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July 3, 1979

CURRENT-ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

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SELECTED DOMESTIC NONFINANCIAL DATA
AVAILABLE SINCE PRECEDING GREENBOOK
(Seasonally adjusted)

	Latest Data			Per Cent Change from		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year earlier
(At annual rate)						
Civilian labor force	May	6-1-79	102.2	1.6	-1.1	2.1
Unemployment rate (%) <u>1/</u>	May	6-1-79	5.8	5.8	5.7	6.1
Insured unemployment rate (%) <u>1/</u>	May	6-1-79	3.0	3.0	3.0	3.1
Nonfarm employment, payroll (mil.)	May	6-1-79	88.4	2.3	2.8	3.3
Manufacturing	May	6-1-79	20.9	-1.8	.0	3.0
Nonmanufacturing	May	6-1-79	67.5	3.6	3.7	3.4
Private nonfarm:						
Average weekly hours (hr.) <u>1/</u>	May	6-1-79	35.6	35.4	35.7	35.9
Hourly earnings (\$) <u>1/</u>	May	6-1-79	6.08	6.04	5.99	5.62
Manufacturing:						
Average weekly hours (hr.) <u>1/</u>	May	6-1-79	40.2	39.2	40.7	40.4
Unit labor cost (1967=100)	May	6-29-79	175.4	-10.2	2.3	6.0
Industrial production (1967=100)	May	6-15-79	152.1	15.2	2.4	5.7
Consumer goods	May	6-15-79	151.3	21.8	.8	2.9
Business equipment	May	6-15-79	172.7	15.5	4.9	7.8
Defense & space equipment	May	6-15-79	90.5	9.4	6.3	8.3
Materials	May	6-15-79	154.6	13.3	4.4	6.5
Consumer prices all items (1967=100)	May	6-26-79	214.2	13.0	12.9	10.7
All items, excluding food & energy	May	6-26-79	204.1	10.7	10.7	9.5
Food	May	6-26-79	234.3	8.3	10.9	11.3
Producer prices: (1967=100)						
Finished goods	May	6-7-79	212.0	4.5	9.1	10.0
Intermediate materials, nonfood	May	6-7-79	238.1	12.2	14.8	11.2
Crude foodstuffs & feedstuffs	May	6-7-79	244.8	-3.4	-1.3	15.0
Personal income (\$ bil.) <u>2/</u>	May	6-19-79	1876.5	8.5	9.4	11.6
(Not at annual rates)						
Mfrs. new orders dur. goods (\$ bil.)	May	7-2-79	79.1	2.5	-3.9	13.0
Capital goods industries	May	7-2-79	25.8	4.3	-6.5	16.3
Nondefense	May	7-2-79	22.0	3.1	-6.9	21.1
Defense	May	7-2-79	3.9	11.8	-3.7	-5.1
Inventories to sales ratio: <u>1/</u>						
Manufacturing and trade, total	Apr.	6-13-79	1.43	1.37	1.40	1.41
Manufacturing	May	7-2-79	1.48	1.54	1.49	1.52
Trade	Apr.	6-13-79	1.33	1.30	1.33	1.33
Ratio: Mfrs.' durable goods inven- tories to unfilled orders <u>1/</u>	May	7-2-79	.535	.534	.543	.594
Retail sales, total (\$ bil.)	May	6-11-79	71.1	-.2	.0	8.5
GAF <u>3/</u>	May	6-11-79	15.6	2.1	4.3	8.0
Auto sales, total (mil. units.) <u>2/</u>	May	6-5-79	11.0	-3.1	-2.8	-10.2
Domestic models	May	6-5-79	8.2	-5.9	-9.5	-18.9
Foreign models	May	6-5-79	2.9	6.2	23.1	29.4
Plant & Equipment expen. (\$ bil.) <u>4/</u>						
All Industries	1979	6-7-79	173.33	—	—	12.7
	QII'79	6-7-79	170.30	2.6	—	13.0
	QIII'79	6-7-79	174.74	2.6	—	12.4
	QIV'79	6-7-79	180.98	3.6	—	10.4
Capital Appropriations, Mfg.	QI'79	6-5-79	22,324	15.7	—	27.4
Housing starts, private (thous.) <u>2/</u>	May	6-18-79	1,827	5.3	32.3	-10.3
Leading indicators (1967=100)	May	6-29-79	141.2	.4	-1.2	-.4

1/ Actual data used in lieu of per cent changes for earlier periods.

2/ At annual rate.

3/ Excludes mail order houses.

4/ Planned-Commerce May 1979 Survey.

DOMESTIC NONFINANCIAL DEVELOPMENTS

There is evidence that economic activity weakened further in the second quarter, reflecting in part the repercussions of continued large increases in prices, particularly for energy, and the effects of gasoline shortages. Employment growth has slowed in recent months, and industrial production was only at its March level despite a rebound in May. The softening of demand has been concentrated in the consumer sector as retail sales in real terms have fallen substantially since the end of last year. In the investment area, real capital spending appears to have dropped somewhat in the second quarter and housing starts remained below late 1973 levels. Energy prices have continued to accelerate, swamping the effects of a moderation in food prices.

Prices and Domestic Energy Developments

Recent price movements continue to be marked by developments in the energy sector as prices for petroleum products have soared. At the same time, price increases for food products at the retail level have slowed somewhat; they were a principal factor in the acceleration of inflation earlier in the year. Over the first five months of this year, consumer prices and producer prices of finished goods have risen at annual rates of about 13-1/2 and 11-1/2 percent, respectively--a pace not seen since 1974.

The most intense inflationary pressures are concentrated in the energy sector where price increases have accelerated even further from the

RECENT CHANGES IN CONSUMER PRICES ^{1/}
 (Percent change at compound annual rates; based
 on seasonally adjusted data) ^{2/}

	Relative importance Dec. 1978	1977	1978	1979	1979	
				Q1	Apr.	May
All items	100.0	6.8	9.0	13.0	13.2	13.0
Food	18.2	8.0	11.8	17.7	11.5	8.3
Commodities (nonfood)	41.1	4.9	7.7	12.9	16.1	12.7
Services	40.8	7.9	9.3	10.6	11.2	15.3
Memoranda:						
All items less food and energy ^{3/}	73.3	6.4	8.5	9.3	11.4	10.7
Gas and electricity	3.4	8.7	7.9	10.7	8.9	30.9
Gasoline	4.2	4.9	8.5	35.6	71.9	59.7
Homeownership	23.6	9.2	12.4	16.7	17.4	15.7

^{1/} Based on index for all urban consumers.

^{2/} Changes are from final month of preceding period to final month of period indicated. Monthly changes are not compounded.

^{3/} Energy items excluded: gasoline and motor oil, fuel oil and coal, gas and electricity. Not seasonally adjusted.

RECENT CHANGES IN PRODUCER PRICES
 (Percent change at compound annual rates; based
 on seasonally adjusted data) ^{1/}

	Relative importance Dec. 1978	1977	1978	1979	1979	
				Q1	Apr.	May
Finished goods	41.0	6.6	9.2	13.7	10.9	4.5
Consumer foods	10.4	6.6	11.9	20.1	-3.2	-15.3
Consumer nonfoods	18.6	6.1	8.4	12.9	16.5	15.0
Capital equipment	12.1	7.2	8.0	9.8	13.6	7.9
Materials:						
Intermediate ^{2/}	44.8	6.4	8.3	13.2	18.6	12.2
Construction	8.3	8.2	11.0	11.6	12.5	1.5
Crude nonfood	4.8	6.8	15.6	29.5	-6.6	27.5
Crude food	6.8	1.4	18.3	30.6	-3.4	-3.4

Memorandum:

Energy commodities ^{3/} 11.0 11.8 7.1 20.8 39.0 51.1

^{1/} Changes are from final month of preceding period to final month of period indicated. Monthly changes are not compounded.

^{2/} Excludes intermediate materials for food manufacturing and manufactured animal feeds.

^{3/} Fuels and related products and power. This series is on a commodity basis, while the other data in this table are on a stage of processing basis.

rapid rates earlier in the year. At retail, fuel oil and gasoline prices increased at 50 and 70 percent annual rates, respectively, from March to May--the largest rises since the record climb of early 1974. Furthermore, cost pressures are likely to remain intense in the energy sector as a result of the June 28 OPEC decisions to raise crude oil prices. Although the increase will vary among producers, the new average OPEC contract sales price may be about 25 percent above the second quarter level.

The gasoline situation in recent months has been characterized by sharply rising prices and supply shortages. These price increases reflect the pass-through of higher crude oil costs as well as market forces and new Department of Energy regulations permitting a large increase in margins. Gasoline production in the second quarter was somewhat below the comparable period last year and deliveries at retail may have fallen more than 5 percent below the year-earlier level. Moreover, under federal allocation rules, some users have been given priority to available supplies and, as a result, the reduction in deliveries has been considerably greater in some localities.

Retail food prices, which rose very rapidly in early 1979, increased at an 8 percent annual rate in May--this was the slowest rate of advance in six months. Producer prices of finished foods declined in April and May and average food prices at the farm level have dropped somewhat recently. These developments suggest the possibility of near-term retail food price increases continuing to be more moderate. However,

the longer term prospects for food prices appear to have been affected adversely by unfavorable crop conditions in the USSR, which have pushed U.S. grain prices sharply higher, and by freeze damage to the Brazilian coffee crop.

Increases in consumer prices of items other than food and energy accelerated from March to May to about an 11 percent annual rate. The increase in homeownership costs, reflecting a combination of rising mortgage interest rates and house prices, has been a major factor in the acceleration of CPI nonfood, nonenergy items this year. Since December, these homeownership prices have risen at an annual rate of about 17 percent, well above the 12-1/2 percent rate over 1978. Among other items, new car prices rose sharply in April and May while apparel nearly leveled off after the large March increase. Rent increases accelerated markedly in May following 4 months in which rises were more moderate.

Employment and Production

Growth in demand for labor has slowed appreciably in recent months as employment at nonfarm establishments rose by 160,000 (strike-adjusted) in May following a gain of only 60,000 in April; monthly increases in the preceding six months averaged 340,000. A substantial share of the May increase was in the service sector. Manufacturing employment fell 30,000 in May after a similar decline in April; the cumulative drop in factory payrolls in these two months was the largest in the past 4 years. Cutbacks in employment were widespread among producers of both durable and nondurable goods; the machinery industry was the only manufacturing sector in which

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

	1977	1978	1978	1979			
			QIV	QI	Apr.		May
			- - - Average monthly changes - - -				
<u>Nonfarm payroll employment</u> <u>2/</u>	284	297	373	327	4	171	
Strike adjusted	302	281	352	329	60	157	
Manufacturing	66	62	148	78	-36	-31	
Durable	50	53	108	69	-28	-22	
Nondurable	16	9	39	9	-8	-9	
Construction	30	37	33	43	-9	67	
Trade, Finance and Services	79	145	140	169	79	83	
Private nonfarm production workers	215	224	306	245	-93	143	
Manufacturing production workers	52	45	128	56	-49	-17	
<u>Total employment</u> <u>3/</u>	342	275	282	329	-668	144	
Nonagricultural	336	268	288	344	-512	147	

1/ Changes are from final month of preceding period to final month of period indicated.

2/ Survey of establishments. Not strike adjusted, except where noted.

3/ Survey of households.

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

	1973	1978		1979		
	Annual average	HI	H2	QI	Apr.	May
Total, 16 years and older	4.9	6.1	5.9	5.7	5.8	5.8
Teenagers	14.5	16.5	16.2	15.8	16.5	16.8
20-24 years old	7.8	9.9	9.2	8.7	8.5	8.9
Men, 25 years and older	2.5	3.4	3.3	3.2	3.3	3.1
Women, 25 years and older	4.0	5.1	5.1	4.9	4.9	5.0
White	4.3	5.3	5.2	5.0	4.9	5.0
Black and other	8.9	12.3	11.6	11.4	11.8	11.6
Fulltime workers	4.3	5.6	5.4	5.2	5.3	5.2
White collar	2.9	3.6	3.5	3.4	3.3	3.2
Blue collar	5.3	7.0	6.8	6.5	6.9	6.7

employment in May exceeded its March level. The factory workweek rebounded in May to 40.2 hours from the effects of strikes and holidays in April, but was still somewhat below the first-quarter average.

Total employment, as measured by the household survey, rose almost 150,000 in May after a large decline in April, and the unemployment rate was unchanged at 5.8 percent. Jobless rates for most groups of workers--both experienced and inexperienced--remained close to those prevailing since mid-1978.

Industrial production is estimated to have risen 1.3 percent in May, following a drop in April of about the same magnitude. The May level of the index was only fractionally above that of December, a marked slowing from the 8 percent annual rate rise over the last half of 1978. By type of product, the May increase was fairly widespread; an especially large rebound in consumer goods production reflected a pick-up in auto assemblies following reductions in April largely caused by the Teamsters' strike. However, in light of weaker auto sales and rising stocks of large cars, the industry has already curtailed production of some models and further reductions in the months ahead may be necessary. Output of business equipment increased sharply in May, and since the start of the year, gains in this sector have been at a 5-3/4 percent annual rate. In addition, materials production rose briskly as many metals and parts industries resumed normal schedules following the strike-related disruptions of April.

Reflecting the marked slowing of growth in manufacturing output so far this year, pressures on industrial capacity have eased somewhat.

INDUSTRIAL PRODUCTION ^{1/}
 (Percent change, seasonally adjusted)

	1978		1979		
	H1	H2	QI	April ^{2/}	May ^{3/}
	--- Compound annual rate ---			--- Monthly rate ---	
Total	6.9	8.1	4.9	-1.4	1.3
Final products	5.3	5.8	5.6	-1.8	1.6
Consumer goods	2.6	3.6	4.1	-2.5	1.8
Durables	6.5	1.1	.2	-7.2	6.1
Nondurables	1.0	4.9	5.6	-.3	.1
Business equipment	9.3	9.2	7.9	-.9	1.3
Materials	9.1	10.6	2.1	-.8	1.1
Durable Goods	9.4	16.2	0.0	-1.5	1.7
Nondurable Goods	10.9	4.6	5.9	.2	.9

SELECTED CAPACITY UTILIZATION RATES FOR U.S. INDUSTRY
 (Percent, seasonally adjusted)

	1973-	1978	1979		May 79
	1974		^{2/}	^{3/}	less ^{4/}
	High		Apr.	May	Dec. 78
Manufacturing	88.0	86.3	84.7	85.6	-.7
Primary Processing	93.6	89.4	87.2	87.6	-1.8
Advanced Processing	85.4	84.6	83.3	84.4	-.2
Materials	93.1	88.1	86.7	87.4	-.7
Durable Goods Materials	92.5	88.2	85.7	86.9	-1.3
Basic Iron and Steel	105.2	90.8	85.0	88.1	-2.7
Nondurable Goods Materials	94.6	88.3	89.0	89.5	1.2
Textile Materials	94.4	81.9	80.0	80.5	-1.4
Paper Materials	100.5	86.8	89.6	90.4	3.6
Chemical Materials	93.8	88.3	90.1	90.5	2.2
Energy Materials	94.6	86.9	85.7	85.3	-1.6

^{1/} Changes over a period longer than one quarter are from final quarter of preceding period to final quarter of period indicated.

^{2/} Preliminary.

^{3/} Estimated.

^{4/} Percentage points.

In May, the operating rate in manufacturing--at 85.6 percent--was about 1/2 percentage point below the relatively high first quarter figure. Lower rates have been recorded in the primary metals, motor vehicles and parts, and petroleum and coal products industries. Similarly, utilization rates in most materials industries are beginning to show more slack than during last winter.

Personal Income and Consumer Spending

Personal income rose at an annual rate of 8-1/2 percent in May after a much smaller increase in April. The May gain reflected a rebound in private payrolls following the trucking industry work stoppage and construction disruptions from flooding in several areas. Income growth in the first five months of 1979 was at an 8-1/2 percent annual rate, as compared with a 12-1/2 percent rise during 1978. In real terms, the May level of personal income was about 1-1/2 percent below that of late last year.

Reflecting in part the slackening of income growth, household demands for goods continued to weaken in May. Retail sales declined 0.2 percent from the already low April level, and they have been virtually flat for the last five months. In real terms, retail sales have fallen 4-3/4 percent from the December peak--the sharpest and longest decline of such sales since the 1974-1975 recession.

Retail sales excluding autos and mainly nonconsumer items rose 0.6 percent in nominal terms in May, following a fractional increase in April. Sales at food stores have changed little in recent months after large increases early this year. Sales of discretionary items--general

PERSONAL INCOME
(Based on seasonally adjusted annual rate data)

	1977	1978			1979		
		HI	QIII	QIV	QI	Apr.	May
- - Average monthly change, in billions of dollars - -							
Total personal income	\$13.5	\$14.4	\$16.3	\$22.3	\$14.7	\$7.5	\$13.2
Nonagricultural income	12.3	14.9	16.0	19.2	16.0	7.2	12.9
Agricultural income	1.2	-.5	.4	3.1	-1.2	.3	.4
Wage and salary disbursements	8.3	11.9	7.2	13.8	12.6	1.9	7.1
Private	7.0	10.9	6.4	11.8	11.8	1.0	6.2
Manufacturing	2.7	2.9	1.8	5.3	3.8	-1.9	1.7
Other income	5.7	3.7	9.5	9.1	4.5	5.6	6.5
Less: Personal contributions for social insurance	.5	1.1	.4	.6	2.3	.0	.3
- - Percentage change, compound annual rates <u>1/</u> - -							
Total personal income							
Current dollars	11.4	11.5	12.2	13.9	10.9	4.8	8.5
Constant dollars <u>2/</u>	4.4	2.3	3.1	4.4	-.1	-8.2	-4.5
Wage and salary disbursements							
Current dollars	11.0	14.0	8.7	13.7	13.1	1.9	7.1
Constant dollars <u>2/</u>	4.1	4.6	-.1	4.1	1.8	-11.2	-5.9

1/ Changes over a period longer than one quarter are from final quarter of preceding period to final quarter of period indicated. Monthly per cent changes at annual rates, not compounded.

2/ Deflated by the CPI for all urban consumers, seasonally adjusted.

merchandise, apparel, and furniture and appliances--rebounded in May following a drop in April.

Total auto sales declined to an 11.0 million unit annual rate in May, down almost 400,000 units from the April rate and off almost 1-1/4 million units from the near record set in March. Due to the preference for gas-efficient cars, sales of imports--at a 2.9 million unit rate--were at an all-time high and sales of the smaller domestic models were also very strong. Apparently reflecting the same forces, sales of domestic-type automobiles in the first 20 days of June tumbled to a 7.5 million annual rate from an 8-1/4 million unit rate in May and over a 9 million unit rate in the first quarter. The sharpness of the decline in auto sales apparently reflected heightened uncertainties concerning the availability and price of gasoline as well as tight supplies of small cars.

The reduced level of real consumer spending has coincided with a deterioration of attitudes as reported in consumer surveys. In May, the Conference Board index of consumer confidence--a monthly composite of five questions on both present and expected economic conditions--declined further to the lowest level since 1975. Similarly, the Michigan Survey Research Center index of sentiment remained low in May and was sharply off from a year earlier. The latter survey also revealed that consumers' expectations of price inflation were at a record high and that buying conditions for cars were rated more unfavorable than at any time in the past three years.

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

	1978	1979			
	QIV	QI	Mar.	Apr.	May
Total sales	4.2	1.9	1.3	-1.1	-.2
(Real) <u>1/</u>	2.4	-1.0	.4	-2.1	-1.0
Total, less auto and nonconsumption items	4.0	1.7	1.0	.1	.6
GAF <u>2/</u>	3.2	-.4	3.4	-1.1	2.1
<u>Durable</u>	5.7	1.6	1.7	-3.6	-1.6
Auto	4.6	3.6	.3	-5.3	-2.0
Furniture & appliances	3.9	1.7	.8	-1.2	1.1
<u>Nondurable</u>	3.4	2.1	1.1	.2	.6
Apparel	4.4	-1.1	7.0	-4.5	3.0
Food	3.1	3.5	.0	1.4	.0
General merchandise <u>3/</u>	2.5	-1.0	3.0	.2	2.1
Gasoline	4.2	4.4	-.1	2.2	2.9

1/ BCD series 59.

2/ General merchandise, apparel, furniture and appliance stores.

3/ General merchandise excludes mail-order nonstores; mail-order sales are also excluded in the GAF composite sales summary.

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

	1978	1979			
	QIV	QI	March	April	May
Total	11.1	11.5	12.3	11.4	11.0
Imports	2.0	2.4	2.8	2.7	2.9
Domestic	9.1	9.1	9.5	8.7	8.2
Small	3.5	3.8	4.2	4.1	4.1
Intermediate & large	5.6	5.4	5.2	4.6	4.1

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

Business Fixed Investment

Investment spending weakened somewhat in the April-May period due to sluggishness in the equipment area. Shipments of nondefense capital goods rose only 1 percent in May after a sharp strike-related decline in April; shipments for the two months were marginally below the first quarter level. In addition, business purchases of trucks have declined sharply. However, expenditures on nonresidential construction put-in-place were very strong in the past 3 months and the April-May average was about 5-3/4 percent above the first quarter level.

Indicators of near-term capital spending commitments, which had been quite buoyant in the first quarter, have weakened recently. New orders for nondefense capital goods gained 3 percent in May after falling almost 13 percent in April. The machinery component, more indicative of underlying equipment demand, was up only slightly in May following a very large drop in April. However, despite the reduced level of orders, capital goods shipments are expected to be relatively well-maintained in the next few months because of the high level of unfilled orders.

In the construction area, new commitments for commercial and industrial buildings have fallen in recent months and in May, were 17-1/2 percent below the February peak and only slightly above the monthly average in the fourth quarter of last year.

The recent weakening in commitments for fixed capital investment contrasts with the indications of the latest Commerce Department survey of plant and equipment expenditure plans for 1979. The survey, taken in late

BUSINESS INVESTMENT SPENDING
 (Percent change from preceding comparable period, based on seasonally adjusted data)

	1978		1979				May. 1978 to May. 1979
	QIII	QIV	QI	Mar.	Apr.	May.	
Nondefense capital goods shipments	6.3	4.4	5.1	5.8	-4.4	1.0	19.0
Nonresidential construction put-in-place	5.1	6.5	4.0	6.5	-0.3	4.0	27.6.
Building	8.3	4.5	2.3	11.2	-1.4	6.1.	32.3
Nonbuilding	1.0	9.2	6.1	1.0	1.1	1.2	21.7

BUSINESS COMMITMENTS FOR CAPITAL EQUIPMENT
 (Percent change from preceding comparable period, based on seasonally adjusted data)

	1978		1979				May. 1978 to May. 1979
	QIII	QIV	QI	Mar.	Apr.	May.	
Nondefense capital goods orders	5.4	12.4	10.0	3.5	-12.8	3.1	21.1
Machinery	4.2	8.8	7.7	8.9	-12.4	.7	12.0
Nonmachinery	8.3	21.4	15.1	-6.4	-13.7	8.3	45.3

April and May, indicated that businesses plan to boost plant and equipment spending in 1979 to almost 13 percent, an upward revision from the rise reported in the February survey. It should be noted, however, that this survey generally has overpredicted spending during previous periods of contraction in overall activity. The Conference Board survey of capital appropriations showed a trend similar to the Commerce Department reading, with a 15 percent increase in manufacturing appropriations in the first quarter following a comparable gain in the fourth quarter.

Inventory Investment

Inventory investment by manufacturing and trade establishments in April increased at an annual rate of \$68 billion in book value terms, substantially above the \$49 billion rate in the first quarter and the largest monthly increase on record. Accumulation was especially large at manufacturing and auto dealers.

In May, the book value of manufacturers' inventories rose at a seasonally adjusted annual rate of \$28 billion in May, well below the exceptionally large, strike-related April gain and somewhat below the first quarter pace. A substantial rebound in shipments occurred in May, and as a result the ratio of inventory to sales dropped back to about the relatively low March level. Increases in manufacturers' stocks were concentrated in the durable goods sector, largely for producers of nonelectrical machinery and aircraft and parts. Stocks of primary metals

PLANT AND EQUIPMENT EXPENDITURES
(Percent change from prior year)

	Anticipated for 1979				
	December Survey	Commerce ^{1/}		McGraw-Hill	
		February Survey	May Survey	Fall Survey	Spring Survey
All business	11.2	11.3	12.7	9.9	15.7
Manufacturing	13.8	14.7	14.8	10.3	20.3
Durables	16.2	19.5	16.9	12.2	23.3
Nondurables	11.7	10.4	12.9	8.6	17.8
Nonmanufacturing	9.1	8.6	11.1	9.5	12.0

^{1/} Results are adjusted for systematic bias. Without this adjustment the December Commerce survey showed an 11.6 percent increase, the February Commerce survey showed a 13.5 percent increase and the May survey a 14.1 percent rise.

RECENT PERFORMANCE OF PLANT AND EQUIPMENT SURVEYS
(Percent change from prior year)

Year	Actual	Commerce			McGraw-Hill	
		December Survey	February Survey	May Survey	Fall Survey	Spring Survey
1974	12.7	12.0	13.0	12.2	13.6	19.5
1975	0.3	4.6	3.3	1.6	11.8	5.5
1976	6.8	5.5	6.5	7.3	8.8	12.9
1977	12.7	11.3	11.7	12.3	13.0	18.0
1978	13.3	10.1	10.9	11.2	11.1	17.3

BUSINESS INVENTORIES
 (Billions of dollars; annual rate of change
 in seasonally adjusted book values)

	1978				1979		
	QI	QII	QIII	QIV	QI	Apr.(r)	May (p)
Manufacturing and trade	45.5	44.6	36.7	39.5	49.2	68.1	n.a.
Manufacturing	16.6	22.8	18.0	15.0	30.4	42.9	27.6
Durable	13.2	15.9	14.0	11.9	24.6	29.8	19.5
Nondurable	3.4	6.9	4.1	3.1	5.8	13.1	8.1
Trade, total	28.9	21.8	18.7	24.5	18.9	25.3	n.a.
Wholesale	18.5	10.2	7.7	14.6	13.2	12.0	n.a.
Retail	10.4	11.6	11.0	9.9	5.6	13.2	n.a.

r = Revised.
 p = Preliminary.

INVENTORY TO SALES RATIOS

	1978				1979		
	QI	QII	QIII	QIV	QI	Apr.(r)	May (p)
Manufacturing and trade	1.46	1.43	1.43	1.40	1.41	1.43	n.a.
Manufacturing	1.56	1.52	1.54	1.49	1.48	1.54	1.48
Durable	1.90	1.86	1.87	1.80	1.80	1.91	1.83
Nondurable	1.17	1.15	1.16	1.13	1.10	1.12	1.09
Trade, total	1.37	1.33	1.33	1.32	1.33	1.33	n.a.
Wholesale	1.26	1.20	1.20	1.20	1.23	1.21	n.a.
Retail	1.47	1.46	1.46	1.44	1.43	1.45	n.a.

r = Revised.
 p = Preliminary.

producers declined somewhat, resuming the downward trend evident in the December-March period. In the nondurable goods sector, most of the increase was in stocks of producers of food products.

By stage-of-fabrication, manufacturers' inventories of finished goods increased at only a \$4.8 billion annual rate in May, much below the \$16.0 billion rate in April when the Teamsters' strike/lockout and the steel haulers' strike reduced total shipments sharply. The remaining accumulation in May was equally divided between materials and supplies and work-in-process.

Housing

With a small increase in May, private housing starts averaged a 1.8 million unit annual rate in the first two months of the second quarter. This was 10 percent above the weather-depressed first quarter rate but well below the 2.1 million unit rate in the final quarter of 1978. Similar movements occurred in new residential building permits issued during this period.

Much of this year's slowdown in new housing activity has been in the single-family sector. In May, new starts were about 20 percent below the pace in late 1978; activity in all major regions of the country has declined from the earlier levels. Sales of new and existing single-family homes also have fallen significantly since late last year. Since then the average price of new houses has risen sharply further and in April this price--at \$70,000--was 18 percent above a year earlier.

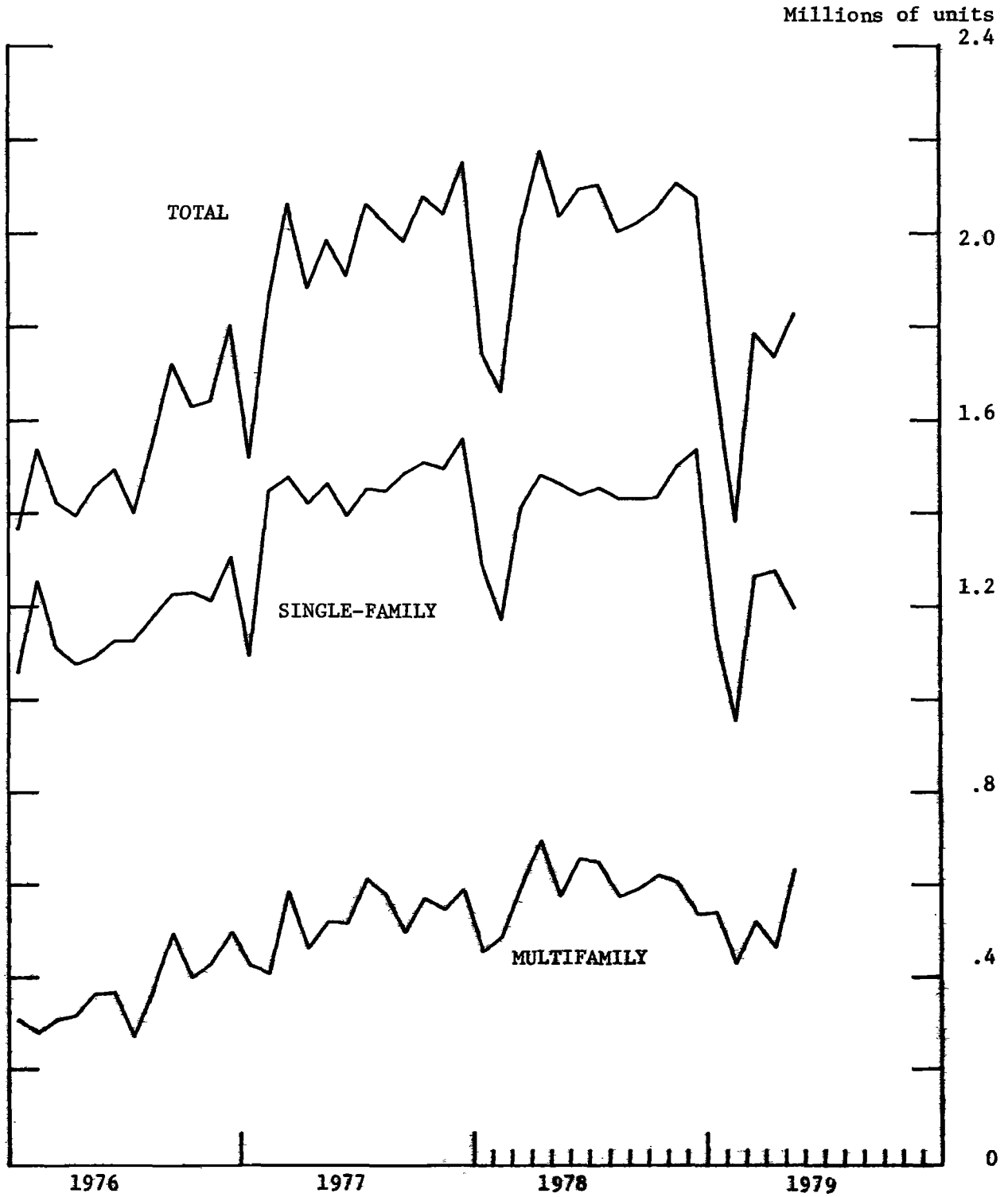
NEW PRIVATE HOUSING ACTIVITY
 (Seasonally adjusted annual rates, millions of units)

	1978		1979			
	Annual	QIV	QI	Mar. ^{1/}	Apr. ^{1/}	May. ^{2/}
Total						
Permits	1.80	1.82	1.50	1.62	1.52	1.59
Starts	2.02	2.08	1.62	1.79	1.74	1.83
Single-family						
Permits	1.18	1.22	.95	1.06	1.04	1.03
Starts	1.43	1.49	1.12	1.27	1.27	1.20
Sales						
New homes	.82	.84	.75	.78	.73	NA
Existing homes	3.91	4.27	3.66	3.65	3.76	NA
Multifamily						
Permits	.62	.60	.54	.57	.48	.56
Starts	.59	.59	.50	.52	.46	.63
Mobile home shipments	.28	.29	.28	.27	.27	.26

^{1/} Regular monthly revision.

^{2/} Preliminary estimates except permits which reflect first monthly revision.

NEW PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



Activity in the multifamily sector, which is typically quite volatile, also has slowed from 1978 levels. Starts of new multifamily units increased almost 40 percent in May, following sharply reduced rates earlier in the year. Nonetheless, total units started so far in 1979 are 12-1/2 percent below the rate in the final quarter of 1978. In part, this reflects reductions in HUD-subsidized multifamily starts although the budgeted level for the entire fiscal year for such starts is generally in line with last year's rate. In recent months, market conditions for unsubsidized units apparently have remained quite tight; in fact, vacancy rates remained at historically low levels through the first quarter and sales of new condominiums continued brisk through the end of 1978.

Government Sector

The Federal deficit (NIPA basis) in the second quarter is now estimated to have been around an \$11 billion annual rate, \$12 billion smaller than a year earlier. Withheld taxes rose rapidly in April and May and nonwithheld taxes were quite strong due to large final settlements on 1978 tax liabilities. Federal nondefense purchases apparently fell in the second quarter as Commodity Credit Corporation (CCC) loans to farmers declined by about \$2-1/2 billion at a seasonally adjusted annual rate. (Redemptions of CCC loans are treated as negative outlays in the national income accounts.)

Recent growth in activity of state and local governments remains modest. Capital outlays, as measured by the value of construction put-in-place, increased appreciably in April and May, but in real terms, state and local construction in May was still about 5 percent below the December

level. This weaker recovery from winter interruptions is in marked contrast to last spring when construction rebounded sharply from weather-depressed levels.

Employment in the state and local sector was virtually unchanged in May despite some increase in payrolls under CETA funding. Payroll employment is currently slightly below that of a year ago--an unprecedented occurrence for the state and local governments during the past quarter century.

Wages

Wage rates for production and nonsupervisory workers in the private nonfarm sector of the economy--as measured by the volatile index of average hourly earnings--rose at a moderate 1.6 percent annual rate in May to a level 7.6 percent above that of a year ago. Over the past year, the index for the manufacturing sector has risen at an 8-1/2 percent rate, slightly faster than the pace of the preceding 12 months. A similar rate of increase was reported for the trade sector, where the January minimum wage adjustment had a large impact.

After lengthy strikes, collective bargaining agreements were reached for machinists at United Airlines and workers in the rubber industry. The latter contract included a significant increase in the cost-of-living provisions beginning in the second year of the contract; it is estimated that the new escalator clause will compensate workers fully for future price rises. According to COWPS, both contracts probably exceed the wage standards.

HOURLY EARNINGS INDEX 1/
 (Percent change at compound annual rates;
 based on seasonally adjusted data) 2/

	May 76-	May 77-	May 78-	1979		
	May 77	May 78	May 79	QI	Apr.	May
Total private nonfarm	7.6	8.0	7.6	9.0	8.0	1.6
Manufacturing	8.1	8.3	8.5	8.7	11.0	3.6
Contract construction	4.8	6.7	6.4	7.6	6.1	9.4
Transportation and public utilities	8.4	8.2	6.4	10.7	-4.0	10.4
Total trade	7.9	8.5	8.2	10.7	5.5	-.5
Services	7.8	7.1	6.7	8.3	9.7	-4.8

1/ Excludes the effect of interindustry shifts in employment and fluctuations in overtime pay in manufacturing.

2/ Changes over a period longer than one quarter are from final quarter of preceding period to final quarter of period indicated. Monthly percent changes at annual rates, not compounded.

III-T-1
SELECTED DOMESTIC FINANCIAL DATA

Indicator	Latest data		Net Change from:		
	Period	Level	Month ago	Three months ago	Year ago
		\$ billions	Per cent at annual rates		
Monetary and credit aggregates^{1/}					
Total reserves	June	40.5pe	0.5	-2.9	-0.7
Nonborrowed reserves	June	39.2pe	12.9	-6.7	-0.9
Money supply					
M1	June	369.1pe	15.1	11.3	4.7
M2	June	904.5pe	14.4	11.4	7.1
M3	June	1551.5pe	11.6	9.0	8.1
Time and savings deposits (less CDs)	June	535.3pe	13.4	11.4	9.2
CDs ^{2/}	June	84.4pe	-6.2	-14.6	-2.3
Thrift deposits (S&Ls + MSBs)					
+ Credit Unions	June	647.0pe	7.7	5.6	9.6
Bank credit (end of month)	May	1038.0	11.1	10.3	12.0

Indicator	Latest data		Net Change from:			
	Period	Per cent or index	Month ago	Three months ago	Year ago	
Market yields and stock prices						
Federal funds	wk. endg.	6/27/79	10.32	.15	.32	2.54
Treasury bill (90 day)	"	6/27/79	8.85	-.69	-.66	1.98
Commercial paper (90-119 day)	"	6/27/79	9.68	-.27	-.13	1.93
New utility issue Aaa	"	6/29/79	9.45	—	-.42	.29
Municipal bonds (Bond Buyer) 1 day		6/28/79	6.12	-.04	-.16	-.17
FNMA auction yield (FHA/VA)		7/2/79	10.74	-.05	.32	.78
Dividend price ratio (common stocks)	wk endg.	6/27/79	5.52	-.13	.24	.20
NYSE index (12/31/65=50)	end of day	7/2/79	57.86	1.83	1.13	2.94

	Period	Net Change or Gross Offerings			
		Latest Data	Year ago	Year to Date	
				1979	1978
Credit demands					
Business loans at commercial banks ^{1/}	May	4.3	5.5	20.8	16.0
Consumer instalment credit outstanding ^{1/}	May	3.6e	4.3	17.7e	17.8
Mortgage debt outstanding (major holders) ^{1/3/}	April	8.1	8.9	24.6	24.8
Corporate bonds (public offerings)	June	3.8	1.7	12.9e	10.2
Municipal long-term bonds (gross offerings)	June	4.4e	4.4	20.3e	24.6
Federally sponsored agcy. (net borrowing)	June	1.6e	1.8	11.2e	11.0
U.S. Treasury (net cash borrowing)	June	-1.5e	5.4	5.9e	23.3

^{1/} Seasonally adjusted.

^{2/} \$ billions, not at annual rates

^{3/} Includes comm'l banks, S&Ls, MSBs, life ins. cos, FNMA, and GNMA.

e - Estimated

pe - Partially estimated.

DOMESTIC FINANCIAL DEVELOPMENTS

Aggregate credit flows to nonfinancial sectors of the economy apparently picked up slightly in the second quarter. In April and May, businesses maintained the strong pace of short- and intermediate-term borrowing evident since year-end, while corporate bond and equity offerings continued at the moderate level of the first quarter. In June, business borrowing from large banks appeared to accelerate somewhat, and public bond offerings surged. In the household sector, growth in both net installment and mortgage borrowing strengthened in the April-May period from the weather-depressed volume of the winter, but stayed well below the average rate for 1978. Net borrowing by the Treasury accelerated in the quarter, while state and local borrowing about matched that of the first three months of the year.

Growth in the key monetary aggregates accelerated sharply in the second quarter. Following two quarters of virtually no change, M-1 expanded at a 7-3/4 percent annual rate last quarter, owing in part to reduced shifting to ATS accounts and temporary tax-related factors. Boosted by enlarged net inflows of MMCs and reduced net outflows from savings accounts, growth of the interest-bearing component of M-2 also picked up from the first-quarter rate, despite the record runoffs of large time deposits accompanying the move toward still greater Eurodollar financing. At thrifts--for whom the ceiling rate advantage on MMCs was lost during most of the quarter--slower growth of MMCs contributed to a moderate reduction in second-quarter deposit inflows.

With incoming data suggesting a weakening in economic activity and thus causing market participants to anticipate an easing of monetary policy, most interest rates have fallen since the May FOMC meeting, even though Federal funds have continued generally to trade at about 10-1/4 percent. Yields on

SELECTED FINANCIAL MARKET QUOTATIONS
(percent)

	1978 1/		1978 - 1979 2/					Change from:	
	High*	Low	End of 1978	FOMC Apr.17	FOMC May 22	June 25	July 2	End of 1978	May FOMC
<u>Short-term rates</u>									
Federal funds 1/	10.25	6.58	10.25	9.96	10.17	10.32	10.54 ^{3/}	+ .29	+ .37
Treasury bills									
3-month	9.30	6.16	9.26	9.50	9.70	8.75	8.93	-.33	-.77
6-month	9.51	6.45	9.48	9.49	9.50	8.91	8.89	-.59	-.61
1-year	9.62	6.55	9.69	9.24	9.16	8.73	8.64	-1.05	-.52
Commercial paper									
1-month	10.29	6.48	10.32	10.03	9.90	9.66	9.72	-.60	-.18
3-month	10.52	6.68	10.55	10.13	10.00	9.68	9.68	-.87	-.32
6-month	10.56	6.70	10.61	10.15	10.01	9.63	9.61	-1.00	-.40
Large negotiable CDs 4/									
1-month	10.36	n.a.	10.29	10.04	10.02	9.89	9.82	-.47	-.20
3-month	10.96	6.77	10.83	10.21	10.21	9.94	9.84	-.99	-.37
6-month	11.52	6.97p	11.44	10.40	10.44	10.08	9.87	-1.57	-.57
Euro-dollars									
3-month	11.95	7.20	11.69	10.88	10.75	10.69	11.00	-.69	+ .25
Bank prime rate	11.57	7.75	11.75	11.75	11.75	11.50	11.50	-.25	-.25
<u>Intermediate- and long-term rates</u>									
U.S. Treasury (constant maturity)									
3-year	9.59	7.40	9.59	9.45	9.35	8.96	8.74	-.85	-.61
7-year	9.22	7.72	9.23	9.20	9.15	8.90	8.72	-.51	-.43
20-year	9.00	8.01	8.99	9.12	9.16	8.89	8.77	-.22	-.39
Municipal (Bond Buyer) 5/									
6.67	5.58	6.61	6.33	6.30	6.18	6.12	-.49	-.18	
Corporate Aaa									
New issue 6/	9.30	8.61	--	9.68	9.85	--	9.45p	--	-.40
Recently offered 7/	9.54	8.48	9.51	9.68	9.85	9.48	9.40p	-.11	-.45
Primary conventional mortgages 7/									
10.38	8.98	10.38	10.48	10.73	11.10	11.10	+ .72	+ .37	
	Low 8/	High 8/	End of 1978	FOMC Apr.17	FOMC May 22	June 25	July 2	End of 1978	May FOMC
<u>Stock prices</u>									
Dow-Jones Industrial	742.12	907.74	805.01	857.93	845.37	844.25	834.04	+29.03	-11.33
NYSE Composite	48.43	60.38	53.62	57.05	56.65	57.90	57.86	+4.24	+1.21
AMEX Composite	119.73	176.87	150.56	178.65	181.75	199.73	198.99	+48.43	+17.24
NASDAQ (OTC)	102.66	149.53	117.98	132.26	131.90	136.89	136.98	+19.00	+5.08

1/ Daily averages for statement week, except where noted.

2/ One-day quotes except as noted.

3/ Average for first 5 days of statement week ending July 4.

4/ Secondary market.

5/ One-day quotes for preceding Thursday.

6/ Averages for preceding week.

7/ One-day quotes for preceding Friday.

8/ Calendar week averages.

* All highs were reached at or close to the end of 1978.

Treasury bills have fallen 50 to 100 basis points on balance, while short-term private yields have declined 20 to 50 basis points. Contributing to this movement has been a decline in the volume of bills outstanding, as well as a swing to bill purchases by foreign central banks associated with renewed dollar support operations. Treasury and corporate bond yields have also declined--by about 40 basis points--but rates on conventional home mortgages have posted a substantial further increase in the primary market.

Monetary Aggregates and Bank Credit

In June, M-1 grew at a 15 percent annual rate. Only a small part of this surge was due to the earlier than usual disbursement of social security payments; viewed along with the preceding two months, the June growth suggested the possibility of some strengthening of the underlying demand for M-1. However the marked acceleration of M-1 growth in the second quarter also reflected in part two other influences. First, the diversion of funds from demand deposits to ATS and New York NOW accounts is estimated to have slowed M-1 growth by only 1-1/2 percentage points at an annual rate in the second quarter, compared to 2-3/4 points in the preceding three months.¹ Second, Treasury delays in processing the mid-April tax payments and a bunching of refunds raised quarterly M-1 growth by an estimated 1-1/2 percentage points.

The interest-bearing component of M-2 also resumed a more rapid rate of expansion in the second quarter. Indeed, the 13-1/2 percent annual rate of growth registered in June was the highest since last August, and reflected the first increase in savings deposits in nine months. For the quarter, a

1/ Discussions with bankers indicate that despite the recent court decision barring ATS after year-end, banks generally have continued to actively advertise ATS, and the public has continued to open new accounts at about the same rate as before the decision.

MONETARY AGGREGATES
(Seasonally adjusted annual rates of growth) 1/

	1978			1979				June '78
	H1	QIII	QIV	QI	QII ^{e/}	May ^{p/}	June ^{e/}	to June '79 ^{e/}
<u>Major monetary aggregates</u>								
1. M-1 (currency plus demand deposits)	8.0	7.9	4.1	-2.1	7.7	0.7	15.1	4.7
2. M-2 (M-1 plus time & savings deposits at CBs, other than large CDs)	7.7	9.8	7.6	1.8	8.6	5.4	14.4	7.3
3. M-3 (M-2 plus all deposits at thrift institutions)	8.3	10.3	9.3	4.7	7.8	4.6	11.6	8.3
<u>Bank time and savings deposits</u>								
4. Total	12.2	11.3	12.3	8.4	1.0	-1.4	-0.2	7.5
5. Other than large negotiable CDs at weekly reporting banks	7.6	11.0	10.2	4.5	9.3	8.7	13.4	9.2
6. Savings deposits	2.9	2.9	0.2	-9.6	-3.3	-7.2	8.3	-2.5
7. Individuals <u>2/</u>	2.7	4.1	0.0	-9.4	-2.7	-7.7	7.7	-2.1
8. Other <u>3/</u>	5.2	-10.1	0.0	-10.4	-8.0	8.2	8.2	-7.5
9. Time deposits	11.7	17.9	18.2	15.6	18.5	19.9	16.9	19.1
10. Small time <u>4/</u>	6.8	12.7	15.8	16.5	36.3	35.9	34.8	23.9
11. Large time <u>4/</u>	21.5	26.9	22.4	13.6	-12.1	-10.1	-18.1	10.2
12. Time and savings deposits subject to rate ceilings (6+10)	4.7	6.9	7.0	2.2	15.1	13.5	21.3	9.0
<u>Deposits at nonbank thrift institutions <u>5/</u></u>								
13. Total	9.2	11.1	11.6	8.8	6.6	3.6	7.7	9.6
14. Savings and loan associations	9.5	12.3	13.1	11.3	7.8	5.1	9.4	11.3
15. Mutual savings banks	5.6	6.8	7.8	4.6	3.4	0.8	2.5	5.4
16. Credit unions	17.0	13.7	10.1	0.8	6.0	0.0	4.5	6.7
<u>MEMORANDA:</u> Average monthly changes, billions of dollars								
17. Total U.S. Govt. deposits <u>6/</u>	0.3	1.1	-0.4	-2.0	1.4	1.2	4.4	0.0
18. Total large time deposits <u>7/</u>	3.6	2.9	4.7	1.3	-6.5	-5.3	-7.8	0.6
19. Nondeposit sources of funds <u>8/</u>	0.8	1.4	3.0	2.4	n.a.	1.1	n.a.	n.a.

e--estimated. n.a.--not available. p--preliminary.

1/ Quarterly growth rates are computed on a quarterly average basis.

2/ Savings deposits held by individuals and nonprofit organizations.

3/ Savings deposits of business, government, and others, not seasonally adjusted.

4/ Small time deposits are time deposits in denominations less than \$100,000. Large time deposits are time deposits in denominations of \$100,000 and above excluding negotiable CDs at weekly reporting banks.

5/ Growth rates computed from monthly levels are based on average of current and preceding end-of-month data.

6/ Includes Treasury demand deposits at commercial banks and Federal Reserve Banks and Treasury note balances.

7/ All large time certificates, negotiable and nonnegotiable, at all CBs.

8/ Nondeposit borrowings of commercial banks from nonbank sources include Federal funds purchased and security RPs plus other liabilities for borrowed money (including borrowings from the Federal Reserve), gross Eurodollar borrowings, and loans sold, less interbank borrowings.

moderation in outflows from small time deposits other than MMCs, and the heavier net issuance of MMCs, more than offset a sizable runoff of large time accounts included in M-2.¹

Net issuance of MMCs at commercial banks during the April-May period increased to \$15 billion, a record two-month net inflow. (See table on page 6.) Commercial banks reportedly intensified their marketing efforts following the elimination in mid-March of the 1/4-point ceiling rate advantage on MMCs for thrift institutions.² MMC growth at thrifts slowed markedly in April, still further in May, and was very small at S&Ls again in the first three weeks of June. During April and May, thrifts garnered only 43 percent of net MMC issues, after acquiring a two-thirds market share through the previous nine months. For banks and thrifts combined, growth in total MMC balances, not seasonally adjusted, was somewhat slower in May than in April, perhaps reflecting a lagged effect of the mid-March prohibition of interest compounding on new issues of the certificates. The average level of noncompetitive tenders at weekly Treasury bill auctions and the increase in money market mutual fund net assets remained strong in both months.

Despite the decline in net MMC sales at S&Ls and MSBs, expansion of total thrift deposits is estimated to have weakened only moderately in the second quarter, on a quarterly average basis. Thrift deposit expansion was bolstered in May and early June by increased issuance of large CDs.

- ^{1/} Beginning July 1, banks and thrifts were able to offer the new 4-year variable-ceiling counterpart to the MMC, paying maximum rates of 7.60 and 7.85 percent, respectively, 35 basis points above the fixed ceiling applicable to 4-year accounts, and 15 basis points below the fixed ceiling on 8-year accounts. On the same date, a 1/4 point increase in the savings account ceiling became effective. Press reports indicate that some banks are taking this opportunity to introduce minimum balance requirements on savings accounts. Under such plans, accounts not satisfying these requirements would be assessed a monthly fee or would earn no interest.
- ^{2/} In mid-June, auction yields on six-month Treasury bills fell sufficiently that a small offering rate differential between commercial banks and thrifts reappeared.

Net Inflows of Money Market Certificates
(in millions of dollars)

	Net MMC inflows ^{1/} at:			
	Commercial banks	FSLIC-insured S&Ls	MSBs	All institutions
1978 - June	2.1	5.4	1.6	9.1
July	3.4	6.4	1.9	11.7
August	2.3	3.3	1.5	7.1
September	1.9	4.2	1.1	7.2
October	4.2	7.4	2.8	14.4
November	5.8	7.9	1.9	15.6
December	3.3	6.2	2.0	11.5
1979 - January	8.9	14.2	4.7	27.8
February	4.1	5.9	1.7	11.7
March	5.2	7.9	2.1	15.2
April	7.3	5.8	1.9	15.0
May	7.8	3.0	0.9	11.7
June	n.a.	1.0 ^{2/}	n.a.	
Total MMC balances	<u>56.3</u>	<u>78.6^{2/}</u>	<u>24.1</u>	<u>158.0</u>
Percent of total deposits outstanding	13.5 ^{3/}	17.3	16.8	15.5

^{1/} Net inflows are defined as total MMCs issued less maturing MMCs. Commercial bank and MSB net flows are based on the last Wednesday of each month.

^{2/} As of June 20, 1979.

^{3/} Percent of small-denomination time and savings deposits for commercial banks.
n.a.-Not available.

Note: All data are estimates based on sample reporting.

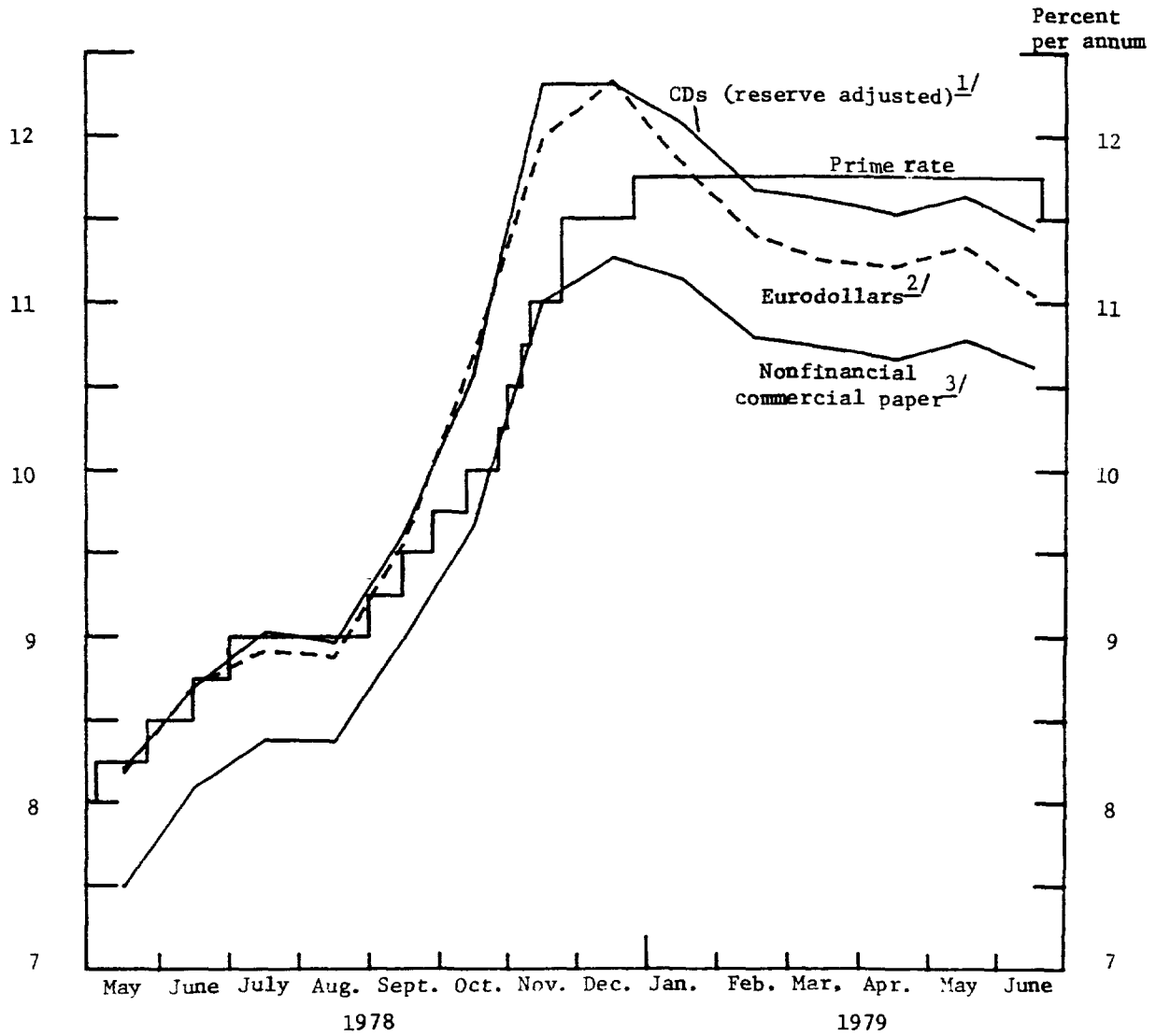
Commercial banks, in contrast, allowed \$19-1/2 billion of large time deposits to run off in the second quarter, including a decline of about \$13 billion at member banks with foreign branches. Partly offsetting this decline, member banks tapped their foreign branches for \$2-1/2 billion in June, and nearly \$10 billion in the quarter--following a \$6 billion net inflow in the first quarter--by both increasing their liabilities to and reducing their claims on these branches.¹ Since year-end, Eurodollar borrowing has been less costly than issuance of large time deposits by domestic offices, as the 8 percent reserve requirement on domestic CDs has more than offset the market yield differential between these two instruments. (See chart on page 8.) By May, member banks had moved to a net liability position with respect to their own foreign branches for the first time since late 1974.

Commercial banks also increased their reliance on domestic nondeposit sources, as they had during the first quarter. During April and May, these nondeposit funds averaged nearly \$2 billion higher than during the first quarter--owing entirely to increases in security RPs with the nonbank public; this pattern appeared to continue in early June. As a result of the substitution of RPs and Eurodollars--both of which tend to be short term--for a portion of domestic CDs, short-dated large negotiable CDs have declined as a proportion of total CDs at domestic offices of large banks.

Total bank credit grew at a 12-1/2 percent annual rate in the April-May period, moderately below its pace in the first quarter but about equal to that in 1978. (For large banks indicate relatively stronger growth in early

^{1/} On an end week of month basis, net borrowing from own foreign branches totaled about \$5-1/2 billion in the second quarter, with essentially no change in June.

The Prime Rate and Related Interest Rates



1/ 90-day secondary market CDs converted to an investment yield and adjusted for the cost of required reserves. Month is average of 5-day weeks.

2/ 90-day Eurodollars converted to an investment yield. Month is average of 5-day weeks.

3/ 90-119 day series converted from a discount basis to investment yield.

June.) Banks acquired Treasury securities at a substantially faster rate in April and May than in the first quarter, but such growth apparently slowed--at least at large banks--in June. Bank loan growth slowed slightly during the first two months of the quarter, with some diminution in the advance of all major loan categories except lending to individuals. However, available data for large banks suggest faster growth in June, especially for real estate, security and business loans.

Business Credit

The rapid growth of bank loans to businesses in June appears to have exceeded the accelerated pace of about 20 percent set in both the first quarter and April-May. In mid-June, the prevailing prime rate dropped to 11-1/2 percent, reflecting the decline in banks' cost of funds and the lower rates on competing credit sources. Moreover, responses from large banks in May to the Senior Loan Officer Opinion Survey of Bank Lending Practices indicated greater willingness to relax compensating balance requirements.

In addition to the strength in bank loans to businesses, outstanding commercial paper issued by nonfinancial firms surged in April and increased slightly further in May. Business credit at finance companies increased more rapidly over the two months--buoyed by auto dealer financing--and brought the April-May growth of these three types of business credit to just above the strong first-quarter pace. In contrast, long-term borrowing by nonfinancial corporations, while somewhat stronger in the second quarter than in the first, remained moderate. These financing patterns are not unusual when economic activity levels off (see the chart on page 12 which plots average growth of debt components over four-quarter intervals). The relative shift to short- and intermediate-term financing at such times probably reflects in part

COMMERCIAL BANK CREDIT

(Percentage changes at seasonally adjusted annual rates) 1/

	1978			1979	Apr.-	1979		12
	HI	QIII	QIV	Q1	May	Apr.	May	months ending May
1. Total loans and invest- ments <u>2/</u>	14.0	11.1	7.9	14.1	12.5	13.8	11.1	12.0
2. Investments	8.5	3.2	-8.6	10.5	12.7	9.8	15.5	4.3
3. Treasury securities	9.6	-9.6	-36.8	7.7	26.5	18.6	33.9	-3.5
4. Other securities	7.8	11.0	7.8	12.0	6.0	4.7	6.7	9.0
5. Total loans <u>2/</u>	16.2	14.2	14.1	15.5	12.4	15.4	9.4	15.1
6. Business loans	16.7	11.4	9.3	21.8	19.7	18.5	20.6	15.1
7. Security loans	23.5	-28.7	-43.3	43.9	21.9	162.5	-104.6	6.4
8. Real estate loans	18.7	18.9	18.6	15.1	14.5	14.2	14.6	18.4
9. Consumer loans	20.5	15.6	16.1	14.2	15.4e	16.1	14.5e	17.2e
MEMORANDA:								
10. Commercial paper issued by non- financial firms <u>3/</u>	11.5	28.9	42.7	24.4	51.7	91.9	10.7	40.0
11. Sum of items 6 & 10	12.4	12.6	11.7	22.0	22.2	24.3	19.8	16.8
12. Memo item 11 plus business loans from finance companies	13.2	10.7	15.4	20.5	21.3	22.7	19.8	16.8

e--estimated.

- 1/ Last-Wednesday-of-month series except for June and December, which are based on the last business day of the month.
- 2/ Loans include outstanding amounts of loans reported as sold outright to a bank's own foreign branches, unconsolidated nonbank affiliates of the bank, the bank's holding company (if not a bank), and unconsolidated nonbank subsidiaries of the holding company.
- 3/ Measured on an end-of-month basis.

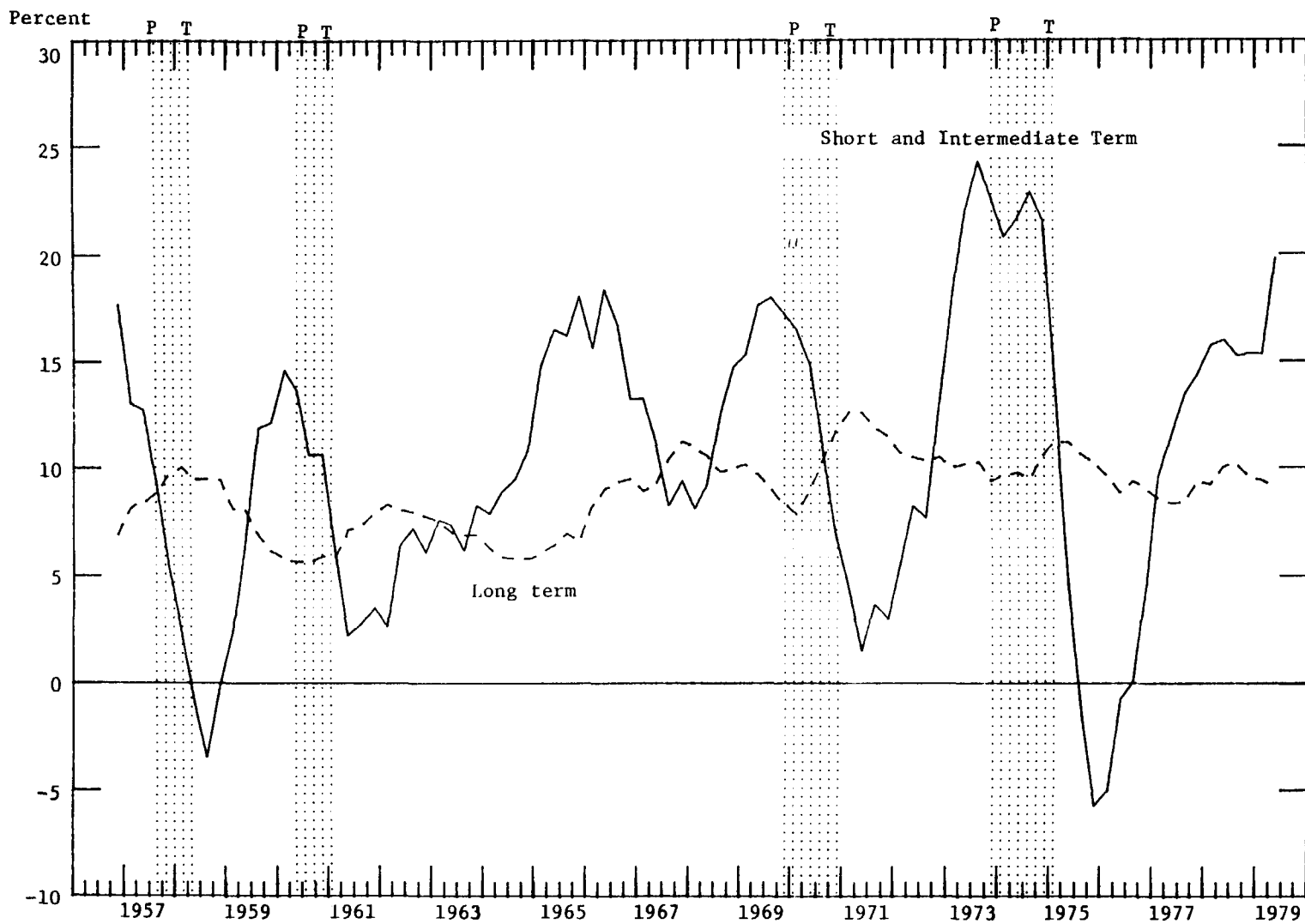
that long-term interest rates will fall. In addition, inventories rise, collection of receivables slows, and profits weaken as sales turn sluggish, generating a temporary need for funds.

Cyclically rapid expansions in bank business loans, which dominate movements in short- and intermediate-term business financing, often have been accompanied by increases in the proportion of term loans to total business loans at banks. Term loans, predominantly with maturities of 1 to 5 years, offer corporations an alternative to bond financing while allowing banks to lock in loan rates perceived to be cyclically high. The share of term business loans outstanding at large banks in May remained at the record high reached in the first quarter. Moreover, fixed-rate agreements represented a much higher than usual proportion of term loans made by commercial banks, according to the Survey of Terms of Bank Lending taken in early May.

In the long-term area, gross public offerings of corporate bonds increased in June to \$3-3/4 billion, seasonally adjusted, the largest monthly total in four years and well above the \$1-3/4 billion monthly average over the first five months of the year. Public offerings of bonds by industrial corporations totaled about \$1-1/2 billion last month (NSA), compared to a \$400 million monthly average earlier in the year. The June increase in longer-term debt financing by industrial corporations reportedly was in response to the decline in corporate bond yields after the May FOMC meeting. Apparently, corporate borrowers did not expect this decline in long-term rates to continue--or perhaps even to be maintained. The bond calendar for July and August is much lighter than in June; thus, it appears that last month's slate was in part just a speed-up of planned offerings.

Note and bond issues by financial corporations also contributed to June's large slate of offerings. Intermediate- and long-term issues by finance

Four-Quarter Rates of Growth in Debt Components
of Nonfinancial Business Corporations 1/



III-12

1/ Growth for Q_t equals the level in Q_t minus the level in Q_{t-4} , all divided by the level in Q_{t-4} .

Source: Seasonally adjusted Flow of Funds data.

Latest plot: Second quarter 1979, preliminary.

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

	1978	1979					
	Year	QI ^{e/}	QII ^{e/}	May ^{e/}	June ^{e/}	July ^{f/}	Aug.
<u>Seasonally adjusted</u>							
Corporate securities--total	3,938	3,607	4,165	3,450	5,150	3,050	3,400
Publicly offered bonds	1,651	1,359	2,615	2,000	3,650	1,650	2,000
Privately placed bonds	1,424	1,645	1,100	1,100	1,100	1,000	1,000
Stocks	863	603	450	350	400	400	400
<u>Not seasonally adjusted</u>							
Publicly offered bonds	1,651	1,473	2,767	1,800	3,900	1,800	1,600
By quality <u>1/</u>							
Aaa and Aa	853	950	1,542	775	1,750	--	--
Less than Aa <u>2/</u>	798	523	1,225	1,025	2,150	--	--
By type of borrower							
Utility	610	605	785	450	1,075	--	--
Industrial <u>3/</u>	526	378	840	575	1,525	--	--
Financial	515	490	1,142	775	1,300	--	--
Foreign securities--total <u>4/</u>	504	513	274	300	300	300	200

- 1/ Bonds categorized according to Moody's bond ratings.
2/ Includes issues not rated by Moody's.
3/ Includes equipment trust certificates.
4/ Includes both publicly offered and privately placed issues.
e/ Estimated.
f/ Forecast.

companies, floating-rate note issues by major bank holding companies, and mortgage-backed bond issues by West Coast S&Ls boosted the second-quarter total of financial offerings to the largest dollar volume on record. The slate of public bond offerings by nonfinancial and financial corporations combined was the largest for any quarter since mid-1977.

Stock price indexes have increased about 2 percent since the last FOMC meeting, and year-to-date gains are approximately 8 percent. These increases reflect in large part the substantial upward movement in the share prices of corporations in the petroleum and natural gas industries. The stock prices of these companies, as a group, have climbed about 20 percent this year, with about one-half of the gain occurring since mid-May. The stock prices of companies outside the petroleum and natural gas industries also have advanced thus far in 1979, but their overall gain is somewhat less than 5 percent.

Government Debt Markets

Net offerings of marketable obligations by the Treasury in the second quarter totaled \$14-1/2 billion (SA), up from \$5 billion in the first quarter. Since the last FOMC meeting, the Treasury has raised \$600 million (NSA) of new money through the sale of marketable issues. Continuing the pattern evident throughout the quarter, a further decline in the volume of Treasury bills outstanding was more than offset by a nearly \$4 billion net increase in coupon issues. Of this latter amount, \$1-1/2 billion was obtained through the sale of 15-year bonds and the remainder by issues of 2-year and 4-year notes.

The federally sponsored credit agencies raised approximately \$5 billion (SA) in the second quarter. While still substantial, this volume was down significantly from the record pace of the preceding quarter and

reflected a large seasonally adjusted decline in funds raised by the Federal Home Loan Banks. Their advances to member S&Ls apparently increased about as much in the second quarter as in the previous quarter, but the FHLBs relied more heavily on reductions in liquidity and on inflows of deposits from S&Ls to finance such lending. Similarly, the pace of borrowing by the Federal Farm Credit Banks was down somewhat from the first quarter, but remained historically high. FNMA, however, continued to borrow large amounts.

The gross volume of bonds issued by state and local governments in the second quarter was essentially unchanged from that of the first quarter, as issues in June rebounded following the May decline. The June advance reflected an increase in offerings of general obligations as well as in issuance of revenue bonds to finance housing programs. About three-fourths of the \$650 million in housing bonds issued during June were to finance single-family mortgages. (See table on p. 17.) The reduced issuance of these bonds in May resulted from the introduction of legislation to ban them. More recently, however, Congress has seemed inclined to limit rather than prohibit the issuance of single-family mortgage revenue bonds, and recent issues have been sold contingent on favorable legislative action.

Despite the heavy offerings of general obligations, the average yield on these bonds--as measured by the Bond Buyer Index--has fallen 18 basis points since mid-May to its current level of 6.12 percent June 29. The ratio of tax-exempt to corporate bond yields fell to a record low in June. This ratio has been trending downward since late 1977, apparently due to the continued demands for tax-exempt bonds by commercial banks, property/liability insurance companies, and the growing number of individuals pushed by inflation into higher tax bracket

GOVERNMENT SECURITY OFFERINGS
(Monthly totals or monthly averages, in millions of dollars)

	1978	1979					
	Year	QI	QII	May ^{e/}	June ^{f/}	July ^{f/}	Aug. ^{f/}
		<u>Seasonally Adjusted</u>					
State and local government securities, gross offerings							
Total		4,853	4,869	3,085	4,700	5,600	4,300
Long-term		3,138	3,254	2,510	3,800	4,100	3,000
Short-term		1,715	1,615	575	900	1,500	1,300
U.S. Government securities, net offerings							
U.S. Treasury ^{1/}		1,732	4,824	9,030	-1,255	1,585	3,253
Sponsored agencies		2,608	1,656	374	2,237	851	2,360
		<u>Not Seasonally Adjusted</u>					
State and local government securities, gross offerings							
Total	5,851	4,765	5,055	3,803	5,600	5,200	4,100
Long-term	4,042	3,266	3,514	3,087	4,400	4,000	2,900
Short-term	1,809	1,499	1,541	716	1,200	1,200	1,200
U.S. Government securities, net offerings							
U.S. Treasury ^{1/}	2,337	2,998	933	7,230	-4,700	0	6,700
Sponsored agencies	1,930	2,120	1,887	617	2,450	1,185	2,794

^{1/} Marketable issues only.

^{e/} Estimated.

^{f/} Forecasted.

Revenue Bonds Issued for Housing
(\$ millions)

	<u>1979</u>			Q1	Q2	H1
	April	May	June ^{1/}			
Total	1,002.8	304.2	639.5	2,545.3	1,946.5	4,491.8
State HFAs	237.8	250.4	505.3	1,564.5	993.5	2,558.0
Single-family	214.2	—	355.2	1,054.7	569.4	1,624.1
Multi-family	23.6	250.4	150.1	509.8	424.1	933.9
Cities & counties (single-family)	765.0	53.8	134.2	980.8	953.0	1,933.8

^{1/} All single-family mortgage revenue bonds issued in June are subject to cancellation if the Ullman bill is passed by Congress in its original wording.

Source: Board staff.

Mortgage and Consumer Credit

Although the pace of mortgage lending by commercial banks in May was about unchanged from the previous month, lending by S&Ls picked up further, particularly by those in the West. As S&Ls' new commitments were less than their takedowns during May, outstanding mortgage commitments at these institutions declined for the fifth time in six months, reaching \$31-1/4 billion, nearly \$3 billion below the peak last November. Meanwhile, issuance of GNMA pass-through securities increased somewhat in May.

Average interest rates on new commitments for 80 percent 30-year mortgages at sampled S&Ls have climbed more than 35 basis points since the May FOMC meeting, attaining a new high of 11.10 percent. All major regions have contributed to the increase, with the largest advances registered in the Midwest and the West.¹ Field reports suggest that the additional mortgage rate increases in the primary market last month reflected relatively heavy credit demands at a time of S&L uncertainty about the volume and cost of future cash flows. With the recent weakness in MFC flows at thrifts and with only moderate inflows of deposits subject to fixed rate ceilings S&Ls relied on other sources to meet their increased mortgage commitments. These sources included issuance of large CDs, reduction of liquid assets, and to a lesser extent, issuance of commercial paper and mortgage-backed bonds. On the other hand, growth of S&L borrowing from Federal Home Loan Banks in May was well below the very high April increase. Moreover, in late May the FHLB System adopted a less accommodative position toward future borrowing by encouraging

^{1/} As market rates have risen further, additional states have moved to liberalize or remove usury ceilings. Such legislation has recently been enacted in Texas, Missouri, South Dakota, Minnesota and Tennessee. Aside from these cases, usury ceilings in more than a dozen other states have reportedly been pinching the supply of credit available.

INTEREST RATES AND SUPPLY OF MORTGAGE FUNDS
AT SELECTED S&Ls

Period	Conventional home mortgages			
	Average rate on new commitments for 80% loans (percent)	Basis point change from month or week earlier	Spread ^{1/} (basis points)	Percent of S&Ls ^{2/} with mortgage funds in short supply
1978--High	10.38	--	+104	60
Low	8.98	--	+38	17
1979--Jan.	10.39	+ 4	+88	64
Feb.	10.41	+ 2	+85	59
Mar.	10.43	+ 2	+81	57
Apr.	10.50	+ 7	+76	62
May 4	10.60	+ 7	+67	73
11	10.68	+ 8	+75	76
18	10.73	+ 5	+88	72
25	10.75	+ 2	+101	78
June 1	10.90	+15	+118	80
8	11.03	+13	+145	78
15	11.05	+ 2	+159	79
22	11.10	+ 5	+162	78
29	11.10	0	+165	77

^{1/} Average mortgage rate minus average yield on recently offered Aaa utility bonds.

^{2/} Percent reporting supply of funds slightly or substantially below normal seasonal patterns.

SECONDARY HOME MORTGAGE MARKET ACTIVITY

Period	FNMA auctions of forward purchase commitments						Yields on GNMA- guaranteed mortgage-backed securities for immediate delivery ^{2/}
	Conventional			Government-underwritten			
	Amount (\$ millions)		Yield to FNMA ^{1/}	Amount (\$ millions)		Yield to FNMA ^{1/}	
Offered	Accepted	Offered		Accepted			
1978--High	717	363	10.92	1249	605	10.60	9.68
Low	75	48	9.28	130	80	9.13	8.43
1979 May 7							10.05
14	250	102	11.30	279	119	10.88	10.03
21							9.98
29	208	112	11.41	147	66	10.80	9.51
June 4							9.83
11	237	123	11.54	160	66	10.79	9.76
18							9.72
25	120	72	11.60	60	34	10.74	9.70

^{1/} Average gross yield before deducting fee of 38 basis points for mortgage servicing. Data, based on 4-month FNMA purchase commitments, reflect the average accepted bid yield for home mortgages, assuming a prepayment period of 12 years for 30-year loan without special adjustment for FNMA commitment fees and related stock requirements. Mortgage amounts offered by bidders relate to total eligible bids received.

^{2/} Average net yields to investors assuming prepayment in 12 years on pools of 30-year FHA-VA mortgages carrying the prevailing ceiling rate on such loans.

members to first utilize their liquidity and by monitoring more closely members' reasons for obtaining advances. In addition, the San Francisco district raised its rates on advances.

With further increases in primary market rates on conventional home mortgages coming during a period when rates on corporate bonds have declined the gross yield spread favoring mortgages has increased to an unusually wide margin. This incentive has stimulated renewed investment by life insurance companies in home mortgages. Through the first four months of 1979, life insurance companies committed nearly three-fifths more funds for home loans than in the comparable period of last year.

In FNMA's latest (June 25) auction of forward purchase commitments, which was based on a slim volume of offerings, yields rose further on conventional loans and continued to decline on FHA/VA loans. Yields also declined in the GNMA securities market.

Growth of consumer installment credit outstanding appeared somewhat slower in May than in April, probably approximating the first-quarter pace. With the weakness in car sales in June (especially for the larger, more expensive models), the overall second-quarter growth may have been well below last year's high. Commercial bank finance rates in May for new automobile loans and mobile home loans were somewhat higher than in February, while rates for personal and other consumer goods loans and credit card balances were little changed.

The ratio of home mortgage and consumer credit repayments to disposable personal income--which grew steadily from 1976-QII through 1978-QIII--appears to have moved little since late 1978. The commercial bank consumer loan delinquency rate series declined during the first quarter of 1979, after

remaining essentially constant from mid-1976 through 1978 at a level a little below the peak at the end of the last business recession. In the two most recent business cycles, increases in this indicator preceded the turndown in economic activity by roughly seven quarters.

CONSUMER INSTALLMENT CREDIT ^{1/}

	1976	1977	1978	1978	1979		2/
				QIV	QI	Apr.	May
<u>Total</u>							
Change in outstandings							
Billions of dollars	21.7	35.3	44.8	46.5	40.4	48.5	43
Percent	12.6	18.2	19.4	17.9	14.8	17.2	15
Bank share (percent)	49.8	52.9	53.1	46.2	43.8	50.3	50
Extensions							
Billions of dollars	211.0	254.1	298.3	312.9	313.8	322.7	...
Bank share (percent)	46.1	46.4	47.8	47.2	47.2	48.2	...
Liquidations							
Billions of dollars	189.4	218.8	253.5	266.4	273.4	274.2	...
Ratio to disposable income	16.0	16.8	17.5	17.6	17.5	17.2	...
<u>Automobile Credit</u>							
Change in outstandings							
Billions of dollars	10.5	15.2	19.6	19.6	18.9	15.8	...
Percent	18.3	22.5	23.6	20.1	18.5	14.8	...
Extensions							
Billions of dollars	63.7	75.6	89.0	92.5	92.4	94.1	...

1/ Quarterly and monthly dollar figures and related percent changes are seasonally adjusted annual rates.

2/ Early estimate.

INTERNATIONAL DEVELOPMENTS

Foreign exchange markets. For the first two weeks of the period since the last green book in mid-May, the dollar's value in foreign-exchange markets was under considerable upward pressure. The forces tending to raise the dollar's value abated in early June, however, and gave way around mid-month to strong downward pressure, which lasted until nearly the end of the month.

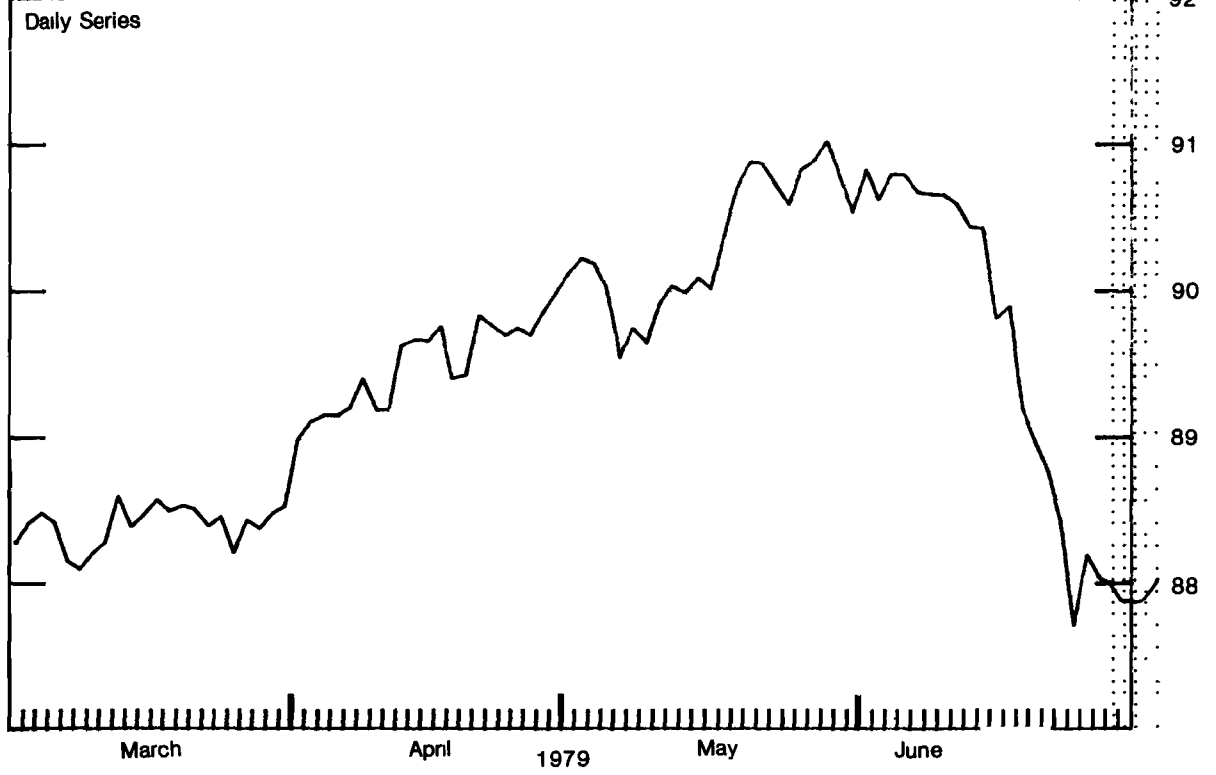
The effect of the forces tending to push up the dollar's value during the early part of the period can be seen in both the top and bottom panels of Chart 1. The dollar's value fluctuated for about two weeks around a level about one per cent higher than it had been in mid-May (upper panel),

. The favorable market evaluation of the dollar's prospects during that period seemed to derive from published data confirming an apparent slowing in U.S. economic activity and showing a sharp decline in the leading-indicators series. In addition, evidence became available that Japan's trade surplus was decreasing, and the yen depreciated in terms of the dollar by about 3-1/2 per cent during the last two weeks of May.

Market conditions were generally calm and the dollar traded in a narrow range until the middle of June, when -- soon after the Bank of England raised its minimum lending rate by 2 percentage points -- figures were released showing a very sharp acceleration in the growth of U.S. monetary aggregates. Market participants seemed to view the new data, which came at time when some U.S. interest rates

March 1973=100

WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



were falling, as evidence that the Federal Reserve would not resist an easing of financial conditions while U.S. economic activity slowed. The prospect that U.S. inflation would diminish therefore dimmed somewhat. Moreover, attention was focussed on an apparently sharp contrast between U.S. policies and those of some other countries, where efforts to tighten financial conditions had been in process for several months (as discussed below in the section on foreign economic developments).

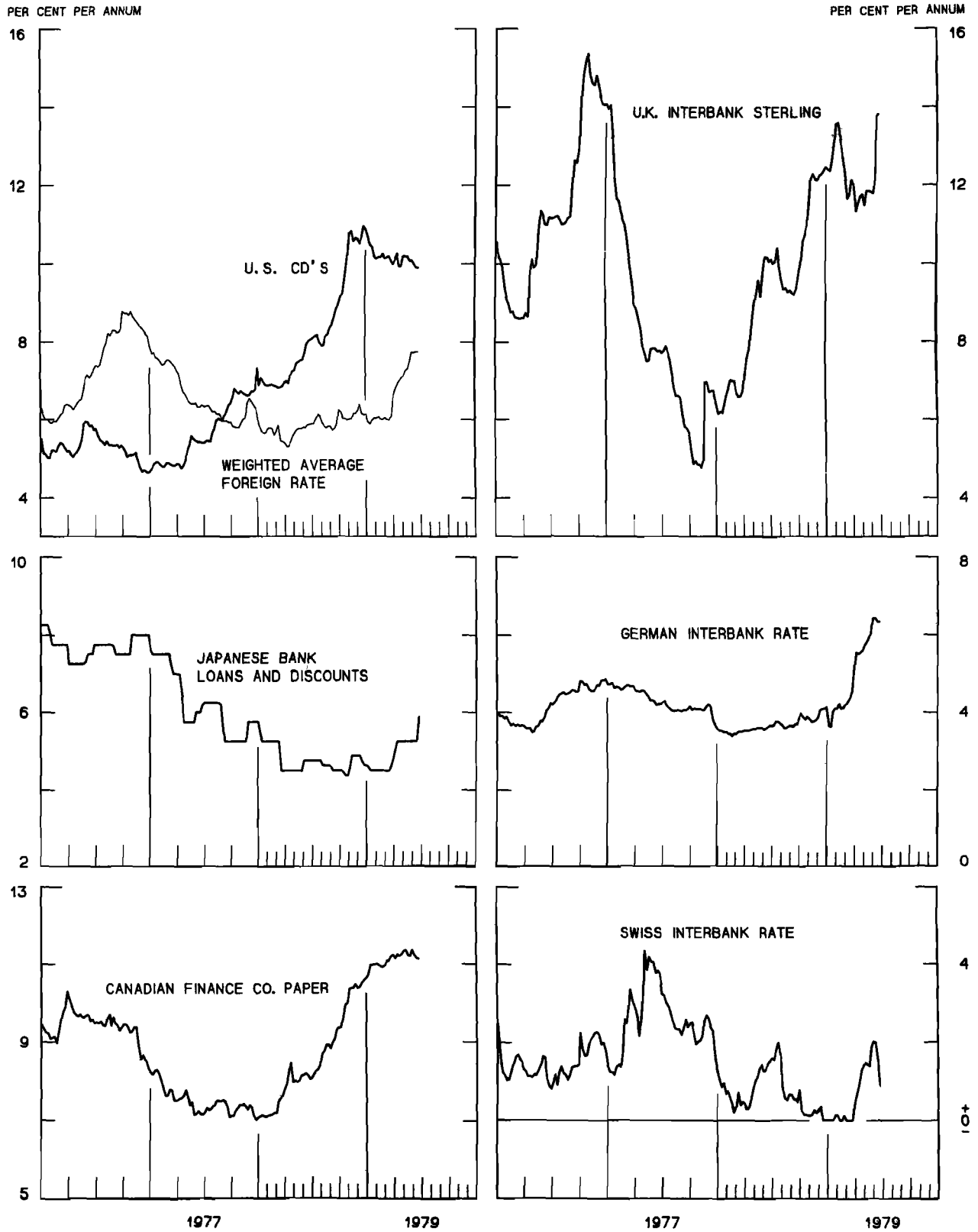
A highlighted feature of the apparent contrast was the narrowing of interest differentials pictured in Chart 2. As shown there, many foreign interest rates had been rising during the period this spring when the foreign currencies were under downward pressure vis-a-vis the dollar.

The view of market participants that U.S. policies had changed and were different from those of foreign authorities led to a very rapid depreciation of the dollar. Intervention support was given to the dollar by U.S. authorities, but the dollar declined about 2-1/2 per cent during the last two weeks in June.

CHART 2

7/3/79

3-MONTH INTEREST RATES AVERAGES FOR WEEK ENDING WEDNESDAY



U.S. authorities were net sellers of \$1.7 billion equivalent of foreign currencies.

U.S. intervention was shared as follows: The Treasury sold (net) about \$800 million equivalent of marks, which were taken from balances. The Federal Reserve sold about the same net amount of marks,

OPEC surpluses and investments. The OPEC current account surplus, which almost disappeared in 1978, will soar in 1979 and will probably be the largest since 1974 when it reached \$70 billion. This will result principally from steep increases in oil prices and secondarily from a slowing of OPEC import growth. The current account surplus is expected to be about \$45 billion this year.

OPEC oil revenues, which in 1978 amounted to an estimated \$131 billion, could rise 40 percent to \$185 billion in 1979, assuming oil exports volume of 28 million b/d (up slightly from 27.8 million b/d in 1978). This projection is subject to uncertainties with regard to the level of the average oil export price in the second half of the year, when marker prices are scheduled to be lower in Saudi Arabia, the UAE and Qatar (\$18/bbl.) than in other countries (apparently \$21-22/bbl.), which latter will also continue to apply premiums. The projection in the table assumes an average export price (including premia) in the second half of \$21/bbl., which compares with \$12.93 in 1978 (yearly average), \$13.79 in the first quarter of 1979, and an estimated \$16.85 in the second quarter. Any difference between the actual and the projected average export price in the second half will change projected second-half oil export receipts by \$5 billion for every \$1/bbl. of difference in price.

The dollar value of OPEC imports is expected to rise only about 8 percent in 1979, to \$109 billion, compared with increases of 20 percent last year and 25 percent in 1977. Import volume seems likely to show little if any increase this year. In Iran the volume of imports may actually fall by

Estimates of OPEC Current Account and Investible Surplus
(in billions of dollars)

	<u>1977</u>	<u>1978</u>		<u>1979</u>		
	<u>Year</u>	<u>1st H</u>	<u>2nd H</u>	<u>Year</u>	<u>Q-1</u>	<u>Year^{p/}</u>
<u>Current Account</u>						
Oil exports	138	63	69	131	35	185
Other exports	10	5	5	10	3	11
Imports f.o.b.	<u>-84</u>	<u>-47</u>	<u>-54</u>	<u>-101</u>	<u>-22</u>	<u>-109</u>
Trade balance	63	21	19	40	16	87
Net services & private transfers	<u>-29</u>	<u>-17</u>	<u>-19</u>	<u>-35</u>	<u>-8</u>	<u>-39</u>
Balance on above	35	4	0	5	7	48
Grant aid	<u>-5</u>	<u>-2</u>	<u>-2</u>	<u>-3</u>	<u>-1</u>	<u>-4</u>
Current-account balance	30	3	-2	2	6	44
<u>Investible Surplus</u>						
Current-account balance	30	3	-1	2	6	44
Cred to(-) or from oil companies	<u>3</u>	<u>3</u>	<u>-2</u>	<u>1</u>	<u>1/</u>	<u>-9</u>
Investible surplus	33	6	-3	3	6	35
Investments:						
In United States	9.2	.2	1.7	1.9	-1.0	
a. Treas. bills & bank deposits	-1.5	-1.0	.8	-.2	-.5	
b. Other securities	6.5	.5	-.4	.1	-1.0	
c. Other capital flows	2.2	.7	1.3	2.0	.5	
In United Kingdom	.7	-.2	.5	.3	.4	
a. Liquid sterling assets	.1	-.3	.5	.2	.4	
b. Other loan & investments	.6	.1	0	.1	0	
In Euro-currency market	11.9	-.4	2.0	1.6)	
) 6.6	
Other investments and net new borrowing	11.2	6.4	-7.2	-.8)	

^{p/} Projection.

^{1/} Less than \$1/2 billion.

^{2/} Direct investment, import prepayments, debt repayment, real estate, accounts with U.S. agencies, and miscellaneous.

^{3/} Including domestic-currency deposits outside the U.S. and the U.K.

Note: Detail may not add to totals because of rounding.

as much as 50 percent, in response to the change in Iran's economic attitudes, the reduction in economic activity that now seems likely to persist most of the year, and a backlog of goods built up during last year's customs and port strikes. In dollar terms such a cutback in the volume of Iranian imports would amount to around \$10 billion. In Saudi Arabia the rate of increase in import volume is expected to slow by one-half as the government stretches out development programs or otherwise deliberately slows the pace of economic expansion for socio-political reasons. Indonesia's devaluation last November will temper import demand there. The growth in the dollar value of total OPEC imports this year is also expected to be held down by a smaller rise in the dollar value of import prices this year than last. This projection reflects a much smaller year-over-year decline in the weighted average exchange rate of the dollar, with consequent smaller upward effect on the dollar equivalent of prices of imports from countries other than the United States. Total OPEC import prices in dollars may rise about 8-10 percent this year compared with 12 percent last year.

In other accounts, OPEC non-oil exports are projected at \$11 billion in 1979, there is expected to be a smaller rise this year than last, to \$39 billion. In the net deficit on services and private transfers, and little change is expected in OPEC grant aid of about \$4 billion. The foregoing suggest a current account surplus of about \$44 billion.

The OPEC investible surplus will rise this year by considerably less than the current account surplus because of the lag in payments for oil in a year of rising oil prices. This lag may cause a \$9-10 billion rise in accounts receivable from oil companies.

In the first quarter of 1979 the OPEC current account surplus appears to have been about \$6 billion, already several times larger than the 1978 quarterly average. Oil exports were up only moderately, reflecting both the relatively small rise in oil export prices in the first quarter (6.7 percent from the 1978 average) and reduced exports from Iran; but Iranian imports were down sharply. There was a net outflow of OPEC funds from the United States of about \$1 billion, and a net inflow of \$0.4 billion into sterling balances in the United Kingdom. Most of the first-quarter surplus appears to have been invested in the Euro-currency markets.

U.S. International Transactions. The U.S. current account balance shifted to a small surplus (\$0.6 billion, annual rate) in the first quarter of 1979 from a small (revised) deficit in the fourth quarter of last year and a much larger deficit in the third quarter. This was the first surplus recorded since the fourth quarter of 1976.

There were two major elements in this swing. The U.S. trade deficit was reduced by \$7½ billion, annual rate, between the third quarter of 1978 and the first quarter of 1979. In addition, net direct investment income receipts (revised data) increased by an unusually large \$8 billion annual rate over the same period.

U.S. Current Account
(billions of dollars, seasonally adjusted annual rates)

	1978	1978		1979	\$ Change	
	<u>Year</u>	<u>3Q</u>	<u>4Q</u>	<u>1Q</u>	<u>1Q-4Q</u>	<u>1Q-3Q</u>
<u>U.S. Current Account Balance</u>	-13.9	-12.9	-1.3	+0.6	1.9	13.5
Trade balance	-34.2	-32.0	-25.5	-24.4	1.1	7.6
Direct investment income, net	21.7	19.7	26.4	27.7	1.3	8.0
Military transactions, net	0.5	1.0	-1.0	-0.5	0.5	-1.5
Other service transactions, net	3.2	3.3	4.1	3.1	-1.0	-0.2
<u>Unilateral transfers</u>	-5.1	-4.9	-5.3	-5.3	0	-0.4

In May the U.S. merchandise trade deficit, \$33.7 billion at an annual rate on an international accounts basis, was slightly larger than the April deficit. See the chart on the next page. For April-May combined, the deficit was larger than the first quarter average by \$7 billion (annual rate).

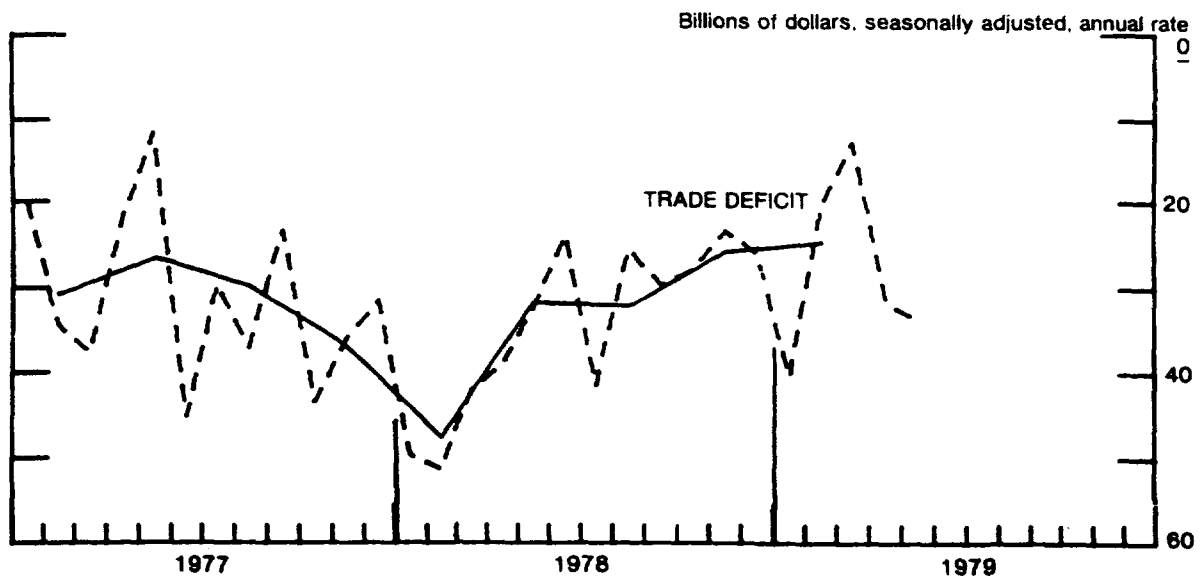
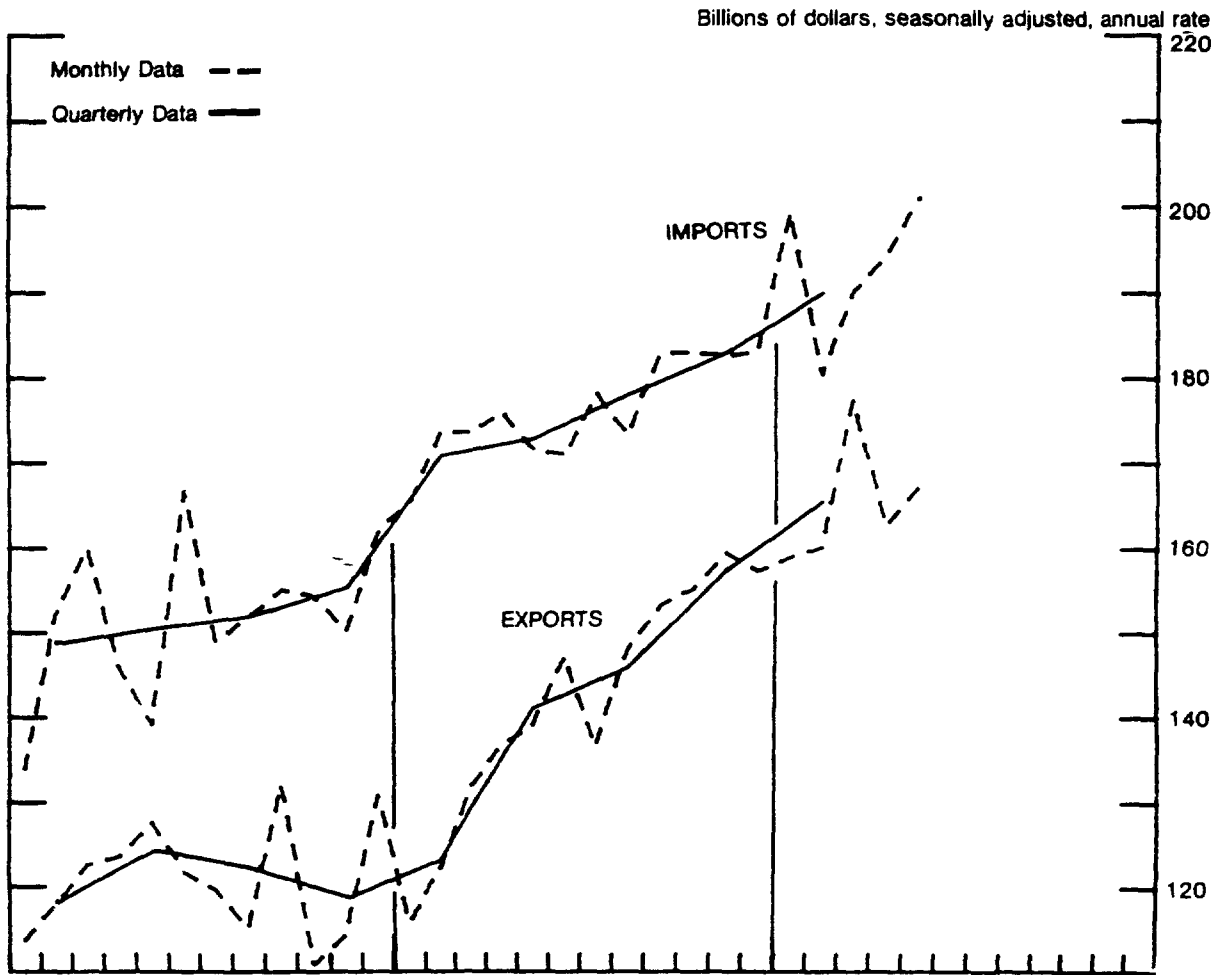
In May, exports increased slightly from the April level but for the two months averaged at about the first quarter rate. Increases in exports of nonagricultural industrial supplies were about offset by declines in exports of civilian aircraft and automotive equipment to Canada. Exports of machinery have been little changed in value for four months. Agricultural exports declined slightly in May, particularly soybeans, but for the two months combined were little changed from the first-quarter average.

Imports increased by about 4 per cent in May even though oil imports declined. For April and May combined, the value of imports rose by 4 per cent from the first quarter average.

Oil imports declined sharply in May to 8.2 million barrels per day (mbd) bringing the average for April-May to 8.7 million barrels per day. This was 6 per cent less than in the first quarter. Oil import prices averaged \$16.23 per barrel in May, 21 per cent higher than at the end of last year.

U.S. Merchandise Trade

International Accounts Basis



Non-oil imports rose sharply in May with most of the increase in industrial supplies, particularly steel, other metals, chemicals, and natural gas from Canada. Foreign car imports declined in May from the record April level to a rate only slightly higher than in the first quarter. For April-May combined the increase in non-oil imports from the first quarter average was primarily in industrial materials and foreign cars.

U.S. Merchandise Trade, International Accounts Basis
(billions of dollars, seasonally adjusted annual rates)

	1978 ^r			1979			
	<u>Year</u>	<u>3Q</u>	<u>4Q</u>	<u>1Q^r</u>	<u>May & April</u>	<u>April*</u>	<u>May*</u>
<u>EXPORTS</u>	<u>141.9</u>	<u>146.0</u>	<u>157.3</u>	<u>165.4</u>	<u>165.0</u>	<u>162.3</u>	<u>167.3</u>
Agric.	29.9	31.7	31.3	30.6	29.9	31.3	28.5
Nonagric.	112.0	114.2	126.0	134.8	135.0	131.2	138.7
<u>IMPORTS</u>	<u>176.1</u>	<u>178.0</u>	<u>182.7</u>	<u>189.8</u>	<u>197.5</u>	<u>194.1</u>	<u>200.9</u>
Petroleum	42.3	43.5	43.2	46.6	49.9	50.2	49.6
Nonpetroleum	133.8	134.5	139.5	143.2	147.6	143.9	151.4
<u>BALANCE</u>	<u>-34.2</u>	<u>-32.0</u>	<u>-25.5</u>	<u>-24.4</u>	<u>-32.6</u>	<u>-31.5</u>	<u>-33.7</u>

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

^r/ Revised

*/ The monthly International Accounts figures are only rough estimates and are subject to considerable revision.

On June 28, the OPEC oil ministers announced an increase in oil prices effective July 1. The marker price was raised to \$18 per barrel which is 24 per cent higher than the marker price set April 1. OPEC oil producers, other than Saudi Arabia, United Arab Emirates, and Qatar, have set a base price of \$20 per barrel plus some additional

surcharges; however they indicated that the total price should not exceed \$23.50 per barrel. This means that on average the OPEC sales price of petroleum could be raised to \$16.85 per barrel in the second quarter and \$21 per barrel in the third and fourth quarters. The next meeting of the OPEC oil ministers is scheduled for December 17, but they indicated that they could meet earlier if it were judged necessary.

Intervention sales of dollars and U.S. repayments of swap debt in April resulted in a \$7.2 billion decline in foreign official reserve holdings in the United States (line 14 in the table on page ____.)

. OPEC holdings of U.S. securities and bank liabilities rose by slightly less than \$500 million in April, following a \$1.7 billion fall in the first quarter of 1979. See line 16.

. Over the seven weeks

RESTRICTED

U.S. International Transactions
(in millions of dollars; receipts, or increase in liabilities, +)

	1977	1978	1 9 7 8				1 9 7 9		
	Year	Year	Q2	Q3	Q4	Q1	Feb.	Mar.	Apr.
1. <u>Trade balance</u> 1/	-30,873	-34,187	-7,907	-8,012	-6,369	-6,098	-1,671	-1,065	-2,806
2. Merchandise exports	120,816	141,884	35,267	36,491	39,315	41,350	13,344	14,761	13,939
3. Merchandise imports	-151,689	-176,071	-43,174	-44,503	-45,684	-47,448	-15,015	-15,826	-16,745
4. <u>Change in net foreign positions of banking offices in U.S. (excl. liab. to foreign official inst.)</u>	-3,909	-13,719	2,700	2,112	-12,414	14,037	3,051	4,308	2,383
Through interbank transactions with									
5. a) Own offices in foreign countries	-2,718	5,616	5,107	5,704	-1,760	14,953	4,820	8,455	-2,665
6. b) Unaffiliated banking offices in foreign countries	-2,204	-11,400	-981	-1,420	-6,631	606	-1,466	-2,904	4,772
Through nonbank transactions									
7. a) Claims on nonbanks in foreign countries (increase, -)	-424	-9,436	-1,818	-2,651	-4,788	-1,032	-661	-737	34
8. b) Liabilities to private nonbanks in foreign countries (inc. custody liab.)	1,436	1,501	392	479	765	-490	357	-505	240
9. <u>Private securities transactions, net (excl. U.S. Treas. Oblig.)</u>	-3,068	-692	126	-114	-120	-514	-331	301	229
10. Foreign net purchases of U.S. corp. bonds	1,112	1,124	159	378	513	-11	-59	72	177
11. Foreign net purchases of U.S. corp. stocks	1,326	1,674	1,065	-17	285	423	77	266	48
12. U.S. net purchases (-) of foreign securities	-5,506	-3,490	-1,098	-475	-918	-926	-349	-37	4
13. <u>Foreign net purchases of U.S. Treasury obligations</u> 2/	534	2,278	902	-1,054	1,548	2,586	154	1,322	1,376
14. <u>Change in foreign official reserve assets in U.S. (increase +)</u>	35,448	31,210	-5,323	4,656	16,645	-8,235	-2,920	-5,715	-7,224
By Area									
15. G-10 countries and Switzerland	29,414	29,950	-3,100	5,151	15,567	-7,255	-2,990	-5,185	-8,015
16. OPEC	5,743	-1,263	-2,334	-1,528	889	-1,742	-316	-741	454
17. All other countries	291	2,523	111	1,033	189	762	386	211	337
By Type									
18. U.S. Treasury securities	30,266	24,069	-5,685	3,167	13,602	-8,341	-3,414	-5,823	-8,138
19. Other 3/	5,182	7,141	362	1,489	3,300	106	494	108	914
20. <u>Change in U.S. reserve assets (increase -)</u>	-237	662	328	14	200	-3,008	176	-1,366	255
21. <u>All other transactions and statistical discrepancy</u>	2,105	14,448	9,174	2,398	510	1,232	1,541	2,215	5,610
MEMO:									
Current Account (bil. \$, seasonally adj., annual rates)	-15.3	-13.9	-13.7	-12.9	-1.3	.6	n.a.	n.a.	n.a.

1/ International accounts basis, seasonally adjusted.

2/ Includes U.S. Treasury notes publicly issued to private foreign residents.

3/ Includes deposits in banks, commercial paper, bankers' acceptances, and borrowing under repurchase agreements.

4/ Includes \$1,103 million of newly allocated SDR's.

ending June 20, OPEC countries' holdings at the FRBNY declined by slightly more than \$200 million; recent price increases are not yet showing up in increased investments.

Bank-reported private capital transactions resulted in a net private capital inflow of \$2.4 billion in April (line 4), about half the monthly average for the first quarter of 1979. Data for May show that head offices of member banks continued to raise additional funds through their foreign branches. (about a \$3 billion increase over the month, comparing the daily average in the last week of May with the daily average of the first week of May). In June (through the 20th) the net outstanding amount of member banks' borrowings from their own foreign branches showed little further change.^{1/}

Foreign private purchases of dollar-denominated Treasury securities rose to \$1.4 billion in April from less than \$500 million in the first quarter of 1979. Over half of April's net private purchases of Treasury bills was accounted for by one Japanese securities firm.

Deposits Abroad of U.S. Manufacturing Corporations

In the past 4 years, the domestic operations of U.S. manufacturing corporations have increased their deposits in banks outside the United States from \$1.5 billion to \$8.8 billion (see

^{1/} On a daily average basis the change for May was \$4.5 billion and for June, \$2.5 billion.

Table 1). Large corporations (with over \$1 billion in net assets) reported \$6.7 billion of this increase. However, it is noteworthy that the ratio of deposits outside the United States to total worldwide deposits increased over the period for all size classes.

In the first quarter of 1979, the ratio of deposits outside the United States to total deposits rose abruptly for large U.S. manufacturing corporations from 25 cents of every dollar deposited to 38 cents of every dollar deposited. These firms are thought to be among the most aggressive cash managers and money-market investors.

Table 2 shows that the proportion of reporting firms holding deposits outside the United States varies directly with the size of firm -- two-fifths of reporters with more than \$1 billion in net assets showed deposits abroad while less than 2 per cent of firms with less than \$100 million in net assets reported holdings deposits outside the United States. A comparison of the proportion of corporations depositing abroad in each size class for 1977IQ and 1979IQ does not show a marked change in the percentage of firms depositing abroad. This suggests that the recent surge in offshore deposits reflects primarily a more intensive use of offshore accounts rather than an increase in the number of domestic firms depositing abroad.

Table 1

U.S. Manufacturing Corporations' 1/
Deposits in Banks Outside the United States

Net asset size → Year	Under \$100 million		\$100 million - \$250 million		\$250 million - \$1 billion		More than \$1 billion		Total Deposits Outside the U.S.
	Amount (millions of \$'s)	Deposits Outside the U.S. Total deposits	Amount (millions of \$'s)	Deposits Outside the U.S. Total deposits	Amount (millions of \$'s)	Deposits Outside the U.S. Total deposits	Amount (millions of \$'s)	Deposits Outside the U.S. Total deposits	(millions of \$'s)
1975 - Q-1	56	.004	24	.010	178	.045	1,236	.132	1,494
Q-2	62	.004	12	.004	185	.043	1,037	.112	1,295
Q-3	54	.003	22	.008	165	.037	1,151	.122	1,391
Q-4	70	.004	31	.011	215	.045	1,468	.143	1,784
1976 - Q-1	49	.002	43	.017	283	.064	1,800	.163	2,177
Q-2	60	.003	53	.023	276	.059	1,868	.157	2,257
Q-3	42	.001	74	.030	290	.063	1,440	.131	1,845
Q-4	51	.002	92	.034	330	.064	1,944	.143	2,415
1977 - Q-1	62	.003	106	.045	276	.056	2,305	.179	2,749
Q-2	47	.002	122	.049	229	.045	2,969	.219	3,367
Q-3	43	.002	111	.043	378	.080	2,959	.227	3,491
Q-4	86	.005	86	.032	431	.072	3,535	.200	4,140
1978 - Q-1	107	.007	118	.053	452	.087	4,506	.263	5,184
Q-2	94	.006	110	.050	351	.072	4,890	.273	5,445
Q-3	123	.008	155	.068	331	.066	4,101	.260	4,710
Q-4	168	.010	131	.055	630	.111	5,205	.253	6,133
1979 - Q-1	148	.009	170	.079	592	.126	7,889	.379	8,799

SOURCE: Quarterly Financial Report, Federal Trade Commission
1/ Data are for domestic operations only.

Table 2

U.S. Manufacturing Corporations
with Deposits Outside the United States 1/

By net asset size	Under \$100 million	\$100 million - \$250 million	\$250 million - \$1 billion	Over \$1 billion
1977 1Q				
Number of reporting corporations holding deposits outside the United States	128	30	46	69
(as a percent of the total number of reporters)	(1.5)	(7.3)	(15.1)	(42.8)
1979 1Q				
Number of reporting corporations holding deposits outside the United States	133	29	61	82
(as a percent of the total number of reporters)	(1.9)	(6.7)	(18.3)	(40.0)

SOURCE: Federal Trade Commission
1/ Domestic operations only

Foreign economic developments. Economic activity abroad, in contrast to developments in the U.S., has been quite strong during the first four months of this year. Industrial production -- although generally not maintaining the brisk pace of the second half of last year -- was stronger than in the first half of last year in Japan, Germany, Canada, the United Kingdom, and Italy. Activity in Japan particularly showed renewed signs of strength in April and May. Only the French economy showed a decline in industrial production during the first four months of this year. This generally strong foreign activity picture is supported by improved labor market data. The seasonally adjusted rate of unemployment in May was lower than its 1978 average in Japan, Germany, Canada and Britain, the latter three countries having achieved a steady decline in the rate during recent months. Only the French rate of unemployment has been higher than in 1978 and has been rising recently.

Inflation in May has continued at high levels and the increase in the price of oil has been a major inflationary factor in all countries. Annualized rates of increase in the CPI for the first five months of 1979 were as much as 7-1/2 percentage points above those for the second half of last year in Germany, Italy and the United Kingdom. In Canada and Japan the acceleration was somewhat more moderate at about 4 percentage points over the second half of last year. Recent monthly rates have shown no clear signs in any country that inflation may be abating. Foreign central banks accordingly have sought to continue and

Consumer and Wholesale Prices in Major Industrial Countries
(percentage change, from previous period or as indicated)

	1976	1977	1978	1978						1979		Latest 3 Months from:		
				1978				1979		Previous 3 Months (at Ann. Rate)	Year Ago	Latest Month		
				Q1	Q2	Q3	Q4	Q1	Q2					
Canada: CPI	7.5	8.0	8.9	1.8	2.4	2.5	1.6	2.3			12.0	9.4	May	
WPI	5.1	7.7	9.4	3.0	2.8	2.1	3.3	3.9			17.9	12.8	April	
France: CPI	9.6	9.5	9.2	1.6	2.9	2.7	2.1	2.2			11.2	10.1	May	
WPI	7.4	5.6	4.3	1.4	1.9	1.9	2.9	4.4			21.8	13.3	May	
Germany: CPI	4.6	3.9	2.6	1.3	0.9	0.0	0.1	2.1	1.6		6.5	3.7	June	
WPI	5.8	1.8	-0.3	1.0	0.3	-0.6	0.0	3.5			17.5	5.6	May	
Italy: CPI	16.8	18.4	12.1	2.6	3.0	2.4	3.0	3.8			19.1	13.8	May	
WPI	22.9	17.4	8.4	2.1	2.3	1.8	2.2	4.4			21.2	13.0	May	
Japan: CPI	9.7	8.3	4.3	0.9	2.0	0.8	0.2	-0.2			7.4	2.6	May	
WPI	5.0	1.9	-2.5	-0.5	-0.3	-1.7	-0.6	1.9			14.0	1.9	May	
United Kingdom: CPI	16.6	15.8	8.3	1.7	2.7	1.7	1.7	3.1			13.8	10.1	May	
WPI	17.3	19.8	9.1	2.3	1.8	1.9	1.7	2.7			13.6	9.5	May	
United States: CPI	5.7	6.5	7.6	1.7	2.6	2.4	2.0	2.5			13.7	10.5	May	
WPI	4.6	6.1	7.8	2.4	3.0	1.5	2.3	3.6			16.4	11.3	May	

Real GNP and Industrial Production in Major Industrial Countries
(percentage change from previous period, seasonally adjusted)

	1976	1977	1978	1978			1979	1979				
				Q2	Q3	Q4	Q1	Jan	Feb	Mar	Apr	May
Canada: GNP	5.5	2.7	3.0	0.9	1.1	0.7	1.7	*	*	*	*	*
IP	5.1	4.0	5.3	1.3	1.8	2.6	2.1	0.5	0.6	0.3	n.a.	n.a.
France: GDP	4.9	3.0	3.3	1.7	0.3	1.2	n.a.	*	*	*	*	*
IP	9.4	1.7	2.2	2.4	-1.0	2.1	0.3	-0.8	0.0	1.5	-1.5	n.a.
Germany: GNP	5.2	2.6	3.4	2.1	0.7	0.9	0.0	*	*	*	*	*
IP	7.9	2.7	2.0	-0.6	3.2	0.8	0.3	0.0	-0.8	2.5	0.8	n.a.
Italy: GDP	5.9	2.0	2.6	0.4	0.6	2.9	1.0	*	*	*	*	*
IP	12.4	1.1	1.9	-2.2	1.0	6.1	1.1	-0.2	4.9	-2.4	1.1	n.a.
Japan: GNP	6.4	5.4	5.6	1.0	0.8	1.7	1.8	*	*	*	*	*
IP	11.1	4.2	6.2	1.9	1.3	2.2	1.8	0.2	1.4	-0.5	0.8	1.6
United Kingdom: GDP	3.0	1.9	3.0	2.4	0.7	-0.4	n.a.	*	*	*	*	*
IP	1.9	3.8	3.7	3.5	0.7	-1.3	-1.1	-7.3	7.1	1.6	2.2	n.a.
United States: GNP	5.7	4.9	4.0	2.1	0.6	1.7	0.2	*	*	*	*	*
IP	10.1	5.6	5.8	3.1	2.1	1.9	1.2	0.0	0.2	0.7	-1.4	1.3

* GNP data are not published on monthly basis.

Trade and Current-Account Balances of Major Industrial Countries^{a/}
(billions of U.S. dollars; seasonally adjusted)

	1977	1978	1978				1979	1979		
			Q1	Q2	Q3	Q4	Q1	Mar	Apr	May
Canada: Trade	2.7	3.0	1.2	0.6	0.6	0.6	0.4	0.0	0.0	n.a.
Current Account	-3.9	-4.7	-0.9	-1.1	-1.2	-1.5	-1.4	*	*	*
France: Trade	-2.2	0.4	0.0	0.2	0.2	0.1	0.3	0.3	0.1	-0.3
Current Account	-3.3	4.0	0.1	1.4	1.2	1.3	0.8	*	*	*
Germany: Trade	16.5	20.6	4.6	4.9	5.4	5.6	4.3	1.3	1.8	n.a.
Current Account ^{b/}	4.3	8.9	2.0	1.8	0.2	4.9	1.4	1.0	0.5	0.0
Italy: Trade	-2.8	-0.2	-0.2	0.3	-0.8	0.5	-0.4	-0.7	0.4	n.a.
Current Account ^{b/}	2.3	6.3	0.3	1.8	2.6	1.6 ^e	n.a.	*	*	*
Japan: Trade	17.4	24.7	7.4	6.8	6.7	3.9	2.7	0.8	0.3	0.9
Current Account	10.9	16.5	5.5	4.8	4.5	1.7	0.3	-0.2	-0.5	0.0
United Kingdom: Trade	-3.0	-2.3	-1.1	-0.3	-0.7	-0.1	-2.4	-0.6	-0.7	-0.4
Current Account	0.7	0.9	-0.7	0.4	0.3	0.9	-1.6	-0.3	-0.4	-0.2
United States: Trade	-30.9	-34.2	-11.9	-7.9	-8.0	-6.4	-6.1	-1.1	-2.6	-2.8
Current Account	-14.1	-13.9	-6.9	-3.4	-3.2	-0.3	0.2	*	*	*

^{a/} The current account includes goods, services, and private and official transfers.

^{b/} Not seasonally adjusted.

^e Estimate.

* Comparable monthly current account data are not published.

to intensify their restraining policies: In Japan and Italy limits on credit expansion were tightened. The Bundesbank, having once more raised its lombard rate, also limited the banks' use of a new repurchase facility. The United Kingdom reduced the target rate for monetary growth from 8-12 percent to 7-11 percent and raised its minimum lending rate. Other countries, such as Belgium and Denmark, have adopted restrictive measures, including discount rate increases, in order to avoid depreciation of their currencies within the EMS.

Japan's current account (s.a.) continued its trend toward adjustment in May, recording for the first five months of 1979 a deficit of \$162 million compared with a surplus of \$8 billion for the comparable period in 1978. The German current-account surplus (n.s.a.) also declined from \$2.9 billion for the first five months in 1978 to \$1.9 billion in 1979.

Individual country notes. Strong inflationary pressure from both external and internal sources continues to plague the Japanese economy. In May, wholesale prices rose at a nearly 20 percent annual rate, due in part to large increases in the price of imported oil, and there are indications that a further substantial increase will be recorded in June. Consumer prices have followed a strong upward trend as well; in the three months ending in May the Tokyo CPI advanced at an annual rate of 7.4 percent over its level in the previous three months.

Interest rates have moved upward, reflecting the effects of the mid-April discount-rate increase. But the impact of the tightening of lending limits earlier this year on the money stock (M-2), which had been expanding at a rate exceeding 20 percent (s.a.a.r.) in March and April, is not yet clear. The recently announced expansion of lending limits for the large city banks in the third quarter is 30 percent below the increase of the previous year.

GNP growth in the first quarter, led by private investment, maintained the strong growth of late last year. The expansion of domestic activity appears to be continuing in the second quarter. Industrial production rose sharply in April and May, and strong gains were recorded in retail sales and new construction orders. Recent business surveys also continue to support a positive outlook for investment in private plant and equipment.

The current-account (s.a.) increased by about \$1/2 billion in May, from its April level and was nearly balanced in May after showing deficits in the previous two months. Preliminary data indicate that higher dollar prices for Japanese imports were more than offset by a substantial increase in the volume of Japanese exports.

German GNP for the first quarter of 1979 was flat as a result of the steel workers' strike and bad weather early this year. Other indicators of economic activity, on the other hand, convey a more positive picture: The rate of unemployment

has continued its gradual decline into May, when it was 3.7 percent (s.a.). Industrial production, up only slightly from March to April, was revised upward from February to March to an increase of 3.3 percent (monthly rate). Capacity utilization improved further in April to a level 3.5 percentage points above April 1978. The latest business climate survey indicates further gains in positive responses, indicating the most favorable outlook in years.

Consumer prices during the first six months of this year have risen at an annual rate of 7.5 percent. A major factor in the inflation picture has been import prices, which rose at a 27 percent annual rate through May. About one-half of the rise in import prices may be attributed to rising petroleum prices.

The monetary aggregates, while still growing at last year's high rates during early 1979 have shown some slight indication of deceleration in May. Central bank money has recently been growing somewhat less rapidly than late last year and in May was 10.2 percent above May 1978. This level is nearly consistent with the upper range of the Bundesbank's target of 6 to 9 percent growth from the fourth quarter of 1978 to the fourth quarter of 1979.

The current-account surplus for the first five months of this year, at \$1.9 billion, was significantly lower than the comparable figure of \$2.9 billion for last year. The trade surplus, however, at \$7 billion for this year through May (n.s.a.), was only slightly below last year's \$7.5 billion.

Inflation rates in the United Kingdom have increased markedly in 1979 and the current-account balance has swung into deficit. Output, after declining during the winter months, appears to be fairly strong -- the unemployment rate has been falling and industrial production is up sharply from its winter levels. The current-account data are distorted by last winter's labor disputes, including a dispute that delayed publication of the data. However, even after allowing for the distortions, there appears to have been a sharp deterioration in the U.K.'s underlying current-account position so far this year.

In the May 3 general election, the Conservative Party defeated the Labour Party and took over control of the government. The Conservatives' program includes labor market reforms, cuts in government spending, cuts in direct taxation as well as increases in indirect taxation, liberalization of exchange controls, and an anti-inflation policy based on monetary and fiscal policy. In its budget announcement on June 12 the new Conservative government took steps to implement its program.

The fiscal policy actions announced in the budget include decreases in (nominal) government spending amounting to some £3 billion, decreases in direct taxes -- including reductions in the basic rate as well as the highest marginal tax rate -- of about £3-1/2 billion, and an increase in various indirect taxes (principally the value-added tax) which will yield an additional £2-1/2 billion this fiscal year. In addition, the government announced its intention to sell £1 billion of its

British Petroleum shares. The net effect of these moves is to reduce the public sector borrowing requirement (PSBR) in the fiscal year ending March 1980 to about £8-1/4 billion (4-1/2 percent of GDP). In the last fiscal year, the PSBR was £9-1/4 billion -- 5-1/2 percent of GDP.

Monetary policy figured prominently in the government's budget announcement. The target annual rate of growth of sterling denominated M3 was reduced to a 7-11 percent range. (The previous target was 8-12 percent.) In order to facilitate the achievement of the target, the Bank of England's Minimum Lending Rate (MLR) was raised from 12 percent to 14 percent and the system of quantitative limits on the growth of banks' interest-bearing liabilities (the corset) was extended for 3 months.

Some liberalization of exchange and capital controls was announced also, including a relaxation of some restrictions on outward direct investment.

The French economy has suffered reversals on almost all fronts since the last quarter of 1978. Industrial production has been nearly flat for the first four months of this year and was on the average only 1.4 percent higher than in the last four months of 1978. Inflation is once again accelerating, growing at an 11 percent annual rate during the last three months including May. At about 6 percent (s.a.), the unemployment rate in May was at its highest level since the series began in 1973.

Early in the year, a strong foreign sector was being counted on to provide some stimulus and to pay for oil price increases. For the first quarter of this year the current account surplus was \$770 million. The trade surplus for the first four months was \$400 million. However, over two thirds of the accumulated surplus was nullified by a May deficit of \$280 million, reflecting the recent petroleum developments.

Real GDP in Canada rose at a seasonally adjusted annual rate of 7.1 percent during the first quarter after rising only 3.1 percent in the fourth quarter of last year. Growth was led by a 5.3 percent annual rate increase in real consumption spending and by a strong accumulation of inventories particularly in the export sector. In May, the unemployment rate (s.a.) fell to 7.7 percent from 7.9 percent during the previous three months. Consumer prices (n.s.a.) in May were over 9 percent above the same month a year earlier; the non-food CPI was up by 8 percent. The growth rates (s.a.a.r.) of all monetary aggregates relative to the June 1978 base period accelerated in May. M1 has grown by 8.2 percent (a.r.) to move close to the center of the Bank of Canada's target band of 6 to 10 percent.

The Canadian current-account deficit (s.a.) narrowed slightly to \$1.4 billion in the first quarter from \$1.5 in the fourth quarter of last year. However, the merchandise trade surplus (s.a.) declined by 45 percent from the previous quarter to \$357 million and disappeared in April.

The inflation rate in Italy remains at a very high level and shows few signs of decelerating. Consumer prices have risen at an annual rate of 18 percent between December and May, while the annual rate of wholesale price inflation between December and April has been 20 percent. Although price increases may slow somewhat over the next few months, because of seasonal factors, the outlook is for continued high inflation because of cost-push pressures. Wages are rising because of wage-indexation and will rise further once the new labor contracts are signed, more rent adjustments are expected, and much of the increase in oil prices has not yet been passed on to product prices.

At the same time, activity continues to be strong. GDP rose in the first quarter by 1 percent, and in April industrial production rose by 1.6 percent. The outlook for the next few months still appears good according to business surveys, and very low inventory levels should impart some strength to activity.

Despite strong activity and accelerating inflation, the external situation is strong; on a customs basis (s.a.) the trade deficit for the first four months was only about \$90 million, implying a substantial current account surplus.

In Switzerland wholesale and consumer prices in the first five months of 1979 rose at annual rate of 10.8 and 6.5 percent, respectively compared with -2.3 and 0.8 percent for the year 1978. Import prices, particularly for oil, continued to account for most of the increase of the price indices.

The recovery of economic activity in Belgium which began in the last quarter of 1978 is threatened by rising interest rates in addition to the depressing effects on activity resulting from the oil situation. The Belgian central bank has raised its discount rate from 6 to 9 percent since May 1 to counter the Belgian franc's weakness in the European Monetary System. The authorities had previously sought to lower interest rates to stimulate private investment and reduce the costs of financing the large public sector deficit.

The Danish government, also influenced by the EMS exchange rate constraint, announced an austerity program in June. It's main ingredients are increased taxes on energy products, some cuts in local government spending, and a 1 percent increase in the discount rate to 9 percent. Also included is a one-day ban on driving each week.