compared with a surplus of $14.4 billion in 1983. More recently, the trade surplus was $1.12 billion in January up slightly from December's $1.08 billion. The current account showed a surplus of $1.6 billion in 1984, compared with a surplus of $1.4 billion in 1983.

The recovery in Italy continued at a moderate pace at the end of 1984. Industrial production was 1.6 percent higher in the fourth quarter of 1984 than in that of 1983, but it has still not reached the peak achieved in April 1980. The year-over-year rate of inflation as measured by the consumer price index in February was 8.6 percent. This rate has stopped coming down in the last three months, and there is some concern that the government's official goal of a 7 percent rate for the end of this year may be unattainable. Still, the official January household survey shows that consumers have increased confidence in the general economic situation of the country.

The trade deficit in 1984 was $10.5 billion (s.a.), a greater deficit than that of $7.8 billion (s.a.) in 1983; the January trade deficit was more than $1.3 billion (s.a.). In recent weeks, the lira has been depreciating against the mark and the ECU, while the mark has been falling against the dollar. This depreciation of the lira is a reversal of the situation of the last year, and some analysts feel that the market has been reacting according to expectations of a devaluation of the lira within the European Monetary System.

The Swedish government imposed an indefinite general price freeze effective March 6. The freeze was introduced to keep inflation within the government's 3 percent target for 1985. Imports of goods and intermediate inputs are exempt from the freeze, which could be lifted if firms pledged not to raise prices beyond what the government considers appropriate. A price freeze had been imposed from April 17, 1984, to July 1, 1984; in spite of that freeze, prices in 1984 rose by 8.2 percent, more than twice the government's target of 4 percent. In January, consumer prices were 7.3 percent higher than a year earlier.

Debt Situation in Selected Developing Countries

In Mexico, the rate of crawl of the peso was increased on March 6 from 17 to 21 centavos per day. If this rate of crawl is maintained until the end of 1985, the peso price of the dollar at year-end will be about 38 percent higher than a year earlier. However, most observers expect the Mexican rate of inflation on a December-to-December basis to be 45-50 percent. The rates of interest on time deposits, which had remained unchanged since mid-November and had turned negative in real terms as inflation rose, were increased sharply on March 11 so as to restore positive real yields. Earlier, the authorities announced cuts in public sector spending amounting to 1.4 percent of total budgeted public expenditures and to about 0.5 percent of GDP. This step was taken in part to intensify efforts to reduce the public sector deficit and in part to offset the loss of public revenues resulting from a $1.25 per barrel reduction in the export price of light crude oil announced at the beginning of February. Over a full year, the oil export price reduction is estimated to reduce export earnings by about $300 million. At the same time as they reduced the oil price, the authorities raised the self-imposed ceiling on oil exports from 1.4 million barrels per day back to 1.5 mbd. The size of the 1985 public sector deficit has been an issue in Mexico's discussions with the IMF on the terms of the program for 1985, the last year of the IMF Extended Fund Facility agreement. However, it is expected that the matter will be resolved shortly and that a program will be presented to the IMF Executive Board in April for consideration in May. Drafting of the multi-year debt restructuring agreement reached last September took longer than originally anticipated, but the documentation was sent to the participating banks on March 2 and final signing is expected to begin on March 29. The Mexican monthly rate of inflation bulged to 7.4 percent in January, but eased to 4.2 percent in February. Real GDP growth in 1984 was 3.5 percent, well above the 2-3 percent range mentioned most recently as likely to have been reached.

Brazil must negotiate an amended IMF program for 1985 since monetary and fiscal developments in late 1984 and early 1985 have made the targets of the agreement reached in November 1984 unrealistic. Preliminary agreement on the terms of a multi-year rescheduling covering about $45 billion in public and private sector debt due between 1985 and 1991 has been reached. The terms include a maturity of 16 years, a grace period effectively averaging six years, and a reduction in the average spread from an average close to 2 percentage points to 1-1/8 for Brazilian public sector debt and 1-1/4 for private sector debt. However, the commercial banks will not complete the agreement on the rescheduling until the IMF indicates its endorsement of the Brazilian program and the new government of Tancredo Neves signals its approval. A telex has gone out to the banks putting in place interim arrangements and asking the banks to maintain their trade and interbank lines after the February 19 expiration of existing commitments. So far this year, the Brazilian trade surplus has been below that recorded in the same months of 1984. In January and February the trade surplus averaged $556 million, $177 million less than the January-February 1984 level. Inflation moderated somewhat in February to a monthly rate of 10.2 percent; in the 12 months since February 1984 general prices rose 226 percent. In January, the comparable figures were 12.6 and 232 percent, respectively. However, recent monetary growth data seem to indicate that the moderation of inflation could be short-lived. Between February 1984 and February 1985, the monetary base grew 269 percent, up considerably from the 220 percent rate registered during the 12-month period ending January 1985. On March 18, the new government announced some measures aimed at limiting the growth in public spending and inflation. The measures included a three-month moratorium on spending on new public projects, a three-month suspension of government credit for export, finance, and agricultural projects, a 10 percent cut in the budget approved by the former government, and a two-month freeze on government borrowing on the domestic money market.

Argentina has exceeded some of the quantitative performance limits specified in its IMF stand-by agreement for the end of 1984 and would require a waiver to be able to make the first-quarter drawing under the stand-by. If Argentina and the IMF are unable to agree quickly on the steps necessary to put the program back on track, the bank package of new money and debt rescheduling arranged with Argentina's bank advisory committee at the end of November may well be at risk. The deviations from the program are in the fiscal area and in the "operating losses" of the central bank. Not only has public spending been excessive, in large part as a consequence of the compensatory wage increases granted during the fourth quarter, but in addition public sector revenues have been weak and the adjustment of public sector prices has lagged inflation. Monetary policy was eased in late December and the first two months of 1985, with the result that the free market premium for the dollar rose sharply while unregulated domestic interest rates declined almost to the level of the regulated rates. However, following the replacement of the top leadership of the economic team on February 18, there has been some reversal in monetary policy: regulated interest rates have been raised by 2 percentage points per month, and the degree of monetary ease has been reduced somewhat, with the result that the unregulated interest rates have risen by 5 percentage points per month (to 26.6 percent on March 13) and the free market premium on the dollar has declined from about 40 percent to about 34 percent between late February and March 13. The CPI rose by 25 percent in January and by 20.7 percent in February, when it was 804 percent higher than in February 1984. The official peso price of the dollar kept pace with prices in this period. Beginning in March, monthly wage increases are to be set at 90 percent of the previous month's inflation rate, with quarterly catch-up raises payable early in the next quarter.

In the Philippines, the proposed signing on February 26 of loan agreements with the creditor commercial banks for $925 million in new credits and a rescheduling of about $4.8 billion in debts had to be postponed. This was attributable mainly to the reluctance of one bank to participate in the new credit and rescheduling. On March 4 an IMF mission began its scheduled review of the Philippine economic situation. The IMF team is reportedly concerned that the peso has shown too much strength recently and that the country's export performance has been poor. During the fourth quarter of last year, exports were up only 2 percent over the same period a year earlier. By the end of this month, the Philippine authorities will be required to meet an important performance criterion for reserve money (a type of monetary base concept). At the end of February, reserve money was 8 percent above the end-March ceiling. Last December, the Philippines exceeded the reserve money ceiling and as a consequence became ineligible to make its second drawing under the IMF program during March.

Venezuela and its bank advisory committee are nearing completion on the terms sheet for the multi-year rescheduling agreement negotiated last September. Previous disagreements about provisions for currency switching of dollar denominated debt and the obligation of the public sector to provide foreign exchange to private sector debtors have been essentially resolved. The terms sheet should be completed by early April, with circulation to Venezuela's 450 creditor banks beginning in late April or early May. Before the final signing of the rescheduling agreement, however, Venezuela must show further progress in the registration of some $10 billion in private sector debt. Roughly $7.5 billion of this private sector debt has been registered so far. Venezuelan officials claim that the entire private sector debt to financial institutions will be registered by the end of this month.

In Peru, the government has continued to implement an adjustment program, including an acceleration of daily devaluations, increases in gasoline prices and sales taxes, and a halt or a slowing of public investment projects. In support of the program, the U.S. government recently released $30 million in disaster aid from 1983 that had been suspended when Peru fell out of compliance with its IMF program. The IMF may suggest a set of interim targets prior to negotiation of a program with the new government to be elected later in the year.

Interest arrears to commercial banks now approach $350 million. However, Peru made a payment of $22 million in mid-February, and the government has announced its intention to make similar payments each month for the remainder of the present administration's term, which ends July 28, 1985. In return, the bank advisory committee has agreed to recommend that trade credit lines be maintained at their present level of between $300 and $350 million. Maturing medium- and long-term debt is being rolled over on a continuing basis for 30-day periods.

The Chilean government recently reached a tentative agreement with the IMF on a three-year, SDR 750 million, Extended Fund Facility arrangement. Under the program, the public sector deficit for 1985 is targeted at 3.5 percent of GDP (versus about 4.5 percent estimated for 1984). The current account deficit is also forecast to drop from $2 billion in 1984 to under $1.4 billion in 1985. The government is confident that it can come close to meeting these ambitious targets despite the damage caused by the major earthquake that struck Santiago and surrounding cities on March 3. The earthquake caused major damage to roads, housing, and other infrastructure. Chilean exports are likely to decline temporarily since port facilities and copper mines and refineries suffered significant damage. The IMF has agreed to allow the government deficit in 1985 to be "front-loaded" in order to speed the recovery from the earthquake.