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August 12, 1981

RECENT DEVELOPMENTS

Prepared for the Federal Open Market Committee

By the staff of the Board of Governors of the Federal Reserve System

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DOMESTIC FINANCIAL DEVELOPMENTS

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SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest data			Percent change from		
	Period	Release date	Data	Preceding period	Three periods earlier	Year earlier
(At annual rate)						
Civilian labor force	July	8-7-81	106.5	3.3	-1.0	1.4
Unemployment rate (%) <u>1/</u>	July	8-7-81	7.0	7.3	7.3	7.6
Insured unemployment rate (%) <u>1/</u>	July	8-7-81	3.2	3.4	3.4	4.5
Nonfarm employment, payroll (mil.)	July	8-7-81	92.0	5.0	2.2	2.2
Manufacturing	July	8-7-81	20.5	6.3	3.9	3.3
Nonmanufacturing	July	8-7-81	71.4	4.6	1.8	1.9
Private nonfarm:						
Average weekly hours (hr.) <u>1/</u>	July	8-7-81	35.3	35.3	35.4	35.1
Hourly earnings (\$) <u>1/</u>	July	8-7-81	7.26	7.23	7.14	6.66
Manufacturing:						
Average weekly hours (hr.) <u>1/</u>	July	8-7-81	40.0	40.1	40.2	39.2
Unit labor cost (1967=100)	June	7-29-81	208.1	4.6	6.6	5.1
Industrial production (1967=100)	June	7-15-81	152.7	-.8	1.3	7.9
Consumer goods	June	7-15-81	149.4	-3.2	3.2	5.1
Business equipment	June	7-15-81	183.0	-1.3	5.5	7.8
Defense & space equipment	June	7-15-81	100.9	.0	1.6	4.2
Materials	June	7-15-81	154.7	3.1	.8	10.5
Consumer prices all items (1967=100)	June	7-23-81	270.3	8.5	7.2	9.5
All items, excluding food & energy	June	7-23-81	255.3	12.3	11.3	9.4
Food	June	7-23-81	271.5	2.2	-.1	8.4
Producer prices: (1967=100)						
Finished goods	June	7-7-81	269.8	6.7	6.9	10.2
Intermediate materials, nonfood	June	7-7-81	310.7	3.5	8.1	10.5
Crude foodstuffs & feedstuffs	June	7-7-81	263.7	33.2	8.2	8.7
Personal income (\$ bil.) <u>2/</u>	June	7-21-81	2,382.1	7.3	7.1	12.0
(Not at annual rates)						
Mfrs. new orders dur. goods (\$ bil.)	June	7-31-81	88.5	.4	2.0	25.8
Capital goods industries	June	7-31-81	28.4	-3.0	-3.2	10.6
Nondefense	June	7-31-81	23.2	-2.6	-5.0	10.1
Defense	June	7-31-81	5.1	-4.6	6.0	13.0
Inventories to sales ratio: <u>1/</u>						
Manufacturing and trade, total	May	7-31-81	1.40	1.39	1.38	1.53
Manufacturing	June	7-31-81	1.58	1.61	1.61	1.76
Trade	May	7-31-81	1.22	1.20	1.19	1.32
Ratio: Mfrs.' durable goods inven- tories to unfilled orders <u>1/</u>	June	7-31-81	.565	.564	.564	.574
Retail sales, total (\$ bil.)	June	7-13-81	86.4	1.2	-1.4	11.0
GAF <u>3/</u>	June	7-13-81	18.3	1.2	.7	10.2
Auto sales, total (mil. units.) <u>2/</u>	July	8-4-81	8.2	7.0	1.5	-9.3
Domestic models	July	8-4-81	5.9	8.7	2.6	-8.4
Foreign models	July	8-4-81	2.3	3.0	-1.3	-11.6
Housing starts, private (thous.) <u>2/</u>	June	7-17-81	1,032.0	-11.0	-20.4	-12.8
Leading indicators (1967=100)	June	7-29-81	133.8	-1.3	-2.1	8.0

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

2/ At annual rate.

3/ Excludes mail order houses.

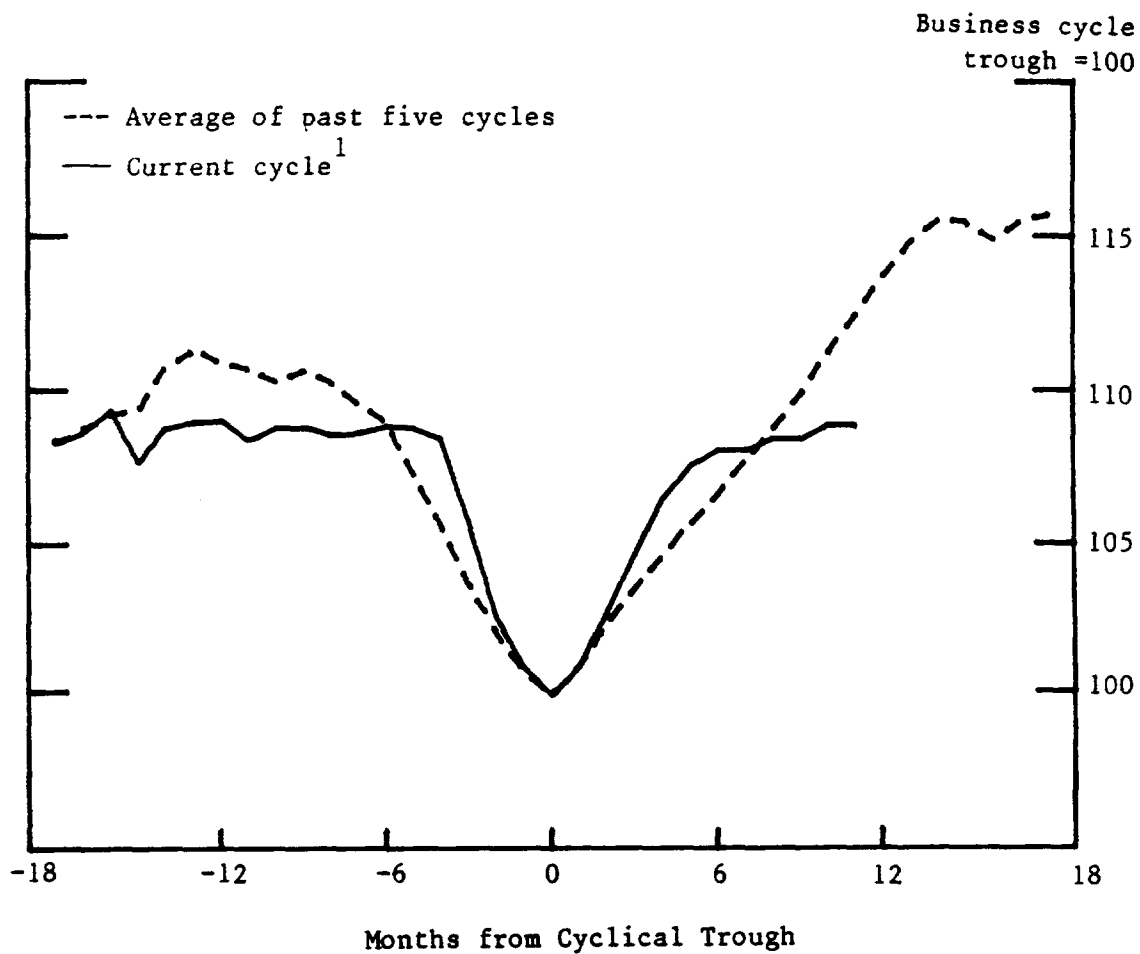
DOMESTIC NONFINANCIAL DEVELOPMENTS

Most indicators of production and sales suggest that economic activity has shown little movement in recent months. During the spring quarter, activity had dropped-off, reflecting in part the weakness in homebuilding and the post-rebate slump in auto sales. Although autos and housing continue to be extremely weak, there are no indications of cumulating weakness; there was a widespread pickup in labor demand in July and industrial production rose somewhat. Owing in part to a leveling-off of petroleum-related prices and a continuation of relatively little change in food prices, aggregate price measures continued to decelerate in the second quarter. Accompanying the slowing of inflation, wages increased less rapidly in the first half of 1981 than during 1980.

Industrial Production

Early data suggest that industrial production edged up about 1/4 percent or so in July, after a small decline in June. (Industrial production data will be released August 14.) Recent developments in economic activity have been reflected in the performance of the industrial production index. A quick cyclical rebound in the second half of last year followed the extremely sharp spring contraction (chart). Unlike past recoveries, which typically continue for about a year, this expansion lost momentum after only six months, and by July industrial output was only about 1-1/4 percent above its level at the end of 1980. In July, coal output continued its post-strike rebound and the production of business machinery increased, but these gains were partially offset by reductions in output of transit equipment. After allowance for the usual drop associated with a model changeover period,

INDUSTRIAL PRODUCTION INDEX
(Seasonally adjusted)



1. Current cycle trough is July 1980; last point plotted is June 1981.

seasonally adjusted auto assemblies edged down in July to a 7.2 million unit annual rate; production of trucks declined more sharply. Changes in materials output in July varied by industry, but overall rose somewhat.

Capacity utilization in manufacturing in July probably continued close to the preliminary 79.6 percent rate that prevailed in June. During the entire first half of the year the utilization rate held close to 80 percent. In June, declines in utilization were widespread among manufacturing industries except in motor vehicles and related industries. However, a number of these changes were apparently reversed in July as steel production rose and auto output edged off. Materials utilization rates apparently also changed little in July.

Employment

After several months of sluggish growth, labor demand picked up in July. The household measure of employment rose 570,000 in July--after plummeting 840,000 the previous month, and the unemployment rate declined 0.3 percentage points to 7.0 percent. This is the lowest rate reported in more than a year. The establishment survey reported an increase of 385,000 jobs to payrolls--the largest monthly increase in the now year-long recovery period, with net gains in most sectors. Manufacturing employment rose 110,000. About 60,000 of the increase occurred in durable goods. The advance in this sector was concentrated in industries associated with the production of business equipment, which have fared significantly better in the past year than the auto and related metals industries. Among producers of nondurable goods, employment rose by almost 50,000; most of this increase occurred in apparel and textile products industries.

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

	1980	1981		1981		
	Q4	Q1	Q2	Apr.	May	June
	----annual rate----			----monthly rate----		
Total	21.3	7.4	2.0	.0	.4	-.1
Final products	12.2	3.5	6.0	.7	.4	-.1
Consumer goods	13.1	.0	5.7	.7	.4	-.3
Durable	39.9	-2.6	15.4	.5	1.7	-.5
Nondurable	4.7	1.0	2.2	.8	-.1	-.2
Business equipment	11.2	10.4	8.1	.9	.6	-.1
Defense and space eq.	10.9	3.4	1.2	.3	.1	.0
Construction supplies	32.2	14.1	-4.1	-.5	-.3	-1.4
Materials	34.4	12.0	-0.3	-.8	.7	.3
Durable goods	48.4	17.5	5.0	.0	.9	-.7
Nondurable goods	38.2	8.5	1.3	.8	.7	-.3
Energy materials	-.2	3.6	-16.3	-5.7	.1	4.1

CAPACITY UTILIZATION RATES: MANUFACTURING AND MATERIALS
(Percent, seasonally adjusted)

	1978-80	1980	1981		1981	
	High	Low	Q1	Q2	May	June
Manufacturing industries	87.2	74.9	79.9	79.9	80.1	79.6
Primary processing	90.1	70.9	81.0	80.5	80.7	80.2
Advanced processing	86.2	77.1	79.4	79.5	79.9	79.3
Motor vehicles & pts.	94.5	51.0	58.6	64.5	65.4	65.6
Materials producers	88.8	73.7	81.7	81.1	81.3	81.3
Durable goods mats.	88.4	68.0	78.4	78.8	79.2	78.6
Raw steel	100.7	55.3	87.5	83.9	84.6	81.0
Nondurable goods mats.	90.9	76.8	85.9	85.5	85.8	85.3
Energy materials	88.8	83.1	84.8	80.7	79.6	82.7

Outside of manufacturing, service and retail trade payrolls each posted a gain of 85,000. For services, this represents a return to its usual pace after a month of slow growth, while the jump in retail trade employment is much larger than the average gain of 30,000 per month experienced over the past year. Mining employment increased 30,000, as striking coal miners continued to return to work. Construction employment, down another 20,000 in July, is now below the trough of a year ago.

Personal Income and Consumer Spending

Nominal personal income rose in June at about the same 7-1/4 percent annual rate as in May; these advances compare with the 12 percent gain posted in the first quarter. The wage and salary component, which tends to parallel movements in employment and hours over the short run, accounted for the deceleration in the rate of growth. Much of the modest second quarter advance in income was offset by price rises; as a result, real disposable income increased at only a 1-1/4 percent annual rate during this period, compared with a 3 percent pace during the winter quarter.

Real consumer spending fell in the second quarter at a 1.9 percent annual rate. In addition to the slump in auto purchases, declines in real terms were registered for other durable goods as well as for energy-related outlays. As a result of this retrenchment in spending, the personal saving rate rose to 5-1/4 percent--up from the 4.6 percent rate in the first quarter.

The weak pace of auto purchases continued into the third quarter. Sales of new domestic autos in July--at a 5.9 million unit annual rate--bettered the extremely low June sales performance, but were only a little above the 5.6 million unit selling rate posted for the entire second.

CHANGES IN EMPLOYMENT¹
 (Thousands of employees; based on seasonally adjusted data)

	1979	1980	1981				
			Q1	Q2	May	June	July
-Average monthly changes-							
<u>Nonfarm payroll employment</u> ²	170	34	133	79	106	19	383
Strike adjusted	176	28	130	106	137	-107	351
Manufacturing	-5	-58	5	76	82	6	108
Durable	1	-47	7	59	47	23	62
Nondurable	-6	-12	-2	17	35	-17	46
Construction	15	-12	10	-47	-84	-60	-21
Trade	30	12	55	23	78	-11	95
Finance and services	84	79	57	78	75	32	99
Private nonfarm production workers	103	-9	98	105	65	97	335
Manufacturing production workers	-16	-67	5	57	60	-2	106
<u>Total employment</u> ³	172	-42	377	-7	259	-843	570
Nonagricultural	174	-48	416	-3	369	-755	577

1. Average change from final month of preceding period to final month of period indicated. These figures are revised to reflect new seasonal factors and the 1980 benchmark to the establishment survey data.

2. Survey of establishments. Strike-adjusted data noted.

3. Survey of households.

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

	1979	1980	1981				
			Q1	Q2	May	June	July
Total, 16 years and older	5.8	7.1	7.4	7.4	7.6	7.3	7.0
Teenagers	16.1	17.7	19.1	19.2	19.5	19.0	18.1
20-24 years old	9.0	11.5	11.8	12.4	12.9	12.1	11.3
Men, 25 years and older	3.3	4.7	4.8	4.8	4.8	5.0	4.7
Women, 25 years and older	4.8	5.5	5.8	5.7	5.9	5.6	5.7
White	5.1	6.3	6.6	6.5	6.8	6.4	6.2
Black and other	11.3	13.2	13.2	13.7	13.6	14.2	13.6
Fulltime workers	5.3	6.8	7.1	7.1	7.3	7.0	6.7
White collar	3.3	3.7	3.9	4.0	4.1	3.8	4.1
Blue collar	6.9	10.0	10.0	9.8	10.0	9.8	9.4

PERSONAL INCOME
(Based on seasonally adjusted data)

	1979	1980	1981			
			Q1	Q2	May	June
- - Percentage changes at annual rates ¹ - -						
Total personal income	12.3	11.0	11.8	8.5	7.1	7.3
Wage and salary disbursements	10.8	9.0	13.5	6.5	5.8	4.3
Private	11.6	9.2	15.3	6.9	6.0	4.2
Disposable personal income						
Nominal	11.7	10.9	11.2	7.9	6.0	6.0
Real	2.0	.8	3.0	1.3	.7	-1.0e
- - Changes in billions of dollars ² - -						
Total personal income	18.3	18.7	21.3	13.9	13.9	14.5
Wage and salary disbursements	10.3	9.8	13.9	6.3	7.0	5.3
Private	8.9	8.1	12.7	5.3	6.0	4.2
Manufacturing	2.0	2.3	3.2	2.6	3.9	- .5
Other income	8.9	9.6	11.0	7.8	7.1	9.3
Transfer payments	2.8	4.1	2.4	1.3	1.0	2.3
Less: Personal contributions for social insurance	.9	.8	3.6	.2	.2	.1
Memorandum:						
Personal saving rate ³	5.2	5.6	4.6	5.3	5.3	n.a.

1. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Changes for quarterly periods are compounded rates of change; monthly changes are not compounded.

2. Average monthly changes are from the final month of the preceding period to the final month of period indicated; monthly figures are changes from the preceding month.

3. Monthly saving rate equals the centered three-month moving average of personal saving as a percentage of the centered three-month moving average of disposable personal income.

e - Based upon the 1981-Q2 NIPA estimate.

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

	1980		Q1	1981			
	Q3	Q4		Mar.	Apr.	May	June
Total	8.8	9.0	10.0	10.3	8.1	7.9	n.a.
Foreign-made	2.3	2.5	2.7	2.6	2.3	2.2	n.a.
U.S.-made	6.5	6.6	7.3	7.7	5.8	5.7	5.7 ¹
Small	3.2	3.3	3.9	4.1	2.8	2.9	n.a.
Intermediate & standard	3.3	3.3	3.4	3.5	2.9	2.8	n.a.

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

1. First 20-days.

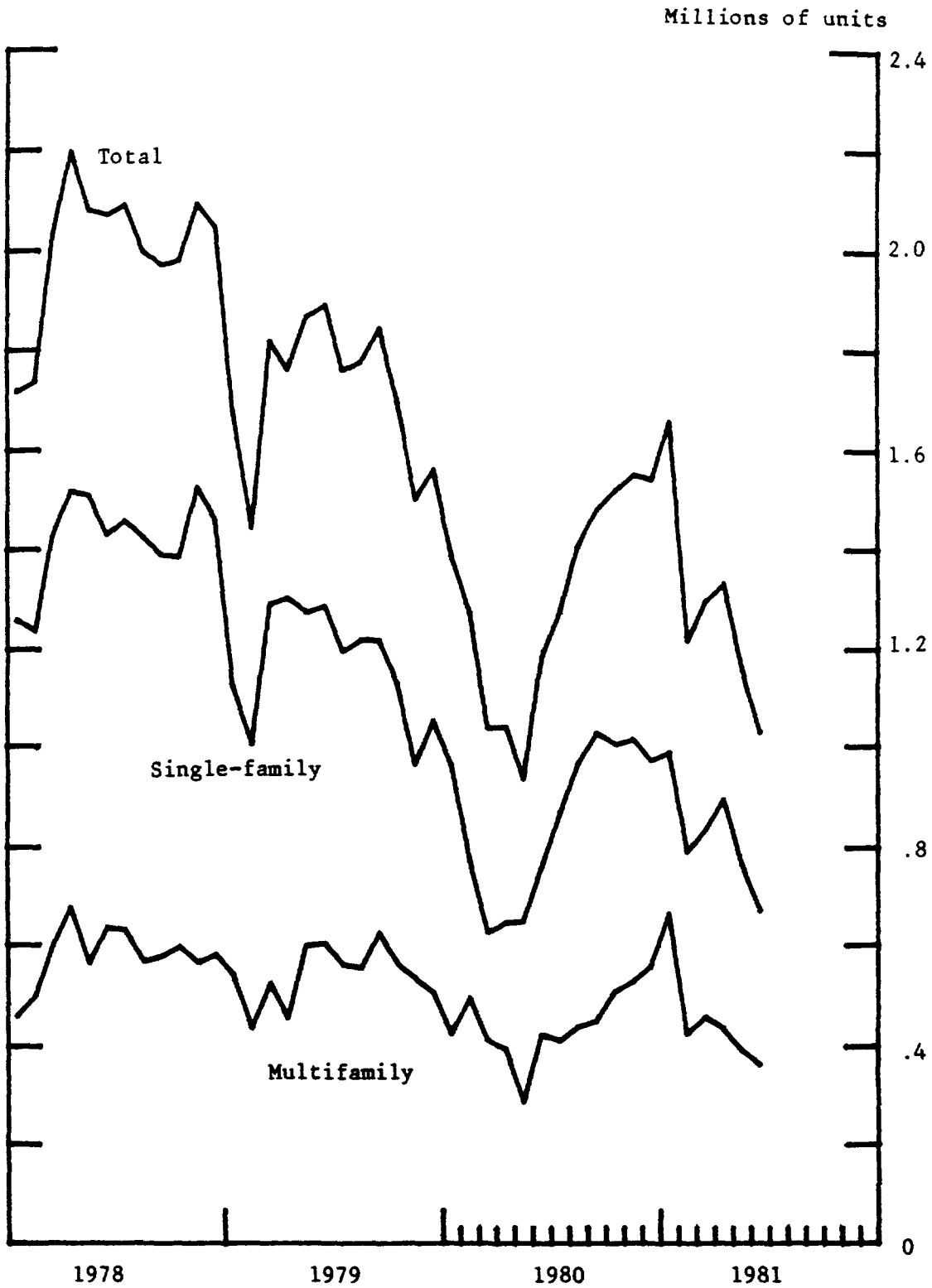
quarter. Except for the period of credit controls last year, sales of domestic units over the past four months have been lower than at any time since the final two months of 1970 when a strike against General Motors and a recession combined to depress domestic sales to a 5.4 million unit annual rate. Sales of new imported cars picked up slightly in July to a 2.3 million unit annual rate, interrupting a downtrend in foreign car purchases that began in April.

Consumer surveys by The Conference Board and the University of Michigan Survey Research Center continued to give mixed signals in July. Reflecting consumer attitudes about business conditions and their personal financial situation, both surveys showed an overall improvement in attitudes to about the same level as reported during the cyclical rebound last November. The University of Michigan survey also reported that consumers, as in June, expected an inflation rate over the next 12 months of less than 7 percent--the lowest inflation expectation reported in this survey since mid-1977. Nonetheless, attitudes toward buying conditions of durable household goods, automobiles, and houses continued to be relatively depressed. Follow-up questions in the University of Michigan survey on the reasons for these responses indicated continued consumer concern about the high price of cars and houses as well as credit conditions.

Residential Construction

Activity in housing markets weakened further in the early summer months, as financial conditions continued to tighten. Total private housing starts fell in June to just over one million units at an annual

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



rate, down 33 percent from the fourth quarter of 1980 and the lowest--except for May 1980--since early 1975. Newly-issued residential building permits likewise dropped sharply in June to 976,000 at an annual rate, also well below historical norms.

The poor performance of housing starts paralleled continued softness in new-house sales. These sales in June fell 17 percent to a 408,000 unit annual rate, with weakness widespread regionally. Sales activity in June was below the cyclical low recorded in the 1973-1975 downturn and just barely higher than the troughs of 1970 and 1966. Existing-house sales in June, while edging up to a 2.7 million unit annual rate, were still quite depressed.

New residential construction activity has waned in both the single-family and multifamily area. In the rental sector, vacancy rates in the second quarter of 1981 returned to a record low of 5.0 percent for the 25-year series. In the single-family sector, inventories of unsold new houses fell to 312,000 at the end of June--the lowest level in the last five years, but in terms of the June sales rate, this backlog was equal to a 9-1/4 months' supply.

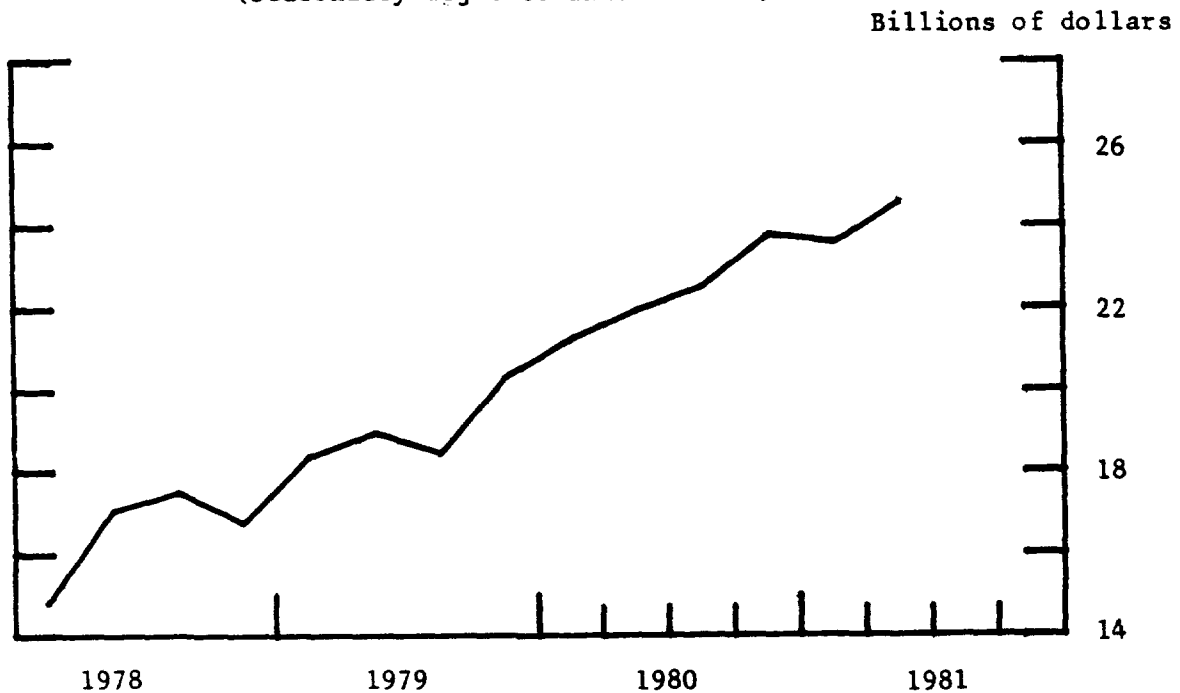
There continues to be substantial appreciation in the measures of house prices over year-earlier levels, although part of the actual return to sellers may be offset by the costs of concessionary financing. The average price of an existing house sold during the second quarter was 9-1/2 percent above a year earlier, while that for a new house was 14 percent higher. The average sales price of a standardized new house in the second quarter of 1981 was 8-1/2 percent above a year earlier.

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

	1980		1981				
	Annual	Q4	Q1	Q2	Apr.(r)	May(r)	June(p)
All units							
Permits	1.19	1.32	1.18	1.11	1.19	1.17	.98
Starts	1.29	1.54	1.39	1.17	1.33	1.16	1.03
Single-family units							
Permits	.71	.79	.69	.64	.69	.65	.57
Starts	.85	1.00	.87	.78	.90	.77	.67
Sales							
New homes	.53	.54	.51	.45	.46	.49	.41
Existing homes	2.88	3.00	2.54	2.59	2.61	2.50	2.65
Multifamily units							
Permits	.48	.53	.49	.47	.50	.51	.41
Starts	.44	.53	.52	.40	.44	.39	.36
Mobile home shipments	.22	.25	.2527	.26	...

(p) Preliminary estimates.
(r) Revised estimates.

EXPENDITURES ON ADDITIONS AND ALTERATIONS
(Seasonally adjusted annual rates)



Data are plotted quarterly through 1981-Q2.

Just as high costs of credit on conventional mortgage financing have prompted alternative "creative" means of funding, the high purchase price of traditional homes has encouraged alternative ways of meeting demands for shelter. Mobile home shipments in May were at a 255,000 unit annual rate--slightly above the rate at the end of last year. Further, expenditures on additions and alterations to existing structures have continued to rise at a relatively rapid pace (chart). In the second quarter of 1981, such spending was 12 percent above a year earlier and more than 40 percent higher than three years earlier; construction expenditures on new residential dwellings have fallen 10-3/4 percent over the same three-year period.

Business Fixed Investment

Real business fixed investment fell at a 6 percent annual rate in the second quarter, following the 13 percent first quarter surge. In the business equipment category, a substantial gain in shipments of electrical machinery was more than offset by declines in spending for nonelectrical machinery, motor vehicles, and other transportation equipment. In the construction category, the volatile petroleum drilling and mining components jumped, while spending for business structures experienced a broad-based decline. In June, constant dollar nonresidential construction activity edged off, following a fall of about 1.0 percent in May.

Capital spending commitments data suggest a stagnation of real business investment spending over the near-term. Total constant dollar commitments have been essentially flat for the past two quarters, but separate indicators of the equipment and structures components

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

	1980		1981			
	Q4	Q1	Q2	Apr.	May	June
Nondefense capital goods shipments						
Current dollars	4.2	1.4	2.8	-.8	1.0	1.2
Constant dollars ¹	-.6	3.8	-1.1	-1.6	-.6	.1
Addendum: Sales of heavy-weight trucks (thousands)						
	230	246	227	270	220	190
Nonresidential construction						
Current dollars	1.8	8.0	.7	.9	-.2	-.1
Constant dollars	.3	5.7	-1.1	.0	-.9	-.1
Addendum: Oil and gas well drilling (millions of feet)						
	26.5	24.4	29.9	31.8	27.1	30.7

1. FRB staff estimate.

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

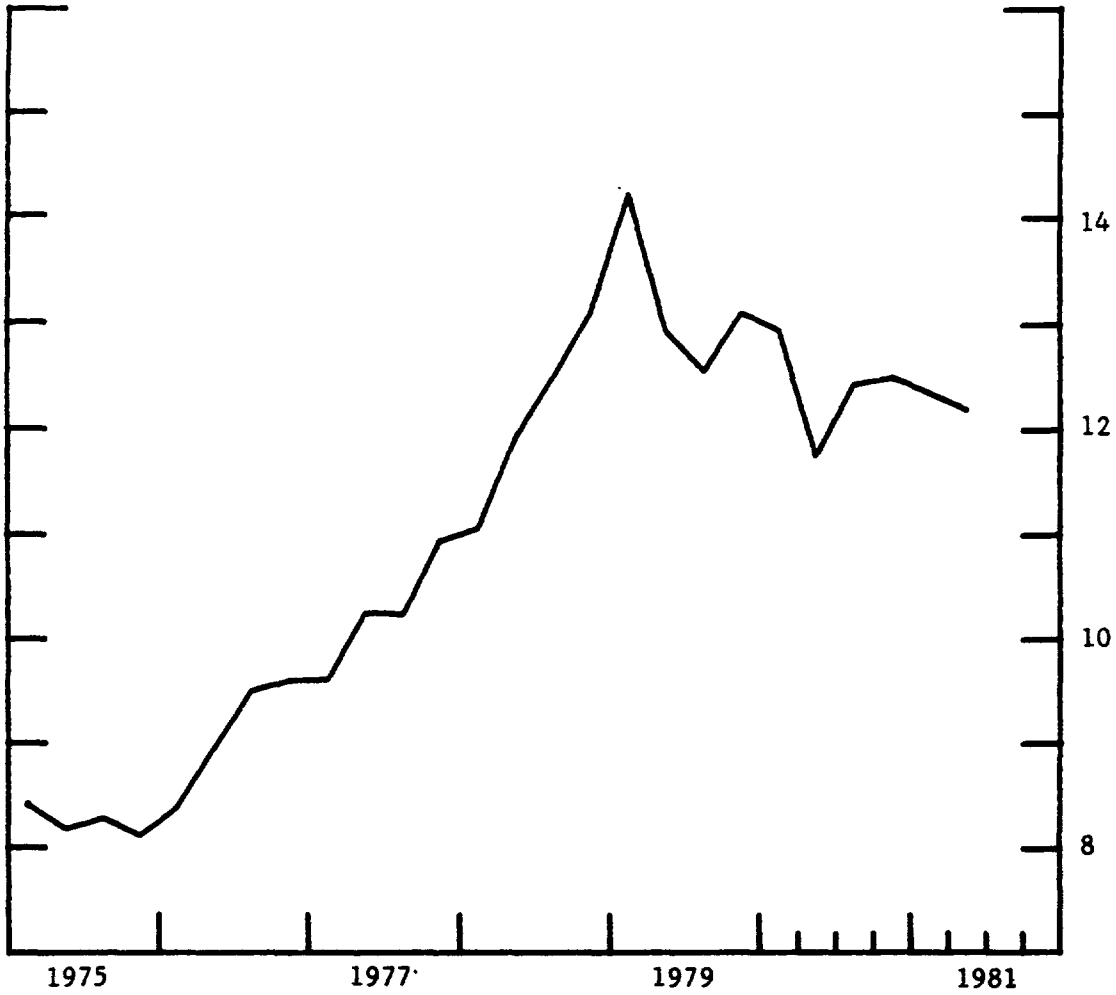
	1980		1981			
	Q4	Q1	Q2	Apr.	May	June
Nondefense capital goods orders						
Current dollars	3.4	1.2	1.9	1.1	-3.5	-2.6
Constant dollars	.5	-1.3	-.7	-.9	-2.7	-2.9
Machinery						
Current dollars	6.2	1.1	2.9	3.3	.8	-1.4
Constant dollars ¹	3.9	-2.0	.5	1.8	.9	-2.4
Addenda: Ratio of current dollar unfilled orders to shipments						
Total	6.40	6.32	6.13	6.25	6.18	6.07
Machinery	4.79	4.68	4.65	4.66	4.64	4.60
Nonresidential building permits						
Current dollars	-.8	10.1	.4	24.4	-32.6	10.6
Constant dollars ¹	-1.7	8.6	-1.3	23.5	-33.1	10.5

1. FRB staff estimate.

COMMITMENTS FOR BUSINESS CAPITAL SPENDING
(Seasonally adjusted)

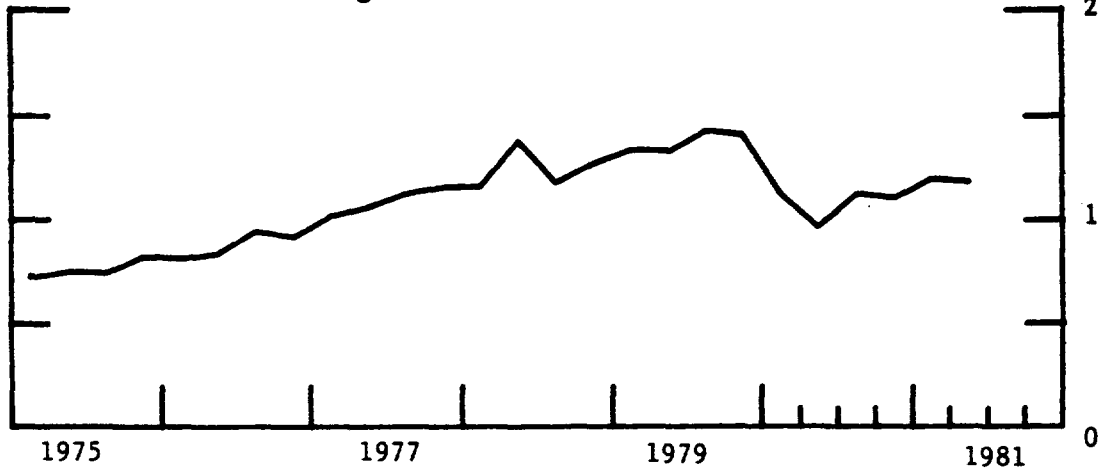
Nondefense Capital Goods Orders

Billions of 1972 dollars



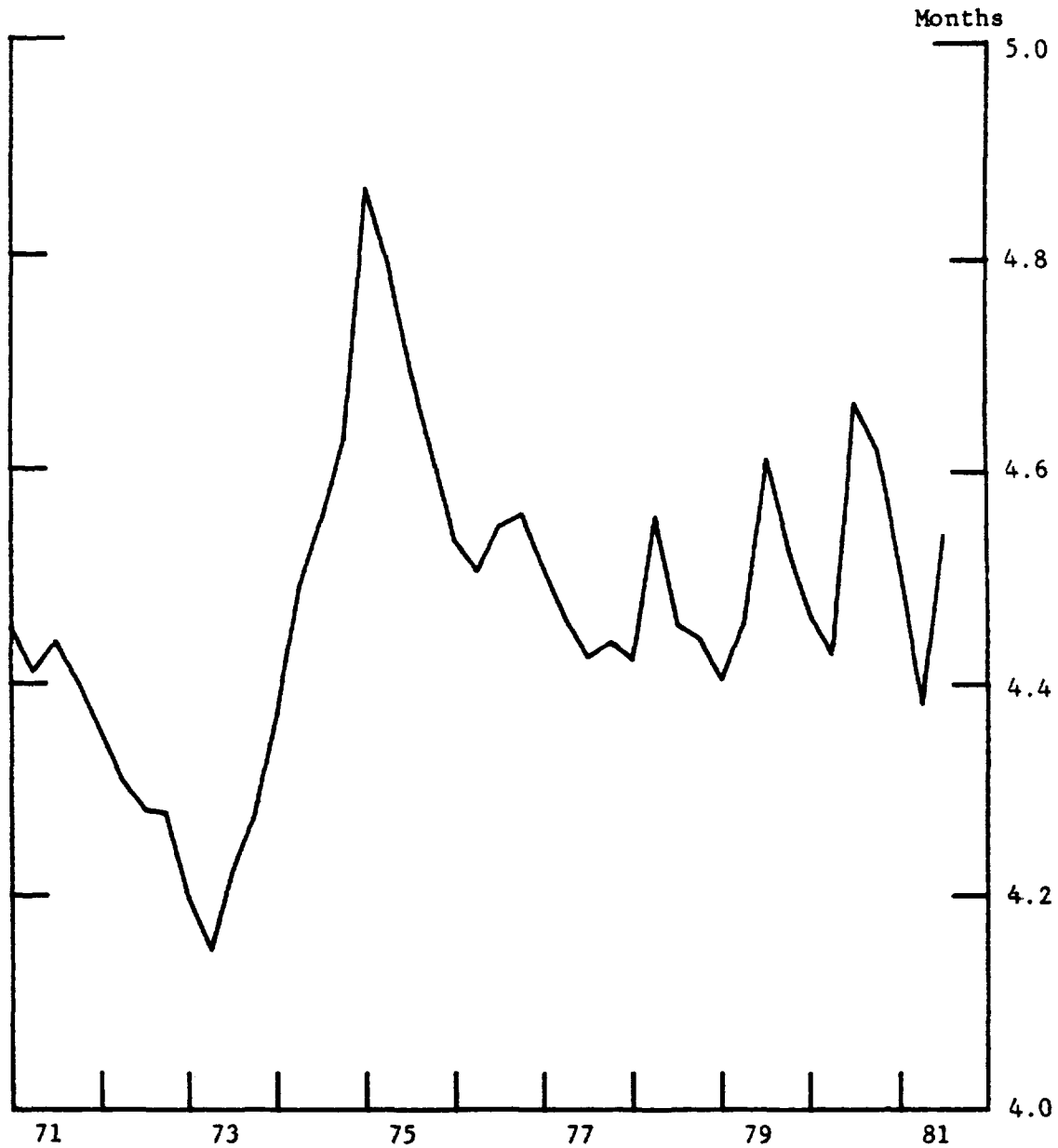
Nonresidential Building Permits

Billions of 1972 dollars



Data are plotted quarterly through 1981-Q2.

INVENTORIES IN RELATION TO SALES¹
 (Seasonally adjusted)



1. Ratio of constant 1972 dollar nonfarm business inventories to business final sales of goods and structures, NIPA basis. Data are plotted quarterly through 1981-Q2.

appeared to have diverged somewhat by mid-year (chart). Real orders for nondefense capital goods declined steadily since March, and June's level of these commitments was 4-3/4 percent below the last quarter of 1980-- thus, suggesting near term weakness ahead. Real nonresidential building permits have edged up somewhat this year, but they still remain below their level in 1979.

Inventory Investment

The pace of business inventory accumulation appears to have accelerated only slightly since the first quarter, and ratios of stocks to sales indicate a generally cautious business inventory posture (chart). The book value of manufacturers' inventories remained virtually unchanged over June, as a \$5-1/2 billion annual rate accumulation of durable stocks was offset by a comparable liquidation of nondurable stocks. By stage of fabrication, the composition of inventory change over the second quarter as a whole reflected the loss of momentum in the growth of manufacturing output. Work-in-process inventories were drawn down in June, following the liquidation of stocks of raw materials and supplies during May; finished goods were accumulated at a brisk pace in both months.

At the trade level, stocks of the automotive and construction sectors have risen substantially, but aggregate inventories have remained about in line with sales. The book value of wholesale trade inventories increased substantially in June, in part reflecting increases in motor vehicle stocks-- mainly recreational vehicles and foreign-made cars. A buildup of domestic car stocks at automotive dealers began in April; despite this accumulation, auto production has continued to exceed sales for the past four months. The July pickup in sales and adjustment in production were not sufficient to prevent a further run-up, and dealers' stocks continued to accumulate.

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

	1979	1980	1981				
			Q1	Q2	Apr.	May(r)	June(p)
<u>Book Value Basis</u>							
Total	49.0	31.0	41.1	n.a.	19.1	38.8	n.a.
Manufacturing	31.5	16.4	34.2	11.0	11.8	21.0	.2
Materials	12.3	2.5	10.1	-.1	7.3	-6.7	-.8
Work-in-Process	12.9	8.7	13.3	3.5	5.2	13.4	-8.0
Finished Goods	6.2	5.2	10.8	7.6	-.7	14.4	9.0
Wholesale	10.3	11.7	.0	4.8	.6	-.3	14.1
Automotive	.6	1.3	-2.4	.5	.8	-4.6	5.4
Retail	7.2	2.9	6.8	n.a.	6.7	18.0	n.a.
Automotive	1.4	-2.3	-3.3	n.a.	9.6	10.9	n.a.
<u>Constant Dollar Basis</u>							
Total	7.2	-2.5	-1.3	n.a.	6.1	11.2	n.a.
Manufacturing	6.8	-1.0	4.6	n.a.	.7	1.3	n.a.
Wholesale	.4	.6	-1.6	n.a.	.0	2.3	n.a.
Retail	-.1	-2.2	-4.3	n.a.	5.4	7.6	n.a.

INVENTORIES RELATIVE TO SALES¹

	1980		1981				
	May ²	Q4	Q1	Q2	Apr.	May(r)	June(p)
<u>Book Value Basis</u>							
Total	1.53	1.40	1.39	n.a.	1.39	1.40	n.a.
Manufacturing	1.76	1.59	1.61	1.60	1.60	1.61	1.58
Wholesale	1.21	1.12	1.08	1.11	1.08	1.10	1.12
Retail	1.44	1.35	1.31	n.a.	1.33	1.35	n.a.
<u>Constant Dollar Basis</u>							
Total	1.77	1.66	1.64	n.a.	1.67	1.69	n.a.
Manufacturing	2.12	1.96	1.97	n.a.	1.98	1.98	n.a.
Wholesale	1.46	1.39	1.37	n.a.	1.40	1.46	n.a.
Retail	1.48	1.42	1.36	n.a.	1.39	1.41	n.a.

1. Ratio of end-of-period inventories to average monthly sales for the period.

2. Period of cyclical peak in ratios.

(r) Revised estimates.

(p) Preliminary estimates.

Government Sector

Federal government purchases of goods and services (NIPA basis) declined sharply in the second quarter because of a liquidation of Commodity Credit Corporation inventories that had increased during the first quarter. Purchases of defense goods and services continued at the high first quarter rate.

The Administration's Mid-Session Review of the budget, released July 15, projects a FY81 deficit of \$55-1/2 billion--only slightly higher than the previous estimate prepared in March. However, there were a considerable number of changes to the size and composition of outlays and receipts. Increases in estimates for interest payments and costs of farm price support programs were only partially offset by downward revised estimates for some transfer items and defense purchases. Additionally, revenue estimates were raised by the postponement of the effective date of personal tax cuts until FY82. The FY82 deficit projected by the Administration was revised downward slightly to \$42-1/2 billion. The projected level of outlays is close to \$10 billion higher than in March, primarily reflecting larger interest costs than previously anticipated. Projected revenues are about \$12 billion higher, on balance, as the scaling back of the proposed tax reductions more than offset the effect of lower expected oil prices on windfall profits tax receipts.

Nearly all of the Administration's FY82 program was ratified by Congress in recent weeks; the major exception was a new proposal for social security financing designed to trim outlays by \$3-3/4 billion. The budget reconciliation bill, which would reduce nondefense spending in FY82 by \$35-1/4 billion from existing law, was close to Administration

NEW CAR INVENTORIES, ASSEMBLIES, AND SALES
(Seasonally adjusted)

	1980	1981				
	Q4	Q1	April	May	June	July
-----millions of units, end of period-----						
Dealers' stocks						
Domestic	1.53	1.16	1.27	1.38	1.53	1.68
Standard	.26	.23	.25	.26	.28	n.a.
Intermediate	.51	.36	.40	.42	.44	n.a.
Compact/subcompact	.75	.56	.62	.71	.80	n.a.
Foreign	.55	.44	.39	.39	.41	n.a.
-----millions of units, annual rate-----						
Domestic production	6.7	5.9	6.8	7.3	7.4	7.2
Sales of domestic- type models	6.6	7.3	5.8	5.7	5.4	5.9
Sales of foreign- made cars	2.5	2.7	2.3	2.2	2.2	2.3

anticipations. Similarly, the tax bill sent to the President in early August provided for \$37-3/4 billion in revenue cutbacks, closely matching the Administration's mid-year proposals for reductions in personal income taxes and stepped-up depreciation write-offs. (A description of the provisions of the tax bill is contained in Appendix II-A.)

At the state and local government level, July data indicate a rise in payroll employment of about 70,000, following the 180,000 drop over the first half of the year. The earlier fall-off was in large part the result of the phase-out of federally-funded public service jobs. The July pickup is in line with recent Department of Labor reports that a significant number of laid-off public service employment workers have been reinstated on regular state and local payrolls.

Construction activity at the state and local government level remains weak. Outlays decreased 1.0 percent in June, and in real terms construction expenditures have declined over 15 percent since December 1980. Lower outlays were reported in June for all types of projects except highways and streets, which had fallen sharply earlier in the year. Construction outlays, often viewed as a postponable expenditure by state and local government units, have undoubtedly been constrained by both reduced federal support and high interest rates--about one-third of state and local capital projects are bond financed.

Prices

Broad measures of prices have indicated a slowing of inflation in recent months. Much of the recent deceleration has been concentrated in energy markets; petroleum-related prices have leveled off or declined

RECENT CHANGES IN PRODUCER PRICES

(Percentage change at annual rates; based on seasonally adjusted data)¹

	Relative importance Dec. 1980	1980	1981			
			Q1	Q2	May	June
Finished goods	100.0	11.8	12.0	7.1	4.5	6.7
Consumer foods	23.1	7.5	.3	1.8	-.5	5.7
Consumer nonfood	56.6	14.2	17.4	7.7	3.5	6.1
Energy	12.0	27.8	61.7	5.2	-5.9	2.3
Exc. energy	44.6	10.4	7.2	8.6	6.6	7.7
Capital equipment	20.3	11.4	11.5	10.6	10.6	8.7
Intermediate materials ²	93.6	12.4	13.2	8.4	7.4	3.5
Exc. energy	77.3	10.1	7.1	9.4	8.6	6.0
Crude food materials	57.7	8.6	-23.1	8.5	-26.5	33.2
Crude nonfood	42.3	19.1	35.7	9.7	18.0	-6.4
Exc. energy	15.5	7.5	-37.3	23.3	37.9	-10.2

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

2. Excludes materials for food manufacturing and animal feeds.

RECENT CHANGES IN CONSUMER PRICES¹(Percentage change at annual rates; based on seasonally adjusted data)²

	Relative importance Dec. 1980	1980	1981			
			Q1	Q2	May	June
All items	100.0	12.4	9.6	7.4	8.1	8.5
Food	17.3	10.2	2.1	-.1	-2.7	2.2
Energy	10.8	18.1	49.1	4.7	4.4	7.9
All items less food and energy	71.8	12.1	5.8	11.8	13.4	12.3
Homeownership	25.8	16.5	3.1	16.9	20.5	18.4
All items less food, energy, and homeown- ership ³	49.6	9.9	8.0	8.8	7.4	8.4
Used cars	3.0	18.3	6.5	4.9	2.5	14.9
Other commodities ³	20.5	8.1	6.6	7.8	7.9	5.4
Other services ³	26.1	10.3	10.1	10.0	10.3	8.9

1. Based on index for all urban consumers.

2. Changes are from final month of preceding period to final month of period indicated.

3. Includes the home maintenance and repair component of homeownership costs.

following a surge early in the year. But, in addition, food prices have been essentially flat for most of this year. On the other hand, homeownership costs jumped sharply in the second quarter, owing to a surge in the volatile home purchase index and continued increases in mortgage interest costs. Rates of increase in prices of other than food, energy, and homeownership items also have moderated somewhat. In addition, prices for capital equipment rose somewhat less in June than in earlier months this year.

Consumer food prices continued to rise quite slowly in June, with the moderation fairly widespread. Despite the downturn in meat production in the second quarter, additionally upward price pressures for meats apparently are still being tempered by consumer resistance to the already high level of prices. Many other consumer foods were favorably influenced by a confluence of events, including a spring-time recovery from last winter's freeze of fruit and vegetable supplies and declines in the prices of internationally traded commodities such as sugar, coffee and cocoa. However, labor cost pressures at all levels of the food industry have continued to be intense this year, suggesting some likelihood of price hikes later this year. In addition, advance supply indicators point to further declines in meat production in coming quarters.

Excluding food, energy, and homeownership, consumer prices rose at about an 8-1/2 percent annual rate during the first half of this year--down from the 10 percent rate of 1980. This reduction reflects a significant slowdown in residential rents and in apparel and upkeep prices, where increases through mid-year were at half the rate of 1980.

HOURLY EARNINGS INDEX¹
 (Percentage change at annual rates;
 based on seasonally adjusted data)²

	1979	1980	1981			
			Q1	Q2	July	1st 7 months ³
Total private nonfarm	8.0	9.6	9.6	8.3	4.7	8.2
Manufacturing	8.7	10.9	9.3	9.6	6.4	8.8
Durable	8.6	11.6	9.4	9.5	6.1	8.7
Nondurable	8.8	9.8	9.1	9.8	7.0	8.8
Contract construction	6.7	7.6	9.2	5.0	12.1	7.6
Transportation and public utilities	8.9	9.4	9.4	10.8	.3	9.0
Total trade	7.5	8.8	9.6	7.1	3.5	7.6
Services	7.7	9.5	9.8	8.4	2.4	7.6

1. Excludes the effect of interindustry shifts in employment and fluctuations in overtime pay in manufacturing. These figures are revised to reflect new seasonal factors and the 1980 benchmark to the establishment survey data.

2. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Quarterly changes are at compound rates; monthly changes are not compounded.

3. Changes from December 1980 to July 1981 at compound annual rates.

Wages and Labor Costs

The easing of inflation has been accompanied by some slowing in the rate of increase of wage rates for most workers. The rise in the hourly earnings index for production and nonsupervisory workers in the private nonfarm sector of the economy--9-1/2 percent over 1980--decelerated to about an 8-1/4 percent annual rate during the first seven months of this year. Slowing has been most marked for manufacturing workers, who received especially large increases last year. Hourly compensation-- a broader measure of wage costs that includes fringe benefits and nonwage payments for all workers in this sector--increased at a 9-1/2 percent annual rate in the second quarter, somewhat below the 10 percent advance over the four quarters of 1980.

Wage rate increases provided by major collective bargaining agreements that were signed during the first half of this year averaged 11-1/4 percent in the first contract year and 9-1/4 percent annually over the life of these contracts, excluding possible further increases under cost-of-living clauses. These increases exceeded the increases contained in settlements reached in 1980 by nearly 2 percentage points. However, the number of workers covered by these new settlements is relatively small due to the light bargaining calendar, and a large portion were in the construction and coal mining industries where settlements have tended to be larger than average. In the building trades, new union contracts have provided wage increases averaging 11 percent over the contract life so far in 1981, down slightly from the 1980 figure. The new coal settlement will raise wage rates an average of 10-1/4 percent a year over the 39-month contract.

MAJOR COLLECTIVE BARGAINING SETTLEMENTS¹
 (Annual percentage change in negotiated wage rates,
 excluding cost-of-living adjustments)

	Average Adjustment			
	1978	1979	1980	1981 H1
<hr/>				
All Industries				
First-year adjustments	7.6	7.4	9.5	11.3
Average over life of contract	6.4	6.0	7.1	9.2
Workers affected ²	2548	3492	3787	927
Manufacturing				
First-year adjustments	8.3	6.9	7.4	8.1
Average over life of contract	6.6	5.4	5.4	6.4
Workers affected ²	598	1939	1554	164
Construction				
First-year adjustments	6.5	8.8	13.6	13.0
Average over life of contract	6.2	8.3	11.5	10.9
Workers affected ²	742	462	777	387
Non-Manufacturing, Non-Construction				
First-year adjustments	8.0	7.7	9.5	11.0
Average over life of contract	6.5	6.2	6.6	8.7
Workers affected ²	1208	1091	2233	376

1. Settlements covering 1,000 or more workers.

2. In thousands.

Labor productivity in the nonfarm business sector declined at an annual rate of nearly 1 percent in the second quarter, following the 4-1/2 percent rate rise in the first quarter that accompanied the burst of output growth. Since the cyclical peak in the first quarter of 1980, output per hour has grown at a 3/4 percent annual rate--about the same peak-to-peak rise as over the previous business cycle. However, the cyclical recovery in real output growth typically produces stronger than average productivity increases, and over the three quarters from 1980-Q3 to 1981Q1, output per hour rose at only a 2-1/2 percent annual rate--well below past performance. Reflecting recent movements in compensation and productivity, unit labor costs in the nonfarm business sector rose at a 10-1/2 percent annual rate in the second quarter, following a 7 percent increase in the first quarter. From mid-1980 through mid-1981, these costs rose 8-1/4 percent.

LABOR PRODUCTIVITY AND COSTS
(Percentage change at compound annual rates;¹
based on seasonally adjusted data)

	1978	1979	1980		1981	
			H1	H2	Q1	Q2
<u>Output per hour</u>						
Total private business	-.4	-.7	.0	.0	4.6	1.1
Nonfarm business	-.5	-.9	-1.2	1.6	4.3	-.9
Manufacturing	.8	.1	-2.5	5.2	3.2	4.2
Durable	.1	-1.5	-2.8	4.9	4.4	5.2
Nondurable	2.1	2.6	-2.7	5.9	1.4	2.8
<u>Compensation per hour</u>						
Total private business	9.1	10.1	11.5	9.1	11.8	10.3
Nonfarm business	9.1	9.9	10.7	9.5	11.6	9.6
Manufacturing	8.4	9.7	13.0	11.5	11.1	10.4
Durable	8.1	9.4	14.3	12.4	11.1	10.3
Nondurable	8.6	10.1	11.2	10.1	11.2	10.5
<u>Unit labor costs</u>						
Total private business	9.5	10.9	11.6	8.9	6.9	9.2
Nonfarm business	9.6	10.9	12.3	7.7	7.0	10.6
Manufacturing	7.5	9.6	15.9	6.0	7.7	6.0
Durable	7.9	11.1	17.6	7.1	6.4	4.9
Nondurable	6.4	7.4	14.1	4.0	9.6	7.6

1. Changes are from final quarter of preceding period to final quarter of period indicated.

APPENDIX II-A*

SUMMARY OF THE ECONOMIC RECOVERY ACT OF 1981 AND AN OVERVIEW OF THE BUDGET AT MID-SESSION

Two major elements of the Administration's economic program for fiscal year 1982 and beyond, the reconciliation bill which reduces spending and the tax bill, were enacted in July and early August. These measures were largely anticipated in the Mid-Session Review of the 1982 Budget, released on July 15. The table below places estimates of the reductions in costs of nondefense programs and of reductions in revenues that will result from these two bills in the context of the Administration's Mid-Session budget estimates for fiscal years 1982, 1983 and 1984.

The table shows that the reconciliation bill is estimated to cut spending in fiscal year 1982 by \$35.2 billion, about \$12 billion less than the total reductions announced in the Reagan Administration's March budget revisions. The Administration is reported to believe that the remainder of the outlay reductions can be achieved by administrative actions (for example, personnel ceilings) and by reductions in single year appropriations which were not subject to the reconciliation process. Major appropriations bills for fiscal year 1982 are yet to be enacted. The table also shows, however, that outlay estimates were revised upward by \$13.3 billion between March and July. Of these revisions, \$10.3 billion are accounted for by interest-related costs (principally interest on the public debt but also including higher costs for deposit and credit insurance programs). Scattered technical re-estimates in other programs and the fiscal 1982 effects of the supplemental appropriations enacted for fiscal year 1981 also raised estimated outlays. These higher costs are only partially offset in fiscal 1982 by the Social Security financing proposals made by the Administration after the March budget and incorporated in the Mid-Session Review. These proposals have not yet been taken up by the Congress.

In future years, the effects on the budget of current, higher-than-anticipated interest rates and other technical factors are assumed to dwindle rapidly as interest rates fall rapidly in the Administration's projections. The gap between cost reductions estimated to result from the reconciliation bill and those announced in the March budget widens in fiscal years 1983 and 1984 but is partially offset by the growing cost savings projected for the Social Security financing proposal. Nevertheless, further cost reduction measures yet to be announced are projected to amount to almost \$30 billion in FY 1983 and over \$40 billion in FY 1984.

The major tax bill recently enacted by the Congress is estimated to reduce revenues by amounts almost exactly matching those assumed in the Mid-Session Review for fiscal year 1982, 1983, and 1984. The two most important elements of the tax bill are across-the-board reductions in personal income tax rates and a program for accelerated depreciation

* Prepared by Susan Lepper, Senior Economist, Government Finance Section, Division of Research and Statistics.

which replaces the more complex "asset depreciation range" system previously in the tax code. The tax rate reductions in the personal income tax account for \$25.8 billion, \$65.7 billion, and \$104.5 billion of revenue reduction in fiscal years 1982, 1983, and 1984, respectively, while the accelerated depreciation provisions account for \$9.6 billion, \$16.8 billion and \$26.3 billion in the three fiscal years.

The reductions in personal income tax rates are effected by reductions in withholding rates by 5 percent effective October 1, and additional 10 percent cuts on July 1, 1982 and July 1, 1983. Calendar year liabilities are reduced by 1-1/4 percent in 1981, 10 percent in 1982, 19 percent in 1983 and 23 percent in 1984. Thereafter, the tax brackets, zero bracket amount and personal exemptions are linked to movements in the consumer price index. In addition:

- . the top marginal rate on unearned income is dropped from 70 percent to 50 percent effective January 1, 1982 and the corresponding reduction, from 28 percent to 20 percent, in the maximum tax on capital gains is retroactive to June 9, 1981;
- . two-earner households filing joint returns are permitted to deduct 5 percent of the income of the spouse with lower earnings, up to \$1,500 in 1982 and 10 percent, up to \$3,000 thereafter;
- . the child care credit is liberalized (the maximum credit for two or more dependents is raised from \$4,000 to \$4,800);
- . charitable contributions (up to a cap, through 1984) are made deductible even though a taxpayer does not itemize deductions;
- . the roll-over period for reinvestment of gains on the sale of a principal residence is lengthened to 2 years and the amount of the one-time exclusion of gain for sellers aged 55 and above is raised from \$100,000 to \$125,000;
- . a few other minor provisions apply to Americans working abroad, state legislators, etc.

The accelerated cost recovery system (effective January 1, 1981) places depreciable property in 15-, 10-, 5-, or 3-year classes. Equipment in these classes will be written off using rates that approximate the 150 percent declining balance method. (Certain long-lived utility property is the only equipment in the 15-year class.) The recovery rate is increased to approximately 175 percent for property placed in service in 1985 and to 200 percent beginning in 1986. For real estate, the recovery period is 15 years and the recovery rate is approximately 175 percent of declining balances except for low-income housing for which

the rate is 200 percent. Assets in the 3-year class (primarily autos, light-trucks and R and D equipment) receive a 6 percent investment tax credit (more than previously) and equipment in the other classes receives the full 10-percent credit. A liberalized leasing rule will permit firms with low tax liabilities, and thus not able to use the full amount of tax write-off were they to buy equipment, to lease the equipment from firms that can take advantage of the tax benefits.

Other business tax provisions include the following:

- . liberalized credit for rehabilitation of structures;
- . a new 25 percent credit for incremental expenses incurred for research and development;
- . immediate expensing of the first \$5,000 of investment in equipment in 1982, this amount increasing to \$10,000 by 1986;
- . phased reduction of corporate tax rates for the two lowest brackets (there is no change in the 46 percent rate paid on profits above \$100,000 or the 30 and 40 percent rates for profits above \$50,000 and \$75,000, respectively);
- . extension of the targeted jobs credit through 1982 with certain modifications;
- . for 1982 only, an increase in commercial bank bad debt reserve to 1.0 percent of loans;
- . facilitation of "tax-free" mergers for thrift institutions certified as troubled by the appropriate regulatory agency; in particular, operating losses of the transferor can be carried over to the transferee so long as substantially all of the assets and liabilities of the transferor are acquired by the transferee.

A number of other provisions are intended to stimulate saving and/or assist the thrift and housing industries. These include:

- . provision for a lifetime exclusion of \$1,000 (\$2,000 for a joint return) of interest from "all savers certificates" if such certificates are authorized by the regulatory agencies; "all savers certificates" may be issued with a one-year maturity and a maximum interest rate of 70 percent of the yield on a one-year Treasury bill, between October 1, 1981 and December 30, 1982; 75 percent of the lesser of the proceeds of the

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certificates or of net new savings must be devoted to mortgage or mortgage related purposes or agricultural loans;

- . the present \$200 (\$400 for joint return) exclusion of interest and dividends reverts to the former exclusion of \$100 (\$200 for joint return) of dividends only. Beginning in 1985, however, 15 percent of interest (net of interest costs except those associated with the taxpayer's business or dwelling) up to \$3,000 (\$6,000 joint returns) is excludable from tax;
- . IRA and Keogh account limitations are liberalized, increasing the amounts of tax-deferred contributions and permitting individuals participating in employer-sponsored retirement plans to utilize IRA deductions.

Other provisions of the bill include:

- . estate and gift tax relief;
- . liberalization of the windfall profit tax through credits for royalty owners, phased reduction of the tax rate on new (Tier 3) oil and exemption from the tax for oil from independently owned "stripper" (lower production) wells beginning in 1983;
- . tightened tax treatment of gains and losses on trading in futures (straddles) requiring commodities futures contracts to be "marked-to-market" at year end and treated as if 60 percent of gains and losses were long-term and 40 percent short-term;
- . faster payment of taxes by large corporations as quarterly payments are raised relative to annual liabilities (primarily affecting fiscal year 1983 receipts).

DOMESTIC FINANCIAL DEVELOPMENTS

Most interest rates have risen on balance since the July FOMC meeting, with some of the largest increases occurring in the intermediate- and long-term debt markets where many rates registered new highs before easing in recent days. The bearishness of market sentiment--despite indications of reduced inflationary momentum--appeared to reflect increased market recognition of the implications of the Federal Reserve's restrictive monetary policy in conjunction with intense concern about the dimensions of current and prospective federal budget deficits.

The major exception to the upward movement of interest rates was the federal funds rate, which fluctuated considerably, but generally in a range below levels prevailing before the July FOMC meeting. The pattern of the funds rate was consistent with the lower average volume of borrowing at the discount window that emerged against a backdrop of slow growth of M1-B and expansion of M2 which kept this broader aggregate running just below the upper bound of its long-run target range for 1981.

In the credit markets, flows of funds in recent weeks have continued to reflect the relative interest rate sensitivities of various sectors of the economy. The Treasury, needing to cover a substantial third-quarter deficit, has been a heavy borrower. In the tax-exempt sector, short-term borrowing moderated in July, but the pace of bond issuance was well maintained. Business firms, in contrast, have been considerably deterred from bond issuance by record rates; public offerings by industrial and financial companies fell off substantially in July, as such firms turned instead to banks and, in some instances, to the commercial paper market. Aggregate borrowing by households appears to have diminished further, with high rates

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SELECTED FINANCIAL MARKET QUOTATIONS¹
(Percent)

	1981					Change from:	
	1980	Early		FOMC	Early		
	Dec. High	Mar. Low	May High	July 7	Aug. 11	May High	FOMC July 7
<u>Short-term rates</u>							
Federal funds ²	19.83	13.48	18.91	19.93	18.41p	-.50	-1.52
Treasury bills							
3-month	17.14	12.36	17.01	14.89	14.85	-2.16	-.04
6-month	15.74	11.58	15.83	14.47	14.93	-.90	.46
1-year	14.06	11.50	14.85	13.63	14.15	-.70	.52
Commercial paper							
1-month	20.77	12.62	18.57	17.92	17.65	-.92	-.27
3-month	19.88	12.48	18.29	16.68	17.13	-1.16	.45
6-month	18.58	12.19	17.38	15.38	16.26	-1.12	.88
Large negotiable CDs ³							
1-month	21.29	12.94	18.80	17.97	17.93	-.87	-.04
3-month	20.90	12.99	19.01	17.34	17.82	-1.19	.48
6-month	19.19	12.94	18.50	16.66	17.69	-.81	1.03
Eurodollar deposits ²							
1-month	22.54	13.84	19.39	18.86	18.80	-.59	-.06
3-month	21.36	14.31	19.56	18.19	18.78	-.78	.59
Bank prime rate	21.50	17.00*	19.00	20.00	20.50	1.50	.50
<u>Intermediate and long-term rates</u>							
U.S. Treasury (constant maturity)							
3-year	14.41	12.85	15.69	14.73	15.37	-.32	.64
10-year	13.57	12.58	14.69	14.04	14.40	-.29	.36
30-year	13.17	12.16	14.11	13.42	13.63	-.48	.21
Municipal (Bond Buyer)	10.56	9.81	10.94	10.85 ⁴	11.63 ⁴	.69	.78
Corporate Aaa							
New issue	14.51	14.42	16.12	— 5	— 5	—	—
Recently offered	15.03	13.98	16.26	14.94 ⁶	16.69p ⁶	.43	1.75
Primary conventional mortgages	14.95	—	16.12	16.64 ⁶	17.13 ⁶	1.01	.49
	1980	1981		Percent change from:			
	Dec. 31	June 30	FOMC July 7	Aug. 11	Dec. 31	FOMC July 7	
<u>Stock Prices</u>							
Dow-Jones Industrial	963.99	976.88	954.15	949.30	-1.5	-.5	
NYSE Composite	77.86	76.15	74.39	77.65	-.3	4.4	
AMEX Composite	348.99	374.63	360.77	374.67	7.4	3.9	
NASDAQ (OTC)	202.34	215.75	208.01	211.67	4.6	1.8	

1. One-day quotes except as noted.

2. Averages for statement week closest to date shown.

3. Secondary market.

4. One-day quotes for preceding Thursday.

5. Averages for preceding week.

6. One-day quotes for preceding Friday

* Low reached on April 2.

and taut conditions in the mortgage and consumer credit markets helping to reduce effective demands for houses and consumer durables.

Monetary Aggregates and Bank Credit

Shift-adjusted M1-B expanded at a 3-1/4 percent annual rate in July, after substantial declines in each of the two previous months. The staff estimates that more than a third of the total increase in the daily average level of this aggregate reflected the early distribution of social security checks, which were augmented by the annual cost-of-living adjustment. Other checkable deposits rose \$2 billion after a net decrease of \$1/4 billion in the preceding two months; in the absence of new evidence on shift proportions, the staff in its adjustment of M1-B has continued to assume that 70 to 75 percent of the net inflow of other checkable deposits (above trend) is from demand deposits.

Growth in M2 picked up in July from the relatively sluggish pace of the previous two months. The 8-1/2 percent annual rate of expansion of M2 reflected in part stepped-up growth in its nontransaction component. Faster expansion of money market mutual fund (MMMF) shares and a deceleration in savings deposit outflows more than offset slower growth in small time deposits and a decline in the overnight RP and Eurodollar component.

MMMF shares increased \$11-1/2 billion during July, on a month-average basis, more than double the increase in June. MMMF growth during the first week of August continued at about the July pace. The persistence of a large spread between money fund yields and returns available on consumer-type time deposits at commercial banks and thrift institutions helps to explain the rapid inflows into MMMFs as well as the weakness in small time deposit growth at depository institutions. During July, the margin between

III-4
MONETARY AGGREGATES
(Based on seasonally adjusted data unless otherwise noted)¹

	1980		1981				July '80
	Q4	Q1	Q2 ^e	May	June	July ^e	to July '81 ^e
---- Percentage change at annual rates ----							
<u>Money stock measures</u>							
1. M1-A	8.2	-20.8	-5.3	-5.6	-9.9	-1.3	-4.0
2. (Adjusted) ²	n.a.	(-1.7)	(5.1)	(-6.1)	(-10.1)	(2.5)	n.a.
3. M1-B	10.8	4.9	8.7	-6.1	-7.5	3.9	7.7
4. (Adjusted) ²	n.a.	(-0.8)	(5.3)	(-5.1)	(-8.8)	(3.2)	n.a.
5. M2	8.1	8.3	10.7	3.7	4.2	8.6	9.2
6. M3	11.3	12.4	10.4	8.35	9.5	8.4	11.6
<u>Selected components</u>							
7. Currency	8.8	5.5	7.9	9.1	1.0	10.0	7.9
8. Demand deposits	7.9	-32.9	-11.8	-11.8	-14.0	-7.1	-9.3
9. Other checkable deposits	52.9	372.3	107.4	-7.1	3.6	34.0	202.6
10. M2 minus M1-B (11+12+13+16)	7.3	9.4	11.3	6.9	8.0	10.2	11.5
11. Overnight RPs and Eurodollars, NSA ³	15.3	0.0	60.1	139.9	47.0	-21.1	32.1
12. Money market mutual fund shares, NSA	-15.5	84.5	113.7	10.2	47.8	112.4	66.6
13. Commercial banks	10.2	6.0	4.2	4.5	5.9	5.9	7.0
14. savings deposits	1.5	-30.5	-11.9	-16.0	-24.0	-11.5	-11.2
15. small time deposits	16.2	30.2	13.4	15.8	22.0	14.5	19.4
16. Thrift institutions	7.6	3.5	-0.3	1.4	-0.5	-2.9	3.4
17. savings deposits	-2.2	-29.6	-12.8	-22.2	-24.5	-17.3	-12.1
18. small time deposits	12.5	19.0	4.8	10.8	9.2	2.7	10.8
19. Large time deposits	28.1	39.6	9.9	34.3	39.4	12.2	26.7
20. at commercial banks, net ⁴	24.8	40.6	9.4	36.7	45.5	15.6	26.4
21. at thrift institutions	44.9	34.7	11.2	23.0	10.0	-5.0	28.3
22. Term RPs, NSA	47.7	16.4	2.1	42.0	34.4	-30.4	25.4
--Average monthly change in billions of dollars--							
<u>MEMORANDA:</u>							
23. Managed liabilities at commercial banks (24+25)	9.1	4.0	9.4	16.9	10.8	7.5	6.6
24. Large time deposits, gross	7.0	5.1	7.5	10.5	8.8	9.2	6.3
25. Nondeposit funds	2.1	-1.1	1.9	6.4	2.0	-1.7	0.3
26. Net due to related foreign institutions, NSA	-0.2	-1.6	0.5	9.1	-3.2	-0.3	-0.5
27. Other ⁵	2.4	0.4	0.4	-2.6	5.2	-1.4	0.8
28. U.S. government deposits at commercial banks ⁶	-0.9	1.1	-0.3	1.9	-3.3	1.0	0.2

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

2. Figures in parentheses have been adjusted to remove the distorting effects since the beginning of 1981 of shifts of funds out of demand deposits and other accounts into NOW accounts. Based on a variety of evidence, it is estimated that 77-1/2 percent of inflows into other checkable deposits--in excess of "trend"--was from demand deposits in January, and 72-1/2 percent in subsequent months.

3. Overnight and continuing contract RPs issued to the nonbank public by commercial banks, net of amounts held by money market mutual funds, plus overnight Eurodollar deposits issued by Caribbean branches of U.S. member banks to U.S. nonbank customers.

4. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.

5. Consists of borrowings from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase and other liabilities for borrowed money (including borrowings from the Federal Reserve), loans sold to affiliates, loan RPs, and other minor items. Changes since October 1980 are partially estimated.

6. Consists of Treasury demand deposits at commercial banks and Treasury note balances.

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

the weekly average yield on MMMF shares and the deposit rate ceiling on MMCs increased to 175 basis points.

Some savers also have been placing their funds in retail repurchase agreements (term RPs with denominations of less than \$100,000) rather than in conventional deposit instruments. The Federal Home Loan Bank Board in February approved the offering of retail RPs; since then, a number of S&Ls have reportedly marketed them actively to attract and retain funds, while a recent survey by the bank contact group indicates that commercial bank participation is, to date, quite limited. Offering terms vary widely, but RPs typically are issued in minimum denominations of \$1,000 to \$2,500 with maturities of 30 to 89 days. An estimate of retail term RPs at S&Ls is included in M3--along with large-denomination thrift and bank RPs--but not in M2.

Bank issuance of large time deposits (line 24 in the table on page III-4) increased a bit in July, but after allowance for estimated CD acquisition by MMMFs, the bank large time deposit component of M3 grew less rapidly than in June (line 20).¹ S&Ls meanwhile ran off a small amount of large time deposits in July; investor concerns about the financial position of thrift institutions have resulted in unusually large premiums that even the strongest S&Ls must pay relative to rates paid on large CDs by commercial banks.

At commercial banks, overall issuance of managed liabilities slowed in July; their need to purchase funds was reduced as U.S. government deposits

1. Data on MMMF asset composition currently are available only with about a one-month lag. Consequently, the necessary consolidation adjustments in calculating M2 must be regarded as tentative and subject to considerable uncertainty. Efforts are underway, with the cooperation of the Investment Company Institute, to improve the data flow in this area.

III-6

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

	1980		1981				July 80 to July 81 ^e	
	Q3	Q4	Q1	Q2 ^e	May	June	July ^e	
----- Commercial Bank Credit -----								
1. Total loans and investments at banks ²	12.9	14.6	7.7	7.3	11.7	5.7	5.0	10.8
2. Investments	20.5	11.9	10.5	6.2	12.3	7.5	5.0	11.0
3. Treasury securities	39.1	11.1	15.2	15.7	25.0	18.4	9.1	17.8
4. Other securities	11.5	12.3	8.2	1.3	5.5	1.6	2.7	7.5
5. Total loans ²	10.2	15.6	6.8	7.7	11.4	5.3	5.1	10.8
6. Business loans ²	15.2	21.0	6.6	10.1	11.9	15.3	17.3	15.1
7. Security loans	-10.2	60.1	27.3	36.2	18.2	23.9	-52.7	31.5
8. Real estate loans	4.5	11.0	9.4	7.3	9.4	5.3	6.2	8.5
9. Consumer loans	-7.6	-0.2	-1.4	-1.1	-4.1	1.4	n.a.	n.a.
-- Short- and Intermediate-Term Business Credit --								
10. Total short- and intermediate-term business credit (sum of lines 14, 15 and 16)	8.9	14.5	13.9	14.8	16.6	21.5	n.a.	n.a.
11. Business loans net of bankers acceptances	14.3	24.2	5.8	7.0	13.0	14.3	17.4	15.4
12. Commercial paper issued by nonfinancial firms ³	-19.3	-3.0	30.7	40.9	48.9	82.9	7.8	13.6
13. Sum of lines 11 & 12	10.3	21.2	8.3	12.6	17.1	22.0	16.2	15.2
14. Line 13 plus loans at foreign branches ⁴	9.6	19.6	11.6	12.7	15.5	22.3	18.1	15.5
15. Finance company loans to business ⁵	-4.6	14.6	8.5	19.3	23.1	30.8	n.a.	n.a.
16. Total bankers acceptances outstanding ⁵	21.0	-15.7	35.6	23.1	15.7	5.8	n.a.	n.a.

1. Average of Wednesdays for domestic chartered banks and average of current and preceding ends of months for foreign-related institutions.

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. Average of Wednesdays.

4. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestic-chartered banks.

5. Based on average of current and preceding ends of months.

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

increased slightly after dropping appreciably in the preceding month. U.S. banks maintained an essentially unchanged position vis-a-vis their own foreign branches; in June they had advanced funds, net, to their branches, raising money in the domestic money market. The reduction in managed liability growth was more than accounted for by a swing from net issuance to net repayment of "other" nondeposit liabilities to nonbank sources--mainly RPs.

Bank credit advanced in July at only a 5 percent annual rate, the weakest pace since April. Net acquisitions of U.S. government securities slowed significantly as large banks reduced their holdings of securities for trading account. Total loan growth also edged down. The only source of strength in bank credit came from a sizable increase in business loans, which was concentrated at large banks. Security loans fell in July, following five months of strength, as dealer holdings of U.S. government securities decreased. Real estate lending--although up somewhat from the June pace--remained relatively weak.

Business Finance

Available data suggest that overall credit demands by nonfinancial business firms have moderated somewhat in July from the levels in May and June. Borrowing nevertheless remained quite substantial as weak corporate profitability has limited the availability of internally generated funds. In shorter-term markets, a step-up in business borrowing at banks was more than offset by a virtual levelling off in the volume of nonfinancial commercial paper outstanding, even though the margin between the prime rate and the commercial paper rate remained wide. The deceleration in nonfinancial commercial paper reportedly reflected in part a reduction in issues by

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

	1980	1981			
		Q1	Q2 ^p	June ^p	July ^p
----- Seasonally adjusted -----					
Corporate securities--total	6,141	5,941	6,001	6,100	3,800
Publicly offered bonds ¹	3,466	3,443	2,846	3,000	1,500
Privately placed bonds	968	523	600	600	600
Stocks	1,707	1,975	2,555	2,500	1,700
----- Not seasonally adjusted -----					
Publicly offered bonds--total ¹	3,466	3,038	3,386	4,000	1,900
By quality ²					
Aaa and Aa	1,666	914	1,266	1,960	840
Less than Aa ³	1,800	2,124	2,120	2,040	1,060
By type of issuer					
Utility	1,304	1,125	1,121	1,175	1,120
Industrial	1,323	1,289	1,494	1,850	465
Financial	839	624	771	975	315
Memo Items:					
Convertible bonds	390	439	471	305	125
Original discount bonds					
Par value	--	167	1,175	1,400	700
Gross proceeds	--	85	480	490	327
Foreign ⁴	225	200	858	1,375	546
Stocks--total	1,707	1,889	2,505	2,900	1,500
By type of issuer					
Utility	612	499	946	1,700	400
Industrial	840	1,186	1,223	800	800
Financial	255	204	336	400	300

p--preliminary.

1. Total reflects gross proceeds rather than par value of original discount bonds.

2. Bonds categorized according to Moody's bond ratings.

3. Includes issues not rated by Moody's.

4. Not reflected in the above totals.

oil companies, whose inventories were declining. By contrast, total commercial paper outstanding rose significantly, resulting to some extent from further expansion in inventory financing requirements at auto company finance subsidiaries as well as a large increase in bank-related issues, a portion of which reportedly was channeled to nonbank affiliates to finance business credit.

Business lending by U.S. commercial banks in July was affected only marginally by takedowns of lines of credit associated with merger activities. Although U.S. banks are participating in a large volume of merger-related C&I loan commitments, most of the relatively small amount taken down by the end of July was booked offshore.¹ Thus, it appears that about 1-1/2 percentage points of the 17-1/2 percent July increase in C&I loans (excluding bankers acceptances) at domestic bank offices was merger-related.

In the securities markets, yields on corporate bonds rose about 1-3/4 percentage points between early July and early August, reaching record highs. During July, the volume of public bond offerings dropped to \$1.5 billion (seasonally adjusted)--about half the average during the previous few months. The decline in offerings appears to reflect the sharp rise in long-term yields and the expectation of more favorable market conditions later this year. All of the fall-off in July was in the industrial and the financial sectors, as offerings by utilities remained at a \$1.1 billion per month pace. Foreign bond issuance--not included in totals cited above--has been quite buoyant. Such offerings have averaged about \$530 million per month through July, well above the record rate set in 1975.

1. Recent merger-related activity and its effect on measures of business lending are discussed in more detail in an appendix.

Less than half of this amount can be attributed directly to borrowing by foreign governments.

Private placements of corporate bonds have remained sluggish. According to market observers, many potential issuers of privately placed debt have been unwilling to incur the high costs of borrowing. However, the available data suggest that liquidity pressures on the life insurance industry may also be a factor; policy loans outstanding have advanced at a strong pace through May (latest available), and commercial paper issuance by life insurance companies also has increased in recent months.

Share prices generally have increased, on balance, during the intermeeting period. The NYSE, NASDAQ, and AMEX composite indexes all have risen approximately 2 to 4 percent since early July. New stock issues totaled \$1.7 billion (seasonally adjusted) in July, down about \$500 million from the strong first-half monthly average.

Government Finance

The Treasury during July and thus far in August has raised, net, about \$10 billion (not seasonally adjusted) through marketable borrowing, in contrast to a slight paydown in debt in the second quarter as a whole. In the recent mid-quarter financing, the Treasury paid record high rates on each of the three issues involved, a reflection of the generally anxious tone of fixed-income markets. However, the auctions were well-covered, and the volume of noncompetitive tenders was the largest on record, suggesting a possible diversion of some funds from deposits or MMMFs into market instruments. Noncompetitive tenders also have been running high in auctions of bills and other securities.

FEDERAL GOVERNMENT AND SPONSORED AGENCY FINANCING¹
 (Total for period; billions of dollars)

	Q2	Q3 ^f	June ^e	July	Aug. ^f
<u>Treasury financing</u>					
Combined surplus/deficit(-)	10.8	-18.4	13.9	-12.7	-8.5
Net marketable borrowings/ repayments (-)	-0.4	16.9	2.2	5.2	5.9
Bills	-16.5	2.4	-5.7	-1.7	2.0
Coupons	16.1	14.5	7.9	6.9	3.9
Nonmarketable borrowings/ repayments (-)	-2.1	-3.2	-1.6	-2.1	-0.6
Other means of finance ²	-2.5	4.7	-3.8	4.5	-1.0
Change in cash balance	5.7	0.0	10.7	-5.1	-4.2
<u>Federally sponsored credit agencies net cash borrow- ings³</u>					
	9.7	11.5	3.5	4.7	3.1

1. Numbers reported on a not seasonally adjusted, payment basis.

2. Includes checks issued less checks paid, accrued items and other transactions.

3. Includes debt of Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, and the Federal Farm Credit Bank System.

f--forecast.

e--estimated.

The Board staff projects a combined unified and off-budget federal deficit of \$18-1/2 billion for the current quarter. To finance the deficit, Treasury borrowing in the market may be close to \$17 billion.¹ In the fourth quarter, the staff expects a record combined deficit of \$47 billion, partly reflecting reduced revenues as a result of the tax cut, and marketable borrowing by the Treasury of \$37 billion--even larger than the fourth-quarter borrowing expectations announced by the Treasury to date.

Federally sponsored credit agencies borrowed an estimated \$4.7 billion in July, eclipsing the strong \$3.2 billion monthly pace of the second quarter. The FHLB raised \$2.4 billion in new money in July, mainly because advances to S&Ls and MSBs have expanded rapidly as thrifts have become increasingly dependent on borrowing due to the persistent weakness in their deposit flows. FHLB advances in July totaled a near-record \$3.1 billion after seasonal adjustment, up from \$2.5 billion in June. The rise in advances occurred despite the FHLBB's adoption of a tighter policy in June 1981 to restrict the use of advances to funding of net deposit withdrawals and existing loan commitments.

The Farm Credit Banks borrowed \$1.4 billion in July, somewhat above the second quarter pace; however, borrowings by this agency in August are expected to be much reduced. Meanwhile, FNMA is estimated to have borrowed \$524 million in July, considerably more than the monthly average during the second quarter, reflecting a moderate recovery in mortgage purchases. Yields on FNMA debentures have increased to as much as 140 basis points

1. This borrowing projection is based on the assumption that the Congress will act by the end of September to raise the debt ceiling from its current level of \$985 billion.

above Treasury issues of comparable maturities, apparently due in part to investor uneasiness about FNMA's current and prospective earnings.

STATE AND LOCAL GOVERNMENT SECURITY OFFERINGS
(Monthly averages, billions of dollars, s.a.)

	1980		1981				
	Q4	Q1	Q2 ^e	May	June	July ^e	Aug. ^f
Total	6.05	5.63	7.40	8.84	7.20	5.70	5.20
Long-term	3.60	3.40	4.00	3.15	3.50	3.30	3.00
Short-term	2.45	2.23	3.40	5.69	3.70	2.40	2.20

e--estimate. f--forecast.

Yields in the long-term tax-exempt securities market have risen to record levels since the last FOMC meeting, maintaining a roughly stable relationship to corporate bond rates. Despite the high rates, municipal bond volume totaled \$3.3 billion (seasonally adjusted) in July--down \$200 million from the amount sold in June but considerably above the 1979-80 pace of offerings exclusive of mortgage revenue bond issues. The supply of municipal issues has been sustained in part because some states have removed or increased their statutory interest rate ceilings that had thwarted previous attempts to sell securities. In addition, issues of revenue bonds, which currently account for about 70 percent of tax-exempt volume, typically are less sensitive to high interest costs, especially in the case of utilities faced with rigid annual funding needs and scheduled payments for construction that is underway. In July, postponements of municipal bonds of all types totaled about \$525 million, slightly above the monthly average for all of 1981 but less than half the amount postponed when municipal bond interest rates peaked in December 1980.

HOME MORTGAGE RATES AND YIELDS
(percent)

Period	Primary market ¹		Secondary market		
	New commitments ²	Loans closed ³	FNMA commitment auction ⁴		GNMA-guaranteed securities ⁵
			FHA/VA	Conventional	
1980--High	16.35	13.26	15.93	17.51	14.17
Low	12.18	11.48	12.28	12.81	10.73
1981--High	17.13	14.12	17.27	16.94	16.55
Low	14.80	12.81	14.84	14.83	13.18
1981--July 6	16.79	14.05	16.43	16.34	15.35
13	16.74	—	—	—	15.56
20	16.88	—	16.87	16.53	16.17
27	17.11	—	—	—	15.96
Aug. 3	17.13	n.a.	17.27	16.94	16.55
10	n.a.	—	—	—	16.04

1. For primary market rates, weekly figures shown are as of July 10, 17, 24, 31, and August 7.

2. Average contract rate on new commitments for fixed-rate level-payment conventional home loans with 30-year maturities and 80 percent loan-to-value ratios at a sample of savings and loan associations (FHLMC series).

3. Average contract rate on conventional new-home loans made by major lenders (FHLBB series), including fixed- and adjustable-rate mortgages.

4. Average gross yields (before deduction of 38 basis points for mortgage servicing) on accepted bids in FNMA's auctions of forward commitments to purchase fixed-rate level-payment home mortgages, assuming prepayment in 12 years for 30-year mortgages.

5. Average net yields to investors on GNMA securities for immediate delivery, based on dealer prices and assuming prepayment in 12 years on pools of 30-year FHA/VA level-payment mortgages typically carrying the prevailing ceiling rate on such loans.

Mortgage Markets

Costs of both construction and permanent mortgage funds have risen further since the last FOMC meeting. In the primary market for long-term mortgage credit, interest rates have reached new highs on fixed-rate level-payment conventional home loans at a sample of savings and loan associations; they averaged 17.13 percent in the week ended August 7, up nearly 1/2 percentage point since early July. Yield increases were much larger in the secondary mortgage market, prior to the recent rally in the bond market. As a result, average discounts on FHA/VA level-payment home mortgages bearing the current 15-1/2 percent ceiling rate have risen to a level that has discouraged transactions financed with this type of credit.

Average rates paid by consumers on all types of conventional home loans closed at major types of institutions (FHLBB series) have been well below rates quoted on new commitments for unsubsidized fixed-rate loans. This gap is attributable partly to the usual lag between commitment and closing rates, but also reflects the presence in the loans-closed series of below-market-rate contracts funded through municipal revenue bonds as well as mortgages with adjustable-rate features which are being offered at initial interest rates below those prevailing on fixed-rate contracts. In addition, field reports continue to indicate wide use of builder buydown arrangements and "creative" seller financing in existing-home markets to enable buyers to soften the impact of high interest rates in the early years of a loan.^{1,2}

1. Nontraditional financing techniques also have become a feature of the markets for income-producing real estate. About 30 percent of a limited number of large mortgage loan commitments made by reporting life insurance companies on income properties during the first quarter of 1981 (latest data available) provided for income or equity sharing by lenders or for renegotiated rates. The proportion by dollar volume was two-thirds.
2. Rates reported by lenders for first mortgages in the closing rate series are not affected by builder buydown arrangements.

The problem of sorting through the variety of adjustable-rate mortgage arrangements permitted by the recent regulations issued by the FHLBB and the Comptroller of the Currency apparently has caused some delays in marketing these types of contracts. FHLMC recently established weekly auctions of commitments to purchase adjustable-rate mortgages--conventional home loans providing for adjustments to interest rates (and monthly payments) once a year on the basis of movements in average rates on mortgage loans closed. The volume of bids in the first four auctions was quite low, and average initial yields on accepted bids in these pilot programs ranged from 66 to 103 basis points below yields set in FHLMC's auctions of commitments to purchase fixed-rate loans--roughly the degree of yield concession indicated in field reports.

The volume of residential mortgage lending has continued to be restrained by the high level of interest rates and by conservative lending policies. New mortgage commitments at S&Ls in June (latest information available) fell by 11 percent, seasonally adjusted, to about half the volume made at last August's high. Mortgage commitments outstanding (including loans in process) also declined, and in nominal terms were about 12 percent below the recent peak reached in the fall of 1980; nevertheless, they were well above their 1980 monthly low.

With home sales dwindling and a rising share of sales apparently being funded through assumptions of outstanding loans in connection with some form of seller financing, the rate of turnover of mortgages held by S&Ls has dropped further, thus contributing to the earnings difficulties experienced by these institutions. In June, mortgage repayments at S&Ls fell to \$2.5 billion (seasonally adjusted)--the lowest volume since June

1980 and far below the peaks of \$5 billion or more in 1978 when existing-home sales reached their highs.

Consumer Installment Credit

Growth in consumer installment credit outstanding during July probably remained sluggish, judging from indications of continued weakness in consumer loans at large commercial banks and still depressed new-car sales. Installment credit growth had picked up slightly in June on the strength of a sharp advance in the revolving credit component, but the second-quarter expansion, at a 7 percent annual rate, trailed the first quarter tempo by a small margin.

Automobile credit outstanding remained weak in June, increasing marginally after a small contraction during May. In a renewed effort to stimulate car sales, General Motors announced in late July that its finance company subsidiary would finance the purchase of a new GM car at a below-market rate of 13.8 percent.¹ Chrysler followed in early August with an announcement of cash rebates for any purchaser of a new Chrysler car, while Ford and AMC have been providing allowances that dealers can pass along to buyers as price concessions, lower downpayments, or interest rate subsidies.

In June, new-car finance rates at finance companies rose 90 basis points to a record 16.97 percent. (See chart on page III-20.) Despite the GM focus on interest rates in its sales campaign, financing costs have not been the primary factor underlying the sharp increase in average monthly loan payments since the end of 1979. Staff estimates show that

1. Compared with the average level of auto finance rates at finance companies, the new GM offer rate represents a 3 percentage point discount. On a typical amount financed of \$7,500 for 48 months, the total payment over the life of the loan would be reduced \$580, or \$12 per month.

CONSUMER INSTALLMENT CREDIT¹

	1979	1980	1981			
			Q1	Q2	May	June
<u>Total</u>						
Change in outstandings						
Billions of dollars	38.4	1.4	23.9	22.4	16.2	23.2
Percent	14.0	0.5	7.8	7.1	5.1	7.3
Extensions						
Billions of dollars	324.8	305.9	342.4	344.1	337.8	348.1
Bank share (percent)	47.6	43.7	40.6	42.5	42.8	43.0
Liquidations						
Billions of dollars	286.4	304.5	318.5	321.7	321.6	324.9
Ratio to disposable income (percent)	17.5	16.7	16.4	16.2	16.2	16.3
<u>Automobile credit</u>						
Change in outstandings						
Billions of dollars	14.7	0.0	10.4	1.2	-2.3	0.7
Percent	14.5	0.0	8.9	1.0	-2.0	0.6
Extensions						
Billions of dollars	93.9	83.0	97.1	87.9	87.8	89.3
<u>Revolving credit</u>						
Change in outstandings						
Billions of dollars	8.6	2.9	6.3	8.8	4.2	12.2
Percent	19.9	5.5	11.3	15.3	7.2	20.8
Extensions						
Billions of dollars	120.2	129.6	141.7	147.7	142.8	152.0

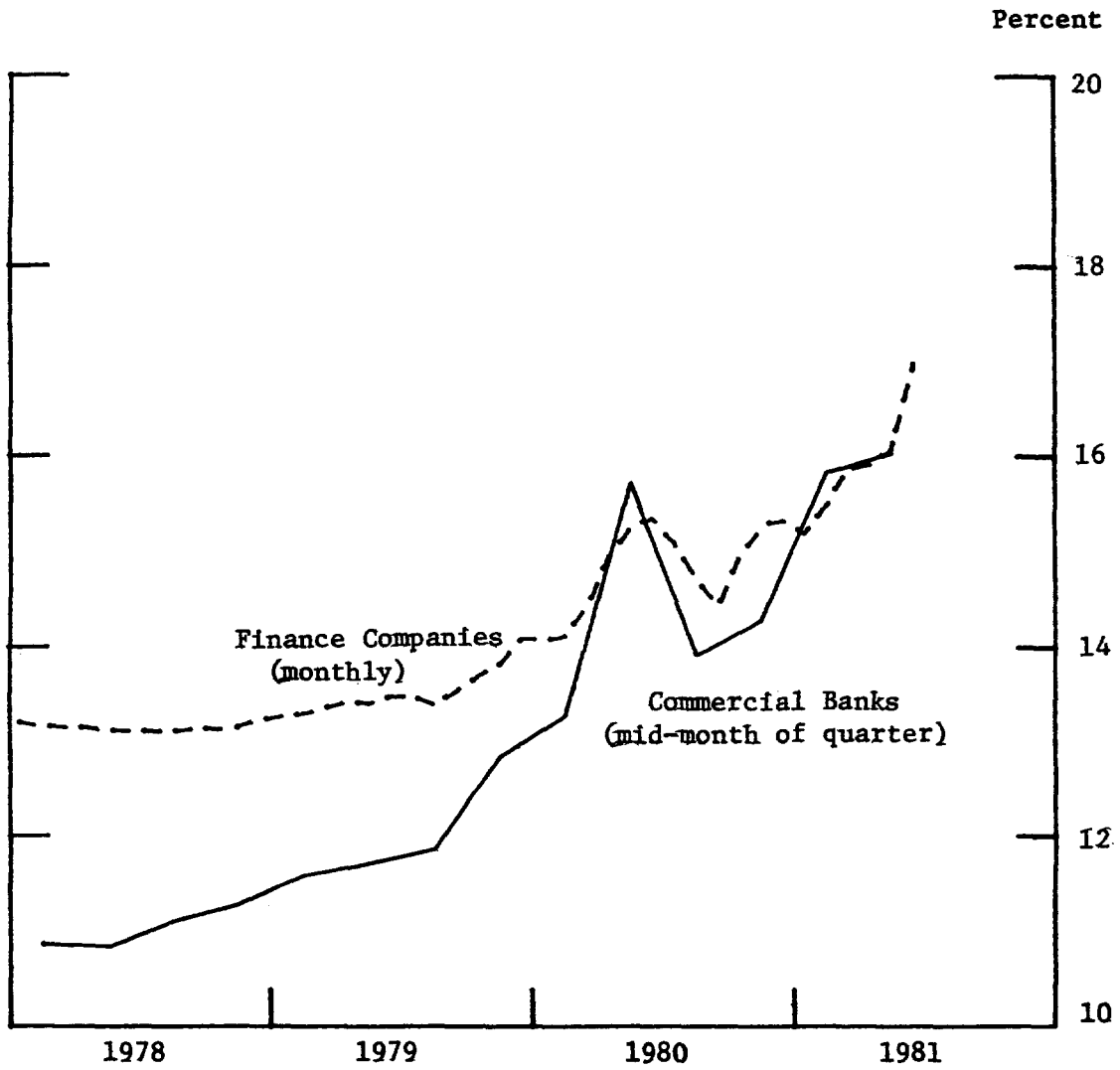
1. Quarterly and monthly dollar figures and related percent changes are at seasonally adjusted annual rates.

typical new-car monthly payments have risen in the interim by more than \$40 (to over \$200), with higher car prices contributing at least three-fourths of the increase and higher interest rates accounting for the rest.

At commercial banks, consumer finance rates also have risen to record levels for all major loan types. In May (latest data available), rates on personal loans averaged 150 basis points above the previous peak in May of last year. Recent actions suggest that consumer rates were still moving up in early August. Citibank, for example, increased rates to 20 percent from 18 percent for both secured installment loans and revolving credit plans, unless the borrower is a "full relationship" customer of the bank.

Personal bankruptcies, which soared during 1980, have leveled off since the fourth quarter. Although the monthly figures have been volatile, and June bankruptcy filings were up substantially from May, the second quarter total (seasonally adjusted) was 2 percent below the 1980-Q4 high.

NEW-CAR FINANCE RATES



Appendix*

MERGER-RELATED LOANS AND THEIR EFFECT ON BUSINESS CREDIT MEASURES

This appendix discusses lines of credit associated with the recent spate of corporate takeovers and corresponding business loan activity. While the aggregate amount of recently announced merger-related lines of credit involving participation by U.S. chartered banking entities is approximately \$41 billion, the effect on domestic bank credit has been relatively small through July.¹ The actual amount of publicly announced loans for these purposes included in the bank credit statistics is estimated to be roughly \$1.8 billion during the first half of the year. In July, loans made by U.S. banking offices against merger-related lines of credit amounted to approximately \$850 million. This included a small portion of the \$6 billion loan to Mobil; just over \$5 billion of the loan was booked at foreign banks or foreign offices of U.S. banks. These merger-related loans, at roughly \$2.6 billion through July, account for about 14 percent of the increase in total business loans made by U.S. banking offices (SA monthly averages of Wednesday data) of approximately \$18.5 billion between December 1980 and July 1981.² Loans for August likely will reflect some portion of the recent \$3.8 billion takedown by DuPont--at least half of which, it is suspected, will be funded by foreign banks, but the final booking of the transaction has not been learned.

Table 1 summarizes major U.S. and Canadian lines of credit associated with recent merger activity. Of the roughly \$41 billion of U.S. lines listed, U.S. banking syndicates (where known) are estimated to account for about one-half of the total credit lines for which information on participation is available. Commitments associated with the bids for Conoco total roughly \$13.5 billion.

To obtain additional information on U.S. bank participation in merger-related credit commitments, Reserve Bank staff talked with loan officers at nine large banks in late July; information on another bank had been collected independently by the New York Bank staff. In the aggregate, the banks contacted indicated a recent increase in their volume of merger-related commitments of more than \$10 billion.³ Although most banks did not expect all the lines to be actually drawn down for merger-related purposes, they indicated that the lines also were available for general corporate purposes. Most banks reported that they would fund any draw-downs through "normal" channels--specifically citing CDs and federal funds--and did not expect to limit credit to other customers. The respondents

* Prepared by Eugenie Mallinson and Thomas Brady, Economists, Banking Section, with contributions from Margaret Pickering, Economist, Capital Markets Section, all of the Division of Research and Statistics.

1. In addition, nearly \$7 billion of Canadian lines are known to have been established recently primarily for foreign takeovers of foreign subsidiaries of U.S. concerns.

2. This share estimate assumes none of these merger-related loans have been repaid.

3. "Recent" was undefined in the survey; the respondents interpreted "recent" to mean "from April 1" to "in the last three weeks."

confirmed substantial foreign participation with estimates of 25 percent to "at least half" being the non-U.S. banks' share. Eight banks indicated that U.S. banking laws limiting the amount of loans made to a single customer did constrain their participation in these large lines of credit.

The commitments provide for loans with maturities on the order of 7 to 12 years. Typically, for the first 4 years of the commitment, loans may be drawn down under a revolving facility--allowing loans outstanding to fluctuate without penalty--after which they convert to term loans. Under most commitments, loans can be drawn down at either prime- or LIBOR-based rates at the option of the borrower.¹ Some of the commitments provide for an increase in the mark-up over the base rate when the term loan provision becomes effective.

Table 2 lists publicly announced loans made through July in connection with large merger-related transactions.² Of the roughly \$5.3 billion of borrowings listed, loans extended for the Fluor-St. Joe merger and for the Mobil bid for Conoco account for about \$3 billion. For the following reasons, it is estimated that only about \$2.6 billion of the \$5.3 billion is included in U.S. commercial bank loan statistics:

- About \$1.25 billion of the Mobil loan reportedly is booked at foreign branches of U.S. banks and is not included in bank credit as usually defined.
- One large New York bank reportedly is booking large loans at nonbank subsidiaries of the holding company parent. In table 2, approximately \$425 million in loans fall in this category.
- One New York investment firm, formed at the beginning of this year, apparently specializes in "leveraged buy-outs" in which the investment firm is the nominal purchaser but the actual transaction is financed by large institutional investors, whose identity generally is not announced. This firm has completed \$750 million of such transactions this year, but the amount of its bank borrowings is unknown.

In a fundamental sense, merger financing should have no significant macroeconomic impact. The transactions do not represent a call on the savings of the economy, since what is involved is the transfer of existing assets. The proceeds from stock sales will be reinvested, with some of these funds finding their way into bank liabilities, thereby providing banks with loanable funds. Funds may also be directed into other fixed-income securities or reinvested in equities, in the process satisfying financing demands that might otherwise be placed on banks.

1. All respondents mentioned commitment fees of 1/4 or 3/8 of a percent on the unused lines; only one requires "some" compensating balances.
 2. One transaction for the buy-back of a company's own common shares from another company was included because of its size and defensive nature.

Many of the mergers that occurred earlier in the year were effected through exchanges of stocks, and do not involve credit markets at all.

In the short-run, however, it is possible that merger-related financing could affect the price and availability of credit. Liquidity and capital considerations could cause those banks extending large sums to finance merger activities to reduce their lending to others. As the proceeds of the stock purchases are invested, temporary imbalances could emerge in some markets. Such imbalances--which would tend to be accompanied by changes in rate relationships--likely would be temporary as asset holders shifted funds to those markets with relatively high yields.

It is also possible that, especially in the short run, the behavior of the monetary aggregates--most likely the broader measures, M2 and M3--could be boosted by the financial flows involved in mergers. To the extent that the Federal Reserve does not accommodate the resulting movements in the aggregates, interest rate pressures could result, with borrowing for other purposes perhaps being crowded out to some small degree.

Table 1

Major Credit Lines Recently Announced
for Nonfinancial Corporate Mergers or
Acquisitions of U.S. Firms
(Billions of dollars)

U.S. bank lines

Borrower	Purpose	Date	Amount	Participation, if known		Lead banks
				U.S.	Non-U.S.	
Fluor ¹	St. Joe merger	May takedown	\$1.0 (or more)	\$1.0	\$n.a.	Morgan
Conoco	defensive	possibly June	3.0	2.4	.6	Bank of America, Chase, Morgan
Mobil ¹	bid for Conoco	July	6.0	2.0	4.0	Citibank
Texaco	initially Conoco; now possibly another takeover	July	5.5	2.8	2.7	Chase
DuPont	bid for Conoco	July	4.0	n.a.	likely	Chase
Seagram ²	bid for Conoco	July	.5	.2 ¹	.3	Citibank
Cities Service	defensive	July	4.0	n.a.	n.a.	Morgan
Marathon	possibly defensive	July	5.0	1.7	3.3	Chase
Pennzoil	possibly acquisition	July	2.5	1.7	.8	Citibank
Gulf	possibly acquisition	July	6.0	n.a.	n.a.	Bankers Trust
U.S. Steel ³	possibly acquisition	July	2.5	n.a.	n.a.	n.a.
Northwest Indus. ⁴	possibly acquisition	August	.5 ^e	n.a.	n.a.	n.a.
Misc. other ¹	mergers	June/July	.5	n.a.	n.a.	n.a.
Total ⁵			\$41.0	\$11.8	\$11.7	

Canadian lines for takeovers of U.S. entities (converted to U.S. dollars)

Canadian Development ¹	Can. oper. of Texasgulf	July	2.1			Montreal, Royal Bank of Canada, Bank of Nova Scotia
Husky Oil	Can. div. of Shell Oil	July	.4	details not available; believed to have only limited U.S.- participation		n.a.
Dome Petroleum Ltd. ¹	Conoco shares	May	1.3			4 Canadian Banks
Nu West Group Ltd.	Cities Serv. shares	possibly June	.2			Toronto-Dominion
Rogers Telecommuni- cations Ltd. ¹	UA Columbia Television	July	.1			Toronto-Dominion Canadian Imperial Bank
Canadian Pacific Ent.	initially U.S. mfr.;- now Can. div. of another U.S. mfr.	n.a.	.3			Bank of Montreal
Husky Oil and Drummond Petroleum ¹	Can. div. of Allied Corp.	June	.4			3 Canadian Banks
Francana Oil and Gas	Adobe shares from Amax	July	.1			Royal Bank of Canada
Total ⁶			4.9			4.9

Other lines for takeover of U.S. entities

Elf Aquitaine		possibly June	1.9	n.a.	n.a.	n.a.
Total lines announced ⁷			\$47.8	\$11.8	\$16.6	

e—estimated.

1. Reported to have been taken down. "Miscellaneous other" includes \$.3 billion taken down.

2. In addition to \$3 billion Eurodollar line arranged in late 1980.

3. Purpose not disclosed, but company had earlier indicated it may acquire another company as part of its overall strategy.

4. Extension of previous line.

5. Includes \$7.5 billion loans reported taken down (\$3.5 U.S. banks, \$4.0 non-U.S. banks). Does not include DuPont takedown of \$3.8 billion on August 5 and 6 because details of transaction are not known.

6. Includes \$3.9 billion reported to have been taken down.

7. Includes \$11.4 billion reported to have been taken down.

Source: Banking Section.

Table 2

Publicly Reported Loans for Mergers, Sell-Offs,
or Buybacks: 1981 U.S. Lender Participation
(Millions of dollars)

Acquiring company	Acquired company	Total value of transaction	Loans			Lead bank	Closing date
			Total	Bank	Nonbank		
Texas International Kohlberg, Kravis Robert and Company ¹	bid for Continental Airlines	pending	\$50	\$50		Man. Hanover	February
Asarco	Forest Products div. of Bendix own shares from Bendix	\$ 425 342	425 150 ^e	n.a. 150 ^e	n.a.	n.a.	January May
Fluor	St. Joe	2,600	1,000	1,000 ²		Morgan	by May 6
Associated Dry Goods	Caldor Incorporated	313	150	partial	partial	Citi. Indus. Cr.	by June 1 by June 16
TCF Holdings	20th Century-Fox Film Corp.	722	550 ³	550 ^e		Man. Hanover	by June 16
Harley Acquisition Group	Harley Davidson sub. of AMF	100	100	partial	partial	Citi. Indus. Cr.	by June 30
Kohlberg, Kravis Robert and Company	Marley Company	325	325	n.a.	n.a.	n.a.	by June 9
Total First Half		4,827	2,750	1,750	n.a.		
M-G-M Seagram	United Artists bid for Conoco	380 pending	250 ⁴ 200	250 200		n.a. Citibank, Man. Han.	July 28 by July 24
Mobil	bid for Conoco	pending	2,000	1,250 ^{e5} 400 ^e	325	Citibank	July 21
Capital Cities Communications	Cablecom-General	n.a.	100	n.a.	n.a.	Chemical, Citibank	by July 20
Total July		380	2,550	2,100	325		
memo: DuPont	Conoco	7,570	3,800	n.a.	n.a.	Chase	August 5

NOTE: The data in this table are drawn from sources generally available to the public and therefore the table does not represent a definitive listing. Reporting of these transactions appears to have improved somewhat since June.
e--estimated.

1. Likely borrower as this firm has announced its intention to acquire at least two other firms in leveraged buy-outs in addition to its two transactions above.
2. Reportedly \$300 million in New York banks, \$700 million other U.S. banks.
3. Reportedly to be reduced with proceeds from joint venture with Aetna Life and Casualty.
4. Reportedly to be substantially repaid with proceeds of sale of 10 million additional shares to a private investor.
5. Represents loans of foreign branches of U.S. banks to U.S. residents, and would not be included in bank credit estimates unless an adjustment is made.

Source: Capital Markets Section and Banking Section.

INTERNATIONAL DEVELOPMENTS

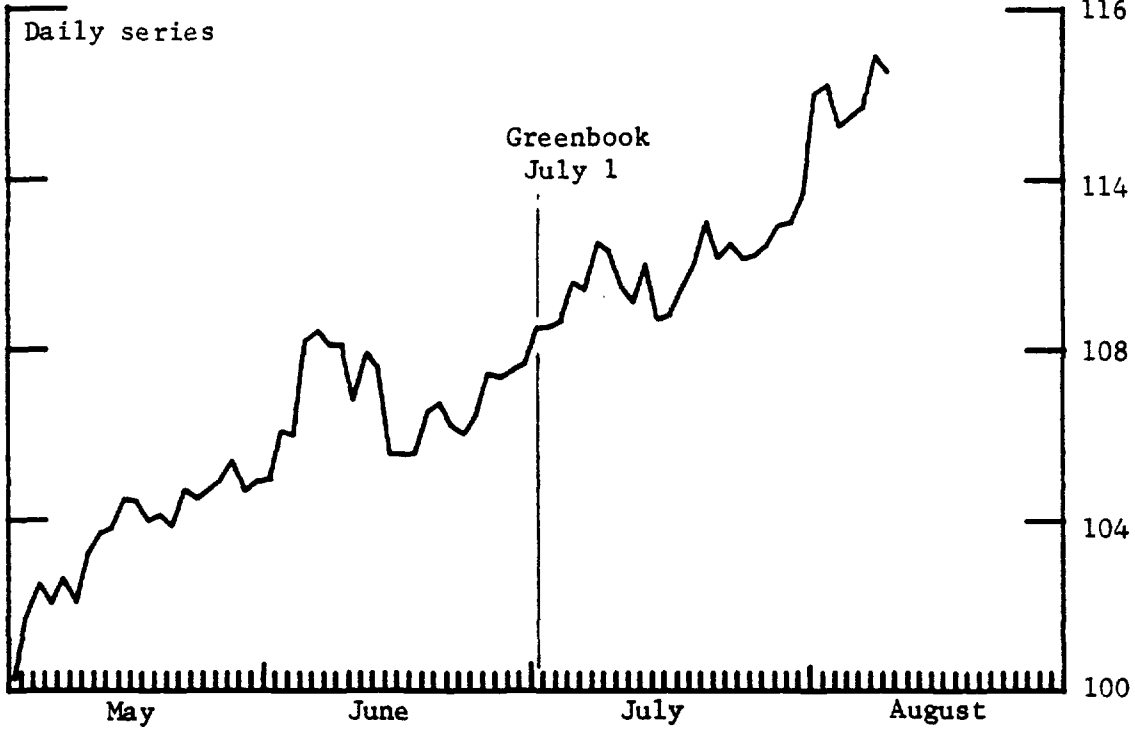
Foreign Exchange Markets

The dollar's weighted-average foreign exchange value has increased by 4-1/2 percent since the time of the last Greenbook at the beginning of July, reaching its highest level in nearly a decade. The dollar has appreciated relative to all major foreign currencies over the past six weeks, rising by about 5 percent against the EMS currencies and the pound and firming by about 2 percent against the yen and Canadian dollar.

The dollar started to move sharply higher in the last week in July and the dollar remained under strong upward pressure on the exchange markets in early August before easing back partially in recent days. This rise was apparently triggered by Congressional action on the President's tax cut proposals which, along with Treasury announcements of heavy borrowing requirements for the remainder of the year, convinced many market participants that U.S. interest rates would remain high. In addition, the inability of a number of European governments to reach political agreement on economic stabilization measures was contrasted unfavorably with the situation in the United States. This market perception of relative instability in Europe was heightened by renewed unrest in Poland.

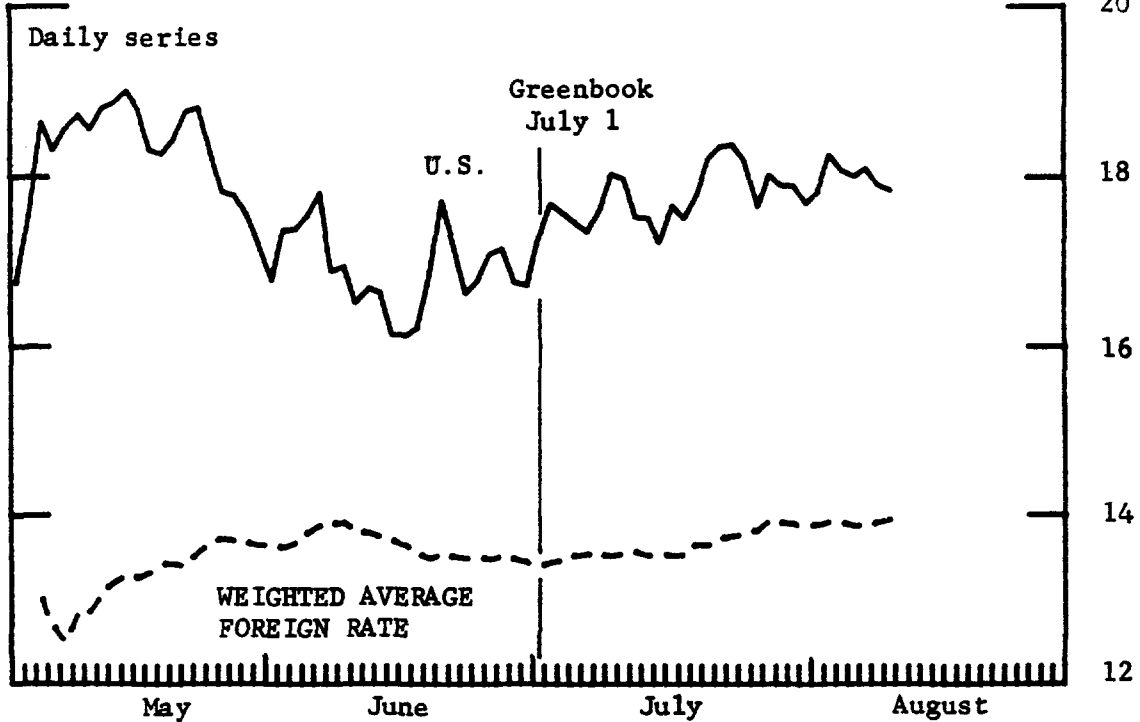
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WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR March 1973=100



SELECTED 3-MONTH INTEREST RATES

Percent per annum



any intervention operations, as it has since the end of March.

. U.K. short-term interest rates have increased by 1-3/4 percentage points over this period. In contrast, Swiss and French interest rates have eased and interest rates in Germany and Japan have remained unchanged. As shown in the chart on the opposite page, average foreign short-term interest rates remain about 4 percentage points below comparable U.S. rates, little changed from the differential that prevailed at the time of the last Greenbook.

Strains within the European Monetary System intensified in the second week of August, with both the French and Belgian francs falling to near their lower limits relative to the mark. The speculative pressure on the French currency which had been touched off by the May elections had abated temporarily after the newly elected Socialist government sharply raised interest rates and tightened exchange controls. However, strong downward pressure on the French franc re-emerged in August because of speculation that the franc would soon be devalued relative to the other EMS currencies.

The further appreciation of the dollar and prospective high U.S. interest rates contributed to a further decline in the dollar price of gold to below the \$400 level. In recent days, gold has recovered to \$412, about 3 percent below its level at the beginning of July.

U.S. International Transactions

U.S. Merchandise Trade. Despite a small dip in the June merchandise trade deficit, the second-quarter deficit was almost \$10 billion greater at an annual rate than in the first quarter. The increase in the second quarter resulted from a 1 percent decline in exports and 2-1/2 percent rise in imports.

A drop in the value of agricultural exports more than accounted for the total second-quarter export change. However, the value of agricultural exports in the first half of this year was well ahead of levels reached last year. Much of the higher level of agricultural

	1980			1 9 8 1		
	Year	4Q	1Q	2Q	May	June
<u>Value (Bil. \$, SAAR)</u>						
<u>Exports</u>	<u>224.0</u>	<u>228.6</u>	<u>244.5</u>	<u>241.5</u>	<u>238.4</u>	<u>239.6</u>
Agricultural	42.2	44.3	50.9	43.4	44.4	40.5
Nonagricultural	181.7	184.3	193.5	198.2	194.0	199.0
<u>Imports</u>	<u>249.3</u>	<u>250.9</u>	<u>262.9</u>	<u>269.5</u>	<u>268.0</u>	<u>265.0</u>
Petroleum	78.9	77.3	83.3	84.9	76.2	84.2
Nonpetroleum	170.4	173.6	179.6	184.6	191.8	180.8
<u>Trade Balance</u>	<u>-25.3</u>	<u>-22.3</u>	<u>-18.4</u>	<u>-27.9</u>	<u>-29.6</u>	<u>-25.4</u>
<u>Volume (Bil. 72\$, SAAR)</u>						
<u>Exports - Agricultural</u>	18.1	17.5	19.5	17.1	17.4	16.2
- Nonagricultural	73.4	71.1	73.2	73.5	71.7	74.0
<u>Imports - Petroleum</u>	6.8	6.2	6.3	6.3	5.7	6.3
Nonpetroleum	67.6	66.8	67.7	70.7	73.7	69.7

*/ International Transactions Basis.

exports early this year resulted from changes in prices; export prices of most agricultural commodities peaked in the first quarter, but by June had returned to, or fallen below, 1980 year-end levels. The quantity of agricultural goods exported in the first half of 1981 was marginally higher than during either half of last year.

The value of nonagricultural exports increased in the second quarter largely because rises in automotive equipment to Canada, and in machinery and civilian aircraft, exceeded declines in exports of more price and cyclically sensitive industrial supplies. The increase in machinery exports continued the steady upward movement that began in 1979 and the increase was widespread among the various types of machinery. The higher values during the past two years resulted largely from rising prices. The rise in civilian aircraft exports reflected primarily an increase in the number of planes delivered to OPEC countries as well as to the United Kingdom, Canada, and Japan. Second-quarter industrial supplies exports dropped back to levels of the second-half 1980 after a moderate increase in the first quarter. The fall-off in coal exports because of the strike accounted for about one-third of the decline. Export declines were also recorded in metals and chemicals.

On the import side, most of the second-quarter rise was in items other than oil, particularly in steel and automotive products from Canada. The rise in steel imports was by far the largest single increase, and was primarily in the volume of pipe products and sheet steel. Average steel import prices changed only marginally between the first and second quarters, rising by less than 1 percent. Automotive imports from Canada are primarily vehicles assembled under the U.S.-Canadian automotive

agreement, and the rise in these imports offset increased second-quarter exports of automotive parts to Canada. The value of foreign car and truck sales was about 4 percent above the first quarter rate. The gradual increase in the value of foreign car imports since the fourth quarter of 1980 is attributable to rising prices; the number of units imported declined in both the first and second quarters of this year. Foreign car sales exceeded imports in the first quarter, resulting in a decline in dealers' inventories, but stocks changed little in the second quarter as sales declined. Partly offsetting the increase in steel and automotive imports were declines in foods (due to lower coffee and sugar prices) and natural gas from Canada.

The small rise in oil imports in the second quarter was accounted for entirely by higher prices. While import prices peaked in April, the average for the quarter was about \$1 per barrel above the first quarter level. The average OPEC price has dropped about 2 percent since the beginning of the year as falling demand has reduced sales by high-price countries. At the same time, the Saudis have maintained a high output rate at lower prices. OPEC has scheduled a meeting for August 19 in Geneva to discuss a possible price/production compromise. The volume of oil imported in the second quarter was down marginally from the first-quarter average rate, with sharp month-to-month fluctuations.

	Oil Imports					
	4Q80	1Q81	2Q81	April 81	May 81	June 81
Volume (mbd, SA)	6.57	6.59	6.53	7.10	5.89	6.48
Price (\$/BBL)	32.25	34.63	35.64	36.16	35.23	35.66
Value (Bil.\$, SAAR)	77.3	83.3	84.9	94.2	76.2	84.2

U.S. International Capital Transactions. The large inflows through banking offices that occurred in late April and May were partially reversed in June and early July, but resumed at a strong rate in late July.

Banking Position Vis-a-vis Own Foreign Offices
(billions of dollars, daily averages, net due to foreign offices = +)

	1 9 8 1				Week Ending	
	Apr.	May	June	July	7/15	7/29
All banks' net positions						
with own foreign offices	-1.4	7.9	4.9	4.9	2.1	10.1
(a) 10 largest U.S.-based banks	-7.6	-3.5	-4.8	-4.4	-5.8	-1.1
(b) All other U.S.-based banks	-13.6	-10.1	-9.4	-9.8	-10.5	-8.6
(c) Foreign-based banks	19.9	21.5	19.1	19.1	18.4	19.8
Memo:						
Credit extended to U.S. nonbank residents by foreign branches of U.S. banks.	7.5	7.1	7.1	7.6	7.2	8.4

SOURCE: Required reserve reports
*/ July figures are through the 29th.

The new inflow in late July also appears to have been related to the take down of a \$6 billion loan by the Mobil Oil Corporation. A large majority of the 22 foreign-based banks and 19 U.S.-based banks that participated in the syndication apparently booked the loans at foreign offices. Loans to U.S. nonbank residents from foreign offices

of U.S. banks increased sharply at the time of the Mobil takedown, as reflected in the daily average figure for the last week of July that is shown in the above table. The proceeds of the loans were apparently placed in overnight Eurodollars, which the U.S. banking offices may then have repatriated.

Total Eurodollar holdings of U.S. nonbanks, which had grown relatively slowly during 1980, have surged during the first five months of this year. As shown in the table below, the \$17 billion increase this year has been evenly divided between holdings of negotiable CDs and holdings of nonnegotiable time deposits. Money market funds and short-term unit investment trusts accounted for about three-quarters of the increase in holdings of CDs. The money market funds continue to hold about 10 percent of their portfolios in these instruments. While the bulk of the total increase has been placed with foreign offices of U.S. banks, the table shows that U.S. nonbank residents have also been increasing their Eurodollar holdings at foreign offices of foreign banks.

Eurodollar Holdings of U.S. Nonbank Residents
(Billions of dollars, end of month)

	1979	1980	1981				
	Dec.	Dec.	Jan.	Feb.	Mar.	Apr.	May
Total	51.3	60.8	65.7	68.0	66.3	74.4	77.7 ^P
Negotiable CDs	20.4	18.0	20.6	22.0	22.4	25.1	26.5 ^P
Time Deposits	30.9	42.8	45.1	46.0	43.9	49.3	51.2 ^P
U.S.-based banks ^{*/}	38.6	47.8	51.8	53.0	50.8	57.5	60.2 ^P
Foreign-based banks ^{*/}	12.7	13.0	13.9	15.0	15.5	16.9	17.5 ^P

SOURCE: FR2502; Unpublished data provided by Bank of England and the Bank of Canada.

^{*/} These figures are based on the assumption that all CDs held by U.S. residents are issued by U.S.-based banks. To the extent that they hold CDs of foreign-based banks the figures for U.S.-based banks are overstated; those for foreign-based banks are understated.

U.S. INTERNATIONAL TRANSACTIONS
IN MILLIONS OF DOLLARS; RECEIPTS, OR INCREASE IN LIABILITIES,+

	1979 Year	1980 Year	1 9 8 0		1 9 8 1					
			QIII	QIV	QI	QII	Apr.	May	June	
1. CHANGE IN NET FOREIGN POSITIONS OF BANKING										
OFFICES IN U.S. (EXCL. LIAB. TO FOREIGN OFF-INST.)	14,697	-29,847	-11,084	-4,410	-10,232	-4,934	5,647	4,303	-14,883	
THROUGH INTERBANK TRANSACTIONS WITH										
A. OWN OFFICES IN FOREIGN COUNTRIES	20,683	-12,803	-2,129	910	-11,557	4,163	6,340	7,883	-10,059	
B. UNAFFILIATED BANKING OFFICES IN FOR. COUNTRIES	3,820	-6,231	-4,366	-2,543	2,098	-7,402	-641	-3,805	-2,956	
THROUGH NONBANK TRANSACTIONS										
A. CLAIMS ON NONBANKS IN FOREIGN COUNTRIES (INC.,-)	-12,130	-11,826	-4,260	-3,708	-975	-3,264	-726	130	-2,668	
B. LIABILITIES TO PRIVATE NONBANKS IN FOREIGN COUNTRIES (INC. CUSTODY LIAB.)	2,324	1,013	-329	931	202	1,569	673	95	800	
2. PRIVATE SECURITIES TRANSACTIONS, NET - EXCL. U.S. TREAS	-3,349	2,547	-579	2,120	1,960	1,737	127	996	614	
A. FOREIGN NET PURCHASES OF U.S. CORP. BONDS	256	1,213	203	358	758	623	214	136	273	
B. FOREIGN NET PURCHASES OF U.S. CORP. STOCKS	1,037	4,264	37	1,883	1,690	2,563	636	1,021	907	
C. U.S. NET PURCHASES(-) OF FOREIGN SECURITIES	-4,641	-2,929	-818	-120	-488	-1,449	-723	-161	-566	
3. FOREIGN NET PURCHASES OF U.S. TREASURY OBLIGATIONS 1/	4,821	2,680	-254	894	1,404	701	-378	513	566	
4. CHANGE IN FOREIGN OFFICIAL RESERVE ASSETS IN U.S.	-13,079	14,879	7,630	7,507	5,617	-3,188	388	-4,947	1,378	
(INCREASE+)										
BY AREA										
A. G-10 COUNTRIES AND SWITZERLAND	21,121	-2,539	1,351	5,525	1,879	-7,956	-843	-6,952	-161	
B. OPEC	6,540	12,116	3,874	737	5,746	2,487	1,846	509	132	
C. ALL OTHER COUNTRIES	1,500	5,303	2,405	1,245	-2,011	2,281	-616	1,496	1,401	
BY TYPE										
D. U.S. TREASURY SECURITIES 2/	-21,636	12,417	4,469	6,911	7,241	-977	1,673	-3,491	841	
E. OTHER 3/	8,557	2,462	3,161	596	-1,624	-2,211	-1,285	-1,456	537	
5. CHANGE IN U.S. RESERVE ASSETS (INCREASE-) 4/	-306	-7,800	-1,051	-3,762	-3,654	828	717	298	-187	
6. TRADE BALANCE 5/	-27,346	-25,312	-2,902	-5,570	-4,602	-6,986	-2,403	-2,467	-2,116	
7. ALL OTHER TRANSACTIONS AND STATISTICAL DISCREPANCY	24,562	42,853	8,240	3,221	9,507	11,842	-4,098	1,304	14,628	
MEMO:										
BIL. \$ SEASONALLY ADJ. ANNUAL RATES										
MERCHANDISE TRADE BALANCE	-27.3	-25.3	-11.6	-22.3	-18.4	-27.9	-28.8	-29.6	-25.4	
CURRENT ACCOUNT BALANCE	1.4	3.7	19.9	5.6	12.3	n.a.	n.a.	n.a.	n.a.	

1/ INCLUDES U.S. TREASURY NOTES PUBLICLY ISSUED TO FOREIGN RESIDENTS TO PRIVATE FOREIGN RESIDENTS.

2/ INCLUDES NON-MARKETABLE AND MARKETABLE SECURITIES.

3/ INCLUDES DEPOSITS IN BANKS, COMMERCIAL PAPER, ACCEPTANCES, & BORROWING UNDER REPURCHASE AGREEMENTS.

4/ INCLUDES NEWLY ALLOCATED SDR'S OF \$1,139 MILLION IN JANUARY 1979; \$1,152 MILLION IN JANUARY 1980; AND \$1,093 MILLION JANUARY 1981.

5/ INTERNATIONAL ACCOUNTS BASIS, SEASONALLY ADJUSTED.

Intervention sales of dollars by foreign countries accelerated in July and the first week of August. OPEC inflows, which had totalled about \$7.5 billion during the first four months of the year, slowed considerably, beginning in May. In the May-July period they are estimated to have totalled only \$1.1 billion. The reduction in OPEC inflows is partly a result of the sharp decline in the OPEC current account surplus, which began in late 1980. In addition, large reductions in Libyan holdings were apparently related to the expulsion of its diplomats from the United States in May. As a whole, foreign reserve assets in the United States increased \$1.4 billion in June and decreased as estimated \$2.6 billion in July.

Foreign Economic Developments. Economic activity has continued to be weak in the major foreign industrial economies. Although Japan and Germany experienced fairly strong real GNP growth in the first quarter of 1981, preliminary indications are that activity moderated considerably in the second quarter. Latest production data for France indicate further weakness in the second quarter following a decline in real GDP of some 4 percent (s.a.a.r.) in the first quarter. It appears that economic activity in the United Kingdom has stopped declining, but there are few signs of an upturn in activity. In Canada, which has experienced rather buoyant GNP growth in recent quarters, there are some signs of a weakening in economic activity.

In France and Japan wholesale price inflation increased in the second quarter, while in Germany wholesale price inflation declined in the second quarter from the high rate recorded in the first quarter of this year. Except for the United Kingdom, there was little change in the rate of increase of consumer prices in the major foreign industrial countries in the second quarter. U.K. inflation rates were increased substantially by changes in various indirect taxes and public charges.

During the course of the first half of this year, there has been a strengthening of the trade balances for the three largest foreign industrial economies: Japan, Germany, and France. The Canadian trade surplus, reflecting in part the relatively strong rate of growth of Canadian demand, declined in the second quarter.

Macroeconomic policy generally has remained restrictive in the major foreign industrial countries, with emphasis being placed on reducing price inflation. Recently, the German government began the process of cutting back on its spending and borrowing plans for 1982. A notable exception to this general pattern is in France, where the new government has switched to expansionary fiscal and monetary policy intended to reduce unemployment.

Individual Country Notes. In Japan, economic growth continued to be sluggish. Industrial production (s.a.) revived in June from its sharp May decline, but the second-quarter average was below that of the preceding quarter and only slightly above that of a year ago. Growth in personal consumption has picked up, but full-scale revival of demand in that sector has not yet materialized. Plant and equipment investment in large companies remains fairly robust, but in smaller firms it has been sluggish, and housing investment continues to be weak. The main sources of demand strength appear to be public works expenditure and exports.

The price situation in Japan continues to be favorable, but there is concern over the effect of recent weakness in the yen on domestic prices. The WPI moved upward again in July, for the fourth consecutive month following several months of decline earlier in the year. Since March the WPI has been advancing at about a 6-1/2 percent annual rate. Consumer prices fell in July, making the rate of advance of the CPI between the 3-month period ending in April and July about 4-1/2 percent (a.r.).

The current-account surplus widened in June to about \$900 million (s.a.) bringing the total surplus for the first half to about \$1.3 billion.

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

		1978	1979	1980	1979	1980				1981		1981			
					Q4	Q1	Q2	Q3	Q4	Q1	Q2	Mar.	Apr.	May	June
Canada:	GNP	3.4	2.6	0.6	0.5	-0.2	-1.0	0.2	2.3	1.0	n.a.	*	*	*	*
	IP	5.3	2.1	-1.5	-0.5	-0.6	-2.5	-0.1	2.3	0.6	n.a.	1.6	0.9	-0.1	n.a.
France:	GDP	4.0	3.7	1.6	0.4	0.3	-0.4	0.3	-0.2	-1.0	n.a.	*	*	*	*
	IP	1.9	4.7	-1.1	-2.2	0.5	-1.7	-0.5	-2.0	-4.4	n.a.	4.1	-2.4	-0.8	n.a.
Germany:	GNP	3.6	4.5	1.8	0.8	2.1	-2.1	0.0	-0.5	0.7	n.a.	*	*	*	*
	IP	2.0	5.3	-0.1	0.3	0.9	-2.4	-1.5	-1.8	2.2	-0.3	-3.6	0.9	0.9	-3.6
Italy:	GDP	2.6	5.0	4.0	4.0	2.1	-0.9	-2.7	2.0	0.3	n.a.	*	*	*	*
	IP	1.9	6.7	5.5	8.4	4.2	-2.7	-7.6	5.3	0.5	-2.4	-1.4	-0.1	-5.8	0.1
Japan:	GNP	6.0	5.9	5.5	1.1	1.8	0.8	1.5	0.5	1.1	n.a.	*	*	*	*
	IP	6.2	8.3	7.1	2.6	4.1	0.2	-2.3	1.6	1.7	-0.6	-0.7	0.3	-1.8	2.0
United Kingdom:	GDP	2.8	1.5	-1.9	1.6	-0.9	-1.4	-1.5	-0.7	-0.4	n.a.	*	*	*	*
	IP	3.6	2.7	-6.7	-0.1	-2.3	-3.0	-3.1	-2.7	-1.5	-0.3	-0.2	-0.4	-0.6	1.3
United States:	GNP	4.8	3.2	-0.2	0.2	0.8	-2.6	0.6	0.9	2.1	-0.5	*	*	*	*
	IP	5.8	4.4	-3.6	-0.1	0.0	-5.2	-1.7	4.9	1.8	0.5	0.5	0.0	0.4	-0.1

* GNP data are not published on monthly basis.

CONSUMER AND WHOLESALE PRICES IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change from preceding period)

												MEMO:
	1980				1981		1981					Latest 3 Months from Year Ago
	Q1	Q2	Q3	Q4	Q1	Q2	Mar.	Apr.	May	June	July	
Canada: CPI	2.2	2.8	2.8	2.8	3.2	3.1	1.3	0.7	0.9	1.5	n.a.	12.6
WPI	4.9	1.1	2.8	3.2	2.4	2.3	1.0	0.7	1.8	-0.8	n.a.	11.2
France: CPI	3.8	3.1	3.2	2.8	3.0	3.3	1.0	1.4	0.9	1.0	n.a.	12.8
WPI	3.1	0.8	0.6	3.4	1.5	4.2	0.9	1.9	1.3	1.3	n.a.	10.0
Germany: CPI	1.9	1.8	0.7	0.8	2.2	1.8	0.7	0.7	0.4	0.5	0.4	5.6
WPI	3.8	1.7	-0.2	0.7	3.9	2.3	1.7	0.6	0.1	0.2	0.7	6.8
Italy: CPI	6.5	3.9	4.2	5.3	5.0	4.8	0.8	2.9	0.5	0.9	0.9	20.3
WPI	6.6	3.6	2.2	3.8	5.0	5.1	1.6	1.7	2.0	1.0	n.a.	17.1
Japan: CPI	2.0	3.0	1.1	1.2	1.3	1.3	0.6	0.3	0.8	0.0	-0.3	4.7
WPI	6.4	4.8	0.7	-0.7	-0.7	1.1	0.0	0.5	0.8	0.4	0.4	0.9
United Kingdom: CPI	4.7	5.8	2.2	1.9	2.4	4.9	1.5	2.9	0.7	0.6	n.a.	11.7
WPI	5.3	4.0	2.3	1.2	3.0	3.3	1.5	1.3	0.6	0.8	0.5	9.9
United States: CPI(SA)	3.9	3.1	1.9	3.1	2.6	1.8	0.6	0.4	0.7	0.7	n.a.	9.7
WPI(SA)	3.9	2.5	3.3	2.1	2.5	2.1	0.9	0.8	0.4	0.6	n.a.	10.4

TRADE AND CURRENT-ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES^a
(Billions of U.S. dollars; seasonally adjusted)

	1979	1980	1979	1980					1981				
			Q4	Q1	Q2	Q3	Q4	Q1	Q2	Apr.	May	June	
Canada: Trade	3.4	6.7	1.3	1.4	0.9	2.0	2.4	1.5	0.9	0.0	0.4	0.5	
Current Account	-4.2	-1.6	-0.8	-0.8	-1.0	-0.2	0.3	-0.9	n.a.	*	*	*	
France: Trade ^b	-2.4	-14.2	-1.3	-3.5	-3.6	-4.0	-3.2	-2.7	-2.1	-0.4	-0.6	-1.0	
Current Account ^b	1.1	-7.9	-0.4	-2.6	-1.2	-2.1	-2.0	-2.1	n.a.	*	*	*	
Germany: Trade	12.3	4.9	1.7	1.7	1.2	1.1	0.9	0.2	n.a.	1.2	0.9	n.a.	
Current Account (NSA)	-5.3	-16.0	-1.3	-2.9	-3.8	-7.1	-2.3	-4.4	-2.3	0.0	-0.7	-1.6	
Italy: Trade	-5.2	-22.6	-3.4	-4.1	-4.4	-8.6	-5.5	-4.5	-4.8	-1.6	-1.8	-1.4	
Current Account (NSA)	5.5	-9.8	-0.3	-4.4	-1.5	-1.0	-2.9	n.a.	n.a.	*	*	*	
Japan: Trade ^b	1.8	2.1	-1.6	-1.9	-0.9	1.7	2.8	3.4	5.5	1.9	1.4	2.2	
Current Account	-8.8	-10.4	-4.3	-5.1	-4.1	-1.6	0.4	-0.7	2.0	0.8	0.3	0.9	
United Kingdom: Trade	-7.4	2.9	-1.7	-0.9	-0.7	1.5	3.0	n.a.	n.a.	n.a.	n.a.	n.a.	
Current Account ^b	-3.4	6.5	-1.2	0.2	-0.2	2.1	4.5	n.a.	n.a.	n.a.	n.a.	n.a.	
United States: Trade	-27.3	-25.3	-8.4	-10.1	-6.7	-2.9	-5.6	-4.6	-7.0	-2.4	-2.5	-2.1	
Current Account	1.4	3.7	-0.2	-2.1	-0.5	5.0	1.4	3.1	n.a.	*	*	*	

a The current account includes goods, services, and private and official transfers.

b Quarterly data are subject to revision and are not consistent with annual data.

* Comparable monthly current account data are not published.

Deterioration in the services account in June was more than offset by a sharp decline in imports, related mainly to weaker activity in the domestic economy.

Both long-term and short-term interest rates in Japan rose somewhat in June, partly under the influence of increased U.S. rates, causing difficulties for the issuance of new government debt to the financial syndicate. The July issue was cancelled. In mid-July the Bank of Japan announced its projection of 9-10 percent year-over-year M2 growth for the third quarter, well above the second-quarter's roughly 7-3/4 percent rate.

After unexpectedly strong real GNP growth in Germany in the first quarter, preliminary indications point to a flat second quarter. Industrial production, which by May was about 6 percent above its low point at the end of last year, fell by nearly 4 percent in June. The rate of unemployment continued its steady climb in July, when it reached 5.6 percent (s.a.) a level exceeding the peak of the unemployment rate in the 1975 recession. With the overall situation thus continuing to be weak, there have been two sources of relative strength: the volume of exports rose by over 5 percent, while imports have grown more slowly. Second, government consumption has been much higher than anticipated, growing by 5 percent in the first quarter.

The rate of consumer price inflation has been just below 5 percent annual rate for the last 3 months including July. The June current-account deficit of \$1.6 billion has pushed the cumulative 1981 deficit to \$6.7 billion, well above the comparable 1980 result. However, the cumulative trade balance this year has significantly improved over last year's result.

In June the growth of Central Bank Money, the Bundesbank's target variable, continued to grow in the middle of the 4 to 7 percent target range. The Bundesbank recently has announced its intention to slow CBM growth toward the lower part of its target range.

With monetary policy on a restrictive course, the fiscal sector has so far been more expansionary than anticipated, with the growth of federal spending expected to reach 7 percent this year as opposed to the originally planned 4 percent. This will mean net federal borrowing this year of at least DM 34 billion as opposed to the DM 27 billion originally planned. In order to trim back an anticipated further rise of this figure to over DM 40 billion next year, the government is currently undertaking a major effort to control its 1982 budget. So far, the Finance Minister has proposed cuts of DM 14 billion (almost 1 percent of nominal GNP). Details are not yet known except that growth in defense spending will be limited to 4.2 percent in nominal terms -- a cut of about 1 percent in real terms. (The budget process for 1982 is in its beginning stage. The coalition government's official budget submission will take place in September.)

French industrial production in April and May averaged nearly 3/4 of a percent below the previous quarter and was over 8 percent below the figure for a year ago. Recent surveys indicate little if any improvement since May. In a June survey, demand indicators seemed to have shown a slight deterioration from the previous two months; however, foreign demand in some areas showed improvement. The same survey indicated that private real investment in 1981 may fall by 12 percent. Consumer demand for industrial products in June reached its highest level since January, and for the second quarter was about 1-1/2 percent above the first quarter.

In the second quarter, consumer price inflation accelerated to 14 percent (a.r.) from 12-1/2 percent the previous quarter and from an average 13-1/2 percent in 1980. Wholesale prices accelerated in the second quarter as well. For the first half of 1981 the French trade deficit was under \$10 billion (s.a.a.r.) compared with a deficit of over \$14 billion last year. In June the trade deficit increased to about \$1 billion which was below the January deficit but above those recorded in the interceding months.

In the 5 months to May of this year, M2 has grown by roughly 18 percent (s.a.a.r.). Last year's growth and the previous government's target for this year (not yet officially renounced or replaced by the present government) were 10 percent. The relaxation of the credit controls announced in June is to be broadened and extended through August. The Bank of France has continued to lower the various rates at which it provides refinancing to the banking system and market interest rates have fallen. Preliminary announcements indicate that the 1982 budget deficit will be around FF 100 billion (2-1/2 percent of GDP) compared with a forecast deficit of FF 70 billion (2 percent of GDP) for 1981.

The Socialist government has announced that a nationalization bill covering industrial companies and banks without significant foreign ownership will be presented by September 15, to be voted on by October 4.

In the United Kingdom, according to preliminary data, real personal consumption expenditures fell about 1-1/2 percent (s.a.) between the first and second quarters of 1981. Nevertheless, personal consumption so far this year is still 1 percent (s.a.) greater than it was in the second half of 1980; the decline recorded this year in real personal disposable

income has been offset by a lowering of the personal saving rate. Industrial production rose nearly 1-1/2 percent (s.a.) in June 1981. So far this year the industrial production index essentially has been flat at a level about 3 percent (s.a.) below that prevailing in the second half of 1980. The rapid rundown in inventories that took place last year continued in the first quarter, but at a rate somewhat less than the extraordinarily high rate recorded in the final quarter of 1980.

The recent weakness of the pound sterling has led to an increase in the rate of growth of wholesale prices -- particularly those for inputs purchased by manufacturing industry, which rose 1-1/2 percent in June and 25 percent (a.r.) in the 6-month period ending in June -- but has not yet had a perceptible impact on consumer prices. In the 6 months to May 1981, average earnings rose 8 percent (s.a.a.r.) while consumer prices increased 15 percent (a.r.), which implies a sharp fall in real wages so far this year. Of the 15 percent (a.r.) increase in consumer prices recorded so far this year (December 1980 to June 1981), perhaps 5 percentage points can be attributed to increases in various indirect taxes and public charges in March and April. In reaction to the weakness of sterling -- particularly its weakness against the dollar -- and the acceleration of inflation in recent months, the Bank of England has taken steps to raise U.K. interest rates.

On August 5, the Bank of England announced some changes in its system of monetary control. The changes, which have been discussed publicly for several months, are intended to allow the market more scope in the determination of interest rates. As of August 20, the Bank's Minimum Lending Rate will no longer be published regularly and the Bank primarily will use open market operations to keep short-term interest

rates within an unpublished band. In addition, the liquid-asset-ratio requirement will be abolished and the required cash-reserve ratio will be lowered from 1-1/2 percent to 1/2 percent and extended to include all U.K. banks. As a part of the changes in the monetary system, the statistical coverage of the U.K. monetary aggregates will be enlarged, resulting in an expected once-and-for-all increase of some £8 billion in sterling M3 (13 percent). The Bank of England also has extended the list of "eligible" banks to include some foreign banks. The acceptances of an eligible bank are eligible for discount at the Bank of England; in return for this privilege, each eligible bank must have a certain amount of funds on deposit with the London discount houses and/or similar institutions.

Real growth in Canada appears to have slowed in the second quarter of this year. Industrial production (s.a.) fell slightly in May after rising about 1-1/2 percent and 1 percent in March and April, respectively. Unemployment in June rose to 7.3 percent from 7.1 percent in May and 7.0 percent in April. There was little change in Canadian inflation rates in the second quarter. The Canadian trade surplus for the second quarter was almost \$900 million (s.a.), down from \$1.5 billion in the first quarter.

The Canadian dollar has weakened markedly against the U.S. dollar. In response to this depreciation of the Canadian dollar, the Bank of Canada has raised short-term interest rates in recent weeks, and on July 29, Deputy Prime Minister and Finance Minister Allan MacEachen announced that he had requested Canadian banks and a number of major foreign banks to reduce substantially the amount of their lending in which the proceeds

are converted to foreign currency and used to finance takeovers. The government believes that such transactions have contributed to the recent downward pressure on the exchange value of the Canadian dollar. Mr. MacEachen also gave his assurance that the Canadian government has no intention of imposing mandatory foreign exchange controls.

In Italy, some signs of economic weakness have appeared in recent months. After declining slightly in April, industrial production fell by almost 6 percent (s.a.) in May to a level about 3 percent below that of May 1980. A leading indicator series was negative in April for the first time since last fall, while business surveys in May showed a sharp deterioration in orders and expected production levels. Consumer prices in June and July rose by almost 1 percent (n.s.a.); during the 3-month period ending in July, consumer prices rose by 15 percent (a.r.) over the preceding 3 months. In June the trade deficit narrowed to about \$1.4 billion compared with \$1.8 billion in May. June's deficit was smaller in part as a result of the imposition in late May of a 30 percent prior deposit requirement on imports.

The new Spadolini government approved proposals to reduce the public sector deficit that has been running over 30 percent above the target set last fall. More than half of the \$6-1/2 billion cut in spending during 1981 was achieved by deferring planned projects. Since capital spending is often delayed by bureaucratic inefficiency, these cuts may not result in a deficit lower than would have otherwise occurred. Another recent development was an accord reached between the Treasury and the Bank of Italy, in which the Bank will no longer be obligated to

absorb Treasury paper not purchased by the market. In view of the large volume of Treasury debt to be rolled over and the continuing large budget deficits, it is unclear how independent monetary policy will be notwithstanding this accord.

In the Benelux countries preliminary data indicate that real economic activity has not yet begun to recover. In the Netherlands industrial production (s.a.) fell again in May and has been below its May 1980 peak level for a full year. The unemployment rate rose further (s.a.) in June, to 8.8 percent from 8.6 percent in May. Belgian unemployment rose as well, to 9.2 percent (n.s.a.) in June, and is now 2 percentage points above its level of June 1980. The Dutch consumer price index for the second quarter was 6-1/2 percent above its year earlier level, approximately the same increase as that experienced in the first quarter. Belgian inflation appears to have accelerated again in July. The consumer price index in that month was 8 percent above its year-earlier level, the largest such increase since 1977. The reduced level of domestic activity has had an effect on the Dutch external sector. Through May of this year the trade account was approximately in balance, in contrast to a deficit of \$500 million for the first five months of last year.

Sweden's trade balance has gone from a deficit of \$1.3 billion in the second half of 1980 to a surplus of \$400 million in the first half of this year. This positive swing in the trade balance is attributable in part to a weakening in Swedish economic activity.