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September 16, 1987

RECENT DEVELOPMENTS

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

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DOMESTIC NONFINANCIAL DEVELOPMENTS

Production and spending indicators suggest that growth in real GNP will be greater in the third quarter than in the second. Labor demand strengthened further in August: employment rose enough to hold the jobless rate at 6.0 percent, and aggregate hours worked by production and nonsupervisory workers expanded rapidly. Manufacturing activity has been rising sharply since the spring, and the index of industrial production apparently is posting its strongest quarterly gain in 3-1/2 years.

On the spending side, consumption outlays and business equipment spending probably have risen sharply this quarter, but construction has been soft. What information is available suggests that business inventory accumulation has been moderate, owing, in part, to a runoff of auto dealers' stocks; the fragmentary data on foreign trade suggest that the trend of improvement in real net exports may be interrupted by a jump in oil imports.

Price increases have eased in recent months after a sharp rise earlier in the year and appear consistent with a third-quarter increase in the fixed-weighted price index for GNP noticeably below the first-half pace.

Employment and Unemployment

Nonfarm payroll employment advanced again in August; although the gain was half the size of the July increase, the average change in the two months approximated the pace of the first half of the year. The average workweek also rose in August and, coupled with the overall employment gains, pushed up aggregate hours of production and nonsupervisory

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

	1985	1986	1986 Q4	1987 Q1	1987 Q2	1987 July	1987 Aug.
	—Average monthly changes—						
Nonfarm payroll employment[2]	213	159	176	254	163	296	156
Manufacturing	-30	-14	12	8	7	91	-5
Durable	-22	-17	-2	0	0	19	24
Nondurable	-8	4	14	8	7	72	-29
Construction	20	13	-4	32	-8	0	-1
Trade	60	31	19	57	35	60	-21
Finance and services	130	110	101	124	100	136	112
Total government	34	30	42	18	18	-6	49
Private nonfarm production workers	152	105	106	199	112	219	85
Manufacturing production workers	-27	-7	18	6	11	63	0
Total employment[3]	162	174e	217	244	296	470	354
Nonagricultural	182	174e	210	203	332	429	481

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

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

	1985	1986	1986 Q4	1987 Q1	1987 Q2	1987 July	1987 Aug.
Civilian, 16 years and older	7.2	7.0	6.9	6.7	6.2	6.0	6.0
Teenagers	18.6	18.3	17.8	17.9	17.0	15.5	16.0
20-24 years old	11.1	10.7	10.5	10.4	10.0	9.8	9.1
Men, 25 years and older	5.3	5.4	5.4	5.2	4.8	4.7	4.7
Women, 25 years and older	5.9	5.5	5.3	5.1	4.6	4.7	4.7
White	6.2	6.0	6.0	5.7	5.3	5.1	5.1
Black	15.1	14.5	14.1	14.2	13.2	12.6	12.4
Fulltime workers	6.8	6.6	6.5	6.3	5.9	5.7	5.6
Memo:							
Total national[1]	7.1	6.9	6.8	6.6	6.1	5.9	5.9

1. Includes resident Armed Forces as employed.

workers 0.5 percent last month to a level 1 percent above the second-quarter average.[1]

By industry, more than half the job growth during August took place in the services industry, where hiring at business and health service establishments continued quite strong. In contrast, employment fell somewhat in retail trade, where job gains had averaged nearly 40,000 per month over the first seven months of the year. In manufacturing, employment was about unchanged, on balance, after a sharp increase in July. Jobs were up in machinery and printing, but down by small amounts in food, textiles, and lumber and off sharply in apparel (where there had been a jump reported in July).

Employment as measured by the household survey rose sharply in August, continuing the strong upward trend evident so far this year. However, growth in the labor force about matched the rise in employment last month, leaving the unemployment rate unchanged. Most of the August advance in both the labor force and employment occurred among teenagers, although employment also rose for adult men and women.

Other indicators underscore the persistent strength in labor demand. Initial claims for unemployment insurance moved down to about 300,000 per week in the last three weeks of August--the lowest levels of the current expansion. In addition, the Conference Board's help-wanted index rose in July to its highest level since 1979, while both the August Michigan and

1. The staff anticipates that the workweek for September will be reduced by 0.3 to 0.4 hour because Labor Day fell during the reference week for the labor market survey. This Labor Day effect does not have implications for overall economic activity measured for the month as a whole.

Conference Board surveys of consumer sentiment suggest that respondents view job availability as quite good.

Industrial Production

Industrial production increased 0.3 percent in August, after gains of 0.8 percent in July and 0.7 percent in both June and May. Output of consumer goods was up about one-quarter of a percent last month, as a drop in auto assemblies, from an annual rate of 6.7 million units in July to a 5.9 million rate in August, was more than offset by a further rise in light truck production. Output of business equipment, which has increased rapidly this year, rose further in August with increases in all major components; significant gains so far this year have occurred in manufacturing and commercial equipment, apparently reflecting improvement in both domestic and foreign demand.

Output of intermediate products--supplies for both construction and business--was about unchanged in August, after several months of solid gains. Materials output rose 0.2 percent last month; gains of about 1 percent, on average, were recorded in the preceding two months. Production of durable materials--in particular, equipment parts and metals--increased in August, and nondurable materials output was up fractionally to a level more than 7 percent higher than a year earlier. Production of energy materials was unchanged during the month.

Overall, the August index of industrial production was 4-1/2 percent higher than a year earlier. The August increase boosted the index 1.8 percent above its second-quarter average--a growth rate equal to more than 7 percent at an annual rate.

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

	1987 Q1	1987 Q2	1987 June	1987 July	1987 Aug.
	--Annual rate--		---Monthly rate---		
Total Index	3.4	4.1	.7	.8	.3
Previous		(3.6)	(.4)	(.8)	
Products	3.6	3.6	.6	.6	.4
Final products	4.3	3.1	.6	.5	.5
Consumer goods	4.6	1.7	.4	.5	.2
Durable consumer goods	8.6	-6.2	-.5	.4	.3
Nondurable consumer goods	3.3	4.6	.6	.6	.1
Equipment	3.9	4.7	.9	.6	.9
Business	4.7	6.2	1.3	.1	1.0
Defense and space	2.2	.0	-.4	.3	.3
Oil and gas drilling	3.2	16.8	2.1	12.2	6.4
Intermediate products	1.5	5.4	.5	1.0	-.1
Construction supplies	4.4	-.1	.9	1.1	.1
Materials	3.1	5.0	.8	1.1	.2
Durable goods	4.1	3.0	.9	1.3	.3
Nondurable goods	5.3	9.1	.3	1.6	.2
Energy materials	-1.2	5.0	1.1	.3	.0

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

	1978-80 High	1982 Low	1967-86 Avg.	1984 High	1987 June	1987 July	1987 Aug.
Total industry	86.9	69.5	81.5	81.8	80.3	80.9	81.0
Manufacturing	86.5	68.0	80.6	81.3	80.7	81.2	81.3
Durable	86.3	63.7	78.6	79.8	77.0	77.4	77.7
Nondurable	87.0	74.4	83.5	84.3	86.2	86.8	86.7
Mining	95.2	76.9	87.1	86.6	75.7	75.7	75.8
Utilities	88.5	78.0	87.5	85.8	81.2	81.5	81.7
Industrial materials	89.1	68.4	82.3	82.9	79.8	80.6	80.7
Metal materials	93.6	45.7	77.8	70.8	70.5	73.2	74.6
Paper materials	97.3	79.9	91.6	98.6	97.1	98.9	97.9
Chemical materials	87.9	63.3	80.8	78.5	84.6	85.9	86.7

Capacity Utilization

Consistent with the strength in industrial production, capacity utilization in manufacturing, mining, and utilities increased 0.1 percent in August after rising 0.6 percent in July. The August utilization rate—at 81.0 percent—was up 1-1/2 percentage points from April and the highest since late 1984. Nonetheless, utilization for total industry remained a bit below the 1967-86 average of 81.5 percent.

In manufacturing, the utilization rate rose 0.1 percent in August, after a 0.5 percent increase in July. Gains in capacity use in manufacturing were widespread over those two months, with the largest increase in primary metals, especially raw steel. At 77.8 percent of capacity, the operating rate for primary metals is at its highest level since September 1981. These gains in the primary metal utilization rate, however, have resulted primarily from cutbacks in capacity: output of primary metals in August was still 13 percent below that in September 1981.

Producers of industrial materials operated at 80.7 percent of capacity in August, adding to the steady increases of recent months. Utilization rates for durable goods materials and energy materials are still far below earlier cyclical highs, but the rates for nondurable goods materials such as pulp, paper, and textiles are high.

Personal Income and Consumption

Total personal income rose at about the same pace in July as in the second quarter. Although wages and salaries grew somewhat less than their average for the first half, stronger growth in hours worked in both July and August and an increase in average hourly earnings for August suggest that wages and salaries grew faster than reported initially. With the

PERSONAL INCOME
(Billions of dollars; based on seasonally adjusted data)

	1986	1987 Q1	1987 Q2	1987 May	1987 June	1987 July
	-------- Average monthly change --------					
Total personal income	14.2	23.5	13.3	9.6	9.9	14.3
Wages and salaries	7.5	12.9	8.8	12.2	5.9	5.4
Private	5.6	10.1	6.8	10.1	3.9	3.4
Other labor income	.7	.8	.7	-1.0	.6	.8
Nonfarm proprietors' income	2.6	6.7	-.6	-11.7	5.0	2.9
Farm proprietors' income	.5	3.5	-2.2	-13.3	2.5	.1
Rent, dividends and interest	1.7	2.7	2.3	2.9	2.3	2.7
Transfer payments	2.5	2.1	2.5	8.1	-3.6	3.1
Less: Personal contributions for social insurance	.8	1.7	.5	.9	.3	.4
Less: Personal tax and nontax payments	3.2	-1.2	7.0	-91.6	16.4	2.4
Equals: Disposable personal income	11.0	24.7	6.2	101.2	-6.5	11.9
Memo: Real disposable income	6.3	6.1	-5.8	73.2	-14.0	--

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from preceding period; based on seasonally adjusted data)

	1986[1]	1987 Q1	1987 Q2	1987 May	1987 June	1987 July[2]
	----Annual rate----			----Monthly rate----		
Real personal consumption expenditures	4.1	-.7	2.1	-.2	.6	.7
Durable goods	12.4	-21.2	9.0	-1.5	1.9	.9
Excluding motor vehicles	12.7	-3.8	2.3	.0	.2	.2
Nondurable goods	2.9	1.3	-1.8	.2	-.1	.7
Food	1.0	3.2	-4.9	-.7	-.2	--
Clothing and shoes	5.5	5.2	-7.3	.1	3.1	--
Services	2.4	5.4	3.0	-.1	.7	.6
Memo:						
Personal saving rate (percent)	4.3	4.4	3.0	4.3	3.3	2.8

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

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

	1986	1987 Q1	1987 Q2	1987 June	1987 July	1987 Aug.
Autos and light trucks	16.1	13.8	15.0	15.4	15.4	17.7
Autos	11.5	9.7	10.3	10.3	10.5	12.2
Light trucks	4.7	4.2	4.8	5.1	4.9	5.5
Domestically produced[1]	12.0	10.2	11.0	11.3	11.3	13.1
Autos	8.2	6.9	7.2	7.2	7.2	8.5
Light trucks	3.7	3.4	3.8	4.1	4.1	4.6
Imports	4.2	3.6	4.0	4.1	4.1	4.6
Autos	3.2	2.8	3.1	3.1	3.3	3.7
Japanese	2.4	2.0	2.1	2.1	2.1	2.5
Korean	.2	.2	.3	.4	.4	.4
European	.7	.6	.7	.7	.8	.7
Light trucks	.9	.8	.9	.9	.8	.9

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.

RETAIL SALES
(Seasonally adjusted percentage change)

	1987		1987		
	Q1	Q2	June	July	Aug.
Total sales	-1.1	2.4	1.2	.5	1.3
Previous estimate[1]			2.4	1.4	.8
(REAL)[2]	-2.5	1.0	.7	.4	—
Previous estimate[1]			1.4	.9	.6
Total less auto dealers, nonconsumer stores, and gasoline stations	1.7	.7	.4	.3	.3
Previous estimate[1]			.8	.8	.3
GAF[3]	2.1	.8	.3	.9	-.2
Durable	-5.9	4.2	2.5	.8	2.3
Automotive dealers	10.8	8.1	4.2	.8	4.5
Motor vech. & misc. dlrs.	-11.6	8.8	4.4	.8	4.9
Furniture and appliances	-.1	-1.1	-.3	2.1	-1.5
Other durable goods	2.1	.5	2.2	.4	-.2
Nondurable	2.1	1.3	.3	.4	.6
Apparel	2.1	.6	2.2	1.1	-.4
Food	.1	.7	.6	-.2	1.0
General merchandise[4]	3.2	1.8	-.4	.3	.5
Gasoline stations	4.6	4.2	.3	2.5	1.9
Memo:					
Motor vehicle sales[5]	13.8	15.0	15.4	15.4	17.7
Autos	9.7	10.3	10.3	10.5	12.2
Light trucks	4.2	4.8	5.1	4.9	5.5

1. Based on incomplete sample counts approximately one month ago.
2. BCD series 59. Data are available approximately 3 weeks following the retail sales release.
3. General merchandise, apparel, furniture and appliance stores.
4. General merchandise excludes mail order nonstores; mail order sales are also excluded in the GAF grouping.
5. Millions of units at an annual rate; FRB seasonals.
--Data are unavailable because of a future release date.

temporary bulge in capital gains taxes largely completed by midyear, the growth in nominal disposable income in July was larger than in the second quarter. In real terms, disposable personal income probably rose somewhat in July, but was only fractionally above the December level.

Personal consumption expenditures posted a strong increase in July, with gains widespread across goods and services. In addition, nominal retail sales increased 1.3 percent in August, bolstered by higher spending for motor vehicles and gasoline; however, spending at the retail control group of stores was up only 0.3 percent in August to a level about 1 percent above the second-quarter average. To some extent the August figure may reflect the lateness of Labor Day this year, with sales that normally would have occurred in August being moved into September.

Total sales of autos and light trucks rose in August to a 17.7 million unit annual rate from a 15.4 million unit rate in July, as manufacturers offered an end-of-model-year round of price and financing incentives for both cars and trucks. Although most of the additional sales were of domestic models, automakers also offered the incentive plans on their captive imports, increasing sales of these Japanese-produced cars as well. Overall, however, the response of sales has not been as strong as during the summer of 1986, when the incentives were somewhat more generous. Indeed, the figures for domestic car sales in the first ten days of September, indicating a drop to less than an 8 million unit rate, suggest that the program may be losing its punch.

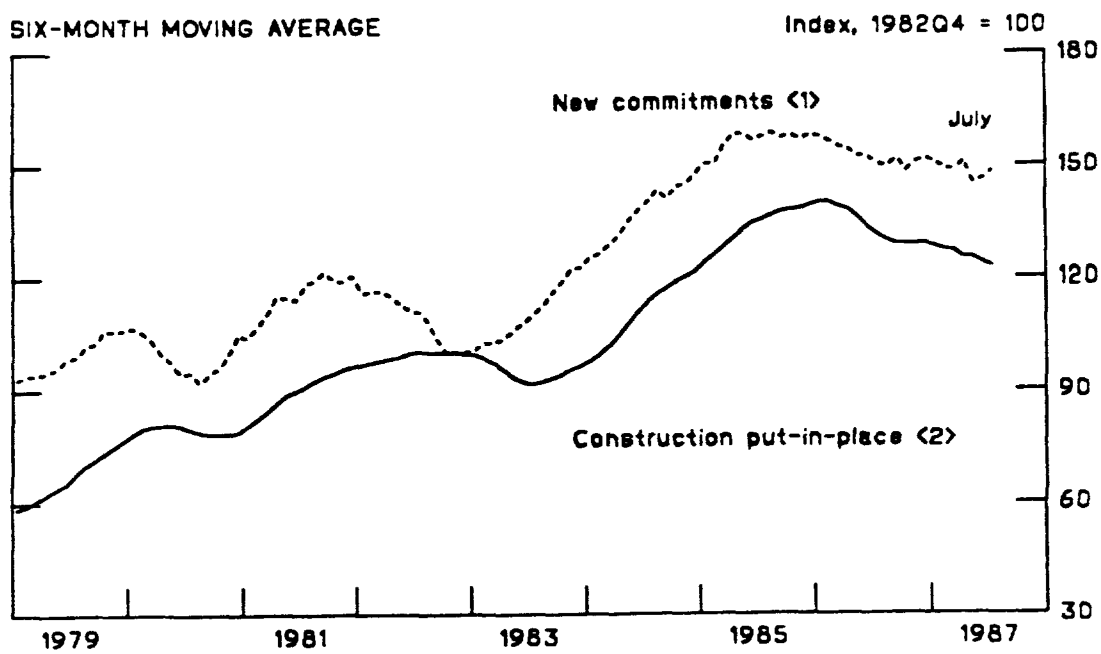
Business Fixed Investment

Real outlays for producers' durable equipment apparently began the third quarter at a strong pace. Nominal shipments of nondefense capital

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

	1987 Q1	1987 Q2	1987 May	1987 June	1987 July
Producers' durable equipment					
Nondefense capital goods					
Shipments	-3.2	2.7	-1.3	3.3	.8
Aircraft	-13.7	4.1	-14.6	16.2	-8.3
Excl. aircraft	-1.8	2.5	.5	1.8	2.0
Orders	-3.8	9.0	6.1	-.1	5.1
Aircraft	-26.2	30.5	50.3	-25.3	30.7
Excl. aircraft	.6	5.9	-.6	5.6	1.0
Sales of heavy-weight trucks (thousands of units, A.R.)	277	312	335	288	309
Nonresidential structures					
Nonresidential construction	-3.8	.8	4.5	-4.0	-1.1
Commercial building	-5.4	-1.5	4.8	-7.0	-3.2
Office	-5.2	-5.3	6.0	-8.3	4.0
Other commercial	-5.5	2.2	3.7	-5.9	-9.6
Industrial building	-13.8	3.9	16.0	-9.5	-6.7
Public utilities, institutional, and other	.1	2.2	2.1	-.1	1.8
Rotary drilling rigs in use	3.4	6.8	-2.9	.9	10.7

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.

goods rose 3/4 percent in July to a level 2-1/2 percent above the second-quarter average, led by the aircraft group and office and computing equipment. In addition, near-term indicators of equipment spending have been quite favorable recently. New orders for nondefense capital goods rose 5.1 percent in July, powered by bookings for aircraft and parts. Aircraft orders this year have outpaced shipments by a wide margin, and the backlog of unfilled aircraft orders has been climbing rapidly. Excluding the aircraft group, the July level of orders was 4-1/2 percent above the second-quarter average, fueled by increased orders for office and computing equipment.

Spending for nonresidential structures still appears to be trending lower, but not nearly so fast as over the past couple of years. The value of nonresidential construction put-in-place declined 1.1 percent in July to a level 2.3 percent below the second-quarter average. Lower industrial and other commercial construction accounted for all of the July decline. However, some offsetting support is evident in petroleum drilling, which rose sharply in July and August (petroleum drilling is not included in the data on construction put-in-place). New commitments for nonresidential construction have held fairly steady in recent months, after a sustained downtrend over the past two years.

The Commerce Department's latest capital spending survey, taken in July and August, indicates that business expects outlays for plant and equipment to rise 2.5 percent in 1987. This is a smaller increase than in the previous survey, which was taken in April and May, although anticipated spending in manufacturing industries for the remainder of 1987 rose substantially. Most of the overall reduction reflects, arithmetically, a shortfall in second-quarter outlays from what had been expected. The latest survey continues to indicate an enormous spending gain in the second half of 1987; however, the track record of this survey in predicting second-half spending indicates that, though unbiased, its forecast errors have been substantial.

Newly approved capital appropriations (net of cancellations) of the nation's 1,000 largest manufacturers advanced 26.4 percent in the second quarter, reaching the highest level since the first quarter of 1985. The second-quarter increase was widespread. The backlog of unspent appropriations--which has been a good indicator of the direction of manufacturers' capital spending in the next quarter or two--turned up after two years of decline.

Business Inventories

Inventories in mid-summer appeared to be under good control in most segments of the nonfarm business sector. Although the current-cost value of manufacturers' inventories rose in July at a rate faster than the average pace seen in recent months, nearly half of the accumulation was in stocks of aircraft and parts, where shipments and orders generally have been quite strong. As a result of the apparently conservative inventory stance in manufacturing, factory stocks are generally lean, with the July inventory-shipments ratio near its lowest point in the current cycle.

In the trade sector, current-cost inventories were little changed in July. At the wholesale level, stocks of electrical goods, machinery, and farm products were drawn down as sales advanced. For retailers other than auto dealers, stocks rose at an annual rate of $5.8 billion, and the inventory-sales ratio edged down.

CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Billions of dollars at annual rates; based on seasonally adjusted data)

	1986 Q4	1987 Q1	1987 Q2	1987 May	1987 June[r]	1987 July[p]
Current Cost Basis:						
Total	-1.1	41.2	47.0	68.8	37.7	17.4
Manufacturing	-.7	7.7	6.1	12.8	-2.7	16.5
Wholesale	-4.9	8.8	14.1	31.5	5.0	-8.4
Retail	4.5	24.8	26.7	24.6	35.4	9.4
Automotive	5.2	19.9	9.3	13.0	12.4	3.6
Ex. auto	-.7	4.8	17.4	11.6	23.0	5.8
Constant Dollar Basis:						
Total	-2.9	34.1	20.3	37.4	12.6	--
Manufacturing	-4.9	5.3	-3.7	6.6	-22.4	--
Wholesale	-4.7	3.6	8.9	19.1	5.6	--
Retail	6.7	25.2	15.2	11.8	29.4	--
Automotive	4.1	21.3	2.0	9.7	8.8	--
Ex. auto	2.6	3.9	13.2	2.1	20.7	--

INVENTORIES RELATIVE TO SALES[1]
(Months' supply; based on seasonally adjusted data)

	Range in Preceding 12 months:[2] low	Range in Preceding 12 months:[2] high	1986 Q4	1987 Q1	1987 Q2	1987 May	1987 June[r]	1987 July[p]
Current Cost Basis:								
Total	1.47	1.57	1.50	1.51	1.51	1.50	1.49	1.50
Manufacturing	1.61	1.73	1.65	1.65	1.63	1.63	1.60	1.62
Wholesale	1.21	1.29	1.25	1.24	1.23	1.23	1.23	1.22
Retail	1.44	1.59	1.51	1.58	1.60	1.58	1.58	1.58
Automotive	1.33	2.12	1.64	2.03	1.96	1.96	1.92	1.91
Ex. auto	1.43	1.49	1.47	1.46	1.49	1.47	1.49	1.48
Constant Dollar Basis:								
Total	1.49	1.54	1.49	1.51	1.51	1.51	1.50	--
Manufacturing	1.62	1.67	1.64	1.64	1.63	1.65	1.62	--
Wholesale	1.24	1.30	1.28	1.26	1.26	1.26	1.26	--
Retail	1.43	1.57	1.46	1.55	1.57	1.56	1.56	--
Automotive	1.42	2.05	1.56	1.97	1.87	1.87	1.83	--
Ex. auto	1.43	1.49	1.43	1.44	1.49	1.47	1.49	--

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.

At auto dealers, the quickened selling pace in August, in combination with scaled-back production, is reducing stocks to more tolerable levels. Relative to the average selling pace of the past year--7-3/4 million units--inventories at the end of August had fallen to 62 days' supply from 71 days' supply a month earlier. Automakers typically consider a 60 days' supply to be the norm.

One of the significant question marks in the assessment of GNP growth in the current quarter is the measurement of oil stocks. The evidence on imports suggests that there should be a large inflow of oil into the country--more than could be taken up in current use. Unfortunately, oil inventories have a way of escaping the normal reporting channels, and there is a risk that the national income accounts will not record a full offset to the rise in imports, causing an understatement of actual GNP growth. The staff forecast has made an allowance for the typical understatement of stocks in the short run.

Housing Markets

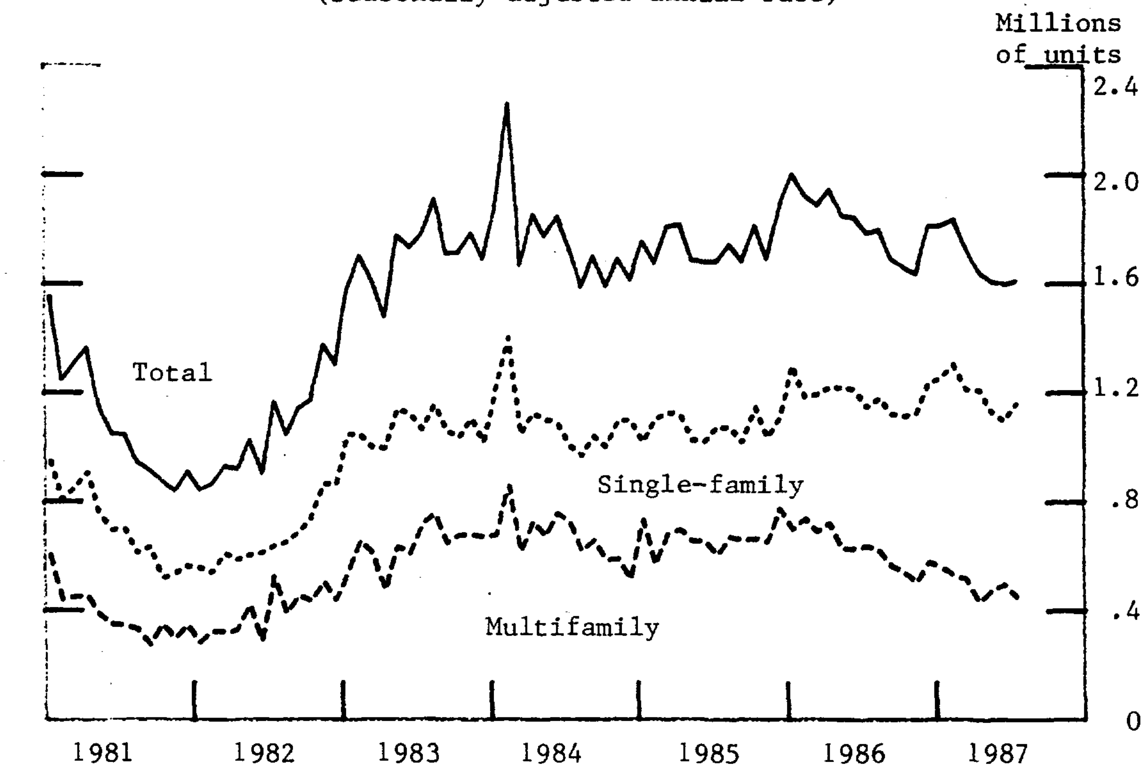
Prior to the most recent jump in interest rates, housing activity had steadied. Total private housing starts in July, at a 1.61 million unit annual rate, were about unchanged from the second-quarter average. In the single-family sector, the adjustment resulting from the April-May spike in mortgage interest rates apparently was completed by early summer, and single-family housing starts rose in July to an annual rate of 1.16 million units. The number of new homes sold was little changed over the three months ending in July; in the existing home market, sales fell sharply in June but then leveled off in July. Although conventional fixed-rate

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

	1986	1986	1987	1987	1987	1987	1987
	Annual	Q4	Q1	Q2	May	June	July[1]
All units							
Permits	1.75	1.73	1.68	1.54	1.49	1.52	1.49
Starts	1.81	1.70	1.80	1.62	1.61	1.60	1.61
Single-family units							
Permits	1.07	1.08	1.15	1.04	1.01	1.04	.99
Starts	1.18	1.16	1.26	1.15	1.13	1.10	1.16
Sales							
New homes	.75	.71	.72	.68	.64	.65	.65
Existing homes	3.57	3.89	3.62	3.61	3.77	3.50	3.53
Multifamily units							
Permits	.68	.65	.54	.50	.48	.48	.50
Starts	.63	.54	.54	.47	.48	.50	.45
Mobile home shipments	.24	.24	.23	.23	.22	.23	n.a.

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

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



mortgage interest rates fell slightly in July, they remained approximately 1-1/4 percentage points above their March low; and in the past couple of weeks loan rates have soared, moving above the spring highs.

Multifamily housing starts in July—at an annual rate of 450,000 units--were toward the lower end of the range in which they have been fluctuating in recent months. The weakness in this sector continues to reflect both tax law changes that reduced the rate of return on multifamily rental investment and a substantial excess supply of units in particular regions. The recent rise in interest rates will reinforce these negative factors, which already had caused widespread pessimism among builders about the outlook for apartment construction.

Incoming data on house prices continue to show big year-to-year gains in series that do not adjust for changes in quality and regional mix but only small increases in the data for which such adjustments are made. For example, the median price of new homes, a series that is not adjusted for these influences, advanced 13.7 percent during the year ended in July; in contrast, the constant-quality new home price index, which also adjusts for the regional mix of sales, rose only 2 percent during the year ended in June.

Government

The mid-year budget updates of the administration and the Congressional Budget Office both showed downward revisions in their respective estimates of the FY1987 federal budget deficit--to about $158 billion from around $175 billion in the January estimates. Most of the revisions are attributable to higher-than-anticipated revenues from tax reform. By contrast, deficit projections for FY1988 through FY1992 were revised up. For

UPDATES OF ADMINISTRATION AND CONGRESSIONAL BUDGET OFFICE BUDGET PROJECTIONS
(Fiscal years, billions of dollars)

	1987	1988	1989	1990	1991	1992
Administration:[1]						
Current services:						
Receipts	858	903	965	1040	1121	1188
Outlays	1017	1064	1131	1186	1244	1293
Deficit	159	161	166	147	123	105
policy proposals:						
Receipts	859	909	973	1049	1131	1198
Outlays	1017	1032	1085	1129	1176	1219
Deficit	158	123	113	80	45	21
Congresional Budget Office:[2]						
Baseline:						
Receipts	853	897	954	1036	1115	1195
Outlays	1010	1080	1146	1212	1280	1345
Deficit	157	183	192	176	165	151
With Congressional Budget Resolution policy:						
Receipts		918	979	1062		
Outlays		1064	1119	1170		
Deficit		146	140	108		
Memo:						
January 1987 deficit projections						
Administration current services	175	150	147	126	101	78
CBO baseline	176	171	164	137	110	84

1. Office of Management and Budget, Mid-session Review of the 1988 Budget, August 17, 1987.
2. Congressional Budget Office, The Economic and Budget Outlook: An Update, August 1987.

both the administration and CBO, outlay estimates were raised to reflect the effects of higher assumed inflation and interest rates and higher spending levels enacted in this year's supplemental appropriation bill. The CBO estimate also assumed that slower nominal income growth would damp receipts, while in the administration reestimates, slower real growth is largely offset by higher inflation.

Despite the similarity of the CBO and administration numbers for fiscal 1987, the current year deficit estimates remain subject to considerable uncertainty for several reasons. First, a "safe harbor" regulation allowed corporations to base estimated tax payments due through June 30 on last year's income levels. Both the administration and CBO revenue estimates assume that there will be a sizable catch-up from the safe harbor in tax payments due after June 30. The magnitude of these payments should become apparent in September when most corporations make their third quarterly estimated tax payment.

Second, the receipts expected from estimated tax payments of individuals for the third quarter also are uncertain. In particular, there is little evidence on how the base-broadening provisions of tax reform have affected these collections. Nor is there information on how capital gains realizations (which are a major source of nonwithheld tax payments and may be especially large given the recent strong performance of the stock market) will be affected by repeal of the preferential tax rate for long-term capital gains. The July monthly Treasury data and preliminary daily data from August do indicate some pickup in nonwithheld individual income taxes compared with last year, but the increase does not appear to be unusually large. Most third-quarter estimated tax payments will not be received by the Treasury until after September 15, however.

On the outlay side, a major source of uncertainty is the extent to which planned asset sales (which are counted as negative outlays in the budget) will be completed before the end of the fiscal year. On September 2 the Treasury received $1 billion for a package of Rural Development Fund loan assets in its first major sale of loan assets in FY1987. Another $1.7 billion of assets may be offered before the end of the fiscal year.

The administration and CBO also released, on August 20, the "snapshot" deficit estimate for FY1988 that is required by the Gramm-Rudman Balanced Budget Act. This snapshot estimate of the deficit (an average of separate CBO and OMB estimates) was $153.4 billion[1], indicating that uniform outlay cuts of $45.4 billion would be needed to reach the FY1988 Gramm-Rudman target of $108 billion. A congressional vote on such cuts, though required by the Act, is not likely because amendments to the Gramm-Rudman Act that would drastically alter FY1988 sequester requirements are currently before a conference committee.

In addition to Gramm-Rudman fixes Congress will have to extend the debt ceiling which expires September 23, and pass all of the required FY1988 budget legislation--the 13 regular appropriation bills and a reconciliation bill that makes changes in entitlement-driven spending programs and taxes.

GNP data received in the period since the last Greenbook showed a sharp upward revision in real federal purchases for the second quarter.

1. The "snapshot" estimate differs from the baseline or current services estimates primarily because programs for which no 1988 appropriations have been enacted are projected at the enacted 1987 level without inflation adjustment in the "snapshot" and with inflation adjustment in the baseline or current services estimates.

Greater staffing at the IRS and Justice agencies was authorized in recent tax, immigration, and justice reform legislation; spending has picked up accordingly. Spending related to the NASA space shuttle program also was revised up.

So far in the third quarter, indicators of growth in real purchases of goods and services by state and local governments have been mixed. Employment grew 35,000 in August after remaining flat for three consecutive months. In contrast, real spending on construction edged down in July, following a 7.5 percent decline, at an annual rate, in the second quarter.

Prices

Price increases have eased in recent months, after a sharp rise earlier in the year. Both the CPI and the PPI for finished goods were up 0.2 percent in July, and the latter was unchanged in August.

Excluding food and energy, the CPI rose 0.3 percent in July. Nonenergy service prices were up 0.4 percent, more than in May or June but about the average rate over the past 12 months. After leveling off in June, the CPI for commodities excluding food and energy rose 0.3 percent in July; on balance, prices in this grouping have picked up notably so far this year for apparel as well as for some other commodity categories affected by rising import prices.

At the producer level, prices of (domestic) finished consumer goods, excluding food and energy items, rose 0.3 percent in both July and August. This index had edged down in the second quarter, after some large increases earlier in the year. Capital equipment prices advanced 0.2 percent in August, similar to their average pace for more than three years. In both of these categories a drop in the index for new cars—reflecting

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 June	1987 July
			-Annual rate-			-Monthly rate-	
All items[2]	100.0	1.1	2.5	6.2	4.6	.4	.2
Food	16.2	3.8	4.1	2.5	6.5	.7	-.2
Energy	7.4	-19.7	-9.9	26.1	7.9	1.5	.1
All items less food and energy	76.4	3.8	3.7	5.2	4.0	.2	.3
Commodities	26.1	1.4	1.4	5.1	3.8	.0	.3
Services	50.3	5.2	5.1	5.3	3.8	.2	.4
Memorandum:							
CPI-W[3]	100.0	.7	2.2	6.3	4.8	.4	.2

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 July	1987 Aug.
			-Annual rate-			-Monthly rate-	
Finished goods	100.0	-2.3	1.8	4.3	4.7	.2	.0
Consumer foods	26.3	2.9	1.0	-6.7	14.3	-.6	-1.3
Consumer energy	8.6	-38.0	-12.5	59.8	10.9	1.5	1.5
Other consumer goods	40.6	3.0	4.4	4.2	-.3	.3	.3
Capital equipment	24.5	2.1	3.4	.4	1.4	.1	.2
Intermediate materials[2]	95.0	-4.5	-1.2	7.8	5.2	.8	.5
Exc. energy	82.9	.1	1.2	3.3	4.5	.5	.3
Crude food materials	42.5	-1.4	-2.7	-10.3	33.9	-2.0	.1
Crude energy	40.9	-27.5	-.5	50.0	15.8	2.8	.5
Other crude materials	16.6	1.7	8.5	15.9	33.7	2.9	1.0

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

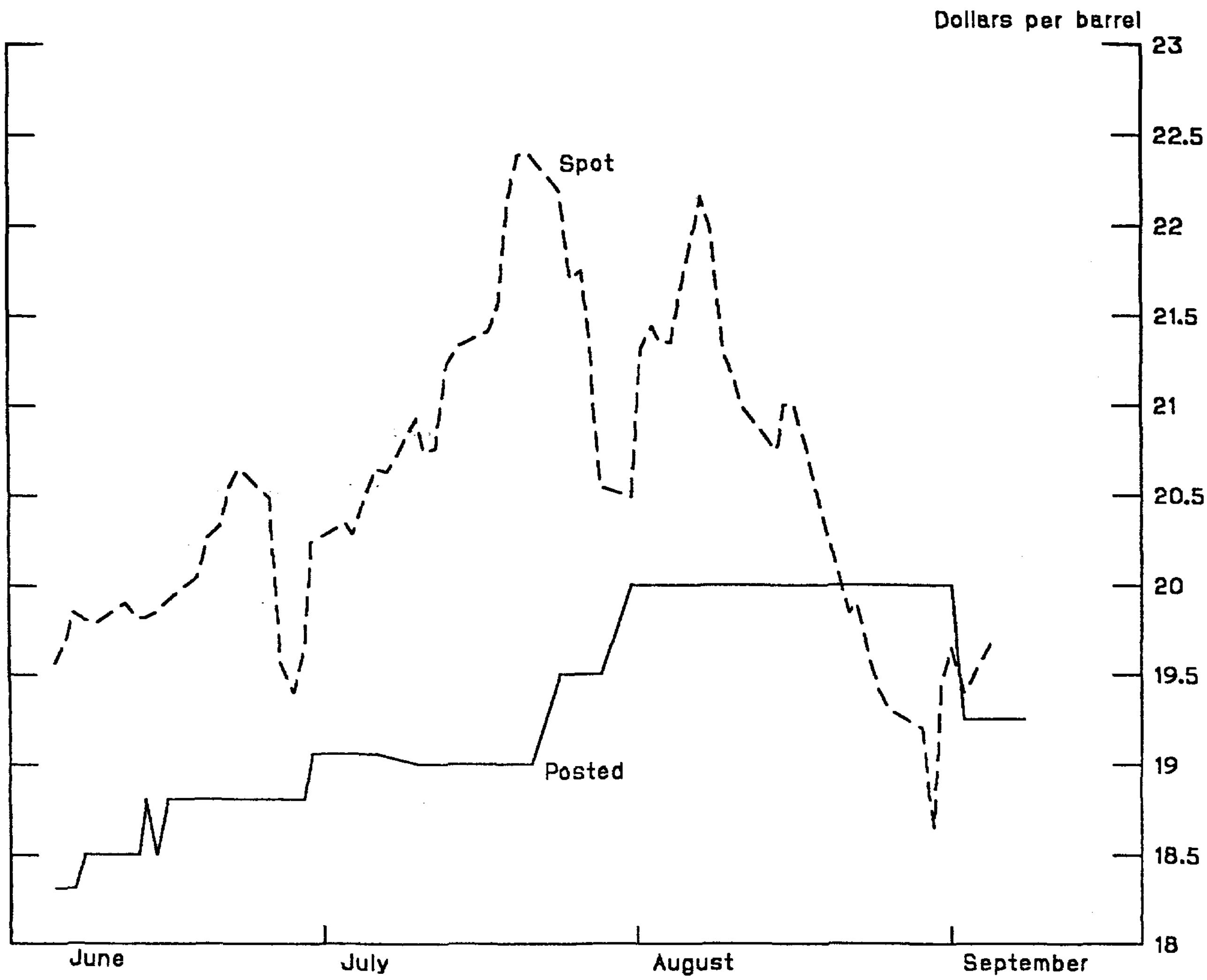
enhanced incentive programs--provided an offset to a pickup in the prices of other items. If car prices had remained flat last month, the index for consumer goods other than food and energy would have risen more than 1/2 percent.

Producer prices of intermediate materials (less food and energy) rose another 0.3 percent in August--after advances of 0.5 percent in June and July--with further notable increases for nonferrous metals, lumber, plywood, and paperboard. However, prices dropped back for industrial chemicals and plastic resins and materials. Prices of crude nonfood materials less energy--one of the broader measures of industrial commodity prices--were up 1 percent in August, less than the very rapid pace of the May to July period.

Food. Consumer food prices turned down in July, owing mainly to a reversal of the springtime runup in fruit and vegetable prices. In addition, the price index for meats, poultry, fish and eggs rose 0.3 percent, after significantly larger increases in the second quarter. The prices of other foods were up slightly, on balance, similar to the experience during the first half of the year. In addition, with the producer prices of finished foods down sharply in August, the near-term outlook for retail food prices looks favorable.

There also seems to be little chance of a serious runup in food prices over the longer term. Supplies of most food commodities remain abundant, with stocks of field crops still at high levels, an expansion in pork and poultry production apparently on track, and harvests of a number of fruit crops up substantially from last year. The one question mark is that beef production appears likely to trend lower over the next

Figure 1
Spot and Posted Prices of West Texas Intermediate



* Posted prices are evaluated as the mean of the range listed in the Wall Street Journal.

couple of years. Although the number of cattle currently in feedlots is up from a year ago, the pool of animals available for future placement into feedlots has dwindled, owing to herd reductions of the past few years. Consequently, the prices of these "feeder cattle" have been bid up sharply, with spot prices in mid-September more than 25 percent above a year ago.

Energy. Consumer energy prices also eased in July, reflecting a 3 percent drop in natural gas prices that resulted from lower utility rates in some states and a one-time refund to gas customers in Michigan. In contrast to natural gas, the prices of gasoline and fuel oil each rose more than 1 percent in July, owing to the passthrough of higher crude oil prices, while electricity prices were about flat.

The spot prices for crude oil and petroleum products remained highly volatile into mid-September, owing to upside pressures associated with tensions in the Middle East, and downside pressures stemming from OPEC production that is well in excess of quota. According to industry sources, OPEC production of crude oil was between 19 and 20 mb/d in August, as compared to their second-half quota of 16.6 mb/d.

Posted prices for West Texas Intermediate have been more stable than spot prices in recent months (chart). Posted prices represent longer-term contracts (typically three to six months), which are the primary means of transaction in the oil market. While posted prices rose in response to Middle East uncertainties in July and August, the rise was much more muted than in spot markets. Posted prices in early September dropped back to their late-July level, probably reflecting the build-up of inventories and the high level of OPEC production.

Wages and Labor Costs

Wage data available for the third quarter still are quite limited. The hourly earnings index for production and nonsupervisory workers rose 0.4 percent last month to a level about 2-1/2 percent above a year earlier. By industry, the largest increases in recent months have been in service-producing industries where employment gains have been the greatest. In contrast, wages for construction workers fell in both July and August while manufacturing pay raises have remained quite small.

Data from the Bureau of National Affairs, which presents wage adjustments negotiated in collective bargaining agreements covering 50 or more workers, indicate that union wage gains, in particular, have been restrained this year. The median first-year wage increase negotiated during the first 34 weeks of 1987 was just 2 percent, compared with an average 3 percent initial pay hike in 1986. However, factoring lump sum bonuses into the pay gains boosts the first-year average increase to 3 percent so far this year. Lump sum payments appear to be most important in manufacturing, where their inclusion increases the average first-year settlement from 1.3 percent to 3.0 percent. In contrast, average wage increases in construction and other nonmanufacturing industries are not altered much by the inclusion of lump sums.

Elsewhere in the union sector, contract talks for two of the largest agreements up for renegotiation this year—those between the UAW and Ford and GM—are currently under way. Earlier this month, the UAW chose Ford as the target company for negotiations after receiving initial proposals from both automakers. Preliminary indications suggest that any wage increases negotiated in the new Ford contract are likely to be relatively

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

	1986	1986 Q4	1987 Q1	1987 Q2	1987 June	1987 July	1987 Aug.
			--Annual rate--		--Monthly rate--		
Total private nonfarm	2.3	3.3	2.1	2.6	.0	.2	.4
Manufacturing	1.7	1.4	1.5	2.1	.2	.1	.3
Durable	1.3	.9	.3	2.1	.1	.1	.3
Nondurable	2.3	2.3	3.5	2.2	.2	.0	.2
Contract construction	2.2	6.1	-2.7	3.4	.6	-.4	-.3
Transportation and public utilities	2.8	3.6	3.2	3.5	-.4	.4	.2
Total trade	1.8	2.9	.7	2.5	.0	.2	.6
Services	3.1	4.7	4.2	3.2	.0	.3	.7

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

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

	1986[1]	1987 Q1	1987 Q2 Prelim.	1987 Q2 Revised	1986 Q2 to 1987 Q2
Output per hour					
Total business	1.5	.5	1.3	1.3	.4
Nonfarm business	1.5	.4	1.4	1.3	.3
Manufacturing	3.0	3.5	3.3	4.9	3.4
Compensation per hour					
Total business	3.3	1.4	3.2	3.3	2.8
Nonfarm business	3.4	1.1	2.9	3.0	2.7
Manufacturing	2.3	-1.0	1.8	2.0	1.4
Unit labor costs					
Total business	1.8	.9	1.9	1.9	2.4
Nonfarm business	1.9	.8	1.5	1.7	2.5
Manufacturing	-.7	-4.4	-1.4	-2.9	-1.9

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

small in return for some agreements on job security. GM may resist agreeing to job security provisions as strong as those likely to be negotiated between Ford and the UAW without additional concessions on wages in its parts plants because GM produces more of its parts internally than does Ford.

Finally, revised data on productivity and costs in the nonfarm sector were little different from the preliminary data reported earlier. Nonfarm productivity is estimated to have risen 1.3 percent at an annual rate in the second quarter while compensation per hour was up 3 percent at an annual rate. In manufacturing, second-quarter productivity growth was revised up sharply, reflecting stronger industrial production data than previously reported. With first-quarter productivity also revised up, output per hour in manufacturing now is estimated to have risen 4-1/4 percent at an annual rate over the first half of this year, compared with a 3 percent increase in 1986.

DOMESTIC FINANCIAL DEVELOPMENTS

III-T-1

SELECTED FINANCIAL MARKET QUOTATIONS[1]

(Percent)

	1986	1987				Change from:	
	Oct. lows[2]	Spring highs	FOMC Aug. 18	Sept. 3	Sept. 15	Sept. 3	FOMC Aug. 18
Short-term rates							
Federal funds[3]	5.75	6.90	6.66	6.85	7.21	.36	.55
Treasury bills[4]							
3-month	5.04	6.02	6.02	6.19	6.34	.15	.32
6-month	5.05	6.28	6.18	6.30	6.66	.36	.48
1-year	5.25	6.80	6.50	6.98	7.10	.12	.60
Commercial paper							
1-month	5.64	6.96	6.62	6.88	7.37	.49	.75
3-month	5.60	7.16	6.69	6.97	7.47	.50	.78
Large negotiable CDs[4]							
1-month	5.59	7.07	6.62	6.90	7.33	.43	.71
3-month	5.57	7.33	6.72	7.01	7.41	.40	.69
6-month	5.57	7.65	6.96	7.35	7.78	.43	.82
Eurodollar deposits[5]							
1-month	5.79	7.05	6.65	7.01	7.24	.23	.59
3-month	5.79	7.36	6.93	7.11	7.40	.29	.47
Bank prime rate	7.50	8.25	8.25	8.25	8.75	.50	.50
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	6.41	8.35	7.97	8.48	8.63	.15	.66
10-year	7.28	8.92	8.73	9.29	9.44	.15	.71
30-year	7.53	9.07	8.95	9.47	9.64	.17	.69
Municipal revenue[6] (Bond Buyer index)	7.30	8.68	8.04	8.47	8.67	.20	.63
Corporate--A utility Recently offered	9.32	10.27	10.34[e]	10.60[e]	10.90[e]	.30	.56
Home mortgage rates[7]							
Fixed-rate	9.89	10.81	10.34	10.63	10.91	.28	.57
ARM, 1-yr.	7.98	8.01	7.78	7.84	7.96	.12	.18

	1986	1987			Percent change from:	
	Highs	Record highs	FOMC Aug. 18	Sept. 15	Record highs	FOMC Aug. 18
Stock prices						
Dow-Jones Industrial	1955.57	2722.42	2654.66	2566.58	-5.72	-3.32
NYSE Composite	145.75	187.99	184.12	177.98	-5.32	-3.33
AMEX Composite	285.19	365.01	357.98	353.47	-3.16	-1.26
NASDAQ (OTC)	411.16	455.26	446.76	441.94	-2.93	-1.08

1. One-day quotes except as noted.
2. Low period for short-term rates.
3. Averages for reserve maintenance periods closest to date shown, except Sept. 3 which is one-week average ending Sept. 2. Last observation is the average to date for the maintenance period ending Sept. 23, 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.

Market interest rates have moved up substantially since the last FOMC meeting. During the early part of the intermeeting period, long-term rates rose as adverse trade data led to downward pressure on the dollar and accompanying concerns over inflation and foreign investors' willingness to hold dollar-denominated assets. Most short-term rates also began to rise, partly in anticipation of a possible tightening action by the Fed.

On September 4, the discount rate was raised 1/2 percentage point. Commercial banks—which had been experiencing rising funding costs for some time—seized the opportunity to announce an increase in the prime lending rate from 8-1/4 to 8-3/4 percent. Since the discount rate increase, most Treasury bill rates have increased about 15 basis points further while most private short-term rates are up 40 to 50 basis points. Long-term Treasury rates, which had increased about 50 basis points prior to September 4, also are up about 15 basis points, on balance, since then.

Like the bond market, the stock market has been volatile of late. The major stock price indexes established new records in late August but have since dropped 3 to 6 percent below those all-time highs.

Growth of the monetary aggregates picked up in August. However, with growth at annual rates of 6 and 7-1/2 percent respectively, M2 and M3 made up only small parts of their shortfalls from the annual target cones. From the fourth quarter of 1986 through August, M2 expansion averaged only about 4 percent and M3 growth 5 percent. M1 increased moderately last month and has grown at a 6-3/4 percent rate since the fourth quarter.

Debt, like money, has been on a distinctly less rapid growth path this year than last. Even assuming no debt ceiling-related disruption

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

	1985:Q4 to 1986:Q4	1987 Q1	1987 Q2	1987 June	1987 July	1987 Aug.p	Growth from Q4 1986 to Aug. 1987p
	------ Percentage change at annual rates ------						
1. M1	15.3	13.1	6.4	-10.4	1.6	5.1	6.7
2. M2	8.9	6.3	2.3	0.6	2.5	5.9	3.9
3. M3	8.8	6.4	3.8	4.8	1.7	7.5	5.0
							Levels in billions of dollars Aug. 1987p
Selected components							
4. M1-A	10.0	5.5	2.7	-13.4	-0.7	3.2	496.3
5. Currency	7.5	10.1	6.6	5.7	6.3	6.9	193.2
6. Demand deposits	11.6	2.5	0.0	-25.7	-4.8	0.4	296.3
7. Other checkable deposits	28.5	29.7	14.0	-4.8	6.2	9.5	254.5
8. M2 minus M1[2]	6.9	4.0	0.8	4.7	2.8	6.1	2109.3
9. Overnight RPs and Eurodollars, NSA	14.7	10.9	-26.3	-24.3	1.7	44.5	75.5
10. General purpose and broker/dealer money market mutual fund shares, NSA	17.3	6.2	-0.6	6.3	1.1	17.1	213.4
11. Commercial banks	6.8	6.0	-1.4	3.6	2.7	2.8	907.3
12. Savings deposits, SA, plus MMDAs, NSA[3]	16.0	13.4	0.8	-0.7	-2.9	0.4	542.0
13. Small time deposits	-4.2	-4.9	-4.6	10.1	11.0	6.3	365.3
14. Thrift institutions	4.3	4.0	5.0	5.4	3.3	5.0	921.8
15. Savings deposits, SA, plus MMDAs, NSA[3]	12.0	14.3	9.7	0.3	-7.6	-4.0	421.5
16. Small time deposits	-1.2	-4.3	0.9	9.9	12.7	12.8	500.4
17. M3 minus M2[4]	8.4	6.4	10.0	21.2	-1.5	14.2	733.8
18. Large time deposits	3.0	2.9	9.3	13.8	-0.5	4.6	466.6
19. At commercial banks, net[5]	2.7	9.7	18.3	16.2	-5.3	0.4	313.6
20. At thrift institutions	3.4	-9.5	-8.4	8.9	8.8	14.3	153.0
21. Institution-only money market mutual fund shares, NSA	30.3	0.9	-11.4	-7.3	31.0	0.0	83.4
22. Term RPs, NSA	28.3	14.4	55.4	24.9	-25.6	3.7	96.6
23. Term Eurodollars, NSA	3.2	34.0	-0.5	33.1	-48.3	102.1	93.1
	-- Average monthly change in billions of dollars --						
MEMORANDA:							
24. Managed liabilities at commercial banks (25+26)	2.0	8.3	6.0	2.1	-9.1	5.2	529.8
25. Large time deposits, gross	0.6	2.8	6.3	6.7	-1.1	-0.9	370.9
26. Nondeposit funds	1.4	5.5	-0.3	-4.6	-8.0	6.1	158.9
27. Net due to related foreign institutions, NSA	0.6	4.3	1.4	-1.9	-5.7	6.4	-1.2
28. Other[6]	0.8	1.3	-1.7	-2.9	-2.1	-0.4	160.1
29. U.S. government deposits at commercial banks[7]	0.4	-1.2	3.4	1.8	-3.2	4.4	29.1

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 July and August 1987 at rates of 7.5 percent and 9.5 percent, respectively. At thrift institutions, savings deposits excluding MMDAs increased during July and August 1987 at rates of 2.0 percent and 9.5 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.
6. Consists of borrowings from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowings from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
7. Consists of Treasury demand deposits and note balances at commercial banks.
p--preliminary

later this month, the federal government's borrowing will rise less than seasonally from the pace of the spring, when the Treasury's cash balance was sharply increased. State and local debt issuance has been damped recently by higher interest rates, which have been an especially strong deterrent to advance refunding operations. Net borrowing by nonfinancial businesses also appears to have eased this summer; with a relatively small gap between aggregate capital expenditures and internal funds, share retirements associated with mergers and other restructurings have remained the major force behind business debt expansion. The available data on household borrowing suggest some slowing in mortgage credit growth, but consumer installment debt appears likely to record its strongest quarterly gain in a year.

Monetary Aggregates and Bank Credit

M1 expanded at a 5 percent annual rate in August after declining in June and rising only marginally in July. The pickup last month reflected a cessation of runoffs of demand deposits and an acceleration in other checkable deposits to better than a 9 percent rate. Against the backdrop of an uptrend in market interest rates, M1 velocity appears likely this quarter to post its first increase since the fourth quarter of 1984.

M2 growth was bolstered last month by inflows to money market mutual funds and by a sharp increase in overnight RP liabilities at commercial banks; the latter development apparently was associated with a surge in trading account acquisitions of Treasury securities. Among the retail deposit components, a relatively steep offering rate curve continued to induce strong inflows to small time deposits, while the more liquid savings deposits and MMDAs were about flat in August after running off in

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 Q2	1987 June	1987 July	1987 Aug.p	Levels in bil. of dollars Aug.p
		---------- Commercial Bank Credit ----------						
1.	Total loans and securities at banks	9.8	7.0	7.7	3.6	1.3	10.7	2188.7
2.	Securities	14.2	2.4	4.4	-5.3	3.0	16.2	523.7
3.	U.S. government securities	11.9	5.7	3.3	-12.0	11.0	33.0	328.6
4.	Other securities	18.0	-2.8	6.1	5.5	-9.8	-11.0	195.1
5.	Total loans	8.4	8.4	8.7	6.3	0.8	8.9	1665.1
6.	Business loans	6.6	7.6	4.6	4.8	-5.2	0.4	555.7
7.	Security loans	-3.7	-3.1	41.8	5.7	-17.0	63.3	43.9
8.	Real estate loans[2]	14.1	17.9	19.3	21.1	13.8	15.7	551.2
9.	Consumer loans[2]	7.3	2.1	0.5	-2.7	3.1	8.4	316.8
10.	Other loans	5.4	0.0	0.0	-13.0	-16.8	3.6	197.5
		---------- Short- and Intermediate-Term Business Credit ----------						
11.	Business loans net of bankers acceptances	6.3	8.1	4.0	4.8	-4.8	-1.5	549.3
.	Loans at foreign branches[3]	-8.6	-2.4	-14.7	-7.6	45.9	81.0	17.4
.	Sum of lines 11 & 12	5.8	7.8	3.4	4.5	-3.4	0.6	566.6
14.	Commercial paper issued by nonfinancial firms	-0.8	-13.0	17.6	-16.2	-14.9	-16.6	78.4
15.	Sums of lines 13 & 14	4.9	5.2	5.1	2.0	-4.8	-1.5	645.0
16.	Bankers acceptances: U.S. trade related[4,5]	-3.9	2.5	23.8	25.4	46.2	n.a.	35.1 (July)
17.	Line 15 plus bankers acceptances: U.S. trade related	4.4	5.0	6.1	3.0	-2.3	n.a.	680.9 (July)
18.	Finance company loans to business[4]	11.7	14.7	17.9	15.0	16.7	n.a.	188.9 (July)
19.	Total short- and intermediate-term business credit (sum of lines 17 & 18)	5.8	7.0	8.6	5.6	1.8	n.a.	869.8 (July)

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

July. Small time account growth again was strongest in the Boston, New York and Dallas districts where the interest rates offered remained unusually attractive.

M3 accelerated in August as net issuance of wholesale managed liabilities picked up with a strengthening of bank credit. Banks appeared to be fairly aggressive in raising funds abroad to meet domestic credit needs; issuance of Eurodollar deposits was up sharply along with borrowing from foreign offices. Domestic large time deposits at banks, however, ran off for the second consecutive month, after four months of strong increases. At thrift institutions, by contrast, large time deposits grew at a 14-1/4 percent rate, apparently reflecting in part a substitution for FHLB advances. Thrifts also may have relied more heavily on large time deposits to fund their increased volume of ARM loans, which are more difficult to securitize and finance with RPs; after rising at a hefty pace over the last year, term RPs at thrifts have contracted in recent months, by a substantial amount in August.

Bank credit increased at almost an 11 percent annual rate in August, well above the pace of earlier months. Net acquisitions of securities strengthened noticeably as banks absorbed a large volume of Treasuries during the congested auction schedule early in August after Congress raised the debt ceiling. Bank loans accelerated to a 9 percent clip in August. Business loans were flat, after declining in July, although loans at foreign branches continued to surge; this pattern may reflect a somewhat wider spread of the prime rate over LIBOR than early in the summer as LIBOR-based loans tend to be booked offshore. Real estate lending remained strong last month, exceeding the July pace, and consumer loans posted the most rapid increase in over a year.

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

	1986	1987				
	Year	Q1	Q2p	June p	July p	Aug. p
Corporate securities - total[1]	28.22	29.79	24.30	28.68	26.69	20.96
Public offerings in U.S.	24.52	26.81	22.20	26.80	23.50	18.20
Stocks--total[2]	5.15	5.50	5.67	6.24	4.60	3.70
Nonfinancial	2.51	2.74	3.52	3.98	2.90	1.40
Utility	.64	.74	.82	1.33	.70	.40
Industrial	1.87	2.00	2.70	2.65	2.20	1.00
Financial	2.64	2.76	2.15	2.26	1.70	2.30
Bonds--total[1]	19.37	21.31	16.53	20.56	18.90	14.50
Nonfinancial	9.65	8.98	6.07	8.04	7.80	5.40
Utility	3.61	2.05	1.54	2.24	2.10	2.70
Industrial	6.04	6.93	4.53	5.80	5.70	2.70
Financial	9.72	12.33	10.46	12.52	11.10	9.10
By quality[3]						
Aaa and Aa	4.68	3.30	2.25	3.47	3.52	2.50
A and Baa	5.92	7.29	5.05	7.86	4.15	4.10
Less than Baa	3.45	3.06	2.91	2.64	4.57	2.50
No rating (or unknown)	.20	.08	.22	.31	.09	.10
Memo items:						
Equity-based bonds[4]	.86	1.37	1.29	1.27	.30	.40
Mortgage-backed bonds	4.16	7.26	5.18	4.07	5.00	5.20
Variable-rate notes	1.02	2.37	1.65	1.01	1.95	2.65
Bonds sold abroad - total	3.55	2.92	1.82	1.53	3.03	2.72
Nonfinancial	1.50	1.14	.97	.42	.95	2.10
Financial	2.05	1.78	.85	1.11	2.08	.62
Stocks sold abroad - total	.15	.06	.28	.35	.16	.04
Nonfinancial	.09	.06	.24	.25	.16	.04
Financial	.06	.00	.04	.10	.00	.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.

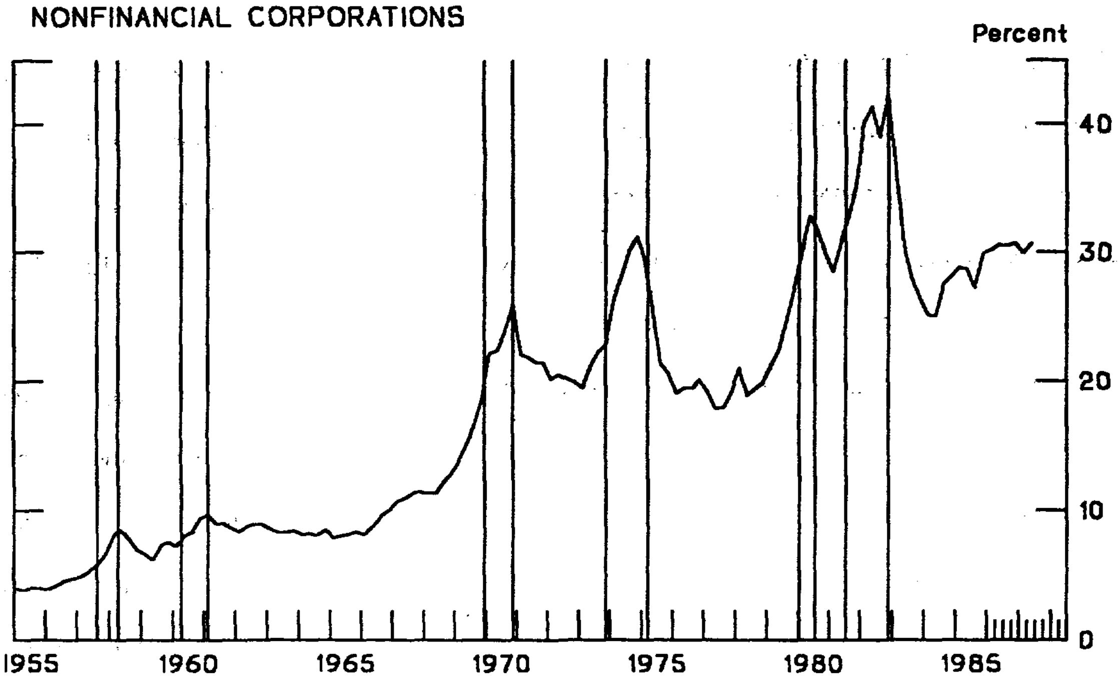
Corporate Finance

Borrowing by nonfinancial corporations appears to have slowed somewhat in the past two months from the pace earlier in the year. The sum of business loans at banks and commercial paper outstanding was down, on balance, in July and August. The increase in interest rates also has led some firms to defer long-term borrowing.

Domestic public offerings of bonds by industrial firms in August were the lowest in two years and were concentrated in short- and intermediate-term maturities; less than 15 percent had maturities of 20 years or more. In the first half of 1987, when the bond market was more receptive, more than half of such offerings carried maturities of at least 20 years, but more recently the share has trended down gradually. Eurobond sales, which typically are of shorter maturity, picked up last month, supported by good investor demand for bonds with convertible features. As has been true throughout this year, financial issues accounted for the greater share of gross bond offerings, owing largely to the heavy supply of mortgage-backed securities issued by investment banks and other private firms.

Low-rated bond offerings, which were unusually heavy in July, fell in August when some large merger-related issues were postponed or cancelled. With supply light and demand good for those issues that did come to market, the Salomon Brothers low-rated bond index stood just 340 basis points over Treasuries in early September, down from a spread of more than 500 basis points early in the year. Supply factors also contributed to a recent slight narrowing of spreads between higher-rated corporate debt and Treasuries. Risk premiums thus have remained relatively low even though the exposure of nonfinancial firms to rising interest rates is substantial.

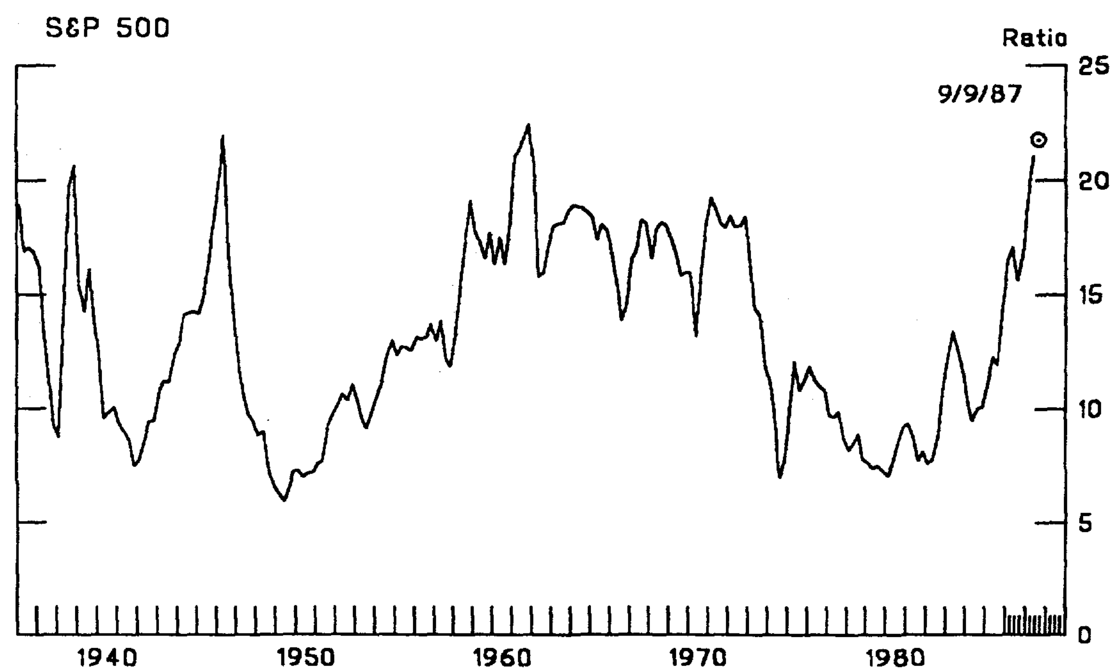
INTEREST SHARE OF PROFITS*



Source: Department of Commerce.

*Net interest to the sum of net interest plus economic profits before tax.

COMMON STOCK PRICE-EARNINGS RATIO*



Source: Standard and Poor's.

*End of quarter prices to latest 4-quarter earnings.

Net interest payments absorbed a hefty 30 percent of the earnings of nonfinancial corporations before interest and taxes in the first half of this year, and recent increases in interest rates likely will move this ratio higher.

Share prices reached their highest point ever in late August. At the peak, the S&P 500 price-earnings index (based on reported profits of the previous four quarters) stood at 23.3, slightly above the values of the mid-1960s and the highest multiple since the early 1920s and 1930s. Even with the apparent low cost of equity financing, gross offerings by nonfinancial firms totaled only $1.4 billion in August, well below the $3 billion average pace in the first half. Issuance by financial firms was larger, buoyed by offerings of preferred stock by thrifts and several large closed-end mutual fund issues. Sales of such mutual fund shares have totaled more than $6.5 billion this year.

Treasury and Sponsored Agency Financing

The Board staff is projecting a federal budget deficit of $40 billion in the current quarter. Barring an interruption of normal borrowing patterns by a failure of Congress to act on the federal debt ceiling that expires on September 23, debt issuance by the Treasury should exceed the size of the deficit, leaving a massive cash balance at the end of the month. In the fourth quarter, the federal deficit is projected by the staff to total about $75 billion, a substantial part of which would be financed by drawing down the Treasury's cash balance. Third-quarter net marketable borrowing has been entirely in the form of coupon issues, and essentially no net bill issuance is expected in coming months. Although the Treasury's financing pattern may have been a factor, the possibility

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

	1987 Q2	Q3e	Q4e	July	Auge	Septe
Treasury financing						
Total surplus/deficit(-)	2.5	-40.1	-75.2	-22.3	-25.9	8.0
Means of financing deficit:						
Net cash borrowing from the public	31.7	42.4	47.8	-3.1	32.6	12.9
Marketable borrowings/ repayments(-)	23.2	38.1	43.6	-7.5	34.1	11.6
Bills	-15.2	-.2	2.6	-15.7	15.2	.3
Coupons	38.4	38.3	41.0	8.2	18.9	11.3
Nonmarketable	8.5	4.2	4.2	4.4	-1.5	1.3
Decrease in the cash balance	-31.0	-6.3	23.6	20.6	-3.2	-23.7
Memo: Cash balance at end of period	40.1	46.4	22.7	19.4	22.6	46.4
Other[2]	-3.2	4.0	3.8	4.8	-3.6	2.8
Federally sponsored credit agencies, net cash borrowing[3]	6.9	6.2	6.4	2.9	2.0	1.3
FHLBs	7.6	4.6	4.0	1.3	1.8	1.5
FNMA	-.6	.2	1.0	.6	.0	-.4
Farm Credit Banks	-1.0	-1.5	-1.5	-.9	-.3	-.3
FHLMC	-1.0	.3	.3	.1	.1	.1
FICO[4]	--	--	.8	--	--	--
SLMA	1.9	2.6	1.8	1.8	.4	.4

e--staff estimate.
1. Data reported on a not seasonally adjusted, payment basis.
2. Includes checks issued less checks paid, accrued items and other transactions.
3. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
4. The Financing Corporation began operating in late August, 1987.
Note: Details may not add to totals due to rounding.

of temporary bill paydowns resulting from debt ceiling constraints also likely has contributed to the continued wide spread between bill rates and private short-term yields.

The first of several proposed loan sales by federal agencies reached the market during the first week of September. In this transaction, the Farmers Home Administration sold a pool of rural development loans to a trust which issued a combination of senior and subordinated pay-through bonds secured by the loans. The bonds are not government guaranteed but because all principal and interest payments received are passed through first to the senior bonds--leaving most of the default risk with the subordinated issues--the senior bonds received a AAA rating. The senior issues sold for $1.1 billion and offered yields ranging from 8.77 to 10.25 percent on five maturity classes. To date, it is not clear whether the subordinated securities will be offered to the public or placed privately. If they cannot be sold, the subordinated debt will be held by the Farmers Home Administration; even if this were to be the case, the proceeds of the senior issue apparently would still be treated as a loan sale and not a borrowing.

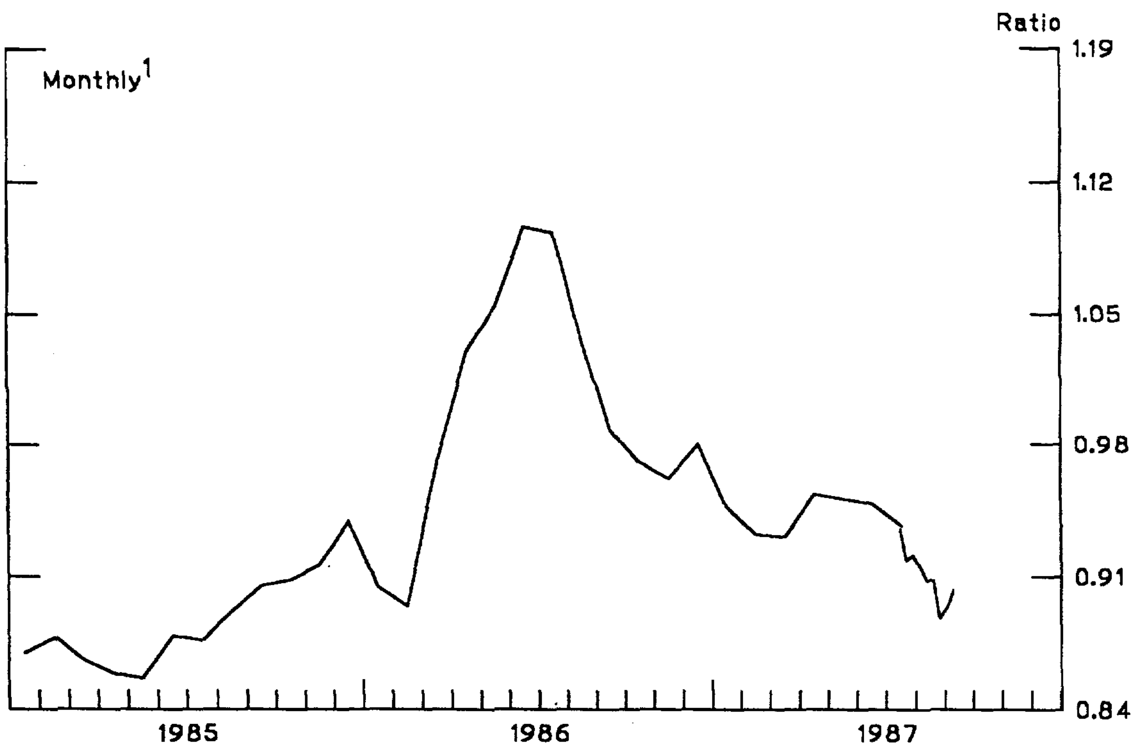
Borrowing by the federally sponsored agencies is projected to slow somewhat during the third quarter from its second-quarter pace. Debt issuance by Federal Home Loan Banks will show a sizable drop as a result of a slowdown in their advances to member thrifts. After paying down debt during the first half of 1987, both Fannie Mae and Freddie Mac should be modest net borrowers during the third quarter owing to a significant slowing in mortgage prepayments.

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

	1985	1986	1987		1987		
	Year	Year	Q1	Q2	June	July	Aug.p
Total tax-exempt	19.81	14.04	10.86	9.70	13.14	9.44	8.19
Short-term[1]	1.96	1.79	.56	1.83	2.42	2.47	2.19
Long-term	17.85	12.25	10.30	7.57	10.72	6.97	6.00
Refundings[2]	4.85	5.29	7.24	2.99	3.17	2.49	1.10
New capital	13.00	6.96	3.06	4.88	7.55	4.48	4.90
Total taxable	.03	.38	.27	.29	.50	.18	.03

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

RATIO OF TAX-EXEMPT TO TAXABLE INTEREST RATES*



*--Bond Buyer 30-year revenue to 30-year Treasury.
1. Data for August through September 10 are weekly.

The Farm Credit Banks (FCB) are expected to continue to pay down debt in the third quarter as farm loan demand remains weak. Spreads between FCB and comparable maturity Treasury securities narrowed between the FCB auctions in July and August after the Farm Credit System's announcement of a smaller-than-expected loss in the second quarter. The spread on 3-month securities narrowed from 95 basis points at the time of the auction in July to 53 basis points in August.

The newly created Financing Corporation (FICO), which has been established to provide financial assistance to the FSLIC, is included in the total for sponsored agencies for the first time. FICO has indicated that it will market at least one, and possibly two, bond issues of $400 to $600 million by year-end, the principal of which will be backed by holdings of zero-coupon Treasury issues; interest will be paid out of future insurance premiums and a reserve fund. The first of these issues will reach the market in late September but will not be settled until October. This issue will have a maturity of 30 years, and market participants expect it to yield between 75 and 100 basis points over 30-year Treasuries.

Municipal Securities Markets

The volume of new tax-exempt bonds eased to $6 billion in August, and is expected to be light again in September. Offerings of bonds for new capital held up last month, but issuance of refunding bonds continued to wane. Reduced supplies helped to stabilize municipal bond yields during August while taxable bond yields were rising, and the ratio of tax-exempt to taxable rates reached its lowest level in some time. But, with the further rise in interest rates in early September, the ratio backed up as the tax-exempt market reportedly was burdened with selling pressure from dealers, institutional investors, and bond funds (see chart on page III-12).

Gross issuance has continued strong in short-term municipal markets. As in recent months, the short-term market was dominated by tax and revenue anticipation notes in August as governments refinanced maturing cash management notes. Of the $2.2 billion August volume, $1.3 billion came from an offering by Texas to enable that state to deal with its current budget crisis. This is only the second time Texas has sold securities for cash flow purposes; the recent issue follows a $600 million offering last November.

Issuance of taxable municipal securities has been low this year, but likely will be boosted in September when Orange County, California, sells $600 million in commercial paper and notes. The stated purpose of the offering is to earn arbitrage profits, expected to be at least $1.3 million in a 12-month period. Proceeds of the commercial paper issue, $400 million, will be reinvested in a variety of instruments, including term RPs and bank CDs.

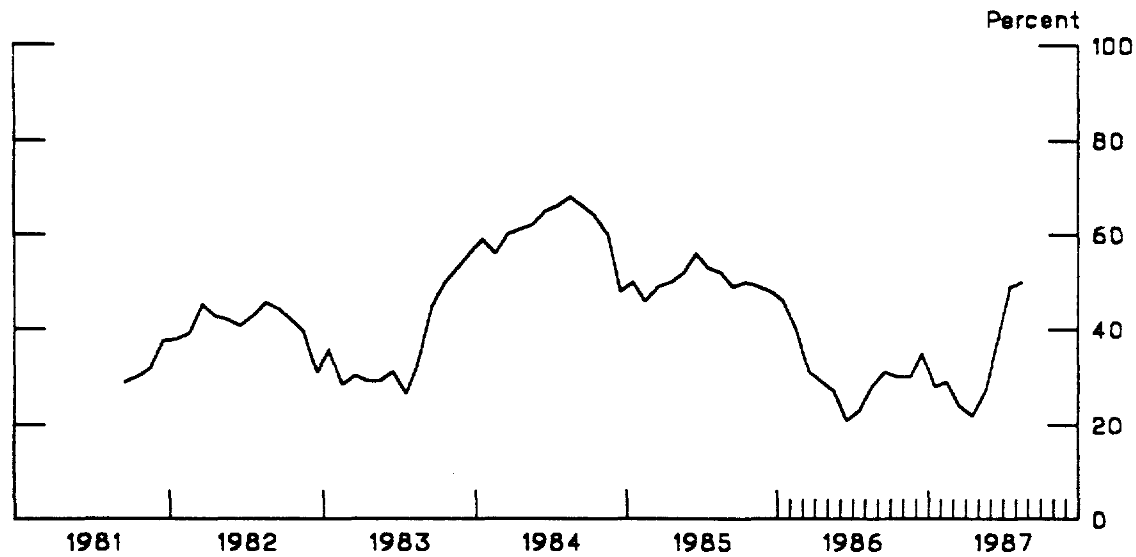
Mortgage Markets

Interest rates on fixed-rate mortgages have increased significantly since the last FOMC meeting. As of last week, the average contract rate on new commitments for 30-year fixed-rate conventional home mortgages had risen almost 60 basis points, and prevailing secondary market yields point to some further increase in this rate. Meanwhile, on September 8, the Veterans Administration raised the maximum allowable contract rate on VA-guaranteed, fixed-rate home loans by 50 basis points to 10.50 percent.

By contrast, the average initial rate quoted on one-year adjustable-rate mortgages, which are indexed to the one-year constant maturity Treasury yield, has increased only 20 basis points during the intermeeting period.

In fact, this is little changed from the level in early July, though over the same interval yields on secondary mortgage market ARM instruments have jumped about 100 basis points and the one-year Treasury rate has risen even more. These data on ARM pricing, as well as recent trade reports, suggest that lenders have been offering larger initial rate discounts on adjustable-rate products in attempts to gain shares of the burgeoning ARM market. Half of all conventional home purchase mortgages closed in July and August carried adjustable rates, and more than half of ARMs closed in July possessed first-year "teaser" rates.

ARM SHARE OF CONVENTIONAL HOME PURCHASE MORTGAGES CLOSED



Note: Data are for the first five working days of the month.

The rise in fixed-rate mortgage rates has further slowed refinancings and has damped mortgage volume at almost all lenders. However, different lender groups have been affected in varying degrees. Buoyed by the recent ARM popularity, mortgage originations at FSLIC-insured thrifts totaled

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

	Mortgage transactions		Net change in mortgage assets[1]		
	Originations	Sales	Total	Mortgage loans	Mortgage-backed securities
1987-Jan. r	20.0	13.7	1.2	-3.3	4.5
Feb. r	21.3	12.1	.3	-.5	.9
Mar. r	22.6	11.6	2.1	1.7	.4
Apr. r	24.1	14.9	8.1	1.8	6.3
May r	22.4	12.0	11.8	3.1	8.7
June r	23.2	11.4	1.6	2.3	-.7
July p	21.6	12.2	4.3	1.6	2.8

1. Net changes are adjusted to account for structural changes caused by mergers, acquisitions, liquidations, terminations, or de novo institutions.

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: Total ARM-backed issues
1984	5.0	2.3	1.6	1.1	.2
1985	9.0	3.8	3.2	2.0	.3
1986	21.6	8.2	8.3	5.0	.7
1987-Q1	24.0	10.4	8.4	5.2	1.0
Q2 p	24.8	9.6	8.3	6.9	1.1
1987-Jan.	25.2	10.6	8.2	6.4	1.0
Feb.	22.2	9.7	7.8	4.7	1.3
Mar.	24.5	10.7	9.1	4.6	.8
Apr.	28.8	11.9	9.9	7.0	1.0
May p	23.2	8.4	7.8	7.1	1.4
June p	22.2	8.4	7.2	6.6	1.0
July p	21.4	8.8	6.8	5.8	1.4
Aug. p	n.a.	n.a.	4.4	4.0	n.a.

r—revised. p—preliminary.

$21.6 billion in July, only 3 percent below the average during the first half of the year. In contrast, mortgage bankers--who tend to specialize in FHA/VA lending, almost all of which is fixed-rate--appear to have suffered much reduced origination volumes as the demand for fixed-rate mortgages has eased. With their traditional sources of business in a slump, mortgage bankers have turned to the conventional ARM market. However, intense price competition from thrifts and lack of a well-developed secondary market for ARMs have hindered their ability to profitably originate and sell adjustable-rate loans. According to trade reports, many mortgage companies have trimmed staffs in response to reduced lending volumes.

Reflecting the drop in fixed-rate lending activity, mortgage pass-through security issuance apparently declined in August for the fourth consecutive month, though volume normally picks up during the summer. Despite the increased ARM share of loan closings, ARM-backed securities issued in July totaled a relatively meager $1.4 billion.

Consumer Installment Credit

Consumer installment credit outstanding rose at a 7 percent annual rate in July. Combined with an upward-revised 9-1/2 percent increase in June, the July gain established the strongest two-month period of growth since September-October of last year when financing incentives were boosting auto sales and borrowing.

The stepped-up use of installment credit is consistent with the strength in retail sales in June and July, which was particularly evident in the durable goods component that relies more heavily on such financing. The rebound in consumer credit also may reflect a cooling of the torrid

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	Q2r	June r	July p	June r	July p	July p
Total[1]	17.1	10.5	1.5	5.5	9.4	7.1	4.55	3.46	591.3
Total, excluding auto	14.9	5.7	1.1	4.9	7.1	8.9	1.99	2.50	340.2
Selected types									
Auto	20.7	17.8	1.7	6.2	12.4	4.6	2.55	.95	251.1
Revolving	22.5	10.6	.6	6.6	4.7	11.4	.53	1.30	138.7
All other	10.6	2.6	1.3	3.7	8.8	7.2	1.46	1.20	201.5
Selected holders									
ommercial banks	15.7	8.1	.5	3.8	4.2	2.7	.93	.60	265.0
inance companies	26.3	20.7	-1.3	5.8	14.4	6.1	1.64	.71	138.7
redit unions	9.9	8.0	3.7	10.3	16.7	16.3	1.11	1.10	81.7
Savings institutions[2]	30.0	10.7	10.0	10.1	18.8	18.2	.94	.93	61.9

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.	May	June	July	Aug.
At commercial banks[1]							
New cars (48 mo.)	12.91	11.33	10.35	10.24	...	...	10.37
Personal (24 mo.)	15.94	14.83	14.11	14.00	...	...	14.22
Credit cards	18.69	18.26	18.11	17.93	...	...	17.85
At auto finance cos.[2]							
New cars	11.98	9.44	10.78	10.69	10.64	10.52	n.a.
Used cars	17.59	15.95	14.56	14.45	14.47	14.53	n.a.

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

pace of home equity borrowing. Data collected from commercial banks indicate some slowing of revolving home equity loans over the course of the summer. These data are not seasonally adjusted and data on the other lenders are sparse, but contacts at several institutions with major home equity programs indicate that they have experienced a sharp falloff in new applications since midyear.

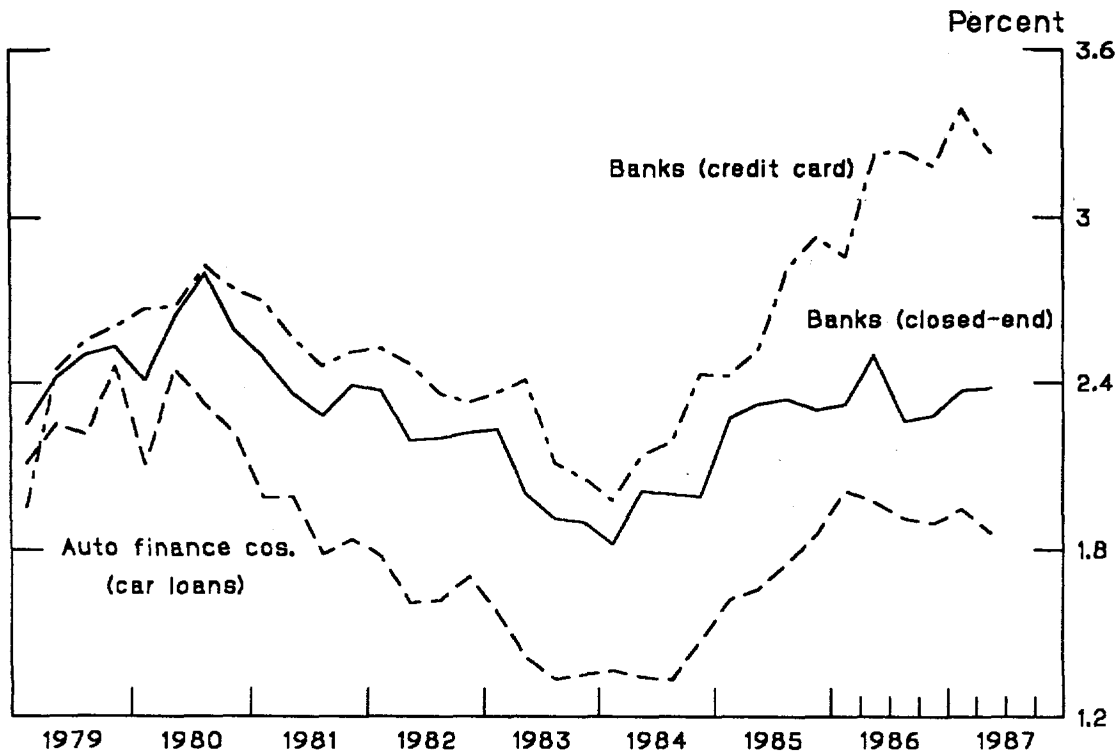
Growth in auto credit was moderate in July (prior to announcement of the latest round of financing incentives from the automakers), but revolving credit jumped to an 11-1/2 percent increase, a figure topped only twice in the past 15 months. This component of consumer credit has been held back partly by homeowners drawing on lower-cost home equity lines to pay off credit card balances. Thus, the pickup in revolving credit may indicate that the backlog of card balances subject to being paid off in this manner has by now been substantially worked down.[1]

Second-quarter data on debt payment difficulties showed little change from the first quarter. Delinquency rates on closed-end consumer loans at banks were up slightly, and were about at the midpoint of their historical range. Auto loan delinquencies at the financing subsidiaries of the automakers dropped a little, also staying at a moderate level. Despite a decline, delinquencies on bank credit cards remained at a historically high level. Mortgage loan delinquencies reported by the Mortgage Bankers Association continued a gradual downtrend that began early last year, but they were still fairly high by historical standards.

1. Based on household survey data, it was estimated that at the end of 1985 around one-fifth (or $25 billion) of outstanding credit card balances were held by people who both typically revolved their credit card debts and had sufficient equity in a home to obtain a home equity line of credit. Since then, home equity line balances have increased perhaps $40 billion, enough to eradicate much of the credit card balances vulnerable to refinancing, as well as to accommodate a variety of other uses.

DELINQUENCY RATES ON CONSUMER LOANS

(Quarterly, seasonally adjusted)



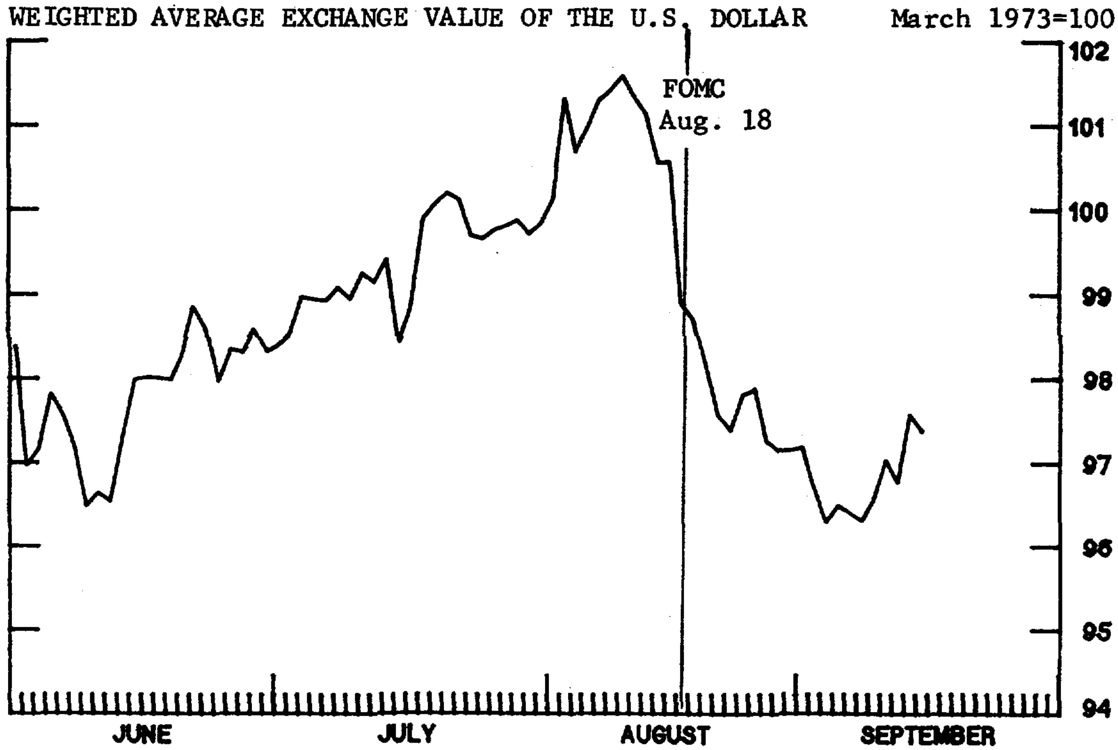
INTERNATIONAL DEVELOPMENTS

Foreign Exchange Markets

The trade-weighted, foreign-exchange value of the dollar has declined about 1-3/4 percent since the last FOMC meeting on August 18 and more than 4 percent from its peak on August 11. Selling pressure on the dollar, which intensified following the release on August 14 of worse-than-expected data on U.S. merchandise trade in June, persisted despite official intervention purchases of dollars by the Desk . Market participants inferred from the lack of official comments from the United States concerning the dollar and from the size of the intervention purchases that these transactions were intended to smooth the dollar's decline, not to stop or reverse it. The value of the dollar stabilized later in the period following the half-point increase in the discount rate by the Federal Reserve and the widening of short-term interest-rate differentials favoring the dollar. The release of data showing a smaller-than-expected trade surplus for Japan in August provided additional support for the dollar and seemed to help offset the immediate negative reaction to the release of data showing a larger-than-expected U.S. trade deficit in July.

While long-term interest rates in the United States rose sharply during the intermeeting period, the yields on mark- and yen-denominated assets also rose, but by less. The average yield on German bonds increased during the period about 20 basis points to 6.14 percent. This increase may be due in part to some concern about the future reaction of the monetary authorities to the above-target rate of money growth in Germany. The yield on the Japanese bellwether bond rose about 25 basis points on net to 5.35 percent, after having fallen

Chart 1



Selected Interest Rates

	August 11*	August 18 (FOMC)	August 28	Sept. 4	Sept. 11	Sept. 15
3-Month						
Germany	3.95	3.95	3.95	3.95	3.95	4.00
Japan	3.72	3.72	3.70	3.73	3.76	3.75
U.S.	6.69	6.72	6.88	7.06	7.44	7.41
Long-term						
Germany	6.07	5.93	6.02	6.15	6.15	6.14
Japan	5.11	5.11	4.22	5.20	5.51	5.35
U.S.	8.73	8.73	9.02	9.30	9.33	9.44

*Recent peak for the weighted-average value of the dollar.

sharply in the first half of the period to 4.16 percent as the yen continued to strengthen against the dollar. The yield rose later in the period partly in reaction to concerns about the vulnerability of Japanese corporations following the revelation that a Japanese chemical company had incurred heavy losses in bond futures trading.

The Desk purchased $169.75 million against yen and $50 million against marks for the System account and $219.75 million against yen for the Treasury account during the intermeeting period. Early in the period the Desk also purchased $38.8 million equivalent of yen in customer transactions with the World Bank to help replenish yen balances in the System account.

. To help reduce the selling pressure on the lira, on September 14 the Italian government imposed a ceiling on domestic credit growth and tightened foreign-exchange controls.

U.S. International Financial Transactions

Foreign official reserve assets in the United States declined by $6 billion in July. (See line 4 of the Summary of U.S. International Transactions table.) There were substantial declines in the holdings of members of OPEC, but the bulk of the decline was accounted for by members of the G-10, only a fraction of which was attributable to reported intervention sales of dollars. The Federal Reserve Bank of New York (FRBNY) attributed much of the decline, which was concentrated in holdings of Treasury bills, to the fact that maturing holdings could not be rolled over because of Treasury debt-ceiling problems and the postponement of the weekly auctions. Partial information from the FRBNY indicates some increase in Treasury bill holdings in August, after the auctions were resumed, but the increase did not reverse the July decline.

Little information is available on how the G-10 monetary authorities invested the dollars they shifted out of the United States in July, but it is likely that the very large inflow reported by banks between the end of June and the end of July (line 1) was related, at least indirectly, to the availability of funds in the Euromarkets resulting from foreign official investment decisions. In addition, the pattern of bank flows is also likely to be related to the demand for funds in the United States. The table on International Banking Data, which presents data on a monthly average basis on U.S. banks' net claims on their affiliated banking offices abroad and International Banking Facilities (line 1), suggests that the inflows that occurred towards the end of July did not reverse on average in August. These inflows contributed to the financing of a sharp expansion in domestic bank credit in August, substantially in excess of core deposit growth.

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

	1985 Year	1986 Year	1986 Q2	1986 Q3	1986 Q4	1987 Q1	1987 Q2	1987 May	1987 June	1987 July p/
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	-3.2	-8.0	-7.9	11.4
Securities										
2. Private securities transactions, net	43.0	66.0	21.3	17.2	14.7	17.0	15.9	5.2	5.8	4.8
a) foreign net purchases (+) of U.S. corporate bonds	46.0	53.3	15.9	12.6	12.1	8.6	7.5	2.0	2.1	3.0
b) foreign net purchases (+) of U.S. corporate stocks	4.8	18.0	7.0	4.5	0.3	10.2	8.7	3.8	1.6	2.3
c) U.S. net purchases (-) of foreign securities	-7.9	-5.3	-1.5	0.1	2.3	-1.8	-0.2	-0.5	2.0	-0.5
3. Foreign net purchases (+) of U.S. Treasury obligations	20.5	4.4	3.8	-1.5	-3.8	-1.8	-2.0	-3.4	7.2	0.4
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	10.9	0.3	1.7	-6.1
a) By area										
G-10 countries (incl. Switz.)	-0.4	30.6	11.2	14.6	0.9	15.7	12.8	3.2	1.3	-5.4
OPEC	-6.9	-8.1	-2.3	-2.9	-4.7	-2.8	-2.0	-0.3	-0.9	-1.2
All other countries	5.3	10.7	5.8	3.0	5.5	2.4	-0.1	-2.6	1.3	0.6
b) By type										
U.S. Treasury securities	-0.8	34.5	14.5	12.2	4.6	12.1	11.1	1.4	2.2	-5.2
Other 1/	-1.1	-1.2	0.1	2.5	-2.8	3.2	-0.2	-1.1	-0.5	-0.9
5. Changes in U.S. official reserve assets (+ = decrease)	-3.9	0.3	-0.0	0.3	0.1	2.0	3.4	0.1	0.6	0.4
Other transactions (Quarterly data)										
6. U.S. direct investment (-) abroad	-17.3	-28.0	-7.5	-5.7	-3.8	-9.8	-4.6	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	19.0	25.1	4.5	6.1	12.6	7.7	7.2	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow) 2/ 3/	5.6	-3.9	-4.6	1.1	-3.0	2.5	-4.1	n.a.	n.a.	n.a.
9. U.S. current account balance 3/	-116.4	-141.4	-33.8	-36.6	-38.0	-36.8	-41.1	n.a.	n.a.	n.a.
10. Statistical discrepancy 3/	17.9	23.9	10.2	-8.5	11.8	-5.5	17.6	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	-38.8	-39.5	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.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1983 Dec.	1984 Dec.	1985 Dec.	1986 Dec.	1987 Mar.	1987 Apr.	1987 May	1987 June	1987 July	1987 Aug.
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	44.5	33.0	28.2	22.3	9.1	12.8	3.2	5.0	10.8	4.4
(a) U.S.-chartered banks	40.5	32.1	32.4	31.7	21.6	23.1	16.3	16.3	22.8	18.4
(b) Foreign-chartered banks	4.0	.9	-4.2	-9.4	-12.4	-10.3	-13.1	-11.3	-12.0	-14.0
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	18.6	20.7	18.7	16.8	16.0	16.4	15.7	15.6	16.1	17.2
3. Eurodollar Holdings of U.S. Nonbank Residents 1/	124.3	117.4	111.9	123.2	134.0	130.4	133.5	135.7	127.6	135.6

1. Includes term and overnight Eurodollars held by money market mutual funds.
Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an 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.

Private holdings of U.S. securities continued to increase in July, although not at record rates. Foreign net purchases of U.S. corporate bonds (line 2a on the Summary of U.S. International Transactions table) were $3 billion in July, up somewhat from the second quarter pace. Based upon more recent information on new Eurobond issues by U.S. corporations, net purchases of bonds are likely to remain at about that level at least through August. Foreign net purchases of U.S. corporate stocks (line 2b) were over $2 billion in July, with about half the net purchases accounted for by Japanese residents. U.S. residents increased their holdings of foreign stocks and bonds (line 2c). However, they appear to have been net sellers of Japanese stocks, while buying stocks in Canada and Europe. Foreign net purchases of U.S. Treasury obligations (line 3) were small in July; there were net sales by private residents of Japan and by the World Bank, and net purchases by private residents of the rest of the world.

Data released recently by the Department of Commerce (September 15) on other international transactions in the second quarter of 1987 are shown on lines 6 through 10. Direct investment in the United States (line 7) is running very strong in 1987 as the result of a large number of mergers and acquisitions including, for example, British Petroleum's takeover of Standard Oil. The direct investment inflow resulting from these transactions depends on inflows into the United States from the foreign parent company and, since financing arrangements vary, the size and timing of these inflows need not match exactly the size and timing of the underlying transactions. U.S. direct investment abroad (line 6) was almost $6 billion in the second quarter, down from the first quarter, which was inflated by the inclusion of large unrealized currency translation gains in reinvested earnings. The statistical discrepancy in the accounts (line 10) was large and positive in the second quarter, more than reversing the outflow recorded in the first quarter.

July Trade Data

As reported on September 11 by the Census Bureau, the U.S. merchandise trade deficit for July, on a c.i.f. basis, was $198 billion at an annual rate (not seasonally adjusted) -- the largest single monthly deficit recorded so far this year. Correcting for seasonal factors and translating the data to a balance of payments basis, the staff estimates the July deficit to have been $165 billion at an annual rate, which is about unchanged from the June deficit and only slightly larger than the second-quarter average (see table).

Monthly U.S. Merchandise Trade
(billions of dollars, annual rates)

	Census Basis (Revised-NSA)			BOP Basis (SA)**		
	Exports*	Imports (CIF)	Balance (CIF)	Exports	Imports	Balance
	(1)	(2)	(3)	(4)	(5)	(6)
1987						
April	246	402	-156	238	386	-148
May	249	418	-168	234	394	-160
June	254	442	-189	247	414	-167
July	252	450	-198	264	429	-165

*Beginning with the June data, adjustments have been added to Census basis export data for undocumented exports to Canada.
**BOP basis data have always included estimates for undocumented exports to Canada. Monthly data on a BOP basis are for official use only.

The value of seasonally unadjusted exports for July remained about unchanged from June levels. When correcting for seasonal variation, however, the value of exports rose about 7 percent in July. Increases were recorded in agricultural exports (particularly soybeans and wheat) and capital goods (almost entirely aircraft to Brazil and Japan), with small decreases in exports of passenger cars to Canada.

The value of imports was somewhat higher in July relative to the previous month, and was sharply higher than the second-quarter average, whether measured on a seasonally unadjusted or seasonally adjusted basis. The increase in imports occurred almost entirely in crude oil and petroleum products, as the volume of imported oil jumped 13 percent and the average price rose about 40 cents per barrel.

Q2: Merchandise Trade

For the second quarter, the merchandise trade balance recorded a deficit of $158 billion (annual rate) on a seasonally adjusted, balance of payments basis. Overall growth in exports was somewhat more rapid than growth in imports, but the second quarter deficit was nevertheless slightly larger than in previous quarters (see table).

U.S. Merchandise Trade
(billions of dollars, annual rates)

	Balance of payments basis, seasonally adjusted						
	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil	Nonoil	Balance
Years							
1984	220	38	182	332	57	275	-112
1985	216	30	186	338	50	288	-122
1986	224	27	197	369	34	335	-145
Quarters							
1986-3	226	27	199	375	32	343	-149
-4	228	28	200	383	32	351	-155
1987-1	228	26	202	383	35	348	-155
-2	240	29	211	398	40	358	-158

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

The value of exports rose roughly 6 percent over the revised first quarter levels. Most of the recorded increases were in export volume and were spread across agricultural products (primarily corn and wheat), machinery (where increases were widespread) and industrial supplies (particularly chemicals and paper products).

Import value increased almost 4 percent in the second quarter, with most of the rise concentrated in imports of petroleum and products. The price of imported oil increased 11 percent or $1.70 per barrel from the price in the first quarter, and the volume of oil imports rose 4 percent. The value of non-oil imports increased 3 percent in the second quarter, with a small decline in imports of industrial supplies (particularly metals) more than offset by rising imports of capital goods, consumer goods, and automobiles (new cars from Japan and Korea). The increase in imports of capital goods was widespread across categories (electrical and nonelectrical machinery as well as aircraft) while the rise in consumer goods was concentrated in apparel and nondurable goods. Slightly more than one half of the pick-up in value was due to a rise in the prices of imported products, with the remainder due to increases in volume.

Q2: Current Account

The current account deficit continued to widen in the second quarter, recording a deficit of $164 billion at an annual rate, about $17 billion worse than the deficit for the first quarter. Declines in receipts of capital gains on U.S. direct investment assets abroad accounted for almost the entire increase in the current account deficit, as the widening trade deficit contributed only $3 billion (see table).

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

		1986 Year	1987 Q1	1987 Q2	$ Change Q2/Q1
1.	Trade balance	-144.3	-155.0	-158.1	-3.1
2.	Exports	244.4	228.0	240.0	11.9
3.	Imports	368.7	383.0	398.0	15.0
4.	Investment income, net	20.8	22.0	6.4	-15.6
5.	Direct investment, net	30.9	37.0	26.0	-11.0
6.	Capital gains or losses 1/	10.1	14.8	3.4	-11.4
7.	Other D.I. income	20.7	22.3	22.7	0.4
8.	Portfolio income, net	-10.1	-15.0	-19.6	-4.6
9.	Military, net	-3.7	-0.2	0.4	0.6
10.	Other services, net	1.5	-1.2	-1.2	0.0
11.	Unilateral transfers	-15.7	-12.4	-11.6	0.8
12.	Current Account Balance	-141.4	-147.1	-164.4	-17.3
Memo:					
	Statistical discrepancy, not AR	23.9	-8.1	19.5	

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

Developments in the Foreign Industrial Countries

The average pace of economic growth in the major foreign industrial economies increased in the second quarter following a very weak first quarter. Scattered evidence on the pace of economic activity since the second quarter has been mixed. In Germany, real GNP grew by 4.1 percent (s.a.a.r.) in the second quarter, reversing a first-quarter decline but leaving GNP no higher than in the third quarter of last year. Real GDP also resumed growing in the second quarter in France and Italy after virtually no growth in the first quarter. Both Canada and the United Kingdom showed continued strong growth of real GDP in the second quarter. In Japan, indicators of second-quarter activity appear weak. Although the level of inflation abroad has remained generally low, consumer price inflation (measured on a year-over-year basis) has edged higher in recent months in Japan, Germany, the United Kingdom, Canada, and Italy. Trade and current account surpluses for the year to date remain at or near record high levels in Japan and Germany, but data on trade volumes indicate continued real adjustment of exports and imports in both countries.

Individual country notes. In Japan, economic indicators for the second quarter have been mixed, but on balance they suggest significantly slower growth than in the first quarter. Preliminary data for the third quarter suggest some rebound in growth. Industrial production fell 0.2 percent (s.a.) in the second quarter as a whole, but rose 4.3 percent in June and a further 1 percent in July. Capacity utilization in the manufacturing sector declined in April and May, after

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 Apr.	1987 May	1987 June	1987 July	1987 Aug.	Latest 3 months from year ago 2/
<u>Canada</u>												
GDP	4.0	1.8	.1	.0	1.5	1.5	*	*	*	*	*	3.1
IP	5.2	-1.4	-1.2	.9	9.1	1.3	-.2	.4	1.4	n.a.	n.a.	10.2
<u>France</u>												
GDP	1.8	2.0	.5	.3	-.0	.8	*	*	*	*	*	1.6
IP	2.0	-.3	1.6	-1.3	-.3	2.0	-1.0	1.0	1.9	n.a.	n.a.	2.0
<u>Germany</u>												
GNP	1.7	2.4	.8	-.3	-.8	1.0	*	*	*	*	*	.8
IP	3.4	.6	.7	-.8	-2.8	2.8	3.4	.5	-1.3	-1.3	n.a.	-1.0
<u>Italy</u>												
GDP	3.1	2.4	.0	.3	.2	1.4	*	*	*	*	*	1.9
IP	1.0	2.8	-3.4	1.6	3.0	n.a.	-2.1	n.a.	n.a.	n.a.	n.a.	1.2
<u>Japan</u>												
GNP	4.2	2.0	.7	.7	1.2	n.a.	*	*	*	*	*	3.7
IP	.9	-.5	-.4	-.0	1.4	-.2	-1.6	-1.4	4.3	1.0	n.a.	2.1
<u>United Kingdom</u>												
GDP	2.6	3.5	.7	1.0	1.3	n.a.	*	*	*	*	*	3.3
IP	4.6	2.2	1.0	-.0	1.2	.1	-.6	.9	-1.1	n.a.	n.a.	2.4
<u>United States</u>												
GNP	3.3	2.2	.4	.4	1.1	.6	*	*	*	*	*	2.4
IP	1.8	1.1	.5	.8	.8	1.0	.1	.8	.6	.9	.3	4.3

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 May	1987 June	1987 July	1987 Aug.	Latest 3 months from year ago
Canada													
CPI	4.2	4.3	1.2	.8	1.2	1.0	.9	1.4	.6	.3	.7	n.a.	4.7
WPI	2.5	1.1	.9	-1.5	1.1	.6	-.6	1.4	1.0	.3	.3	n.a.	3.2
France													
CPI	4.8	2.1	.1	.7	.6	.7	1.2	.9	.2	.2	.2	n.a.	3.4
WPI	1.9	-3.5	-.7	-1.4	-.7	-.7	.7	.5	*	*	*	*	-.3
Germany													
CPI	1.8	-1.0	.0	-.3	-.5	-.3	.6	.4	.1	.2	.0	-.1	.6
WPI	-1.1	-9.0	-2.1	-2.6	-2.9	-1.6	-.2	.0	.0	.1	-.4	n.a.	-3.5
Italy													
CPI	8.6	4.7	1.8	1.1	.6	1.2	1.3	1.0	.4	.4	.3	.0	4.3
WPI	5.9	-2.4	-.5	-1.8	-.8	.7	1.5	1.0	.4	.2	.1	n.a.	3.1
Japan													
CPI	2.0	.1	.3	.3	-.5	.0	-.3	1.2	.2	-.2	-.5	.2	.6
WPI	-3.7	-10.5	-2.4	-4.2	-2.8	-1.5	-.5	-.5	-.2	.5	.9	.2	-2.5
United Kingdom													
CPI	5.5	3.4	.7	1.3	.1	1.3	1.2	1.5	.1	.0	-.1	.3	4.3
WPI	5.2	4.2	1.4	1.6	.4	.8	1.2	1.1	.4	-.1	.1	.3	3.6
United States													
CPI (SA)	3.5	1.3	.4	-.3	.6	.7	1.3	1.2	.3	.4	.2	n.a.	3.9
WPI (SA)	1.4	-1.8	-1.2	-1.2	-.1	.7	.7	1.3	.4	.2	.2	.0	3.1

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 May	1987 June	1987 July	1987 Aug.
Canada												
Trade	12.4	7.5	1.7	2.3	1.7	1.8	2.1	2.0	.8	.1	.4	n.a.
Current account	-.4	-6.7	-1.9	-1.1	-1.5	-2.1	-1.3	-1.5	*	*	*	*
France												
Trade	-2.6	-.1	.4	-.8	-.1	.4	-1.0	-2.2	-.9	-.6	-.5	n.a.
Current account	.1	3.7	1.1	.5	1.2	.9	-.1	-.7	*	*	*	*
Germany												
Trade (NSA)	25.4	52.3	9.5	12.5	14.1	16.2	15.1	15.4	5.9	4.6	5.4	n.a.
Current account (NSA)	15.8	37.7	7.1	8.3	8.6	13.8	10.9	10.7	4.3	3.0	2.6	n.a.
Italy												
Trade	-11.2	-1.4	-1.5	-.8	.9	.0	-1.4	-4.0	-1.0	-2.2	-1.4	n.a.
Current account (NSA)	-3.5	4.6	-3.3	1.3	5.4	1.2	-2.2	n.a.	*	*	*	*
Japan												
Trade	46.1	82.5	15.9	20.4	23.6	22.5	23.6	19.0	6.4	5.5	6.2	5.9
Current account 2/	49.2	85.5	15.9	21.6	23.8	24.3	24.9	20.9	7.1	6.4	6.3	n.a.
United Kingdom												
Trade	-2.6	-12.4	-2.1	-2.4	-4.3	-3.7	-1.7	-3.9	-1.9	-1.2	-1.5	n.a.
Current account	3.9	-1.6	.6	.2	-1.4	-1.1	1.0	-.9	-.9	-.2	-.5	n.a.
United States												
Trade 2/	-122.1	-144.3	-35.0	-33.6	-37.1	-38.6	-38.8	-39.5	*	*	*	*
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.

rising in the first quarter, and remained well below its peak level of mid-1985. The unemployment rate fell from 3.2 percent (s.a.) in May to 2.7 percent in July.

The consumer and housing sectors have provided some signs of strength. Retail sales rose 2.3 percent (s.a.) in the second quarter but then declined 0.5 percent in July. For the first seven months of 1987, retail sales were 4.5 percent above their level in the comparable period of 1986. After sluggish growth earlier in the year, new housing starts rose 7.9 percent (s.a.) in the second quarter and 3.3 percent in July. So far this year, housing starts are about 20 percent above their year-earlier level.

Inflation remains low in Japan. The index of consumer prices rose 0.2 percent (n.s.a.) in August, to a level 0.8 percent above its August 1986 level, but the average for the first eight months of the year was only 0.1 percent above the level for the first eight months of 1986. The all-commodities index of wholesale prices rose in July and August but was still 1.1 percent below its year-earlier level. Wholesale prices have increased in recent months due to higher domestic prices of oil products.

Japan's trade surplus in dollar terms increased (s.a.) in July but then declined in August. For the first eight months of 1987, the cumulative trade surplus was $82 billion (s.a.a.r.), the same rate as in 1986 as a whole. In the first eight months of 1987, export volume was 2.3 percent below its year-earlier level while import volume was 6 percent above its year-earlier level. The current account surplus narrowed further in July to $6.3 billion (s.a.). The cumulative current account surplus for the first seven months of 1987 totaled $89 billion (s.a.a.r.), slightly higher than in 1986.

Money growth has been rapid, with M2+CDs increasing 10.3 percent in the 12 months through July. For the third quarter, the Bank of Japan projects annual growth of M2+CDs of "around 10 percent." Bank of Japan officials have recently stressed that, while there are no plans to alter the relaxed stance of monetary policy in the near term, they are carefully watching price developments. Concern over rapid price increases for construction-related materials and for land in the Tokyo area has been mentioned frequently.

Three tax reform measures have passed the lower house of the Diet and are expected to be passed by the upper house later this month. The bills provide a personal income tax cut of 1.54 trillion yen ($11 billion) for the current fiscal year (larger than the 1 trillion yen tax cut promised in the recent demand stimulus package), elimination of preferential tax treatment for postal savings accounts in FY1988, and an increase in central government transfers to local governments to fund public works projects.

In Germany, real GNP in the second quarter grew 4.1 percent (s.a.a.r.) after falling at a 3.5 percent rate in the first quarter. The level of real GNP reached in the second quarter was only 0.8 percent above that in the second quarter of 1986 and not significantly higher than in the second half of last year. The fluctuation in activity between the first two quarters of this year was due in large part to unusually severe winter weather, which slowed construction in the first quarter and led to a rebound of construction in the second quarter. Private consumption also fluctuated sharply between the first two quarters with growth rates of minus 3.4 percent (s.a.a.r.) in the first quarter and plus 12.7 percent in the second. This pattern was caused in part by the timing of a special tax incentive program designed to promote the purchase of autos with new pollution-control equipment. Real exports rose at a rate of 10.3 percent in the second quarter, but imports rose slightly faster, leaving the net foreign contribution unchanged at its first-quarter level, which was significantly below last year's average level.

Industrial production in July declined by 1.3 percent (s.a.) for the second consecutive month. The July level was 4.1 percent below that of July last year. Total manufacturing orders rose 0.9 percent (s.a.) in July on the strength of foreign orders. The latter recovered their year-ago level for the first time since late in 1985. Domestic orders, on the other hand, remained 3 percent below their year-ago level. The unemployment rate remained unchanged at 9 percent (s.a.) in August. The most recent release of the business sentiment index showed some continued improvement in July from the trough of early this year.

The consumer price index fell slightly in August to a level 0.8 percent above August of last year. Import prices began rising again in March and have put some moderate upward pressure on consumer prices.

The current account surplus in July was $2.6 billion (n.s.a.) bringing the cumulative total so far this year to $24 billion, compared to $18 billion for January through July of last year. The volume of exports in the first half of this year was unchanged from one year ago, while the volume of imports grew 3.4 percent.

In France, real GDP grew by 3.4 percent (s.a.a.r.) in the second quarter after having stagnated in the first quarter. For the first half of the year, total domestic demand grew by 4.4 percent (s.a.a.r.), boosted by strong investment, while net exports made a negative contribution to growth.

In the United Kingdom, the output measure of real GDP rose by 3 percent (s.a.a.r.) in the second quarter and was 4 percent above its year-earlier level, while unemployment declined (s.a.) for the thirteenth consecutive month in July. The surge in imports in July, which kept the current account in deficit for the third consecutive month, reinforced concerns about domestic overheating that had prompted the government to increase official lending rates by 1 percentage point on August 6.

Canadian real growth in the second quarter also continued to be robust. Real GNP rose by 6 percent (s.a.a.r.) in the second quarter following a similar rise in the first quarter. Already strong consumption increased further in the second quarter, and investment continued its strong pace. Net exports showed little change in either quarter.

In Italy, the new government has introduced a number of temporary tax increases designed to restrain the rate of growth of domestic demand. A related objective of these taxes is to reduce the projected

1987 budget deficit, which is currently expected to exceed last year's deficit. The Bank of Italy raised its discount rate by 1/2 percentage point to 12 percent on August 28, mainly in response to recent exchange market pressure on the lira. On September 14, Italian authorities tightened exchange controls and imposed a ceiling on bank lending.

Economic Situation in Major Developing Countries

Following a meeting with U.S. officials, Brazil's Finance Minister Bresser Pereira stated that his earlier proposals to capture part of the secondary market discount on Brazil's foreign debt to commercial banks would not be unilaterally imposed on banks by Brazil. In Argentina, the Radical Party of President Alfonsin lost its majority in the Chamber of Deputies and several gubernatorial seats, including the Buenos Aires governorship, in September 6 election. Mexico's plan to increase subsidies to state enterprises puts in jeopardy the Mexican commitment to the IMF to raise additional government revenues from public sector price adjustments this year. The Venezuelan government has decided to sign its revised, $20 billion public sector debt restructuring agreement with commercial banks. In Peru, legislative action on President Garcia's plan to nationalize private banks and insurance companies is proceeding; key provisions of the bill remain to be considered. In the Philippines, the Finance Minister and probably the Central Bank Governor will be replaced in a cabinet shuffle following the attempted coup of August 28-29.

Individual Country Notes. On September 8, Brazil's Finance Minister Bresser Pereira met with U.S. officials about the Brazilian debt situation. Following the meeting, Bresser Pereira stated that his earlier proposals to exchange debt to commercial banks for bonds at a rate reflecting part of the market discount on loans would be a voluntary option and not be unilaterally imposed on banks by Brazil. Brazil expects to make proposals to banks regarding rescheduling of its debt on September 25.

On September 9, the IMF Executive Board assessed Brazil's economic policies. A positive IMF report is one condition set by the Paris Club for rescheduling principal payments due the first half of 1987. The report from the IMF is unlikely to be unambiguously positive; it is uncertain at this point what action the Paris Club will take at its meeting scheduled for the week of September 21.

In August, the Brazilian authorities took further steps to raise domestic interest rates and control government expenditures, recognizing that without corrective action the government could not hope to meet its goals of reducing the fiscal imbalance and containing inflation. Inflation in August was 6.4 percent with price controls, higher than the government had hoped. Price and wage controls are now in the process of being dismantled. Preliminary estimates indicate that the trade surplus in August again was over $1 billion.

In Argentina, the Radical Party of President Alfonsin lost its majority in the Chamber of Deputies in the September 6 elections. The government, which was already a minority in the upper house, retains a plurality of seats in the Chamber. In addition, the Radical Party lost five gubernatorial seats to the opposition Peronists, including the Buenos Aires governorship to likely 1989 presidential candidate Antonio Cafiero. Following the vote, the outcome of which was attributed in the press to the poor performance of the economy, the entire cabinet submitted its resignation. Several of the resignations have been accepted, but President Alfonsin has announced that Economy Minister Sourrouille would retain his job.

Consumer prices rose 13.8 percent in August, up from 10.1 percent in July and the highest monthly inflation rate since the inception of the Austral plan in June 1985. Industrial production in the first seven months of 1987 was 8 percent above the same period a year ago.

The Mexican government announced that it will increase subsidies to the state enterprises that have raised prices by less than the rate of inflation, in order to avoid accelerated price increases by these enterprises. This decision puts in jeopardy the Mexican commitment to the IMF, under the stand-by arrangement, to generate 0.5 percent of GDP in additional revenues from public sector price adjustments this year. As the campaign for the 1988 presidential election gets under way, increases in public expenditures beyond originally planned levels may be expected. While petroleum revenues have been exceeding expectations as world oil prices have strengthened, other revenues were running below expectations in the first half of 1987, mainly because of the continuing depressed levels of economic activity.

The effective annual yield of 91-day Treasury bills at the September 8 auction was 135 percent, compared with 150 percent in early March when rates began to decline. In contrast, the annualized inflation rate in June-August was 147 percent, so that, ex-post, the bill yield was negative in real terms, as has been the case since May.

The monthly rate of crawl of the peso price of the dollar in the controlled market averaged 5 percent in July and August, more than 3 percentage points less than the monthly inflation rate. Since last November, the peso has appreciated against the dollar in real terms by about 8 percent, taking account of U.S. inflation. In the first half of 1987, the current account was in surplus by $3.1 billion, compared with a deficit of $1.1 billion in the same period in 1986.

On September 7, the Venezuelan government announced that it would sign its revised $20 billion public sector debt rescheduling agreement with commercial banks. Finance Minister Azpurua stated that the agreement would be signed on September 18, meeting the end of September deadline to allow reduction in the spread, from 1-1/8 percentage points to 7/8 of a percentage point over LIBOR, retroactive to April 1987. Government officials had previously suggested that signature would require "assurances" from its bank creditors of new money. Venezuela is now attempting to assemble about $2 billion in new finance from bond issues, increased trade credits, and additional project-related finance from commercial banks. The government also continues to discuss with the World Bank the possibility of World Bank policy-based lending, focusing on trade liberalization.

In Peru, legislation nationalizing private banks and insurance companies has cleared the Chamber of Deputies (lower house) and is now in the Senate. Key provisions of the bill remain to be considered, along with amendments that would exempt some domestic firms from nationalization or require, in special circumstances, less than 100 percent government ownership. Some version of the bill is expected to be passed by end-September, and the Chamber of Deputies will then vote on whether to accept the Senate version. Industry and Commerce Minister Romero, an important moderate in the cabinet, resigned his post in opposition to the nationalization. However, President Garcia will not accept the resignation until a suitable successor is found.

The government also announced in August that terms had been completed on "payment-in-kind" agreements with two banks, First Interstate of California and Midland Bank, whereby the banks will accept goods in lieu of overdue debt payments. A government spokesman also indicated that payments to eliminate arrears to the World Bank might be forthcoming, but no date was specified.

In early-September, the Philippines cabinet resigned in the wake of political turmoil following the attempted coup of August 28-29. The resignation of Finance Minister Ongpin subsequently was accepted, and unconfirmed reports indicate that Central Bank President Fernandez will also be replaced. These cabinet changes may well reflect discontent with the government's handling of the economy and the debt issue.