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August 12, 1987

# RECENT DEVELOPMENTS

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

## TABLE OF CONTENTS

DOMESTIC FINANCIAL DEVELOPMENTS III



Tables



Charts



INTERNATIONAL DEVELOPMENTS IV



Tables



Charts

Economic activity appears to have expanded moderately in recent months. Labor demand has been strong, and the unemployment rate has declined further. The industrial sector appears to be benefiting from increased international competitiveness; moreover, improving shipments and orders trends in manufacturing, outside of autos, are providing some impetus to domestic equipment spending. However, growth of real personal income has remained weak, and consumer spending rather sluggish. On the whole, the consumer and producer price indexes have registered less rapid increases in the past couple of months, despite adverse movements in food and energy prices, and wage trends have been stable.

Employment and Unemployment

The July household and establishment surveys both confirmed a continued strong trend in employment growth. Moreover, contrary to the general expectation, the June drop in the unemployment rate not only held up, but was extended by another tenth of a percent last month.

According to the establishment survey, nonfarm payroll employment rose about 300,000 in July, with job gains widespread by industry. In manufacturing, the number of factory jobs was up 70,000 last month despite a decline of nearly 40,000 in the automobile industry, where model changeovers and production cuts led to some temporary layoffs. The pickup in manufacturing employment followed several months of small increases and has brought the number of factory jobs back to the level of early 1986. In the service-producing sector, employment growth showed renewed vigor. Employment in finance and services rose 100,000 in July, close to the

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

| | 1986 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 June | 1987 July |
|---|---|---|---|---|---|---|
| | --Average monthly changes-- | | | | | |
| Nonfarm payroll employment[2] | 159 | 176 | 254 | 161 | 103 | 304 |
| Strike adjusted | 159 | 174 | 241 | 162 | 103 | 311 |
| Manufacturing | -14 | 12 | 8 | 11 | 10 | 70 |
| Durable | -17 | -2 | 0 | 1 | 4 | 15 |
| Nondurable | 4 | 14 | 8 | 10 | 6 | 55 |
| Construction | 13 | -4 | 32 | -7 | 11 | -1 |
| Trade | 31 | 19 | 57 | 32 | 17 | 71 |
| Finance and services | 110 | 101 | 124 | 93 | 45 | 101 |
| Total government | 30 | 42 | 18 | 22 | 11 | 65 |
| Private nonfarm production workers | 105 | 106 | 199 | 100 | 74 | 193 |
| Manufacturing production workers | -7 | 18 | 6 | 14 | 21 | 61 |
| Total employment[3] | 174[e] | 217 | 244 | 296 | -190 | 470 |
| Nonagricultural | 174[e] | 210 | 203 | 332 | -33 | 429 |

1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments. Strike-adjusted data noted.
3. Survey of households.
e--Adjusted by Board staff to eliminate distortions caused by the introduction of revised population estimates.

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

| | 1986 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 June | 1987 July |
|---|---|---|---|---|---|---|
| Civilian, 16 years and older | 7.0 | 6.9 | 6.7 | 6.2 | 6.1 | 6.0 |
| Teenagers | 18.3 | 17.8 | 17.9 | 17.0 | 15.9 | 15.5 |
| 20-24 years old | 10.7 | 10.5 | 10.4 | 10.1 | 10.2 | 9.8 |
| Men, 25 years and older | 5.4 | 5.4 | 5.2 | 4.8 | 4.7 | 4.7 |
| Women, 25 years and older | 5.5 | 5.3 | 5.1 | 4.6 | 4.4 | 4.7 |
| White | 6.0 | 6.0 | 5.7 | 5.3 | 5.2 | 5.1 |
| Black | 14.5 | 14.1 | 14.2 | 13.2 | 12.7 | 12.6 |
| Fulltime workers | 6.6 | 6.5 | 6.3 | 5.9 | 5.9 | 5.7 |
| Memo: | | | | | | |
| Total national[1] | 6.9 | 6.7 | 6.6 | 6.1 | 6.0 | 5.9 |

1. Includes resident Armed Forces as employed.

average monthly gain over the first half of this year, and hiring at trade establishments picked up in July from its sluggish pace in May and June.

Recent gains in employment as measured by the household survey have been larger than those seen in the establishment survey, averaging 340,000 per month over the last four months. In addition, the unemployment rate has dropped sharply in recent months and, at 6.0 percent among civilians, now stands 0.7 percentage point below last December's level. Jobless rates have fallen substantially for almost all demographic groups. While the drop in the unemployment rate has been surprisingly sharp, given available estimates of output growth, the tenor of anecdotal evidence suggests that a significant tightening of labor markets has been occurring.

Industrial Production

Industrial production appears to have posted a sizable gain in July. The July payroll report showed increased labor input across a broad range of manufacturing industries. In addition, production of raw steel rose 9-1/2 percent in July, truck assemblies were up more than 7 percent, and oil and gas drilling advanced. These gains were only partly offset by a further decline in auto production--to a 6.7 million unit annual rate. Overall, a number of industries--such as steel, machinery, chemicals, textiles, and paper--likely have been benefiting in recent months from developments in the external sector and increased demand for capital equipment.

Personal Income and Consumption

Nominal personal income picked up somewhat in the first half of 1987, rising about 7 percent at an annual rate. Wages and salaries

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

| | 1987 | | 1987 | | |
|---|---|---|---|---|---|
| | Q1 | Q2 | Apr. | May | June |
| | --Annual rate-- | | ---Monthly rate--- | | |
| Total Index | 3.4 | 2.6 | .0 | .5 | .2 |
| Products | 3.6 | 1.3 | -.5 | .6 | -.1 |
| Final products | 4.3 | 1.0 | -.5 | .6 | -.1 |
| Consumer goods | 4.6 | -.7 | -.7 | .6 | -.1 |
| Durable consumer goods | 8.6 | -8.2 | -2.6 | 1.3 | -1.0 |
| Nondurable consumer goods | 3.3 | 1.9 | .0 | .3 | .2 |
| Equipment | 3.9 | 3.0 | -.2 | .6 | .0 |
| Business | 4.7 | 3.1 | -.2 | .6 | -.1 |
| Defense and space | 2.2 | 2.1 | .0 | .3 | .3 |
| Oil and gas drilling | 3.2 | 16.8 | -1.4 | 4.1 | 2.1 |
| Intermediate products | 1.5 | 2.2 | -.4 | .8 | -.1 |
| Construction supplies | 4.4 | -3.0 | -1.0 | .6 | -.6 |
| Materials | 3.1 | 4.7 | .6 | .4 | .7 |
| Durable goods | 4.1 | 2.7 | .3 | -.4 | .5 |
| Nondurable goods | 5.3 | 9.7 | 1.6 | .9 | .6 |
| Energy materials | -1.2 | 3.5 | .2 | 1.7 | 1.1 |

Note: Data for July, together with any revisions for the three preceding months, will be released Friday, August 14 and will be included in the Supplement to the Greenbook.

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

| | 1967-86 | 1984 | 1987 | | |
|---|---|---|---|---|---|
| | Avg. | High | Q1 | Q2 | June |
| Total industry | 81.5 | 81.8 | 79.6 | 79.6 | 79.7 |
| Manufacturing | 80.6 | 81.3 | 80.2 | 80.1 | 80.1 |
| Durable | 78.6 | 79.8 | 76.9 | 76.6 | 76.6 |
| Nondurable | 83.5 | 84.3 | 85.1 | 85.4 | 85.3 |
| Mining | 87.1 | 86.6 | 73.6 | 74.3 | 74.9 |
| Utilities | 87.5 | 85.8 | 79.0 | 79.3 | 80.4 |
| Industrial materials | 82.3 | 82.9 | 78.7 | 79.3 | 79.7 |
| Metal materials | 77.8 | 70.8 | 67.0 | 69.0 | 69.7 |
| Paper materials | 91.6 | 98.6 | 96.9 | 96.7 | 97.0 |
| Chemical materials | 80.8 | 78.5 | 84.1 | 85.8 | 86.3 |

PERSONAL INCOME
(Average monthly change; billions of dollars)

| | 1986 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Apr. | 1987 May | 1987 June |
|---|---|---|---|---|---|---|---|
| Total personal income | 14.2 | 15.2 | 23.5 | 15.9 | 16.9 | 17.5 | 13.2 |
| Wages and salaries | 7.5 | 10.0 | 12.9 | 9.2 | 8.4 | 11.1 | 8.0 |
| Private | 5.6 | 8.0 | 10.1 | 7.2 | 6.5 | 9.0 | 6.0 |
| Other labor income | .7 | .7 | .8 | .7 | 2.6 | -1.0 | .6 |
| Proprietors' income | 2.6 | 2.9 | 6.7 | .2 | .2 | -4.5 | 4.8 |
| Farm | .5 | 1.5 | 3.5 | -1.4 | -.7 | -6.5 | 2.9 |
| Rent, dividends and interest | 1.7 | .8 | 2.7 | 3.8 | 3.1 | 4.4 | 3.9 |
| Transfer payments | 2.5 | 1.3 | 2.1 | 2.5 | 3.0 | 8.3 | -3.7 |
| Less: Personal contributions for social insurance | .8 | .6 | 1.7 | .5 | .4 | .6 | .5 |
| Less: Personal tax and nontax payments | 3.2 | 7.2 | -1.2 | 7.1 | 96.3 | -92.0 | 16.9 |
| Equals: Disposable personal income | 11.0 | 7.9 | 24.7 | 8.8 | -79.4 | 109.5 | -3.7 |
| Memo: Real disposable income | 6.3 | 3.2 | 6.1 | -3.4 | -75.4 | 79.4 | -14.2[e] |

e--Staff estimate.

PERSONAL CONSUMPTION EXPENDITURES
(Percent change from preceding period in constant dollars)

| | 1986[1] | 1987 Q1 | 1987 Q2 | 1987 Apr. | 1987 May | 1987 June[2] |
|---|---|---|---|---|---|---|
| | ----Annual rate---- | | | ----Monthly rate---- | | |
| Personal consumption expenditures | 4.1 | -.7 | 2.1 | .5 | -.6 | .3 |
| Durable goods | 12.4 | -21.2 | 11.4 | 2.4 | -1.9 | 2.0 |
| Excluding motor vehicles | 12.7 | -3.8 | 3.7 | 1.1 | .5 | -.1 |
| Nondurable goods | 2.9 | 1.3 | -4.3 | -.1 | -.9 | -1.0 |
| Food | 1.0 | 3.2 | -7.5 | -.2 | -1.3 | -1.0 |
| Clothing and shoes | 5.5 | 5.2 | -11.7 | -2.9 | -.1 | -.1 |
| Services | 2.4 | 5.4 | 4.0 | .4 | -.1 | .6 |
| Memo: | | | | | | |
| Personal saving rate (percent) | 4.3 | 4.4 | 3.2 | 1.1 | 4.6 | 3.9 |

1. Percent change from fourth quarter of 1985 to fourth quarter of 1986.
2. Staff estimate.

were supported by sizable gains in employment, and interest and nonfarm proprietors' income moved up. In addition, the level of farm proprietors' income was about $50 billion at an annual rate, nearly $15 billion above the 1986 average. Real income gains, however, remained small as the acceleration in consumer prices erased much of the nominal gain; after adjustment for inflation, disposable personal income rose only about 1 percent over the first six months of the year.

Consumer spending remained relatively sluggish in the second quarter. Real personal consumption expenditures increased roughly 2 percent, about half the recorded amount during the 1984-86 period. Spending on services expanded at a robust pace in the second quarter, reflecting strong gains in most major categories. In addition, outlays for motor vehicles rebounded some from the sharp first-quarter decline. Purchases of other goods were down, with large declines in real purchases of food and apparel. Although the severity of the spending decline for these items appears somewhat questionable, demand for clothing and shoes may indeed have been damped by large increases in prices.

Consumers spent an historically large proportion of current disposable income in the second quarter, as the saving rate fell to 3.2 percent, from an upward-revised level of 4.4 percent in the first quarter. The sharp drop in the saving rate in the second quarter is partly attributable to the extraordinary one-time tax payments in April. The average saving rate in May and June--after the April bulge in tax payments--was about 4-1/4 percent, close to the average for 1986 as a whole. Nonetheless, the saving rate in recent quarters has remained low on an historical basis, suggesting that increases in net worth have provided substantial impetus to spending in a period of slow income growth.

Motor Vehicles

Total auto sales registered a 10.5 million unit annual rate in July, about the same pace that has prevailed, on average, since February. Sales of domestically produced cars were unchanged at a 7.2 million unit rate last month, while sales of foreign cars moved up to a 3.3 million unit pace. Domestic production in July was 6.7 million units at an annual rate. Current schedules call for assemblies to be just a touch below this level during the rest of the summer, but that output pace would be the lowest in any quarter since mid-1983.

Production adjustments in recent months have helped to draw dealers' stocks down a little, but at the end of July inventories still represented a hefty 76 days' supply at last month's sales pace. Stocks are particularly high at General Motors, and on August 5, GM sweetened their existing incentive programs. The new programs cover almost all GM cars and include rebates and finance rates as low as 1.9 percent on two-year loans. Ford and Chrysler followed suit later in the week.

Although purchases of new autos have been sluggish in recent months, light-duty truck sales have remained brisk. Over the first seven months of 1987, sales of such vehicles, which include vans and small pickups that have come increasingly to substitute for consumer purchases of cars, almost matched the strong pace of 1986. In July, sales of domestically produced light trucks totaled 4.1 million units, while sales of imported trucks, most of which are light-duty models, recorded a 1 million unit

SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, FRB seasonals)

| | 1986 | 1987 Q1 | 1987 Q2 | 1987 June | 1987 July |
|---|---|---|---|---|---|
| Autos and light trucks | 16.1 | 13.8 | 15.0 | 15.4 | 15.6 |
| Autos | 11.5 | 9.7 | 10.3 | 10.3 | 10.5 |
| Light trucks | 4.7 | 4.1 | 4.8 | 5.1 | 5.1 |
| Domestically produced[1] | 12.0 | 10.2 | 11.0 | 11.3 | 11.3 |
| Autos | 8.2 | 6.9 | 7.2 | 7.2 | 7.2 |
| Light trucks | 3.7 | 3.3 | 3.8 | 4.1 | 4.1 |
| Imports | 4.2 | 3.6 | 4.0 | 4.0 | 4.3 |
| Autos | 3.2 | 2.8 | 3.1 | 3.1 | 3.3 |
| Japanese | 2.4 | 2.0 | 2.1 | 2.1 | 2.1 |
| Korean | .2 | .2 | .3 | .4 | .3 |
| European | .7 | .6 | .7 | .7 | .8 |
| Light trucks | .9 | .8 | 1.0 | .9 | 1.0 |

Note: Data for sales of light trucks and imported automobiles for the current month are preliminary and subject to revision. Components may not add to totals due to rounding.
1. Includes vehicles produced in Canada and Mexico.

annual sales rate. Incentives were available on some trucks in the past few months; the GM and Ford programs expired in early August and have not yet been renewed, while Chrysler's most recent plan remains in effect.

Business Fixed Investment

Real outlays for business fixed investment posted a sizable gain in the second quarter, reversing much of the tax-related decline in spending earlier in the year. Equipment outlays accounted for all of the second-quarter advance, boosted by a rebound in purchases of office and computing equipment and stronger truck sales. Despite this bounceback, equipment outlays are now estimated to have been little different from year-ago levels.

Spending for nonresidential structures edged down during the second quarter. The office sector continued to be quite weak; since peaking in mid-1985, outlays for office construction have fallen nearly 30 percent. However, spending in other sectors was up, on balance; notably, petroleum drilling activity expanded for the third straight quarter, in response to rising oil prices.

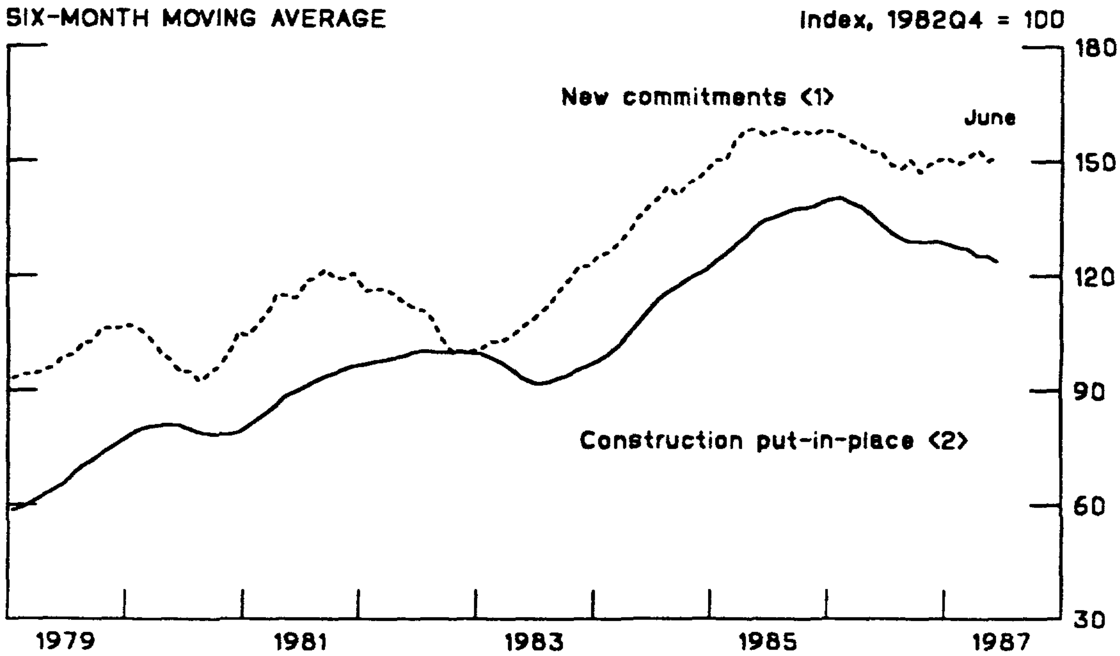
Recent indicators of future investment outlays generally have been favorable. New orders for nondefense capital goods rose 8-1/2 percent in the second quarter. Even excluding the sharp advance in the aircraft component,[1] new orders increased more than 5 percent, after having shown little net change over the preceding 2-1/2 years. Also, the backlog of

1. There are several reasons for abstracting from orders in the aircraft group. Most important, orders for aircraft and parts contain little information about near-term shipments because they are filled with long lags--often more than five years. Also, a sizable share of aircraft shipments ends up as exports or intermediate inputs (the latter owing to the presence of aircraft parts) rather than as equipment spending.

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

| | 1986 | 1987 | | 1987 | | |
|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | Apr. | May | June |
| **Producers' durable equipment** | | | | | | |
| Nondefense capital goods | | | | | | |
| Shipments | 3.2 | -3.2 | 2.7 | -.1 | -1.3 | 3.2 |
| Aircraft | 17.7 | -13.7 | 3.8 | -5.6 | -14.6 | 15.4 |
| Excl. aircraft | 1.5 | -1.8 | 2.5 | .7 | .5 | 1.8 |
| Orders | 6.2 | -3.8 | 8.5 | 3.3 | 6.1 | -1.5 |
| Aircraft | 78.0 | -26.2 | 30.8 | 2.4 | 50.3 | -24.7 |
| Excl. aircraft | -1.7 | .6 | 5.2 | 3.5 | -.6 | 3.8 |
| Sales of heavy-weight trucks (thousands of units, A.R.) | 274 | 277 | 312 | 314 | 335 | 288 |
| **Nonresidential structures** | | | | | | |
| Nonresidential construction | .1 | -3.8 | .9 | -.1 | 4.4 | -3.3 |
| Commercial building | -.8 | -5.4 | -1.2 | -2.6 | 4.2 | -4.8 |
| Office | -1.1 | -5.2 | -3.5 | -5.3 | 5.6 | -2.0 |
| Other commercial | -.5 | -5.5 | 1.1 | -.1 | 2.9 | -7.4 |
| Industrial building | 5.5 | -13.8 | 4.7 | 1.3 | 16.2 | -7.5 |
| Public utilities, institutional, and other | -.3 | .1 | 2.0 | 2.0 | 2.3 | -1.1 |
| Rotary drilling rigs in use | 5.1 | 3.2 | 7.6 | 3.2 | 1.0 | 1.0 |

Nonresidential Construction and New Commitments




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

unfilled orders excluding the aircraft group has edged up in recent months. For nonresidential construction, new commitments remained firm through June, supported by gains in the institutional sector (which includes private educational and religious buildings and hospitals). Outside the institutional sector, new commitments have continued to trend down, but the pace of decline has slowed considerably. Vacancy rates for both office buildings and hotels remain at extremely high levels, suggesting further declines in outlays in these sectors.

Business Inventories

Inventory investment apart from autos picked up in the spring. However, given improving sales and shipments in a number of sectors, the inventory-sales ratio was little changed between February and May.

Manufacturers' inventories have risen a bit over the past several months, after two years of liquidations. Nonetheless, these stocks continued to run relatively lean compared with factory shipments: the ratio of inventories to sales for all manufacturing (measured at current cost) fell in June to its lowest level in the current expansion. Such accumulation in factory stocks as there was in recent months was largely concentrated in the earlier stages of processing, and, in light of orders trends, may reflect anticipations of future increases in production.

In the trade sector, the pace of nonauto inventory accumulation quickened in the spring. Wholesale inventories increased moderately for the second quarter in a row. At the retail level, data are available only through May; and, apart from automobile dealers, show few, if any, signs of serious imbalances.

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

| | 1986 | 1987 | | 1987 | | |
|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | Apr. | May[r] | June[p] |
| **Current Cost Basis:** | | | | | | |
| Total | -1.1 | 41.2 | -- | 34.4 | 55.9 | -- |
| Manufacturing | -.7 | 7.7 | 5.2 | 8.3 | 12.8 | -5.3 |
| Wholesale | -4.9 | 8.8 | 13.2 | 5.8 | 31.5 | 2.2 |
| Retail | 4.5 | 24.8 | -- | 20.2 | 11.7 | -- |
| Automotive | 5.2 | 19.9 | -- | 2.6 | 6.6 | -- |
| Ex. auto | -.7 | 4.8 | -- | 17.7 | 5.1 | -- |
| **Constant Dollar Basis:** | | | | | | |
| Total | -2.9 | 34.1 | -- | 10.2 | 24.3 | -- |
| Manufacturing | -4.9 | 5.3 | -- | 4.0 | 5.7 | -- |
| Wholesale | -4.7 | 3.6 | -- | 1.7 | 19.6 | -- |
| Retail | 6.7 | 25.2 | -- | 4.5 | -1.1 | -- |
| Automotive | 4.1 | 21.3 | -- | -12.2 | 2.1 | -- |
| Ex. auto | 2.6 | 3.9 | -- | 16.7 | -3.2 | -- |

INVENTORIES RELATIVE TO SALES[1]

| | Range in Preceding 12 months:[2] low | high | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Apr. | May[r] | June[p] |
|---|---|---|---|---|---|---|---|---|
| **Current Cost Basis:** | | | | | | | | |
| Total | 1.47 | 1.58 | 1.50 | 1.51 | -- | 1.50 | 1.50 | -- |
| Manufacturing | 1.61 | 1.75 | 1.65 | 1.65 | 1.62 | 1.64 | 1.63 | 1.60 |
| Wholesale | 1.21 | 1.32 | 1.25 | 1.24 | 1.23 | 1.22 | 1.23 | 1.21 |
| Retail | 1.44 | 1.59 | 1.51 | 1.58 | -- | 1.56 | 1.57 | -- |
| Automotive | 1.33 | 2.12 | 1.64 | 2.03 | -- | 1.90 | 1.95 | -- |
| Ex. auto | 1.42 | 1.49 | 1.47 | 1.46 | -- | 1.46 | 1.47 | -- |

1. Ratio of end-of-period inventories to average monthly sales for the period.
2. Highs and lows are specific to each series and are not necessarily coincidental.
r--Revised estimates.
p--Preliminary estimates.

Housing Markets

Housing activity has softened in recent months. Total private housing starts were virtually unchanged in June at 1.6 million units (seasonally adjusted annual rate), the lowest level since 1984. Multi-family starts--at 1/2 million units or less since early spring--continue to be damped by near-record levels of vacancies in rental properties. Single-family activity also has weakened recently, reflecting the higher average level of mortgage interest rates, with both starts and sales well below the levels of earlier in the year.

Despite weak sales, some measures of new house prices have accelerated in recent months. In particular, the average sales price for new homes soared in June to 26 percent above its year-earlier level. However, this reading may overstate substantially the true movement in home prices, in part because the figure for June 1986 was abnormally low. Moreover, much of the rise in the average sales price appears to reflect increases in size and amenities that affect home costs as well as some change in the regional mix of home sales; the Census Bureau's constant quality price index, which controls for both of these factors, has risen only 2 percent over the past four quarters, compared with a 13 percent increase in the unadjusted price measure. Finally, informal reports suggest that some less affluent buyers may have dropped out of the market for new homes--contributing to both the fall in new home sales and the high average price--in part because home prices in many areas have outrun the loan limits on government-backed mortgages.[1]

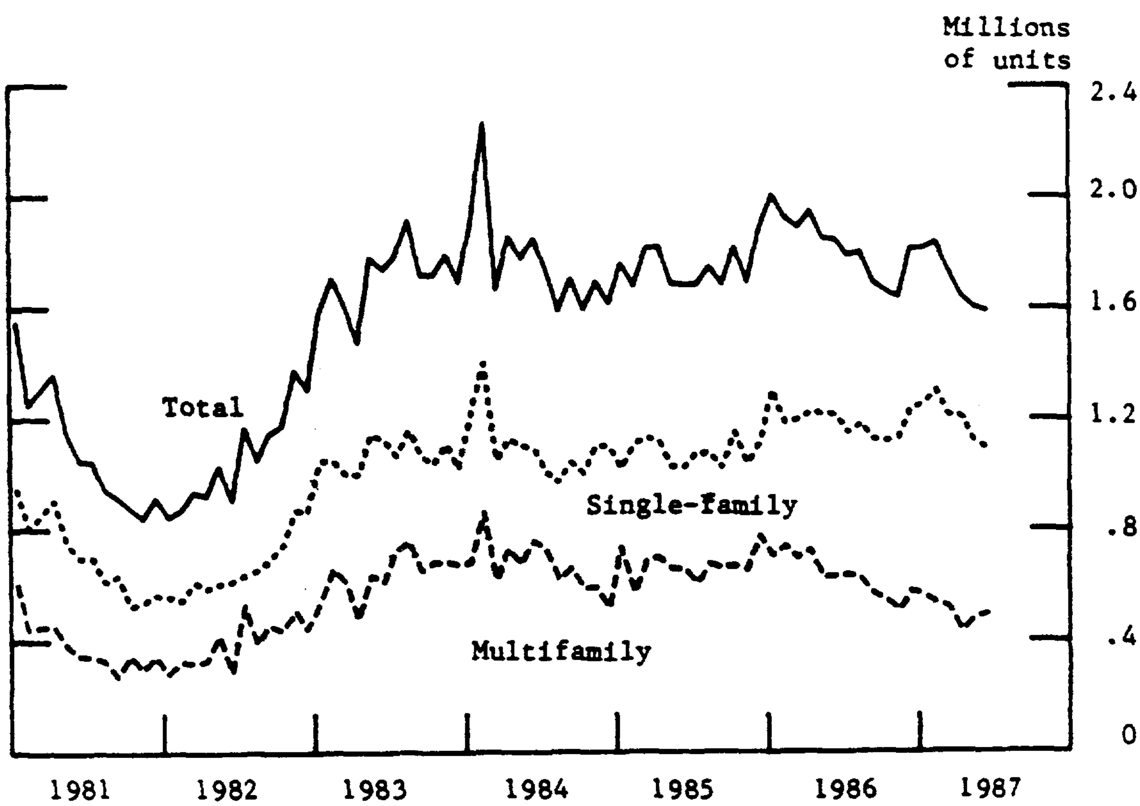
1. The FHA will not insure a home loan for more than $90,000 (and only then in areas designated as having high home costs). The VA does not have a loan size limit, but only guarantees the first $27,500 of any loan; effectively, this places an upper bound of $110,000 on most VA-insured loans, as secondary market purchasers require at least 25 percent of the loan to be backed by owner's equity, or a loan guarantee.

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

| | 1986 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Apr. | 1987 May | 1987 June[1] |
|---|---|---|---|---|---|---|---|
| All units | | | | | | | |
| Permits | 1.75 | 1.73 | 1.68 | 1.54 | 1.60 | 1.49 | 1.51 |
| Starts | 1.81 | 1.70 | 1.80 | 1.61 | 1.64 | 1.60 | 1.59 |
| Single-family units | | | | | | | |
| Permits | 1.07 | 1.08 | 1.15 | 1.03 | 1.06 | 1.01 | 1.04 |
| Starts | 1.18 | 1.16 | 1.26 | 1.14 | 1.21 | 1.12 | 1.09 |
| Sales | | | | | | | |
| New homes | .75 | .71 | .72 | .68 | .73 | .64 | .66 |
| Existing homes | 3.57 | 3.89 | 3.62 | 3.62 | 3.56 | 3.77 | 3.54 |
| Multifamily units | | | | | | | |
| Permits | .68 | .65 | .54 | .50 | .54 | .48 | .48 |
| Starts | .63 | .54 | .54 | .47 | .44 | .48 | .50 |

1. Preliminary estimates.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



Federal Government

Work on FY1988 budget legislation continues to lag behind the official congressional schedule. After passing the Budget Resolution, Congress turned its attention to the goal of revitalizing the Gramm-Rudman Act by setting more realistic deficit targets and restoring an automatic spending cut mechanism. The Senate amended legislation extending the debt ceiling with a Gramm-Rudman "fix" in late July, but the Conference Committee failed to reconcile the Senate amendment with features desired by the House before Congress left on its summer recess last Friday. Congress did temporarily extend the debt ceiling to September 23, and the Gramm-Rudman conferees are expected to make further attempts to reach agreement before that date. Meanwhile, the regular appropriations process has been slowed down, and the major legislative elements that would implement the FY1988 Budget Resolution have yet to be specified.[1]

The Gramm-Rudman "fixes" being considered by the Conference Committee would increase intermediate deficit target levels, extend the deadline for a balanced budget by one or two years, and restore for at least two years the vehicle for automatic spending cuts by having the Office of Management and Budget rather than the General Accounting Office certify any required sequester order.[2] The President would be given some discretion in allocating automatic defense cuts among defense categories.

1. To date, the House has passed only 9 of the 13 regular appropriations bills and the Senate has not yet acted on any. The deadline for committee action on the reconciliation instructions in the Budget Resolution has been extended from July 28 to September 29 (the regular budget process calls for work on reconciliation to be completed by June 15).
2. The Supreme Court ruled the General Accounting Office's role in the sequester process unconstitutional because it is a legislative rather than an executive agency.

PRELIMINARY CBO REESTIMATE OF THE BASELINE BUDGET[1]
(Fiscal years, billions of dollars)

| | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 |
|---|---|---|---|---|---|---|
| Revenues | 852 | 897 | 954 | 1034 | 1113 | 1192 |
| Outlays | 1013 | 1078 | 1152 | 1218 | 1286 | 1352 |
| Deficit | 161 | 181 | 198 | 183 | 173 | 160 |
| memo: | | | | | | |
| Proposed deficit target in Senate Gramm-Rudman amendment | | 150 | 131 | 90 | 45 | 0 |

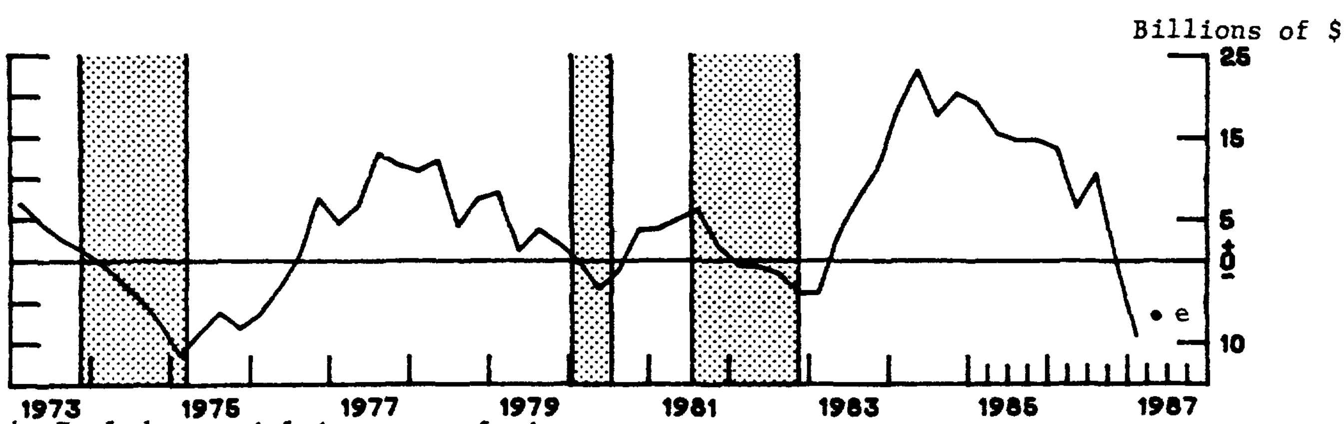
1. Preliminary reestimate of CBO baseline provided to Senate and House Budget Committees in early July. The final version of the CBO baseline update is scheduled to be released on August 19.

Federal Receipts and Expenditures
(NIPA basis, seasonally adjusted annual rates)

| | 1986 | | | | 1987 | |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 |
| Receipts | 808 | 817 | 832 | 853 | 879 | 918[e] |
| Personal | 353 | 358 | 365 | 376 | 382 | 416 |
| Corporate | 79 | 81 | 84 | 91 | 103 | 104[e] |
| Other | 376 | 378 | 383 | 386 | 394 | 398 |
| Expenditures | 1004 | 1047 | 1036 | 1041 | 1050 | 1052 |
| Defense purchases | 267 | 278 | 288 | 279 | 288 | 293 |
| Nondefense purchases | 90 | 90 | 84 | 90 | 79 | 79 |
| Other | 647 | 679 | 664 | 672 | 683 | 680 |
| Deficit | 196 | 230 | 204 | 189 | 171 | 134[e] |

e--FR staff estimate.

STATE AND LOCAL GOVERNMENT
Surplus (Deficit) of Operating and Capital Accounts*




*--Excludes social insurance funds.
e--Estimate for 1987-Q2.

Major differences between the Senate and House conferees include the amount of deficit reduction that must be enacted for 1988 and the number of years over which the sequester mechanism is to remain in effect. Conferees have proposed a suspension of the automatic spending reduction in FY1988 if Congress cuts $23 billion or more from the CBO baseline. In comparison, the Budget Resolution specified cuts of $37 billion.

The deficit in the federal sector of the national income accounts declined sharply in the second quarter, primarily because of large final payments on 1986 personal income tax liabilities associated in part with higher capital gains realizations late last year. On the spending side, growth in real defense purchases was boosted to an 8 percent annual rate by a catch-up in deliveries that had been delayed late last year. Non-defense purchases, however, remained depressed by large redemptions by farmers of surplus farm stocks, and there was a sharp decline in farm subsidy payments from unusually high first-quarter levels.

The upward revision to personal income (discussed in Appendix A) alters somewhat the interpretation of this spring's unusually large tax payments. The higher nominal income implies that regular tax liabilities in 1986 were larger than previously thought, and temporary tax reform effects were correspondingly smaller. Personal tax liabilities in 1987 now appear to be higher as well, suggesting somewhat larger final payments in April 1988. The upward revision to the level of wage and salaries also helps to explain the strength of withheld tax collections during the first half of 1987. The downward revisions of corporate profits data for 1986 and 1987-Q1 have only a small effect on the federal revenue outlook, because much of the change was attributable to new information on depreciation; revisions to reported profits (on which taxes are based) were much smaller.

State and Local Governments

Purchases of goods and services by state and local governments are estimated to have increased at a 3.4 percent annual pace in real terms in the second quarter, compared with a 5 percent rise in the first quarter. A sharp reduction in growth of outlays for construction accounted for all of the second-quarter slowdown. Overall, sizable increases in real purchases have continued despite budgetary erosion in many states over the past year and fiscal crises in a few energy-dependent states, especially Texas and Alaska.

The operating and capital account balance (excluding social insurance funds) turned slightly negative at the end of last year after more than three years of surplus. The deficit reached a $9 billion annual rate in the first quarter, the largest since early 1975; another, somewhat smaller deficit apparently occurred in the second quarter.

With concern about budgetary positions mounting, many states raised sales and excise taxes in fiscal 1987, which ended June 30 for most governments. In addition, a number of states altered their personal income tax code in some way, reflecting a desire to return at least part of the tax windfall expected from the base-broadening effect of federal tax reform.

Some cities, too, have been experiencing fiscal stress and have reacted by cutting back spending or by raising revenues. More than a third of cities participating in a recent survey increased taxes and about half raised user fees and other nontax charges during the past year.

Prices

Inflation in June was boosted by developments in the food and energy sectors. However, prices of other goods were little changed—at both the consumer and producer levels—and consumer service prices rose less than in recent months. On net, the CPI total was up 0.4 percent in June, about the average pace since February, while the PPI for finished goods slowed to a 0.2 percent increase. So far this year, the CPI has risen at about a 5-1/2 percent annual rate, compared with only 1 percent last year.

Consumer food prices rose 0.7 percent in June, after advancing 0.5 percent in May, led by large increases for meats and for fresh fruits and vegetables. The increase for meats reflected the passthrough to the retail level of higher livestock prices this spring. Futures prices suggest a general expectation of some easing in coming months of recent tight meat supplies, especially for pork products. Producer prices of crude foods overall turned down in June and probably fell sharply in July. The retail impact of the fall in crude food prices may be damped, however, owing to the large share of nonfarm costs in food production and the tendency of retailers to smooth out farm price fluctuations.

Energy prices picked up in June, as most of the May-June increases in crude oil costs were passed on to the refinery and retail levels. Spot market and posted prices for crude increased somewhat further in July, as market developments were affected by fears of a disruption of supplies from the Persian Gulf region. Nevertheless, OPEC apparently has increased its oil production, suggesting that prices may soften if tensions ease.

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

| | Relative Importance Dec. 1986 | 1986 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 May | 1987 June |
|---|---|---|---|---|---|---|---|
| | | | | -Annual rate- | | -Monthly rate- | |
| All items[2] | 100.0 | 1.1 | 2.5 | 6.2 | 4.6 | .3 | .4 |
| Food | 16.2 | 3.8 | 4.1 | 2.5 | 6.5 | .5 | .7 |
| Energy | 7.4 | -19.7 | -9.9 | 26.1 | 7.9 | .2 | 1.5 |
| All items less food and energy | 76.4 | 3.8 | 3.7 | 5.2 | 4.0 | .3 | .2 |
| Commodities | 26.1 | 1.4 | 1.4 | 5.1 | 3.8 | .3 | .0 |
| Services | 50.3 | 5.2 | 5.1 | 5.3 | 3.8 | .3 | .2 |
| Memorandum: | | | | | | | |
| CPI-W[3] | 100.0 | .7 | 2.2 | 6.3 | 4.8 | .4 | .4 |

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

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

| | Relative Importance Dec. 1986 | 1986 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 May | 1987 June |
|---|---|---|---|---|---|---|---|
| | | | | -Annual rate- | | -Monthly rate- | |
| Finished goods | 100.0 | -2.3 | 1.8 | 3.9 | 5.1 | .3 | .2 |
| Consumer foods | 26.3 | 2.9 | 1.0 | -6.7 | 14.3 | 1.4 | .5 |
| Consumer energy | 8.6 | -38.0 | -12.5 | 57.6 | 12.4 | .0 | .9 |
| Other consumer goods | 40.6 | 3.0 | 4.4 | 3.4 | .5 | -.2 | .1 |
| Capital equipment | 24.5 | 2.1 | 3.4 | .1 | 1.7 | .1 | .0 |
| Intermediate materials[2] | 95.0 | -4.5 | -1.2 | 8.0 | 5.0 | .4 | .6 |
| Exc. energy | 82.9 | .1 | 1.2 | 3.3 | 4.5 | .4 | .5 |
| Crude food materials | 42.5 | -1.4 | -2.7 | -11.3 | 35.4 | 4.8 | -1.4 |
| Crude energy | 40.9 | -27.5 | -.5 | 41.2 | 23.1 | 2.7 | .9 |
| Other crude materials | 16.6 | 1.7 | 8.5 | 16.3 | 33.3 | 2.4 | 4.2 |

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

Excluding food and energy items, the CPI slowed further in June. The commodities component leveled off as decreases in apparel prices offset increases for motor vehicles and medical care commodities. The drop in apparel prices reflected discounting of spring and summer clothing, after very large increases earlier this year. Detail from the BLS import price index for June confirms that price increases for foreign-source apparel have been sizable. Import prices also have continued to rise rapidly for a variety of other consumer goods, including photographic equipment, pharmaceuticals, and glassware and chinaware.

Prices of nonenergy services rose only 0.2 percent in June. This CPI component has risen at about a 4-1/2 percent rate during the first half of this year, down from 5-1/4 percent in 1986. Smaller increases in rents and auto insurance rates, as well as declines in long-distance telephone rates, account for most of the deceleration, but prices of some other services also rose less than last year.

Domestic producer prices for finished consumer goods less food and energy show little indication of a response to higher import prices. This PPI component was little changed in June, as well as over the second quarter. Its average pace so far this year, of about 1-1/2 percent at an annual rate, is below that of last year. Similarly, the PPI for capital equipment was flat in June and has risen little this year, despite rapid increases in prices of imported capital goods.

By contrast, prices of intermediate materials (also less food and energy) rose 0.5 percent in June and at about a 4 percent annual rate since December, after two years of little change. Although the recent acceleration has been sharpest for chemicals and other petroleum-related materials, it was evident for other industries as well, notably for metals and paper. Acceleration also can be observed in the recent BLS export price indexes for materials, particularly for chemicals and nonferrous metals. Moreover, import prices have risen rapidly this year for a broad range of materials, including most primary materials. On the whole, the data are consistent with reports from industrial purchasing managers of rising input prices.

Wages and Labor Costs

Several recent indicators suggest that employment costs continue to rise at a comparatively moderate pace. The year-over-year change in hourly compensation in the private nonfarm sector, as measured by the employment cost index (ECI), was 3.0 percent in June, about the same as in the preceding few observations. Available evidence suggests that benefits continue to advance at about the same pace as wages and salaries. According to the BLS, recent trends in benefit costs largely reflect the net effect of lower pension costs and higher insurance costs.

Compensation in service-producing industries appears to have accelerated somewhat over the first half of this year after a sharp slowdown in 1986. In contrast, compensation gains for workers in goods-producing industries remained quite moderate in the first half of the year, owing primarily to small wage increases for manufacturing workers. By occupation, increases in compensation for white-collar workers continued to outpace gains for blue-collar workers by a substantial margin. Separately, the hourly earnings index for production and nonsupervisory workers rose 0.2 percent in July, about the same as the average over the first half of this year and similar to the trend in blue-collar wages as reported in the ECI.

EMPLOYMENT COST INDEX
(Percentage change from 12 months earlier; not seasonally adjusted)

| | Dec. 1985 | Dec. 1986 | 1987 March | 1987 June |
|---|---|---|---|---|
| Total private nonfarm compensation | 3.9 | 3.2 | 3.1 | 3.0 |
| By industry: | | | | |
| Goods-producing | 3.4 | 3.1 | 2.5 | 2.3 |
| Service-producing | 4.4 | 3.2 | 3.4 | 3.6 |
| By occupation: | | | | |
| White-collar | 4.8 | 3.5 | 3.7 | 3.4 |
| Blue-collar | 3.2 | 2.7 | 2.1 | 2.5 |
| Service workers | 3.0 | 3.1 | 2.9 | 3.1 |
| By bargaining status | | | | |
| Union | 2.6 | 2.1 | 1.6 | 1.9 |
| Nonunion | 4.6 | 3.6 | 3.6 | 3.4 |
| Memo: | | | | |
| Wages and salaries | 4.1 | 3.1 | 3.2 | 3.0 |

PRODUCTIVITY AND COSTS
(Percent change from preceding period
at compound annual rates;
based on seasonally adjusted data)

| | 1984[1] | 1985[1] | 1986[1] | 1987 Q1 | 1987 Q2 |
|---|---|---|---|---|---|
| Nonfarm business sector: | | | | | |
| Output per hour | 1.5 | 1.0 | 1.5 | .4 | 1.4 |
| (Previous) | (1.0) | (.2) | (.7) | (.5) | |
| Compensation per hour | 4.2 | 4.8 | 3.4 | 1.1 | 2.9 |
| (Previous) | (4.3) | (3.9) | (2.6) | (.0) | |
| Unit labor costs | 2.6 | 3.7 | 1.9 | .8 | 1.5 |
| (Previous) | (3.2) | (3.7) | (1.8) | (-.5) | |

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

For workers in unions, compensation--as measured by the ECI--has increased about 2 percent over the past year. Separate data on collective bargaining activity under major contracts (1,000 or more workers) also show only moderate increases, with first-year adjustments (excluding potential COLAs) averaging 2.1 percent and adjustments over the life of the contract averaging 2.5 percent annually. Overall union wages, as measured by the effective wage change series for major contracts, rose at a 2.8 percent annual rate in the first half of 1987, compared with 2.3 percent last year. This year's increase primarily reflects wage adjustments negotiated under prior contracts, owing to greater backloading in recent years. However, wage increases due to COLAs also picked up a bit in the first half of this year, responding to the rise in the CPI. Initial wage adjustments contributed very little to overall union wage inflation, because of the relatively small number of workers negotiating new agreements in the first half of this year.

Indeed, the recent postal service agreement and the upcoming settlement in the auto industry together cover more workers than all of the contracts negotiated in the first six months of this year combined. The postal service agreement calls for a series of wage increases totaling about 7 percent over the 40 months of the contract, and retains the current COLA provisions, which effectively pass through about 60 percent of price increases into wages. In the auto industry, where contract talks have opened at GM and Ford, negotiations likely will be centered on job security. The union has announced plans to focus talks on limiting outsourcing and overtime and may try to modify the profit-sharing formula at GM, where workers received no payments for last year despite reported company profits of almost $3 billion. The auto companies likely will seek to reduce labor costs through improvements in plant productivity and wage restraint. Typically, the talks move slowly until late August when the UAW executive board meets to single out one of the companies as a strike target. Union negotiators then concentrate their efforts at the target company for a settlement that will serve as a pattern for the other firm. Contracts at both companies expire on September 14.

Preliminary data for the nonfarm business sector indicate that productivity rose 1.4 percent at an annual rate in the second quarter, after a 0.4 percent increase in the first quarter. With the second-quarter release, productivity and cost estimates have been revised back to 1984 to reflect the revisions to the NIPA and to the employment data compiled from the establishment survey. As a result of the revisions, average annual productivity growth for 1984-86 was revised upward by 0.7 percentage point; over the current cyclical expansion, productivity has risen at a 1-3/4 percent annual rate. In addition, compensation growth in 1986 was revised up to 3.4 percent, closer to the ECI figures. Based on the new productivity and compensation estimates, unit labor costs grew 3.7 percent in 1985 and 1.9 percent in 1986, essentially unchanged from earlier figures.

APPENDIX A*

ANNUAL REVISION OF THE NATIONAL INCOME AND PRODUCT ACCOUNTS

The Commerce Department in July released its annual revision of the National Income and Product Accounts. The revision covers the past three years and incorporates new source data and updated seasonal factors. The revisions to GNP primarily reflect the incorporation of newly available information from the Census Bureau's annual surveys of wholesale and retail trade, services, manufacturing, and state and local governments. The changes to the income side of the accounts largely are based on data from the state unemployment insurance system, farm statistics, and government regulatory reports on financial institutions.

The revised figures indicate that real GNP increased somewhat more rapidly than previously estimated, but continue to portray the period since 1984 as one of moderating growth accompanied by slower inflation. Real GNP now is estimated to have increased about 5 percent in 1984 and 3-1/4 percent in 1985, about 1/2 percentage point per year above the previous estimates, while growth in 1986 was raised 1/4 percentage point to 2-1/4 percent. In contrast, the growth rate for 1987-Q1 was lowered a bit, from 4.8 to 4.4 percent at an annual rate. Taken together, the revisions added about 1 percent to the level of economic activity in 1987-Q1. Changes to aggregate inflation measures generally were small, with the GNP fixed-weight price index still rising slightly more than 3-1/2 percent per year in 1984 and 1985 and about 2-1/4 percent last year.

The upward revision to real GNP mainly is attributable to higher personal consumption expenditures, which are now estimated to have increased more than 4 percent in each of the past three years. Outlays for services were raised to reflect new information on the use of medical services and the introduction of video rentals into the recreational services category. Net purchases of used cars by households also were revised up, but in this case the higher consumption was largely offset by a reduction in the motor vehicles component of business investment.[1] In addition to the change in consumer spending, there were noticeable upward revisions to purchases by state and local governments since 1984 and nonfarm inventory investment in 1986 and 1987-Q1.

The only sizable downward revision was to business fixed investment. The change was primarily in purchases of producers' durable equipment, which were reduced by the sectoral reallocation of outlays for used cars mentioned above and by lower spending for most other types of capital goods. However, a reassessment of recent trends in computer prices (taking into account quality improvements), in conjunction with higher

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* Prepared by Andrea Kusko, Senior Economist, Economic Activity Section, Division of Research and Statistics.

1. Excluding retail and wholesale margins, expenditures on used items generally have no effect on GNP, which measures only current production. In this instance, new data on fleet ownership indicated that a higher volume of used cars had been sold by business and purchased by consumers.

nominal shipments, led to substantially larger estimates of real purchases of such items; computers and office equipment now account for about one-fourth of overall equipment spending.

On the income side of the accounts, there were sizable revisions to both the level and distribution of income, especially for the most recent years. These new figures imply a substantial shift of income from corporations to households (and noncorporate businesses), which added more than 2 percent to the level of real disposable personal income in 1987-Q1. The additional household income was concentrated in interest receipts and farm proprietors' income. Wages and salaries also were raised, while employer payments for fringe benefits (primarily pension benefits) were lowered. In 1984 and 1985, the revisions to disposable income were not as large as the changes to consumer spending, and the personal saving rate was reduced somewhat. In 1986 and 1987-Q1, however, the changes to income were considerably larger, and the saving rate was raised, especially in the most recent quarters. Nonetheless, at only about 4 percent of disposable income, on average, over the past year-and-a-half, personal saving remains low on a historical basis.

Meanwhile, there was a sizable downward revision to corporate profits; economic profits--which include the capital consumption and inventory valuation adjustments and thus measure earnings from current production--were reduced by $16 billion in 1986 and $41 billion in 1987-Q1. In part, the revision was attributable to lower reported earnings in the domestic financial and rest-of-world sectors. In addition, BEA cut its estimate of the capital consumption adjustment to reflect newly available data on depreciation from IRS tabulations of corporate tax returns; this narrowed the gap between the reported and economic measures of profits. As a share of nominal GNP, profits now appear to have hovered around 6-3/4 percent since early 1986, a bit below the 1985 average. In contrast, the previous figures had indicated a marked uptrend over the past year.

REAL GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Percent change from previous period)

| | 1983-Q4 to 1984-Q4 | 1984-Q4 to 1985-Q4 | 1985-Q4 to 1986-Q4 | 1987-Q1 |
|---|---|---|---|---|
| 1. Gross national product | 5.1 | 3.3 | 2.2 | 4.4 |
| Previous | (4.6) | (2.9) | (2.0) | (4.8) |
| 2. Final sales | 4.7 | 4.6 | 2.6 | -2.3 |
| Previous | (4.4) | (4.0) | (2.7) | (-2.7) |
| 3. Personal consumption expenditures | 4.1 | 4.5 | 4.1 | -.7 |
| Previous | (3.6) | (3.5) | (4.0) | (-1.1) |
| 4. Business fixed investment | 13.8 | 4.7 | -4.7 | -14.6 |
| Previous | (14.7) | (6.6) | (-4.0) | (-9.7) |
| 5. Residential structures | 6.1 | 6.0 | 12.5 | -7.7 |
| Previous | (5.3) | (7.8) | (10.0) | (-4.7) |
| 6. Government purchases | 7.9 | 8.7 | 2.4 | -6.2 |
| Previous | (7.7) | (8.4) | (2.7) | (-9.6) |
| 7. Exports | 5.9 | -2.7 | 5.9 | 10.2 |
| Previous | (5.5) | (-3.2) | (6.3) | (11.8) |
| 8. Imports | 17.4 | 5.2 | 8.9 | -5.2 |
| Previous | (16.5) | (5.8) | (7.9) | (-2.6) |
| ADDENDA: | | | | |
| 9. Change in nonfarm inventories[1] | 38.7 | 16.7 | 2.3 | 43.9 |
| Previous | (33.9) | (16.1) | (-9.8) | (32.8) |
| 10. Net exports[1] | -94.8 | -129.3 | -151.8 | -135.2 |
| Previous | (-92.7) | (-132.0) | (-148.0) | (-133.7) |
| 11. Nominal GNP | 8.6 | 6.6 | 4.5 | 8.6 |
| Previous | (8.5) | (6.3) | (4.2) | (9.1) |
| 12. GNP implicit price deflator | 3.4 | 3.1 | 2.2 | 4.2 |
| Previous | (3.6) | (3.3) | (2.1) | (4.2) |
| 13. GNP fixed-weight price index | 3.7 | 3.6 | 2.3 | 4.5 |
| Previous | (3.9) | (3.6) | (2.4) | (3.9) |
| 14. Real disposable personal income | 4.3 | 2.8 | 3.6 | 2.7 |
| Previous | (4.2) | (1.9) | (2.2) | (2.9) |

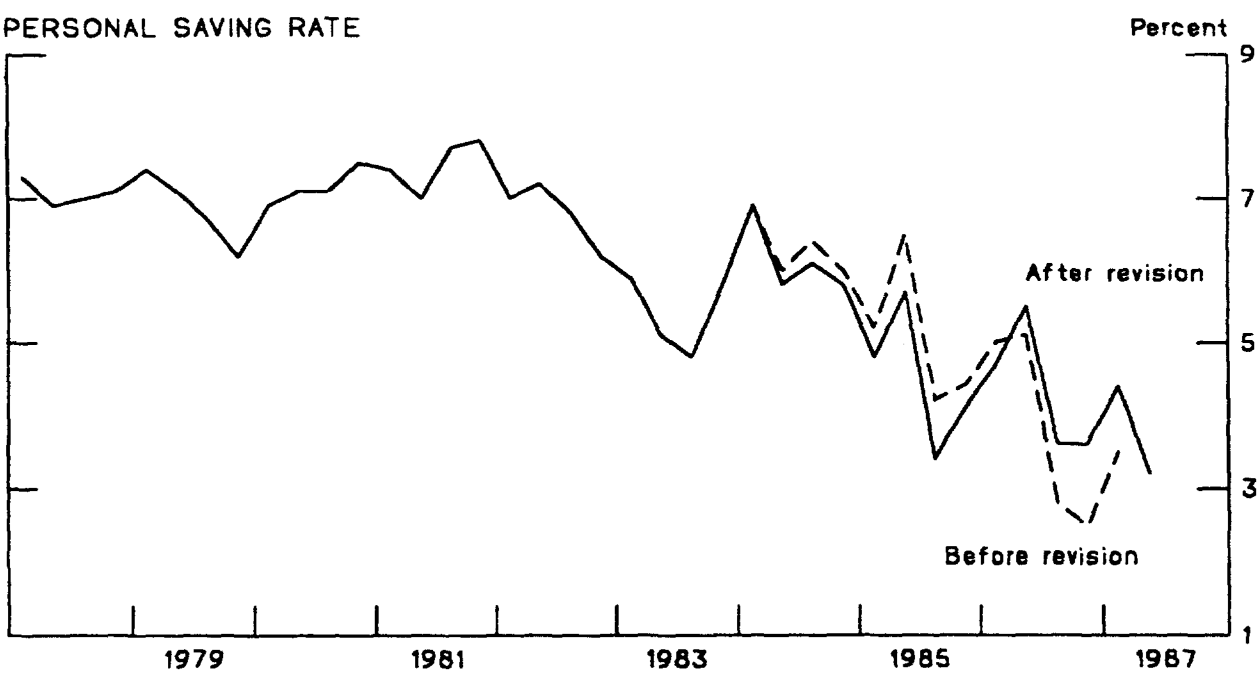
1. Billions of 1982 dollars, end of period.

REVISIONS TO PERSONAL INCOME AND OUTLAYS
(Billions of dollars)

| | 1984 | 1985 | 1986 | 1987-Q1[1] |
|---|---|---|---|---|
| 1. Personal income | -1.5 | 12.5 | 48.6 | 74.1 |
| 2. Wages and salaries | 1.8 | 8.9 | 15.6 | 19.7 |
| 3. Other labor income | -1.6 | -4.6 | -7.7 | -8.7 |
| 4. Proprietors' income | -2.4 | 2.9 | 11.0 | 24.8 |
| 5. Interest income | -2.2 | .3 | 22.6 | 29.1 |
| 6. Less: Tax and nontax payments | .6 | -.6 | -1.9 | 3.1 |
| 7. Disposable personal income | -2.0 | 13.1 | 50.5 | 71.0 |
| 8. Personal outlays | 2.6 | 29.4 | 34.1 | 39.1 |
| 9. Personal saving | -4.6 | -16.2 | 16.4 | 31.9 |

1. Annual rate.

PERSONAL SAVING RATE

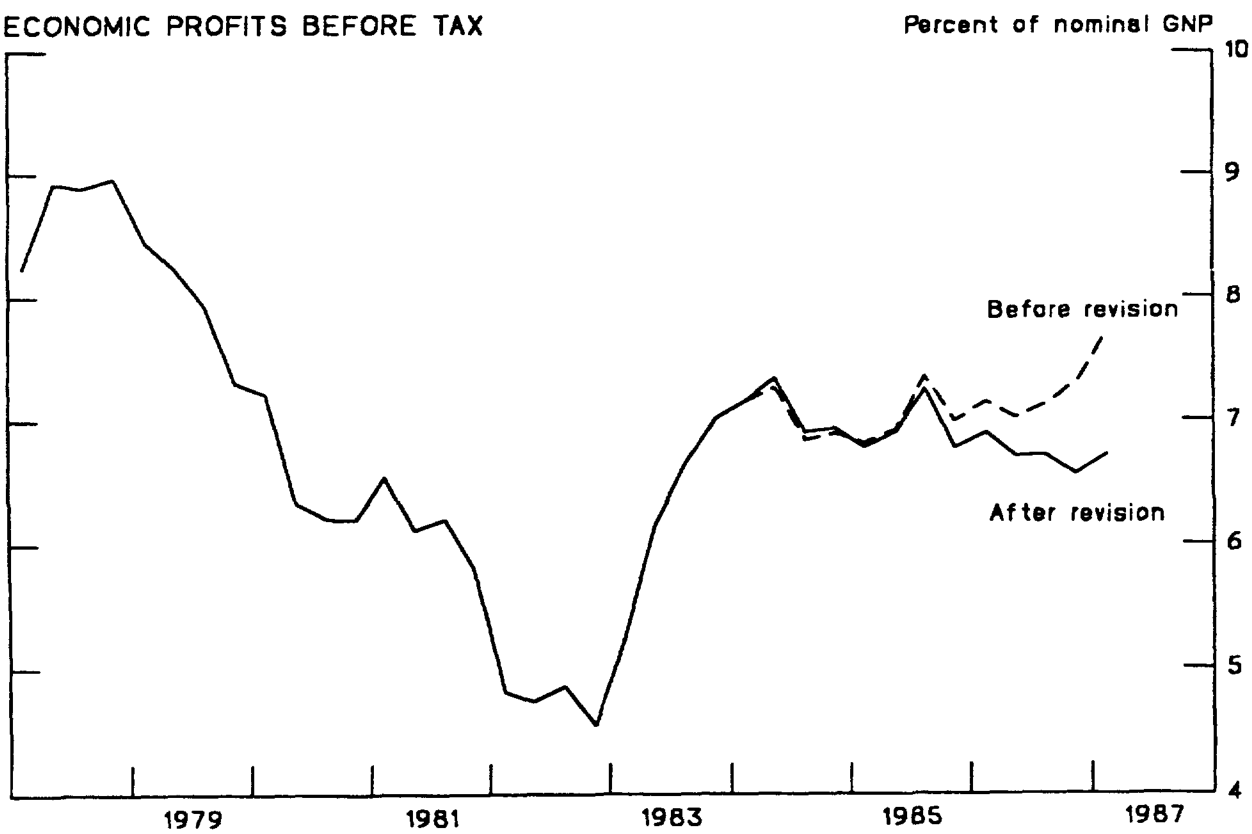


REVISIONS TO CORPORATE PROFITS
(Billions of dollars)

| | 1984 | 1985 | 1986 | 1987-Q1[1] |
|---|---|---|---|---|
| 1. Profits before tax | 4.3 | 1.6 | -5.6 | -10.6 |
| 2. Capital consumption adjustment | -1.8 | -4.6 | -10.6 | -26.5 |
| 3. Inventory valuation adjustment | -.3 | -.1 | .0 | -4.4 |
| 4. Economic profits | 2.2 | -3.1 | -16.3 | -41.4 |

1. Annual rate.

ECONOMIC PROFITS BEFORE TAX



III-T-1

SELECTED FINANCIAL MARKET QUOTATIONS[1]

(Percent)

| | 1986 | 1987 | | | Change from: | |
|---|---|---|---|---|---|---|
| | Oct. lows[2] | FOMC May 19 | FOMC July 7 | Aug. 11 | FOMC May 19 | FOMC July 7 |
| **Short-term rates** | | | | | | |
| Federal funds[3] | 5.75 | 6.78 | 6.70 | 6.66 | -.12 | -.04 |
| Treasury bills[4] | | | | | | |
| 3-month | 5.04 | 5.78 | 5.60 | 5.94 | .16 | .34 |
| 6-month | 5.05 | 6.27 | 5.59 | 6.07 | -.20 | .48 |
| 1-year | 5.25 | 6.80 | 6.21 | 6.48 | -.32 | .27 |
| Commercial paper | | | | | | |
| 1-month | 5.64 | 6.95 | 6.69 | 6.60 | -.35 | -.09 |
| 3-month | 5.60 | 7.07 | 6.74 | 6.68 | -.39 | -.06 |
| Large negotiable CDs[4] | | | | | | |
| 1-month | 5.59 | 6.97 | 6.68 | 6.59 | -.38 | -.09 |
| 3-month | 5.57 | 7.15 | 6.77 | 6.69 | -.46 | -.08 |
| 6-month | 5.57 | 7.41 | 6.91 | 6.96 | -.45 | .05 |
| Eurodollar deposits[5] | | | | | | |
| 1-month | 5.79 | 6.81 | 7.01 | 6.70 | -.11 | -.31 |
| 3-month | 5.79 | 7.10 | 7.08 | 6.94 | -.16 | -.14 |
| Bank prime rate | 7.50 | 8.25 | 8.25 | 8.25 | -- | -- |
| **termediate- and long-term rates** | | | | | | |
| U.S. Treasury (constant maturity) | | | | | | |
| 3-year | 6.41 | 8.27 | 7.63 | 7.94 | -.33 | .31 |
| 10-year | 7.28 | 8.89 | 8.28 | 8.73 | -.16 | .45 |
| 30-year | 7.53 | 9.06 | 8.40 | 8.95 | -.11 | .55 |
| Municipal revenue[6] (Bond Buyer index) | 7.30 | [illegible].68 | 8.05 | 8.20 | -.48 | .15 |
| Corporate--A utility Recently offered | 9.32 | 10.26[e] | 10.01[e] | 10.40[e] | .14 | .39 |
| Home mortgage rates[7] | | | | | | |
| S&L fixed-rate | 9.89 | 10.81 | 10.30 | 10.35 | -.46 | .05 |
| S&L ARM, 1-yr. | 7.98 | 7.99 | 7.86 | 7.73 | -.26 | -.13 |

| | 1986 | 1987 | | | Percent change from: | |
|---|---|---|---|---|---|---|
| | Highs | March highs | FOMC July 7 | Aug. 11 | March highs | FOMC July 7 |
| **Stock prices** | | | | | | |
| Dow-Jones Industrial | 1955.57 | 2372.59 | 2449.78 | 2680.48 | 12.98 | 9.42 |
| NYSE Composite | 145.75 | 171.08 | 172.89 | 186.13 | 8.80 | 7.66 |
| AMEX Composite | 285.19 | 339.31 | 344.45 | 363.89 | 7.24 | 5.64 |
| NASDAQ (OTC) | 411.16 | 439.64 | 424.55 | 449.36 | 2.21 | 5.84 |

1. One-day quotes except as noted.
2. Low period for short-term rates.
3. Averages for two-week reserve maintenance period osest to date shown. Last observation is the erage for the maintenance period ending August 12, 1987.
4. Secondary market.
5. Averages for statement week closest to date shown.
6. One-day quotes for closest Thursday.
7. Averages for week ending Friday closest to date shown.

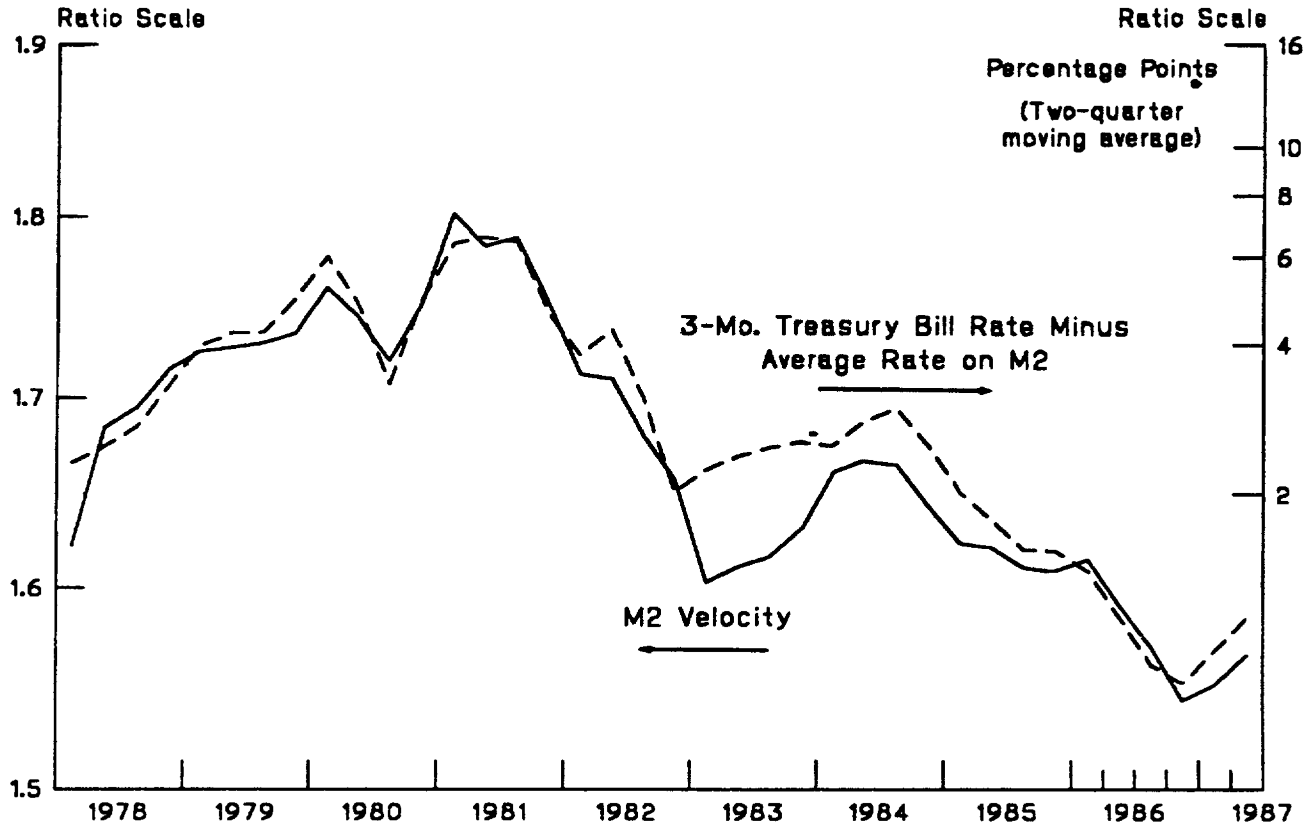
e--estimate.

A slight decline in the federal funds rate has had a favorable effect in the private money markets, but interest rates on most intermediate- and long-term securities have risen considerably since the July FOMC meeting. Developments in the Persian Gulf area have raised concerns about a potential price shock from the energy sector. And, while the dollar has strengthened further, competing interest rates abroad have risen sharply. In the Treasury market, which has been hurt as well by debt-ceiling disruptions, bond yields have increased about 1/2 percentage point from their levels at the time of the FOMC meeting. Corporate bond rates have risen a little less than Treasury yields, and municipal rates considerably less. Treasury bill rates have increased 1/4 to 1/2 percentage point, on net, reflecting shifting supply conditions, while most other short-term rates are about unchanged to down 1/8 of a point. Shrugging off the rise in nominal bond yields, the stock market has continued to soar.

The monetary aggregates grew little in July, and M2 and M3 moved farther below their annual target ranges. A small further drop in demand deposits held down M1, and growth in the more liquid deposit components of M2 generally has been restrained by the availability of more attractive yields on alternative assets. M3 expansion was damped last month by declines in managed liabilities as bank asset expansion was negligible.

Debt growth, like monetary growth, appears to be on a slower growth track this year. In July, although bond issuance by nonfinancial firms remained fairly strong, driven primarily by the need to fund corporate share retirements, a part of this borrowing financed paydowns of short-term debt. Federal debt declined, on net, in July when statutory debt

# M2 VELOCITY AND AVERAGE M2 OPPORTUNITY COST




Last observation plotted is 1987:Q2.

VELOCITY GROWTH RATES
(percent, seasonally adjusted annual rate)

| | M1 | M2 | M3 |
|---|---|---|---|
| 1980 | 2.4 | 0.9 | 0.3 |
| 1981 | 4.0 | 0.1 | -2.6 |
| 1982 | -5.1 | -5.4 | -6.1 |
| 1983 | 0.2 | -1.6 | 0.5 |
| 1984 | 3.1 | 0.7 | -1.9 |
| 1985 | -4.9 | -2.1 | -1.0 |
| 1986 | -9.4 | -4.1 | -4.0 |
| Quarterly | | | |
| 1986:Q3 | -10.9 | -5.3 | -4.4 |
| Q4 | -14.3 | -7.0 | -5.8 |
| 1987:Q1 | -4.6 | 2.0 | 2.0 |
| Q2 | 0.1 | 3.9 | 2.4 |

limitations in midmonth forced the Treasury to postpone several auctions and to suspend issuance of savings bonds and other nonmarketable securities until the end of the month; borrowing accelerated again around the end of the month and in early August when temporary debt ceiling extensions permitted the Treasury to make up the postponed auctions. Tax-exempt bond offerings have dropped off substantially after a surge in June. In the household sector, use of home equity lines appears to be cutting into consumer credit expansion, but other mortgage borrowing is being damped by the higher interest rates that are deterring homebuilding.

Monetary Aggregates and Bank Credit

M1 was essentially flat in July after dropping sharply in June. Runoffs of demand deposits continued, but at a much slower pace, and moderate inflows into other checkable deposits (OCDs) resumed. To some extent, the recent weakness in demand deposits likely has reflected downward adjustments to compensating balances and reduced mortgage refinancing activity. OCD growth may have been encouraged by a slight narrowing of spreads between their yields and those on market instruments and small time deposits.

Growth in M2 picked up a little in July, to a 3 percent annual rate, as the effect of somewhat slower growth in its nontransactions components was offset by the turnaround in M1. The increase this year in the opportunity cost of holding liquid deposits has continued to cause substitutions among the components of M2 and, moreover, to boost M2 velocity. Savings deposits decelerated for the third consecutive month in July, to a 5 percent rate, the slowest pace since February 1986, while small time deposits grew at a double-digit rate for the second consecutive month. As in June,

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

| | 1985:Q4 to 1986:Q4 | 1987 Q1 | Q2 | May | June | July pe | Growth from Q4 1986 to July 1987 pe |
|---|---|---|---|---|---|---|---|
| | ------ Percentage change at annual rates ------ | | | | | | |
| 1. M1 | 15.3 | 13.1 | 6.4 | 4.5 | -10.4 | 1 | 7 |
| 2. M2 | 8.9 | 6.3 | 2.4 | 0.3 | 1.3 | 3 | 3-3/4 |
| 3. M3 | 8.8 | 6.3 | 4.0 | 4.7 | 5.4 | 2 | 4-3/4 |
| | | | | | | | Levels in billions of dollars June 1987 |
| Selected components | | | | | | | |
| 4. M1-A | 10.0 | 5.5 | 2.7 | 3.1 | -13.2 | -1 | 495.4 |
| 5. Currency | 7.5 | 10.1 | 6.6 | 8.3 | 5.7 | 6 | 191.1 |
| 6. Demand deposits | 11.6 | 2.5 | 0.1 | 0.0 | -25.3 | -6 | 297.5 |
| 7. Other checkable deposits | 28.5 | 29.7 | 14.0 | 7.2 | -4.8 | 6 | 251.2 |
| 8. M2 minus M1[2] | 6.9 | 4.0 | 1.0 | -1.2 | 5.5 | 4 | 2095.4 |
| 9. Overnight RPs and Eurodollars, NSA | 14.7 | 10.9 | -25.3 | -14.4 | -12.9 | 2 | 73.4 |
| 10. General purpose and broker/dealer money market mutual fund shares, NSA | 17.3 | 6.2 | -0.6 | -10.8 | 6.3 | 1 | 210.2 |
| 11. Commercial banks | 6.8 | 6.0 | -1.4 | -6.2 | 3.6 | 3 | 903.2 |
| 12. Savings deposits, SA, plus MMDAs, NSA[3] | 16.0 | 13.4 | 0.8 | -9.2 | -0.7 | -3 | 543.1 |
| 13. Small time deposits | -4.2 | -4.9 | -4.5 | -1.3 | 10.4 | 12 | 360.2 |
| 14. Thrift institutions | 4.3 | 4.0 | 5.2 | 1.7 | 6.5 | 5 | 916.5 |
| 15. Savings deposits, SA, plus MMDAs, NSA[3] | 12.0 | 14.3 | 9.7 | 4.5 | 0.3 | -7 | 425.6 |
| 16. Small time deposits | -1.2 | -4.3 | 1.3 | -0.7 | 11.9 | 15 | 490.9 |
| 17. M3 minus M2[4] | 8.4 | 6.4 | 10.4 | 22.6 | 22.0 | -2 | 727.2 |
| 18. Large time deposits | 3.0 | 2.9 | 9.3 | 13.5 | 14.1 | -1 | 465.1 |
| 19. At commercial banks, net[5] | 2.7 | 9.7 | 18.3 | 18.8 | 16.6 | -5 | 315.0 |
| 20. At thrift institutions | 3.4 | -9.5 | -8.4 | 2.4 | 8.9 | 9 | 150.1 |
| 21. Institution-only money market mutual fund shares, NSA | 30.3 | 0.9 | -11.4 | -18.8 | -7.3 | 31 | 81.3 |
| 22. Term RPs, NSA | 28.3 | 14.4 | 55.4 | 71.2 | 24.9 | -18 | 98.4 |
| 23. Term Eurodollars, NSA | 3.2 | 34.0 | 1.8 | 49.9 | 37.0 | -57 | 90.3 |
| | -- Average monthly change in billions of dollars -- | | | | | | |
| MEMORANDA: | | | | | | | |
| 24. Managed liabilities at commercial banks (25+26) | 2.0 | 8.4 | 6.0 | 14.3 | 2.0 | -11 | 533.6 |
| 25. Large time deposits, gross | 0.6 | 2.8 | 6.3 | 6.4 | 6.7 | -1 | 372.9 |
| 26. Nondeposit funds | 1.4 | 5.6 | -0.3 | 7.9 | -4.7 | -10 | 160.7 |
| 27. Net due to related foreign institutions, NSA | 0.6 | 4.3 | 1.4 | 10.2 | -1.9 | -8 | -1.9 |
| 28. Other[6] | 0.8 | 1.3 | -1.7 | -2.2 | -2.9 | -3 | 162.6 |
| 29. U.S. government deposits at commercial banks[7] | 0.4 | -1.2 | 3.4 | 5.4 | 1.8 | -3 | 27.9 |

1. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Growth rates are for savings deposits, seasonally adjusted, plus money market deposit accounts (MMDAs), not seasonally adjusted. Commercial bank savings deposits excluding MMDAs increased during June and July 1987 at rates of 6.9 percent and 8 percent, respectively. At thrift institutions, savings deposits excluding MMDAs increased during June and July 1987 at rates of 12.6 percent and 3 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.
6. Consists of borrowings from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowings from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
7. Consists of Treasury demand deposits and note balances at commercial banks.
pe--preliminary estimate

inflows to small time deposit accounts at banks in July were especially strong in Districts 1 and 2, where relatively high rates continued to be posted on such deposits.

Growth in M3 weakened to a 2 percent annual rate in July. Bank credit was essentially flat, allowing the institutions to reduce their reliance on managed liabilities, even in the face of sluggish core deposit growth and a shift of $8 billion of funds by banks to their offshore branches. A runoff in large time deposits at banks offset moderate growth at thrifts. At insolvent Texas thrifts, however, large time deposits continued to decline slightly, contributing to a shrinkage in total deposits. Eurodollar deposits and RPs also declined in July.

Preliminary data on bank credit for July indicate little movement in either investments or total loans. Business loans declined during the month after growing at about a 4-1/2 percent annual rate over the second quarter, with weakness particularly evident at several money center banks. Despite continued strong growth in home equity loans, real estate loan growth slowed to a 13 percent pace, down from the 20 percent rate of May and June, mainly reflecting a slowdown at large banks. Consumer loans edged up slightly after dipping in June.

Corporate Finance

Revisions to the national income accounts suggest that the gap between capital expenditures and internally generated funds in the non-financial corporate sector has been running a bit wider than previously indicated.[1] Nonetheless, that gap has not been large, and it is clear

1. The NIPA revisions show lower levels of both corporate profits and fixed investment, the downward adjustment in the former being the larger.

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

| | 1985:Q4 to 1986:Q4 | 1987 Q1 | 1987 Q2p | 1987 May | 1987 June | 1987 Julyp | Levels in bil. of dollars Julyp |
|---|---|---|---|---|---|---|---|
| | ---------- Commercial Bank Credit ---------- | | | | | | |
| 1. Total loans and securities at banks | 9.8 | 7.0 | 7.5 | 7.4 | 3.2 | 0.7 | 2167.5 |
| 2. Securities | 14.2 | 2.4 | 4.2 | 11.0 | -6.0 | 1.4 | 515.7 |
| 3. U.S. government securities | 11.9 | 5.7 | 3.1 | 16.3 | -12.7 | 7.6 | 318.7 |
| 4. Other securities | 18.0 | -2.8 | 6.1 | 2.4 | 5.5 | -9.1 | 197.0 |
| 5. Total loans | 8.4 | 8.4 | 8.6 | 6.3 | 6.1 | 0.4 | 1651.7 |
| 6. Business loans | 6.6 | 7.6 | 4.7 | 4.1 | 5.0 | -6.7 | 554.9 |
| 7. Security loans | -3.7 | -3.1 | 43.9 | -44.0 | 14.3 | -22.6 | 41.7 |
| 8. Real estate loans[2] | 14.1 | 17.9 | 19.0 | 19.6 | 20.4 | 12.9 | 543.4 |
| 9. Consumer loans[2] | 7.3 | 2.1 | 0.6 | 0.4 | -2.3 | 1.5 | 314.3 |
| 10. Other loans | 5.4 | 0.0 | -1.0 | -1.1 | -16.6 | -10.8 | 197.4 |
| | ---------- Short- and Intermediate-Term Business Credit ----- | | | | | | |
| 11. Business loans net of bankers acceptances | 6.3 | 8.1 | 4.1 | 3.3 | 5.0 | -6.5 | 549.3 |
| 12. Loans at foreign branches[3] | -8.6 | -2.4 | -14.7 | -71.4 | -7.6 | 38.2 | 16.2 |
| 13. Sum of lines 11 & 12 | 5.8 | 7.9 | 3.5 | 1.1 | 4.7 | -5.3 | 565.5 |
| 14. Commercial paper issued by nonfinancial firms | -0.8 | -13.0 | 17.6 | 28.6 | -16.2 | -13.4 | 79.6 |
| 15. Sums of lines 13 & 14 | 4.9 | 5.2 | 5.1 | 4.3 | 2.0 | -6.1 | 645.1 |
| 16. Bankers acceptances: U.S. trade related[4,5] | -3.9 | 2.5 | 23.8 | 11.0 | 25.4 | n.a. | 33.8 (June) |
| 17. Line 15 plus bankers acceptances: U.S. trade related | 4.4 | 5.0 | 6.1 | 5.0 | 3.2 | n.a. | 682.3 (June) |
| 18. Finance company loans to business[4] | 11.7 | 14.7 | 17.9 | 21.2 | 15.0 | n.a. | 186.3 (June) |
| 19. Total short- and intermediate-term business credit (sum of lines 17 & 18) | 5.8 | 7.0 | 8.6 | 8.2 | 5.4 | n.a. | 868.6 (June) |

n.a.--not available.
p--preliminary.
1. Average of Wednesdays.
2. June growth rates for real estate and consumer loans are adjusted for series breaks caused by earlier reporting errors for home equity loans.
3. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
4. Based on average of current and preceding ends of month.
5. Consists of acceptances that finance U.S. imports, U.S. exports and domestic shipment and storage of goods.

that the major factor behind business borrowing has been the financing of mergers, buyouts, and share repurchases. Indeed, the pace of share retirements picked up to an estimated $135 billion annual rate in the second quarter.

Most recently, in July, the outstanding volume of business loans and commercial paper fell, in part reflecting the repayment of short-term debt utilized earlier to fund restructurings until assets could be sold or permanent financing could be arranged. Public bond issuance by nonfinancial corporations continued strong; about $4-1/2 billion of below investment grade debt was issued domestically during the month, and similar volume is expected this month as spreads of junk bond yields over those of higher quality bonds have not widened appreciably.

In the Euromarket, bond issuance by nonfinancial corporations picked up in July from the depressed June level to a pace in line with the second-quarter average. The Eurobond market was shaken by the Treasury's June 29 announcement that it was cancelling its tax treaty with the Netherlands Antilles. About $30 to $35 billion of bonds issued before August 1984--when U.S. withholding tax rules were changed--were affected. With the expiration of the treaty, the U.S. parents of the Caribbean subsidiaries that issued the bonds would have been subjected to new taxes. Most of the bonds were callable in the event of such tax changes, and because the bonds had been issued when interest rates were higher, the call prices were below market prices and investors would have suffered large losses. The Treasury later reversed itself, however, and virtually all issuers that had called their bonds rescinded their calls;

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

| | 1986 | 1987 | | | | |
|---|---|---|---|---|---|---|
| | Year | Q1 | Q2P | MayP | June P | JulyP |
| Corporate securities - total[1] | 28.22 | 29.73 | 24.04 | 20.23 | 27.97 | 25.86 |
| Public offerings in U.S. | 24.52 | 26.81 | 22.05 | 17.93 | 26.40 | 23.10 |
| Stocks--total[2] | 5.15 | 5.50 | 5.73 | 6.59 | 6.40 | 4.60 |
| Nonfinancial | 2.51 | 2.74 | 3.49 | 3.19 | 3.90 | 2.90 |
| Utility | .64 | .74 | .67 | .58 | .90 | .70 |
| Industrial | 1.87 | 2.00 | 2.82 | 2.61 | 3.00 | 2.20 |
| Financial | 2.64 | 2.76 | 2.24 | 3.40 | 2.50 | 1.70 |
| Bonds--total[1] | 19.37 | 21.31 | 16.32 | 11.34 | 20.00 | 18.50 |
| Nonfinancial | 9.65 | 8.98 | 6.06 | 4.99 | 8.00 | 7.80 |
| Utility | 3.61 | 2.05 | 2.20 | .73 | 2.20 | 1.95 |
| Industrial | 6.04 | 6.93 | 5.54 | 4.26 | 5.80 | 5.85 |
| Financial | 9.72 | 12.33 | 10.26 | 6.35 | 12.00 | 10.70 |
| By quality[3] | | | | | | |
| Aaa and Aa | 4.68 | 3.30 | 2.15 | 1.27 | 3.21 | 3.00 |
| A and Baa | 5.92 | 7.29 | 4.93 | 3.36 | 7.52 | 4.20 |
| Less than Baa | 3.45 | 3.06 | 2.91 | 3.38 | 2.64 | 4.50 |
| No rating (or unknown) | .20 | .08 | .24 | .20 | .38 | .15 |
| Memo items: | | | | | | |
| Equity-based bonds[4] | .86 | 1.37 | 1.29 | .92 | 1.27 | .38 |
| Mortgage-backed bonds | 4.16 | 7.26 | 5.25 | 2.72 | 4.05 | 5.00 |
| Variable-rate notes | 1.02 | 2.37 | 1.65 | 1.37 | 1.01 | 1.90 |
| Bonds sold abroad - total | 3.55 | 2.86 | 1.71 | 2.04 | 1.22 | 2.60 |
| Nonfinancial | 1.50 | 1.08 | .95 | 1.53 | .37 | .95 |
| Financial | 2.05 | 1.78 | .76 | .51 | .85 | 1.65 |
| Stocks sold abroad - total | .15 | .06 | .28 | .26 | .35 | .16 |
| Nonfinancial | .09 | .06 | .24 | .26 | .25 | .16 |
| Financial | .06 | .00 | .04 | .00 | .10 | .00 |

p--preliminary.
1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. Includes equity issues associated with debt/equity swaps.
3. Bonds categorized according to Moody's bond ratings or Standard and Poors if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.
4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.

prices rebounded, but generally have remained below earlier levels because of residual uncertainty about the future tax status of these bonds.

In the equity markets, stock prices have gained 6 to 9 percent, on average, over the intermeeting period, with all major indexes reaching new highs. Despite the increases, new share offerings dipped in July, though they remained at historically high levels. The volume of new convertible bond offerings also was down in July.

Treasury and Sponsored Agency Financing

The staff is projecting a total federal budget deficit of $44 billion in the current quarter. The Treasury is expected to borrow $36 billion, net, from the public; it has continued to raise funds through coupon issues, while paying down bills, although the pace of bill paydowns has begun to diminish.

The Treasury was forced to suspend issuance of SLGS and savings bonds and to postpone several auctions as a result of the reduction in the debt ceiling from $2.315 to $2.111 trillion at midnight on July 17. The Treasury resumed issuance of securities on July 29 when the debt ceiling was increased temporarily and extended through August 6. Thus, of the nearly $16 billion in bill paydowns in July, about $14 billion was made up early in August when an extra, catch-up bill auction was held. On August 8, the debt ceiling was further extended to September 23 at a level of $2.35 trillion. This second temporary extension has enabled the Treasury to conduct its previously postponed mid-quarter refunding operation; 3-, 10-, and 30-year issues are being auctioned this week to raise about $17 billion in net new money.

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

| | 1987 | | | | | |
|---|---|---|---|---|---|---|
| | Q2 | Q3[e] | June | July[p] | Aug[e] | Sept[e] |
| Treasury financing | | | | | | |
| Total surplus/deficit(-) | 2.5 | -43.5 | -.4 | -23.8 | -24.5 | 4.8 |
| Means of financing deficit: | | | | | | |
| Net cash borrowing from the public | 31.7 | 35.8 | 9.7 | -3.0 | 35.5 | 3.3 |
| Marketable borrowings/ repayments(-) | 23.2 | 31.5 | 8.0 | -7.3 | 36.9 | 1.9 |
| Bills | -15.2 | -4.2 | -4.1 | -15.7 | 18.5 | -7.0 |
| Coupons | 38.4 | 35.7 | 12.1 | 8.4 | 18.4 | 8.9 |
| Nonmarketable | 8.5 | 4.3 | 1.7 | 4.3 | -1.4 | 1.4 |
| Decrease in the cash balance | -31.0 | 1.9 | -7.0 | 20.7 | -7.3 | -11.5 |
| Memo: Cash balance at end of period | 40.1 | 38.1 | 40.1 | 19.4 | 26.6 | 38.1 |
| Other[2] | -3.2 | 5.8 | -2.3 | 6.1 | -3.7 | 3.4 |
| Federally sponsored credit agencies, net cash borrowing[3] | 7.8 | 4.7 | 4.2 | 2.4 | 1.3 | 1.0 |
| FHLBs | 7.5 | 3.3 | 3.7 | 1.3 | 1.1 | .9 |
| FNMA | -.7 | -.5 | .5 | -.3 | -.1 | -.1 |
| Farm Credit Banks | -.8 | -.7 | -.4 | -.3 | -.2 | -.2 |
| FHLMC | .6 | .6 | .2 | .2 | .2 | .2 |
| SLMA | 1.2 | 2.0 | .2 | 1.5 | .3 | .2 |

e--staff estimate.
p--preliminary.
1. Data reported on a not seasonally adjusted, payment basis.
2. Includes checks issued less checks paid, accrued items and other transactions.
3. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
Note: Details may not add to totals due to rounding.

Borrowing by the federally sponsored agencies in the third quarter is expected to slow a bit from the second-quarter pace. The Federal Home Loan Banks, which had accounted for the bulk of agency issuance through June, apparently reduced their borrowing in July and are expected to continue to slow their pace of issuance during the current quarter as advances to thrifts ease from the brisk second-quarter pace. FNMA is expected to continue to pay down debt in the third quarter, after retiring $700 million in the second quarter when an increase in loan prepayments reduced the need for financing. The Farm Credit System also is expected to continue to pay down debt in the face of slack loan demand.

President Reagan this week signed into law a wide-ranging banking bill that provides authority for the insolvent FSLIC to acquire $10.8 billion of additional funds. This bill may have assuaged market fears that FHLB creditworthiness would be compromised by the problems of the FSLIC. In any event, the most recent FHLB securities were issued at narrower spreads over Treasury securities than those of comparable issues priced in July. The spreads between Farm Credit and Treasury securities also have narrowed recently as a congressional bailout bill appears in the works and amid signs that the farm economy may be improving. In late July, the Farm Credit System's offerings of 3- and 6-month bonds were priced at spreads of 95 and 77 basis points over comparable Treasuries, a narrowing of 25 and 16 basis points, respectively, from those at the time of the previous pricing.

## Municipal Securities Markets

Offerings of long-term tax-exempt bonds slowed last month after a strong resurgence in June that accompanied a drop-back in yields from the May highs. The lower pace of issuance has persisted into early August. Both new-capital and refunding volumes were lighter in July, with the temporary suspension of SLGS issuance, noted above, a factor inhibiting advance refunding deals. Offerings to raise new capital have been reduced this year, owing largely to provisions in the tax reform legislation that tightened arbitrage restrictions and further limited issuance of private-purpose bonds.

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

| | 1985 | 1986 | 1987 | | 1987 | | |
|---|---|---|---|---|---|---|---|
| | Year | Year | Q1 | Q2 | May | June | July |
| Total tax-exempt | 19.81 | 14.04 | 10.86 | 9.70 | 6.33 | 13.14 | 9.09 |
| Short-term[1] | 1.96 | 1.79 | .56 | 1.83 | .29 | 2.42 | 2.34 |
| Long-term | 17.85 | 12.25 | 10.30 | 7.57 | 6.04 | 10.72 | 6.75 |
| Refundings[2] | 4.85 | 5.29 | 7.24 | 2.99 | 2.19 | 3.17 | 2.08 |
| New capital | 13.00 | 6.96 | 3.06 | 4.88 | 3.85 | 7.55 | 4.67 |
| Total taxable | .03 | .38 | .27 | .29 | .01 | .50 | .18 |

1. Does not include tax-exempt commercial paper.
2. Includes all refunding bonds, not just advance refundings.

In contrast to the slowing in the issuance of long-term securities, gross issuance of short-term tax-exempt securities--mainly tax and revenue anticipation notes (TRANs)--has continued strong in recent months as many governments have refinanced maturing notes issued for cash flow purposes.

The ability of the municipal bond market to outperform the taxable market recently evidently reflects at least in part a swing in bond-fund activity. Open-end bond funds returned to the market in June as they experienced net inflows of over $1-1/4 billion after two months of net outflows. Anecdotal evidence suggests that positive inflows persisted through July. Additional demand for tax-exempt securities during the recent period came from several newly created closed-end municipal funds; the John Nuveen fund, at $1.5 billion, is the largest to date.

NET FLOWS TO OPEN-END MUNICIPAL BOND FUNDS
($ billions)

| | |
|---|---|
| 1986-Dec. | 2.3 |
| 1987-Jan. | 4.4 |
| Feb. | 3.0 |
| Mar. | 1.8 |
| Apr. | -3.1 |
| May | -0.3 |
| June | 1.3 |

Source: Investment Company Institute.

An investigation by several federal agencies into the sale of up to $12 billion in tax-exempt securities has had little effect on the tax-exempt securities market as a whole. The bonds in question were offered in late 1985 or during the summer of 1986 to beat anticipated tax law changes; the suspicion is that the motivation for the issues was to capture still-allowable arbitrage profits rather than to finance capital projects.

Mortgage Markets

Primary mortgage interest rates have changed little during the intermeeting period. Contract rates on fixed-rate home loan commitments have fluctuated between 10-1/4 and 10-3/8 percent--still about 1-1/4 percentage points above the March lows. Initial rates on one-year adjustable rate mortgages have risen only fractionally since March, however, and the initial rate advantage of ARMs has run at about 2-1/2 percentage points in recent weeks—close to the record 2-3/4 percent level reached in mid-1984 when ARMs briefly captured two-thirds of the market. The ARM share of new conventional mortgage lending has doubled in recent months. In early July, half of all conventional loans closed for the purchase of single-family homes carried adjustable rates—the largest proportion since late 1985.

The competitive position of ARMs also has been enhanced by the increased availability of convertible ARMs, which allow borrowers the option of converting to fixed-rate loans at some point during the life of their loan. In addition, FNMA and FHLMC have been buying and swapping a wider variety of ARM products this year, increasing the liquidity of this market.

The rise in fixed-rate mortgage rates in recent months has resulted in a moderation in the pace of refinancings. In June, refinancings accounted for 28 percent of all mortgage loans originated by FSLIC-insured institutions, off from the record 40 percent in March, but still high by historical standards. The waves of refinancings during the past two years have contributed to a dramatic lowering of interest rates on mortgage debt outstanding. For instance, at the beginning of 1986, a full 46 percent of the $200 billion of FHA/VA fixed-rate level payment home mortgages pooled into GNMA securities carried interest rates of 12 percent or higher; the volume of such securities outstanding has declined by more than half.

The easing in the pace of refinancings and the slackening in real estate activity have resulted in lower gross lending volumes.

Applications for FHA home loans were off in June from a month earlier and were only slightly more than half the volume in June of last year. At FSLIC-insured institutions, mortgage originations were up only slightly in June, despite the sharp market shift toward ARMs, a product in which thrift institutions normally are market leaders.

The slower pace of lending also is evident in the volume of new issues of mortgage pass-through securities. Issuance dropped 10 percent in June, and continued moderation seems likely. In contrast to the slowdown in pass-through issuance, offerings of derivative mortgage securities have rebounded from a May lull. These derivative products, most of which have federally related pass-throughs as collateral, include the now familiar CMOs and more recent innovations such as senior and subordinated classes backed by conventional loans. With the renewed activity of the past two months, gross public issuance of these securities over the first seven months of the year has neared the $60 billion total issuance of 1986.

Consumer Installment Credit

Consumer installment credit grew at an annual rate of 7 percent in June, after declining slightly in May. Growth in the first half of the year averaged just 3 percent, at an annual rate.

The slowdown in consumer credit this year has stemmed in part from the sluggishness of consumer spending, but it also reflects a shift by some households from use of consumer credit to borrowing against home equity lines of credit. Based on data received since June from the regular weekly and monthly reporting banks, it appears that all commercial banks may have held somewhere around $25 billion in revolving home equity

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

| | Mortgage transactions | | Net change in mortgage assets[1] | | |
|---|---|---|---|---|---|
| | Originations (1) | Sales (2) | Total (3) | Mortgage loans (4) | Mortgage-backed securities (5) |
| 1986-Oct. | 25.3 | 17.0 | 6.5 | 2.0 | 4.5 |
| Nov. | 22.5 | 16.0 | 6.0 | 1.7 | 4.3 |
| Dec. | 28.6 | 12.1 | 4.3 | 1.4 | 3.0 |
| 1987-Jan.r | 20.0 | 13.7 | 1.3 | -3.2 | 4.5 |
| Feb.r | 21.3 | 12.1 | -.3 | -.5 | .8 |
| Mar.r | 22.6 | 11.6 | 1.9 | 1.5 | .4 |
| Apr.r | 24.2 | 14.9 | 8.1 | 1.8 | 6.3 |
| May r | 22.4 | 12.0 | 11.8 | 3.1 | 8.7 |
| June p | 22.9 | 10.9 | 1.2 | 2.1 | -.9 |

1. Net changes are adjusted to account for structural changes caused by mergers, acquisitions, liquidations, terminations, or de novo institutions. Prior to January 1987, mortgage assets held by FSLIC-insured institutions, as reported to the FHLB Board, excluded loans in process and other contra assets. Since then, however, these mortgage data have been reported by thrifts to include contra assets. As a result, the net changes in mortgage assets since the beginning of this year reflect the new gross reporting procedure implemented by the FHLB Board.

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

| Period | Total | GNMAs | FHLMCs | FNMAs | Memo: FNMA and FHLMC swap issues |
|---|---|---|---|---|---|
| 1986-Q2 | 19.2 | 7.0 | 7.5 | 4.7 | 8.5 |
| Q3 | 27.3 | 10.0 | 10.4 | 6.8 | 10.9 |
| Q4 | 27.3 | 10.7 | 11.0 | 5.6 | 11.1 |
| 1987-Q1 r | 24.0 | 10.4 | 8.4 | 5.2 | 10.8 |
| Q2 p | 24.9 | 9.6 | 8.4 | 6.9 | 13.2 |
| 1987-Jan. | 25.2 | 10.6 | 8.2 | 6.4 | 11.0 |
| Feb. | 22.2 | 9.7 | 7.8 | 4.7 | 10.2 |
| Mar. r | 24.5 | 10.7 | 9.1 | 4.6 | 11.2 |
| Apr. r | 28.8 | 11.9 | 9.9 | 7.0 | 13.7 |
| May p | 24.2 | 8.4 | 8.7 | 7.1 | 14.1 |
| June p | 21.7 | 8.4 | 6.6 | 6.6 | 11.8 |
| July p | n.a. | n.a. | 9.4 | 5.8 | n.a. |

r—revised. p—preliminary.

debt at midyear.[1] Banks are widely recognized as commanding the largest share of the home equity line market, although the size of that share cannot be gauged with much precision. A recent Board-sponsored survey of households by the University of Michigan found that about 45 percent of the home equity lines held by respondents had been issued by a bank;[2] other industry observers place the bank share at over 60 percent. A bank share of 45 percent would point to an aggregate estimate of $50 to $60 billion outstanding at midyear, up dramatically from the $40 billion or so estimated to have been outstanding at the end of 1986. However, if the bank share is as high as 60 percent, then the total market would seem to be smaller than previously thought. In either case, the data point to a pattern of rapid growth: large weekly reporting banks averaged a compound annual growth rate of close to 85 percent for home equity line balances over a five-week period dating from mid-June. These considerations suggest that borrowing under home equity lines likely has been reducing consumer credit growth by several percentage points.

The recent revisions in GNP statistics have resulted in a downward adjustment in the ratio of consumer installment credit outstanding to disposable personal income, an oft-cited measure of household debt burden. The ratio has been lowered by 0.4 to 0.5 percentage points for recent months. The cyclical (and historical) peak of last fall now is estimated

1. Until data on revolving home equity debt become available on the quarterly Report of Condition (probably on the December report), the sample-based estimate will entail a fairly wide margin of error.
2. Because relatively few households (about 4 percent) have a home equity line, this indication of market share is based on a very small number of observations (52).

at 18.9, still surpassing the previous peak of 16.4 reached in 1979.[1] In June, after several months of weak growth in consumer credit, the debt burden ratio was down to 18.5 percent.

1. Estimates of repayment burdens generally have shown less of a rise during the recent upswing than has the outstandings-based measure and are slightly below the previous peak. To a large extent, this result stems from a lengthening of debt maturities.

CONSUMER INSTALLMENT CREDIT
(Seasonally adjusted)

| | Percent change (at annual rate) | | | | | | Net change (billions of dollars) | | Memo: Outstandings (billions of dollars) |
|---|---|---|---|---|---|---|---|---|---|
| | | | 1987 | | 1987 | | 1987 | | 1987 |
| | 1985 | 1986 | Q1 | Q2 | May r | June p | May r | June p | June p |
| Total[1] | 17.1 | 10.5 | 1.5 | 4.7 | -.7 | 7.1 | -.32 | 3.46 | 586.7 |
| Total, excluding auto | 14.9 | 5.7 | 1.1 | 4.3 | -.8 | 5.4 | -.23 | 1.50 | 337.2 |
| Selected types | | | | | | | | | |
| Auto | 20.7 | 17.8 | 1.7 | 5.3 | -.4 | 9.5 | -.09 | 1.96 | 249.5 |
| Revolving | 22.5 | 10.6 | .6 | 6.2 | 1.4 | 3.4 | .16 | .39 | 137.3 |
| All other | 10.6 | 2.6 | 1.3 | 3.0 | -2.4 | 6.7 | -.40 | 1.11 | 199.9 |
| Selected holders | | | | | | | | | |
| Commercial banks | 15.7 | 8.1 | .5 | 3.4 | .1 | 3.2 | .03 | .70 | 264.2 |
| Finance companies | 26.3 | 20.7 | -1.3 | 2.9 | -6.1 | 14.4 | -.69 | 1.64 | 138.0 |
| Credit unions | 9.9 | 8.0 | 3.7 | 5.8 | 3.4 | 3.6 | .22 | .24 | 79.7 |
| Savings institutions[2] | 30.0 | 10.7 | 10.0 | 10.2 | 4.4 | 19.1 | .22 | .95 | 61.0 |

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

CONSUMER INTEREST RATES
(Annual percentage rate)

| | | | 1987 | | | | |
|---|---|---|---|---|---|---|---|
| | 1985 | 1986 | Feb. | Mar. | Apr. | May | June |
| At commercial banks[1] | | | | | | | |
| New cars (48 mo.) | 12.91 | 11.33 | 10.35 | ... | ... | 10.24 | ... |
| Personal (24 mo.) | 15.94 | 14.83 | 14.11 | ... | ... | 14.00 | ... |
| Credit cards | 18.69 | 18.26 | 18.11 | ... | ... | 17.93 | ... |
| At auto finance cos.[2] | | | | | | | |
| New cars | 11.98 | 9.44 | 10.78 | 10.59 | 10.81 | 10.69 | 10.64 |
| Used cars | 17.59 | 15.95 | 14.56 | 14.40 | 14.49 | 14.45 | 14.47 |

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

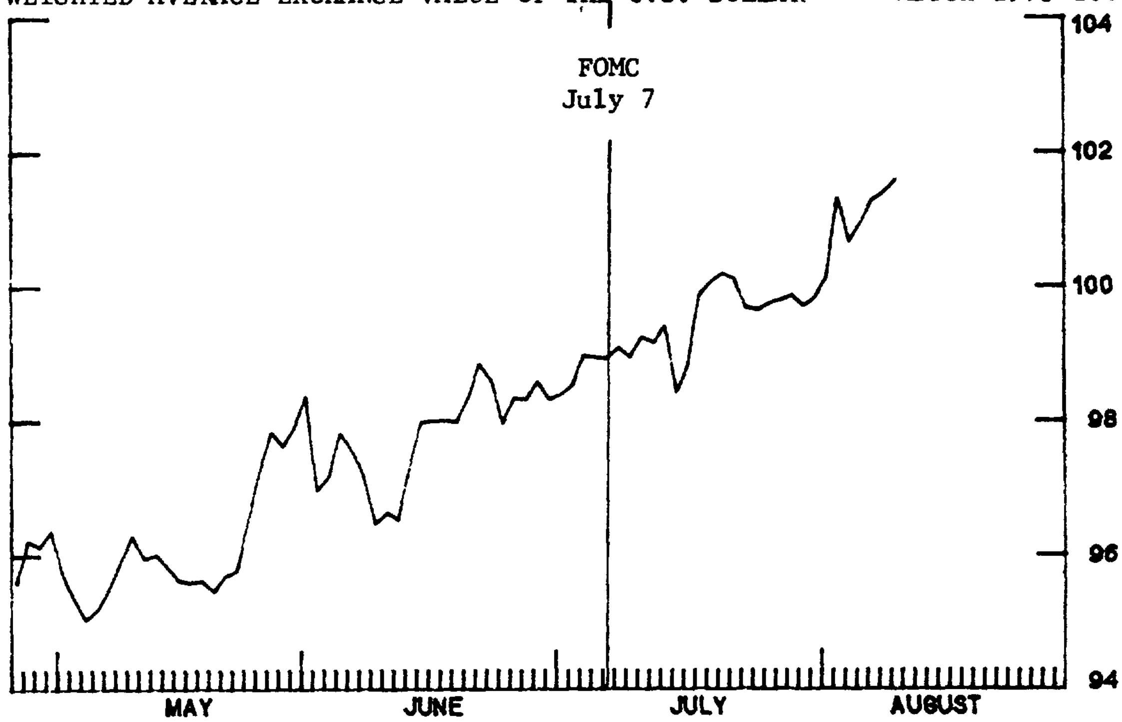
Foreign Exchange Markets

The weighted-average foreign exchange value of the dollar has appreciated 2-1/2 percent on balance since the last FOMC meeting, as shown in the upper panel of Chart 1. Early in the intermeeting period, continued optimism about adjustment in U.S. external accounts provided support for the dollar. But the dollar fell sharply in mid-July following the release of U.S. trade data that disappointed these expectations. Subsequently, the dollar has recovered strongly, buoyed by growing tensions in the Middle East and reports of better-than-expected U.S. economic activity.

The dollar appreciated despite a general narrowing of interest rate differentials that favor dollar-denominated assets. Short-term interest rates in the United States -- shown in the table at the bottom of Chart 1 -- are little changed since the last FOMC meeting, while a weighted-average of comparable foreign rates has risen 20 basis points. In Germany, three-month interest rates have firmed 30 basis points. As selling pressure on the dollar abated further, the Bundesbank has taken the opportunity to tighten monetary conditions, perhaps providing it room to maneuver should exchange rate pressures resurface. The key rate on its securities repurchase agreements was edged up to 3.6 percent in late July from the 3.55 percent that had prevailed since mid-May. Elsewhere, short-term interest rates in Canada were boosted 60 basis points to counter downward pressure on the Canadian dollar that had developed following losses for the Conservative Party in the latest by-election. In the United Kingdom, concern about rapid credit growth and a possible overheating of the economy motivated the Bank of

Chart 1

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




INTEREST RATES IN SELECTED COUNTRIES

| | 3-month | | | | | long-term | | |
|---|---|---|---|---|---|---|---|---|
| | U.S. CD's | Japan | Germany | U.K. | Canada | U.S. | Japan | Germany |
| Week ended: | | | | | | | | |
| 1987 | | | | | | | | |
| July 8 | 6.76 | 3.74 | 3.69 | 9.16 | 8.45 | 8.30 | 3.98 | 5.71 |
| July 15 | 6.68 | 3.75 | 3.77 | 9.06 | 8.51 | 8.37 | 4.25 | 5.71 |
| July 22 | 6.63 | 3.74 | 3.88 | 9.14 | 8.52 | 8.44 | 4.61 | 5.81 |
| July 29 | 6.70 | 3.74 | 3.96 | 9.28 | 8.75 | 8.59 | 4.79 | 5.93 |
| Aug. 5 | 6.76 | 3.74 | 3.91 | 9.30 | 9.20 | 8.72 | 5.07 | 5.93 |
| Aug. 12 | 6.69 | 3.71 | 3.95 | 9.89 | 9.07 | 8.73* | 5.04 | 6.04 |

*Weekly average does not include August 12.

England to raise its money-market dealing rates by a full percentage point in early August. Major U.K. clearing banks responded with a comparable increase in their base lending rates to a level of 10 percent.

During the intermeeting period, bond yields generally rose worldwide, but the increase in yields in Japan was particularly acute. The yield on the bellwether 10-year bond in Japan surged to 5.4 percent reflecting stronger-than-expected economic activity and perceived concern by the Bank of Japan about rapid money growth, but since has dropped back to 5.0 percent as the latest money supply figures indicate a slight slowing in the growth of M2 plus CDs. On balance, these yields are up 90 basis points over the intermeeting period. During the same interval, long-term interest rates in the United States rose about 1/2 percentage point, while yields in Germany advanced only 35 basis points. With the sharp rise in long-term interest rates bolstering the yen, the dollar firmed only 1 percent against the yen, compared with 3 percent against the mark.

. The Desk sold $631 million against marks, shared equally by the accounts of the System and Treasury, Prices of precious metals have risen sharply since the last FOMC meeting in reaction to developments in the Persian Gulf. The price of gold is up 4 percent on balance at a level of $461 an ounce but down from its intermeeting peak of $477. Silver prices posted a slightly larger net gain, ending the intermeeting period at just below $7.80 an ounce.

U.S. International Financial Transactions

U.S. banks reported a small capital inflow in the second quarter, bringing the total inflow through banking offices for the first half of 1987 to $9.8 billion. (See line 1 of the Summary table.) Though small in total, the month-to-month flows in the second quarter were large and variable. In April U.S. banks reported a $3.3 billion outflow; in May they reported a $9.1 billion inflow. At the end of June, U.S. banks increased their claims on their own foreign offices to produce an outflow of $5.4 billion; banking data on transactions with own foreign offices for July indicate that these claims have remained at their higher levels. (See line 1 of the International Banking table.) The inflow in May coincided with large Euromarket deposits by foreign central bank and slow core deposit growth at money center banks. The outflows in June and July, which were concentrated at several money center banks, coincided with a rundown in Eurodollar deposits of U.S. residents and weak loan demand at money center banks.

Recorded inflows due to official transactions (line 4 of the Summary table) were small in May and June, bringing the total inflow for the second quarter to $9.4 billion.

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

| | 1985 Year | 1986 Year | 1986 Q2 | 1986 Q3 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Apr. | 1987 May | 1987 June |
|---|---|---|---|---|---|---|---|---|---|---|
| Private Capital | | | | | | | | | | |
| Banks | | | | | | | | | | |
| 1. Change in net foreign positions of banking offices in the U.S. (+ = inflow) | 33.6 | 20.3 | -8.5 | 12.9 | 7.6 | 9.4 | 0.4 | -3.3 | 9.1 | -5.4 |
| Securities | | | | | | | | | | |
| 2. Private securities transactions, net | 43.0 | 66.0 | 21.3 | 17.2 | 14.7 | 17.0 | 15.5 | 4.9 | 5.3 | 5.4 |
| a) foreign net purchases (+) of U.S. corporate bonds | 46.0 | 53.3 | 15.9 | 12.6 | 12.1 | 8.6 | 7.4 | 3.4 | 2.0 | 2.1 |
| b) foreign net purchases (+) of U.S. corporate stocks | 4.8 | 18.0 | 7.0 | 4.5 | 0.3 | 10.2 | 8.7 | 3.3 | 3.8 | 1.6 |
| c) U.S. net purchases (-) of foreign securities | -7.9 | -5.3 | -1.5 | 0.1 | 2.3 | -1.8 | -0.5 | -1.7 | -0.4 | 1.7 |
| 3. Foreign net purchases (+) of U.S. Treasury obligations | 20.5 | 4.4 | 3.8 | -1.5 | -3.8 | -1.8 | -2.0 | -5.7 | -3.4 | 7.2 |
| Official Capital | | | | | | | | | | |
| 4. Changes in foreign official reserves assets in U.S. (+ = increase) | -2.0 | 33.3 | 14.6 | 14.7 | 1.8 | 15.3 | 9.4 | 8.9 | 0.1 | 0.4 |
| a) By area | | | | | | | | | | |
| G-10 countries (incl. Switz.) | -0.4 | 30.6 | 11.2 | 14.6 | 0.9 | 15.7 | 11.6 | 8.4 | 3.0 | 0.3 |
| OPEC | -6.9 | -8.1 | -2.3 | -2.9 | -4.7 | -2.8 | -2.0 | -0.8 | -0.3 | -0.9 |
| All other countries | 5.3 | 10.7 | 5.8 | 3.0 | 5.5 | 2.4 | -0.3 | 1.3 | -2.6 | 1.0 |
| b) By type | | | | | | | | | | |
| U.S. Treasury securities | -0.8 | 34.5 | 14.5 | 12.2 | 4.6 | 12.1 | 10.9 | 7.5 | 1.4 | 2.1 |
| Other 1/ | -1.1 | -1.2 | 0.1 | 2.5 | -2.8 | 3.2 | -1.5 | 1.4 | -1.3 | -1.6 |
| 5. Changes in U .S. official reserve assets (+ = decrease) | -3.9 | 0.3 | -0.0 | 0.3 | 0.1 | 2.0 | 3.4 | 2.7 | 0.1 | 0.6 |
| Other transactions (Quarterly data) | | | | | | | | | | |
| 6. U.S. direct investment (-) abroad | -17.3 | -28.0 | -7.5 | -5.7 | -3.8 | -10.0 | n.a. | n.a. | n.a. | n.a. |
| 7. Foreign direct investment (+) in U.S. | 19.0 | 25.1 | 4.5 | 6.1 | 12.6 | 3.4 | n.a. | n.a. | n.a. | n.a. |
| 8. Other capital flows (+ = inflow) 2/ 3/ | 5.6 | -3.9 | -5.4 | 1.1 | -3.0 | 3.8 | n.a. | n.a. | n.a. | n.a. |
| 9. U.S. current account balance 3/ | -116.4 | -141.4 | -33.0 | -36.6 | -38.0 | -37.1 | n.a. | n.a. | n.a. | n.a. |
| 10. Statistical discrepancy 3/ | 17.9 | 23.9 | 10.2 | -8.5 | 11.8 | -2.0 | n.a. | n.a. | n.a. | n.a. |
| MEMO: | | | | | | | | | | |
| U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted) | -124.4 | -147.7 | -33.6 | -37.1 | -38.6 | -38.1 | n.a. | n.a | n.a. | n.a. |

1. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
2. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking and official transactions not shown elsewhere. In addition, it includes amounts resulting from revisions of the data in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.
3. Includes seasonal adjustment for quarterly data.
* Less than $50 million.
NOTE: Details may not add to total because of rounding.

OPEC reserves in the United States continued to decline in the second quarter, despite more favorable oil market conditions, probably reflecting movements to diversify the currency composition of reserve assets.

. Foreign official reserve assets in the United States of all other countries were virtually unchanged in the second quarter.

On July 15 Taiwan liberalized its foreign exchange controls making it easier for residents to invest abroad. The aim of the new policy is to reduce official reserves, now estimated at $61 billion. Under the new rules, private foreign exchange transactions for the current account are no longer subject to prior official approval; capital account transactions that result in capital outflows are not subject to prior approval when they are for less than $1 million per transaction and cumulate to less than $5 million per year per account. The likely effect of this change on U.S. capital flows depends on the extent to which the private portfolio preferences differ from those of the Taiwanese authorities. Although recent diversification has reduced the share of dollar assets in Taiwan's official portfolio to about 80 percent in May from 93 percent a year earlier, it is likely that the official portfolio is more heavily weighted toward dollar assets, and U.S. Treasury securities in particular, than will be the private portfolio that will replace part of it if the new program is successful.

INTERNATIONAL BANKING DATA
(Billions of dollars)

| | 1983 Dec. | 1984 Dec. | 1985 Dec. | 1986 Dec. | 1987 Feb. | Mar. | Apr. | May | June | July 2/ |
|---|---|---|---|---|---|---|---|---|---|---|
| 1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS | 44.5 | 33.0 | 28.2 | 22.3 | 15.3 | 9.1 | 12.8 | 3.2 | 5.0 | 12.6 |
| (a) U.S.-chartered banks | 40.5 | 32.1 | 32.4 | 31.7 | 24.7 | 21.6 | 23.1 | 16.3 | 16.3 | 23.7 |
| (b) Foreign-chartered banks | 4.0 | .9 | -4.2 | -9.4 | -9.5 | -12.4 | -10.3 | -13.1 | -11.3 | -11.2 |
| 2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks | 18.6 | 20.7 | 18.7 | 16.8 | 16.5 | 16.0 | 16.4 | 15.7 | 15.5 | 16.0 |
| 3. Eurodollar Holdings of U.S. Nonbank Residents 1/ | 124.3 | 117.4 | 111.9 | 123.2 | 131.7 | 134.0 | 130.6 | 134.0 | 136.7 | 128.8 |

1. Includes term and overnight Eurodollars held by money market mutual funds.
2. Through July 27, 1987.

Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices. Line 2 is an average of daily data. Line 3 is the month-end value for data through September 1983. For dates after September 1983, the overnight portion is an average of daily data and the term portion is an average of Wednesday data.

Net private securities transactions produced an inflow of $13.5 billion in the second quarter of 1987 as net purchases of corporate securities (line 2 of the Summary table) more than offset net sales of Treasury securities (line 3). This shift out of Treasury securities into corporate assets continues a pattern seen since the third quarter of 1986 and brings total foreign private net sales of Treasury securities in the first half of 1987 to $3.8 billion. The trend out of Treasury securities may have been reversed in June, however, as the World Bank recorded net purchases of $3.4 billion and Japanese residents recorded net purchases of $3 billion. In the first half of 1987, more than half of the foreign investment in U.S. corporate securities has been in stocks, compared with about a quarter in 1986. This shift toward stocks has been particularly pronounced for investment from Asia where stocks accounted for 84 percent of the net purchases of corporate securities in 1987, compared with 34 percent in 1986. Reports from the Bank of Japan indicate that Japanese private demand for U.S. stocks and corporate bonds accelerated in July. U.S. residents sold $1.7 billion net of foreign securities in June, probably in response to a firmer dollar. These sales offset the net purchases in the April and May to produce a net outflow of $0.5 billion for the second quarter.

Merchandise Trade

Data for the merchandise trade balance for June will be issued on August 14, and will be discussed in the Greenbook supplement. Available data for April and May suggest that on a seasonally adjusted, balance-of-payments basis the April-May average deficit was about $147 billion, marginally smaller than the deficit in the first quarter (see table below).

U.S. MERCHANDISE TRADE
(Billions of dollar, annual rates)

| | Balance-of-payments basis, seasonally adjusted | | | | | | |
|---|---|---|---|---|---|---|---|
| | Exports | | | Imports | | | |
| | Total (1) | Ag. (2) | Nonag. (3) | Total (4) | Oil (5) | Non-oil (6) | Balance (7) |
| Years | | | | | | | |
| 1984 | 220 | 38 | 182 | 332 | 57 | 275 | -112 |
| 1985 | 216 | 30 | 186 | 338 | 50 | 288 | -122 |
| 1986 | 224 | 27 | 197 | 369 | 34 | 335 | -144 |
| Quarters | | | | | | | |
| 1985-4 | 214 | 28 | 186 | 358 | 56 | 302 | -145 |
| 1986-1 | 216 | 28 | 187 | 355 | 41 | 314 | -140 |
| 2 | 228 | 25 | 202 | 362 | 31 | 332 | -135 |
| 3 | 226 | 27 | 200 | 375 | 32 | 343 | -149 |
| 4 | 228 | 28 | 200 | 383 | 32 | 350 | -154 |
| 1987-1r | 231 | 26 | 205 | 383 | 35 | 348 | -152 |
| Apr/May e | 245 | 30 | 215 | 392 | 37 | 355 | -147 |

r/ Revision derived from GNP Accounts.
e/ FR staff estimate.

The average value of both exports and imports increased in April-May from first-quarter levels. Agricultural exports rose by 10 percent, boosted by strong exports of corn to the Soviet Union. (Data for agricultural shipments in June are also expected to be buoyed by shipments of wheat to the USSR.) The rise in non-agricultural exports (about 6 percent in value) appears to have been largely an increase in volume, as export prices of manufactured goods rose little. Exports of machinery, chemicals and consumer goods appear to have been particularly strong. The rise in imports for April-May (about 2 percent from first-quarter levels) was largely in oil and passenger cars from Japan and South Korea. Import prices continued to climb in the second quarter according to preliminary data, accounting for much of the rise in value.

The value of oil imports increased in May by about $6 billion to about $40 billion, at a seasonally-adjusted annual rate. (See table below.) Prices edged up to $17.20 per barrel reflecting increased demand for oil stocks, increased tension in the Middle East, and Saudi Arabian restrictions on liftings by Aramco partners. The volume of oil imports increased to an average of 6.4 million barrels per day.

OIL IMPORTS

| Oil Imports* | Year 1985 | Year 1986 | 1986 Q3 | 1986 Q4 | 1987 Q1 | 1987 A/M[e] | 1987 May[e] |
|---|---|---|---|---|---|---|---|
| Value (Bil. $, SAAR) | 50.39 | 33.76 | 31.61 | 32.04 | 34.76 | 36.90 | 39.80 |
| Price ($/BBL) | 26.33 | 14.18 | 11.39 | 12.74 | 15.63 | 17.00 | 17.20 |
| Volume (mbd, SA) | 5.24 | 6.52 | 7.61 | 6.90 | 6.09 | 5.94 | 6.35 |

*/ As published in the balance-of-payments accounts.
e/ FR staff estimate.

Import and Export Prices (BLS Measures)

The pattern of increases in the prices of imports and exports in the first half of 1987 reflects the increase in the price of oil since late last year, a strengthening in world commodity prices, the regional distribution of the dollar's depreciation, and the sectoral distribution of barriers to trade. Among the several measures of price movements are the survey-of-transactions price indexes compiled by the Bureau of Labor Statistics. These prices are one of several components incorporated in the calculation of the deflators and fixed-weight indexes used to analyze the trade and GNP accounts.

According to the BLS price indexes, non-oil import prices increased at a 10.4 percent annual rate in the second quarter; prices of non-oil imports averaged about 8.8 percent higher than a year earlier (Q2/Q2). (See table below.)

IMPORT AND EXPORT PRICE MEASURES

(BLS prices*, surveyed last month of each quarter)
(percent change from previous period, annual rate)

| | Annual | Quarters | | | |
|---|---|---|---|---|---|
| | 1986:2-1987:2 | 1986:3 | 1986:4 | 1987:1 | 1987:2 |
| All imports | 14.5 | 3.2 | 10.0 | 26.0 | 16.0 |
| Non-oil | 8.8 | 11.6 | 2.4 | 10.0 | 10.4 |
| Consumer goods1/ | 10.3 | 13.6 | 2.0 | 13.2 | 11.2 |
| Capital goods2/ | 10.4 | 10.0 | 4.8 | 16.8 | 8.8 |
| Industrial materials3/ | 6.9 | 5.6 | -1.6 | 8.4 | 14.8 |
| All exports | 3.3 | -6.8 | 4.8 | 4.0 | 11.2 |
| Consumer goods1/ | 2.5 | 0.0 | 4.4 | 4.4 | 0.8 |
| Capital goods4/ | 1.9 | 0.8 | 2.4 | 2.4 | 1.6 |
| Industrial materials3/ | 8.6 | -6.8 | 6.4 | 14.4 | 20.0 |

* End-use classification.
1/ Excludes automobiles and food.
2/ Excludes automobiles.
3/ Excludes oil.
4/ Excludes automobiles and aircraft.

The prices of imported industrial materials, excluding oil, increased at a 14.8 percent annual rate in the second quarter, significantly faster than in previous quarters. Within this category, increases in prices of chemicals, fertilizers, and other petroleum-based intermediate materials were most notable. Prices increased as well for unfinished imported textile products, which are restrained under the Multifiber Arrangement.

The decline of the dollar against the currencies of the other G-10 countries continues to be reflected in increases in the prices of goods that are imported primarily from Japan and Western Europe. Prices of non-automotive capital goods rose at an 8.8 percent annual rate on average in the second quarter; prices of non-automotive capital goods were 10.4 percent higher than a year earlier (Q2/Q2). Within this category, increases in prices of machine tools (restrained by voluntary agreements) and in the prices of construction and special-purpose machinery were particularly notable.

Average prices of imports of consumer goods rose somewhat more than did prices of capital goods -- increasing 11.2 percent at an annual rate in the second quarter. Prices for consumer goods were 10.3 percent higher than a year earlier (Q2/Q2). In particular, prices increased for textile products, chinaware, photographic equipment, and pharmaceuticals, reflecting quantitative restraints, changes in the value of the dollar, and the increase in oil prices.

Movements in prices of U.S. exports continue to be dominated by price developments in the domestic U.S. economy. However, within certain sectors, export prices appear to have been influenced by changes in world prices for oil and other commodities, and by increasingly competitive pricing by foreign exporters to third markets.

U.S. export prices increased by only 3.3 percent during the last year (Q2/Q2), although in the second quarter, export prices surged by 11.2 percent at an annual rate. The significant increase in prices in the industrial materials category (which jumped by an average of 20 percent at an annual rate in the second quarter) was paced by large increases in chemicals, certain metals (especially silver and iron and steel), and agricultural materials (especially cotton).

Increases in the prices of exports of capital goods have been muted, increasing on average only 1.9 percent over the year (Q2/Q2), and only 1.6 percent, at an annual rate, in the second quarter. In the fight for international markets, U.S. exporters may be exercising restraint in their pricing policies as they compete against aggressive foreign producers who are reducing export prices measured in their domestic currencies.

Increases in the prices of exports of consumer goods also have been small, increasing only 2.5 percent in the last year (Q2/Q2), and less than 1 percent, at an annual rate, in the second quarter. In fact, export prices have fallen in several sensitive sectors, such as electronic goods, where the competition includes firms of the newly industrializing countries whose currencies have appreciated relatively little against the dollar.

Developments in the Foreign Industrial Countries

The pace of economic activity abroad appears to have rebounded on average in the second quarter from its sluggish pace earlier in the year. In the United Kingdom, recent data indicate continued broad-based strength in economic activity, while German industrial production in the second quarter retraced its steep decline of the first quarter. In contrast, growth in Japan and, perhaps, in Canada appears to have slowed from the robust first-quarter rates. While for the second quarter as a whole growth in Japan was sluggish, data available so far for June suggest some pickup in economic activity.

Consumer price inflation remains low abroad but prices have continued to increase relative to year-earlier levels in most major industrial economies. Moreover, year-over-year increases in wholesale or producer prices have picked up in the United Kingdom, Canada, and Italy, and the rate of decline in Japanese, German, and French producer prices has slowed. Trade and current account surpluses remain very large in Japan and Germany, but data on trade volumes indicate continued real adjustment in both exports and imports. Trade balances deteriorated recently in Italy, France and the United Kingdom, but improved in Canada.

Individual Country Notes. In Japan, recent data indicate that growth has slowed substantially in the second quarter from the rapid pace of the first quarter. Industrial production declined 0.5 percent (s.a.) in the second quarter, and the unemployment rate averaged a record 3.1 percent (s.a.). However, industrial production grew 3.4 percent (s.a.) in June and the inventory-to-shipments ratio declined. In four of the first five months of 1987, total private new machinery

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

| | Q4/Q4 1985 | Q4/Q4 1986 | 1986 Q3 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Feb. | 1987 Mar. | 1987 Apr. | 1987 May | 1987 June | Latest 3 months from year ago 2/ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Canada | | | | | | | | | | | | |
| GDP | 4.0 | 1.8 | .1 | .0 | 1.5 | n.a. | * | * | * | * | * | 2.7 |
| IP | 5.2 | -1.4 | -1.2 | .9 | 2.1 | n.a. | 1.1 | .6 | -.7 | .5 | n.a. | 2.1 |
| France | | | | | | | | | | | | |
| GNP | 1.8 | 2.2 | .4 | .4 | .0 | n.a. | * | * | * | * | * | 2.1 |
| IP | 2.0 | -.3 | 1.6 | -1.3 | -.3 | n.a. | 3.0 | 1.0 | -1.0 | 1.0 | n.a. | 2.0 |
| Germany | | | | | | | | | | | | |
| GNP | 2.2 | 2.4 | .7 | -.1 | -.8 | n.a. | * | * | * | * | * | 2.4 |
| IP | 3.4 | .6 | .7 | -.8 | -2.8 | 2.7 | 3.2 | -2.2 | 3.4 | .5 | -1.7 | -.3 |
| Italy | | | | | | | | | | | | |
| GNP | 3.0 | 2.4 | .0 | -.0 | -.4 | n.a. | * | * | * | * | * | 2.2 |
| IP | 1.0 | 2.8 | -3.4 | 1.6 | 3.0 | n.a. | 3.1 | 2.1 | -2.1 | n.a. | n.a. | 1.2 |
| Japan | | | | | | | | | | | | |
| GNP | 4.2 | 2.0 | .7 | .7 | 1.2 | n.a. | * | * | * | * | * | 3.7 |
| IP | .9 | -.5 | -.4 | -.0 | 1.4 | -.5 | -.6 | 1.7 | -1.6 | -1.4 | 3.4 | .5 |
| United Kingdom | | | | | | | | | | | | |
| GNP | 2.6 | 3.5 | .7 | 1.0 | 1.3 | n.a. | * | * | * | * | * | 3.3 |
| IP | 4.6 | 2.2 | 1.0 | -.0 | 1.2 | n.a. | 1.3 | .1 | -.7 | 1.2 | n.a. | 2.6 |
| United States | | | | | | | | | | | | |
| GNP | 3.3 | 2.2 | .4 | .4 | 1.1 | .6 | * | * | * | * | * | 2.5 |
| IP | 1.8 | 1.1 | .5 | .8 | .8 | .7 | .6 | .1 | .0 | .5 | .2 | 2.8 |

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

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

| | Q4/Q4 1985 | Q4/Q4 1986 | 1986 Q1 | 1986 Q2 | 1986 Q3 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Apr. | 1987 May | 1987 June | 1987 July | Latest 3 months from year ago |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Canada | | | | | | | | | | | | | |
| CPI | 4.2 | 4.3 | 1.2 | .8 | 1.2 | 1.0 | .9 | 1.4 | .4 | .6 | .3 | n.a. | 4.6 |
| WPI | 2.5 | .3 | .9 | -1.5 | .2 | .7 | .3 | 1.1 | .4 | .7 | .2 | n.a. | 2.2 |
| France | | | | | | | | | | | | | |
| CPI | 4.8 | 2.1 | .1 | .7 | .6 | .7 | 1.2 | .9 | .5 | .2 | .2 | n.a. | 3.4 |
| WPI | 1.9 | -3.5 | -.7 | -1.4 | -.7 | -.7 | .7 | n.a. | * | * | * | * | -2.2 |
| Germany | | | | | | | | | | | | | |
| CPI | 1.8 | -1.0 | .0 | -.3 | -.5 | -.3 | .6 | .4 | .2 | .1 | .2 | .0 | .3 |
| WPI | -1.1 | -9.0 | -2.1 | -2.6 | -2.9 | -1.6 | -.2 | .0 | .1 | .0 | .1 | -.4 | -3.5 |
| Italy | | | | | | | | | | | | | |
| CPI | 8.6 | 4.7 | 1.8 | 1.1 | .6 | 1.2 | 1.3 | 1.0 | .3 | .4 | .4 | n.a. | 4.2 |
| WPI | 5.9 | -2.4 | -.5 | -1.8 | -.8 | .7 | 1.5 | 1.0 | .5 | .4 | .2 | n.a. | 2.4 |
| Japan | | | | | | | | | | | | | |
| CPI | 2.0 | .1 | .3 | .3 | -.5 | .0 | -.3 | 1.2 | .9 | .2 | -.2 | -.5 | .4 |
| WPI | -3.7 | -10.5 | -2.4 | -4.2 | -2.8 | -1.5 | -.5 | -.5 | -.6 | -.2 | .5 | n.a. | -5.2 |
| United Kingdom | | | | | | | | | | | | | |
| CPI | 5.5 | 3.4 | .7 | 1.3 | .1 | 1.3 | 1.2 | 1.5 | 1.2 | .1 | .0 | n.a. | 4.2 |
| WPI | 5.2 | 4.2 | 1.4 | 1.6 | .4 | .8 | 1.2 | 1.1 | .5 | .4 | -.1 | .1 | 3.6 |
| United States | | | | | | | | | | | | | |
| CPI (SA) | 3.5 | 1.3 | .4 | -.3 | .6 | .7 | 1.3 | 1.2 | .4 | .3 | .4 | n.a. | 3.8 |
| WPI (SA) | 1.4 | -1.8 | -1.2 | -1.2 | -.1 | .7 | .7 | 1.3 | .7 | .3 | .2 | n.a. | 2.6 |

1. Asterisk indicates that monthly data are not available.

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

| | 1985 | 1986 | 1986 Q1 | 1986 Q2 | 1986 Q3 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Apr. | 1987 May | 1987 June | 1987 July |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Canada** | | | | | | | | | | | | |
| Trade | 12.4 | 7.5 | 1.7 | 2.3 | 1.7 | 1.8 | 2.1 | n.a. | 1.2 | .7 | n.a. | n.a. |
| Current account | -.4 | -6.3 | -1.9 | -1.4 | -1.4 | -1.6 | -1.7 | n.a. | * | * | * | * |
| **France** | | | | | | | | | | | | |
| Trade | -2.6 | -.1 | .4 | -.8 | -.1 | .4 | -1.0 | -2.2 | -.6 | -.9 | -.6 | n.a. |
| Current account | .1 | 3.7 | 1.1 | .5 | 1.2 | .9 | .3 | n.a. | * | * | * | * |
| **Germany** | | | | | | | | | | | | |
| Trade (NSA) | 25.4 | 52.3 | 9.5 | 12.5 | 14.1 | 16.2 | 15.1 | 15.4 | 4.9 | 5.9 | 4.6 | n.a. |
| Current account (NSA) | 13.9 | 36.4 | 6.9 | 8.3 | 8.1 | 13.2 | 10.6 | 10.3 | 3.4 | 4.4 | 2.5 | n.a. |
| **Italy** | | | | | | | | | | | | |
| Trade | -11.2 | -1.5 | -1.5 | -1.1 | .9 | .1 | -1.3 | n.a. | -.7 | n.a. | n.a. | n.a. |
| Current account (NSA) | -3.5 | 4.6 | -3.3 | 1.3 | 5.4 | 1.2 | n.a. | n.a. | * | * | * | * |
| **Japan** | | | | | | | | | | | | |
| Trade | 46.1 | 82.5 | 15.9 | 20.4 | 23.6 | 22.5 | 23.6 | 19.0 | 7.1 | 6.4 | 5.5 | 6.2 |
| Current account 2/ | 49.2 | 85.5 | 15.9 | 21.6 | 23.8 | 24.3 | 24.9 | 20.9 | 7.4 | 7.1 | 6.4 | n.a. |
| **United Kingdom** | | | | | | | | | | | | |
| Trade | -2.6 | -12.4 | -2.1 | -2.4 | -4.3 | -3.7 | -1.7 | -4.0 | -.8 | -1.9 | -1.3 | n.a. |
| Current account | 3.9 | -1.6 | .6 | .2 | -1.4 | -1.1 | 1.0 | -1.0 | .2 | -.9 | -.3 | n.a. |
| **United States** | | | | | | | | | | | | |
| Trade 2/ | -122.1 | -144.3 | -35.0 | -33.6 | -37.1 | -38.6 | -38.1 | n.a. | * | * | * | * |
| Current account | -116.4 | -141.4 | -33.0 | -33.8 | -36.6 | -38.0 | -37.1 | n.a. | * | * | * | * |

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

orders (s.a.) declined, including a sizable drop in May. The consumer and housing sectors show signs of strength. Retail sales rose strongly in May to a level 8.4 percent above the May 1986 level. After sluggish growth earlier this year, new housing starts picked up in the second quarter: new housing starts in April and May were on average 4.6 percent (s.a.) higher than in the first quarter.

Inflation remains low in Japan. For the three months ending July, consumer prices were a modest 0.4 percent above their level for the comparable period in 1986. However this represents some pickup in inflation from the first quarter when consumer prices were 0.5 percent below their year-earlier level. The rate of decline of wholesale prices has slowed markedly in recent months. In June, the all-commodities index of wholesale prices was 4.2 percent below the year-earlier level. Japan's trade surplus (s.a.) declined in dollar terms in May and June but then increased in July. For the first seven months of 1987, the cumulative trade surplus was $84 billion (s.a.a.r.) while the cumulative current account surplus for the first six months was $90.8 billion (s.a.a.r.). In the first seven months of this year, export volume was 2.5 percent below, and import volume was 5.4 percent above, their year-earlier levels.

In July, the Diet passed a 2.1 trillion yen ($14 billion) supplemental budget for General Account spending and a 845 billion yen ($6 billion) budget for the Fiscal Investment and Loan Program to provide financing for the core of the 6 trillion yen ($40 billion) fiscal stimulus package announced at the end of May. This is the largest supplemental budget in 13 years. The supplemental budget for the General Account expenditures will be financed by 1.4 trillion yen of construction bonds, 460 billion yen in proceeds from the sale of shares in NTT, and the balance from unspent funds carried over from the previous fiscal year.

The LPD and opposition parties in the Diet recently have agreed upon a limited version of the tax reform plan. Under the compromise plan, the LPD agreed to expand the FY 1987 income tax reduction from 1.3 to 1.5 trillion yen (about $10 billion); to increase the size of FY 1988 tax reduction to more than 2 trillion yen ($13 billion); to postpone the date for elimination of tax exemption on interest for small savings accounts; and to abandon the government's plan to tax income from workers' capital accumulation accounts. No legislation has been submitted authorizing corporate tax cuts or adoption of an indirect tax, nor has a consensus emerged on how to formulate a more generalized tax reform package.

Money growth remains rapid in Japan with M2+CDs increasing 10 percent in June relative to a year earlier. This brings the second-quarter average growth rate of that aggregate to 10 percent over the second quarter of 1986, exceeding the growth rate projected by the Bank of Japan of "about 9 percent." The Japanese yield curve has steepened in recent months. The yield on the bellwether Japanese government bond has risen from 2.6 percent in mid-May to about 5.2 percent currently while the 3-month Gensaki rate edged down from 3.8 to 3.7 percent. Increased concern about future inflation, an upward revision in expectations for economic growth, and a perception that the Bank of Japan is now less likely to reduce the discount rate further in the near future are cited to explain these developments.

Industrial production in Germany fell 1.7 percent in June to a level 1.8 percent below June last year. However, increased production in the second quarter as a whole almost offset the steep decline of the first quarter. The swing in total production between the first and second quarters this year occurred in large part in the construction sector, which suffered from unusually severe winter weather early this year and subsequently made up for earlier losses. By June, industrial production excluding construction exceeded its level at the end of 1986 while total industrial production was still below its end-1986 level. New orders for manufactured goods fell nearly one percent in June, as domestic orders declined but foreign orders increased. These data suggest that the pace of production will be at best moderate this summer. The business sentiment index rose in June, probably reflecting some gain in confidence in a stabilized value of the mark in exchange markets. The consumption climate index, on the other hand, fell in June. The rate of unemployment through June this year remained unchanged at just below 9 percent.

Consumer prices were unchanged from June to July, while the level in July was 0.7 percent above a year ago. Import prices, which have fallen for two years, have risen slightly since March. This pattern is beginning to be reflected in wholesale and producers prices, for which the annual rates of decline have slowed in recent months. The trade surplus in June was $4.6 billion (n.s.a.) bringing the cumulative surplus through June to $30.5 billion, compared with $22 billion for the same period of last year. The cumulative current account surplus through June was $20.9 billion compared with $15.2 billion a year ago.

The volume of exports through April--the latest available data--was 1.8 percent below a year ago, while import volume had risen 2.1 percent.

France. Official announcements concerning the 1988 budget indicate that the government will try to cut the budget deficit further (from 2-1/2 to 2 percent of GDP). While most categories of spending will be cut in real terms, the budgets for defense, labor and social affairs, and research are slated for a real increase.

Giovanni Goria formed a new Italian government on July 28. Goria, a Christian Democrat, is the youngest Prime Minister in the history of the Republic. His minister of the Treasury is the Socialist Giuliano Amato. The new government is again a coalition of the five centrist parties. The economic policies of the new government are not expected to differ significantly from those of the previous government. However, reports that the new government would welcome a lower exchange value of the lira led to downward pressure in late July.

Canadian real GDP expanded rapidly in the first quarter, largely due to strength in domestic demand. The most sizable gains occurred in residential investment and business fixed investment, but consumer spending was also surprisingly strong. Indicators of Canadian economic activity in the second quarter are mixed.

Economic Situation in Major Developing Countries

In late July, Brazil's Finance Minister Bresser Pereira began discussions in the United States about Brazil's recently released adjustment program and financing needs. Mexico reached agreement with its bank creditors rescheduling $9 billion in private sector debt. Argentina and the IMF have revised performance criteria in the IMF stand-by arrangement, that was approved in principle in February 1987, and disbursements have begun. Commitments to Argentina's $1.95 billion new money package with commercial banks now exceed 100 percent of the amount sought. While progress was made concerning commercial bank agreements with the Philippines, Colombia, and Bolivia, Venezuela has not decided whether to sign its revised public sector debt restructuring agreement. Peru's plans to nationalize its domestic banking system have become embroiled in judicial and legislative dispute. Branches of foreign banks are not included in the current nationalization plans.

Individual Country Notes. In late July, Brazil's Finance Minister Bresser Pereira came to the United States to have preliminary discussions with banks, U.S. government officials, and IMF and World Bank officials, about Brazil's adjustment plans and financing needs. Immediately before the trip, the Brazilian government released its medium-term macroeconomic plan for 1987-1991. Under the plan, GDP growth is targeted at 5 percent in 1987, 6 percent in 1988, and 7 percent in 1989-91. The operational fiscal deficit, that was projected at 6.7 percent of GDP in 1987 without recent adjustments, is now projected to be 3.5 percent in 1987 and 2 percent in 1988. According to the plan, the government will maintain a competitive exchange rate and positive real interest rates. Private sector investment is projected to increase sharply as the government's deficit drops. The trade surplus is projected at $8.6 billion in 1987 and about $10 billion annually in 1988-1991.

The issue of the IMF's involvement in any Brazilian financing and stabilization plan has not been resolved. The Brazilian president and finance minister appear to be trying to lay the groundwork in order that an IMF-supported program could be accepted politically in Brazil. Brazil plans to hold more detailed meetings with banks in September.

Mainly as a result of price controls instituted on June 12, monthly inflation fell from 26.1 percent in June to 3.1 percent in July. The trade surplus continued to rebound strongly with a $1.4 billion surplus recorded in both June and July.

In July 1987, Mexico and its Bank Advisory Committee reached an agreement to reschedule $9 billion of private sector debt covered by the FICORCA exchange-rate insurance scheme on terms comparable with those of last September's $52 billion public sector debt rescheduling. The debt will be rescheduled over 20 years at a spread of 13/16 of a percentage point above LIBOR.

On July 21, Mexico accelerated its World Bank-supported trade liberalization program. The principal step taken was the removal ahead of schedule of official reference prices used in assessing import duties for 528 import items, leaving only 53 items still subject to this procedure. These prices were generally higher than actual import prices and increased the protection in the tariff structure for covered items. The accelerated liberalization is designed, in part, to ease inflationary pressures and has been possible because of Mexico's continued accumulation of international reserves and current account surplus. In the first half of 1987, reserves rose by about $7 billion, including the initial $3 billion net drawing on the new bank financing, a continuation of the return of flight capital, and a current account surplus. In the same period, the merchandise trade surplus was about $5.4 billion, more than twice as high as in the same period in 1986. Petroleum exports were up by 38 percent and non-oil exports by 26 percent; imports were down by 8 percent. Exports of manufactured goods were especially strong, with a rise of 50 percent.

Concerned about rising inflation, the government has in 1987 allowed the rate of crawl of the exchange rate to fall below the domestic inflation rate. In July, consumer prices rose by 8.1 percent and the peso price of the dollar by 4.8 percent. During the first seven months of 1987, consumer prices have risen by 67 percent and the peso price of the dollar by 53 percent. Since last November, the peso has appreciated in real terms against the dollar by 5 percent, taking account of U.S. inflation.

Argentina required adjustments to its stand-by arrangement (SBA) with the IMF, that was approved in principle in February, because of problems meeting the original performance criteria. Government authorities agreed to policy adjustments, and the modified SBA became effective on July 23 when the IMF Executive Board approved it after commercial bank commitments to the new money package reached the $1.95 billion sought. In late July, the IMF disbursed the initial SDR 285 million under the SBA and SDR 519 million from the Compensatory Financing Facility to compensate for an export shortfall in 1986 caused by low international prices for Argentina's principal commodity exports. As of mid-August, commitments to Argentina's $1.95 billion new money package with commercial banks were slightly over 100 percent of the amount sought, although about 100 of the 330 banks, generally those with smaller exposures, have declined to participate or have not yet responded to requests for commitments. The final agreement is scheduled for signing on August 21.

Despite the pressure of important congressional and gubernatorial elections on September 6, Argentina is making forward progress with difficult structural adjustment measures. On July 20, Economy Minister Sourrouille announced intentions to move forward with reforms in the areas of privatization of public sector holdings, financial sector reforms, reductions in agricultural export taxes, improvements in the management of public sector enterprises, and deregulation of the energy sector. Monthly CPI inflation averaged about 6 percent over the first five months of 1987, rising to 8 percent in June and 10 percent in July.

In Venezuela, the President has not yet decided whether to sign the revised public sector debt restructuring agreement with its commercial bank creditors. The government is seeking to link signature of the agreement to around $2 billion in new bank money for 1987-88, but such a package is unlikely given current macroeconomic policies. In July, an IMF team visited Venezuela in preparation for the mid-1987 review under Venezuela's enhanced surveillance arrangement with the Fund. The Fund team told the government that current policies were unsustainable and that it was not prepared to write a favorable report. A World Bank mission also visited Venezuela in July to begin talks on possible sectoral loans in support of trade policy reform.

In June, the central bank sharply tightened credit in order to strengthen the free market bolivar and dampen inflationary pressures. Beginning July 20, the central bank offered a 30 percent annualized rate on short-term deposits through its desk operations. (Interest rates on most loans by commercial banks are limited to 13 percent.) As a result, the off-shore bolivar market has dried up and domestic banks are rationing credit. Central Bank President Anzola is seeking an increase in commercial bank deposit and lending interest rates, but so far he has not succeeded in gaining support of the necessary majority of the central bank's Board. The government is also under strong pressure to reduce the fiscal deficit, which, given current measures, could reach 14 percent of GDP in 1987. Inflation in June was 4.1 percent; in the second quarter prices rose at a 55 percent annual rate.

On July 17, the Philippines signed an agreement with its creditor banks to reschedule $13.2 billion of the country's roughly $28 billion total foreign debt. The agreement reschedules nearly $10.3 billion of debt falling due through 1992 over 17 years, including a 7-1/2 year grace period, and renews a $3 billion trade facility. The agreement reduces the margin on the rescheduled debt to 7/8 of a percentage point over LIBOR, down from a rate of 1-5/8 to 1-3/4 percentage points over LIBOR. The new margin for the trade facility is to be 3/4 of a percent, down from 1-1/4 percent. The package gives the creditor banks an option--which is not likely to be exercised by most banks--of receiving part of the interest payments in PINs (foreign-currency-denominated, six-year, non-interest-bearing Philippine Investment Notes) that can be used to make direct investments in the Philippines.

Following a speech by President Aquino criticizing the country's foreign creditors, the new Philippine Congress, which convened for the first time in 15 years on July 27, formed a special committee to explore the possibility of repudiating part of the country's external debt. In addition, the Senate passed a resolution ordering a review of the commercial bank debt agreement.

In July, Colombia reached a preliminary agreement with a group of banks to raise $1.06 billion in new money this year for disbursement in 1987-88. This amount nearly equals Colombia's amortization payments due in this period to commercial banks. The electric power sector will receive $200 million; the coal sector, $260 million; and the central government $600 million for public investment. A tentative term sheet, being circulated to Colombian creditors, contains a spread of 15/16 of a percentage point over LIBOR or 3/8 of a percentage point over the lender's domestic banking interest rate and a maturity of 10-1/2 years with a grace period of 5-1/2 years. These terms represent a longer maturity and grace period and a lower spread over LIBOR by more than 1/2 of a percentage point than those in Colombia's 1985 loan. In addition, the banks have not imposed conditions on the management of the economy and have not required its performance to be monitored by the IMF.

In June 1987, Bolivia's commercial bank creditors agreed to a waiver of provisions in previous rescheduling agreements to allow Bolivia to proceed with a plan to buy back up to $700 million of past due principal at 10-15 cents on the dollar. Bolivia now has four months to make its offer to buy back its debt to creditor banks, who will respond individually; however, all banks selling their debt to the government will receive the same price. Bolivia's ambitious adjustment program has decreased inflation to a 10-12 percent annual rate (from almost 24,000 percent inflation in mid-1985) and led to positive growth in 1987 to date after six consecutive annual decreases. The government announced in July a new reactivation decree aimed at promoting external trade and reforming the financial system. A letter of intent with the IMF was signed in July 1987 for a three-year, SDR 133 million Extended Fund Facility arrangement.

On July 28, Peru's President Garcia announced plans to nationalize domestic banking and insurance firms, and shut down the country's foreign exchange dealers. The moves followed a one-week bank holiday and a weakening of the inti in the parallel foreign exchange market. The firms facing nationalization are challenging the constitutionality of the move in the courts, and legislation introduced by the President in Congress implementing the nationalization plan has become embroiled in controversy. In the interim, the government has returned day-to-day control to the banks following an initial intervention. Foreign banks were not included in the nationalization plan. However, the status of foreign minority holdings in the private banks remains unclear, and measures designed to control capital flight could affect the operations of the foreign banks.