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September 18, 1987

SUPPLEMENT
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

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SUPPLEMENTAL NOTES

THE DOMESTIC NONFINANCIAL ECONOMY

Housing starts.

Total private housing starts edged down about 2 percent in August to a 1.58 million unit annual rate, as a contraction in single-family starts more than offset some increase in multifamily construction. The August construction pace was 2 percent below the second-quarter average and substantially less than the robust pace recorded earlier in the year. Single-family housing starts declined 4.5 percent in August to a 1.10 million unit rate. The run-up in mortgage interest rates during April and May has damped housing demand, as reflected in the reduced pace of housing starts and sales in recent months. Mortgage interest rates have registered a further increase recently, and single-family starts are expected to contract somewhat further in the fourth quarter. Multi-family housing starts rose about 6 percent in August to an annual rate of 484,000 units. This pace of activity remains close to the second-quarter average, but is substantially below that recorded during the first three months of the year.

UAW-Ford Settlement

Negotiators for Ford and the United Auto Workers (UAW) reached a tentative agreement on a new three-year contract. The settlement, if approved by the rank-and-file, would provide additional job security to the 104,000 workers at Ford plants and provide for a combination of general wage increase and lump sum payments. In particular, the tentative settlement would guarantee employment for all workers currently employed at Ford plants except during a "strictly defined" decline in production when temporary layoffs would be permitted. In addition, Ford

would replace one out of every two jobs lost through attrition. Economic terms reportedly include an initial base wage increase of 3 percent, followed by lump sum payments of about 3 percent of annual earnings in the second and third contract years; the lump sum payments will not be rolled into the base wage. The contract also retains the current COLA formula, continues the profit-sharing plan, and makes some improvements in health benefits.

PRIVATE HOUSING CONSTRUCTION
(Thousands of units, SAAR)

	1987		1987			Percent change in Aug. from	
	Q1	Q2 ¹	June ¹	July ¹	Aug. ²	Previous Month	Year Earlier
Starts	1795	1612	1586	1606	1582	-1.5	-12.1
1-family	1256	1142	1088	1150	1098	-4.5	-6.9
2- or more-family	539	470	498	456	484	6.1	-22.0
Permits issued	1682	1536	1517	1487	1486	0	-14.0
1-family	1146	1035	1039	993	1010	1.7	-4.6
2- or more-family	536	501	478	494	476	-3.6	-28.8
Mobile home shipments	234	227	231	245	n.a.	n.a.	n.a.

1. Revised.

2. Preliminary.

n.a.--Not available.

REAL GROSS NATIONAL PRODUCT AND RELATED ITEMS

(Percent change from previous period at compound annual rates;
based on seasonally adjusted data)

	1987-Q1	1987-Q2	
		Previous	Revised
1. Gross national product	4.4	2.3	2.5
2. Final sales	-2.3	3.4	3.5
2a. Excluding CCC purchases	.0	4.1	4.2
3. Consumer spending	-.7	2.1	1.9
4. Business fixed investment	-14.6	9.3	11.7
4a. Equipment	-15.3	12.7	16.5
4b. Structures	-12.8	1.0	.0
5. Residential structures	-7.7	-2.2	-2.8
6. Federal purchases	-18.6	7.3	6.6
6a. Defense	7.6	10.7	9.8
7. State and local purchases	5.0	2.0	1.7
8. Exports	10.2	12.1	17.9
9. Imports	-5.2	7.4	11.1

<i>ADDENDA:</i>			
10. Inventory change ¹	47.6	37.8	39.0
10a. Nonfarm ¹	43.9	23.4	22.7
10b. Farm ¹	3.7	14.3	16.3
11. Net exports ¹	-135.2	-133.3	-132.7
12. Nominal GNP	8.6	6.6	6.3
13. GNP implicit price deflator	4.2	3.8	3.5
14. GNP fixed-weighted price index	4.5	4.3	4.1
15. Real disposable personal income	2.7	-3.9	-4.3
16. Saving rate (percent)	4.4	3.0	3.0
17. Corporate profits ²	294.0	296.5	296.8

1. Level, billions of constant dollars.

2. Level, billions of current dollars, with inventory valuation and capital consumption adjustments.

THE FINANCIAL ECONOMY

September 1987 Senior Loan Officer Opinion Survey on Bank Lending Practices

C&I loan growth, which has been generally, sluggish for some time, weakened considerably in July and August. This development was widespread but was particularly evident at large banks. To help determine the reasons for this further weakness, respondents to the Senior Loan Officer Opinion Survey on Bank Lending Practices (LPS) were asked several questions about their lending policies and loan demand. In addition, the standard questions on willingness to extend credit to households were asked.

The Recent Weakness in C&I Loans. All but a handful of LPS respondents reported that their loan growth had weakened or remained about unchanged in the July-August period relative to the second quarter.¹ A large majority of banks reporting weaker loan growth ascribed it mainly to weaker demand. However, several respondents reported that tightened lending policies or increased loan sales were responsible for reduced loan growth.²

According to the responses, a variety of factors accounted for the recent weakness in loan demand. Among the more important was a reduced need for borrowing by C&I loan customers resulting from both lower expenditures on inventories and fixed capital and greater internally generated funds. A lower level of merger and acquisition activity also

1. At the few respondents reporting a pickup in loan growth, stronger demand was given as the cause.

2. Banks that tightened lending terms or increased loan sales reported they did so for a number of reasons including a desire to slow asset growth because of increased loan-loss provisions and an increase in the perceived riskiness of C&I loans relative to their yield.

was reported to have reduced loan demand. In addition, asset sales were used to pay down loans used for initial financing of mergers and acquisitions, and security issuance was used to restructure corporate balance sheets away from short-term debt including bank loans. Several respondents indicated that substitution into commercial paper was a further, although less important, reason for weak loan growth.³

Over two-fifths of banks experiencing weaker loan demand indicated that they intended to take steps to stimulate lending activity. Increased marketing efforts was the most frequently mentioned action, but pricing concessions were being contemplated by a few banks. Other banks indicated that there was little that could be done in the face of a change in the competitive environment, and some respondents planned to shift corporate resources to other banking areas.

Willingness to Lend to Households. The survey results showed some increase in the number of respondents indicating greater willingness to lend to households in the three months ending with the survey date. The number of banks indicating an increased willingness to lend rose in the last two surveys, but remains somewhat below the number reporting increased willingness during most of 1986. As was the case in the previous two surveys, the number of respondents reporting increased willingness to extend credit to households, including home equity lending, somewhat exceeded the number reporting increased willingness to extend credit in

3. The sharp contraction in commercial paper of nonfinancial corporations in July and August is estimated to have been entirely due to runoffs of merger-related paper. Short-term market interest rates were low in July and August relative to the prime rate, and some borrowers may have used the proceeds of commercial paper issuance to repay loans taken down under the prime rate option of revolving credit arrangements.

the form of consumer installment loans. Evidently, respondents' overall willingness to promote borrowing under home equity lines increased more in the last nine months than willingness to extend consumer installment credit.

SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES
 AT SELECTED LARGE BANKS IN THE UNITED STATES
 (Survey taken during the week of September 8, 1987)
 (Number of banks and percent of banks answering question)
 (By size of total domestic assets, in \$ billion as of June 30, 1987)

1. Commercial and industrial loan growth, which has been depressed through most of 1987, weakened significantly further on an aggregate basis in July.

a. Abstracting from seasonal influences, how would you characterize growth in C&I loans at your bank in July relative to growth in the second quarter?

	Stronger		Weaker		About unchanged		Total Banks
	Banks	Pct	Banks	Pct	Banks	Pct	
All respondents	5	(8.4)	31	(52.5)	23	(39.0)	59
\$7.5 and over	3	(9.4)	18	(56.3)	11	(34.4)	32
Under \$7.5	2	(7.4)	13	(48.1)	12	(44.4)	27

b. If growth has weakened, did this mainly reflect

	Tightened terms of lending		Sales of loans from your portfolio		Weaker demand for credit		Total Banks
	Banks	Pct	Banks	Pct	Banks	Pct	
All respondents	3	(9.7)	3	(9.7)	25	(80.6)	31
\$7.5 and over	3	(16.7)	1	(5.6)	14	(77.6)	18
Under \$7.5	0	(0.0)	2	(15.4)	11	(84.6)	13

c. If your bank has tightened its terms of lending, or if it has sold an increased volume of loans out of its portfolio, did this mainly reflect:

	A desire to substitute other assets for C&I loans		A desire to cut back on overall portfolio growth because of additions to loan loss provisions		A desire to cut back on overall portfolio growth owing to other reasons		Total Banks
	Banks	Pct	Banks	Pct	Banks	Pct	
All respondents	0	(0.0)	2	(33.3)	4	(66.7)	6
\$7.5 and over	0	(0.0)	1	(25.0)	3	(75.0)	4
Under \$7.5	0	(0.0)	1	(50.0)	1	(50.0)	2

d. If C&I loan demand weakened, did this reflect (if more than one applies, please rank in order of importance):

	Reduced merger and acquisition activity		Paydowns of merger and acquisition loans using proceeds of asset divestitures		Corporate balance sheet restructuring in which securities replace bank loans		A switch by borrowers from bank loans to commercial paper		Reduced corporate financing needs owing to lower expenditures on inventories and/or fixed investment		Reduced corporate financing needs owing to greater internally generated funds		Other		Total Banks
	Banks	Average rank ¹	Banks	Average rank ¹	Banks	Average rank ¹	Banks	Average rank ¹	Banks	Average rank ¹	Banks	Average rank ¹	Banks	Average rank ¹	
All respondents	10	(2.9)	13	(2.2)	14	(2.4)	10	(3.4)	11	(2.0)	14	(2.3)	6	(1.8)	25
\$7.5 and over	7	(2.7)	9	(2.3)	12	(2.4)	8	(3.8)	5	(2.8)	9	(2.1)	2	(3.5)	14
Under \$7.5	3	(3.3)	4	(1.8)	2	(2.0)	2	(2.0)	6	(1.3)	5	(2.6)	4	(1.0)	11

e. If demand weakened, does your bank plan to initiate steps to stimulate demand?

	Yes		No		Total Banks
	Banks	Pct	Banks	Pct	
All respondents	11	(44.0)	14	(56.0)	25
\$7.5 and over	7	(50.0)	7	(50.0)	14
Under \$7.5	4	(36.4)	7	(63.6)	11

Note: As of June 30, 1987, 32 respondents had domestic assets of \$7.5 billion or more; combined assets of these banks totalled \$670 billion, compared to \$810 billion for the entire panel of 60 banks and \$2.5 trillion for all federally insured commercial banks.

1. Average rank calculated using 1 for most important, 2 for next most important, and so on.

f. If C&I loan growth at your bank has picked up since June, was this mainly a result of

	<u>Stronger demand</u>		<u>Purchases of loans from other banks</u>		<u>Other</u>		<u>Total Ranks</u>
	<u>Ranks</u>	<u>Pct</u>	<u>Ranks</u>	<u>Pct</u>	<u>Ranks</u>	<u>Pct</u>	
All respondents	5	(100.0)	0	(0.0)	0	(0.0)	5
\$7.5 and over	3	(100.0)	0	(0.0)	0	(0.0)	3
Under \$7.5	2	(100.0)	0	(0.0)	0	(0.0)	2

2. Please indicate your bank's willingness to make general purpose loans to individuals now as opposed to three months ago. "Loans to individuals" here include standard consumer installment loans plus loans taken down under home equity lines of credit.

	<u>Much More</u>		<u>Somewhat more</u>		<u>About unchanged</u>		<u>Somewhat less</u>		<u>Much less</u>		<u>Total Banks</u>
	<u>Banks</u>	<u>Pct</u>	<u>Banks</u>	<u>Pct</u>	<u>Banks</u>	<u>Pct</u>	<u>Banks</u>	<u>Pct</u>	<u>Banks</u>	<u>Pct</u>	
All respondents	7	(12.3)	11	(19.3)	39	(68.4)	0	(0.0)	0	(0.0)	57
\$7.5 and over	5	(16.7)	6	(20.0)	19	(63.3)	0	(0.0)	0	(0.0)	30
Under \$7.5	2	(7.4)	5	(18.5)	20	(74.1)	0	(0.0)	0	(0.0)	27

3. Please indicate your bank's willingness to make consumer installment loans now as opposed to three months ago.

	<u>Much More</u>		<u>Somewhat more</u>		<u>About unchanged</u>		<u>Somewhat less</u>		<u>Much less</u>		<u>Total Banks</u>
	<u>Banks</u>	<u>Pct</u>	<u>Banks</u>	<u>Pct</u>	<u>Banks</u>	<u>Pct</u>	<u>Banks</u>	<u>Pct</u>	<u>Banks</u>	<u>Pct</u>	
All respondents	3	(5.3)	12	(21.1)	42	(73.7)	0	(0.0)	0	(0.0)	57
\$7.5 and over	3	(10.0)	6	(20.0)	21	(70.0)	0	(0.0)	0	(0.0)	30
Under \$7.5	0	(0.0)	6	(22.2)	21	(77.8)	0	(0.0)	0	(0.0)	27

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

September 18, 1987

	1985:04 to 1986:04		1987			Growth from 04 1986 to Aug. 1987 ^p	
	01	02	June	July	Aug. ^p		
----- Percentage change at annual rates -----							
1. M1	15.3	13.1	6.4	-10.4	1.6	5.3	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	7.6	5.0
							Levels in billions of dollars Aug. 1987 ^p
<u>Selected components</u>							
4. M1-A	10.0	5.5	2.7	-13.4	-0.5	3.4	496.5
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	0.8	296.4
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	14.1	733.7
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	-0.5	-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	-4.3	102.1	93.1
-- Average monthly change in billions of dollars --							
<u>MEMORANDA:</u>							
24. Managed liabilities at commercial banks (25+26)	2.0	8.3	6.0	2.0	-0.1	5.0	529.6
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	-4.7	-8.0	5.9	158.7
27. Net due to related foreign institutions, NSA	0.6	4.3	1.4	-1.9	-5.7	6.3	-1.3
28. Other ⁶	0.8	1.3	-1.7	-3.0	-2.1	-0.6	159.9
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

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

September 18, 1987

	1985:04 to 1986:04	1987					Levels in bil. of dollars Aug. ^p
		01	02	June	July	Aug. ^p	
----- Commercial Bank Credit -----							
1. Total loans and securities at banks	9.8	7.0	7.7	3.6	1.3	10.6	2188.7
2. Securities	14.2	2.4	4.4	-5.3	3.0	16.0	523.5
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	-12.2	194.9
5. Total loans	8.4	8.4	8.7	6.3	0.8	9.0	1665.2
6. Business loans	6.6	7.6	4.6	4.8	-5.2	0.0	555.5
7. Security loans	-3.7	-3.1	41.8	5.7	-17.0	66.2	44.0
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	4.8	197.7
----- Short- and Intermediate-Term Business Credit -----							
11. Business loans net of bankers acceptances	6.3	8.1	4.0	4.8	-4.8	-2.0	549.1
12. Loans at foreign branches ³	-8.6	-2.4	-14.7	-7.6	45.9	73.6	17.3
13. Sum of lines 11 & 12	5.8	7.8	3.4	4.5	-3.4	0.2	566.4
14. Commercial paper issued by nonfinancial firms	-0.8	-13.0	17.6	-16.2	-14.9	-16.6	78.4
15. Sum of lines 13 & 14	4.9	5.2	5.1	2.0	-4.8	-1.9	644.8
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.

III-T-1
SELECTED FINANCIAL MARKET QUOTATIONS 1/
(percent)

	1986		1987			Change from:	
	Oct lows ²	Spring Highs	FOMC Aug 18	Sept 3	Sept 17	Sept 3	FOMC Aug 18
Short-term rates							
Federal funds 3/	5.75	6.90	6.66	6.85	7.20	0.35	0.54
Treasury bills 4/							
3-month	5.04	6.02	6.02	6.19	6.38	0.19	0.36
6-month	5.05	6.28	6.18	6.30	6.68	0.38	0.50
1-year	5.25	6.80	6.50	6.98	7.10	0.12	0.60
Commercial paper							
1-month	5.64	6.96	6.62	6.88	7.34	0.46	0.72
3-month	5.60	7.16	6.69	6.97	7.47	0.50	0.78
Large negotiable CD's 4/							
1-month	5.59	7.07	6.62	6.90	7.36	0.46	0.74
3-month	5.57	7.33	6.72	7.01	7.44	0.43	0.72
6-month	5.57	7.65	6.96	7.35	7.87	0.52	0.91
Eurodollar deposits 5/							
1-month	5.79	7.05	6.65	7.01	7.36	0.35	0.71
3-month	5.79	7.36	6.93	7.11	7.44	0.33	0.51
Bank prime rate	7.50	8.25	8.25	8.25	8.75	0.50	0.50
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	6.41	8.35	7.97	8.48	8.69	0.21	0.72
10-year	7.28	8.92	8.73	9.29	9.48	0.19	0.75
30-year	7.53	9.07	8.95	9.47	9.65	0.18	0.70
Municipal revenue 6/ (Bond Buyer index)	7.30	8.68	8.04	8.47	8.65	0.18	0.61
Corporate—A utility recently offered	9.32	10.27	10.34 e	10.60 e	10.90 e	0.30	0.56
Home mortgage rates 7/							
Fixed-rate	9.89	10.81	10.34	10.63	10.91	0.28	0.57
ARM, 1-year	7.98	8.01	7.78	7.84	7.96	0.12	0.18
	1986	1987		Percent change from:			
	Highs	Record highs	FOMC Aug 18	Sept 17	Record highs	FOMC Aug 18	
Stock prices							
Dow-Jones Industrial	1955.57	2722.42	2654.66	2527.90	-7.15	-4.77	
NYSE Composite	145.75	187.99	184.12	176.48	-6.12	-4.15	
AMEX Composite	265.19	365.01	357.98	352.61	-3.40	-1.50	
NASDAQ (OTC)	411.16	455.26	446.76	440.75	-3.19	-1.35	

1/ One-day quotes except as noted.
 2/ Low period for short-term rates.
 3/ Averages for two-week 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/ Quotes for week ending Friday closest to date shown.
 e—estimate

INTERNATIONAL DEVELOPMENTS

Developments in the Foreign Industrial Countries

Japanese real GNP showed no growth in the second quarter after an upward-revised 5.3 percent (s.a.a.r.) growth rate in the first quarter. Domestic demand made a stronger contribution to growth in the second quarter--1.2 percentage points (s.a.) compared to 0.8 percentage point (s.a.) in the previous quarter. Consumer spending and housing investment were two principal sources of growth. This strength in domestic demand was offset by a sizable negative contribution of net exports, -1.1 percentage points. Imports surged 5.9 percent (s.a.) while exports declined 1.6 percent (s.a.).

Money growth increased sharply in August. M2+CDs grew 11 percent relative to a year earlier. The Bank of Japan attributed the surge in M2+CDs to a sharp increase in the demand for long-term funds in anticipation of higher interest rates.