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October 15, 1980

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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SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest Data			Percent Change from		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year earlier
						(At annual rate)
Civilian labor force	Sept.	10-3-80	105.0	.1	1.9	1.5
Unemployment rate (%) <u>1/</u>	Sept.	10-3-80	7.5	7.6	7.7	5.8
Insured unemployment rate (%) <u>1/</u>	Sept.	10-3-80	4.4	4.4	4.7	3.0
Nonfarm employment, payroll (mil.)	Sept.	10-3-80	90.3	2.5	1.1	.0
Manufacturing	Sept.	10-3-80	20.0	3.4	-.2	-5.1
Nonmanufacturing	Sept.	10-3-80	70.3	2.2	1.5	1.6
Private nonfarm:						
Average weekly hours (hr.) <u>1/</u>	Sept.	10-3-80	35.2	35.1	35.0	35.6
Hourly earnings (\$) <u>1/</u>	Sept.	10-3-80	6.74	6.71	6.62	6.26
Manufacturing:						
Average weekly hours (hr.) <u>1/</u>	Sept.	10-3-80	39.5	39.4	39.1	40.1
Unit labor cost (1967=100)	Aug.	9-30-80	202.3	11.4	15.8	15.1
Industrial production (1967=100)	Aug.	9-15-80	140.5	6.0	-9.7	-7.6
Consumer goods	Aug.	9-15-80	141.7	.8	-2.0	-4.7
Business equipment	Aug.	9-15-80	167.3	-5.7	-10.7	-2.5
Defense & space equipment	Aug.	9-15-80	98.4	7.4	4.9	7.1
Materials	Aug.	9-15-80	137.8	11.4	-18.0	-12.0
Consumer prices all items (1967=100)	Aug.	9-23-80	248.8	8.3	6.7	12.7
All items, excluding food & energy	Aug.	9-23-80	234.3	6.2	5.7	11.9
Food	Aug.	9-23-80	257.5	21.8	13.3	9.3
Producer prices: (1967=100)						
Finished goods	Sept.	10-3-80	249.8	-1.9	12.4	12.8
Intermediate materials, nonfood	Sept.	10-3-80	284.4	6.4	7.0	12.9
Crude foodstuffs & feedstuffs	Sept.	10-3-80	281.4	-4.2	73.5	11.5
Personal income (\$ bil.) <u>2/</u>	Aug.	9-18-80	2137.9	9.3	11.3	9.8
						(Not at annual rates)
Mfrs. new orders dur. goods (\$ bil.)	Aug.	10-1-80	72.9	-1.5	8.2	-2.5
Capital goods industries	Aug.	10-1-80	24.3	-6.3	-2.2	.9
Nondefense	Aug.	10-1-80	20.3	-6.0	3.7	-3.6
Defense	Aug.	10-1-80	4.0	-8.2	-24.1	32.4
Inventories to sales ratio: <u>1/</u>						
Manufacturing and trade, total	Aug.	10-14-80	1.47	1.48	1.53	1.43
Manufacturing	Aug.	10-1-80	1.66	1.68	1.72	1.53
Trade	Aug.	10-14-80	1.29	1.30	1.34	1.32
Ratio: Mfrs.' durable goods inven-						
tories to unfilled orders <u>1/</u>	Aug.	10-1-80	.593	.591	.588	.560
Retail sales, total (\$ bil.)	Sept.	10-10-80	80.0	1.6	5.3	4.4
GAF <u>3/</u>	Sept.	10-10-80	17.3	-.1	4.7	3.8
Auto sales, total (mil. units.) <u>2/</u>	Sept.	10-3-80	8.8	2.5	16.0	-18.3
Domestic models	Sept.	10-3-80	6.6	2.9	22.8	-23.5
Foreign models	Sept.	10-3-80	2.1	1.3	-.9	3.0
Housing starts, private (thous.) <u>2/</u>	Aug.	9-17-80	1,399	12.0	54.4	-21.8
Leading indicators (1967=100)	Aug.	9-30-80	131.0	1.9	6.7	-6.5

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

2/ At annual rate.

3/ Excludes mail order houses.

DOMESTIC NONFINANCIAL DEVELOPMENTS

The upswing in economic activity continued in September. Nonfarm payroll employment rose for a second consecutive month, as did industrial production, and consumer spending maintained the upward trend that has been evident since June. Housing activity continued to advance through August, prior to the recent increases in mortgage interest rates. Capital spending, which tends to lag other sectors cyclically, slipped further, and evidence continues to suggest additional declines in the near term. Increases in various indexes of prices and wages have moderated somewhat, but underlying inflationary pressures remain strong.

Industrial Production and Employment

Industrial output has posted two consecutive months of moderate gains after dropping 8-1/4 percent over the preceding six-month period. The September increase--estimated at 1 percent--included a rise in auto and truck assemblies and a second month of sharp gains in the output of home goods and building supplies. Materials production, which had fallen 13 percent between January and July, again advanced sharply in September, particularly at producers of raw steel and at suppliers of auto-related parts. With the pickup in industrial production, capacity utilization at manufacturers increased 0.6 percentage point further in September to 75.6 percent. Capacity utilization for producers of industrial materials rose by a similar amount to 74.9 percent.

Reflecting the rebound in production, the demand for labor has shown a moderate pickup. Total employment, as measured by the household survey, rose about 200,000 in September. Although this latest improvement occurred entirely in the agricultural sector, the household

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

	1980				
	Q2	Q3	July	Aug.	Sept.
	--annual rate--		----monthly rate----		
Total	-19.1	-9.1	-1.0	.6	1.0
Final products	-10.1	-2.8	-.1	.1	.6
Consumer goods	-13.0	-2.6	-.2	.1	.9
Durable	-30.5	-5.6	-.1	-.2	3.2
Nondurable	-5.5	-1.5	-.3	.2	.1
Business equipment	-8.1	-5.0	-.1	.2	-.1
Construction supplies	-43.6	-9.4	-.4	1.8	2.0
Materials	-25.7	-18.4	-2.6	1.2	1.2
Durable goods	-32.3	-24.5	-3.7	1.7	1.5
Nondurable goods	-26.5	-18.8	-2.6	1.4	1.5
Energy materials	-2.3	-.1	.1	-.4	-.3

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

	1975	1979-80		1980			
		Low	High	Q2	Q3	July	Aug.
Manufacturing	69.0	87.2	77.9	75.1	74.7	75.0	75.6
Primary processing	68.2	89.2	76.3	71.7	70.7	71.6	72.8
Advanced processing	69.4	86.2	78.7	76.9	76.9	76.9	77.0
Motor vehicles & pts.	51.3	92.2	53.6	52.9	52.7	50.7	55.3
Materials	69.4	88.6	78.7	74.2	73.6	74.2	74.9
Durable goods mats.	63.6	87.6	74.6	69.0	68.0	69.0	69.9
Raw steel	68.0	94.7	68.3	59.0	55.3	57.5	64.2
Nondurable goods mats.	67.2	90.9	82.2	77.1	76.4	77.1	77.9
Energy materials	84.8	88.3	85.6	85.2	85.7	85.2	84.8

measure of nonfarm jobholders is now 400,000 higher than the June trough. The unemployment rate edged down in September to 7.5 percent, primarily reflecting lower joblessness among adult women and teenagers. After rising rapidly in the spring, the unemployment rate has remained in a 7-1/2 to 7-3/4 percent range for the past five months.

Employment as measured by the payroll survey rose nearly 200,000 in September, following a slightly larger gain in August. In retail trade, where employment dropped 95,000 during the second quarter, increases have averaged 45,000 for the past three months. Growth in service industry jobs also advanced in September and, together with the retail trade gains, accounted for about two-thirds of the overall increase last month. The remainder of the September job increase represented a pickup in activity at contract construction sites and a second month of rehiring at producers of durable goods, particularly in the metal producing and fabricating industries. The total number of manufacturing jobs has risen 175,000 since July, but remains more than 1 million short of its previous peak in July 1979. The factory workweek edged up 0.1 hour in September to 39-1/2 hours and was one-half hour above its July trough.

Personal Income and Consumer Spending

Nominal personal income rose substantially for the second consecutive month in August, following a period of little growth from March to June. While the strength in July was attributable primarily to a cost-of-living adjustment to social security payments, the August rise was spurred by the first substantial gain in wages and salaries since March. A turnaround in manufacturing payrolls led the increase in wages

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

	1978	1979	1980			
			Q2	Q3	Aug.	Sept.
- - - - - Average monthly changes - - - - -						
<u>Nonfarm payroll employment</u> ²	357	176	-366	83	242	187
Strike adjusted	341	182	-390	106	173	192
Manufacturing	74	1	-308	-4	118	57
Durable	62	4	-253	-11	41	54
Nondurable	12	-3	-55	7	77	3
Construction	31	20	-50	7	32	45
Trade, finance and services	182	113	-15	127	84	124
Private nonfarm production workers	264	112	-387	114	220	199
Manufacturing production workers	54	-11	-306	9	113	86
<u>Total employment</u> ³	270	173	-373	223	10	201
Nonagricultural	264	175	-317	140	87	-61

1. Average change from final month of preceding period to final month of period indicated.

2. Survey of establishments. Data for 1980 are revised to reflect benchmark levels for March 1979; revisions for prior years have not yet been received. Data are not strike adjusted, except where noted.

3. Survey of households.

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

	1978	1979	1980			
			Q2	Q3	Aug.	Sept.
Total, 16 years and older	6.0	5.8	7.5	7.6	7.6	7.5
Teenagers	16.3	16.1	18.0	18.5	19.1	17.5
20-24 years old	9.5	9.0	12.2	12.0	11.9	11.9
Men, 25 years and older	3.3	3.3	5.2	5.5	5.4	5.6
Women, 25 years and older	5.1	4.8	5.6	5.6	5.7	5.3
White,	5.2	5.1	6.6	6.8	6.8	6.5
Black and other	11.9	11.3	13.4	14.0	13.6	14.2
Fulltime workers	5.5	5.3	7.2	7.4	7.4	7.3
White collar	3.5	3.3	3.8	3.7	3.7	3.7
Blue collar	6.9	6.9	10.9	11.3	11.4	10.9

PERSONAL INCOME

(Based on seasonally adjusted annual rate data)

	1978	1979	1980			
			QI	QII	July	Aug.
- - Percentage change, at annual rates ¹ - -						
Total personal income	12.9	11.2	10.9	4.6	17.9	9.3
Wage and salary disbursements	12.8	10.1	10.9	2.1	.2	12.2
Private	14.1	10.8	12.0	1.0	-1.0	14.0
Nominal disposable personal income	12.0	10.4	13.5	4.3	20.1	8.0
Real disposable personal income	4.2	.5	.9	-6.0	12.7	n.a.
- - Changes in billions of dollars ² - -						
Total personal income	\$17.8	\$16.8	\$13.9	\$ 6.8	\$31.0	\$16.5
Wage and salary disbursements	11.5	9.7	10.4	-.5	.2	13.3
Private	10.1	8.4	9.1	-2.0	-.9	12.4
Manufacturing	3.2	2.0	2.7	-3.5	-.4	5.0
Other income	7.1	8.1	4.3	7.7	3.3	4.1
Transfer payments	1.5	2.9	2.4	3.4	24.6	-.8
Less: Personal contributions for social insurance	.8	.9	.8	.4	.4	1.0
Memorandum:						
Personal saving rate ³	4.9	4.5	3.7	4.9	4.6	n.a.

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

2. Average monthly change.

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

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

	1980						
	Q1	Q2	Q3	June	July	Aug.	Sept.
Total sales	2.1	-3.6	5.1	1.9	3.0	.6	1.6
(Real) ¹	-1.2	-5.8	n.a.	1.3	2.6	-.7	n.a.
Total, less auto and nonconsumption items	2.6	.2	3.0	1.4	1.1	1.1	.9
GAF ²	-.1	-1.6	4.0	-.7	1.8	3.0	-.1
<u>Durable</u>	.8	-12.0	9.9	3.0	8.0	-.9	2.2
Auto	1.5	-16.6	16.4	4.9	12.6	-1.5	5.4
Furniture & appliances	1.0	-4.6	5.0	-.7	4.7	.7	.0
<u>Nondurable</u>	2.8	.6	3.0	1.4	.8	1.3	1.3
Apparel	1.4	1.0	4.3	1.5	.1	3.6	1.0
Food	2.3	1.8	3.9	1.8	1.5	1.6	1.8
General merchandise ³	-1.2	-1.4	3.5	-1.5	1.5	3.6	-.6
Gasoline	9.2	5.1	3.5	4.3	.7	-.8	2.3

1. BCD series 59. Data are available approximately 3 weeks following the CPI release.

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

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

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

	1979	1980						
	Q4	Q1	Q2	Q3	June	July	Aug.	Sept.
Total	9.7	10.6	7.7	8.8	7.6	9.0	8.6	8.7
Foreign-made	2.4	2.8	2.1	2.3	2.2	2.6	2.1	2.1
U.S.-made	7.4	7.9	5.5	6.5	5.4	6.4	6.4	6.6
Small	3.5	3.8	2.8	3.2	2.7	3.1	3.3	3.3
Intermediate & standard	4.0	4.1	2.7	3.3	2.7	3.3	3.2	3.2

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

and salaries. Most of the August gain in nominal income, however, was eroded by higher prices; real disposable income is estimated to have remained more than 1 percent below its January level. Based on the gains reported in employment and average hourly earnings, nominal income growth appeared to be sustained through September.

The recent increases in nominal income have supported the firming of consumer spending that began in June. This upswing also probably reflects the easing of credit restraints and an improvement in consumer attitudes about the near-term economic outlook. In September, sales of new domestic-model autos were at a 6.6 million unit annual rate-- a slight improvement from July and August, and more than 1 million units above the depressed selling pace in the second quarter. A variety of year-end discounts and rebates, as well as the introduction by General Motors of their 1981 models on September 25, contributed to the higher sales. In the first ten days of October, when 1981 models were generally available, sales of new, domestic cars were at a 6.8 million unit rate. Foreign car sales in September held steady at a 2.1 million unit rate; this selling pace represents some fallback from the record market share taken by imports earlier in the year.

Nominal retail sales excluding autos and nonconsumption items rose 0.9 percent in September, the fourth consecutive monthly increase. Increases in these sales in real terms have diminished over the last two months. Spending in nominal terms at the general merchandise, apparel, and furniture grouping of stores was about unchanged last month, while outlays at food stores and gasoline service stations rose sharply.

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

	1979				1980			1
	Annual	Q4	Q1	Q2	June	July	Aug.	
All units								
Permits	1.55	1.34	1.14	.90	1.08	1.24	1.36	
Starts	1.75	1.59	1.26	1.05	1.22	1.25	1.40	
Single-family units								
Permits	0.98	.82	.68	.53	.63	.78	.86	
Starts	1.19	1.06	.80	.67	.76	.87	.97	
Sales								
New homes	.71	.62	.53	.45	.54	.66	.62	
Existing homes	3.74	3.56	2.98	2.40	2.48	2.92	3.03	
Multifamily units								
Permits	.57	.52	.45	.37	.45	.46	.50	
Starts	.55	.54	.46	.38	.47	.38	.43	
Mobile home shipments	.28	.26	.26	.18	.16	.22	n.a.	

1. Preliminary estimates.

n.a.--not available.

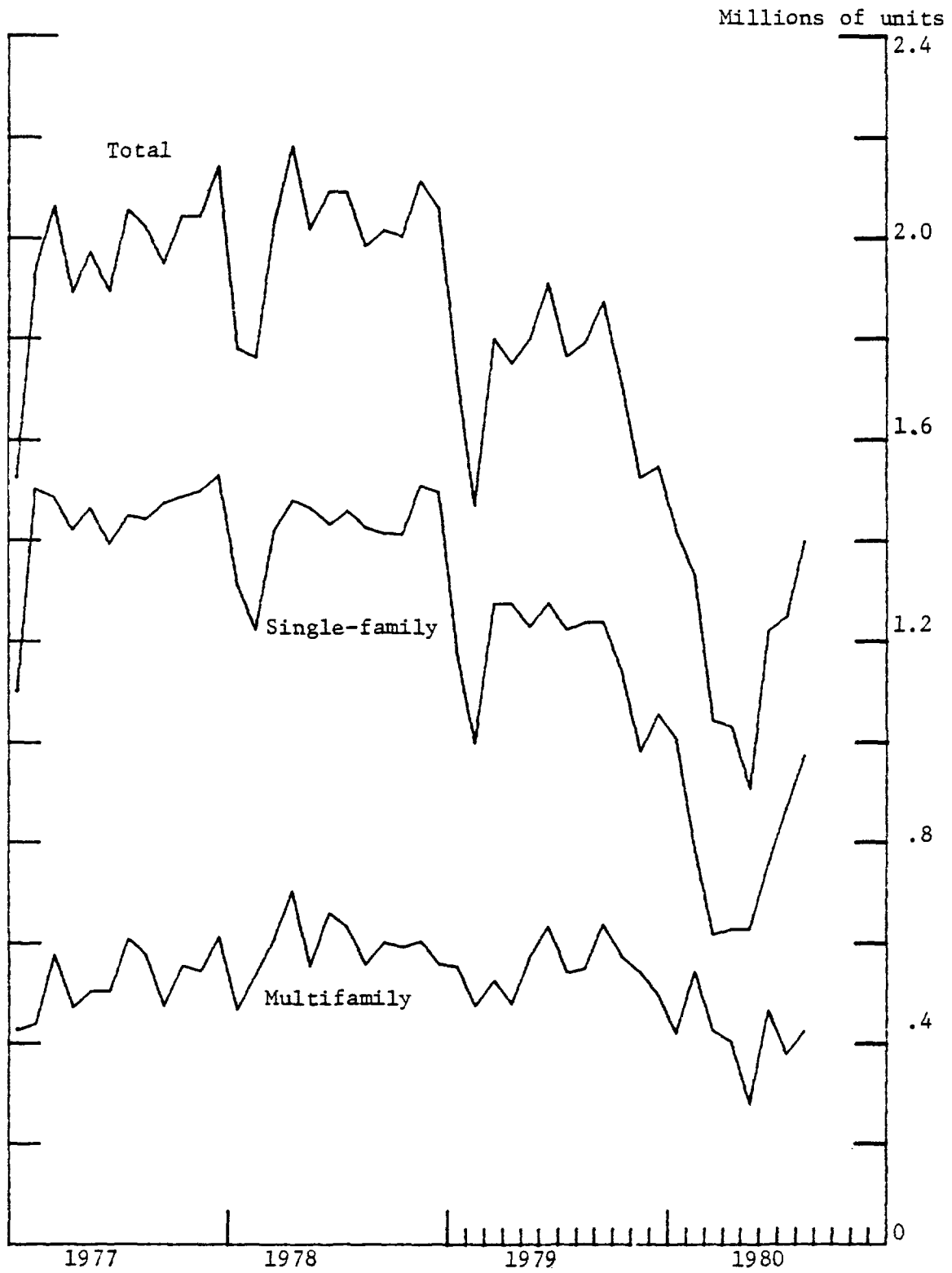
Consistent with the recent data on consumer spending, the composite measures of consumer confidence reported by both the University of Michigan Survey Research Center and Conference Board have advanced steadily since May. According to the surveys, consumers continued to report greater optimism in September about the near-term business outlook and about their personal financial situations. However, attitudes toward house purchases, which had exhibited a marked improvement in the Michigan survey in recent months, fell back somewhat in the September report because respondents expected further increases in mortgage interest rates.

Residential Construction

According to available data, the upswing in housing activity, evident since May, continued through August and probably into early September. The rebound apparently reflected strong underlying demand pressures as well as more favorable financial conditions that prevailed prior to the recent run up in mortgage credit costs. Total housing starts rose further in August to an annual rate of 1.4 million units-- a pace about one-third above the cyclical low in 1980:Q2. Newly-issued building permits increased for the fourth consecutive month in August to a level 50 percent above the second-quarter average. Advance reports show another increase in permits during the first two weeks of September.

The continued recovery in housing activity during August was fairly widespread by sector and region. Although the bulk of the advance in housing starts in August took place in the West, all regions except the Northeast have bounced back considerably since last spring.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



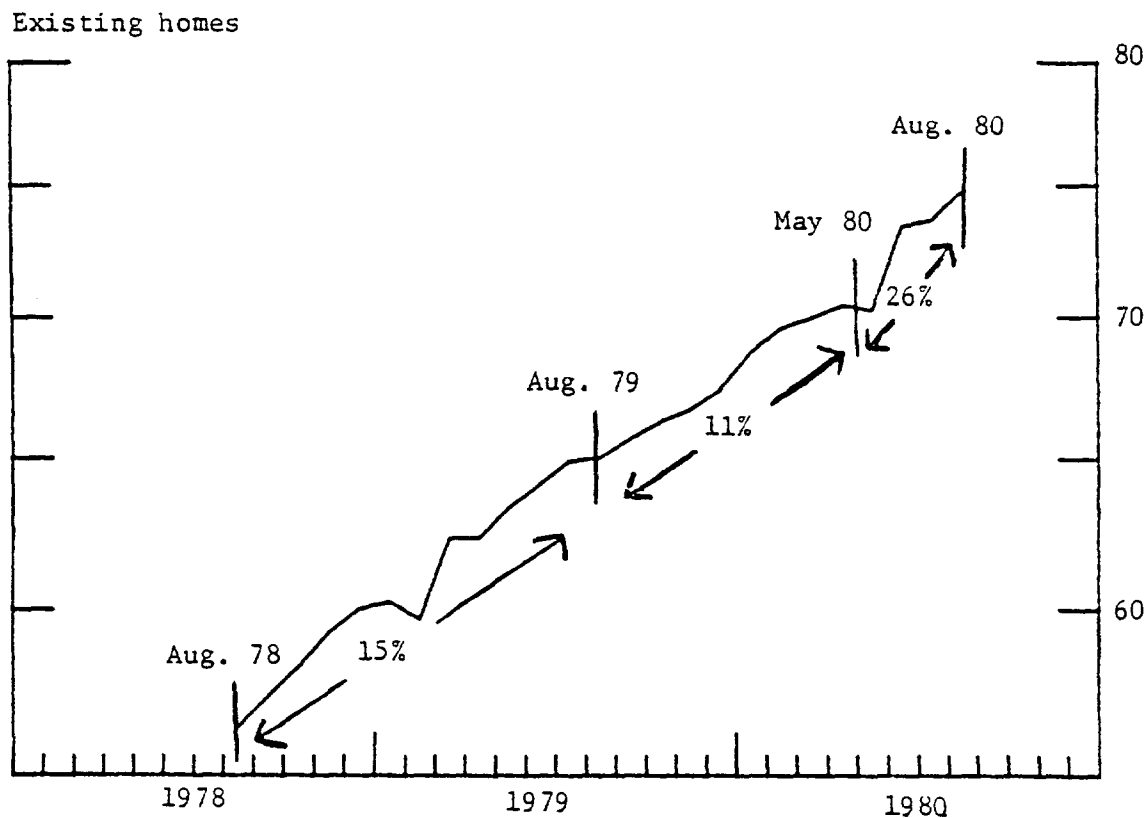
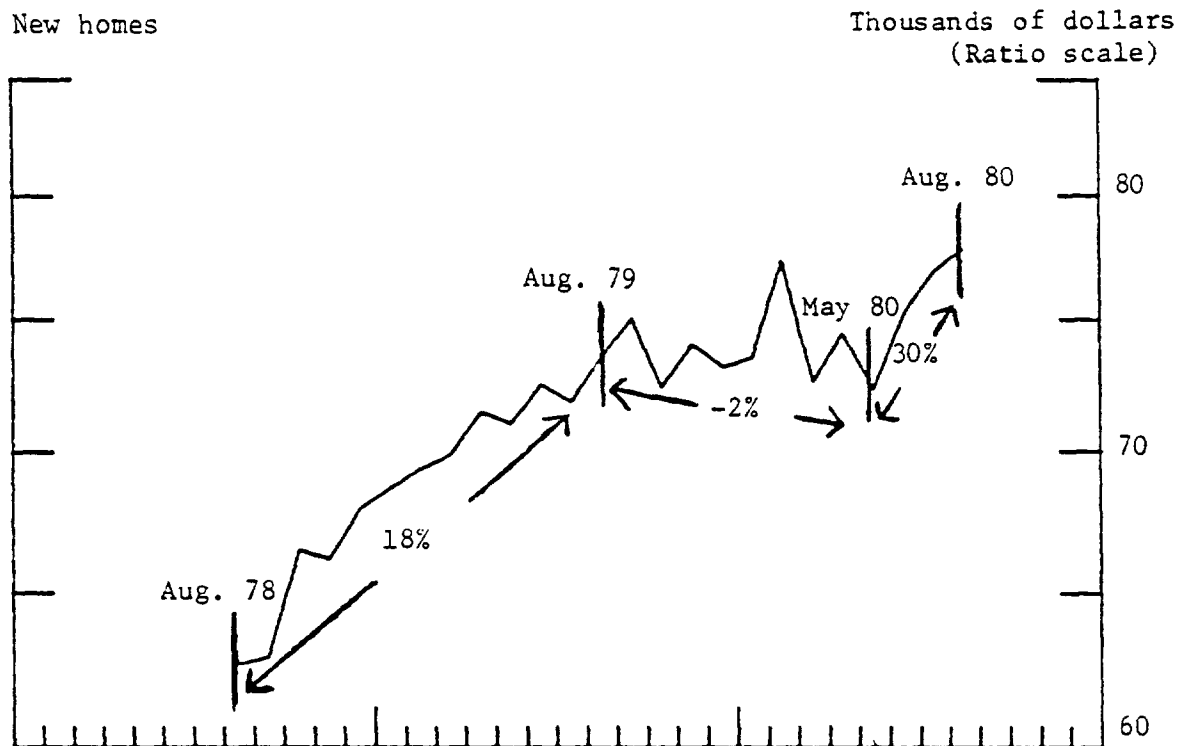
Starts in the multifamily sector rose substantially in August, perhaps reflecting the push in HUD-subsidized (Section 8) starts as fiscal year 1980 ended. The advance in single-family starts to almost a one million unit annual rate in August brought the cumulative increase in that sector since May to more than 50 percent. The latest gain came despite a 5 percent decrease in sales of new houses by merchant builders in August; meanwhile, the stock of unsold new houses at the end of August edged down to the lowest level in four and a half years. In contrast to new homes, sales of existing homes rose further.

The recent strength in housing demand has supported price increases in housing markets. Average prices of both new and existing houses sold have increased at more than a 25 percent annual rate from last spring through August. From August 1979 through May 1980 when mortgage interest rates were rising rapidly, prices of new houses declined slightly, partly due to a shift in the mix of sales, and prices of existing houses increased at a slower rate than over the preceding year.

Business Fixed Investment

Indicators of business capital spending in August suggest that the slide in real investment, which began in the spring, is continuing-- particularly in the construction area. In constant-dollar terms, non-residential construction fell 3.1 percent in August, following an even larger drop in July; the August level of this spending was 9.6 percent below the second-quarter average. As in July, the August decline in construction was centered in the industrial and nonoffice commercial building categories. In contrast, oil- and gas-well drilling--a component of spending on nonresidential structures in the national income and product accounts--continued to expand.

RECENT CHANGES IN AVERAGE PRICES OF HOMES SOLD
(Seasonally adjusted)



Note: Changes between dates are shown at annual rates.

BUSINESS INVESTMENT SPENDING
(Percentage change from preceding comparable period,
based on seasonally adjusted data in current dollars)

	1979		1980		
	Q4	Q1	Q2	July	Aug.
Nondefense capital goods shipments					
Current dollars	1.4	6.0	-2.5	2.0	-0.3
Constant dollars ¹	2.7	2.0	-3.0	2.4	-0.8
Addenda: Unit sales of heavy-weight trucks (thousands)	330	330	240	280	310
Nonresidential construction					
Current dollars	4.2	3.3	-2.0	-4.6	-2.9
Constant dollars	1.0	0.5	-4.0	-5.2	-3.1
Addendum: Oil and gas well drilling (millions of feet)	21.5	21.0	21.5	25.4	25.4

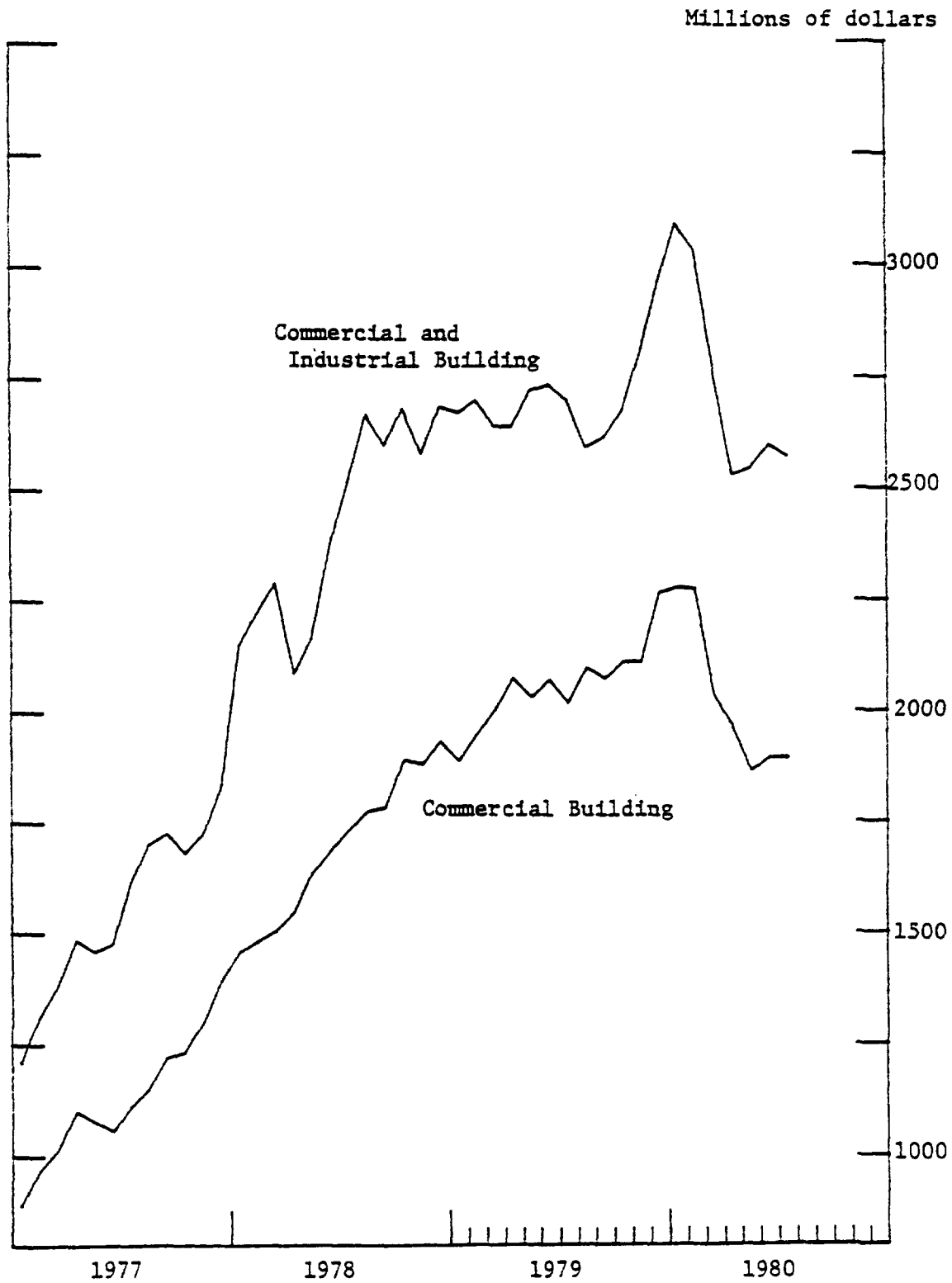
1. FRB staff estimate.

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

	1979		1980		
	Q4	Q1	Q2	July	Aug.
Nondefense capital goods orders					
Current dollars	1.9	4.3	-9.2	8.3	-6.0
Constant dollars	3.2	0.4	-9.6	8.7	-6.5
Machinery					
Current dollars	3.7	5.5	-13.0	7.2	-2.9
Constant dollars ¹	5.0	1.5	-13.4	7.6	-3.3
Addenda: Ratio of unfilled orders to shipments (current dollars, monthly)					
Total	6.59	6.42	6.57	6.48	6.47
Machinery	4.49	4.34	4.34	4.25	4.19
Contracts for nonresidential plant					
Current dollars	19.2	-16.1	-31.7	9.4	41.2
Constant dollars	31.2	-17.8	-37.7	8.8	41.2

1. FRB staff estimate.

NONRESIDENTIAL BUILDING, CONTRACTS AWARDED
(Centered three month moving averages
of seasonally adjusted data)^{1/}



^{1/} F.W. Dodge, Inc. data. Seasonally adjusted by Federal Reserve.

Business spending on equipment also has declined recently. After rising in July, shipments of nondefense capital goods in real terms fell back in August. In contrast, business purchases of motor vehicles continued to advance in August, the third consecutive month of increase, as sales of heavy-weight trucks rose by 30,000 units. Although truck purchases have improved recently, they still are below the first-quarter rate and well below 1979 sales.

Commitments data for near-term business investment point to reduced levels of real capital spending in the coming months. New orders for nondefense capital goods fell substantially in August to a level about 10 percent below that of the first quarter of 1980. In addition, the backlog of unfilled orders for these goods fell in August for the third time in the past four months, and the ratio of unfilled orders to shipments declined further from the high levels of the spring, particularly in the machinery area. Contracts for commercial and industrial building and nonbuilding construction projects increased sharply in August, but this rise was mostly the result of contract awards for several nuclear power plants whose construction will take a number of years. The dollar volume of commercial and industrial building contracts in August (See chart.) remained near the levels that have prevailed since the middle of 1978. This sustained stagnation suggests that there is little likelihood of nonresidential construction advancing above the levels seen earlier this year, especially in real terms.

Over the longer run, commitments data suggest continued weakness in capital outlays into 1981. Capital appropriations by manufacturers fell almost 13 percent in the second quarter and, excluding the volatile

CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Annual rate)

	1977	1978	1979	1980			
				Q1	Q2	July	Aug.
<u>Book Value Basis</u>							
Total	26.7	43.2	47.2	46.1	30.8	29.7	23.3
Manufacturing	10.1	18.1	29.9	41.1	20.4	5.7	-5.8
Wholesale	6.7	12.8	9.1	7.2	7.7	11.8	23.6
Retail	9.9	12.3	8.1	-2.1	2.7	12.2	5.5

Totals may not add due to rounding.

INVENTORIES RELATIVE TO SALES

	1977	1978	1979	1980			
				Q1	Q2	July	Aug.
<u>Book Value Basis</u>							
Total	1.45	1.42	1.52	1.42	1.52	1.48	1.47
Manufacturing	1.59	1.52	1.52	1.57	1.71	1.68	1.66
Wholesale	1.22	1.20	1.17	1.15	1.22	1.18	1.18
Retail	1.41	1.44	1.46	1.40	1.46	1.42	1.41

petroleum sector, the falloff was even more pronounced. Private utilities increased their appropriations 88 percent net of cancellations in the second quarter; this rise largely reflects reappropriations for nuclear power projects that had been canceled after the Three-Mile-Island incident, rather than any broad-based surge in the demand for capital.

Inventory Investment

Inventory developments suggest, on balance, that firms have been relatively successful in reducing the real volume of stocks. The book value of manufacturing and trade inventories rose at a \$23-1/4 billion annual rate in August, following a \$29-3/4 billion rate increase in July. In August, the rise in nominal inventories was accompanied by a 1.4 percent advance in shipments and sales. As a result, the stock-sales ratio for the entire manufacturing and trade sector edged down to 1.47.

Most of the August slowdown in inventory accumulation was attributable to a fall in the book value of manufacturers' stocks. This decline followed two months of relatively low rates of accumulation, and was the first actual drop in the book value of inventories at manufacturers since the beginning of the downturn early in the year. Reductions of stocks occurred at producers of motor vehicles, electrical machinery, primary metals, and most nondurable goods, while a sizable increase occurred at producers of aircraft, missiles, and parts. In contrast to developments at manufacturers, retailers and wholesalers, who tend to adjust their stocks more quickly to changes in sales, added to their inventories in July and August. At retailers, the book value

of stocks rose at a \$5-1/2 billion annual rate in August, with inventories of automotive stores up quite sharply after five months of decline. The book value ratio of retail inventories to sales was about unchanged in August and a little below the relatively high level in the second quarter. A significant portion of the large accumulation at wholesalers in August and July was in raw farm products.

Government Sector

The deficit for the fiscal year just completed (FY1980) is still expected to be fairly close to the administration's mid-year forecast of about \$60 billion. Preliminary Treasury data indicate that outlays will be around the July estimate of \$578 billion; spending for veterans' benefits and some income transfer payments was more than anticipated while payments for unemployment compensation were smaller. Personal income and social security taxes during August and September were slightly larger than the Treasury had expected in its earlier projection, probably reflecting the gradual pickup in employment.

For fiscal year 1981, the administration is in the process of revising its deficit estimate in conjunction with the autumn budget review. Indications are that the fiscal 1981 deficit will be sharply higher than the \$36 billion estimate that accompanied the President's economic revitalization proposal. Because of several difficulties, the Budget Committees decided to postpone action on the Second Concurrent Budget Resolution until after the November elections. To carry on the federal government's operations, the House and Senate--after a lengthy debate--passed a continuing resolution to fund programs through December 15 at a rate equivalent to the lower of their 1980 rate or

that proposed in the House appropriation bill. The Defense Department, however, was permitted to obligate funds at the higher rate in the House's proposed 1981 appropriation.

At the state and local level, recent spending remained about unchanged, as teacher strike activity held down growth in payrolls and capital investment outlays continued their downward trend. In September, state and local government payrolls were little changed, with about 27,000 teachers on strike. Overall hiring in this sector so far this year has risen at only a 1 percent annual rate, the lowest in these decades and about half the already reduced pace of recent years. The recent small employment rise stems in part to a winding down of enrollments in public service jobs funded under the CETA program. Construction outlays by state and local governments dropped 4 percent in August, continuing their downward trend evident since the beginning of the year. This decline was due to a sharp reduction in highway projects and a fall-off in the number of water and sewer projects.

Prices and Wages

Measures of price change have shown volatile movements in recent months, primarily due to developments affecting food prices and homeownership costs. In September, producer prices of finished goods declined slightly, after two months of large increases. Consumer prices rose at an 8-1/2 percent annual rate in August, after being unchanged in July. Excluding food and homeownership, price increases have moderated from the rapid pace earlier in the year as the rise in energy prices has eased dramatically; nevertheless, underlying price pressures remain strong.

RECENT CHANGES IN PRODUCER PRICES

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

	Relative importance ²			1980			
	Dec. 1979	1978	1979	Q1	Q2	Q3	Sept.
Finished goods	100.0	9.2	12.6	19.3	6.0	13.0	-1.9
Consumer foods	24.3	11.9	7.6	-1.2	-7.8	36.9	-2.4
Consumer nonfood	47.4	8.4	18.0	34.8	10.1	5.6	-1.4
Energy	10.3	8.0	62.7	109.4	17.0	-3.4	-5.3
Exc. energy	37.0	8.5	9.6	18.1	7.7	8.8	-.6
Capital equipment	28.4	8.0	8.8	13.4	10.9	8.8	-1.5
Intermediate materials ³	94.9	8.3	16.5	24.0	4.4	7.2	6.4
Exc. food and energy	81.4	8.9	13.0	18.3	4.1	6.0	6.4
Crude food materials	55.5	18.3	11.1	-16.7	-10.5	96.4	-4.2
Crude nonfood	44.5	15.6	26.0	21.9	-3.9	39.1	40.1
Exc. energy	16.0	21.0	13.1	7.4	-38.0	78.9	59.0

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

2. Relative importance weights are on a stage of processing basis.

3. Excludes materials for food manufacturing and animal feeds.

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

	Relative importance			1980			
	Dec. 1979	1978	1979	Q1	Q2	July	Aug.
All items	100.0	9.0	13.3	18.1	11.6	0.0	8.3
Food	17.7	11.8	10.2	3.8	5.6	11.5	21.8
Energy ³	10.3	8.0	37.4	64.8	8.1	3.6	2.3
All items less food and energy ³	72.0	8.5	11.3	15.7	13.5	-2.1	6.2
Homeownership	24.9	12.4	19.8	24.1	26.6	-21.7	-2.7
All items less food, energy and home-ownership ⁴	50.7	6.9	7.5	12.1	7.6	8.0	7.9
Used cars	2.8	13.6	2.2	-2.5	-16.8	8.7	27.1
Other commodities ⁴	21.3	5.3	6.6	12.9	6.9	7.7	8.9
Other services ⁴	26.6	7.7	8.8	12.3	11.0	6.1	8.1
Memorandum:							
Gasoline	5.6	8.5	52.2	105.7	-6.2	-5.5	-4.9

1. Based on index for all urban consumers.

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

3. Energy items: gasoline and motor oil, fuel oil and coal, gas and electricity.

4. Reconstructed series; includes home maintenance and repairs (relative importance weight of 3.6), also a component of homeownership costs.

Cutbacks in livestock and poultry supplies, along with the drought, contributed to the sharp increases in prices of farm products and food this summer. Retail food prices accelerated to more than a 20 percent annual rate in August, led by steep advances in the prices of meats and fresh fruits and vegetables. The producer price index for consumer foods turned down slightly in September. However, food prices are expected to increase at a relatively rapid rate into 1981, reflecting prospects for further reductions in meat supplies. Recent food price and agricultural supply developments are discussed more fully in Appendix II-A.

Homeownership costs fell somewhat further in August, after declining sharply in July, and helped to contain the overall rise in consumer prices. The August drop in the CPI measure of mortgage rates was smaller than in July and was nearly offset by the acceleration in house prices. Available FHLBB survey data on loans closed suggest some additional decline in the CPI mortgage rate index for September despite the one-half percentage point rise in FHA/VA ceiling rates. However, the recent rise in commitment rates will begin to boost the CPI again in October.

Excluding the food, energy, and homeownership categories, the consumer price index continued to increase at about an 8 percent rate in August. While this pace exceeds the 1979 increase of 7-1/2 percent, it remains well below that of the first quarter of this year, when the passthrough of rapidly escalating energy costs contributed significantly to price increases for many goods and services. At the producer level, the rate of increase in the index for finished goods less food and energy also decelerated from the first quarter pace, but

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

	1978	1979	1980			
			Q2	Q3	Aug.	Sept.
Total private nonfarm	8.4	8.1	9.9	8.2	7.3	4.4
Manufacturing	8.4	8.7	12.6	11.6	7.9	7.6
Durable	8.5	8.7	13.6	11.7	5.4	7.1
Nondurable	8.2	8.7	10.8	11.5	12.6	8.4
Contract construction	7.6	6.8	8.9	6.8	10.4	-3
Transportation and public utilities	7.4	9.0	9.1	5.3	-2.6	-1.2
Total trade	9.6	7.6	7.1	8.1	6.4	2.5
Services	7.6	7.6	9.8	6.2	8.9	8.5

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

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

it still rose at about a 9 percent annual rate over the third quarter. In September, this index declined somewhat, reflecting a sharp decline in prices for passenger cars and trucks because of substantial liquidation allowances to dealers on 1980 models. Although automakers typically offer discounts at the end of the model year, this was the first time data were available for inclusion in the producer price index.

Wage increases also appeared to have moderated in recent months, although underlying wage pressures remain strong. Wage rates as measured by the hourly earnings index, which has been frequently revised upward, rose at an 8-1/4 percent annual rate in the third quarter--down from the 9-3/4 percent rate over the first half of the year. With the exception of the trade sector, some deceleration in wage changes occurred in most nonmanufacturing industries. Manufacturing wages also slowed somewhat, but still rose at a rapid 11-1/2 percent annual rate in the third quarter.

APPENDIX II-A*

RECENT FOOD PRICE AND AGRICULTURAL SUPPLY DEVELOPMENTS

Consumer food prices have accelerated sharply in recent months, following a year in which food price increases were generally smaller than increases in overall consumer prices. As shown in table 1, the recent pickup in food price inflation has mainly reflected very large price advances for meats and related products and for fruits and vegetables. On balance, prices for other food items, which make up about two-thirds of total food in the CPI, increased in July and August at about the same rapid pace as over the previous two and a half years.

The recent acceleration in fruit and vegetable prices reflects a variety of developments in markets for specific items. Retail apple prices, bolstered by strong demand, increased sharply in August to a level about one-fourth above a year earlier. Prices for oranges and some other fruits have rebounded following sizable declines in late 1979 and early 1980. Potato farmers, responding to the relatively low prices of the past couple years, reduced acreage for fall harvest by nearly one-tenth from 1979, and retail potato prices have risen by about 40 percent (not at an annual rate) in the past two months alone.

Supply developments appear to account for much of the recent turnaround in meat prices. As shown in table 2, pork production fell off sharply in the third quarter of 1980, following an earlier strong expansion. Poultry supplies also declined for the second quarter in a row.

To a considerable extent, the cutbacks in pork and poultry production have been in the works for some time. Prices received by farmers for these products fell sharply in mid-1979 and remained low through the first half of 1980. As prices fell, farmers began reducing breeding inventories in order to curtail output. Because of biological time lags--especially for pork--these planned cutbacks in production did not immediately show up at the retail level, but have begun to do so this past summer. Severe drought across several regions of the U.S. during July and August reduced supplies still further.

Cyclical contractions in pork production typically last for several quarters, and current indications are that retail pork supplies will continue trending lower at least into mid-1981. This summer's drought--by raising feed prices--will probably cause this contraction to last longer and be deeper than would otherwise have been the case. Of course, it will not in fact be possible to disentangle this drought effect from the normal inventory correction that would have occurred anyway.

The falloff in pork production is likely to exert a significant influence on consumer prices in the coming year. During past contractions in pork production, almost without exception, retail meat prices

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Table 1

CONSUMER FOOD PRICES
(Percent change at compound annual rates
based on seasonally adjusted data)¹

	Relative Importance in CPI for All Items Dec., 1979	1978		1979		1980		
		H1	H2	H1	H2	H1	July	Aug.
1. CPI total food	17.7	14.6	9.1	11.1	9.3	4.7	12.1	24.1
2. Meats, poultry, fish, and eggs	4.2	30.3	11.8	16.0	2.1	-8.9	15.1	61.8
3. Fruits and vegetables	1.7	16.5	2.2	7.3	12.7	1.6	24.1	49.4
4. All other foods ²	11.8	10.0	9.2	10.2	11.3	10.5	10.4	11.2

¹/ Percent change from last month of preceding period to final month of period indicated.

²/ Series constructed by FRB staff. Includes cereal and bakery products, dairy products, sugar and sweets, fats and oils, nonalcoholic beverages, other prepared foods, and food away from home.

Table 2

MEAT AND POULTRY PRODUCTION
(Percent change from previous quarter,
based on USDA data seasonally adjusted by FRB staff)

	1979				1980		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3 ^e
1. Beef	-6.5	-5.7	-1.4	3.1	-1.2	3.2	-1.1
2. Pork	3.9	10.1	4.2	3.0	3.3	2.9	-9.4
3. Total Red Meat ¹	-2.9	.2	.9	3.0	.8	3.0	-4.8
4. Poultry	4.4	3.0	-1.1	2.0	6.3	-3.2	-8.6

^eEstimated, using monthly USDA data for July and August and preliminary weekly data for September.

¹/ Includes veal and lamb, in addition to beef and pork.

have risen considerably faster than overall consumer prices, a pattern that most analysts expect to be repeated during the current contraction.

Poultry and beef supply prospects are not so unfavorable. Advance supply indicators suggest that a renewed expansion in poultry output may already be underway at the farm level, and, if so, the current drop in retail supplies should be of relatively short duration.

In addition, the long-run cyclical contraction which dominated the cattle industry through the late 1970's appears to have bottomed out, and, as shown in the top line of table 2, beef production--though volatile from quarter to quarter--has essentially been on a plateau since mid-1979. Qualitative reports indicate that third quarter production--though down slightly from 1980-Q2--may have been supported in part by the drought-induced slaughter of some cattle. However, there does not appear to have been a widespread selloff of breeding stock, so that the base for a renewed moderate expansion in the nation's cattle herd is probably still intact.

Farm crop production in 1980 (table 3) is off significantly from the increasingly bountiful harvests of the 1975-79 period. Since the 1979 harvest was exceptionally good, some declines in 1980 crop production had been widely expected even prior to the summer drought. However, initial expectations still proved to be too optimistic, and crop prospects declined substantially as the drought lengthened.

The Department of Agriculture's most recent crop estimates are shown in the last column of table 3. Based on conditions as of October 1, USDA expects the production of corn--the major feed crop--to be off 17 percent from 1979. Owing to severe crop losses in the southern and central plains states, sorghum production is down even more sharply, and consequently total feed grain production has fallen to its lowest level since 1975. Production of soybeans and cotton is also down significantly this year, and of the crops shown in the table, only the early-maturing wheat crop escaped the ravages of drought.

Fortunately, large inventories of grains and soybeans had been accumulated from earlier harvests, and consumption over the next year can be maintained at relatively high levels by drawing down these inventories, a large portion of which are currently owned or financed by the Commodity Credit Corporation. As shown in table 4, the Agriculture Department is currently projecting that total feed grain use in the 1980-81 marketing year will be down 2 percent from 1979-80, a relatively small decline compared to the 18 percent drop in total feed grain production. As shown in the middle columns of the table, USDA is also estimating that the decline in soybean consumption will be considerably less than the steep drop in production. Cotton inventories are currently less plentiful, and as a result of this year's crop losses, consumption will need to be cut back sharply. While these specific projections for the various crops are still problematical, it is clear that far greater consumption cutbacks would have been required but for the large stocks built up in recent years.

Table 3

PRODUCTION OF SELECTED FARM CROPS
(Millions of Bushels)¹

Crop	1977	1978	1979	USDA Estimate for 1980, as of			
				July	Aug.	Sept.	Oct.
1. Total Feed Grains ¹	203.4	217.4	233.9	217.8	196.7	194.1	192.4
2. Corn	6,425	7,087	7,764	7,284	6,646	6,534	6,467
3. Sorghum	793	748	814	<u>2/</u>	553	547	547
4. Barley	420	449	378	329	340	352	352
5. Oats	751	596	534	450	441	451	451
6. Soybeans	1,762	1,870	2,268	<u>2/</u>	1,880	1,831	1,757
7. Wheat	2,036	1,798	2,142	2,317	2,325	2,354	2,362
8. Cotton ¹	14.4	10.9	14.6	<u>2/</u>	12.8	11.7	11.6

^{1/} Total feed grain production is measured in millions of metric tons; cotton production is in millions of 480-lb. bales.

^{2/} First estimate is available in the August crop report.

Table 4

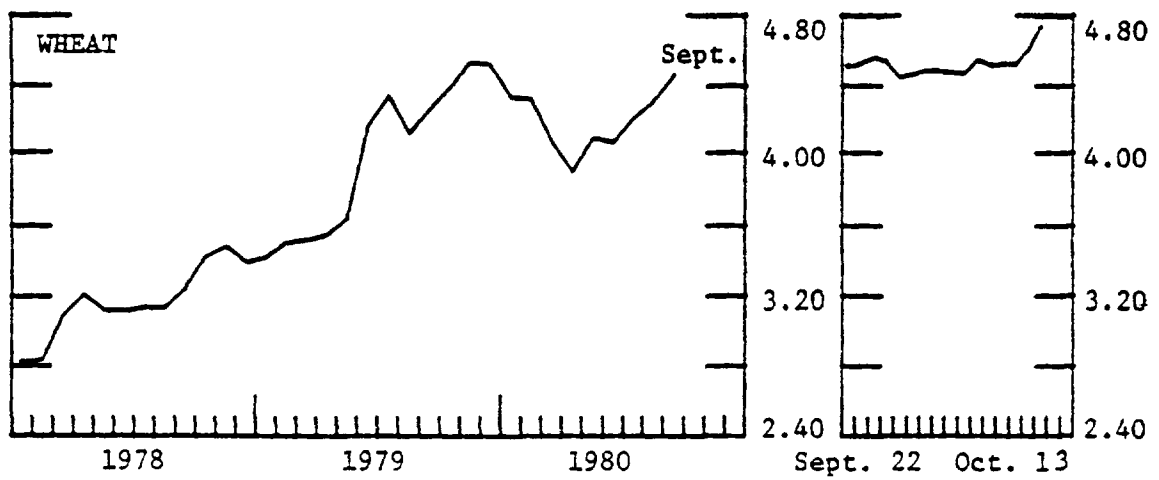
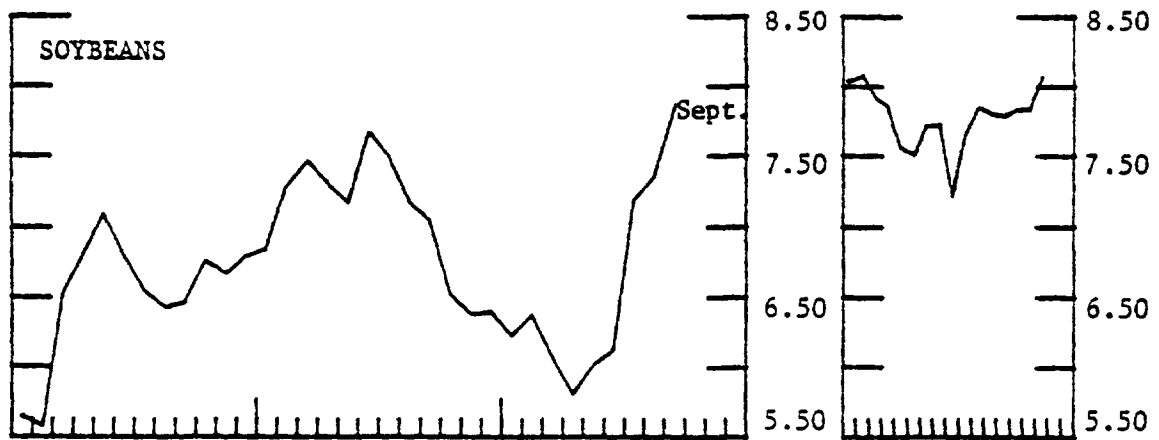
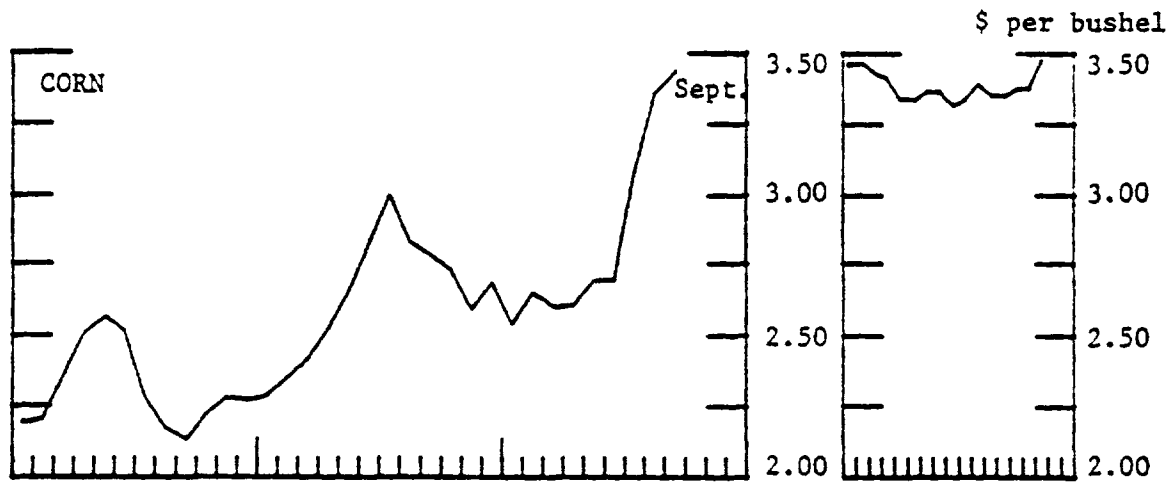
SUPPLY, DEMAND, AND INVENTORIES OF SELECTED FARM CROPS¹
(Percent change from previous marketing year)

	Feed Grains		Soybeans		Cotton	
	1979-80	1980-81	1979-80	1980-81	1979-80	1980-81
1. Beginning Inventories	11.4	17.2	8.1	106.3	-24.5	-25.0
2. Production	7.6	-17.7	21.3	-22.5	33.9	-20.5
3. Total Supplies	8.1	-12.0	20.2	-13.3	14.8	-21.0
4. Domestic Use	1.9	-4.1	8.1	-6.8	1.6	-9.2
5. Exports	17.1	3.4	18.4	-5.7	48.4	-34.8
6. Total Use	6.2	-1.8	12.2	-6.3	25.6	-24.2
7. Ending Stocks	17.2	-55.0	106.3	-54.0	-25.0	-6.7

^{1/} USDA estimates, as of October 14.

Even so, inventories were not large enough to prevent crop prices (shown in chart) from rising sharply as the summer drought worsened. Corn and soybean prices stabilized somewhat in late September and early October as the harvest got into full swing and the danger of an early frost passed; however, prices began rising again in mid-October following reports of export negotiations with China and a further downward revision in USDA crop estimates. With inventories certain to be drawn down in coming months, another bad crop in 1981 would likely result in quite sizable cutbacks in consumption in the 1981-82 marketing year. Hence, farm crop prices in the coming year are likely to be extremely sensitive both to export developments and to planting and growing conditions for the 1981 crop.

CASH PRICES FOR FARM CROPS



III-T-1
SELECTED DOMESTIC FINANCIAL DATA

Indicator	Latest data		Net Change from:		
	Period	Level	Month ago	Three months ago	Year ago
	<u>\$ billions</u>		<u>Percent at annual rates</u>		
Monetary and credit aggregates¹					
Total reserves	September	41.5	22.9	14.0	7.3
Nonborrowed reserves	September	40.2	3.7	4.8	7.6
Money supply					
M-1A	September	383.7	12.6	13.4	4.9
M-1B	September	406.8	15.5	16.3	6.4
M-2	September	1639.9	8.0	13.7	9.1
M-3	September	1901.5	9.7	12.4	8.9
CB Gross Time and savings deposits	September	704.5	22.6	1.4	8.5
Total Thrift deposits (S&Ls + MSBs + Credit Unions)	September	699.7	9.9	10.1	6.5
Bank credit	September	1193.7	14.9	13.4	6.0

		Latest data		Net Change from:		
		Period	Percent or index	Month ago	Three months ago	Year ago
Market yields and stock prices						
Federal funds	wk. endg.	10/8/80	12.59	2.37	3.38	.59
Treasury bill (90 day)	" "	10/8/80	11.34	1.42	3.32	.13
Commercial paper (90-119 day)	" "	10/8/80	12.18	1.78	3.81	-.25
New utility issue Aaa	" "	10/10/80	13.02	.42	1.54	2.14
Municipal bonds (Bond Buyer) 1 day	1 day	10/9/80	9.01	.19	1.06	1.89
FNMA auction yield (FHA/VA)		9/29/80	15.30	1.04	3.02	3.64
Dividend price ratio (common stocks)	wk. endg.	10/8/80	4.74	-.32	-.52	-.56
NYSE index (12/31/65=50)	end of day	10/7/80	75.65	4.38	8.07	13.07

		Net Change or Gross Offerings			
		Period	Latest data	Year ago	Year to date 1980 1979
Credit demands					
Business loans at commercial banks ¹		September	6.0	6.1	16.9 39.2
Consumer instalment credit outstanding ¹		August	0.02	2.4	-4.4 25.6
Mortgage debt outstanding (major holders) ^{1 2}		July	3.7	8.2	30.7 59.8
Corporate bonds (public offerings)		September	2.2e	2.2	35.4e 20.1
Municipal long-term bonds (gross offerings)		September	4.5e	2.5	36.3e 31.4
Federally sponsored agcy. (net borrowing)		August	-0.8	0.8	14.3 15.7
U.S. Treasury (net cash borrowing)		August	11.1	3.3	45.3 14.1

^{1/} Seasonally adjusted.

^{2/} Includes comm'l banks, S&Ls, MSBs, life ins. cos, FNMA and GNMA.

e - Estimated.

DOMESTIC FINANCIAL DEVELOPMENTS

Market interest rates have moved over a considerable range since the last FOMC meeting. Most rates rose substantially during the latter half of September, reflecting a tightening of bank reserve positions and a percentage point increase in the discount rate, as well as the effects on market expectations of strong monetary expansion. As published data in early October showed drops in the narrow money stock measures, market sentiment improved and market interest rates fluctuated thereafter around somewhat lower levels. On balance over the intermeeting period, yields on most short-term market instruments have risen 50 to 150 basis points while yields on corporate and municipal bonds have increased less and long-term Treasury yields have declined slightly. The prime rate at most large banks has been raised by 1-1/4 percentage points as banks have reacted to rising costs of funds and strong loan demand. Average rates on new home mortgage commitments at S&Ls have climbed by 65 basis points.

Although growth in the narrow monetary aggregates for the month of September as a whole was at double-digit rates, it was appreciably slower than in August. M-2 expansion also slowed, with a deceleration in the growth of savings and small time deposits and an absolute decline in shares of money market mutual funds. Commercial banks increased their managed liabilities to help finance another large increase in bank credit, led by business loans.

Total funds raised in financial markets by business evidently slackened somewhat in September as stock offerings changed little while a sharp decline in bond offerings outweighed an increase in bank loans plus

III-2
SELECTED FINANCIAL MARKET QUOTATIONS¹
(Percent)

	1980					Change from:		
	Mar-Apr High	Mid-June** Low	FOMC Sept. 16	Inter- meeting High	Oct. 14	Mar-Apr High	Mid-June Low	FOMC Sept. 16
<u>Short-term rates</u>								
Federal funds ²	19.39	8.99	10.64	12.80	12.80P	-6.59	3.81	2.16
Treasury bills								
3-month	16.00	6.18	10.29	11.53	11.18	-4.82	5.00	.89
6-month	15.64	6.60	10.67	11.62	11.20	-4.44	4.60	.53
1-year	14.58	7.00	10.59	11.36	10.85	-3.73	3.85	.26
Commercial paper								
1-month	18.00	7.98	10.80	12.69	12.63	-5.37	4.65	1.83
3-month	17.69	7.78	10.95	12.78	12.34	-5.35	4.56	1.39
6-month	17.25	7.59	11.04	12.78	12.09	-5.16	4.50	1.05
Large negotiable CDs ³								
1-month	17.87	7.96	11.05	12.75	12.44	-5.43	4.48	1.39
3-month	18.59	7.90	11.51	12.99	12.53	-6.06	4.63	1.02
6-month	18.47	7.66	11.88	13.26	12.53	-5.94	4.87	.65
Eurodollar deposit ²								
1-month	19.04	8.88	11.06	13.05	13.05	-5.99	4.17	1.99
3-month	19.60	8.99	11.86	13.25	13.00	-6.60	4.01	1.14
Bank prime rate	20.00	12.00	12.25	13.50	13.50	-6.50	1.50	1.25
<u>Intermediate- and long-term rates</u>								
U.S. Treasury (constant maturity)								
3-year	14.53	8.56	11.69	12.32	11.60	-2.93	3.04	-.09
10-year	13.65*	9.47	11.52	12.07	11.37	-2.28	1.90	-.15
30-year	12.85*	9.49	11.33	11.93	11.16	-1.69	1.67	-.17
Municipal (Bond Buyer) ⁴	9.44	7.44	8.82	9.22	9.01	-.43	1.57	.19
Corporate Aaa								
New issue ⁵	14.22	10.53	12.60	13.10	13.02P	-1.20	2.49	.42
Recently offered ⁶	14.12	10.79	12.48	13.06	12.88P	-1.24	2.09	.40
Primary conventional mortgages ⁶	16.35	12.35	13.08	13.73	13.73	-2.62	1.38	.65
	Mar-Apr Low	Mid-June High	FOMC Sept. 16	Inter- meeting Low	Oct. 14	Mar-Apr Low	Mid-June High	FOMC Sept. 16
<u>Stock Prices</u>								
Dow-Jones Industrial	759.13	881.91	945.90	921.93	962.20	203.07	80.29	16.30
NYSE Composite	55.30	66.36	73.41	71.26	76.32	21.02	9.96	2.91
AMEX Composite	215.69	297.60	340.94	324.38	352.74	137.05	55.14	11.80
NASDAQ (OTC)	124.09	159.18	191.31	185.79	199.02	74.93	39.84	-7.71

1. One-day quotes except as noted.

2. Averages for statement week closest to date shown. Secondary market. Highs reached on February 26.

4. One-day quotes for preceding Thursday.

5. Averages for preceding week.

6. One-day quotes for preceding Friday.

** Most lows occurred on or around June 13.

commercial paper. Funds raised by households, however, probably rose further, given the growth in mortgage commitments at thrift institutions during August and a pickup in consumer lending at large commercial banks in September. Total borrowing by state and local governments increased moderately last month, and Treasury borrowing remained quite substantial.

Monetary Aggregates and Bank Credit

The 12-1/2 percent annual rate of growth in September after a 19-1/4 percent increase in August resulted in an average rate of M-1A expansion during the two months that was the highest on record. The increase in M-1B over this period also set a record, with the gap between M-1A and M-1B growth rates remaining large as other checkable deposits continued to expand rapidly. For the third quarter, the rapid growth of the narrow monetary aggregates appears to have been only moderately faster than might have been expected on the basis of historical money demand relationships, particularly as measured by the Board's quarterly econometric model. The public's desired transaction balances presumably were enlarged by the turnaround in economic activity and the sharp decline in interest rates over the second quarter.

Growth in M-2 exceeded the pace of the narrow monetary aggregates for the third quarter as a whole, but slowed in September to an 8 percent annual rate as the nontransactions component weakened sharply further. Reflecting the general rise in market interest rates, growth of savings deposits slowed markedly in September at all types of depository institutions, more than offsetting a strengthening of inflows to small time deposits. Within the small time deposit category, inflows to the

MONETARY AGGREGATES

(Based on seasonally adjusted data unless otherwise noted)¹

	1980						Sept. '79
	Q1	Q2	Q3	July	Aug.	Sept.	to Sept. '80
---- Percentage change at annual rates ----							
<u>Money stock measures</u>							
1. M-1A	4.8	-3.9	11.1	7.8	19.3	12.6	4.9
2. M-1B	5.9	-2.4	13.5	11.1	21.6	15.5	6.4
3. M-2	7.2	5.5	15.4	18.1	14.5	8.0	9.1
4. M-3	7.8	5.7	12.6	13.4	13.6	9.7	8.9
<u>Selected components</u>							
5. Currency	8.3	7.0	11.3	10.8	15.0	5.3	8.8
6. Demand deposits	3.4	-8.3	10.8	6.0	21.6	16.2	3.3
7. Other checkable deposits, NSA ²	29.3	31.8	61.1	73.5	63.5	60.3	41.1
8. M-2 minus M-1B (9+10+11+14)	7.7	8.1	16.0	20.4	12.2	5.5	10.0
9. Overnight RPs and Eurodollars, NSA ³	-7.5	-72.0	132.7	218.7	103.8	41.5	0.3
10. Money market mutual fund shares, NSA	151.9	82.7	75.7	103.5	1.5	-37.2	132.0
11. Commercial banks	6.9	9.8	10.7	13.5	10.4	7.0	9.2
12. savings deposits	-19.3	-22.6	26.4	38.6	26.5	7.6	-6.7
13. small time deposits	29.1	33.9	0.6	-3.1	0.0	6.1	23.9
14. Thrift institutions	-0.3	3.7	9.6	8.9	11.1	8.4	-4.6
15. savings deposits	-22.5	-27.1	23.2	37.0	32.4	5.1	-11.0
16. small time deposits	12.0	19.3	3.4	-3.8	1.1	10.3	14.1
17. Large time deposits	17.8	10.6	-10.3	-23.4	-4.2	26.1	10.2
18. at commercial banks, net ⁴	9.9	7.4	-14.8	-29.6	-8.8	24.8	4.1
19. at thrift institutions	72.6	28.9	14.6	10.0	16.6	36.0	56.8
20. Term RPs, NSA	-31.9	-19.4	49.6	51.2	98.3	-15.1	-7.1

--Average monthly change in billions of dollars--

MEMORANDA:

21. Managed liabilities at commercial banks (22+23)	8.0	-6.6	0.0	-3.9	-2.3	6.1	-0.2
22. Large time deposits, gross	3.1	0.0	0.3	-3.9	0.3	4.4	1.3
23. Nondeposit funds	4.9	-6.6	-0.3	0.0	-2.6	1.7	-1.5
24. Net due to related foreign institutions, NSA	1.6	-6.0	-2.9	-4.1	-1.8	-2.9	-2.5
25. Other ⁵	3.3	-0.5	2.6	4.0	-0.9	4.7	1.0
26. U.S. government deposits at commercial banks ⁶	-0.2	0.4	1.3	2.1	0.9	0.9	0.1

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

2. Consists of ATS and NOW balances at all institutions, credit union share draft balances, and demand deposits at mutual savings banks.

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

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

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

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

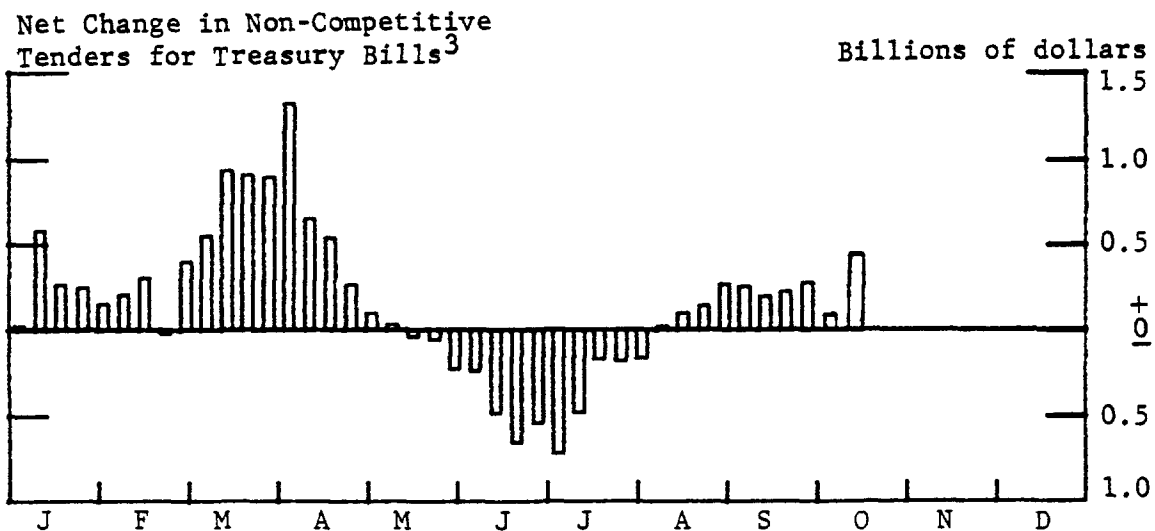
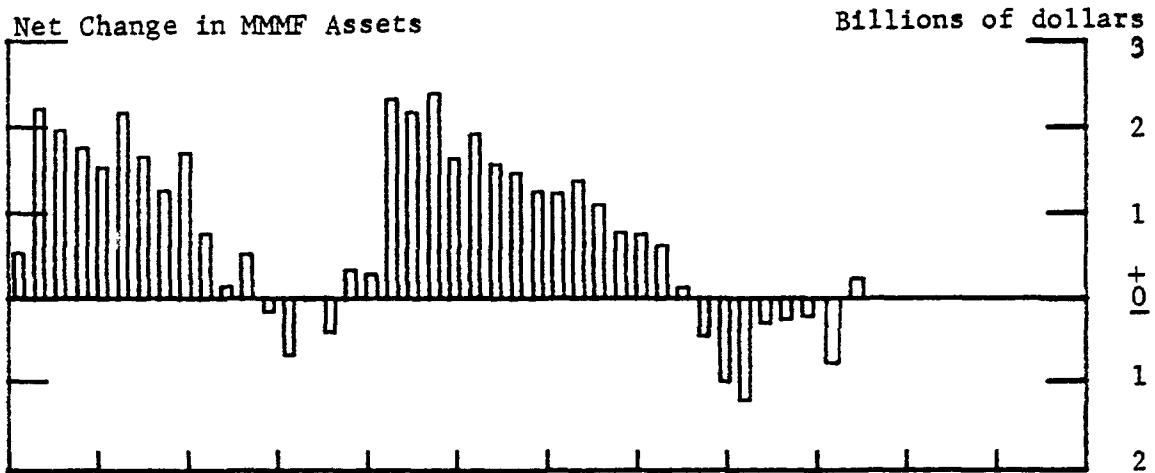
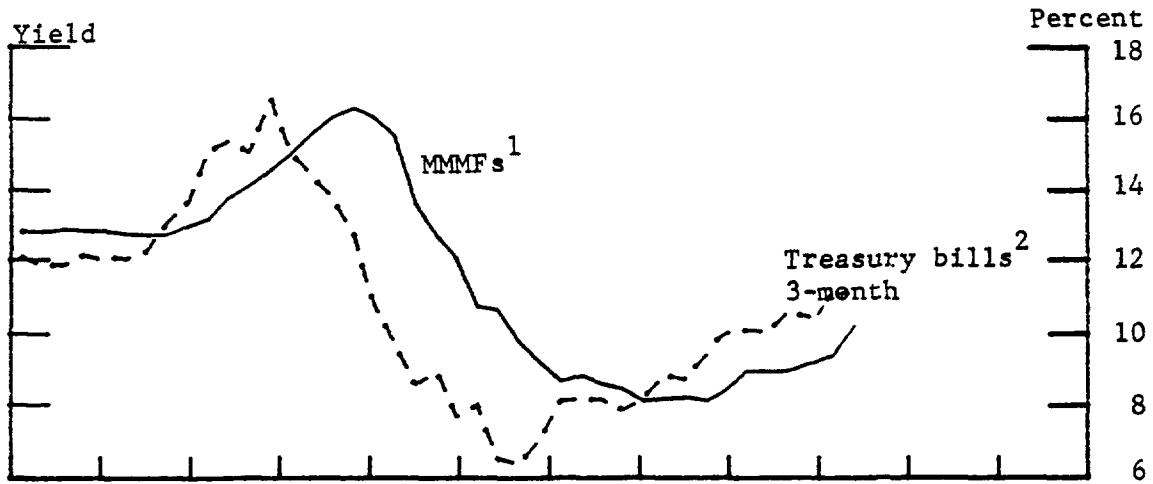
relatively high-yield SSCs increased substantially while MMC levels edged up for the first time in five months.¹

Money market mutual fund shares fell from mid-August through September, but rose in the first full week of October. The decline occurred as the net return on shares lagged considerably the rise in yields on competing short-term instruments, owing to average portfolio maturities of 40 to 50 days (see chart on page III-6). About 85 percent of the decline in shares occurred at institution-only money funds, strongly suggesting that much of the shift was into other money market instruments rather than into small-denomination deposits, although flows to other types of funds also have slackened. The increased attractiveness of Treasury bills is evident in the marked rise of noncompetitive tenders since mid-August.

Growth of required reserves picked up to a 24-1/2 percent annual rate during September as a result of the strong expansion of reservable deposits in August and September. With excess reserves falling slightly during the month, total reserves expanded at a 23 percent annual rate. Growth of nonborrowed reserves decelerated during September to a 3-3/4 percent annual rate, and adjustment credit borrowing at the discount window rose to \$1-1/4 billion while the federal funds rate climbed well above the 10 percent discount rate that prevailed prior to the hike to 11 percent on September 26.

1. The caps on SSC rates--11-3/4 percent at banks and 12 percent at thrift institutions--became effective for certificates issued during the October 2-15 period.

MONEY MARKET MUTUAL FUNDS AND TREASURY BILLS
(Weekly)



1. Net investment yield to shareholder.
2. Discount basis.
3. New bills purchased through non-competitive tenders minus bills maturing that were purchased through non-competitive tenders.

Growth in total commercial bank credit remained quite brisk in September, although moderating slightly from the August pace as banks reduced their acquisitions of Treasury and other securities. Total loans at commercial banks grew at a 16-1/4 percent annual rate, the most rapid pace since February, with growth in business loans accelerating further to a 23-3/4 percent rate. Real estate loan growth increased slightly, and loans to individuals at large banks rose for the first time in six months.

To fund rapid credit growth in the face of a slowdown in the expansion of core deposits, commercial banks increased their managed liabilities substantially in September, following five consecutive months of decline. Large-denomination CDs rose \$4.4 billion, and total non-deposit funds increased as well even though domestically chartered banks further reduced their net Eurodollar borrowings and moved their net claims position against their foreign branches to a near-record \$13.9 billion. Since March, these banks have shifted \$23.2 billion to their foreign branches; over the same period, foreign related institutions located in the United States reduced their net borrowing from their foreign offices by an estimated \$3.6 billion. This pattern reflects the rise in the cost of Eurodollar funds above domestic CD rates (adjusted for reserve requirements) which emerged in April and persisted through September.

Business Finance

The strong increase in business loans at commercial banks in September was accompanied by a somewhat smaller decline than in August

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

	1980						Sept. '79
	Q1	Q2	Q3	July	Aug. ^e	Sept. ^e	to Sept. '80 ^e
----- Commercial Bank Credit -----							
1. Total loans and investments at banks ²	11.5	-4.4	13.4	7.6	17.4	14.9	6.0
2. Investments	7.3	11.0	21.0	26.1	25.2	10.8	11.1
3. Treasury securities	3.0	10.6	39.2	47.0	42.9	24.1	11.9
4. Other securities	9.4	11.2	12.3	16.1	16.5	4.1	10.7
5. Total loans ²	12.8	-9.5	10.8	1.1	14.7	16.3	4.3
6. Business loans	16.4	-9.1	15.9	2.0	21.3	23.7	7.4
7. Security loans	-32.8	-23.8	-10.1	-60.8	64.0	-30.4	-34.5
8. Real estate loans	11.9	1.0	5.6	5.3	5.3	6.2	8.4
9. Consumer loans	3.7	-21.5	n.a.	-14.4	-6.3	n.a.	n.a.
-- Short- and Intermediate-Term Business Credit --							
10. Total short- and intermediate-term business credit (sum of lines 13,14 and 15)	22.0	1.2	n.a.	2.4	11.3	n.a.	n.a.
11. Business loans net of bankers acceptances ¹	17.6	-10.5	16.4	0.0	22.5	26.1	7.5
12. Commercial paper issued by nonfinancial firms ³	76.2	86.9	-22.5	16.9	-47.2	-37.6	42.0
13. Sum of lines 11 & 12	23.1	-0.2	11.4	2.2	13.4	18.2	10.7
14. Finance company loans to business ⁴	-2.8	-4.0	n.a.	-6.9	-3.5	n.a.	n.a.
15. Total bankers acceptances outstanding ⁴	54.1	32.3	n.a.	15.7	17.7	n.a.	n.a.

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

2. Loans include outstanding amounts of loans reported as sold outright to a bank's own foreign branches, unconsolidated nonbank affiliates of the bank, the bank's holding company (if not a bank), and unconsolidated nonbank subsidiaries of the holding company.

3. Average of Wednesdays.

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

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

in outstanding commercial paper of nonfinancial businesses. Growth in the sum of these measures increased to an 18-1/4 percent annual rate, the most rapid pace since early this year.

The recent pattern of growth in bank business loans and nonfinancial commercial paper reflects in part the narrowing of the spread of the prime rate over commercial paper rates: the average spread (based on 30-day paper rates) declined to about 140 basis points in September from more than 400 points in June. Moreover, large banks have become more willing to make very sizable short-term loans at interest rates that are linked to money market yields and fall below the posted prime. According to the most recent Survey of Terms of Bank Lending, taken in early August, there was a noticeable increase in the share of loans made below the prime rate at large banks as well as a substantial decline in the average maturity of short-term business loans.¹

The strength of shorter-term borrowing apparently resulted in part from the deterioration of conditions in long-term markets. Corporate bond yields increased sharply during the latter half of September, reaching a level only about 1 percentage point below the record high posted in March; since then, they have declined somewhat. Public offerings of corporate bonds fell in September to the lowest monthly total since March as a number of issues were postponed. Gross offerings totaled only \$2.2 billion (SA), compared with \$4.4 billion in August, with issuance

1. At 48 large banks, 58 percent of gross short-term loan extensions in early August were made at rates below prime, up from 53 percent in May and 37 percent a year earlier.

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

	1980				
	Q2	Q3 ^P	Aug. ^P	Sept. ^P	Oct. ^f
	----- Seasonally adjusted -----				
Corporate securities--total	7,725	6,300	6,625	4,535	4,775
Publicly offered bonds	5,780	3,870	4,350	2,235	2,475
Privately placed bonds	660	800	800	800	800
Stocks	1,285	1,630	1,475	1,500	1,500
	----- Not seasonally adjusted -----				
Publicly offered bonds--total	6,062	3,800	3,900	2,200	2,800
By quality ¹					
Aaa and Aa ²	3,230	1,685	1,300	1,075	--
Less than Aa ²	2,832	2,115	2,600	1,125	--
By type of borrower					
Utility ³	1,305	1,060	1,600	680	--
Industrial ³	3,132	2,175	1,900	1,100	--
Financial	1,625	565	400	420	--
Memo: convertible bonds	316	369	640	468	--
Stocks--total	1,332	1,335	1,300	1,500	1,700
By type of borrower					
Utility	512	615	500	650	--
Industrial	593	570	600	700	--
Financial	227	150	200	150	--

p--preliminary. f--forecast.

1. Bonds categorized according to Moody's bond ratings.
2. Includes issues not rated by Moody's.
3. Includes equipment trust certificates.

by nonfinancial corporations falling sharply. The relatively high levels of both bond yields and stock prices continued to stimulate the issuance of convertible bonds. Nearly two-fifths of industrial bond offerings in September were convertible issues carrying less than A ratings.

Stock prices have increased moderately on balance since the September FOMC meeting and most broad indexes remain close to their historic highs. The relatively high level of stock prices continued to induce a large volume of equity financing in September. New common and preferred stock offerings totaled \$1.5 billion (SA), about equal to the average monthly rate for the two previous months.

Government Finance

The Treasury raised \$7.1 billion of new money (payment basis) during September through sales of marketable debt, almost entirely in its regular note sales.¹ For the third quarter as a whole, the Treasury's net cash borrowing from the public totaled about \$27 billion, as the Treasury financed a deficit of about \$20.5 billion and realized a large increase in its cash balance. During the quarter, the public redeemed about \$300 million of savings bonds and notes, compared with redemptions of \$3.9 billion and \$2.7 billion in the first and second quarters, respectively, when market rates of interest were much further above yields on these non-marketable instruments.²

1. As shown in the table, net offerings of Treasury securities surged in August and fell sharply in September, reflecting a large volume of offerings in late August for payment in early September.

2. The Congress recently gave the Treasury new powers to make savings bonds competitive with other financial instruments. As of November 1, the yield to maturity on Series EE bonds will be raised from 7 percent to 8 percent.

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

	Q2	Q3 ^{e/}	Aug.	Sept. ^{e/}	Oct. ^{f/}
-----Seasonally adjusted-----					
State and local government securities, gross offerings					
Total	6.55	7.18	6.40	7.34	5.58
Long-term	4.63	4.82	3.78	5.73	3.33
Short-term	1.92	2.36	2.62	1.61	2.25
U.S. government securities, net offerings					
U.S. Treasury ¹	4.87	8.39	9.36	2.95	3.00
Sponsored agencies	1.60	0.58	-1.31	1.62	3.46
-----Not seasonally adjusted-----					
State and local government securities, gross offerings					
Total	7.89	6.60	6.30	6.50	5.10
Long-term	5.07	4.37	4.00	4.50	3.60
Housing revenue bonds	1.38	0.67	0.67	0.44	0.80
Single-family	1.32	0.48	0.48	0.31	0.60
Multi-family	0.06	0.19	0.19	0.13	0.20
Short-term	2.82	2.23	2.30	2.00	1.50
U.S. government securities, net offerings					
U.S. Treasury ¹	0.98	8.87	12.81	2.53	5.15
Bills	-4.18	4.55	5.00	0.19	2.15
Coupons	5.16	4.32	7.81	2.34	3.00
Sponsored agencies	1.78	1.07	-0.87	2.33	3.85

e--estimate. f--forecast.

1. Marketable issues only.

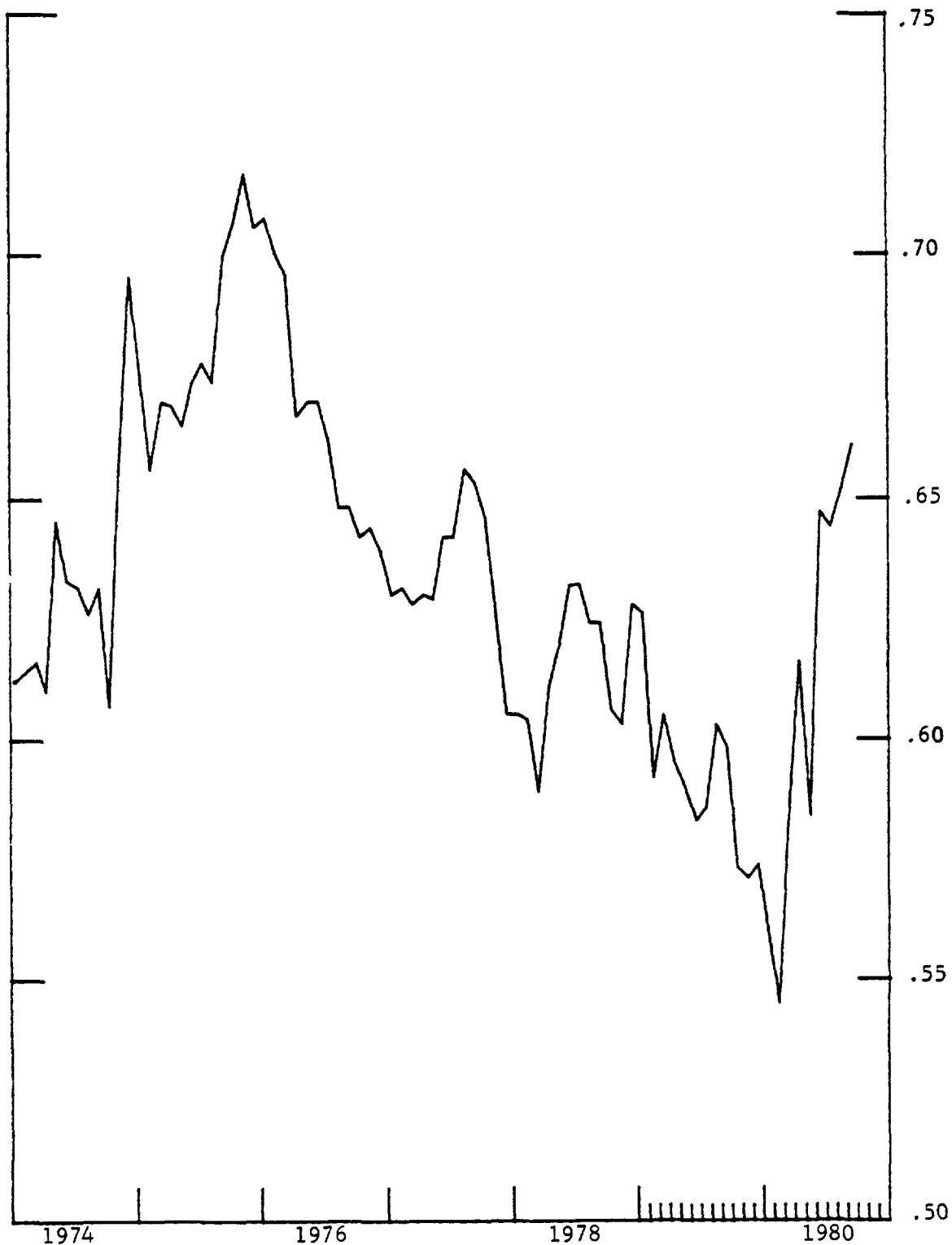
Early in the fourth quarter, the Treasury auctioned \$1.5 billion of 15-year bonds, all for new money.¹ For the fourth quarter as a whole, the Treasury is expected to run a combined deficit of nearly \$30 billion. Nevertheless, the volume of net cash borrowing by the Treasury is expected to be about the same as in the third quarter, and the Treasury's cash balance is expected to decline.

Federally sponsored credit agencies borrowed about \$1.6 billion during the month of September (seasonally adjusted offerings basis) after raising almost no new money, on balance, during the two previous months. After paying down a total of \$1.6 billion of debt in July and August, the FHLBanks raised \$800 million in September, reflecting a pickup in advances to S&Ls. FNMA, on the other hand, continued to make moderate net paydowns of debt during September. The Federal Farm Credit Banks borrowed about \$900 million in September, about the same as the average rate during the prior months of the year.

Gross offerings of long-term tax-exempt securities increased to \$5.7 billion (SA) in September from \$3.8 billion in August. Public utility and general-purpose state issues accounted for much of the increase and represented an unusually large 40 percent of the September volume. About \$800 million of tax-exempt bond offerings were cancelled or postponed during the month, and about two-thirds of these were housing bonds. Most of the housing bond displacements were caused

1. In early October, Congress raised the statutory ceiling on the amount of publicly held bonds outstanding that carry a coupon rate above 4-1/4 percent. Since the ceiling had been reached during the August refunding, congressional action was needed to permit the bond sale in October.

RATIO OF TAX-EXEMPT TO TAXABLE YIELDS¹
(Monthly)



1. Moody's Aaa-rated municipal bond yields relative to the FRB recently offered Aaa-rated corporate utility bond rates.

by statutory interest rate limitations; about half the states have rate limits of 10 percent or less on local revenue bond issues, and the Bond Buyer revenue bond index reached 10 percent in late September.

Indexes of rates on tax-exempt issues are about 20 basis points higher than in mid-September, and are within 30 to 40 basis points of the record levels reached last spring. The ratio of tax-exempt to taxable yields has risen markedly since February; in September, this ratio was the highest since June 1976, although it remained well below the record high reached in late 1975 when the municipal market was affected by the New York City crisis (see chart on page III-14). Reductions in demand for longer-term instruments by the major institutional investors that traditionally purchase tax-exempt securities--property/casualty insurance companies and commercial banks--evidently are putting unusual upward pressure on tax-exempt bond rates. Moreover, the insurance companies apparently are purchasing fewer municipal securities generally because underwriting losses have reduced their need for tax-exempt income.

Mortgage Markets

Interest rates on long-term mortgages in the primary market and on short-term construction loans and warehousing credit have increased significantly since the last FOMC meeting. According to field reports and trade sources, interest rates have reached a level that has stalled the recovery in mortgage commitment volume at the nonbank thrift institutions which had commenced in June. Until very recently, the spread between yields on long-term home mortgages and bonds was quite narrow, providing limited incentive for diversified institutions to channel large portions

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

Period	Conventional home mortgages			Percent of S&Ls ² with mortgage funds in short supply
	Average rate on new commitments for 80% loans (percent)	Basis point change from month or week earlier	Spread ¹ (basis points)	
1980--High	16.35	--	+385	93
Low	12.18	--	-24	60
1980--Apr.	16.33	+105	+369	86
May	14.26	-207	+258	85
June	12.71	-155	+171	74
July	12.19	-52	+75	70
Aug.	12.56	37	-12	68
Sept. 5	13.03	+8	+62	60
12	13.08	+5	+60	65
19	13.25	+17	+47	68
26	13.43	+18	+53	70
Oct. 3	13.60	+17	+47	70
10	13.73	+13	+85	69

1. Average mortgage rate minus average yield on recently offered Aaa utility bonds.
2. Percent reporting supply of funds slightly or substantially below normal seasonal patterns.

SECONDARY HOME MORTGAGE MARKET ACTIVITY

Period	FNMA auctions of forward purchase commitments				Yields on GNMA-guaranteed mortgage-backed securities for immediate ² delivery		
	Conventional		Government-underwritten				
	Amount (\$ millions) Offered	Yield to 1 FNMA Accepted	Amount (\$ millions) Offered	Yield to 1 FNMA Accepted			
1980--High	426	133	17.51	644	324	15.93	13.84
Low	54	24	12.76	199	89	12.28	11.03
1980--Sept. 2	121	71	14.19	324	183	14.41	12.57
8							12.59
15	104	68	14.29	225	136	14.60	12.74
22							12.93
29	123	71	14.86	358	219	15.30	13.35
Oct. 6							12.70
13	29	18	14.47	196	118	14.57	12.59

1. Average gross yield before deducting fee of 38 basis points for mortgage servicing. Data, based on 4-month FNMA purchase commitments, reflect the average accepted bid yield for home mortgages, assuming a prepayment period of 12 years for 30-year loan without special adjustment for FNMA commitment fees and related stock requirements. Mortgage amounts offered by bidders relate to total eligible bids received.
2. Average net yields to investors assuming prepayment in 12 years on pools of 30-year FHA-VA mortgages typically carrying the prevailing ceiling rate on such loans, n.a.--not available.

of their investible funds into comparatively illiquid mortgage loans. Support provided by the federally related agencies operating in the secondary markets also has continued modest, although issues of GNMA-guaranteed passthrough securities were well maintained through September. Issues of mortgage revenue bonds by municipalities have been reduced considerably since mid-year, largely because of the constraints imposed by statutory interest rate ceilings.

Yields on long-term mortgage instruments traded in the secondary markets generally rose sharply during the latter half of September but have come down markedly since then. As secondary market yields for FHA/VA loans climbed last month, the administration raised the ceiling rates on government-underwritten home loans by a full percentage point on September 22. By mid-October, GNMA-guaranteed securities issued against pools of FHA/VA loans bearing the new 13 percent ceiling rate were selling about 2 points below par.

In the primary market for conventional home mortgages, the national average contract rate on new commitments for fixed-rate level-payment loans at S&Ls has risen by 65 basis points since mid-September to 13.73 percent. S&Ls are offering renegotiable-rate or "rollover" mortgages (authorized by the FHLBB in April) in some areas of the country at 1/2 to 1 percentage point below going rates on fixed-rate loans, but customer reaction reportedly is mixed. Moreover, there has been some experimentation with so-called "shared appreciation" home mortgages bearing contract interest rates about a third less than market yields on standard contracts.

On September 30, the FHLBB issued proposed regulations permitting S&L activity in this type of lending.¹

In August (latest data available), net mortgage lending by S&Ls surged to \$3.6 billion (SA) and the volume of new mortgage commitments issued rose to \$9.6 billion. The stock of mortgage commitments outstanding increased by 13 percent to \$26.8 billion, a level about 40 percent above the May trough but nearly a fifth below the peak last fall. S&Ls increased their borrowing from FHLBanks and other sources in August, following four consecutive months of decline, although they also increased their liquid asset balances. S&Ls have improved their balance sheet positions since early this year as the flow of funds from deposits and mortgage repayments generally has exceeded net acquisitions of mortgages by the associations.

Average contract interest rates on all types of conventional home loans closed by major lender groups increased by about 10 basis points in September following 3 months of decline from the May peak. This rise, along with the September 22 increase in the FHA/VA ceilings, will be incorporated in the CPI for October; mortgage rate adjustments, which were a moderating factor in the CPI change during the July-September period, will contribute about a plus two-tenths of 1 percent to the index for October. The third-quarter decline in interest rates on mortgage loans closed brought a halt to the marked upswing in average monthly payments

1. These contracts entitle the lender to a share of any capital gain on the mortgaged property. The FHLBB also issued proposed regulations concerning a "graduated payment adjustable mortgage," which combines the adjustable-interest-rate feature of rollover mortgages with a graduated-payment feature attractive to many first-time homebuyers.

on newly originated conventional home loans which had been evident for more than two years. Recent increases in commitment rates along with accelerating home prices, however, are likely to produce some rise in the payment/income ratio in the fourth quarter.

Consumer Installment Credit

Consumer installment credit outstanding expanded slightly in August, following four months of substantial decline. Growth in August primarily reflected continued strength in finance company auto lending and modest gains in revolving credit at retailers and gasoline companies, which offset continuing declines for all major loan types at commercial banks and credit unions. The reductions at these latter holders, however, were much smaller than during the four preceding months.¹

Finance rates on auto credit have moved down substantially at both commercial banks and finance companies since the spring. Moreover, the proportion of commercial bank new-auto loans with contract maturities longer than 36 months rose during August, and the average loan/value ratio on new-auto loans at finance companies increased significantly.

A special survey of auto financing at commercial banks and finance companies, conducted in mid-September by the Federal Reserve Banks, showed that about one-fifth of respondents had changed their finance rates since mid-August, and rates were reduced in a large majority of these cases. A follow-up telephone sampling of a limited number of banks in early October found that a few had raised finance rates in the preceding two to three weeks but none reported any other change in lending policy. Some banks indicated that they were considering raising auto credit finance rates if the recent rise in market interest rates persisted.

1. Appendix III-A discusses recent trends in credit growth and in the financial position of households, compared with earlier recessions.

CONSUMER INSTALLMENT CREDIT¹

	1978	1979	1980			
			Q2	June	July	Aug.
<u>Total</u>						
Change in outstandings						
Billions of dollars	44.8	35.5	-35.5	-41.6	-7.3	0.2
Percent	19.4	12.9	-11.4	-13.6	-2.4	0.1
Extensions						
Billions of dollars	298.4	322.6	257.9	248.4	294.0	307.2
Bank share (percent)	47.8	46.4	41.4	41.4	43.1	42.6
Liquidations						
Billions of dollars	253.5	287.1	293.5	289.9	301.3	307.0
Ratio to disposable income (percent)	17.4	17.7	16.7	16.4	16.8	17.0
<u>Automobile credit</u>						
Change in outstandings						
Billions of dollars	19.6	12.6	-14.9	-20.9	-1.1	2.1
Percent	23.6	12.3	-12.7	-18.1	-1.0	1.9
Extensions						
Billions of dollars	89.0	91.9	62.8	57.2	79.3	83.6
<u>Revolving credit</u>						
Change in outstandings						
Billions of dollars	7.8	8.1	-6.5	-9.0	0.2	1.7
Percent	20.7	17.9	12.1	-17.0	0.3	3.3
Extensions						
Billions of dollars	104.6	120.8	120.1	115.6	126.3	127.8

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

APPENDIX III-A*

RECENT CONSUMER CREDIT DEVELOPMENTS

After expanding at a rapid rate from 1977 through mid-1979, and more moderately during the next several months, consumer installment credit outstanding began to fall sharply in April of this year. The decline abated considerably in July, however, and a slight increase was registered in August. Brief contractions in consumer credit typically occur during a recession (see chart on page III-A-2). In such periods, when sales of autos and other consumer durables weaken, new extensions of credit generally drop below the more stable volume of repayments, and the stock of debt falls.

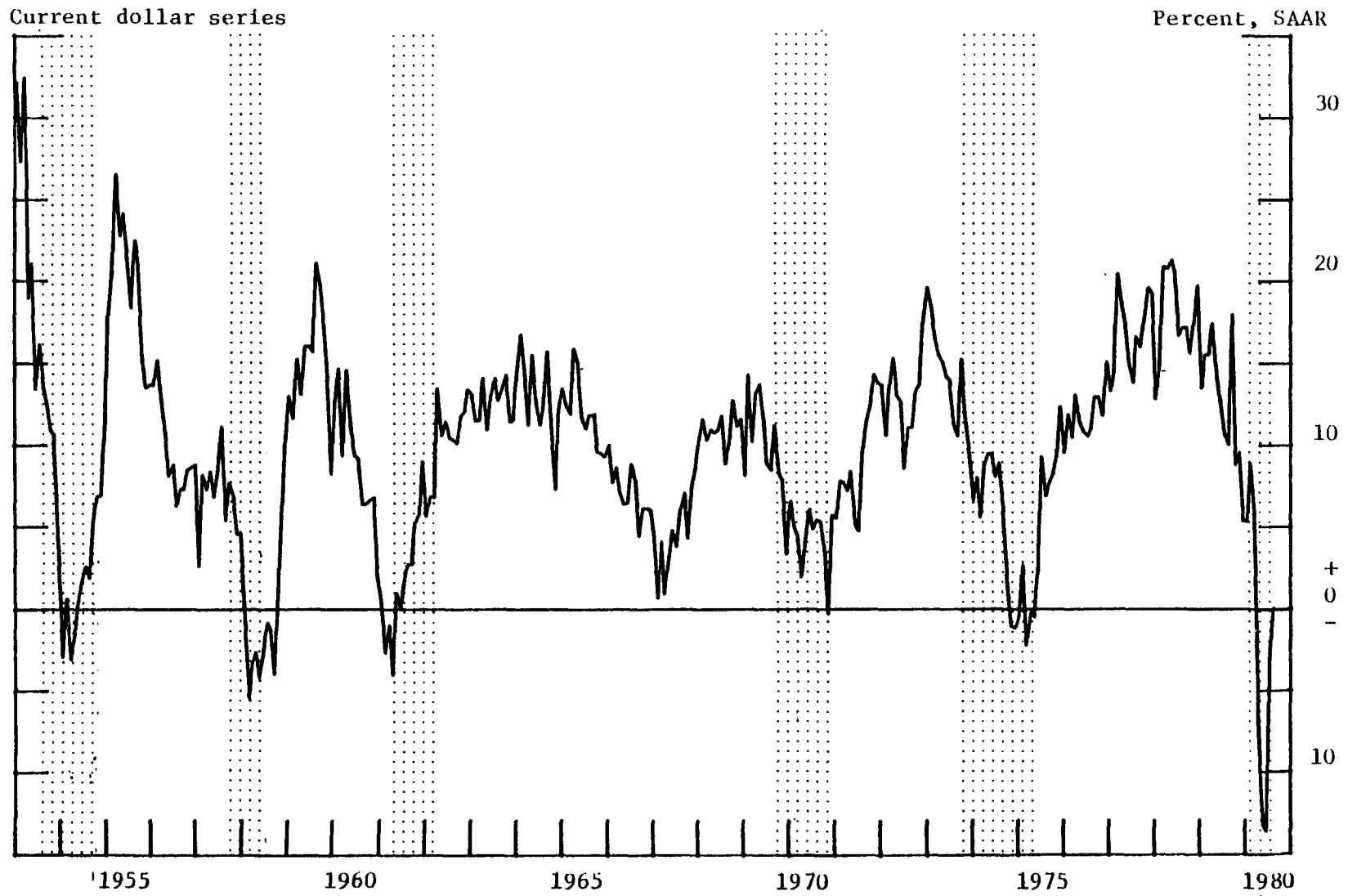
The most striking feature of the recent decline in credit is its comparative depth. Credit outstanding fell at an annual rate of 13 percent in May and June, in contrast to rates of decline of 5 percent or less at previous low points. Contributing to the recent large contraction, gross extensions of new credit dropped as much as 25 percent below the previous peak (see chart on page III-A-3, upper panel), compared with peak-to-trough slides measuring no more than 10 percent during earlier recessions.

Contractions in consumer credit outstanding generally have lasted from 4 to 8 months; the most recent drop apparently has lasted for 4 months. It could be premature to conclude that the small August increase has ended the current contraction, since some months of positive growth have cropped up within a negative trend in the past. However, the strengthening of retail sales since June, and the emergence of a more normal relationship between credit extensions and retail sales, both point to this conclusion (see chart on page III-A-3, lower panel).

An obvious difference between the recent and previous recession periods was the existence from mid-March to July of this year of the consumer credit restraint program, which undoubtedly contributed to the severity of the decline in credit. Many lenders tightened credit policies substantially when the program was in effect; at the same time consumers themselves acted to reduce their reliance on credit. In addition to the restraint program, however, another factor--not so important in past recessions--served to intensify the recent credit contraction. Unusually high market interest rates, together with low usury ceilings in many states, had rendered relative returns on consumer lending less attractive since mid-1979 than around most other cyclical turning points. That was the case even though average rates on consumer loans made also climbed to record levels (see charts on page III-A-4).

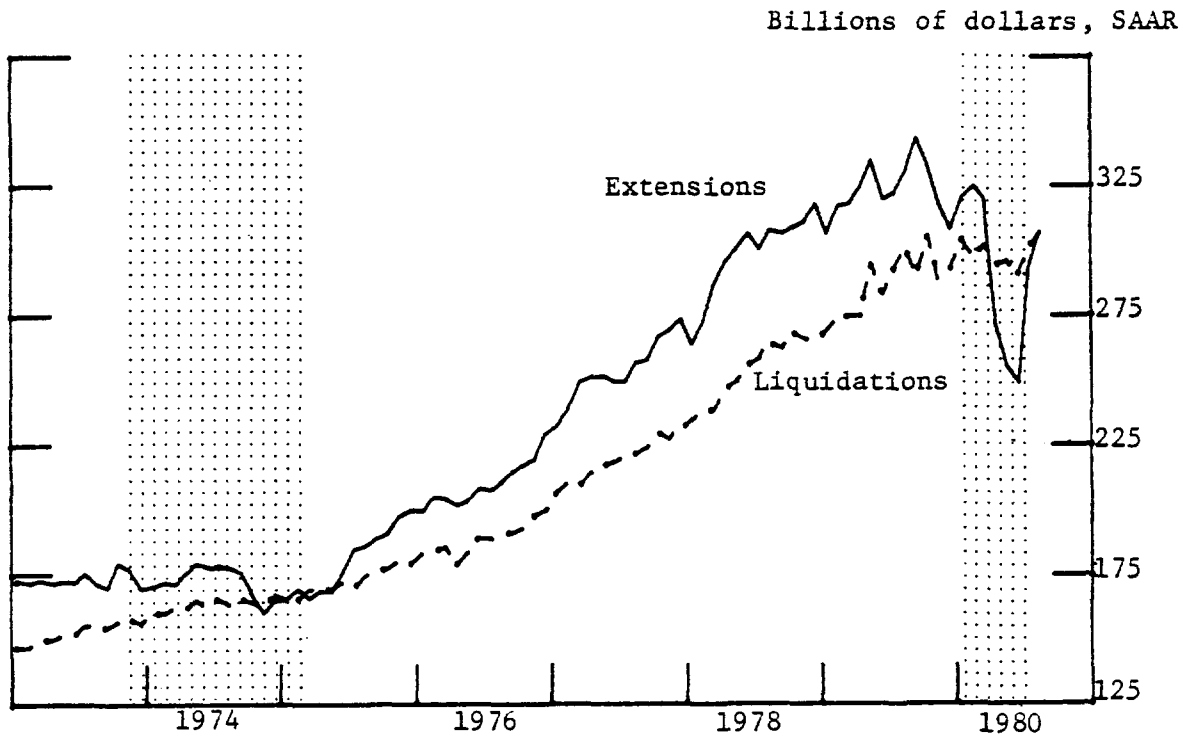
* Prepared by Charles A. Lockett, Economist, Mortgage and Consumer Finance Section, Division of Research and Statistics.

GROWTH RATE OF CONSUMER INSTALLMENT CREDIT



Note: Shaded areas indicate periods of cyclical contraction as determined by the NBER.

INSTALLMENT CREDIT EXTENSIONS AND LIQUIDATIONS

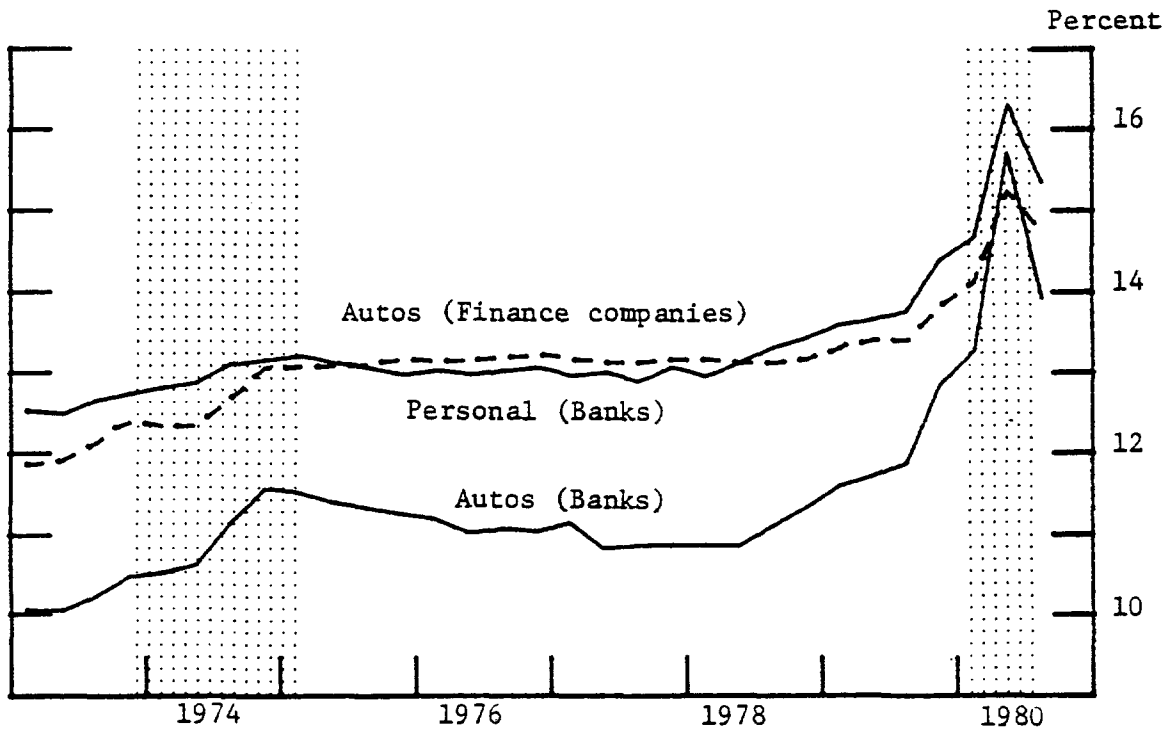


RATIO OF EXTENSIONS TO RETAIL SALES

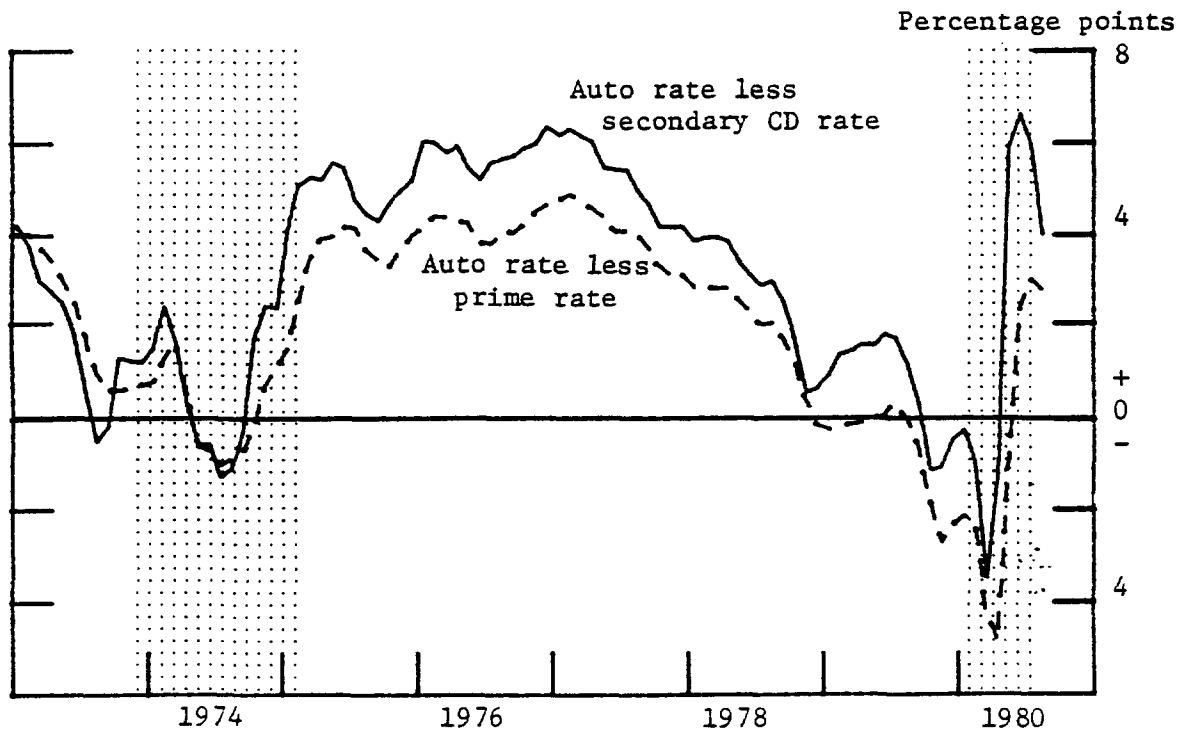


Note: Shaded areas indicate periods of cyclical contraction.

CONSUMER FINANCE RATES



INTEREST RATE SPREADS



Note: Shaded areas indicate periods of cyclical contraction.

When the restraint program was initiated, creditors already inclined to curtail consumer lending found in the program a convenient opportunity to do so with a minimum of customer alienation or competitive pressure. In this environment, constraint on the availability of funds likely played a more prominent role in the recent decline in credit than it had in the past. Qualitative evidence has indicated that willingness to lend increased on balance between May and August, which was reflected in the pullback in consumer finance rates reported for the middle of the third quarter. Finance rates appear to have firmed a bit in recent weeks, but not sharply.

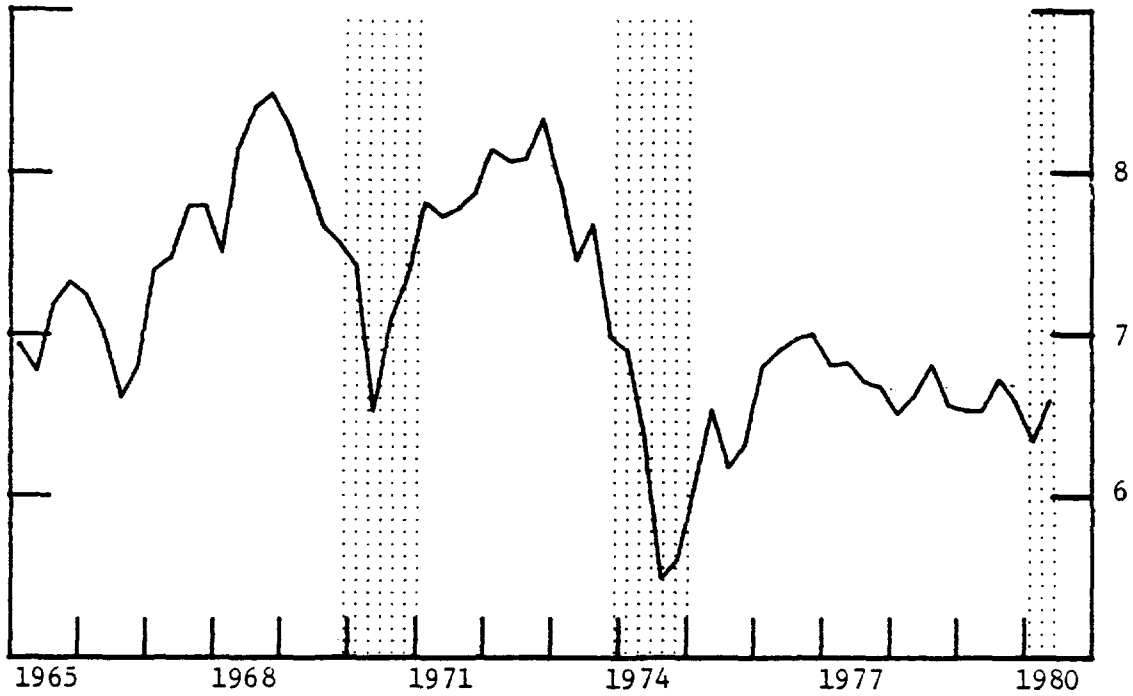
The discussion below considers several aspects of household financial condition that may shed light on the capacity of households to contribute to economic recovery. In rebuilding their real financial net worth after the last recession, households recovered less than half the ground lost in 1973-74, suggesting that they approached the recent recession in generally less liquid condition than in the past (see chart on page III-A-6, upper panel). During these years, inflation was eroding the worth of fixed nominal-value financial assets in consumer portfolios, and balance sheets were being restructured toward greater emphasis on tangible assets. Financial net worth after 1976 was also retarded by the rapid accumulation of consumer and mortgage debt, of which a growing proportion went to support consumption spending--an important factor underlying the reduced levels of the saving rate in recent years.

Nevertheless, the joint effect of stepped up investment in physical assets and increases in their relative prices was sizable enough that total net worth of households in real terms continued to follow a long-term uptrend (see chart on page III-A-6, lower panel). Moreover, during the 1980 recession, financial and total net worth are estimated to have held steady or edged up in real terms, in contrast to the pronounced declines that were recorded in the previous two recessions. This atypical pattern was related primarily to the unusually steep cutback in borrowing during the second quarter, and also to rising stock market and home prices.

The burden of household indebtedness--usually measured by the ratio of debt repayments to income--was an element of many forecasts made in the past two years of a consumption-oriented recession, and is a factor underlying some forecasts of a weak recovery. High debt service obligations relative to income, other things equal, would imply less income available to support consumption in the future. Aside from some technical limitations to such use of the repayments-to-income measure, the recent behavior of the statistic indicates that consumers in the aggregate apparently have pulled back from the positions reached in the second half of last year (see chart on page III-A-7). For consumer installment credit, the debt burden ratio averaged 16.7 percent in the second quarter of 1980. That was midway between the peak of 18.0 percent

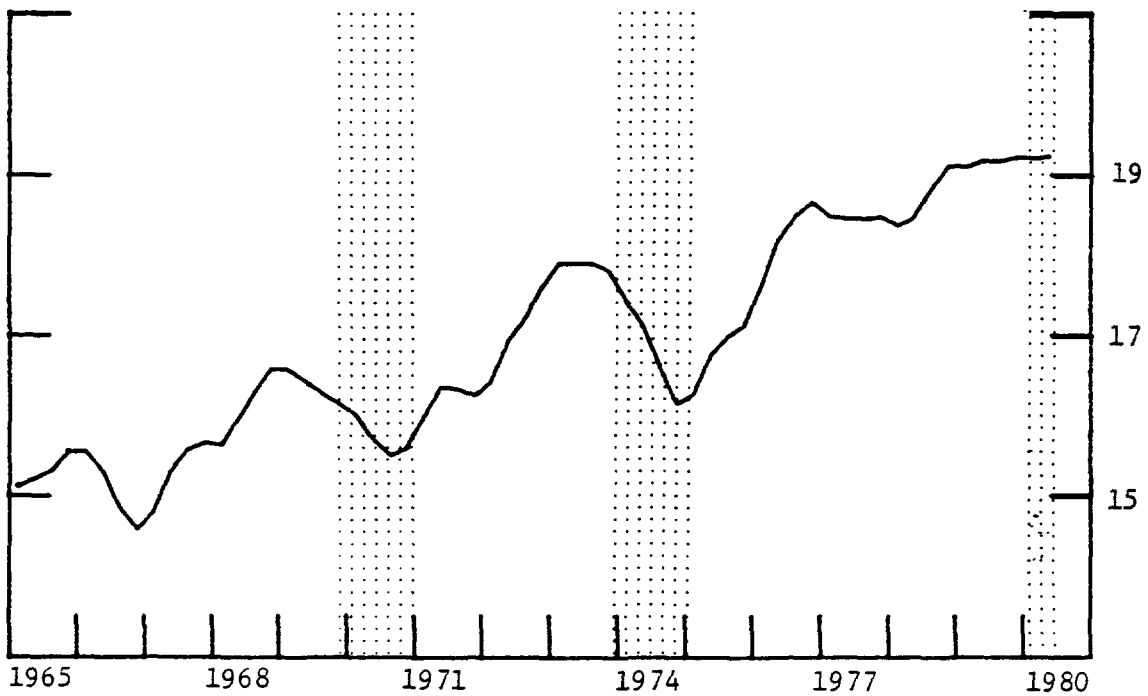
FINANCIAL NET WORTH PER CAPITA

Thousands of 1972 dollars



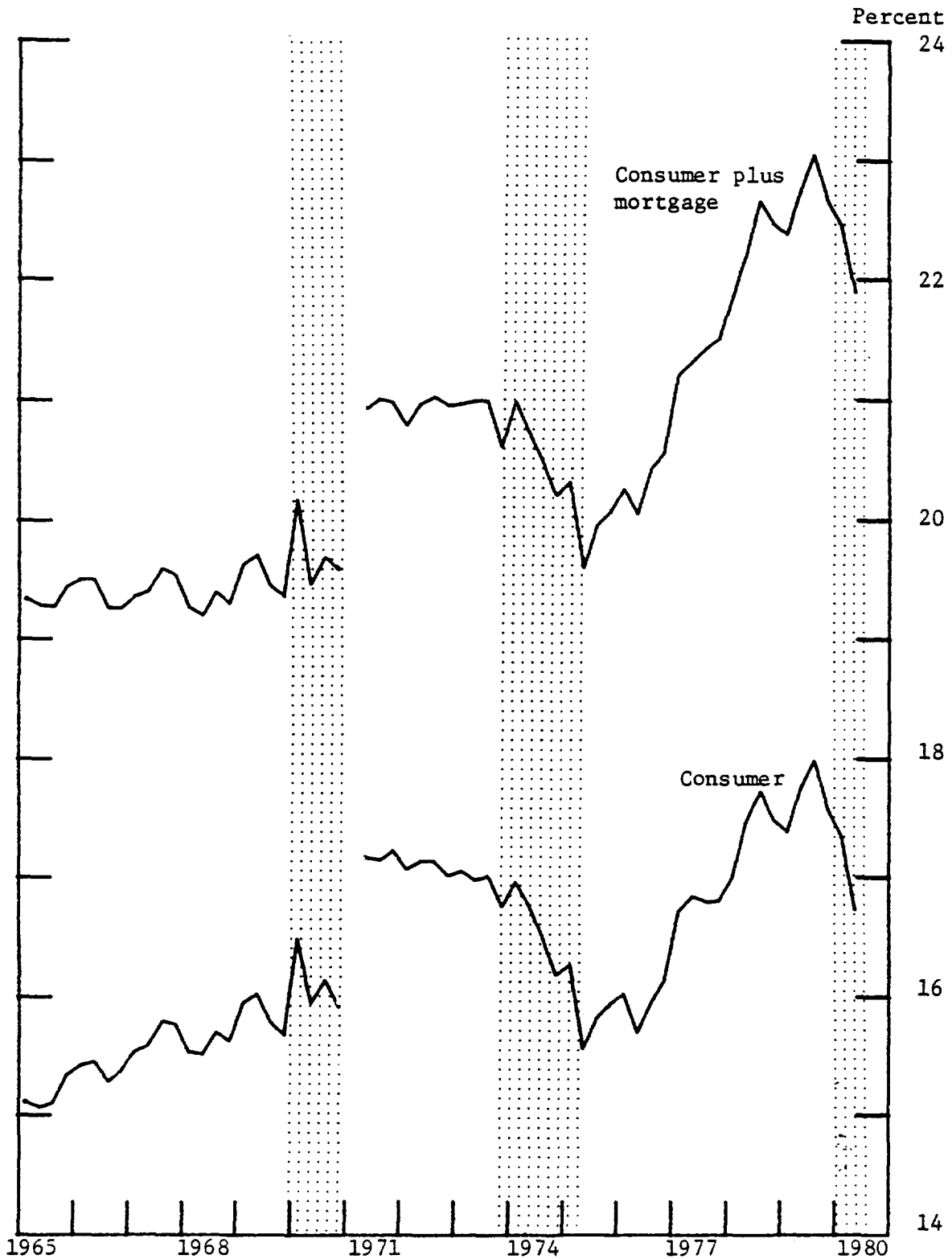
TOTAL NET WORTH PER CAPITA

Thousands of 1972 dollars



Note: Shaded areas indicate periods of cyclical contraction.

DEBT REPAYMENTS RELATIVE TO DISPOSABLE PERSONAL INCOME



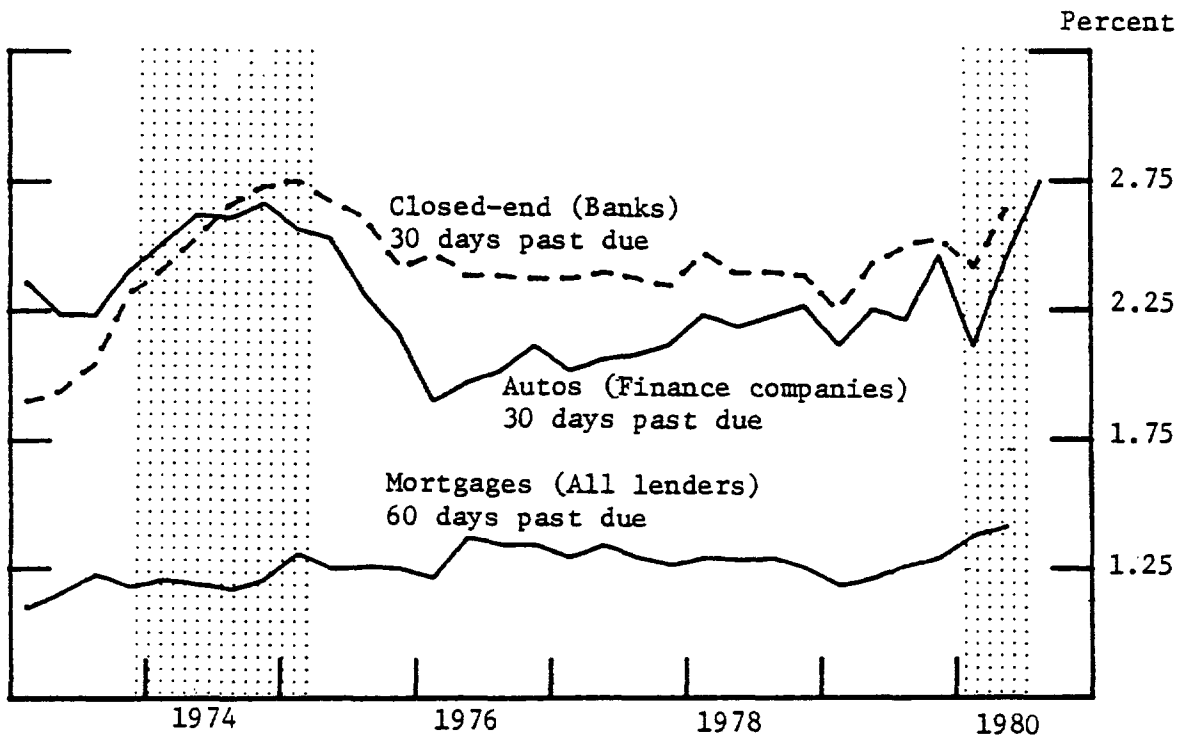
Note: Discontinuity in series reflects inclusion of gasoline company credit beginning in January 1971. Shaded areas indicate periods of cyclical contraction.

III-A-8

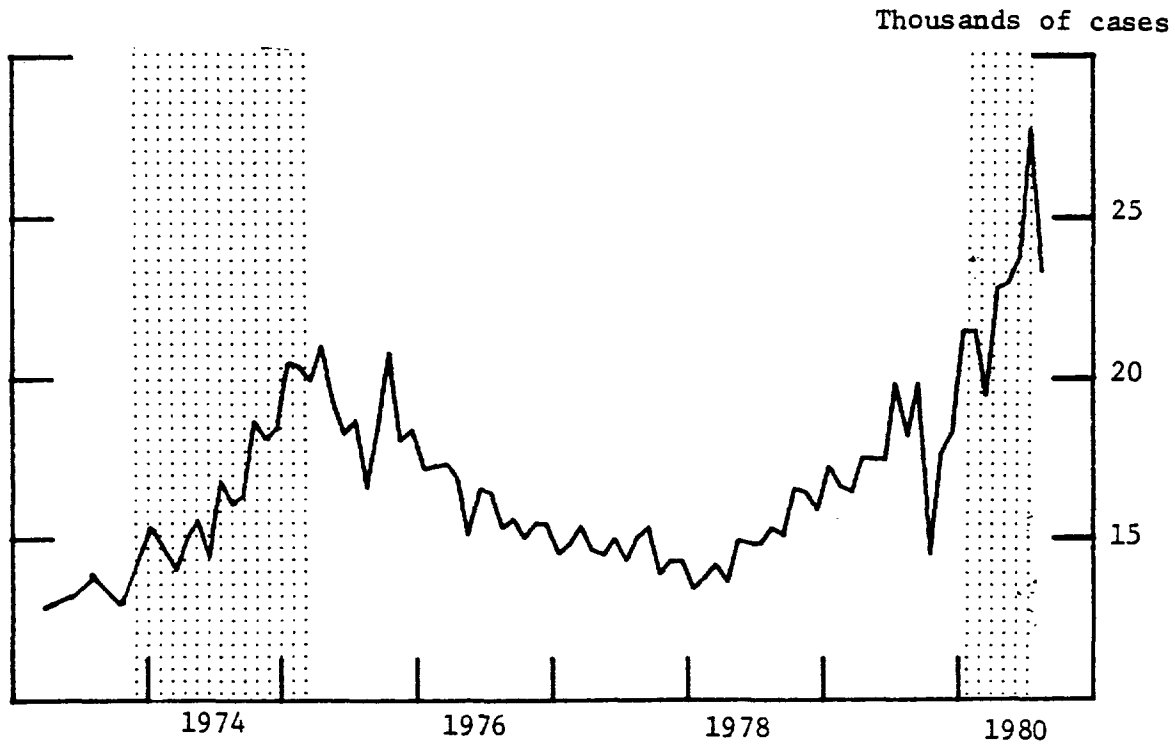
in the third quarter of 1979 and the previous cyclical low of 15.6 percent in early 1975. When scheduled mortgage debt payments are included, however, the ratio remains in an historically high range.

Among the direct measures of repayment problems, the proportion of past due consumer loans of various types rose fairly sharply in this year's second quarter, as typically occurs during a recession (see chart on page III-A-9, upper panel). Personal bankruptcies (lower panel), have climbed considerably above previous peaks, even after a drop in August. Liberalization of federal bankruptcy law last October accounts for part of the upsurge, however, and the number of cases that will likely be filed this year--about 300,000--still appears small compared to the approximately 40 million households with debt. Nevertheless, the trend in bankruptcies has been cited by many creditors as a source of concern.

DELINQUENCY RATE ON LOANS TO HOUSEHOLDS



PERSONAL BANKRUPTCIES



Note: Shaded areas indicate periods of cyclical contraction.

Foreign Exchange Markets

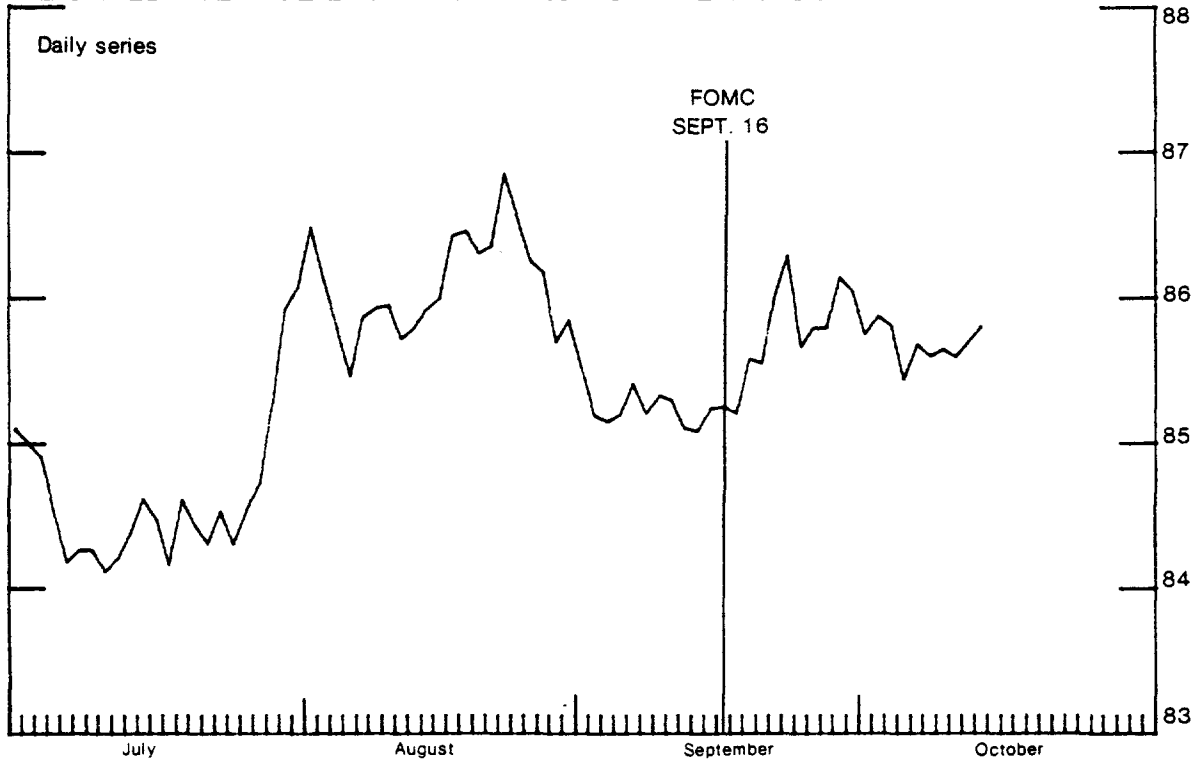
Exchange markets were generally quiet and the dollar has appreciated somewhat on average since the last Greenbook. As indicated by the top panel of the chart on the next page, the dollar's weighted-average value appreciated by 0.6 percent during this five-week interval. Against the continental European currencies the dollar rose by amounts ranging from 1-1/4 percent against the Swiss franc to 2-1/2 percent against the German mark and Belgian franc. Net changes against the pound sterling and Canadian dollar were small. Against the Japanese yen, however, the dollar depreciated by 4-3/4 percent.

Gold fluctuated between the \$660 and \$710 levels during this period, ending the interval around the \$675 level, about unchanged from the time of the last Greenbook.

Both economic and political factors played roles in exchange-rate movements during the past five weeks. As indicated by the bottom panel of the chart, dollar interest rates again rose steeply late in September and, in fact, the U.S. three-month CD rate rose above the weighted average of three-month foreign rates. The dollar's rise against the German mark and other continental European currencies was associated at least in part with the change in these market interest rate differentials and with the increase in the U.S. discount rate on September 26. Favorable U.S. producer and consumer price figures released during the period also contributed to the dollar's firm tenor.

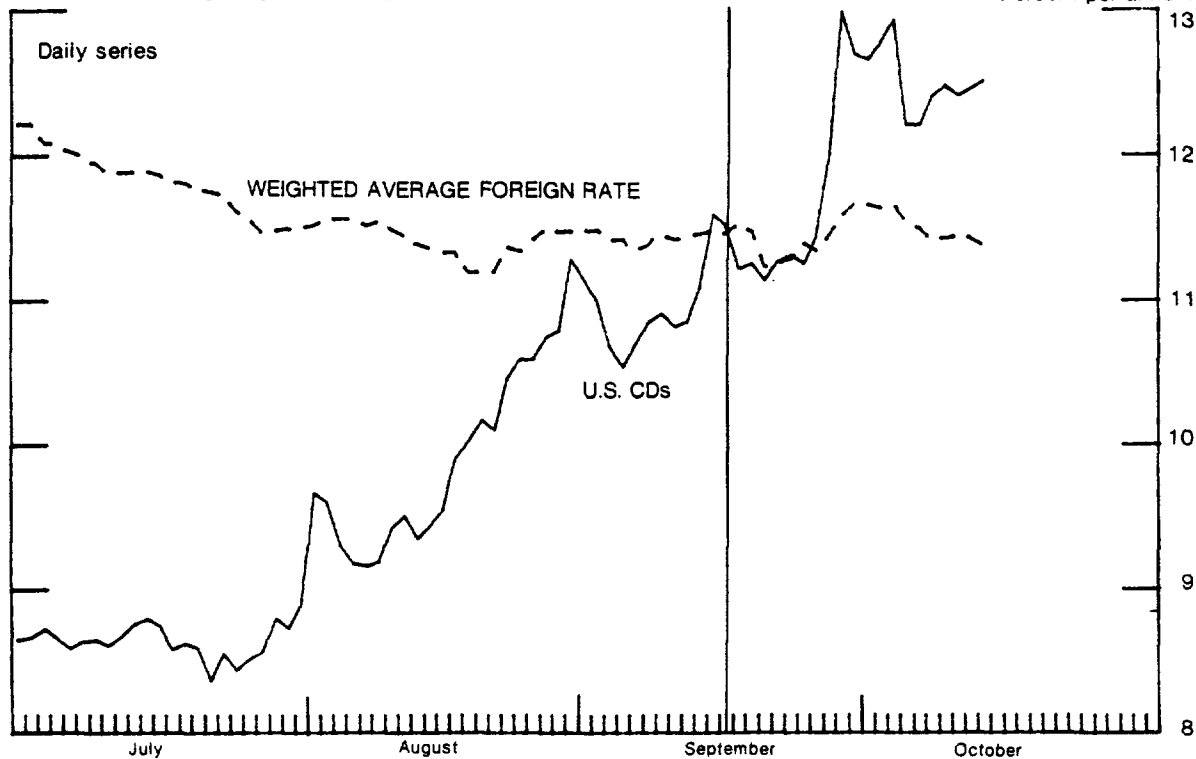
WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR

March 1973 = 100



3-MONTH INTEREST RATES

Percent per annum



Political developments also tended to favor the dollar's exchange rate with some European currencies. Late last month the Cossiga government resigned in Italy and the coalition government in Belgium resigned in early October. Reports of increased political tension in Poland may also have played a role. More generally, the outbreak in late September of the war between Iraq and Iran -- and subsequent indications that other Mid-East countries might be drawn into this conflict -- generated renewed fears about the security of oil supplies. After the initial impact, however, the exchange-market influence of the war tended to recede into the background, in part because of the presently ample state of world oil stocks and reserves. Nonetheless, the firmness of the pound sterling has been attributed in part to concerns about oil and also to the recent \$2/bbl increase in the price of oil by Saudi Arabia at the mid-September OPEC meeting, and expectations of further, albeit moderate, price increases ahead.

The Japanese yen came into recurrent strong demand during the period and rose noticeably against the dollar and other currencies. It dropped briefly after the outbreak of the Iraq-Iran war, but quickly recovered and has risen to around the ¥ 206 level presently. Demand for the yen has been attributed mainly, but not exclusively, to Mid-East interests seeking attractive long-term investment outlets. Japanese companies have reported good profits in recent months, and Tokyo stock market prices have been bid up to record levels. In addition, there is a widespread perception that fundamental aspects of the Japanese economy have been improving; recent trade figures

have been favorable and recent price figures have shown a clear improvement in Japanese inflation performance.

. During the past few weeks the Belgian franc has tended to be at the bottom of the EMS' narrow currency spread, with the French franc and Dutch guilder taking turns at the top of the arrangement. The Italian lira, which is permitted wider fluctuations than other EMS currencies, is about 4 percent below its central rate with the French franc.

Desk operations during this period included purchases of \$532 million equivalent of German marks, \$30 million equivalent of Swiss francs, and \$23 million equivalent of French francs.

, \$279 million equivalent were the System's share, and these were used largely to pay most of the remaining swap debt with the Bundesbank. This debt has now been reduced to \$84 million equivalent, and taking balances into account, the System now has moved into a long position in marks. The Treasury's share of \$253 million equivalent included purchases of \$37 million equivalent made in the forward market for three- and six-months maturity. These were the first outright forward purchases

made by U.S. authorities since early 1971. The Swiss franc acquisitions were for System account and were added to balances. The French franc acquisitions were likewise for System account and were used principally to make payments on swap debt with the Bank of France, which has now been reduced to \$86 million equivalent.

Foreign lending by U.S. banks. Total outstanding claims on foreigners held by head offices and foreign branches of U.S.-chartered banks increased by \$23 billion in the first half of 1980. (See table.) At an annual rate this was substantially greater than the \$37-1/2 billion increase in the full year 1979, especially since foreign lending seems to be seasonally weak in the first half. Most of the larger rise so far this year has been concentrated in the lending to the G-10 countries and Switzerland. A large part of the increased lending to the G-10 countries and Switzerland consisted of placements with other banks in those countries, which in turn reflected, at least in part, stronger loan demand by nonbank borrowers within that area.

Claims on the smaller developed countries (mostly in Southern Europe and Scandinavia) also have increased at a faster rate this year. However, claims on the OPEC countries have declined, presumably as a consequence of those countries' larger current-account surpluses. There has been a slight decline this year in claims on Eastern Europe; over the past 18 months these claims have been unchanged as net repayments by the Soviet Union have matched lending to the rest of the area.

Claims on the non-OPEC developing countries rose more in the first half of 1980 than in the first half of 1979, although at a somewhat slower rate than in 1979 as a whole. There was exceptionally heavy borrowing by some countries last year for reasons that appear to have been transitory. For example, in 1979 there was abnormally large borrowing by Argentina (where exchange rate and interest rate policies induced residents to borrow abroad) and by the Philippines (where U.S. banks' share of total new bank lending to that country picked up sharply).

CLAIMS ON FOREIGNERS OF U.S.-CHARTERED BANKS
(Billions of dollars)

Claims on	Increase			Out- standing June 1980
	<u>1976-78</u> Annual Average	<u>1979</u> Year	<u>1980</u> 1st Half	
Total, all countries	<u>37.0</u>	<u>37.5</u>	<u>23.0</u>	<u>326.8</u>
G-10 and Switzerland	14.9	13.6	15.3	153.7
Smaller developed countries	3.1	.4	.5	20.3
OPEC countries	5.6	.2	-2.0	20.9
Eastern Europe	1.1	.2	-.1	7.2
Non-OPEC developing countries	6.2	10.2	4.3	67.1
of which:				
Brazil	2.4	.3	.2	15.4
Mexico	.6	1.2	1.4	13.4
Korea	.6	1.6	1.5	7.0
Argentina	.4	2.1	.4	5.5
Philippines	.4	1.4	.2	4.6
Taiwan	.4	.5	.4	3.8
Others	1.4	3.1	.2	17.4
Offshore banking centers	3.9	9.5	3.0	43.4
Miscellaneous and unallocated	1.7	2.6	2.7	14.4

This year U.S. banks have stepped up their lending to Mexico and Korea. In the first half, claims on Mexico rose \$1.4 billion, more than the entire 1979 amount. Prior to mid-1979 there was a lengthy period when U.S. bank claims on Mexico declined, partly because of decisions by U.S. banks to reduce the share of Mexico in their total foreign claims and partly because of actions by Mexico itself that (in part unintentionally) lessened dependence on U.S. banks. But since mid-1979 U.S. banks have again been participating actively in lending to Mexico. Claims on Korea were up \$1.5 billion in the first half of this year, almost as much as in the full year 1979. This surge has been part of a sharp increase in Korea's global bank borrowing to finance the large increase in oil import costs. U.S. bank lending to Brazil slowed very greatly as long ago as 1977-78, and has remained low.

The average maturity of U.S. bank lending to non-OPEC developing countries appears to have shortened in the first half of 1980. This is suggested by the fact that U.S. bank lending to these countries increased in the first half of this year relative to a year earlier, while there was a decline in syndicated medium-term Eurocurrency credits to these countries. It is likely that a reduction in the U.S. banks' extensions of syndicated medium-term credits was more than matched by an increase in short-term credits or unsyndicated (hence unpublicized) medium-term credits.

U.S. International Transactions.

In July and August, the U.S. merchandise trade deficit was considerably smaller than in any two-month period during the past several years. Averaging \$8 billion at an annual rate, the July/August deficit was about one-fourth the size of the second quarter deficit. This sharp change was largely the result of a drop in the volume of imports while the volume of exports remained relatively strong. See the table below.

U.S. Merchandise Trade 1/

	1979		1 9 8 0		
	<u>Year</u>	<u>4Q</u>	<u>1Q</u>	<u>2Q</u>	<u>July/Aug.^{e/}</u>
<u>VALUE</u> (Bil.\$, SAAR)					
Exports	<u>182.1</u>	<u>200.9</u>	<u>218.8</u>	<u>218.8</u>	<u>225.7</u>
Agric.	35.4	41.7	41.5	38.9	42.2
Nonagric.	146.6	159.2	177.3	179.9	183.5
Imports	<u>211.5</u>	<u>237.8</u>	<u>262.2</u>	<u>249.1</u>	<u>233.9</u>
Oil	60.0	75.4	86.4	84.0	69.8
Nonoil	151.5	162.4	175.8	165.1	164.1
Balance	<u>-29.5</u>	<u>-36.9</u>	<u>-43.4</u>	<u>-30.2</u>	<u>-8.2</u>
<u>VOLUME</u> (Bil.72 \$, SAAR)					
Exports - Agric.	16.1	18.3	18.1	17.7	18.4
Nonagric.	68.5	68.9	74.5	74.4	73.5
Imports - Oil	8.5	8.4	8.1	7.2	5.8
Nonoil	68.0	69.6	72.1	66.3	64.6

1/ International accounts basis.

2/ Based on preliminary monthly data.

Most of the fall in imports occurred in oil. The volume of oil imports which averaged 6.0 million barrels per day in July/August, was nearly 20 per cent less than the second-quarter rate. U.S. oil consumption began to decline in mid-1979 and continued to fall through August of this year. U.S. oil stocks, while easing slightly (seasonally adjusted) continued at very high levels through September. Oil import prices, which averaged \$31.55 per barrel in July/August, were only 2 per cent higher than in the second quarter; some of the \$2 per barrel retroactive Saudi Arabian increase should be reflected in the September import data.

World spot prices for oil have risen about \$3-4 per barrel since the outbreak of fighting between Iraq and Iran, and have not reached about the same level as official prices. Spot prices had fallen steadily since January and were below official prices before the onset of the war. Before the fighting there had been excess oil supply in world markets and various countries had announced plans to cut production 10 per cent. These proposed cutbacks now have been postponed and some OPEC countries have indicated their intention to increase production to make-up some of the shortfall due to the interruption of Iran/Iraq exports (3.5 to 4.0 mb/d.)

Nonoil imports in July/August were little changed in value from the second quarter rate, but the volume declined by 7 per cent in response to weakened U.S. demand. Declines in volumes of industrial supplies and consumer goods more than offset small increases in capital goods and in automotive imports from Canada. The volume of automotive imports from Europe and Japan in July/August was at about the same rate as in the second quarter but there was an increase in value as prices rose.

Agricultural exports increased in July/August, particularly exports of soybeans and wheat. Prices have risen but most of the increase was in volume.

The volume of nonagricultural exports in July/August held at about the same strong rate as in the first and second quarters of this year even though economic activity in major industrial economies generally turned down beginning in the second quarter. The volume of machinery exports grew steadily throughout the year and increased nearly 4 per cent in July/August from the second-quarter rate. There were increased shipments of many types of machinery, particularly construction, electrical and electronic, and business and scientific equipment. Aircraft exports, while down somewhat in July/August, were still relatively strong. The volume of consumer goods and most industrial supplies exports continued at much the same rates as earlier in the year. Steady increases in exports of coal, steel, aluminum, and fertilizer were offset by small declines in other commodities. Only gold and silver exports declined sharply in July/August from the very high rates of late last year and early this year. Nonagricultural export prices on average rose 3 per cent in July/August from the second quarter level. Much of the July/August rise was from higher export prices for machinery, aircraft and consumer goods; industrial supplies export prices eased somewhat from the second quarter level.

The net outflow of funds through banks, underway since spring, continued through September. As shown in the table on the next page, the U.S. offices of domestically chartered banks have reversed their net positions with their own branches by about \$24 billion since March

Table 1

Net Positions of U.S. Chartered Banks with Their Own Foreign Offices
and Credit Extended to U.S. Residents by These
Foreign Offices (Billions of dollars, daily averages)

	Q-1	Q-2	Q-3	1 9 8 0						
				March	April	May	June	July	August	September
Domestic chartered banks' net position with own foreign offices	7.3	1.2	-10.6	9.3	6.0	2.7	-5.2	-8.1	-9.9	-13.9
Adjustment for weekend reserve avoidance (a)	-2.3	-1.7	-3.1	-2.5	-.8	-2.4	-1.8	-2.9	-3.6	-2.9
Net position adjusted for weekend reserve avoidance	5.0	-.5	-13.7	6.8	5.2	.3	-7.0	-11.0	-13.5	-16.8
Credit extended to U.S. residents by foreign offices of U.S. chartered banks	3.3	4.4	5.6	3.5	3.5	4.3	5.4	5.9	5.8	5.1

(a) See March Greenbook, Appendix B for a description of weekend reserve avoidance activity and the calculation of the adjustment.

on a daily average basis, adjusted for weekend reserve avoidance activity. (The average adjustment for weekend reserve avoidance activity remained almost \$3 billion in September.)

The foreign branches have used this inflow from their U.S. parent banks to fund an increase in claims on foreigners (about 9 per cent between the end of March and the end of August). Their liabilities to foreigners fell slightly during this same period. Over the first eight months of 1980 the liabilities to foreigners of U.S. chartered banks (domestic offices and their foreign branches consolidated) increased only marginally.

Credit extended to U.S. residents by the foreign branches of U.S. banks has fallen somewhat from the July peak (see the table above.) This is probably a reflection of the change in relative costs to borrowers of prime rate and Eurodollar loans.

Official capital flows in August show an inflow of about half a billion dollars. Preliminary data for September, covering only holdings at the FRBNY show little change. OPEC holdings increased by over a billion dollars in August, bringing the total official OPEC inflow in 1980 to over \$9 billion. Partial data for September indicate a further increase of about \$750 million.

RESTRICTED

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

	1978	1979	1979		1980		1980		
	Year	Year	QIII	QIV	QI	QII	June	July	August
1. Trade Balance ^{1/}	-33,759	-29,469	-7,060	-9,225	-10,850	-7,555	-2,218	-422	-948
2. Merchandise exports	142,054	182,055	47,198	50,237	54,708	54,710	18,224	18,389	19,223
3. Merchandise imports	-175,813	-211,524	-54,258	-59,462	-65,558	-62,265	-20,442	-18,811	-20,171
4. <u>Change in net foreign positions of banking offices in U.S. (excl. liab. to foreign official inst.)</u>	-15,403	14,767	675	-5,016	8,975	-23,136	-10,111	-2,162	-723
Through interbank transactions with									
a) Own offices in foreign countries	4,702	20,733	8,297	-9,107	7,119	-18,475	-9,864	-845	5,595
b) Unaffiliated banking offices in foreign countries	-4,725	3,783	-2,321	6,442	2,788	-2,129	468	1,107	-5,645
Through nonbank transactions									
a) Claims on nonbanks in foreign countries (increase,-)	-16,456	-12,002	-5,282	-3,664	-394	-3,488	-2,596	-1,367	-1,289
b) Liabilities to private nonbanks in foreign countries (inc. custody liab.)	1,076	2,253	-19	1,313	-537	955	1,881	-1,057	616
9. <u>Private securities transactions, net (excl. U.S. Treas. Oblig.)</u>	-909	-3,445	-1,977	-958	1,585	-765	-531	607	-323
10. Foreign net purchases of U.S. corp. bonds	929	274	16	8	351	214	108	135	102
11. Foreign net purchases of U.S. corp. stocks	1,689	1,037	144	193	1,999	346	142	175	22
12. U.S. net purchases (-) of foreign securities	-3,527	-4,756	-2,137	-1,159	-765	-1,325	-781	297	-447
13. <u>Foreign net purchases of U.S. Treasury obligations ^{2/}</u>	2,269	3,713	1,465	-198	3,278	-1,225	-970	-711	30
14. <u>Change in foreign official reserve assets in U.S. (inc. by area)</u>	31,238	-13,123	5,606	-472	-7,397	7,100	5,708	3,886	528
By Area									
G-10 countries and Switzerland	29,726	-21,151	4,806	-7,232	-10,689	1,271	2,968	2,548	-928
OPEC	-1,170	6,523	1,595	6,023	3,262	4,264	3,157	466	1,270
All other countries	2,682	1,505	-795	737	31	1,565	-417	872	186
By Type									
U.S. Treasury securities ^{3/}	23,851	-21,557	5,031	-5,769	-5,356	4,314	4,662	2,837	-216
Other ^{4/}	-7,387	8,434	575	5,297	-2,041	2,786	1,046	1,049	744
20. <u>Change in U.S. reserve assets (increase -)</u>	662	-306	2,711	-399	-2,535 ^{5/}	-452	-26	98	846
21. <u>All other transactions and statistical discrepancy</u>	15,902	27,863	-1,420	16,268	6,944	26,033	8,148	-1,296	590
MEMO:									
Current Account (bil. \$ seasonally adj. annual rates)	-14.3	-.8	-6.0	4.4	-7.2	-10.3	n.a.	n.a.	n.a.

^{1/} International accounts basis, seasonally adjusted.^{2/} Includes U.S. Treasury notes publicly issued to private foreign residents.^{3/} Includes non-marketable and marketable securities.^{4/} Includes deposits in banks, commercial paper, bankers' acceptances, and borrowing under repurchases agreements.^{5/} Includes newly allocated SDR's of \$1,150 million in January 1980.

Foreign Economic Developments. Reflecting in part a weakening of economic activity, inflation has continued to moderate in most major foreign countries. The rate of increase of the CPI has declined significantly in Germany, Japan, and the United Kingdom in the most recent 3-month period for which data are available. Consumer price inflation also has moderated somewhat in France, and wholesale price inflation decelerated in the summer in both France and Italy. In Canada and most of the smaller economies, there have been no signs of any deceleration in the rate of consumer price inflation, with several of these countries experiencing small increases in inflation during the last few months.

Economic activity in the six major foreign economies remains weak. Real GNP fell in the second quarter in each of these countries except Japan, while industrial production has been either flat or declining in all of these countries through most of the summer. Among the small economies, Norway is the main example of robust economic activity, though most of this strength is confined to the oil-producing sector.

Despite the continued weakness of foreign economic activity, policies have not eased much, with the possible exception of Japan. Japanese authorities appear to have eased monetary policy somewhat and are reported to be considering further monetary and fiscal stimulus.

Large current-account deficits continue to be recorded by the non-oil industrialized nations. The trade-account position in recent months has improved somewhat in Japan and worsened in Italy and Germany.

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

		1977	1978	1979	1979				1980		1980				
					Q1	Q2	Q3	Q4	Q1	Q2	Apr.	May	June	July	Aug.
Canada:	GNP	2.4	3.4	2.6	0.8	-0.2	1.1	0.5	-0.6	-1.1	*	*	*	*	*
	IP	4.0	5.3	2.1	-1.7	-0.1	1.8	-0.5	-0.6	-2.4	-2.1	-2.0	-0.5	0.1	n.a.
France:	GDP	2.9	3.7	3.4	0.0	0.4	2.5	0.4	0.4	-0.3	*	*	*	*	*
	IP	2.0	1.9	4.5	0.5	1.0	4.0	-2.4	0.5	-1.2	0.7	-2.2	-0.8	n.a.	n.a.
Germany:	GNP	2.8	3.6	4.5	0.7	2.2	0.8	0.5	2.1	-1.9	*	*	*	*	*
	IP	2.6	2.3	5.2	-0.3	3.4	1.6	0.3	1.6	-2.6	-0.8	-2.4	-0.8	1.6	-0.8
Italy:	GDP	1.9	2.6	5.0	1.2	-0.6	1.2	3.9	1.9	-0.8	*	*	*	*	*
	IP	1.1	1.9	6.4	1.1	-2.6	1.4	8.5	4.1	-3.0	0.7	-8.0	2.8	-1.1	-8.5
Japan:	GNP	5.4	6.0	5.9	1.5	1.7	1.7	1.1	1.8	0.6	*	*	*	*	*
	IP	4.2	6.2	8.3	2.0	2.2	2.0	2.6	4.1	0.2	1.8	-1.2	-0.9	0.5	-3.8
United Kingdom:	GDP	2.0	3.1	1.4	-1.1	3.0	-1.9	1.1	-0.8	-1.5	*	*	*	*	*
	IP	3.7	3.6	2.7	0.4	4.0	-1.9	-0.1	-1.8	-3.5	-2.3	-0.4	0.9	-1.7	-2.4
United States:	GNP	5.3	4.4	2.3	0.3	-0.6	0.8	0.5	0.3	-2.5	*	*	*	*	*
	IP	5.9	5.8	4.4	1.3	-0.3	0.2	-0.1	0.0	-5.2	-2.5	-2.9	-1.8	-1.1	0.5

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* GNP data are not published on monthly basis.

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

												MEMO:
	1979			1980			1980					Latest 3 Months from Year Ago
	Q2	Q3	Q4	Q1	Q2	Q3	May	June	July	Aug.	Sept.	
Canada: CPI	2.6	2.0	2.3	2.2	2.8	n.a.	1.2	1.1	0.8	0.9	n.a.	10.3
WPI	3.1	2.7	3.6	4.9	1.4	n.a.	0.9	0.4	0.7	n.a.	n.a.	13.0
France: CPI	2.8	3.2	2.8	3.8	3.1	n.a.	0.9	0.6	1.5	1.0	n.a.	13.6
WPI	3.8	2.8	1.9	3.0	0.7	n.a.	0.0	-0.2	0.1	0.1	n.a.	6.7
Germany: CPI	1.4	1.2	0.9	1.9	1.8	0.7	0.5	0.5	0.2	0.1	-0.1	5.3
WPI	3.3	1.7	1.1	3.8	1.7	n.a.	0.8	0.2	0.4	-1.0	n.a.	7.5
Italy: CPI	3.7	3.5	5.6	6.5	3.9	4.1	1.0	0.9	1.8	1.0	2.1	21.7
WPI	4.6	4.3	5.6	6.6	3.6	n.a.	0.8	1.1	0.3	0.9	n.a.	20.3
Japan: CPI	2.2	0.9	1.9	2.0	3.0	1.1	0.7	0.1	0.4	-0.2	1.7	8.2
WPI	4.1	4.9	4.3	6.4	4.8	0.7	-0.2	-0.1	0.4	0.7	-0.3	17.1
United Kingdom: CPI	3.7	6.7	2.8	4.7	5.8	n.a.	0.9	0.9	0.8	0.2	n.a.	18.0
WPI	4.0	5.0	3.0	5.3	4.0	2.3	1.1	1.1	0.9	0.3	0.4	15.5
United States: CPI(SA)	3.1	3.2	3.2	4.0	3.3	n.a.	0.9	1.0	0.0	0.7	n.a.	13.4
WPI(SA)	2.3	3.0	3.6	4.1	2.4	3.2	0.3	0.5	1.7	1.5	-0.2	13.8

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

	1978	1979	1978	1979				1980		1980		
			Q4	Q1	Q2	Q3	Q4	Q1	Q2	June	July	August
Canada: Trade	3.1	3.4	0.7	0.6	0.6	0.9	1.3	1.5	1.2	0.8	0.3	0.9
Current Account	-4.6	-4.2	-1.5	-1.2	-1.3	-0.9	-0.8	-0.6	-1.1	*	*	*
France: Trade ^b	0.7	-2.4	0.1	0.3	-0.4	-1.4	-1.3	-3.5	-3.6	-1.4	-1.6	-1.0
Current Account ^b	3.8	1.2	1.3	0.5	0.4	0.1	-0.3	-2.5	-1.9	*	*	*
Germany: Trade	20.6	12.1	5.8	4.4	4.0	2.4	1.4	1.9	1.3	0.5	0.1	-0.1
Current Account (NSA)	8.9	-5.8	4.8	1.6	-1.6	-4.7	-1.0	-3.2	-3.6	-1.8	-3.0	-2.2
Italy: Trade	-0.5	-5.3	0.1	-0.1	-0.4	-1.5	-3.3	-4.1	-4.2	-1.8	-3.2	-3.1
Current Account (NSA)	6.2	5.1	1.5	1.3	2.3	3.0	-1.5	-2.5	*	*	*	*
Japan: Trade	24.6	2.0	4.2	2.5	1.9	-1.0	-1.4	-1.9	-0.9	-0.3	-0.4	0.7
Current Account	16.5	-8.7	1.7	0.1	-0.7	-3.9	-4.2	-5.2	-4.1	-1.3	-1.6	-0.4
United Kingdom: Trade	-2.9	-6.9	-0.4	-3.2	-1.0	-1.1	-1.7	-1.4	-0.7	0.0	0.6	0.1
Current Account	1.5	-4.7	-0.9	-2.4	-0.7	-0.2	-1.4	-0.4	-0.2	0.2	0.8	0.3
United States: Trade	-33.8	-29.5	-6.8	-5.1	-8.1	-7.1	-9.2	-10.9	-7.6	-2.2	-0.4	-0.9
Current Account	-14.3	-0.8	-0.8	1.4	-1.5	1.1	-1.8	-2.6	-2.5	*	*	*

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

b French annual data are not seasonally adjusted.

* Comparable monthly current account data are not published.

Individual Country Notes. Consumer prices in Germany declined slightly in September, after small monthly rates of increase in July and August. In the first half of this year the average monthly increase was 0.6 percent. While some of this marked slowdown of inflation in the third quarter is due to seasonal factors, the seasonally-adjusted CPI has also advanced at a slower rate. The pattern of easing inflation is also evident in the movement of wholesale prices, which fell by 1.0 percent in August, and producer prices, which remained unchanged during the same month. The price index of German imports has been declining since April, suggesting that the terms of trade, which were an important factor in the previous acceleration in inflation, are now contributing to its slowing.

After a sharp drop in economic activity in the second quarter, activity appears to have remained nearly level. The rate of unemployment has continued its gradual rise through September, when it reached 4.0 percent (s.a.). The volume of manufacturing orders was flat through July following its very sharp drop early in the year; it fell a further 2 percent (s.a.) in August. Among the most strongly affected industries are construction and automobiles. Recent survey information indicates a continuation of subdued attitudes toward the present business climate with just a hint of improving expectations for the coming six months' period.

Germany's current account continues to move toward a record deficit this year. In August, the trade account was in deficit for the first time in fifteen years. The current account through August showed

a deficit of \$12.0 billion compared with a deficit of \$3.5 billion in the same period of last year and \$5.8 billion for the whole year.

Between March and August, Central Bank Money expanded at an annual rate of 1.7 percent; by August, CBM had increased 4-1/2 percent (s.a.ar.) from the base of the Bundesbank's target in 1979-Q4 and is therefore below the 5 to 8 percent target range. The Bundesbank's announced intention to relax cautiously its policy has been implemented by increased swaps and repurchase facilities and a reduction from 9-1/2 to 9 percent of the Lombard rate as of September 19.

In the national elections that were held on October 5, the government coalition of Chancellor Schmidt's Social Democrats and the Free Democrats was returned to office by a substantial margin. The opposition Christian Democrats' share declined to 43 percent of the vote, resulting in a loss of 17 seats in parliament, mostly to the Free Democrats. The cabinet will remain essentially unchanged.

In Japan, after substantial trade deficits earlier in the year, indications of an improving trend in the external trade account have become evident in recent months. In August, the trade balance (s.a.) recorded a surplus of over \$700 million, the largest such surplus in over a year, reducing the cumulative 8-month deficit to slightly below \$2-1/2 billion, compared with a \$4-1/2 billion trade surplus during the same period last year. The slower pace of activity in Japan, less rapid increases in foreign currency prices of imported materials (including oil), and the short-run price effects of the recent appreciation of the yen have all contributed to the turnaround. The prospects for trade

surpluses in the coming months remain clouded, however, in view of recent government steps to stimulate demand, the longer-run effects of the yen's recent strength, and increased foreign pressures for export restraint.

Latest data on both activity and price developments in Japan confirm the trends cited by Japanese authorities in their recent shift toward more expansionary demand management. The industrial production index (s.a.) fell almost 4 percent in August to its lowest level since late 1979; shipments fell by a similar amount. Although other indicators of labor-market conditions remained relatively stable, unemployment increased noticeably in July. According to survey reports, the prospects for corporate profits over the coming months are not favorable; significant declines from high levels achieved earlier this year are expected. Although the Tokyo CPI registered a sharp upward movement in the mid-September survey, much of that increase is attributed to seasonal factors. On the whole, inflation in both wholesale and consumer prices has continued the moderating trend reported previously -- due in large part to the recent increase in the value of the yen. The yen's recent strength is attributable in large part to heavy capital inflows, particularly, extensive purchases by non-residents of Japanese stocks.

In recent weeks the government's policy stance appears to have shifted even more toward an emphasis on recovery of demand. Following the mid-August cut in the discount rate, the newly announced changes in credit limits for large city banks in the fourth quarter have been widely perceived as reflecting an easing of credit policy. However, the rate of

growth of outstanding loans is expected to continue at about the same 6 percent rate observed throughout this year. The authorities are also reported to be considering a supplementary budget of moderate size (about ¥ 500 billion, or about \$2-1/2 billion) for later in the year, and speculation regarding an additional discount rate cut in the near future is widespread.

In the United Kingdom, real GDP fell 6.1 percent (s.a.a.r.) in the second quarter of 1980, marking the second consecutive quarter in which there has been a decline in real GDP. The intensity of the British recession is also reflected in data on industrial production -- between December 1979 and August 1980, industrial production has fallen 8.1 percent (s.a.); and the decline in manufacturing production has been even sharper -- some 10.2 percent. The U.K. unemployment rate, which stood at 5.5 percent (s.a.) at the beginning of the year, was 7.4 percent (1.8 million people) in September. Particularly large increases (0.4 percentage points) in the rate were recorded in both August and September. The downturn in British economic activity may be having an effect on inflation. The monthly increases in the retail price index since April have been less than 1 percent, and in August the rate of increase in retail prices was only 0.2 percent. (Excluding seasonal foods, the August increase was 0.4 percent). Wholesale prices show a similar deceleration. The U.K.'s trade and current accounts were strong in August, with the trade account showing another surplus, albeit a smaller one than that registered in July.

The U.K.'s monetary target is 7-11 percent growth in sterling M-3 (s.a.a.r.) between February 1980 and April 1981. Recent data call into question the authorities' ability to achieve this target: between February and August 1980, sterling M-3 increased some 25 percent (s.a.a.r.), with most of the increase having been registered in July and August. The reason for the bulge in sterling M-3 is the removal of the supplementary-special deposits scheme (the "corset"), which had placed quantitative limits on the growth of banks' interest-bearing liabilities. Removal of the corset led to a shift of funds into interest-bearing bank deposits, which, in turn, caused a jump in sterling M-3. Data on M-1, which is not as subject to corset-induced distortions, indicate that it has been growing relatively slowly in recent months -- 7.5 percent (s.a.a.r.) between February and August 1980. The U.K. government will be reassessing its monetary target this fall and will decide then whether to change the target base or aim at essentially no monetary growth for the remainder of the target period.

Recent data confirm the weakening of Italian economic activity that began earlier this year. GDP fell by 3.2 percent (s.a.a.r.) in the second quarter after having risen at nearly an 8 percent rate in the previous quarter. Industrial production fell in July and August by over 14 percent (not annual rate), about 6 percent below its second quarter average. The sharpness of the drop, most of which took place in August, may reflect a faulty seasonal adjustment. The continuing stagnation of exports and a weakening of domestic demand account for part of the drop in activity.

Consumer price inflation has slowed since the beginning of this year; in the six months ending in September the CPI rose about 8-1/2 percent, compared with an 11-1/2 percent increase in the previous 6-month period. Inflation slowed markedly in the summer, due in part to seasonal influences; however, it surged in September, again because of seasonal factors, as well as increases in administered prices.

In July and August the trade deficit averaged over \$3 billion (s.a., imports c.i.f.), and the deficit for January-July was over \$14 billion. Imports appeared to have surged in the latest 3 months, perhaps in anticipation of a devaluation. Also, the balance of payments in August recorded a \$320 million deficit; in the previous two years Italy averaged a surplus of \$1.4 billion in the normally strong month of August. In addition to the trade performance, a poor tourist season and capital outflows -- the latter also a reflection of expectations of a devaluation -- figured in the August outcome.

The Italian government fell unexpectedly on September 27, and the decree laws, which embodied the government's economic stabilization package, have lapsed. As a result, the administered-price and VAT increases, as well as the increase in the fiscalization of social insurance charges, are no longer in effect.

In France, real GDP declined by 1.2 percent (s.a.a.r.) in the second quarter after advancing at a 1.5 percent rate in the first quarter. Opinion surveys and retail sales data suggest that activity in the third quarter was roughly stagnant. Recent surveys indicate that very weak growth is expected in the final quarter as well. In the second quarter

household spending cutbacks accounted for the weakness, while private business investment and government spending were sources of strength.

In August the trade deficit fell to \$1 billion (s.a.) from \$1.6 billion the previous month; the main source of the improvement was a decline in non-energy imports. The cumulative trade deficit for the first eight months of this year was nearly \$10 billion compared with close to \$1 billion in the corresponding period in 1979.

After rising at an annual rate of more than 13 percent between December and March, wholesale prices showed almost no change between March and August. Retail prices showed less of an improvement; after rising at an annual rate of 18 percent during the first quarter, retail prices increased at a rate of about 13 percent between April and August.

In a draft budget, the French authorities introduced a 10 percent investment tax credit applying on all investment for a period of five years. In view of the 50 percent corporate tax rate in France and the length of the period of the tax credit's application, this should provide a considerable stimulus to investment; the revenue effects will not be felt until 1982.

French authorities recently have indicated that they will probably overshoot the 11 percent M_2 growth target (Dec./Dec.) by one percent. During the 12-month period ending in August, M_2 rose by 11.2 percent. The growth target for 1981 will be reduced to 10 percent.

There is some evidence in Canada that the sharp declines in real economic activity, which were experienced throughout the first half of 1980, may have begun to moderate. Industrial production in July remained virtually unchanged for the third consecutive month and retail sales

in July (s.a.) rose 3.5 percent after rising 0.6 percent in June. The CPI advanced at an annual rate of 10.3 percent from June to August, as compared with 9.3 percent for the preceding three-month period.

The Canadian trade surplus rose to a record \$863 million in August of this year from \$39 million in July. The rise in the trade surplus was primarily due to the weakness of domestic demand. The large decline in import volume may also be due to a slowing of energy-related investment.

Interest rates in Canada have followed U.S. rates upward with a slight lag. The Bank rate, which stood at 11 percent on September 26, rose to 11.8 percent on October 9.

Deputy Prime Minister and Finance Minister MacEachen has announced that the long-awaited FY1980 budget will be presented to the Parliament in the middle of October. The budget is expected to include an increase in the tax on natural gas exports and a reduction in transfer payments from central to provincial governments. It is unclear when the Parliament will be able to take action on the budget.