## Prefatory Note

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

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

---

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

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

Confidential (FR) Class III FOMC

March 25, 1987

# RECENT DEVELOPMENTS

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

TABLE OF CONTENTS

DOMESTIC FINANCIAL DEVELOPMENTS--continued



Tables



INTERNATIONAL DEVELOPMENTS IV



Tables



Charts

SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

| | Latest Period | | | Percent change from | | |
|---|---|---|---|---|---|---|
| | Period | Release date | Data | Preceding period | Three periods earlier | Year earlier |
| | | | | (At annual rates) | | |
| Civilian labor force | Feb. | 03-06-87 | 119.3 | 3.2 | 2.3 | 2.0 |
| Unemployment rate (%)[1] | Feb. | 03-06-87 | 6.7 | 6.7 | 6.9 | 7.2 |
| Nonfarm employment, payroll (mil.) | Feb. | 03-06-87 | 102.0 | 4.0 | 3.6 | 2.6 |
| Manufacturing | Feb. | 03-06-87 | 19.2 | 3.1 | 1.4 | -.4 |
| Nonmanufacturing | Feb. | 03-06-87 | 82.8 | 4.2 | 4.1 | 3.3 |
| Private nonfarm | | | | | | |
| Average weekly hours (Hr.)[1] | Feb. | 03-06-87 | 35.0 | 34.8 | 34.8 | 34.9 |
| Hourly earnings ($)[1] | Feb. | 03-06-87 | 8.87 | 8.83 | 8.84 | 8.71 |
| Manufacturing | | | | | | |
| Average weekly hours (Hr.)[1] | Feb. | 03-06-87 | 41.2 | 40.9 | 40.8 | 40.7 |
| Unit labor cost (1967=100) | Jan. | 03-03-87 | 77.9 | -9.2 | -11.5 | -5.7 |
| Industrial production (1977=100) | Feb. | 03-13-87 | 127.3 | 4.7 | 4.1 | 1.6 |
| Consumer goods | Feb. | 03-13-87 | 127.5 | 6.6 | 6.1 | 3.4 |
| Business equipment | Feb. | 03-13-87 | 138.9 | 12.2 | .9 | -1.1 |
| Defense and space equipment | Feb. | 03-13-87 | 187.2 | 4.5 | 5.0 | 6.2 |
| Materials | Feb. | 03-13-87 | 115.5 | 2.1 | 4.2 | .6 |
| Consumer prices, all items (1967=100) | Jan. | 02-27-87 | 333.6 | 8.0 | 4.4 | 1.5 |
| All items, excluding food and energy | Jan. | 02-27-87 | 334.1 | 6.1 | 4.1 | 3.8 |
| Food | Jan. | 02-27-87 | 328.6 | 5.1 | 4.2 | 4.3 |
| Producers prices: (1967=100) | | | | | | |
| Finished goods | Feb. | 03-13-87 | 291.9 | .8 | 2.3 | .1 |
| Intermediate materials, nonfood | Feb. | 03-13-87 | 315.0 | 6.1 | 6.1 | -1.6 |
| Crude foodstuffs and feedstuffs | Feb. | 03-13-87 | 226.6 | -.5 | -16.9 | .8 |
| Personal income ($ bil.)[2] | Feb. | 03-19-87 | 3581.3 | 11.0 | 6.6 | 4.2 |
| | | | | (Not at annual rate) | | |
| Mfgrs. new orders dur. goods ($ bil.) | Feb. | 03-24-87 | 101.2 | 6.0 | .5 | -.3 |
| Capital goods industries | Feb. | 03-24-87 | 33.3 | 5.9 | -11.9 | -9.3 |
| Nondefense | Feb. | 03-24-87 | 26.3 | -1.6 | -3.6 | -4.9 |
| Defense | Feb. | 03-24-87 | 7.0 | 48.9 | -33.5 | -22.7 |
| Inventories to sales ratio:[1] | | | | | | |
| Manufacturing and trade, total | Jan. | 03-24-87 | 1.50 | 1.42 | 1.47 | 1.49 |
| Manufacturing | Jan. | 03-24-87 | 1.68 | 1.61 | 1.67 | 1.71 |
| Trade | Jan. | 03-13-87 | 1.36 | 1.27 | 1.32 | 1.30 |
| Ratio: Mfgrs.' durable goods inventories to unfilled orders[1] | Jan. | 03-24-87 | .583 | .574 | .511 | .518 |
| Retail sales, total ($ bil.) | Feb. | 03-12-87 | 122.3 | 4.1 | 1.0 | 4.4 |
| GAF[3] | Feb. | 03-12-87 | 27.4 | 1.6 | 2.1 | 7.2 |
| Auto sales, total (mil. units)[2] | Feb. | 03-04-87 | 10.3 | 23.9 | -2.1 | -5.2 |
| Domestic models | Feb. | 03-04-87 | 7.3 | 25.2 | 5.8 | -8.9 |
| Foreign models | Feb. | 03-04-87 | 3.0 | 20.7 | -17.1 | 5.1 |
| Housing starts, private (thous.) | Feb. | 03-17-87 | 1851 | 2.6 | 13.1 | -3.7 |
| Leading indicators (1967=100) | Jan. | 03-03-87 | 183.8 | -1.0 | 2.2 | 6.0 |

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

Domestic production and employment posted solid gains during the first two months of the year. Although final demand, on balance, has been sluggish, output apparently has been boosted by a substantial accumulation of inventories, following the depletion of stocks that occurred in late 1986. Price increases picked up in January, but much of the rise probably reflects factors with only a temporary influence on inflation.

Employment and Unemployment

The labor market reports this year have been robust. Nonfarm payroll employment rose more than 300,000 in both January and February, up from the 250,000 average monthly gain in the fourth quarter. In addition, employers lengthened workweeks in most sectors. Altogether, the index of aggregate production-worker hours for February exceeded its fourth-quarter level by 1-3/4 percent.

By industry, much of the employment gain once again occurred in finance and services, where increases continued to average more than 100,000 per month. In addition, hiring by retailers has been quite strong on a seasonally adjusted basis after a relatively small rise during the year-end holiday season. Morever, employment at construction sites jumped more than 100,000 in January owing to unusually warm weather during the survey week, and held steady at that elevated level in February. In manufacturing, employment was up 50,000 in February, but much of that rise was associated with the return to work of strikers at USX Corporation and John Deere. Otherwise, there has been little net increase in factory

CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Billions of 1982 dollars at annual rates)

| | 1986 | | | 1986 | | 1987 |
|---|---|---|---|---|---|---|
| | Q2 | Q3 | Q4 | Nov. | Dec.r | Jan.P |
| Total | 1.6 | -11.2 | -9.6 | -9.1 | -32.7 | 87.2 |
| Manufacturing | 1.0 | -6.5 | -3.3 | 2.3 | -2.4 | 29.0 |
| Durable | -4.0 | -3.8 | -6.0 | 2.8 | -12.3 | 7.3 |
| Nondurable | 5.0 | -2.7 | 2.7 | -.5 | 9.9 | 21.7 |
| Wholesale | 4.6 | 8.3 | -4.3 | .6 | 1.5 | 14.6 |
| Durable | 4.4 | 3.2 | -6.9 | 9.2 | -22.5 | 22.5 |
| Retail | -4.0 | -13.1 | -2.0 | -12.0 | -31.8 | 43.6 |
| Automotive | -1.8 | -22.0 | -1.1 | -7.0 | -15.9 | 38.8 |
| Ex. auto | -2.3 | 8.9 | -.9 | -5.0 | -15.9 | 4.8 |

INVENTORIES RELATIVE TO SALES[1]
(Sales and inventories in 1982 dollars)

| | Range in 1986[2] | | 1986 | | | 1986 | | 1987 |
|---|---|---|---|---|---|---|---|---|
| | low | high | Q2 | Q3 | Q4 | Nov. | Dec.r | Jan.P |
| Total | 1.45 | 1.56 | 1.54 | 1.50 | 1.48 | 1.50 | 1.45 | 1.54 |
| Manufacturing | 1.62 | 1.74 | 1.70 | 1.69 | 1.66 | 1.67 | 1.62 | 1.70 |
| Durable | 2.02 | 2.23 | 2.17 | 2.16 | 2.09 | 2.14 | 2.02 | 2.17 |
| Nondurable | 1.19 | 1.24 | 1.22 | 1.21 | 1.20 | 1.19 | 1.19 | 1.22 |
| Wholesale | 1.25 | 1.34 | 1.32 | 1.29 | 1.26 | 1.27 | 1.26 | 1.31 |
| Durable | 1.78 | 1.91 | 1.88 | 1.87 | 1.80 | 1.85 | 1.78 | 1.89 |
| Retail | 1.35 | 1.51 | 1.48 | 1.40 | 1.42 | 1.47 | 1.37 | 1.52 |
| Automotive | 1.12 | 1.89 | 1.74 | 1.33 | 1.41 | 1.59 | 1.25 | 1.88 |
| Ex. auto | 1.40 | 1.45 | 1.41 | 1.43 | 1.42 | 1.44 | 1.41 | 1.44 |

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 coincidental.
r--Revised estimates.
p--Preliminary estimates.

employment so far this year, after sizable gains in the fourth quarter. Nonetheless, manufacturers apparently did stretch workweeks in February to an average 41.2 hours, their highest level since 1966. As a result, the February level of aggregate production-worker hours in manufacturing stood 1-1/2 percent above the fourth-quarter average.

The household survey appeared to confirm the strength in hiring reported by businesses, as it showed employment rising more than 370,000 in both January and February. However, the sizable job gains in each month were accompanied by large increases in the labor force, and the civilian unemployment rate held steady at 6.7 percent.

Industrial Output and Capacity Utilization

Industrial output has expanded at more than a 4 percent annual rate since September, after a lackluster performance during the first three quarters of 1986. On balance, moderate output gains continued in January and February, with some variation across sectors. Production of defense and space equipment, as well as that of construction supplies, has continued to advance strongly, building on the solid increases registered in 1986. In contrast, total output of consumer durables has shown little net change so far this year, as output of home goods (such as furniture and appliances) fell back from its elevated late-1986 level, offsetting higher production of motor vehicles. Output of business equipment moved up during the first two months of the year. The 1 percent gain in February reflected stronger production of both motor vehicles and farm equipment, the latter of which advanced after the settlement of a strike at John Deere. However, output of most other types of business equipment has remained weak in recent months.

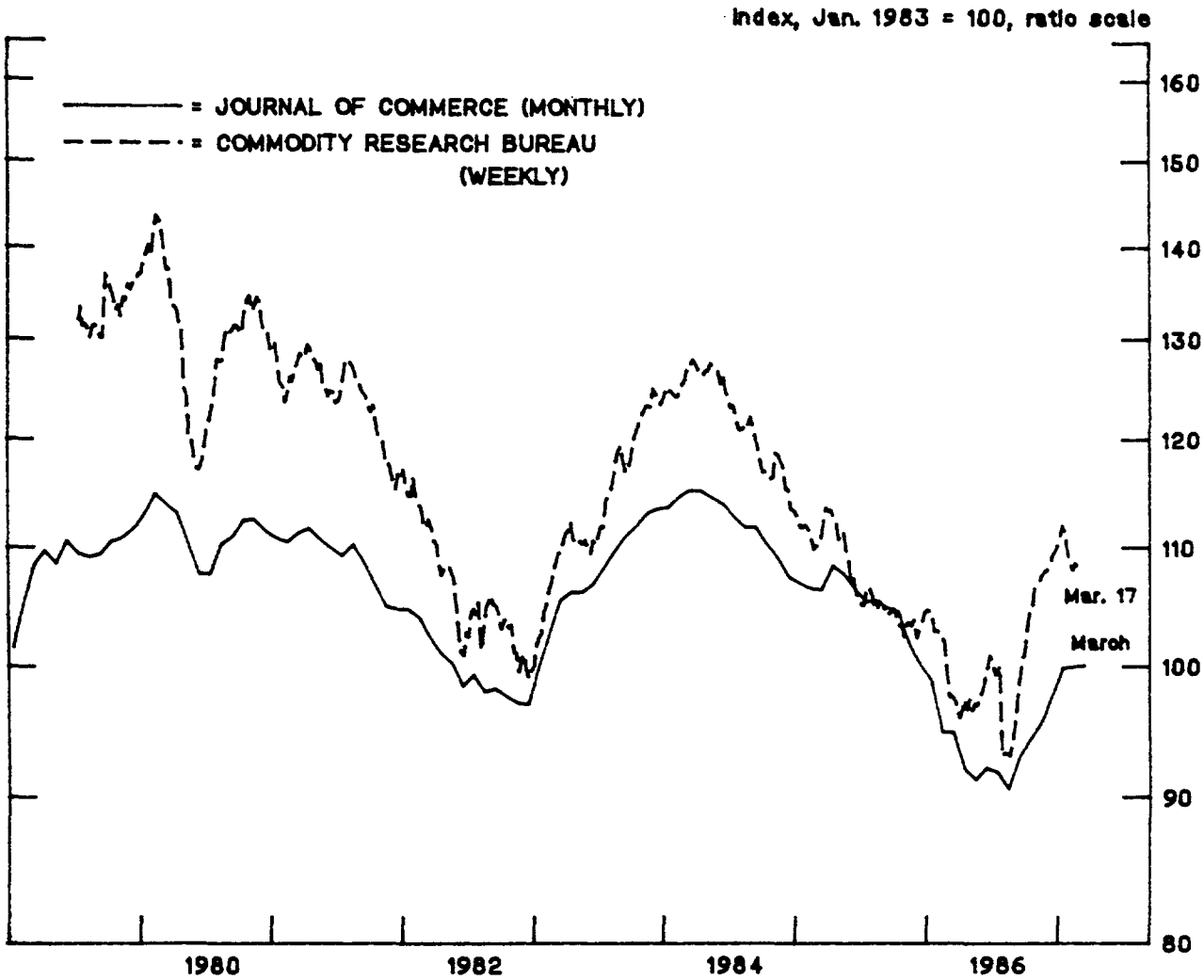
INDUSTRIAL PRODUCTION
(Percentage change from preceding period;
based on seasonally adjusted data)

| | 1986 | | 1986 | 1987 | |
|---|---|---|---|---|---|
| | Q3 | Q4 | Dec. | Jan. | Feb. |
| | --Annual rate-- | | --Monthly rate-- | | |
| Total Index | 1.9 | 3.2 | .5 | .1 | .5 |
| Products | 2.9 | 3.4 | .4 | .1 | .6 |
| Final products | 2.1 | 2.7 | .4 | -.1 | .7 |
| Consumer goods | 1.5 | 3.3 | 1.3 | -.3 | .6 |
| Automotive products | 5.5 | -3.2 | 2.8 | .3 | 4.5 |
| Home goods | 7.4 | 17.3 | 2.9 | -3.7 | .2 |
| Equipment | 2.7 | 2.2 | -.7 | .3 | .8 |
| Business | 3.4 | -1.7 | -1.1 | .3 | 1.0 |
| Defense and space | 6.3 | 9.8 | .5 | .4 | .4 |
| Oil and gas drilling | -39.3 | 48.8 | .7 | -1.6 | -.6 |
| Intermediate products | 5.6 | 5.5 | .4 | .8 | .3 |
| Construction supplies | 4.5 | 6.4 | 1.0 | 1.5 | .2 |
| Materials | .5 | 2.9 | .7 | .1 | .2 |
| Durable goods | .1 | 4.4 | .3 | -.1 | .1 |
| Nondurable goods | 10.0 | 4.6 | 2.0 | .1 | .4 |
| Energy materials | -7.6 | -2.0 | -.1 | .7 | .3 |

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

| | 1978-80 | 1982 | 1984 | 1986 | | 1987 | |
|---|---|---|---|---|---|---|---|
| | High | Low | High | Q3 | Q4 | Jan. | Feb. |
| Total industry | 86.9 | 69.5 | 81.8 | 79.1 | 79.3 | 79.6 | 79.8 |
| Manufacturing | 86.5 | 68.0 | 81.3 | 79.7 | 79.8 | 79.9 | 80.1 |
| Durable | 86.3 | 63.7 | 79.8 | 76.3 | 76.5 | 76.3 | 76.8 |
| Nondurable | 87.0 | 74.4 | 84.3 | 84.7 | 84.8 | 85.4 | 85.2 |
| Mining | 95.2 | 76.9 | 86.6 | 73.2 | 73.4 | 75.1 | 75.3 |
| Utilities | 88.5 | 78.0 | 85.8 | 79.1 | 79.8 | 80.4 | 80.8 |
| Industrial materials | 89.1 | 68.4 | 82.9 | 78.1 | 78.4 | 78.9 | 78.9 |
| Metal materials | 93.6 | 45.7 | 70.8 | 64.2 | 66.8 | 65.4 | 66.3 |
| Paper materials | 97.3 | 79.9 | 98.6 | 97.3 | 96.7 | 98.2 | 98.0 |
| Chemical materials | 87.9 | 63.3 | 78.5 | 81.4 | 82.8 | 84.8 | 85.1 |

# Indexes of Industrial Commodity Prices



In the materials sector, production edged up during January and February, extending the pattern of modest advances during the second half of 1986. The settlement at USX in late January had little effect in February on steel output, owing to a long start-up period after employees returned to work. The bounceback in steel production, however, should be evident in the March index.

Capacity utilization in manufacturing, mining, and utilities increased 0.2 percentage point in February to 79.8 percent. Since October of last year, the overall operating rate is estimated to have risen 0.8 percentage point, but remains little changed from the year-earlier level. Utilization rates in most durable goods industries either have stabilized or advanced somewhat after declining during the first half of 1986. A stronger turnaround has occurred in the mining and utilities sectors, while the utilization rate for nondurable manufacturing has continued to trend up at a modest pace.

With the stronger production gains of recent months, price increases in the industrial sector have become somewhat more widespread. The producer price index for intermediate materials less food and energy--a broad measure of production inputs--rose 0.6 percent over the first two months of 1987 after two years of little change. In addition, various measures of commodity prices (including those shown in the accompanying chart) are up substantially from their lows of last summer, despite some easing on balance in recent weeks.

Personal Income and Consumption

Nominal personal income has expanded at a fairly robust pace so far this year, boosted in large part by sizable increases in wage and salary disbursements. Despite wide month-to-month swings, subsidy payments to

farmers also have contributed to the rise in personal income since year-end, while cost-of-living increases for transfer payments roughly offset larger personal contributions to social insurance.

Personal tax payments dropped sharply in January and a bit more in February, providing a considerable boost to disposable income. BEA estimated that the level of personal taxes in both months was reduced, on balance, $15 billion (annual rate) by provisions of the Tax Reform Act that have a permanment effect on payments. These provisions include the reductions in tax rates and the elimination of various deductions and credits. In addition, tax payments so far this year apparently have been reduced by the underwithholding of taxes, because many taxpayers have been slow to file revised W-4 forms. Although the extent of underwithholding is hard to determine, BEA estimated that it decreased the level of tax payments $20 billion (annual rate) in January; by February, enough revised W-4 forms had been filed to shrink the amount of underwithholding to a $10 billion rate. Even so, personal tax payments fell in February, as the level of nonwithheld taxes--which had been raised in January by the spurt of capital gains realizations late last year--returned to a more normal level.

On balance, consumer spending in recent months has been relatively flat, with month-to-month fluctuations heavily influenced by developments in the auto sector. After plummeting in January, sales of domestic autos have rebounded somewhat--averaging 7-1/4 million units at an annual rate during February and the first twenty days of March. However, despite the boost provided by the current round of sales incentives, first-quarter sales are running well below the fourth-quarter pace.

PERSONAL INCOME AND EXPENDITURES
(Based on seasonally adjusted data)

| | 1985 | 1986 | 1986 Q3 | 1986 Q4 | 1986 Dec. | 1987 Jan. | 1987 Feb. |
|---|---|---|---|---|---|---|---|
| | -- Percentage changes at annual rates[1] -- | | | | | | |
| Total personal income | | | | | | | |
| Nominal | 6.1 | 4.3 | 1.8 | 3.4 | 6.6 | 2.1 | 11.0 |
| Real[2] | 2.4 | 2.6 | -1.7 | .1 | 3.5 | -7.2 | -- |
| Disposable personal income | | | | | | | |
| Nominal | 5.6 | 3.8 | .2 | 1.8 | 4.0 | 10.3 | 15.0 |
| Real | 1.9 | 2.2 | -3.1 | -1.5 | 1.3 | .7 | -- |
| Expenditures | | | | | | | |
| Nominal | 7.3 | 5.7 | 10.3 | 3.0 | 28.5 | -24.5 | 21.0 |
| Real | 3.5 | 4.0 | 6.7 | -.4 | 25.7 | -33.8 | -- |
| | -- Changes in billions of dollars[3] -- | | | | | | |
| Total personal income | 16.8 | 10.4 | 8.7 | 11.6 | 19.4 | 6.2 | 32.4 |
| Wages and salaries | 10.6 | 7.0 | 8.3 | 9.1 | 3.6 | 13.0 | 17.7 |
| Private | 8.1 | 5.2 | 6.2 | 7.1 | 1.7 | 8.6 | 15.6 |
| Other income | 7.6 | 4.1 | 1.0 | 3.0 | 15.9 | -2.8 | 15.8 |
| Farm proprietors | -.4 | -.8 | -2.1 | 2.5 | 13.7 | -8.7 | 12.2 |
| Less: | | | | | | | |
| Personal tax and nontax payments | 3.3 | 3.2 | 4.6 | 6.4 | 9.4 | -19.5 | -5.5 |
| Equals: | | | | | | | |
| Disposable personal income | 13.5 | 7.2 | 4.1 | 5.2 | 10.0 | 25.8 | 37.8 |
| Expenditures | 16.5 | 13.4 | 30.1 | 7.1 | 66.4 | -58.4 | 49.1 |
| Ex. motor vehicles | 15.6 | 10.2 | 5.6 | 17.5 | 19.0 | 9.6 | 27.5 |
| Durables | 1.9 | 5.1 | 27.0 | -7.9 | 50.2 | -69.7 | 24.8 |
| Nondurables | 3.6 | 1.6 | -1.7 | 5.5 | 9.6 | .3 | 10.7 |
| Services | 11.0 | 6.7 | 4.8 | 9.5 | 6.6 | 11.1 | 13.6 |
| Personal saving rate (percent) | 5.1 | 3.8 | 2.8 | 2.5 | 1.2 | 4.0 | 3.6 |

1. Annual figures are from fourth quarter to fourth quarter; 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.

AUTO SALES, PRODUCTION, AND INVENTORIES
(Millions of units at an annual rate, FRB seasonals)

| | 1986 | | | | 1986 | 1986 | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Dec. | Jan. | Feb. | Mar.[1] |
| Total auto sales[2] | 10.7 | 11.2 | 12.9 | 11.3 | 13.2 | 8.3 | 10.3 | -- |
| Domestic | 7.8 | 8.2 | 9.4 | 7.7 | 9.1 | 5.8 | 7.3 | 7.1 |
| Imported | 2.8 | 3.0 | 3.5 | 3.7 | 4.1 | 2.5 | 3.0 | -- |
| Domestic production | 8.3 | 7.9 | 7.4 | 7.5 | 7.9 | 7.5 | 8.3 | -- |
| Dealers' stocks | 1.81 | 1.80 | 1.40 | 1.54 | 1.54 | 1.68 | 1.73 | -- |
| Days' supply[3] | 71 | 68 | 46 | 61 | 52 | 89 | 74 | -- |
| Total light truck sales[4] | 4.1 | 4.6 | 5.2 | 4.5 | 5.1 | 3.5 | 4.4 | -- |
| Domestic | 3.3 | 3.7 | 4.3 | 3.5 | 4.0 | 2.8 | 3.6 | -- |
| Imported[5] | .8 | .9 | .9 | 1.0 | 1.1 | .7 | .8 | -- |

1. First twenty days.
2. Components may not add to totals due to rounding.
3. Days' supply for the quarter are based on end-of-quarter stocks and average sales for the quarter.
4. Trucks having gross weight 10,000 pounds or less.
5. About 1 percent of imported trucks have gross weight above 10,000 pounds.

Excluding motor vehicles, consumer spending since yearend has registered moderate gains on balance, paced by the continued uptrend in outlays for services. Nondurable expenditures also have advanced, largely owing to increased February outlays for food. In addition, nominal outlays for gasoline have risen markedly this year, but much of this expansion represents higher pump prices. Nominal purchases of consumer durables apart from motor vehicles dropped in January and then rebounded sharply in February to a level 7-3/4 percent (annual rate) above the fourth quarter average.

During the past two years, real consumer outlays have expanded at about a 4 percent annual rate, roughly double the pace of real disposable income gains. One factor behind the relatively bouyant pace of spending has been the rising net worth of the household sector. Despite the rapid accumulation of consumer debt, the net worth of U.S. households increased more than $1 trillion during both 1985 and 1986, owing in part to the runup in stock prices. Historical patterns suggest that the marginal propensity to consume out of wealth is quite small—roughly a nickel of consumer spending ultimately is generated by a $1 increase in wealth--and that any rise in spending lags behind accretions to wealth. Even so, the rise in net worth in recent years has been large enough to provide considerable support to consumer outlays. Moreover, increases in household wealth this year--the aggregate market value of common stock has risen more than $600 billion so far in 1987—are likely to play a further role in supporting consumer spending. Still, household debt burdens remain substantial, and consumer spending gains may be tempered by

concerns about fluctuations in income flows and possible reversals in stock prices.

Business Fixed Investment

Outlays for business fixed investment began the first quarter at a sluggish pace. On the equipment side, shipments of nondefense capital goods fell 7-1/4 percent between December and February. This decline affected virtually every category of equipment and represents, in large part, a "payback" from the tax-induced bunching of equipment purchases at the end of 1986. Although the Census Bureau's recent revision of the shipments data tempered the size of the January drop, tax incentives still appear to have had a substantial effect on the timing of expenditures around the turn of the year.[1]

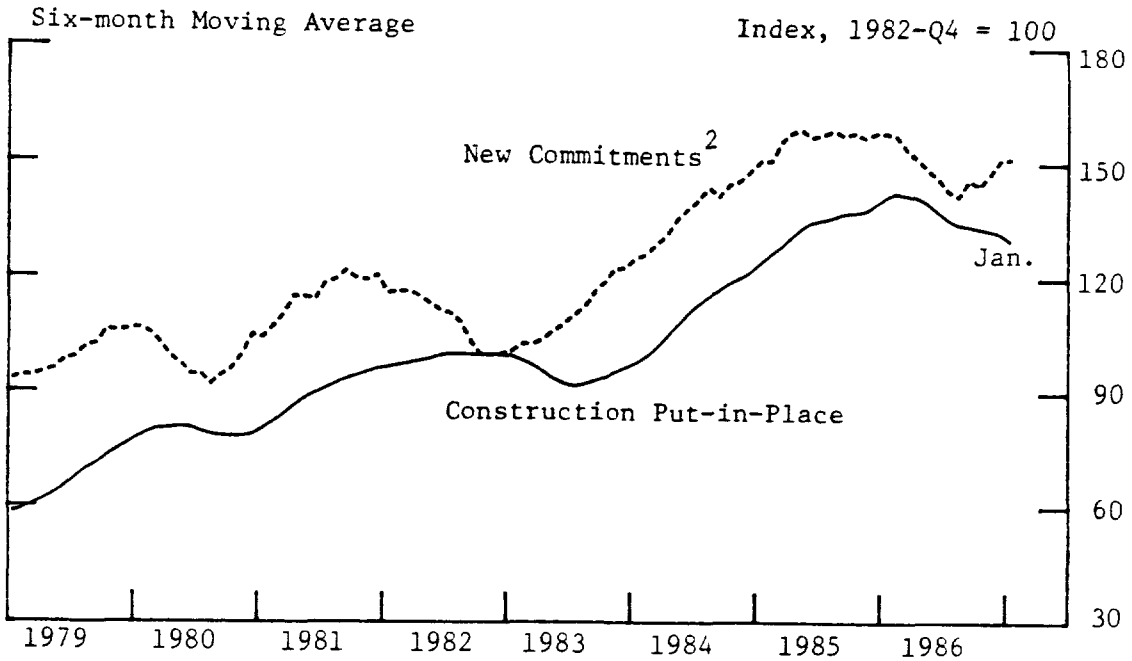
Outlays for nonresidential construction (excluding petroleum drilling activity) also declined in January, extending a downtrend that began in early 1986. The presence of widespread excess capacity in the industrial and commercial sectors has been the principal factor underlying this contraction, with some contribution as well from the anticipation of adverse tax changes for nonresidential structures. Compared with their most recent peaks, the January levels of factory and office construction are down about 25 percent, while construction of hotels and other commercial buildings

1. Two distinct tax factors were responsible for the year-end swing in equipment outlays. Most important, the depreciation provisions in force between 1981 and 1986 encouraged firms to install equipment at the end of their taxable year—which frequently coincides with the end of the fourth quarter. In addition, this year's Tax Reform Act reduced somewhat the front-loading of depreciation deductions for equipment installed after 1986, prompting some acceleration of outlays late last year to avoid this change.

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

| | 1986 | | | 1986 | | 1987 | |
|---|---|---|---|---|---|---|---|
| | Q2 | Q3 | Q4 | Nov. | Dec. | Jan. | Feb. |
| Producers' durable equipment | | | | | | | |
| Nondefense capital goods | | | | | | | |
| Shipments | 2.5 | .7 | 3.4 | -.3 | 5.7 | -14.4 | -- |
| Aircraft | -.9 | 3.5 | 8.8 | -13.0 | 17.2 | -20.3 | -- |
| Office and computing equip. | 11.6 | -.6 | .7 | .1 | 13.2 | -24.8 | -- |
| All other categories | 1.3 | .6 | 3.0 | 2.1 | 2.3 | -11.0 | -- |
| Orders | -.9 | 4.0 | 4.2 | 5.7 | 5.7 | -17.0 | -- |
| Aircraft | -12.2 | .8 | 63.5 | -12.5 | 52.4 | -47.5 | -- |
| Office and computing equip. | 5.3 | 16.5 | -13.6 | 17.6 | -10.1 | -35.9 | -- |
| All other categories | .1 | 2.1 | -1.6 | 8.3 | -1.3 | -3.1 | -- |
| Sales of heavy-weight trucks (thousands of units, a.r.) | 273 | 268 | 274 | 292 | 292 | 246 | -- |
| Nonresidential structures | | | | | | | |
| Nonresidential construction | -5.6 | -.3 | -2.9 | -1.9 | -1.0 | -2.1 | -- |
| Commercial building | -7.8 | .9 | -6.1 | -2.6 | -1.1 | -4.7 | -- |
| Office | -6.6 | -4.3 | -6.9 | -3.0 | -1.3 | -3.1 | -- |
| Other commercial | -9.1 | 6.3 | -5.5 | -2.2 | -.8 | -6.1 | -- |
| Industrial building | -9.4 | -6.4 | 1.4 | 3.7 | -5.1 | -5.0 | -- |
| Public utilities, institutional, and other | -2.2 | -.1 | -.6 | -2.4 | -.1 | 1.0 | -- |
| Rotary drilling rigs in use | -40.2 | -12.6 | 9.4 | 3.5 | .5 | -1.7 | -1.0 |

NONRESIDENTIAL CONSTRUCTION AND NEW COMMITMENTS[1]




1. Sum of contracts (from F.W. Dodge) and permits (from Census).
2. Includes only the building components of nonresidential construction, that is, industrial, commercial, institutional, and hotels and motels.

**Surveys of Plant and Equipment Spending**
**(Percent change from previous year, current dollars)**

| | | Planned for 1987 | |
|---|---|---|---|
| | 1986[1] | McGraw-Hill (Jan.-Mar.) | Commerce Dept. (Oct.-Nov.) |
| **Including petroleum and mining** | | | |
| **All Business** | -1.7 | 2.0 | .9 |
| **Excluding petroleum and mining** | | | |
| **All business** | 1.8 | 2.1 | 2.1 |
| **Manufacturing** | -.5 | 3.4 | -.1 |
| **Durables** | -4.5 | 0 | -.6 |
| **Nondurables** | 5.0 | 7.6 | .5 |
| **Nonmanufacturing** | 3.2 | 1.3 | 3.3 |

1. As estimated in the October-November Commerce Department survey.

both have receded about 20 percent. Petroleum drilling activity, which rebounded a bit last fall, has been relatively stable since then.

Near-term indicators of investment spending provide a mixed picture. The average level of new orders for nondefense capital goods in January and February stood 5-1/2 percent below the fourth-quarter average. The sharpest decline occurred for aircraft and parts; in addition, bookings for office and computing equipment continue to lag, possibly reflecting the unsettled state of this market. In recent months, an unusually large number of new workstations and mainframe computers has been introduced and additional product announcements are widely anticipated. Until this turbulence passes, computer orders are likely to remain sluggish. Bookings for other types of machinery have risen only modestly, on balance, from the fourth-quarter average, suggesting lethargic near-term outlays in these sectors as well. For nonresidential construction, however, new commitments have firmed since mid-1986, indicating that there might be a pause in the downtrend in this sector.

For 1987 as a whole, survey readings still suggest that investment outlays will be lackluster. Most recently, the McGraw-Hill winter survey, conducted between late January and early March, indicated that firms expect nominal spending to rise only 2 percent this year. Even so, this expectation represents an improvement over the 1-3/4 percent decline in nominal outlays estimated for 1986. Most of this pickup reflects the expected stabilization of capital spending by petroleum and mining companies after last year's plunge. There is some evidence, as well, of stronger spending plans for several industries that could be benefiting from an improved trade situation, including iron and steel, machinery, and textiles.

Inventories

Business inventories jumped in January after declining through much of the second half of 1986. After a sharp drawdown late last year, manufacturing and trade inventories rose at an annual rate of $87.2 billion in constant-dollar term in January--the largest monthly increase in the current expansion. This year-end swing was concentrated among stocks of autos and wholesale machinery and reflects, in part, tax incentives favoring the purchase of these items before the end of 1986. Apparently, this surge in demand was met chiefly out of inventories, which then rose sharply once sales dropped back in January.

Despite a sizable accumulation in January, particularly for finished foods, manufacturers' inventories still appear to be on the lean side. Indeed, stocks held by producers of durable goods actually have edged down on balance since November. Moreover, a substantial share of the recent rise in nondurable stocks has occurred in the chemicals industry, where orders have been robust. A number of other industries--including producers of home goods, construction supplies, defense and space equipment, paper, and textiles--have augmented their stocks of materials and supplies and lengthened their workweeks, moves that suggest a relatively optimistic view of demand prospects and, possibly, the need for further stockbuilding.

Except for autos, trade inventories generally appear in line with current sales. Inventory-sales ratios for most types of retail and wholesale establishments in January remained within the range observed over the past two years. In contrast, stocks at auto dealers appear bloated. After sizable liquidations in November and December, these inventories rose

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

| | 1985 | 1986 | 1986 Q3 | 1986 Q4 | 1986 Dec. | 1987 Jan. | 1987 Feb. |
|---|---|---|---|---|---|---|---|
| | | | --Average monthly changes-- | | | | |
| Nonfarm payroll employment[2] | 230 | 201 | 239 | 254 | 254 | 319 | 337 |
| Strike adjusted | 229 | 201 | 194 | 252 | 245 | 318 | 301 |
| Manufacturing | -18 | -9 | -10 | 27 | 30 | -15 | 50 |
| Strike adjusted | -17 | -7 | -11 | 25 | 30 | -15 | 16 |
| Durable | -16 | -14 | -12 | 6 | 7 | -16 | 43 |
| Nondurable | -2 | 6 | 2 | 21 | 23 | 1 | 7 |
| Construction | 21 | 17 | 21 | -5 | 3 | 113 | 2 |
| Trade | 65 | 53 | 50 | 47 | 9 | 125 | 140 |
| Finance and services | 122 | 121 | 107 | 121 | 170 | 111 | 129 |
| Total government | 38 | 25 | 31 | 51 | 38 | -25 | 13 |
| Private nonfarm production workers | 159 | 145 | 173 | 171 | 179 | 224 | 278 |
| Manufacturing production workers | -18 | -4 | -6 | 31 | 33 | -22 | 53 |
| Total employment[3] | 162 | 174e | 125 | 217 | 205 | 374 | 371 |
| Nonagricultural | 182 | 174e | 132 | 210 | 259 | 390 | 280 |

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.
e--Adjusted by Board staff to eliminate distortions caused by the introduction of revised population estimates.

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

| | 1985 | 1986 | 1986 Q3 | 1986 Q4 | 1986 Dec. | 1987 Jan. | 1987 Feb. |
|---|---|---|---|---|---|---|---|
| Civilian, 16 years and older | 7.2 | 7.0 | 6.9 | 6.9 | 6.7 | 6.7 | 6.7 |
| Teenagers | 18.6 | 18.3 | 18.1 | 17.8 | 17.3 | 17.7 | 18.0 |
| 20-24 years old | 11.1 | 10.7 | 10.7 | 10.5 | 10.7 | 10.7 | 10.5 |
| Men, 25 years and older | 5.3 | 5.4 | 5.4 | 5.4 | 5.2 | 5.4 | 5.1 |
| Women, 25 years and older | 5.9 | 5.5 | 5.4 | 5.3 | 5.2 | 5.1 | 5.1 |
| White | 6.2 | 6.0 | 6.0 | 6.0 | 5.8 | 5.9 | 5.7 |
| Black | 15.1 | 14.5 | 14.5 | 14.1 | 13.7 | 14.3 | 14.3 |
| Fulltime workers | 6.8 | 6.6 | 6.5 | 6.5 | 6.3 | 6.4 | 6.3 |
| Memo: | | | | | | | |
| Total national[1] | 7.1 | 6.9 | 6.8 | 6.7 | 6.6 | 6.6 | 6.6 |

1. Includes resident Armed Forces as employed.

at a $38.8 billion annual rate in January, as sales slowed markedly. Moreover, despite a new round of incentives, auto sales in February evidently fell short of manufacturers' expectations, and dealers' stocks rose further. At the end of February, auto dealers held about a 74-day supply of passenger cars--well above the preferred 60-day level.

Housing Markets

Housing construction has been robust early in 1987. Led by strong increases in the single-family sector, total private housing starts in January and February averaged 1.83 million units at an annual rate, up 7 percent from the fourth-quarter pace. To some extent, the recent strength in starts stemmed from unusually good weather conditions during January and February in the Midwest, a region that accounts for about 16 percent of national housing starts.

Nonetheless, residential construction appears to be firming apart from the influence of good weather. Reflecting the underlying strength, permit issuance rose about 1-1/2 percent on average in January and February compared with the fourth-quarter level. This advance occurred even though the number of permits issued jumped in December (and then fell in January), as California builders rushed to avoid new fees applied to permits issued after December 31.

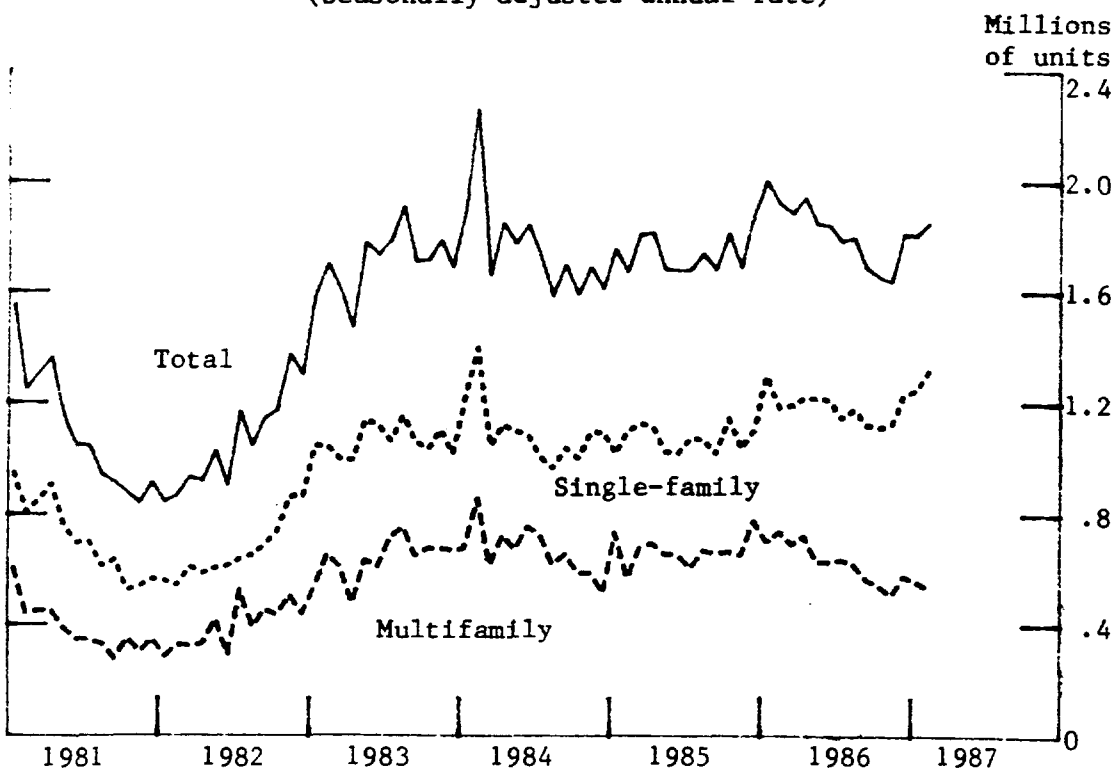
In the single-family sector, housing starts were up 11 percent on average in January and February from the robust fourth-quarter pace, reaching the highest level since early 1984. Sales of new single-family homes fell a bit in January, but the level remained 3 percent above the average for the second half of 1986. Existing home sales dropped

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

| | 1986 | 1986 | | | 1986 | 1987 | |
|---|---|---|---|---|---|---|---|
| | Annual | Q2 | Q3 | Q4 | Dec. | Jan. | Feb.[1] |
| All units | | | | | | | |
| Permits | 1.75 | 1.82 | 1.68 | 1.70 | 1.91 | 1.69 | 1.76 |
| Starts | 1.81 | 1.88 | 1.76 | 1.70 | 1.81 | 1.80 | 1.85 |
| Single-family units | | | | | | | |
| Permits | 1.07 | 1.12 | 1.06 | 1.06 | 1.17 | 1.09 | 1.24 |
| Starts | 1.18 | 1.22 | 1.15 | 1.16 | 1.23 | 1.25 | 1.32 |
| Sales | | | | | | | |
| New homes | .75 | .79 | .69 | .71 | .77 | .72 | n.a. |
| Existing homes | 3.57 | 3.47 | 3.62 | 3.93 | 4.06 | 3.47 | 3.69 |
| Multifamily units | | | | | | | |
| Permits | .68 | .70 | .62 | .64 | .74 | .60 | .53 |
| Starts | .63 | .66 | .61 | .54 | .58 | .56 | .53 |
| Mobile home shipments | .24 | .24 | .24 | .24 | .25 | .24 | n.a. |

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

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



in January after a tax-related surge in December; sales recovered to a 3.7 million unit rate in February, about in line with the level seen last fall.

Multifamily housing construction, by contrast, has remained near the reduced levels seen in the fourth quarter. The decline during the past year in multifamily starts is in accord with the decidedly negative market fundamentals for the sector. Rental vacancy rates in most regions are at 20-year highs, the new tax environment is much less conducive to investment in multifamily housing, and--reflecting these unfavorable factors--builder assessments of current conditions for rental apartment starts are quite pessimistic. Only in the Northeast region, where rental vacancy rates have remained moderate, is the outlook for multifamily construction somewhat more favorable.

Median new home prices rose 16 percent in January from the year-earlier level, compared with the 9 percent gain registered in 1986. Much of the increase last year reflected improvements in housing quality and changes in the regional composition of sales. When adjusted for such changes, new-home prices rose only 3 percent in 1986. Regionally, price increases last year continued to be most rapid in the Northeast, where new home prices jumped 20 percent after adjustment for quality change.

Federal Government

Monthly Treasury data through February point to considerably slower outlay growth in fiscal 1987 than in preceding fiscal years. Indeed, total outlays through the first five months of the current fiscal year are only 2 percent above the same period one year ago. Spending continues to rise for defense, entitlement programs, and the FSLIC; but these increases

largely have been offset by reduced outlays for a variety of other domestic programs by Congress last year and by lower net interest costs on the national debt.

On the revenue side, receipts through February of fiscal year 1987 are running 6-1/2 percent above the level one year earlier. Despite the recent declines in personal tax payments mentioned above, total receipts are up from fiscal year 1986 largely because growth in nominal income has enlarged the tax base. Also raising receipts a bit, corporations in December paid the first installment on the retroactive repeal of the investment tax credit (ITC). Looking ahead, corporate and personal final payments are expected to surge in March and April, reflecting further payments related to the ITC repeal and to the accelerated realizations of capital gains late last year.

State and Local Government

Real purchases of goods and services by state and local governments appear to have been about flat so far this year. In January and February, the level of employment in this sector matched its fourth-quarter average, and real outlays for construction in January were little changed from the fourth-quarter pace.[1]

State legislatures have been preoccupied this year with their response to federal tax reform. Most of the 40 states that have a personal income tax link their tax base to the federal definition of adjusted gross income or taxable income. For these states, the broadening of the federal tax base will yield a "windfall" in state tax revenues. According to a survey recently completed by the National Association of State Budget Officers,

1. The Census Bureau actually reported a sharp rise in January construction activity conducted by state and local governments. However, because BEA uses different seasonal factors, the staff's assessment is that real outlays for January will be measured as little changed in putting together the GNP estimates.

this revenue gain is expected to total $5-1/2 billion in 1988. However, under current proposals by state governors, more than 80 percent of the total windfall would be returned to taxpayers, leaving only a modest revenue gain at the state level.

At least 20 of the states affected by federal tax reform are taking this opportunity to overhaul their own income tax systems. To a large extent, the proposed reforms are similar to those recently enacted at the federal level, including reductions in tax rates, the use of fewer tax brackets, and increases in the value of personal exemptions and standard deductions.

Prices

Inflation picked up early this year, boosted partly by sharp increases in energy prices. In January, the CPI rose 0.7 percent and the PPI for finished goods 0.6 percent. However, the pace of inflation at the producer level slowed in February to only 0.1 percent despite further increases for energy.

Domestic energy prices have turned up sharply since the December OPEC agreement. At the wellhead, prices of crude petroleum climbed about 20 percent in January and another 4-1/2 percent in February; prices of natural gas also were up in both months. Similarly, the PPI for finished energy goods advanced sharply early this year. At the consumer level, energy prices rose 3 percent in January, and further increases are likely in the next few months as the higher price of crude oil is passed through more fully to consumers.

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

| | Relative Importance Dec. 1986 | 1985 | 1986 | 1986 Q3 | 1986 Q4 | 1987 Jan. | 1987 Feb. |
|---|---|---|---|---|---|---|---|
| | | | | -Annual rate- | | -Monthly rate- | |
| Finished goods | 100.0 | 1.8 | -2.5 | -.4 | 1.1 | .6 | .1 |
| Consumer foods | 26.3 | .5 | 2.9 | 11.2 | 1.1 | -1.8 | -.5 |
| Consumer energy | 8.6 | -.3 | -39.1 | -42.7 | -18.4 | 9.8 | 4.0 |
| Other consumer goods | 40.6 | 2.7 | 2.9 | 2.3 | 4.1 | .5 | -.3 |
| Capital equipment | 24.5 | 2.7 | 2.1 | 2.0 | 3.3 | .2 | -.3 |
| Intermediate materials[2] | 95.0 | -.1 | -4.5 | -1.5 | -1.2 | 1.0 | .5 |
| Exc. energy | 82.9 | -.1 | .1 | 1.5 | 1.1 | .4 | .2 |
| Crude food materials | 42.5 | -6.4 | -1.7 | 18.1 | -3.8 | -3.0 | .0 |
| Crude energy | 40.9 | -4.9 | -29.4 | -19.6 | -10.4 | 10.0 | 2.6 |
| Other crude materials | 16.6 | -4.3 | 1.6 | -24.1 | 8.0 | .5 | 4.4 |

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

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

| | Relative Importance Dec. 1986 | 1985 | 1986 | 1986 Q3 | 1986 Q4 | 1986 Dec. | 1987 Jan. |
|---|---|---|---|---|---|---|---|
| | | | | -Annual rate- | | -Monthly rate- | |
| All items[2] | 100.0 | 3.8 | 1.1 | 2.0 | 2.5 | .2 | .7 |
| Food | 16.2 | 2.7 | 3.8 | 8.4 | 4.1 | .2 | .4 |
| Energy | 7.4 | 1.8 | -19.7 | -21.0 | -9.9 | -.2 | 3.0 |
| All items less food and energy | 76.4 | 4.4 | 3.8 | 3.7 | 3.7 | .2 | .5 |
| Commodities | 26.1 | 2.1 | 1.4 | 2.6 | 1.4 | .1 | .6 |
| Services | 50.3 | 5.7 | 5.2 | 4.3 | 5.1 | .3 | .5 |
| Memorandum: | | | | | | | |
| CPI-W[3] | 100.0 | 3.6 | .7 | 1.7 | 2.2 | .2 | .7 |

1. Changes are from final month of preceding period to final month of period indicated.
2. Official index for all urban consumers.
3. Index for urban wage earners and clerical workers.

Food prices posted a sizable 0.4 percent increase in the January CPI, as prices rose markedly for fruits, vegetables, and a number of other categories. However, recent price developments at the producer level do not suggest a significant boost to inflation from this sector in the near term. The PPI for finished foods fell in both months, with large declines for fresh vegetables, pork, poultry, and coffee. Moreover, the index for crude foods was unchanged on balance in February after a three-month decline.

Retail prices also accelerated in January outside the food and energy sectors, particularly for commodities--which were up 0.6 percent in the January CPI. The increases were largest for tobacco products, home electronic equipment, and some other household categories; apart from tobacco, these items are strongly influenced by import prices. Apparel prices were up as well, apparently owing to less-than-seasonal markdowns.

The acceleration in the January CPI apart from food and energy may be related in part to temporary factors. Consistent with this view, the PPI for finished consumer goods less food and energy turned down in February. Producer prices for cars and light trucks declined, reflecting the effects of the latest incentive programs, while price changes in other categories were about offsetting. In addition, part of the rise in the January CPI may result from seasonal adjustment problems typically associated with January clearance sales.

Wages and Labor Costs

Wage inflation continued at a slow pace, on average, early this year. The hourly earnings index for production and nonsupervisory workers was up 0.5 percent in February after two months of little change. Much of

the overall rise was concentrated in transportation and public utilities and in services, typically volatile components of the total index.

In the union sector, recent wage increases have continued at about the pace seen throughout most of last year. The Bureau of National Affairs reported an average first-year wage increase of 2-3/4 percent for contracts negotiated during the first 10 weeks of 1987, compared with a 3 percent increase for negotiations concluded during 1986. When lump-sum payments are included, first-year increases so far this year have averaged nearly 3-1/2 percent. Most of these payments early in 1987 have been negotiated in the manufacturing sector, where they contributed almost 1 percentage point to the the median 3-1/2 percent first-year settlement.

Finally, revised data for the fourth quarter of 1986 now indicate that productivity in the nonfarm business sector fell 2-1/4 percent at an annual rate, a slightly larger decline than indicated in the preliminary report. The fourth-quarter estimate for the rise in compensation per hour also was revised down slightly, from 3 to 2-3/4 percent. As a result, unit labor costs now are estimated to have risen 5 percent at an annual rate, the largest increase last year. Nevertheless, unit labor costs rose only 2 percent for all of 1986, about 1-1/2 percentage points below the pace during 1985. Within manufacturing, unit labor costs were unchanged in 1986, as relatively strong productivity gains offset increases in hourly compensation.

SELECTED MEASURES OF LABOR COSTS IN THE NONFARM BUSINESS SECTOR
(Percentage change at annual rates)

| | 1985 | 1986 | 1986 Q3 | 1986 Q4 | 1987 Jan. | 1987 Feb. |
|---|---|---|---|---|---|---|
| **Hourly earnings index, wages of production workers[1]** | | | | | | |
| | | --Annual Rate-- | | | --Monthly rate-- | |
| Total private nonfarm | 3.0 | 2.1 | 1.2 | 2.9 | .0 | .5 |
| Manufacturing | 3.3 | 1.7 | 1.2 | 1.0 | .0 | .4 |
| Contract construction | 1.4 | 1.9 | .1 | 6.5 | -1.4 | -.2 |
| Transportation and public utilities | 3.0 | 1.7 | .9 | 1.6 | .0 | 1.0 |
| Total trade | 2.0 | 1.7 | 2.0 | 2.9 | -.4 | .1 |
| Services | 4.1 | 3.0 | 1.0 | 4.4 | .6 | .8 |
| **Employment cost index, compensation of all persons[2]** | | | | | | |
| Total | 3.9 | 3.2 | 2.8 | 2.5 | -- | -- |
| By occupation: | | | | | | |
| White collar | 4.8 | 3.5 | 3.1 | 2.4 | -- | -- |
| Blue collar | 3.2 | 2.7 | 2.9 | 1.9 | -- | -- |
| Service workers | 3.0 | 3.1 | 3.7 | 3.7 | -- | -- |
| By bargaining status: | | | | | | |
| Union | 2.6 | 2.1 | 2.2 | 1.2 | -- | -- |
| Nonunion | 4.6 | 3.6 | 3.1 | 2.8 | -- | -- |
| **Employment cost index, wage and salaries of all persons** | | | | | | |
| Total | 4.1 | 3.1 | 2.8 | 2.5 | -- | -- |
| **Major collective bargaining agreements[3]** | | | | | | |
| First-year wage adjustments | 2.3 | 1.2 | -- | -- | -- | -- |
| Total effective wage change | 3.3 | 2.3 | -- | -- | -- | -- |
| **Labor costs and productivity, all persons[1]** | | | | | | |
| Compensation per hour | 3.9 | 2.6 | 2.3 | 2.7 | -- | -- |
| Output per hour | .2 | .5 | -.3 | -2.2 | -- | -- |
| Unit labor costs | 3.7 | 2.1 | -2.6 | 5.1 | -- | -- |

1. Changes are from final quarter of preceding period to final quarter of period indicated. Quarterly and year-to-date changes at compound rates. Seasonally adjusted data.
2. Changes are from final month of preceding period to final month of period indicated. Quarterly changes at compound rates; not seasonally adjusted.
3. Agreements covering 1,000 or more workers; not seasonally adjusted.

III-T-1

SELECTED FINANCIAL MARKET QUOTATIONS[1]

(Percent)

| | 1984 | 1985 | 1986 | | 1987 | Change from: | |
|---|---|---|---|---|---|---|---|
| | Highs | March highs | June highs | FOMC Feb. 11 | Mar. 24 | June highs | FOMC Feb. 11 |
| **Short-term rates** | | | | | | | |
| Federal funds[2] | 11.63 | 8.58 | 6.90 | 6.18 | 6.10 | -0.80 | -0.08 |
| Treasury bills[3] | | | | | | | |
| 3-month | 10.67 | 8.80 | 6.52 | 5.86 | 5.61 | -0.91 | -0.25 |
| 6-month | 10.77 | 9.13 | 6.57 | 5.84 | 5.59 | -0.98 | -0.25 |
| 1-year | 11.13 | 9.25 | 6.62 | 5.77 | 5.70 | -0.92 | -0.07 |
| Commercial paper | | | | | | | |
| 1-month | 11.42 | 8.94 | 6.87 | 6.29 | 6.29 | -0.58 | — |
| 3-month | 11.35 | 9.12 | 6.81 | 6.18 | 6.21 | -0.60 | 0.03 |
| Large negotiable CDs[3] | | | | | | | |
| 1-month | 11.52 | 8.89 | 6.88 | 6.18 | 6.24 | -0.64 | 0.06 |
| 3-month | 11.79 | 9.29 | 6.91 | 6.17 | 6.23 | -0.68 | 0.06 |
| 6-month | 12.30 | 9.92 | 6.97 | 6.17 | 6.23 | -0.74 | 0.06 |
| Eurodollar deposits[4] | | | | | | | |
| 1-month | 11.89 | 8.89 | 7.01 | 6.21 | 6.44 | -0.57 | 0.23 |
| 3-month | 12.20 | 9.58 | 7.01 | 6.24 | 6.38 | -0.63 | 0.14 |
| Bank prime rate | 13.00 | 10.50 | 8.50 | 7.50 | 7.50 | -1.00 | — |
| **Intermediate- and long-term rates** | | | | | | | |
| U.S. Treasury (constant maturity) | | | | | | | |
| 3-year | 13.49 | 11.22 | 7.86 | 6.74 | 6.63 | -1.23 | -0.11 |
| 10-year | 13.99 | 12.02 | 8.39 | 7.37 | 7.27 | -1.12 | -0.10 |
| 30-year | 13.94 | 11.97 | 7.93 | 7.64 | 7.59 | -0.34 | -0.05 |
| Municipal revenue[5] (Bond Buyer index) | 11.44 | 10.25 | 8.57 | 6.98 | 7.08 | -1.49 | 0.10 |
| Corporate--A utility Recently offered | 15.30 | 13.23 | 9.70 | 8.94e | 8.87e | -0.83 | -0.07 |
| Home mortgage rates[6] | | | | | | | |
| S&L fixed-rate | 14.68 | 13.29 | 10.76 | 9.11 | 9.08 | -1.68 | -0.03 |
| S&L ARM, 1-yr. | 12.31 | 11.14 | 8.65 | 7.58 | 7.55 | -1.10 | -0.03 |

| | 1984 | 1985 | 1986 | 1986 | 1987 | Percent change from: | |
|---|---|---|---|---|---|---|---|
| | Lows | March lows | Highs | FOMC Feb. 11 | Mar. 24 | 1986 highs | FOMC Feb. 11 |
| **Stock prices** | | | | | | | |
| Dow-Jones Industrial | 1086.57 | 1247.35 | 1955.57 | 2171.96 | 2369.18 | 21.15 | 9.08 |
| NYSE Composite | 85.13 | 102.46 | 145.75 | 158.47 | 171.08 | 17.38 | 7.96 |
| AMEX Composite | 187.16 | 222.28 | 285.19 | 314.45 | 339.31 | 18.98 | 7.91 |
| NASDAQ (OTC) | 225.30 | 276.18 | 411.16 | 408.25 | 438.13 | 6.56 | 7.32 |

1. One-day quotes except as noted.
2. Averages for two-week reserve maintenance period closest to date shown. Last observation is the average to date for the maintenance period ending March 25, 1987.
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--estimate

## DOMESTIC FINANCIAL DEVELOPMENTS

Interest rates have posted only small net changes since the February 11 meeting of the FOMC. Indeed, by the standards of recent years, the period has been one of remarkable calm in fixed-income markets. Chairman Volcker indicated at the time of his Humphrey-Hawkins testimony that the System's reserve-supplying posture was unchanged, and federal funds have continued to trade for the most part within a range of 6 to 6-1/4 percent. Incoming economic data have been interpreted by private analysts as unlikely to prompt a significant near-term shift in policy; the more stable dollar after the G-6 meeting in Paris also contributed to the general stability of the markets, but recent weakness has been viewed as further circumscribing the System's easing options. Although the international debt situation and problems of the Farm Credit System and the FSLIC attracted considerable attention, they left only mild imprints on the structure of rates.

Meanwhile, the stock market has continued to soar to new highs. Major share price indexes have risen about 8 percent since February 11, bringing the advance for the year to nearly 25 percent--or more than $600 billion in aggregate market value.

Though not a major factor shaping market sentiment, the recent behavior of the monetary aggregates undoubtedly has been constructive psychologically. After surging at the end of 1986, when transactions were accelerated to beat tax law changes, M1 dropped sharply through mid-January; a rebound during February still left the average level for the month virtually even with that for January, and M1 growth was subdued through early March. With the nontransactions component of M2 also flat

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

| | 1985:04 to 1986:04 | 1986 H1 | 1986 H2 | 1986 Dec. | 1987 Jan. | 1987 Feb.P | Growth from Q4 1986 to Feb. 1987P |
|---|---|---|---|---|---|---|---|
| | ------ Percentage change at annual rates ------ | | | | | | |
| 1. M1 | 15.3 | 12.3 | 17.1 | 30.5 | 11.7 | -0.7 | 12.5 |
| 2. M2 | 8.9 | 7.4 | 10.0 | 10.5 | 9.7 | -0.2 | 6.3 |
| 3. M3 | 8.8 | 8.3 | 8.9 | 10.3 | 9.3 | 1.3 | 6.6 |
| | | | | | | | Levels in billions of dollars Feb. 1987P |
| Selected components | | | | | | | |
| 4. Currency | 7.5 | 7.0 | 7.7 | 7.2 | 16.3 | 7.7 | 187.2 |
| 5. Demand deposits | 11.6 | 9.7 | 12.9 | 42.3 | -12.5 | -17.3 | 300.7 |
| 6. Other checkable deposits | 28.6 | 21.7 | 32.0 | 34.0 | 39.8 | 13.5 | 242.7 |
| 7. M2 minus M1[2] | 6.9 | 5.9 | 7.7 | 3.7 | 9.0 | -0.1 | 2084.8 |
| 8. Overnight RPs and Eurodollars, NSA | 14.6 | 1.5 | 27.4 | 9.4 | 99.4 | -55.9 | 79.8 |
| 9. General purpose and broker/dealer money market mutual fund shares, NSA | 17.3 | 19.7 | 13.6 | 2.9 | 8.1 | 10.3 | 210.8 |
| 10. Commercial banks | 6.8 | 6.6 | 6.7 | 8.5 | 10.6 | -1.1 | 905.4 |
| 11. Savings deposits, SA, plus MMDAs, NSA[3] | 16.0 | 11.6 | 19.3 | 16.9 | 18.0 | 2.9 | 542.8 |
| 12. Small time deposits | -4.2 | 0.7 | -9.0 | -3.9 | 0.0 | -7.2 | 362.5 |
| 13. Thrift institutions | 4.3 | 4.4 | 4.2 | 0.4 | 5.2 | 5.4 | 900.5 |
| 14. Savings deposits, SA, plus MMDAs, NSA[3] | 12.0 | 6.8 | 16.5 | 8.7 | 16.0 | 16.7 | 415.1 |
| 15. Small time deposits | -1.2 | 2.6 | -4.9 | -6.8 | -3.2 | -4.2 | 485.5 |
| 16. M3 minus M2[4] | 8.3 | 11.7 | 4.6 | 9.1 | 7.8 | 7.6 | 698.2 |
| 17. Large time deposits | 3.0 | 7.2 | -1.2 | 3.0 | 7.0 | -4.8 | 447.8 |
| 18. At commercial banks, net[5] | 2.8 | 6.2 | -0.6 | 7.9 | 16.0 | 0.4 | 295.9 |
| 19. At thrift institutions | 3.3 | 9.0 | -2.3 | -5.4 | -10.1 | -14.0 | 152.0 |
| 20. Institution-only money market mutual fund shares, NSA | 30.3 | 32.1 | 24.5 | -4.3 | -1.4 | 10.0 | 84.7 |
| 21. Term RPs, NSA | 28.6 | 33.7 | 20.1 | -5.8 | -19.0 | 38.6 | 83.5 |
| 22. Term Eurodollars, NSA | 2.3 | 7.2 | -2.5 | 73.5 | 46.2 | 56.9 | 90.5 |
| | -- Average monthly change in billions of dollars -- | | | | | | |
| MEMORANDA: | | | | | | | |
| 23. Managed liabilities at commercial banks (24+25) | 2.0 | 1.7 | 2.5 | 3.1 | 13.8 | 5.0 | 509.4 |
| 24. Large time deposits, gross | 0.6 | 0.6 | 0.7 | 2.4 | 4.5 | 1.0 | 351.2 |
| 25. Nondeposit funds | 1.4 | 1.1 | 1.8 | 0.7 | 9.3 | 4.0 | 158.2 |
| 26. Net due to related foreign institutions, NSA | 0.6 | 0.4 | 0.8 | 2.8 | 4.0 | 3.1 | -11.9 |
| 27. Other[6] | 0.9 | 0.7 | 1.0 | -2.0 | 5.2 | 0.9 | 170.1 |
| 28. U.S. government deposits at commercial banks[7] | 0.4 | 0.2 | 0.6 | -2.0 | 0.1 | 1.9 | 23.2 |

1. Semi-annual growth rates are computed on a quarterly average basis. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Growth rates are for savings deposits, seasonally adjusted, plus money market deposit accounts (MMDAs), not seasonally adjusted. Commercial bank savings deposits excluding MMDAs increased during January and February 1987 at rates of 41.2 percent and 34.5 percent, respectively. At thrift institutions, savings deposits excluding MMDAs increased during January and February 1987 at rates of 29.5 percent and 33.2 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.
6. 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, loan RPs and other minor items). Data are partially estimated.
7. Consists of Treasury demand deposits and note balances at commercial banks.
p--preliminary

last month, growth of M2 from the fourth quarter to February amounted to 6-1/4 percent at an annual rate—in the lower part of the Committee's 5-1/2 to 8-1/2 percent range for the year—and this aggregate likely is slipping lower in its range in March. M3 growth through February was only a shade stronger, at 6-1/2 percent, also in the lower half of its annual range.

Growth of debt of domestic nonfinancial sectors appears to have slowed to an annual rate of around 9 percent in February, compared with 13-1/4 percent in January; the aggregate is still above its 1987 monitoring range of 8 to 11 percent growth, but is moving closer to the upper level of the range. The deceleration is attributable largely to a marked decline in federal borrowing, as the Treasury runs down its large cash balance. State and local bond issuance has remained moderate and disproportionately in the form of advance refundings. Net business borrowing has fallen considerably from the strong December pace, although long-term issues continue to be substantial. Household borrowing appears to have remained strong, especially in the mortgage category because of the strong housing market and the new tax advantage over consumer credit.

Monetary Aggregates and Bank Credit

M1 was little changed in February on a month-average basis. Demand deposits contracted at a double-digit rate for the second straight month, offsetting further the year-end surge, but the principal source of the deceleration in M1 was a sharp slowdown in the growth of other checkable deposits to an annual rate of 13-1/2 percent. OCDs have not grown this "slowly" in some time, and with the data for early March pointing to only a slight pickup, the pattern suggests the possibility that the heavy shifting prompted by low opportunity costs may be winding down.

The flatness of M2 in February reflected primarily the weakness in M1 and the sharp decline in overnight RPs and Eurodollars. However, retail nontransactions balances also grew more slowly in February. While savings deposits continued to expand rapidly, small time deposits ran off for the tenth straight month. In addition, there were outflows from MMDAs as their rates remained a bit below rates paid on passbook accounts, which were reduced only slightly further. Funds may have been drawn away from M2-type instruments by the stronger inflows to bond and equity mutual funds; these were very strong in January and appear to have continued so in February. It also is possible that some individuals have responded to tax law changes by paying down consumer credit with liquid balances. Despite the abundant publicity about the frailty of many thrift institutions and of the FSLIC, the thrift share of M2-type deposits has held up well thus far this year. In broad terms, retail deposit patterns appear to have extended into March, implying slow M2 growth this month.

NET SALES OF MUTUAL FUND SHARES[1]
(Monthly rates, not seasonally adjusted, billions of dollars)

| | 1984 | 1985 | 1986 | | | | 1987 |
|---|---|---|---|---|---|---|---|
| | Year | Year | Q1 | Q2 | Q3 | Q4 | Jan. |
| Bond and equity funds | 2.2 | 6.7 | 12.3 | 12.8 | 12.0 | 12.6 | 18.0 |
| Bond funds | 1.5 | 5.9 | 9.6 | 9.4 | 9.9 | 10.2 | 13.3 |
| Equity funds | .7 | .8 | 2.7 | 3.3 | 2.1 | 2.4 | 4.7 |

1. Net sales equal total new sales plus reinvested dividends less redemptions.

M3 edged up in February, boosted by a continued substantial buildup of term Eurodollar balances by U.S. residents and a resumption of inflows to term RPs and institution-only money market funds. Large time deposits fell as thrift institutions ran off CDs at a double-digit rate, relying

instead on borrowing from Federal Home Loan Banks. Data for early March suggest that stronger issuance of CDs at banks has compensated for reduced inflows to other non-M2 components, leaving M3 expansion sluggish.

Bank credit decelerated markedly in February as a broadly based slowdown in loan growth was not fully offset by a rebound in securities acquisitions. Banks continued to acquire U.S. government securities, albeit at a reduced rate, and they boosted their holdings of other securities somewhat, after four months of declines. Much of the slackening in total loan growth reflected an unwinding of the surge during the closing weeks of 1986. Real estate lending slowed to a 12-3/4 percent pace in February, about the rate evident during most of 1986; just before year-end, both commercial and residential loans had been boosted as transactions took place in advance of the repeal of the capital gains exclusion and changes in depreciation schedules. Consumer loans were virtually flat last month, possibly influenced both by tax reform and by the continued substitution of home equity lines for outright consumer credit. Business loans showed the sharpest slowdown, actually declining slightly on a month-average basis after two months of extremely rapid growth.

Corporate Finance

Nonfinancial corporate borrowers moved to take advantage of the lowest bond rates in more than nine years by lengthening their debt maturities in February, and, especially, in March. Both bank loans and commercial paper of nonfinancial borrowers declined in February and remained weak in early March, while new bond offerings have risen sharply. This month the volume of new issues by nonfinancial firms likely will be the largest since last April, when rates were falling steeply. Average bond

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

| | 1986 | | | | 1987 | | Levels in bil. of dollars |
|---|---|---|---|---|---|---|---|
| | Q2 | Q3 | Q4 | Dec. | Jan. | Feb.p | February p |
| | Commercial Bank Credit | | | | | | |
| 1. Total loans and securities at banks | 3.9 | 13.5 | 9.5 | 17.4 | 18.4 | 2.0 | 2114.2 |
| 2. Securities | 4.9 | 31.9 | 6.0 | 7.0 | 0.1 | 6.8 | 505.5 |
| 3. U.S. government securities | 7.9 | 28.4 | 20.1 | 16.9 | 18.6 | 8.4 | 316.1 |
| 4. Other securities | 0.7 | 37.3 | -14.5 | -8.6 | -29.2 | 4.5 | 189.4 |
| 5. Total loans | 3.6 | 7.8 | 10.6 | 20.7 | 24.2 | 0.5 | 1608.7 |
| 6. Business loans | 2.0 | 2.8 | 19.4 | 38.5 | 32.0 | -1.7 | 550.4 |
| 7. Security loans | -62.7 | 18.8 | -64.7 | -83.8 | 38.6 | 34.3 | 39.6 |
| 8. Real estate loans | 13.3 | 13.6 | 17.1 | 24.7 | 24.2 | 12.8 | 501.5 |
| 9. Consumer loans | 6.7 | 5.6 | 5.4 | 7.3 | 5.0 | 0.4 | 314.4 |
| 10. Other loans | -1.6 | 9.2 | -1.6 | 7.1 | 30.7 | -28.8 | 202.8 |
| | Short- and Intermediate-Term Business Credit | | | | | | |
| 11. Business loans net of bankers acceptances | 1.0 | 2.7 | 19.8 | 39.4 | 31.8 | -1.3 | 545.5 |
| 12. Loans at foreign branches[2] | -21.5 | 9.1 | -28.9 | -61.4 | -93.4 | 70.1 | 16.3 |
| 13. Sum of lines 11 & 12 | 0.2 | 2.9 | 18.1 | 36.0 | 28.0 | 0.6 | 561.8 |
| 14. Commercial paper issued by nonfinancial firms[3] | -12.7 | 7.3 | -19.1 | -39.3 | 3.0 | -42.1 | 77.1 |
| 15. Sums of lines 13 & 14 | -1.6 | 3.5 | 13.0 | 25.9 | 24.8 | -4.7 | 638.9 |
| 16. Bankers acceptances: U.S. trade related[4,5] | 17.6 | 3.6 | -27.4 | -37.2 | -11.5 | n.a. | 30.9 (Jan) |
| 17. Line 15 plus bankers acceptances: U.S. trade related | -0.6 | 3.5 | 10.9 | 22.8 | 22.9 | n.a. | 672.3 (Jan) |
| 18. Finance company loans to business[4] | 11.4 | 3.4 | 10.5 | 8.4 | 6.3 | n.a. | 172.6 (Jan) |
| 19. Total short- and intermediate-term business credit (sum of lines 17 & 18) | 1.9 | 3.4 | 10.9 | 20.0 | 19.5 | n.a. | 844.9 (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. Consists of acceptances that finance U.S. imports, U.S. exports and domestic shipment and storage of goods.

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

| | 1986 | | | 1987 | | | |
|---|---|---|---|---|---|---|---|
| | Year[p] | Q3 | Q4[p] | Q1[e] | Jan.[p] | Feb.[p] | Mar.[e] |
| Corporate securities - total[1] | 28.07 | 23.85 | 30.21 | 27.27 | 23.75 | 26.06 | 32.00 |
| Public offerings in U.S. | 24.52 | 20.48 | 27.49 | 24.77 | 22.82 | 23.50 | 28.00 |
| Stocks--total[2] | 5.15 | 4.45 | 5.98 | 4.47 | 2.92 | 3.50 | 7.00 |
| Nonfinancial | 2.51 | 2.05 | 2.97 | 2.31 | .62 | 2.10 | 4.20 |
| Utility | .64 | .48 | .82 | .48 | .25 | .60 | .60 |
| Industrial | 1.87 | 1.57 | 2.15 | 1.83 | .37 | 1.50 | 3.60 |
| Financial | 2.64 | 2.40 | 3.01 | 2.16 | 2.30 | 1.40 | 2.80 |
| Bonds--total[1] | 19.37 | 16.03 | 21.51 | 20.30 | 19.90 | 20.00 | 21.00 |
| Nonfinancial | 9.61 | 8.22 | 8.03 | 8.80 | 6.45 | 8.45 | 11.50 |
| Utility | 3.61 | 3.14 | 3.68 | 2.08 | 1.45 | 3.10 | 1.70 |
| Industrial | 6.00 | 5.08 | 4.35 | 6.72 | 5.00 | 5.35 | 9.80 |
| Financial | 9.76 | 7.81 | 13.48 | 11.50 | 13.45 | 11.55 | 9.50 |
| By quality[3] | | | | | | | |
| Aaa and Aa | 5.70 | 3.82 | 7.19 | 3.30 | 3.80 | 3.10 | 3.00 |
| A and Baa | 6.03 | 5.15 | 5.16 | 6.92 | 7.55 | 6.70 | 6.50 |
| Less than Baa | 3.41 | 3.29 | 2.93 | 3.12 | 1.15 | 2.40 | 5.80 |
| No rating (or unknown) | .34 | .19 | .52 | .27 | .10 | .20 | .50 |
| Memo items: | | | | | | | |
| Equity-based bonds[4] | .86 | .70 | .30 | 1.28 | .74 | 1.73 | 1.60 |
| Mortgage-backed bonds | 4.13 | 3.58 | 6.70 | 6.40 | 7.10 | 7.10 | 5.00 |
| Variable-rate notes | 1.29 | .72 | 3.48 | 2.25 | 2.70 | 1.85 | 2.20 |
| Bonds sold abroad - total | 3.55 | 3.28 | 2.72 | 2.50 | .93 | 2.56 | 4.00 |
| Nonfinancial | 1.50 | .93 | .95 | .95 | .58 | .78 | 1.50 |
| Financial | 2.05 | 2.35 | 1.77 | 1.55 | .35 | 1.78 | 2.50 |
| Stocks sold abroad - total | .15 | .09 | .27 | .06 | .02 | .10 | .05 |
| Nonfinancial | .09 | .07 | .22 | .05 | .02 | .10 | .03 |
| Financial | .06 | .02 | .05 | .01 | .00 | .00 | .02 |

p--preliminary. e--staff estimate.
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 or Standard and Poors if unrated by Moody's. Excludes mortgage-backed bonds.
4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.

maturities have been long in both of the last two months. The recent increase in volume has been greater for industrial than utility issues, suggesting that the major part of these offerings are not for refunding purposes, since in 1986 the bulk of the refundings were utility issues. The new issue volume has included an increase in low-grade offerings by firms searching for more permanent financing of earlier mergers and LBOs. Demand for lower-grade issues is still strong, with yield spreads between investment and noninvestment grade bonds now close to last summer's pre-LTV-failure lows. Bond issues convertible into equity or issues with equity warrants also have been sizable in the past two months.

New equity offerings were very weak early in the quarter, but they picked up as the stock market rally continued and will likely reach a record volume this month. Merger activity appears to have receded somewhat after the tax law changes at the beginning of the year, resulting in a smaller amount of equity retirement; announcements of future acquisitions and share repurchases have picked up recently, however.

Not sharing in the recent stock market gains were shares of large banks with substantial exposures to Latin America. Most have lost 6 to 12 percent of their market value since Brazil's suspension of interest payments in mid-February. Prices of some debt issues of large U.S. banks also have suffered; in the Euro floating-rate market, notes with long maturities have lost 2 to 4 percent in value partly because of Brazilian loan concerns. General problems of illiquidity also have developed in this market, after a series of collapses in the prices of perpetual floating-rate note issues; among the principal factors have been increased competition from floating-rate mortgage securities and increased concerns

regarding provisions in primary capital notes of banks that allow them to withhold interest payments at times of financial difficulty.

Treasury and Sponsored Agency Financing

The combined deficit of the federal government is projected to total about $60 billion (NSA) in the first quarter of calendar 1987, $4 billion less than in the last quarter of 1986. The Treasury is expected to finance the bulk of this quarter's deficit by borrowing about $37 billion from the public and by drawing down its cash balance by $14 billion.

Net issuance of marketable coupon securities should total about $37 billion. Unlike the last two quarters, when sales of bills raised a large portion of new cash, auctions of regular weekly and monthly bills will result in a sizable paydown this quarter. This paydown likely will be partially offest by a cash management bill at the end of the quarter to bridge the period until April tax revenues come in. The reduction in the supply of bills has contributed to the downward pressure on bill yields relative to other money market rates since the last FOMC; some precautionary shifting of demand away from bank CDs also has been a factor.

Net issuance of nonmarketable debt is predicted to be down somewhat this quarter, though still substantial at about $10 billion. The decline is largely attributable to lower demand for Treasury savings bonds since last November 1, when the guaranteed minimum rate was reduced from 7.5 to 6 percent. During the months immediately preceding the November 1 cut, savings bond sales averaged $1.7 billion per month, while since December sales have run about $800 million per month. The Treasury's issuance of SLGS is almost unchanged, as advance refunding by state and local governments has been well maintained. A new floating-rate SLGS program--mandated

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

| | 1986 Q4 | 1987 Q1[e] | 1987 Jan. | Feb.[p] | Mar.[e] |
|---|---|---|---|---|---|
| Treasury financing | | | | | |
| Combined surplus/deficit(-) | -64.4 | -60.3 | -2.2 | -28.4 | -29.8 |
| Means of financing deficit: | | | | | |
| Net cash borrowing from the public | 69.2 | 36.8 | 4.4 | 15.2 | 17.1 |
| Marketable borrowings/ repayments(-) | 54.5 | 26.2 | 3.7 | 10.1 | 12.4 |
| Bills | 15.9 | -10.5 | -3.3 | -6.6 | -.6 |
| Coupons | 38.6 | 36.7 | 7.0 | 16.7 | 13.0 |
| Nonmarketable | 14.7 | 10.6 | .7 | 5.1 | 4.7 |
| Decrease in the cash balance | .5 | 14.1 | -10.4 | 16.5 | 8.0 |
| Memo: Cash balance at end of period | 30.9 | 16.8 | 41.3 | 24.8 | 16.8 |
| Other[2] | -5.3 | 9.5 | 8.2 | -3.3 | 4.7 |
| Federally sponsored credit agencies, net cash borrowing[3] | 4.4 | -2.4 | -2.0 | .1 | -.5 |
| FHLBs | 1.6 | 2.8 | 1.5 | 1.0 | 0.3 |
| FNMA | 1.9 | -2.5 | -1.0 | -1.1 | -0.4 |
| Farm Credit Banks | -1.0 | -3.9 | -2.3 | -0.6 | -1.0 |
| FHLMC | 0.3 | 0.5 | 0.2 | 0.1 | 0.2 |
| SLMA | 1.6 | .7 | -.4 | .7 | .4 |

p--preliminary. e--staff estimate.
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.

by the tax reform act--has proved to be unpopular, owing to the low interest rate paid on the certificates, the requirement that investors use only the regular or the new daily program, and certain other complexities of the program; modifications are under consideration by the Treasury.

The federally sponsored credit agencies also have lower financing needs and are expected to reduce their outstanding debt in the first quarter. The Farm Credit Banks continue to pay down debt, owing to the weak overall demand for loans by farmers and, to some extent, the loss of higher quality borrowers to other lenders. Fannie Mae also is expected to repay debt; its volume of mortgage purchases has declined, partly because mortgage originators are selling more mortgage-related securities directly into the market, and partly because the agency had advanced some of its planned borrowing from early this year to late 1986, when it viewed market conditions as especially favorable. In contrast, the Federal Home Loan Banks are expected to raise about $2-3/4 billion in new cash in the first quarter.

The spreads between rates on some FHLB securities and those on Treasuries have widened slightly in secondary market trading of late, but the new securities priced in mid-March had spreads quite similar to those for comparable maturities in recent months and somewhat below those early last summer. Spreads against Treasuries for the securities of the Farm Credit Banks widened after the release in February of their 1986 financial statements. The six-month security of the FCBs, the most frequent issue of these banks, carried a spread of nearly 50 basis points over bills at its pricing in late February and has traded a little higher than that in the secondary market; on earlier six-month issues, spreads were about 25 to 30 basis points.

Municipal Securities Market

Gross offerings of tax-exempt bonds totaled $8 billion in February but in March are expected to be considerably higher, perhaps reaching the average pace of issuance in 1986. Total tax-exempt offerings have been boosted during the first quarter by a continued large volume of advance refundings as public-purpose issuers take advantage of the relatively low rates. In the first quarter, total refundings will account for well over half of all new issues, a record share. The slowdown in borrowing to raise new capital reflects increased restrictions under tax reform, particularly the tightened volume curbs on private-purpose bonds. The bulk of issues so far this year have been general obligation and revenue bonds for public purposes, such as transportation and public utilities.

GROSS OFFERINGS OF MUNICIPAL SECURITIES
(Monthly rates, not seasonally adjusted, billions of dollars)

| | 1985 | 1986 | 1986 | 1987 | | |
|---|---|---|---|---|---|---|
| | Year | Year | Q4 | Jan. | Feb.p | Mar.e |
| Total tax-exempt | 19.82 | 12.87 | 11.37 | 7.20 | 8.37 | 11.70 |
| Short-term[1] | 1.97 | 1.65 | .72 | .37 | .41 | .70 |
| Long-term | 17.85 | 11.22 | 11.00 | 6.83 | 7.96 | 11.00 |
| Refundings[2] | 4.85 | 4.62 | 5.43 | 4.27 | 4.93 | 6.00 |
| New capital | 13.00 | 6.60 | 5.57 | 2.56 | 3.03 | 5.00 |
| Total taxable | .03 | .33 | .35 | .12 | .06 | .65 |

e--staff estimate. p--preliminary.
1. Does not include tax-exempt commercial paper.
2. Includes all refunding bonds, not just advance refundings.

Issuance of taxable municipal bonds also picked up in March after four months of little volume. About $650 million of taxable issues were sold, including $465 million backed by guaranteed investment contracts

(GICs).[1] The proceeds of offerings in March have been intended for agricultural loans and industrial development, as well as for other purposes for which tax-exempt bonds have been precluded under tax reform.

Mortgage Markets

Home mortgage interest rates have not changed significantly since the last FOMC meeting. At 9.08 percent last week, however, the average interest rate on commitments for 30-year fixed-rate conventional loans (FRMs) at major lenders was nearly 30 basis points lower than in early January and at its lowest level in nearly a decade. The average initial rate on one-year adjustable-rate mortgages (ARMs) slipped 3 basis points during the intermeeting period to 7.55 percent in mid-March, keeping the spread between rates on FRMs and ARMs about unchanged from its size in early February.

Interest rates on mortgages closed in early February fell 20 to 30 basis points from their levels at the beginning of the year, the sixth consecutive monthly decline. Rates on FRMs fell more than those on ARMs, which may help to explain the slight decrease in the proportion of mortgages closed with adjustable-rate features in early 1987. Although ARMs accounted for only about 30 percent of all home mortgages made in January and February, they accounted for a much higher proportion of the loans made by thrift institutions; within the S&L industry, West Coast associations have been much more aggressive in their marketing of ARMs than those in the rest of the country as a group, as measured by the offering of a discount or buy-down.

1. Last year most GIC-backed taxable municipals were underwritten by Drexel Burnham Lambert, with Executive Life the primary provider of GICs. So far this year neither of these firms has been active in the market, which has included Equitable Life Assurance Society, Hutton Group, Shearson Lehman Holdings, and Prudential-Bache.

CONVENTIONAL HOME MORTGAGES CLOSED IN 1987
WITH ADJUSTABLE-RATE FEATURES[1]

| Lender type | With discount or buy-down | | With discount or buy-down of at least 100 basis points | |
|---|---|---|---|---|
| | Jan. | Feb. | Jan. | Feb. |
| | --------Proportion of ARMs closed, percent---------- | | | |
| FHLB members[2] | 52 | 57 | 37 | 38 |
| District 11[3] | 71 | 74 | 58 | 60 |
| Other Districts | 38 | 42 | 21 | 21 |
| Other lenders[4] | 47 | 54 | 28 | 39 |

Source: FHLB Board.
1. The data represent first mortgages made for the purchase of new and existing houses during the first five working days of each month; they do not include refinancings.
2. FHLB members include savings and loan associations, FSLIC-insured federal savings banks, and some FDIC-insured savings banks.
3. District 11 is the San Francisco Federal Home Loan Bank District.
4. Other lenders that closed ARMs include savings banks that are not members of the FHLB System, commercial banks, and mortgage companies.

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

| Period | Total | GNMAs | FHLMCs | FNMAs | Memo: FNMA and FHLMC swap issues |
|---|---|---|---|---|---|
| 1985-Q1 | 6.4 | 2.7 | 2.4 | 1.3 | 3.0 |
| Q2 | 7.5 | 3.3 | 2.8 | 1.5 | 3.3 |
| Q3 | 10.4 | 4.1 | 3.8 | 2.5 | 4.7 |
| Q4 | 11.8 | 5.2 | 3.9 | 2.7 | 4.9 |
| 1986-Q1 | 12.6 | 5.1 | 3.1 | 2.2 | 3.8 |
| Q2 | 19.2 | 7.0 | 7.5 | 4.7 | 8.5 |
| Q3 | 27.3 | 10.0 | 10.4 | 6.8 | 10.9 |
| Q4 | 28.2 | 10.6 | 12.0 | 5.6 | 11.1 |
| 1986-Oct. | 27.2 | 10.2 | 11.4 | 5.5 | 10.8 |
| Nov. | 25.8 | 9.6 | 10.5 | 5.6 | 10.5 |
| Dec. | 31.6 | 12.1 | 14.0 | 5.5 | 12.0 |
| 1987-Jan. | 25.6 | 10.6 | 8.6 | 6.4 | 11.6 |
| Feb. | 22.5 | 9.7 | 7.9 | 4.9 | n.a. |

Among the factors affecting the ability of lenders to close ARMs is their willingness to offer initial-year discount rates, or "teaser" rates, on such loans. Of the ARMs closed in early February, 56 percent included such a discount, up from 50 percent in January. It is thought that substantial discounts are being offered less frequently now than when ARMs were first marketed. There are reports that borrowers in some instances may be "rolling over" ARMs in order to take advantage of these initial-year discounts.

Even though residential mortgage borrowing remained strong, total mortgage debt formation seems to have slowed a bit in early 1987 from its very rapid--tax-affected--pace in the fourth quarter of last year. In addition to the slowing of real estate loans at banks in February, mortgage assets held at FSLIC-insured thrift institutions increased at a much slower pace in January than in the preceding month. Moreover, loan originations at FSLIC-insured thrifts totaled $20 billion in January, down sharply from the $29 billion originated in December and the lowest volume of mortgage lending activity at these institutions in nine months. Possibly reflecting a general slowdown, the volume of new issues of federally related pass-through securities has declined in each of the first two months of this year.

Consumer Installment Credit

Consumer installment credit showed little increase again in January. Auto credit outstanding grew at only a 5 percent annual rate, while the other types of installment debt together contracted at a 2 percent rate. Part of the slowdown may be attributable to the incentive households have to repay consumer debt, owing to the loss of full tax-deductibility under tax reform. Many individuals apparently are paying down their consumer

CONSUMER INSTALLMENT CREDIT
(Seasonally adjusted)

| | Percent change (at annual rate) | | | | | | Memo: Outstandings (billions of dollars) |
|---|---|---|---|---|---|---|---|
| | | | 1986 | | 1986 | 1987 | 1987 |
| | 1985r | 1986r | Q3r | Q4r | Dec.r | Jan.p | Jan.p |
| Total[1] | 17.1 | 10.5 | 14.1 | 4.6 | .3 | 1.1 | 578.3 |
| Total, excluding auto | 14.9 | 5.7 | 6.0 | .6 | -6.9 | -1.8 | 332.2 |
| Selected types | | | | | | | |
| Auto | 20.7 | 17.8 | 26.0 | 10.1 | 10.2 | 5.0 | 246.1 |
| Revolving | 22.5 | 10.6 | 7.3 | 5.5 | 4.9 | -3.3 | 134.6 |
| All other | 10.6 | 2.6 | 5.1 | -2.7 | -11.6 | -.7 | 197.7 |
| Selected holders | | | | | | | |
| Commercial banks | 15.7 | 8.1 | 8.8 | 4.1 | -6.1 | 1.5 | 261.9 |
| Finance companies | 26.3 | 20.7 | 33.1 | 2.9 | 1.6 | -7.5 | 135.6 |
| Credit unions | 9.9 | 8.0 | 11.1 | 8.1 | 5.4 | 2.8 | 78.0 |
| Savings institutions[2] | 30.0 | 10.7 | 8.0 | 9.5 | 18.2 | 16.0 | 58.8 |

1. Includes items not shown separately.
2. Savings and loans, mutual savings banks, and federal savings banks.
r--revised. p--preliminary.

CONSUMER INTEREST RATES
(Annual percentage rate)

| | | | 1986 | | | 1987 | |
|---|---|---|---|---|---|---|---|
| | 1985 | 1986 | Oct. | Nov. | Dec. | Jan. | Feb. |
| At commercial banks[1] | | | | | | | |
| New cars (48 mo.) | 12.91 | 11.33 | ... | 10.58 | ... | ... | 10.35 |
| Personal (24 mo.) | 15.94 | 14.83 | ... | 14.19 | ... | ... | 14.10 |
| Credit cards | 18.69 | 18.26 | ... | 18.09 | ... | ... | 18.10 |
| At auto finance cos.[2] | | | | | | | |
| New cars | 11.98 | 9.44 | 6.12 | 11.83 | 11.71 | 11.65 | n.a. |
| Used cars | 17.59 | 15.95 | 15.17 | 15.20 | 15.12 | 14.62 | n.a. |

1. Average of "most common" rate charged for specified type and maturity during the first week of the mid-month of each quarter.
2. Average rate for all loans of each type made during the month regardless of maturity.

loans by borrowing against lines of credit secured by home equity. Information from surveys of both institutions and households suggests that as much as half of this borrowing can be regarded as substituting in one way or another for consumer loans.

Institutions continue to market home equity lines aggressively, hoping to establish a customer base for this service that is viewed as likely to involve a long-term relationship. In Atlanta, however, one of the early hotbeds of home equity promotion, many lending institutions reportedly have reinstated normal settlement charges.

Several measures used as indicators of debt repayment difficulties on the part of consumers held steady during the fourth quarter. Delinquent auto loans at finance companies edged down during the fourth quarter, and past-due consumer loans at banks remained at 2.26 percent of the number of loans outstanding (American Bankers Association series), squarely in the middle of the range of the past 12 years. The ABA series for credit card delinquencies stood at 3.18 percent of loans outstanding during the fourth quarter of 1986, a slight decline from 3.23 percent during the third quarter. However, that rate of delinquencies is considerably higher than the average of 2.67 percent for 1985. Preliminary call report data through the fourth quarter show that consumer loan writeoffs in 1986 were about a third higher than in 1985.

Household delinquencies on first mortgage debt also declined a bit in the fourth quarter, the Mortgage Bankers' series for loans past due 60 days or more falling to 1.86 percent, 0.15 percentage points below the second-quarter record. Delinquencies remained higher than the average in economically distressed areas, including oil-producing states of the Southwest and some heavily industrialized states in the Midwest.

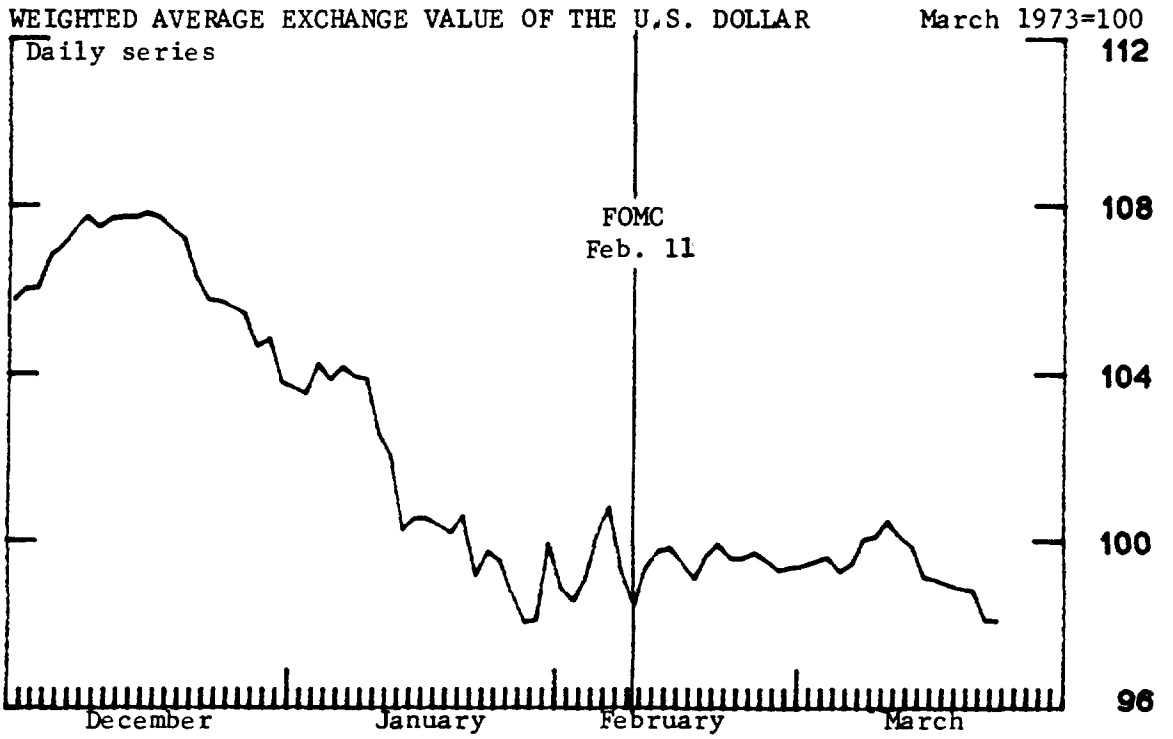
Foreign Exchange Markets

For much of the period since the previous FOMC meeting on February 11 the dollar traded within narrow ranges against most G-10 currencies. During the past week, however, the dollar has come under strong downward pressure -- particularly against the yen -- and U.S. authorities have intervened in volume. On a weighted-average basis, the dollar has declined about 1 percent from its level on February 11. Against the yen, the dollar is down about 3 percent; against the mark, down only 1/2 percent.

During the early part of the intermeeting period, concern about the likelihood of further international cooperation to stabilize exchange rates dominated foreign exchange markets, and market participants reacted strongly to reports of possible joint actions. The announcement by G-6 authorities in late February of their intention to "cooperate closely to foster stability of exchange rates around current levels" appeared to cause market participants to become more cautious and seemed to contribute temporarily to reduced volatility among the major currencies. The credibility of the G-6 agreement also appeared to be enhanced by the market's perception that the United States sold a small amount of dollars in early March when the dollar rose above 1.87 DM/$.

Downward pressure on the dollar may also have been moderated by data released during the intermeeting period that indicated weaker growth prospects in both Germany and Japan. To help stimulate the Japanese economy, on February 25 the Bank of Japan cut its discount

Chart 1


WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR
March 1973=100
Daily series
112
108
104
100
96
FOMC
Feb. 11
December
January
February
March

rate by 1/2 percentage point to 2-1/2 percent. In contrast, new U.S. data revealed a mixed picture, but on balance suggested a somewhat more favorable outlook for the U.S. economy.

Following the weekend of March 21-22, downward pressure on the dollar intensified as concern heightened about deterioration in U.S.-Japanese trade relations. Treasury Secretary Baker's comments indicating that no target zones for currencies had been established at the February G-6 meeting also may have been an influential background factor. , the dollar fell rapidly through 150 yen/dollar to a low of 148.40 yen/dollar on March 24 before recovering slightly. The Desk intervened with small sales of yen on March 23 and much more strongly thereafter, selling a total of $823.2 million worth of yen during the three days, divided evenly between the System and the Treasury.

Before the recent emergence of selling pressure on the dollar, the principal exception to the general pattern of stable currencies had been the U.K. pound. Sterling, which moved up by almost 6 percent against the dollar during the intermeeting period, drew support from favorable fiscal developments revealed in the annual budget speech on March 17. The firming of the pound allowed the Bank of England in mid-March to cut its money-market dealing rates in two steps by a total of a full percentage point; commercial banks' base lending rate were reduced by a similar amount to 10 percent.

. During the intermeeting period, the Canadian dollar rose about 2-1/2 percent and the Swedish krona gained 2 percent. Reflows into EMS currencies other than the mark intensified during the intermeeting period, allowing some countries to rebuild reserves that had been depleted prior to the EMS realignment in January.

Several EMS countries also took advantage of the opportunity provided by strength in their currencies to reduce official interest rates. On March 9, the Bank of France cut both its money-market intervention rate and 7-day repurchase rate by a quarter point to 7-3/4 and 8-1/2 percent, respectively; on March 14, the Bank of Italy reduced its discount rate by 1/2 percentage point to 11-1/2 percent. The interest rate on short-term Treasury certificates in Belgium was lowered in two stages in mid-March by a total of 35 basis points to 7.4 percent, and the Danish overnight rate was cut by 50 basis points to 10-1/2 percent on March 17.

With these official rate reductions, foreign short-term interest rates moved down during the intermeeting period by about 10 basis points on a weighted-average basis, while U.S. short-term interest rates gained about 10 basis points. The differential between U.S. and foreign long-term interest rates also moved in favor of the

dollar, as foreign long-term interest rates declined somewhat more than did U.S. rates.

U.S. bank lending to foreigners in the fourth quarter. In nominal terms, U.S.-chartered banks' claims on foreigners rose $4.2 billion in the fourth quarter, including a $400 million increase in claims on non-OPEC developing countries. After adjustment for the effect of a 2.9 percent decline in the exchange value of the dollar on the dollar value of nondollar claims, total claims at constant exchange rates are estimated to have been about unchanged. For 1986 as a whole, claims on foreigners increased $3.6 billion in nominal terms and decreased approximately $6 billion at constant exchange rates.

The nominal value of claims on non-OPEC developing countries fell by $5.0 billion during 1986. There was a mixed pattern of small increases and decreases in claims on Latin American countries, creating an overall reduction of $0.6 billion (less than one percent) for the year. During 1985, unadjusted claims had declined $3.1 billion, or approximately 4 percent. In contrast, claims on the Asian and African non-OPEC developing countries declined $4.3 billion in 1986, a 14 percent reduction in claims on these countries. This followed a decline of roughly 10 percent in 1985.

The divergence of experience across African and Asian non-OPEC developing countries is striking. Claims on Taiwan increased by $0.4 billion in 1986. This amounted to an increase of nearly 10 percent, and restored the level of gross U.S. bank claims on Taiwan to levels approaching those maintained from end-1982 until mid-1985. This increase in gross bank claims, however, occurred at the same time that Taiwan's external assets were also increasing. Official external assets alone (other than gold) increased by roughly $24 billion (110 percent) in 1986. In contrast during 1986, claims on the Philippines

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

| | Changes (no sign = increase) | | | | | |
|---|---|---|---|---|---|---|
| | 1984 | 1985 | 1986 | | | Outstanding |
| | Year | Year | Year | Q3 | Q4 | 12/31/86 |
| Total, all countries | -28.2 | -13.8 | 3.6 | 0.3 | 4.2 | 395.5 |
| Non-OPEC developing countries | 1.0 | -6.7 | -5.0 | -1.8 | 0.4 | 100.1 |
| of which: | | | | | | |
| (Latin America) | 2.1 | -3.1 | -0.6 | -0.3 | 0.8 | 73.0 |
| (Asia and Africa) | -1.4 | -3.3 | -4.3 | -1.7 | -0.1 | 27.3 |
| OPEC countries | -3.5 | -3.3 | -2.0 | -0.6 | -0.4 | 19.6 |
| Eastern Europe | -0.9 | -0.2 | -0.2 | -0.6 | 0.6 | 4.0 |
| Small developed countries | -2.4 | -3.2 | -4.2 | -1.2 | -3.2 | 26.2 |
| G-10 countries | -19.7 | 0.4 | 11.1 | -1.0 | 0.7 | 159.6 |
| Offshore banking centers | -3.3 | -0.2 | 0.2 | 5.4 | 3.0 | 65.6 |
| Miscellaneous | 0.5 | -0.4 | 3.4 | 0.3 | 2.8 | 20.3 |
| Memorandum: Total, adjusted for exchange rate changes (staff estimates) | -16 | -29 | -6 | 7 | 0 | |

fell slightly, while claims on much smaller debtors such as Malaysia and Thailand continued a longer-term decline.

U.S. bank claims on Korea declined $2.6 billion, or nearly 30 percent in 1986. Almost all of the decline occurred in the third and fourth quarters. The decline apparently reflects the decision by the Korean authorities to use roughly one half of the 1986 Korean current

account surplus of $4.7 billion to reduce external bank debt. It is somewhat surprising that the reduction in U.S. bank claims on Korea is nearly equal to the estimated net capital outflow recorded in the Korean balance of payment statistics for 1986. This suggests that Korean net repayments were used largely to retire U.S. bank debt. There are competing explanations for this phenomenon. Korean authorities may have viewed U.S. bank debt as having a high cost, and repaid this debt first when feasible. Alternatively, U.S. banks may have been unwilling to maintain their share of the Korean debt market at prevailing interest rate spreads for Korean obligations. Since Korea is the largest developing country borrower from U.S. banks that does not presently face debt service problems, it is thus possible that U.S. banks now intend to reduce exposure to those countries where they are free to do so.

During 1986, U.S. bank claims on OPEC countries, Eastern Europe, and the smaller developed countries declined, continuing a trend that began in 1983. Three-fourths of this decline took place in the fourth quarter. Claims on the offshore banking centers rose by a small amount ($0.2 billion) in 1986. At the same time, claims on the G-10 countries rose $11.1 billion (7 percent), although as much as $9 billion of this increase may have been attributable to the effect of the decline in the value of the dollar.

U. S. International Financial Transactions

, ther. was only a small increase recorded in G-10 official reserve assets in the United States. (See line 4 of the Summary of U.S. International Transactions table.)

. Preliminary information from the FRBNY indicates relatively modest increases in G-10 official holdings in the United States in February.

Banks in the United States reported over $12 billion in net inflows between the end of December and the end of January. (See line 1.) These inflows were more than accounted for by a reduction in claims of U.S.-based banks on their own foreign offices in financial centers abroad. However, when viewed on a monthly average basis, the net inflow from own foreign offices was substantially smaller and slowed in February. (See line 1 of the International Banking Data table.) The large Eurodollar inflows into money center banks in January substituted for other sources of funds that showed sharp declines, particularly demand deposits.

The Eurodollar holdings of U.S. nonbank residents continued to climb in January and February, mostly in the form of Eurodollar CDs held in custody by U.S.-based banks in London. (See line 3 of the International Banking Data table.) These CDs, however, are not necessarily the liabilities of the custodian bank. Detailed reports on the balance sheets of London branches of U.S. banks are not available

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

| | 1985 Year | 1986 Year | 1986 Q1 | 1986 Q2 | 1986 Q3 | 1986 Q4 | 1986 Nov. | 1986 Dec. | 1987 Jan. |
|---|---|---|---|---|---|---|---|---|---|
| Private Capital | | | | | | | | | |
| Banks | | | | | | | | | |
| 1. Change in net foreign positions of banking offices in the U.S. (+ = inflow) | 33.6 | 21.5 | 9.4 | -8.2 | 12.4 | 8.0 | 4.2 | 0.5 | 12.1 |
| Securities | | | | | | | | | |
| 2. Private securities transactions, net | 43.0 | 67.0 | 12.9 | 21.4 | 17.5 | 15.1 | 3.2 | 5.6 | 3.6 |
| a) foreign net purchases (+) of U.S. corporate bonds | 46.0 | 53.7 | 12.8 | 16.0 | 12.7 | 12.1 | 3.4 | 4.5 | 1.8 |
| b) foreign net purchases (+) of U.S. corporate stocks | 4.8 | 18.0 | 6.2 | 7.0 | 4.5 | 0.3 | 0.1 | 1.5 | 1.6 |
| c) U.S. net purchases (-) of foreign securities | -7.9 | -4.6 | -6.1 | -1.6 | 0.4 | 2.7 | -0.3 | -0.4 | 0.2 |
| 3. Foreign net purchases (+) of U.S. Treasury obligations | 20.5 | 8.5 | 7.0 | 3.8 | 0.5 | -2.9 | -3.0 | 0.1 | -2.9 |
| Official Capital | | | | | | | | | |
| 4. Changes in foreign official reserves assets in U.S. (+ = increase) | -2.0 | 32.7 | 2.2 | 14.5 | 14.5 | -1.5 | * | * | 1.1 |
| a) By area | | | | | | | | | |
| G-10 countries (incl. Switz.) | -0.4 | 30.5 | 3.9 | 11.2 | 14.4 | 1.0 | -0.4 | -0.3 | 2.5 |
| OPEC | -6.9 | -8.1 | 1.7 | -2.4 | -2.8 | -4.7 | -1.5 | -2.0 | -0.7 |
| All other countries | 5.3 | 10.3 | -3.5 | 5.8 | 2.9 | 5.1 | 2.0 | 2.2 | -0.7 |
| b) By type | | | | | | | | | |
| U.S. Treasury securities | -0.9 | 34.4 | 3.3 | 14.5 | 12.2 | 4.4 | -0.2 | 0.8 | 1.5 |
| Other 1/ | 2.8 | -1.7 | -1.1 | * | 2.4 | -3.0 | -0.2 | -0.8 | -0.5 |
| 5. Changes in U.S. official reserve assets (+ = decrease) | -3.9 | 0.3 | -0.1 | -0.0 | 0.3 | 0.1 | 0.2 | -0.1 | 0.5 |
| Other transactions (Quarterly data) | | | | | | | | | |
| 6. U.S. direct investment (-) abroad | -18.8 | -31.9 | -10.0 | -8.2 | -8.0 | -5.7 | n.a. | n.a. | n.a. |
| 7. Foreign direct investment (+) in U.S. | 17.9 | 25.6 | 1.4 | 4.1 | 5.6 | 14.4 | n.a. | n.a. | n.a. |
| 8. Other capital flows (+ = inflow) 2/ 3/ | 4.4 | -10.2 | 0.8 | -5.5 | -1.5 | -0.9 | n.a. | n.a. | n.a. |
| 9. U.S. current account balance 3/ | -117.7 | -140.6 | -34.0 | -34.4 | -35.3 | -36.8 | n.a. | n.a. | n.a. |
| 10. Statistical discrepancy 3/ | 23.0 | 27.1 | 10.4 | 12.5 | -6.0 | 10.2 | n.a. | n.a. | n.a. |
| MEMO: | | | | | | | | | |
| U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted) | -124.4 | -147.7 | -36.5 | -35.7 | -37.7 | -38.4 | -14.4 | -11.9 | n.a |

1. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
2. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking and official transactions not shown elsewhere. In addition, it includes amounts resulting from revisions of the data in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.
3. Includes seasonal adjustment for quarterly data.

* Less than $50 million.

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

INTERNATIONAL BANKING DATA
(Billions of dollars)

| | 1982 Dec. | 1983 Dec. | 1984 Dec. | 1985 Dec. | 1986 June | 1986 Sept. | 1986 Dec. | 1987 Jan. | 1987 Feb. |
|---|---|---|---|---|---|---|---|---|---|
| 1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS 1/ | 49.1 | 44.5 | 33.2 | 29.0 | 26.8 | 27.4 | 22.2 | 18.2 | 15.5 |
| (a) U.S.-chartered banks | 40.0 | 40.5 | 32.1 | 32.4 | 31.1 | 29.9 | 31.7 | 26.5 | 25.0 |
| (b) Foreign-chartered banks | 9.1 | 4.0 | 1.1 | -3.4 | -4.3 | -2.5 | -9.5 | -8.3 | -9.5 |
| 2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks | 15.8 | 18.6 | 20.7 | 18.7 | 17.7 | 18.1 | 16.8 | 15.8 | 16.5 |
| 3. Eurodollar Holdings of U.S. Nonbank Residents 2/ | 112.6 | 124.3 | 117.6 | 112.1 | 118.9 | 118.5 | 123.8 | 130.9 | 134.0 |

1. Net claims of U.S. banking offices on their own international banking facilities (IBFs) correspond to net claims of IBFs on all foreign residents, including all banks whether related or not, and all nonbanks.

*/ Less than 50 million (±).

Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices. Line 2 is an average of daily data. Line 3 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.

yet, but information from the Bank of England indicates that CDs outstanding at the London branches of U.S. banks increased by a bit over $1 billion in January, far less than the increase in custody holdings.

In 1986 custody holdings of CDs for U.S. nonbanks increased at the same time that CDs issued by U.S. banks in London declined. It appears that much of the increase in U.S. nonbanks' holdings of Eurodollars in 1986 was in the form of CDs or other deposits issued by foreign banks. Foreign-based banks, particularly Japanese-based banks, have become more active in raising funds in the Euro-CD markets. In contrast, U.S.-based banks appear to have reduced their reliance on brokered funds such as Euro-CDs, while their holding companies have increased their issuance of bonds and notes in the Euromarkets.

Net inflows through private securities transactions (line 2 of the Summary of U.S. International Transactions table) moderated in January, reflecting the decline in new issues of Eurobonds by U.S. corporations at the end of 1986. New issues dropped further in January, but picked up again in February and March. Attracted by the booming U.S. stock market, foreign purchases of U.S. corporate stocks remained high in January. Also in January, private foreigners sold net almost $3 billion in U.S. Treasury securities, following similar net sales in the fourth quarter of 1986 (line 3).

The Department of Commerce has released data for the fourth quarter of 1986 on other capital account transactions. Foreign direct investment in the United States (line 7) jumped to a record level in the fourth quarter (over $14 billion), bringing the total for the year to $25.6 billion. Many takeovers and mergers were bunched at the end of the year, before the effective date of the new tax law. Investors from

Western Europe accounted for almost $19 billion of the total, while Japanese investors accounted for about $5 billion. U.S. direct investment abroad (line 6) continued to be inflated by the depreciation of the dollar, and in particular by the impact of unrealized currency translation gains on reinvested earnings. The statistical discrepancy in the U.S. international transactions accounts climbed to $27 billion in 1986, indicating that substantial amounts of current and capital account transactions continue to be missed by current reporting systems.

Current Quarter Data

Data on merchandise trade for the month of January released at the end of February suggest a trade deficit of $177 billion (annual rate) for that month, on a not seasonally adjusted CIF value basis (See table and chart). These data are preliminary and subject to substantial revision. Nevertheless, they suggest a worsening of exports for the month of January, which has been attributed to the harsh winter both here and abroad. Revised data for December, released with the January figures, indicated a larger deficit for that month than first estimated (see table).

COMMERCE DEPARTMENT DATA, CIF, VALUE, NSA, BIL $ AR

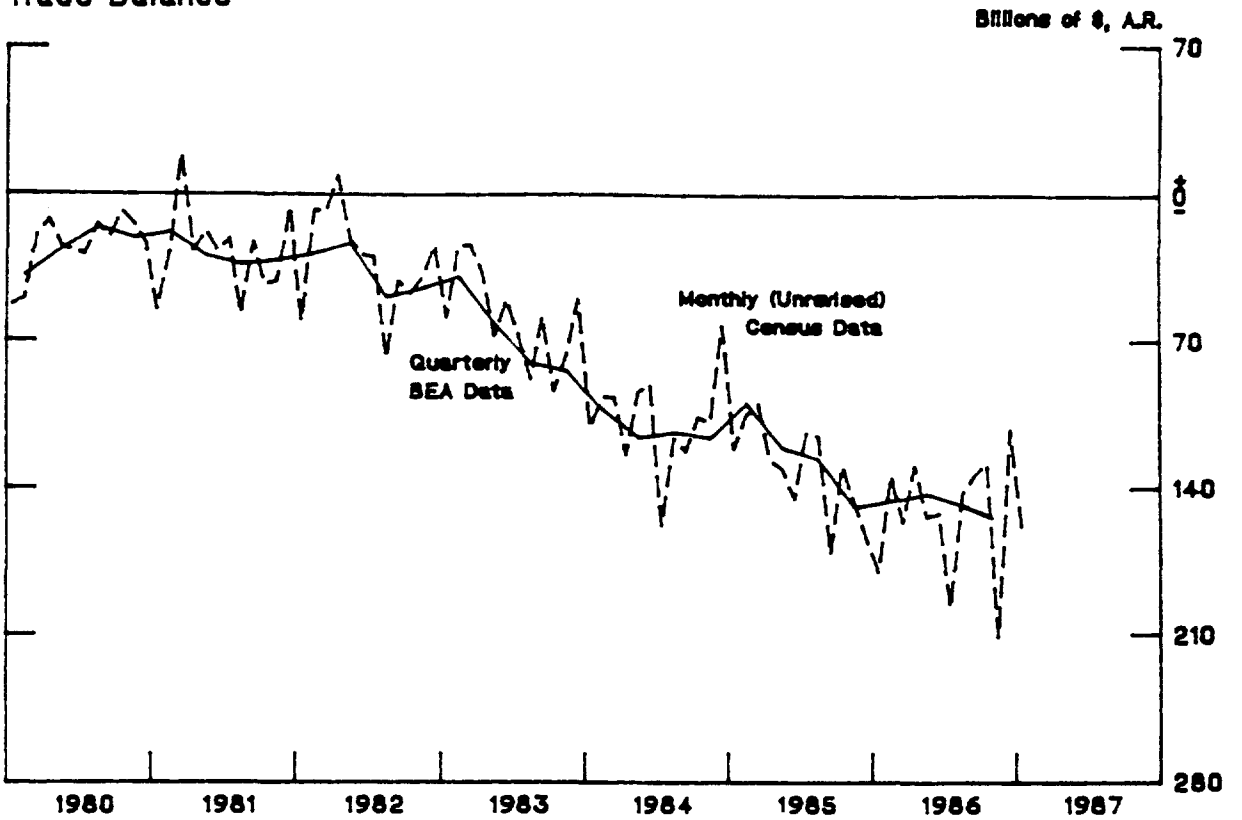
| | Unrevised | | | Revised | | |
|---|---|---|---|---|---|---|
| | Exports | Imports (CIF) | Balance (CIF) | Exports | Imports (CIF) | Balance (CIF) |
| | (1) | (2) | (3) | (4) | (5) | (6) |
| 1986 | | | | | | |
| Oct. | 232 | 377 | -145 | 235 | 411 | -176 |
| Nov. | 223 | 454 | -231 | 221 | 406 | -185 |
| Dec. | 221 | 349 | -128 | 222 | 375 | -153 |
| 1987 | | | | | | |
| Jan. | 197 | 374 | -177 | n.a. | n.a. | n.a. |

Beginning with the next release of merchandise trade figures for February on April 14, all monthly data will be on a revised statistical month basis. The monthly carry-over, which has been responsible for the large month-to-month swings between unrevised and revised data, will be substantially reduced, if not totally eliminated. As a result, the monthly data will tend to be somewhat less volatile and more reliable as an indicator of underlying trends than has previously been the case. Nevertheless, some volatility in the monthly

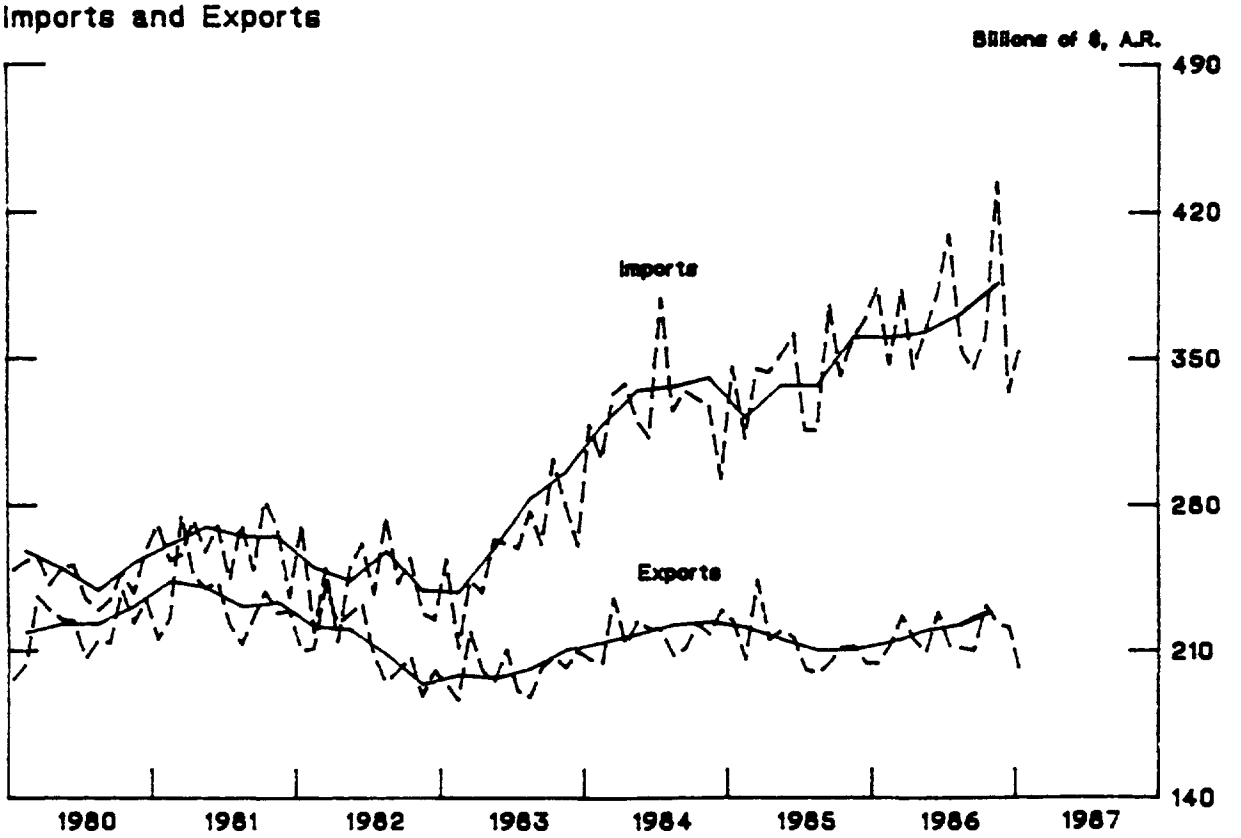
Chart

## U.S. Merchandise Trade

### Trade Balance




### Imports and Exports



data can be expected to remain, partly because they still will not be seasonally adjusted.

Merchandise Trade: 1986

The merchandise trade deficit widened slightly in the fourth quarter of 1986, to $153 billion at an annual rate, on a revised seasonally adjusted balance of payments basis (see table). Although the deficit in the fourth quarter was somewhat larger than for any of the three previous quarters of 1986, the data do suggest some levelling off of the deficit since the end of 1985.

During the fourth quarter of 1986, nominal exports grew about 3 percent, with roughly one-third of the increase in agricultural exports and the remaining two-thirds in non-agricultural products. Soybean exports (primarily to Japan) were particularly strong in the fourth quarter, as production in Brazil (a major Japanese supplier) was reduced by a drought. The increase in non-agricultural exports was not concentrated in any one major category; exports of capital goods (particularly business machines), automotive vehicles and parts, and consumer goods all contributed to export growth in the fourth quarter.

Over 1986 as a whole, the value of exports rose almost 9 percent with the bulk of this growth concentrated in exports of non-agricultural products. The growth in non-agricultural exports appears to have been related to improvements in price competitiveness due to the depreciation of the dollar, as prices of non-agricultural exports fell 3 percent between the fourth quarter of 1986 and the fourth quarter of 1985. Moreover, little of the improvement in exports can be explained by rising foreign demand, as real GNP growth in foreign

industrial countries eased somewhat in 1986 (Q4/Q4) and growth in developing countries was only marginally improved.

The increase in the value of non-agricultural exports over the four quarters of 1986 appears to have been concentrated primarily in consumer goods and certain capital goods (computers, machine tools and aircraft). Exports of industrial supplies also rose, though more moderately. Exports to Western Europe increased about 40 percent over this period, and exports to Japan rose about 20 percent in value terms. Exports to developing countries were essentially unchanged during 1986, while exports to Canada rose sharply on a Q4/Q4 basis but were unchanged over the year.

U.S. Merchandise Trade
Billions of dollars, annual rates

| | Balance-of-payments basis, seasonally adjusted | | | | | | | Census Balance Unrevised, NSA |
|---|---|---|---|---|---|---|---|---|
| | Exports | | | Imports | | | | |
| | Total | Ag. | Nonag. | Total | Oil | Nonoil | Balance | CIF Value |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
| Years | | | | | | | | |
| 1984 | 220 | 38 | 182 | 332 | 57 | 275 | -112 | -123 |
| 1985 | 214 | 30 | 185 | 339 | 51 | 288 | -124 | -149 |
| 1986 | 222 | 27 | 195 | 370 | 34 | 336 | -148 | -170 |
| Quarters | | | | | | | | |
| 1985-4 | 211 | 29 | 182 | 360 | 57 | 304 | -149 | -164 |
| 1986-1 | 214 | 29 | 186 | 360 | 40 | 320 | -146 | -174 |
| 2 | 220 | 25 | 196 | 363 | 31 | 332 | -143 | -162 |
| 3 | 223 | 26 | 197 | 372 | 32 | 340 | -149 | -176 |
| 4 | 229 | 28 | 201 | 383 | 32 | 351 | -154 | -168 |

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis, and Bureau of the Census.

The value of total imports increased roughly 3 percent in the fourth quarter due entirely to increases in imports of non-petroleum products. Oil imports remained essentially flat in the fourth quarter

as increases in oil prices were offset by declines in import volume. However, between the fourth quarter of 1985 and the fourth quarter of 1986, the value of oil imports fell substantially owing to the sharp decline in the price of imported oil, which was partly offset by an increase in import volume (see table). The spot oil price, which had rebounded somewhat during the latter part of 1986, remained firm in January, but eased somewhat in February due to slackened demand. These prices picked up again in early March as OPEC producers cut back production somewhat, and have been in the $18.50 per barrel range for light crude oil in recent weeks.

| Oil Imports* | Year 1985 | Year 1986 | 1985 Q4 | 1986 Q1 | 1986 Q2 | 1986 Q3 | 1986 Q4 |
|---|---|---|---|---|---|---|---|
| Value (Bil. $, SAAR) | 50.52 | 33.89 | 56.48 | 40.09 | 31.36 | 31.94 | 32.18 |
| Price ($/BBL) | 26.40 | 14.22 | 26.30 | 21.56 | 13.17 | 11.42 | 12.73 |
| Volume (mbd, SA) | 5.24 | 6.53 | 5.88 | 5.07 | 6.50 | 7.64 | 6.91 |

*/ As published in the balance-of-payments accounts.

Price increases accounted for about one-third of the rise in non-oil import value during 1986 as a whole (Q4/Q4), and about half of the increase in the fourth quarter. By the end of last year, price increases resulting from the depreciation of the dollar were evident across all categories of imported products, with the strongest increases coming in consumer, automotive and capital goods (particularly nonelectrical machinery).

The increase in non-oil imports came primarily from Japan and the newly industrializing countries of Asia (NICs), as imports from other developed and developing countries either declined or increased only slightly. Imports from the NICs were little affected by exchange rate movements as their currencies, on averge, have not risen against the dollar. Moreover, the relative strength of U.S. consumption demand in 1986 supported strong growth of consumer goods imports in particular from these countries.

Current Account: 1986

The current account deficit increased somewhat in the fourth quarter of 1986 to reach $147 billion (seasonally adjusted annual rate). The current account registered a deficit of $141 billion for the year as a whole, worsening by $23 billion over the 1985 figure (see table). For 1986, the change in the deficit was primarily due to the changing trade balance as other components in the current account showed only minor changes. Between 1985 and 1986, the increase in portfolio income payments (due to rising net interest payments on a growing U.S. net international debt position) was offset by increased net direct investment income receipts and other net service inflows associated with the decline in the dollar.

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

| | | 1985 Year | 1986 Year | 1986 Q3r | 1986 Q4 | $ Changes Q4/Q3 | $ Changes Yr/Yr |
|---|---|---|---|---|---|---|---|
| 1. | Trade balance | -124.4 | -147.7 | -148.6 | -153.5 | -4.9 | -23.3 |
| 2. | Exports | 214.4 | 221.8 | 223.1 | 229.3 | 6.2 | 7.4 |
| 3. | Imports | 338.9 | 369.5 | 371.7 | 382.8 | 11.1 | 30.6 |
| 4. | Investment income, net | 25.2 | 22.9 | 24.6 | 19.6 | -5.0 | -2.3 |
| 5. | Direct investment, net | 26.3 | 32.5 | 33.7 | 32.9 | -.8 | 6.3 |
| 6. | Capital gains or losses 1/ | 4.3 | 8.2 | 9.3 | 7.5 | -1.8 | 3.9 |
| 7. | Other D.I. income | 22.0 | 24.3 | 24.3 | 25.4 | 1.1 | 2.3 |
| 8. | Portfolio income, net | -1.1 | -9.7 | -9.1 | -13.4 | -4.3 | -8.6 |
| 9. | Military, net | -2.9 | -2.4 | -2.2 | -.3 | 1.9 | .5 |
| 10. | Other services, net | -0.5 | 1.7 | 1.7 | 2.7 | 1.0 | 2.3 |
| 11. | Unilateral transfers | -15.0 | -15.1 | -16.7 | -15.8 | .9 | -.1 |
| 12. | Current Account Balance | -117.7 | -140.6 | -141.2 | -147.3 | -6.1 | -22.9 |
| Memo: | | | | | | | |
| | Statistical discrepancy, not AR | 23.0 | 27.1 | -2.1 | 6.1 | | |

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

Developments in the Foreign Industrial Countries

Economic activity in the major foreign industrial countries remained generally weak in the fourth quarter of 1986. In particular, real gross national product fell in Germany, and while the Japanese economy grew somewhat, unemployment reached a historical high at the beginning of 1987. The overall current account surplus of the foreign G-7 countries was $123 billion in 1986, $60 billion larger than in 1985. Germany and Japan nearly doubled their surpluses, and Italy moved sharply into surplus. Industrial production and unemployment data in January indicate that activity abroad is weak everywhere but in the United Kingdom. In keeping with the spirit of the G-6 meeting in Paris at the end of February, several of the foreign industrial countries announced, in late February and March, discount rate cuts and plans for tax reductions.

Individual Country Notes. In Japan, real GNP grew by 3.2 percent (s.a.a.r.) in the fourth quarter of 1986, bringing overall growth to 2.5 percent in 1986, with domestic demand increasing by 4 percent. In the fourth quarter, consumer spending declined 2.7 percent while imports actually fell by 11.2 percent. Rising unemployment in 1987 suggests that the weakness in consumer spending may continue. Although exports fell by 4.8 percent, gross fixed investment was a sector of vigorous economic activity; it grew by 9.1 percent, with investment in machinery and equipment being particularly strong. Current surveys, however, do not suggest that this strength will continue.

Other recent indicators of economic activity were also mixed. In January, industrial production (s.a.) fell and the unemployment rate reached 3 percent. In the fourth quarter of 1986, new machinery orders (s.a.), both foreign and domestic, were quite strong. Retail sales

REAL GNP AND INDUSTRIAL PRODUCTION IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change from previous period, seasonally adjusted) 1/

| | Q4/Q4 1985 | Q4/Q4 1986 | 1986 Q1 | 1986 Q2 | 1986 Q3 | 1986 Q4 | 1986 Oct. | 1986 Nov. | 1986 Dec. | 1987 Jan. | 1987 Feb. | Latest 3 months from year ago 2/ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Canada | | | | | | | | | | | | |
| GDP | 3.9 | 1.6 | .6 | .7 | .2 | .1 | * | * | * | * | * | 1.6 |
| IP | 5.2 | n.a. | -.2 | -.5 | -1.2 | n.a. | 1.4 | -.9 | n.a. | n.a. | n.a. | -1.5 |
| France | | | | | | | | | | | | |
| GNP | 2.4 | n.a. | -.2 | 1.2 | n.a. | n.a. | * | * | * | * | * | 2.7 |
| IP | 1.8 | .2 | -1.5 | 1.5 | 1.7 | -1.5 | .0 | -2.2 | .0 | -1.5 | n.a. | -.2 |
| Germany | | | | | | | | | | | | |
| GNP | 2.2 | 2.4 | -.8 | 2.6 | .7 | -.1 | * | * | * | * | * | 2.4 |
| IP | 3.3 | .8 | -.9 | 1.3 | .7 | -.4 | 1.0 | -.3 | -.9 | -3.0 | n.a. | -.2 |
| Italy | | | | | | | | | | | | |
| GNP | 2.1 | n.a. | -.4 | 2.7 | .4 | n.a. | * | * | * | * | * | 3.0 |
| IP | 1.0 | 3.2 | 2.8 | 1.5 | -3.3 | 2.2 | -.4 | 2.4 | -2.8 | n.a. | n.a. | 3.2 |
| Japan | | | | | | | | | | | | |
| GNP | 4.2 | 2.0 | -.4 | .9 | .7 | .8 | * | * | * | * | * | 2.0 |
| IP | .9 | -.7 | .2 | .2 | -.5 | -.6 | -1.9 | -1.7 | 3.6 | -.5 | n.a. | -.3 |
| United Kingdom | | | | | | | | | | | | |
| GNP | 2.5 | 3.3 | 1.4 | .4 | .8 | .7 | * | * | * | * | * | 3.3 |
| IP | 4.5 | 1.2 | .9 | -.5 | 1.6 | -.8 | -1.1 | .3 | -.6 | .4 | n.a. | 1.2 |
| United States | | | | | | | | | | | | |
| GNP | 2.9 | 2.0 | .9 | .2 | .7 | .3 | * | * | * | * | * | 2.0 |
| IP | 1.8 | 1.0 | .3 | -.5 | .5 | .8 | .3 | .6 | .5 | .2 | .4 | 1.0 |

1. Asterisk indicates that monthly data are not available.
2. For quarterly data, latest quarter from year ago.

CONSUMER AND WHOLESALE PRICES IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change from previous period) 1/

| | Q4/Q4 1985 | Q4/Q4 1986 | 1985 Q3 | 1985 Q4 | 1986 Q1 | 1986 Q2 | 1986 Q3 | 1986 Q4 | 1986 Nov. | 1986 Dec. | 1987 Jan. | 1987 Feb. | Latest 3 months from year ago |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Canada | | | | | | | | | | | | | |
| CPI | 4.2 | 4.3 | .9 | .9 | 1.2 | .8 | 1.2 | 1.0 | .5 | .1 | .2 | .4 | 4.0 |
| WPI | 2.5 | .3 | .0 | .8 | .9 | -1.5 | .2 | .7 | .0 | .0 | .1 | n.a. | -.2 |
| France | | | | | | | | | | | | | |
| CPI | 4.8 | 2.1 | .9 | .6 | .1 | .7 | .6 | .7 | .1 | .1 | .9 | .2 | 2.8 |
| WPI | 1.9 | -3.3 | .1 | -1.4 | -.7 | -1.4 | -.7 | -.5 | * | * | * | * | -3.3 |
| Germany | | | | | | | | | | | | | |
| CPI | 1.8 | -1.0 | -.2 | .3 | .0 | -.3 | -.5 | -.2 | .0 | .2 | .4 | .1 | -.7 |
| WPI | -1.1 | -9.0 | -2.1 | -.9 | -2.1 | -2.6 | -2.9 | -1.6 | -.6 | -.8 | .8 | -.4 | -8.3 |
| Italy | | | | | | | | | | | | | |
| CPI | 8.6 | 4.7 | 1.2 | 2.2 | 1.8 | 1.1 | .6 | 1.2 | .4 | .3 | .6 | .4 | 4.4 |
| WPI | 5.9 | -2.4 | -.1 | .9 | -.5 | -1.8 | -.8 | .7 | .2 | .3 | 1.1 | n.a. | -2.2 |
| Japan | | | | | | | | | | | | | |
| CPI | 2.0 | .1 | .3 | .3 | .3 | .3 | -.5 | .0 | -.4 | -.1 | -.2 | -.1 | -.4 |
| WPI | -3.7 | -10.5 | -1.0 | -2.4 | -2.4 | -4.2 | -2.8 | -1.5 | .3 | .0 | -.6 | -.1 | -9.8 |
| United Kingdom | | | | | | | | | | | | | |
| CPI | 5.5 | 3.4 | .3 | .5 | .7 | 1.3 | .1 | 1.3 | .8 | .3 | .4 | .4 | 3.9 |
| WPI | 5.2 | 4.2 | .5 | .9 | 1.4 | 1.6 | .4 | .7 | .3 | .3 | .7 | .3 | 4.2 |
| United States | | | | | | | | | | | | | |
| CPI (SA) | 3.5 | 1.3 | .6 | 1.0 | .4 | -.3 | .6 | .7 | .2 | .2 | .7 | n.a. | 1.3 |
| WPI (SA) | 1.4 | -1.8 | -.2 | .8 | -1.2 | -1.2 | -.1 | .6 | .0 | -.1 | .6 | .1 | -1.2 |

1. Asterisk indicates that monthly data are not available.

TRADE AND CURRENT ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES 1/
(Billions of U.S. dollars, seasonally adjusted except where otherwise noted)

| | 1985 | 1986 | 1985 | | 1986 | | | | 1986 | | 1987 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Nov. | Dec. | Jan. | Feb. |
| **Canada** | | | | | | | | | | | | |
| Trade | 12.8 | 6.9 | 2.6 | 2.9 | 1.7 | 1.8 | 1.4 | 2.0 | .6 | .7 | .4 | n.a. |
| Current account | -.4 | -6.5 | -.8 | -.7 | -2.0 | -1.4 | -1.4 | -1.6 | * | * | * | * |
| **France** | | | | | | | | | | | | |
| Trade | -2.6 | -.4 | -.8 | -.4 | .1 | -1.1 | .3 | .4 | .0 | .3 | -.4 | -.1 |
| Current account | .3 | 3.8 | -.0 | .6 | 1.1 | .3 | 1.3 | 1.1 | * | * | * | * |
| **Germany** | | | | | | | | | | | | |
| Trade (NSA) | 25.4 | 52.3 | 6.1 | 9.1 | 9.5 | 12.5 | 14.1 | 16.2 | 5.0 | 5.8 | 3.9 | n.a. |
| Current account (NSA) | 13.9 | 36.4 | 2.1 | 7.0 | 6.9 | 8.3 | 8.1 | 13.2 | 4.8 | 4.3 | 2.6 | n.a. |
| **Italy** | | | | | | | | | | | | |
| Trade | -12.0 | -2.1 | -1.2 | -3.4 | -2.3 | -.3 | .8 | -.2 | .3 | .2 | -.4 | -.9 |
| Current account (NSA) | -4.0 | 5.4 | 1.9 | -.9 | -3.4 | 1.2 | 5.0 | 2.6 | * | * | * | * |
| **Japan** | | | | | | | | | | | | |
| Trade | 46.1 | 82.4 | 12.0 | 14.8 | 15.5 | 20.3 | 24.0 | 22.6 | 8.0 | 7.1 | 8.5 | 8.2 |
| Current account 2/ | 49.3 | 85.5 | 12.1 | 15.6 | 15.5 | 21.8 | 23.5 | 24.8 | 8.7 | 7.9 | 8.8 | n.a. |
| **United Kingdom** | | | | | | | | | | | | |
| Trade | -2.6 | -12.7 | -.6 | -.4 | -2.1 | -2.4 | -4.5 | -3.8 | -1.5 | -1.1 | -.8 | n.a. |
| Current account | 3.9 | -1.6 | 1.7 | .7 | .6 | .2 | -1.4 | -1.1 | -.5 | -.4 | .1 | n.a. |
| **United States** | | | | | | | | | | | | |
| Trade 2/ | -124.4 | -147.7 | -31.7 | -37.4 | -36.5 | -35.7 | -37.2 | -38.4 | * | * | * | * |
| Current account | -117.7 | -140.6 | -28.5 | -33.7 | -34.0 | -34.4 | -35.3 | -36.8 | * | * | * | * |

1. The current account includes goods, services, and private and official transfers. Asterisk indicates that monthly data are not available.
2. Annual data are subject to revisions and therefore may not be consistent with quarterly and/or monthly data.

rose 4.5 percent (s.a.) in January, reversing a December decline. New housing starts in January were 10.3 percent higher than their year-earlier level.

Both consumer and wholesale price inflation remained negative in January and February. The current account surplus was again a record in January. In February, however, export volume was 0.9 percent (n.s.a.) lower and import volume 1.6 percent (n.s.a.) higher than their year-earlier levels.

On February 23, the Bank of Japan reduced its discount rate to 2.5 percent. At the G-6 meeting, officials pledged to make efforts to obtain parliamentary approval of the FY 1987/1988 budget, including provisions for tax reform. Approval of the budget has been delayed by political opposition to the introduction of a sales tax. Prime Minister Nakasone has requested that the Economic Planning Agency begin formulating another program to encourage domestic economic activity.

German real GNP fell 0.6 percent (s.a.a.r.) in the fourth quarter. Exports fell 6.3 percent, and imports rose 10.4 percent. Domestic demand grew 4.8 percent, owing mainly to strong inventory accumulation. Private and public consumption stagnated.

In January, industrial production fell sharply. The volume of new orders fell to a level 4.8 percent below its year-earlier level. Foreign orders were 6.7 percent and domestic orders were 5 percent lower than they had been a year ago. There is evidence that exporters have sharply reduced their orders of capital goods.

On March 9, the government announced new tax measures in the wake of the G-6 meeting. A tax cut of DM 5.2 billion, equivalent to 0.25 percent of 1986 GNP, will go into effect on January 1, 1988, as will accelerated depreciation allowances for small businesses. These new

measures will be in addition to the earlier tax reductions of DM 8.4 billion, due to take effect at the same date.

In France and Canada, the pace of economic activity at the end of 1986 was weak. Industrial production (s.a.) in France fell in January, and in Canada real GDP (s.a.) grew only slightly in the fourth quarter. French unemployment was 10.9 percent in January, quite high by historical standards.

In the United Kingdom, recent data indicate comparatively strong activity. Real GDP growth was 2.8 percent (s.a.a.r.) in the fourth quarter, and the data were revised upward for the first three quarters of 1986. Unemployment declined for the seventh consecutive month in February.

In the first three weeks of March, the central banks of France, the United Kingdom, and Italy lowered the discount or money market intervention rate. The British government announced its fiscal 1987 budget on March 17. The budget was relatively expansionary; it includes a slight reduction in the marginal tax rate on personal income. The projected level of the public deficit is unchanged from that for 1986, with expected tax receipts based upon the official forecast for continued strong activity. The current monetary target for M0 was retained, whereas the LM3 target was discontinued. The French government proposed a major reform of the stock exchange, ending the monopoly on trading shares enjoyed by current stockholders; the government's goal is to liberalize trading completely by 1992. The government of Italy fell on March 3; it is likely that early Parliamentary elections will be held this spring.

Economic Situation in Major Developing Countries

On February 20, Brazil suspended interest payments on medium- and long-term debt to commercial banks pending agreement on rescheduling with the banks and the provision of new loans. The Brazilian trade surplus declined sharply during the course of 1986 and the government still appears to be groping for a coherent set of policies. The Mexican commercial bank financing package began to be signed on March 20. Following a catastrophic earthquake in March, Ecuador has suspended most debt service payments for the rest of the year. In response to an upsurge in inflation, Argentina has instituted a package of economic measures including a four-month wage and price freeze. In late February, Chile and Venezuela reached agreements with their bank creditors to reschedule amortization obligations during 1987-88 and 1987-89, respectively; to reduce interest spreads (though not to the Mexican level); and, for Chile, to reschedule interest payments in lieu of new money. Progress was also made in the Philippine negotiations to reschedule $3.6 billion in commercial bank debt.

Individual Country Notes. In late February Brazil suspended interest payments on about $68 billion in medium- and long-term debt to foreign commercial banks, pending agreement with banks on a debt rescheduling and the provision of new loans. Soon after, Brazil froze about $15 billion in short-term credit lines with banks, but said it would continue to pay interest on those lines. Brazil is continuing to service its debt to official bilateral and multilateral creditors.

The Brazilian authorities still appear to be groping for a coherent set of policies to reduce inflation and strengthen the external sector. Interest rates have been kept higher than the inflation rate over the last couple of months and the exchange rate has been

devalued broadly in line with inflation in January and February. However, the loss of competitiveness sustained between March and December 1986 has not been reversed. The sharp rise in inflation over the last few months has automatically triggered almost monthly increases in wages. Strikes and other signs of labor unrest have increased as lagged adjustments to wages have resulted in at least some decline in real wages.

Consumer prices rose 16.8 percent in January and 13.9 percent in February. The trade surplus remained at the low level of the last several months, recording monthly surpluses of $129 million and $261 million in January and February. (In 1984, 1985, and the first eight months of 1986, the trade surplus averaged about $1 billion per month.) Preliminary indicators suggest that the growth in economic activity so far in 1987 has decelerated sharply from the 8 percent average growth rates recorded in 1985 and 1986.

The Mexican commercial bank financing package began to be signed on March 20, with a number of the smaller banks still not willing to participate. Efforts are continuing to obtain commitments from these banks. Mexico completed repayment of the $1.1 billion official portion of the $1.6 billion bridge loan on February 13; repayment of the $500 million commercial bank portion, which was due January 30, has been extended. The next tranche of the IMF stand-by arrangement will not be available until a program review, currently underway, is completed and specific quantitative performance criteria for 1987 have been established. Additional steps in the program to relax trade restrictions were implemented in early March, in accordance with the schedule agreed upon with the IBRD. Treasury bill rates eased somewhat in early March and deposit interest rates, which had not been changed since the end of

September, were lowered slightly on March 9 and again on March 16. Consumer prices rose by 7.2 percent in February and were about 110 percent above a year earlier.

Ecuador suspended most debt service payments for the rest of the year following a catastrophic earthquake in March that killed hundreds of people and caused what is expected to be a four-month interruption of oil exports. Oil revenues account for nearly half of Ecuador's export receipts and government revenues. The loss of oil exports plus additional oil import requirements could cost Ecuador more than $500 million in 1987. Repair of the trans-Andean pipeline will cost at least $100 million, and perhaps as much as $350 million. Negotiations with the commercial banks and with the IMF for a stand-by program are in abeyance while the scope of the damage is being assessed. Possible emergency funding from the World Bank, IDB and IMF, as well as supplemental assistance from the United States, is being explored.

Consumer prices in Argentina increased by 7.6 percent in January and by 6.5 percent in February, following a 4.7 percent rise in December 1986. In response to this acceleration of inflation, the government implemented a new package of economic measures in late February including a currency devaluation to be followed by exchange rate pegging against the dollar, a catch-up wage increase to be followed by a four-month wage and price freeze, and increases in cigarette taxes and gasoline prices. The move is seen as an attempt to put a lid on inflation before the September 6 congressional and gubernatorial elections. In mid-February the IMF Board approved Argentina's compensatory and stand-by loans, conditional on a new money package from commercial banks and further rescheduling from commercial banks--on which discussions are now underway. Argentina's failure to

complete bilateral agreements with all of its Paris Club creditors under the terms agreed in January 1985 is creating an impediment to a proposed Paris Club rescheduling of 1987 maturities.

Venezuela reached an agreement in late February with its commercial bank creditors that amends its February 1986 $21.2 billion public sector restructuring arrangement. The amendment reduces scheduled amortization payments during 1987-89 from $3.4 billion to $1.35 billion, extends final maturity by two years to 1999, and lowers the spread from 1-1/8 to 7/8 percent over LIBOR. Despite the agreement, government officials anticipate the need for a substantial new money package from the banks in 1987.

Chile has recently reached agreement with its Bank Steering Committee regarding a restructuring for 1987-88. The main components of the agreement include a repricing of existing debts, reducing the interest rates from 1-3/8 over LIBOR to 1 to 1-1/8 over LIBOR; a switch from semi-annual to annual interest payments; and a request for a Paris Club rescheduling of 1987-88 maturities.

The Philippines resumed negotiations with its commercial bank creditors on March 3 to reschedule $3.6 billion in external debt falling due in 1987-91. The Philippine objective is to obtain a low spread over LIBOR, comparable to Mexico's. On March 20 the bank advisory committee accepted as one part of an overall package an innovative Philippine offer containing three alternatives for the banks to receive the interest spread, of which the main one was to have an underwriter guarantee a cash payment equal to 7/8s of the face value of special peso-denominated Philippine Investment Notes used to pay the interest spread if there is no buyer in the secondary market. Negotiations continue on other matters.