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Confidential (FR) Class III FOMC

October 30, 1985

RECENT DEVELOPMENTS

Prepared for the Federal Open Market Committee

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

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DOMESTIC FINANCIAL DEVELOPMENTS--continued

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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 rates)		
Civilian labor force	Sept.	10-04-85	115.8	5.4	3.6	1.8
Unemployment rate (%)[1]	Sept.	10-04-85	7.1	7.0	7.3	7.4
Insured unemployment rate (%)[1]	July	10-03-85	2.8	2.8	2.6	2.7
Nonfarm employment, payroll (mil.)	Sept.	10-04-85	98.1	1.6	2.6	3.0
Manufacturing	Sept.	10-04-85	19.3	-6.9	-2.7	-1.1
Nonmanufacturing	Sept.	10-04-85	78.8	3.6	4.0	4.1
Private nonfarm:						
Average weekly hours (hr.)[1]	Sept.	10-04-85	35.2	35.1	35.1	35.3
Hourly earnings ($)[1]	Sept.	10-04-85	8.64	8.59	8.59	8.40
Manufacturing:						
Average weekly hours (hr.)[1]	Sept.	10-04-85	40.7	40.6	40.4	40.6
Unit labor cost (1967=100)	Aug.	09-30-85	84.2	-2.8	-4.7	-5.0
Industrial production (1977=100)	Sept.	10-16-85	124.7	-1.0	1.3	1.1
Consumer goods	Sept.	10-16-85	120.6	-3.0	.7	1.9
Business equipment	Sept.	10-16-85	142.2	-3.4	4.3	2.2
Defense & space equipment	Sept.	10-16-85	176.9	11.6	8.1	8.3
Materials	Sept.	10.16-85	114.2	.0	-.3	-1.5
Consumer prices all items (1967=100)	Sept.	10-23-85	323.6	2.2	2.2	3.2
All items, excluding food & energy	Sept.	10-23-85	316.4	2.7	3.4	3.9
Food	Sept.	10-23-85	309.9	3.9	1.8	1.8
Producer prices: (1967=100)						
Finished goods	Sept.	10-11-85	291.8	-7.0	-2.3	.2
Intermediate materials, nonfood	Sept.	10-11-85	324.2	.7	-1.2	-.4
Crude foodstuffs & feedstuffs	Sept.	10-11-85	217.0	-8.8	-22.3	-14.7
Personal income ($ bil.)[2]	Sept.	10-17-85	3,209.4	3.8	4.2	4.6
				(Not at annual rates)		
Mfgrs. new orders dur. goods ($ bil.)	Sept.	10-23-85	106.1	-1.1	-.6	8.0
Capital goods industries	Sept.	10-23-85	36.9	-1.6	-6.0	6.3
Nondefense	Sept.	10-23-85	28.9	4.7	3.1	5.3
Defense	Sept.	10-23-85	8.0	-19.3	-28.6	9.9
Inventories to sales ratio:[1]						
Manufacturing and trade, total	Aug.	10-23-85	1.34	1.37	1.35	1.36
Manufacturing	Aug.	10-23-85	1.45	1.47	1.46	1.48
Trade	Aug.	10-15-85	1.26	1.29	1.25	1.26
Ratio: Mfgrs.' durable goods inventories to unfilled orders[1]	Aug.	10-23-85	.544	.547	.555	.534
Retail sales, total ($ bil.)	Sept.	10-11-85	120.2	2.7	5.7	10.9
GAF[3]	Sept.	10-11-85	25.2	-.6	1.9	4.5
Auto sales, total (mil. units.)[2]	Sept.	10-03-85	14.2	14.7	35.3	39.2
Domestic models	Sept.	10-03-85	11.2	17.4	45.9	43.0
Foreign models	Sept.	10-03-85	3.0	5.6	6.3	26.7
Housing starts, private (thous.)[2]	Sept.	10-17-85	1,583	-9.3	-6.9	-5.2
Leading indicators (1967=100)	Aug.	09-30-85	170.1	.7	1.6	3.5

1. Actual data used in lieu of percent changes for earlier periods.
2. At annual rates.
3. Excludes mail order houses.

Economic activity expanded at a moderate rate, during the third quarter, with real GNP estimated to have increased at a 3.3 percent annual rate. A spurt in auto sales and a bulge in government purchases contributed importantly to a sharp rise in final demand. But these gains were partly offset by a drawdown in auto inventories and weakness in business spending. Housing starts also were down, although sales figures suggest that demand for housing has responded somewhat to lower mortgage rates. Wage increases remained moderate, and price inflation slowed last quarter.

Industrial Production and Capacity Utilization

Industrial production edged down 0.1 percent in September, and has advanced at an annual rate of only 1.5 percent during the first nine months of this year. In September, gains were reported for defense and space equipment and construction supplies. However, these advances were offset by declines in other major components of the index, including consumer durable goods and durable materials.

In September, the production of motor vehicles and parts fell sharply, but this followed strong gains in July and August. As a result, for the third quarter as a whole, motor vehicle output was responsible for about two-thirds of the 1 percent annual growth in the total index. In addition to a slight rise in auto assemblies in the third quarter, truck production was at a 3-3/4 million unit rate, up from the 3-1/4 million unit pace in the second quarter.

Domestic automakers are currently planning to produce at a 7.8 million unit annual rate in the fourth quarter, down from earlier estimates and

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

	1985			1985		
	Q1	Q2	Q3	July	Aug.	Sept.
	----Annual rate----			---Monthly rate---		
Total	2.3	1.3	1.1	-.2	.6	-.1
Products, total	1.2	4.3	2.8	-.1	.8	-.1
Final products	.3	3.1	2.6	.0	.8	-.1
Consumer goods	.0	2.4	1.8	-.3	.7	-.3
Durable	1.4	-4.5	2.3	-.8	2.3	-1.2
Nondurable	.0	4.9	1.6	-.1	.2	.0
Equipment	1.1	3.9	3.5	.4	.9	.0
Business	3.2	3.8	1.3	.3	1.0	-.2
Defense and space	7.8	10.9	8.8	.1	.9	1.0
Intermediate products	2.5	8.4	3.4	-.4	.7	.0
Construction supplies	4.6	6.9	8.7	.3	1.3	.2
Materials	3.2	-3.2	-1.4	-.4	.3	.0
Durable goods	-.3	-7.0	-2.9	-.6	.8	-.6
Nondurable goods	.0	1.1	6.8	.9	.0	.5
Energy materials	15.4	.9	-5.5	-1.1	-.7	.8

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

	1982	1985			1985		
	Low	Q1	Q2	Q3	July	Aug.	Sept.
Total industry	69.5	81.0	80.7	80.3	80.2	80.5	80.2
Manufacturing, total	68.0	80.5	80.3	80.1	80.0	80.3	80.0
Advanced processing	69.5	80.0	79.6	79.0	79.1	79.2	78.7
Motor vehicles	47.0	84.9	82.7	84.8	83.6	86.2	84.7
Primary processing	65.1	81.6	81.9	82.6	82.2	82.8	82.8
Materials, total	68.4	81.5	80.4	79.6	79.6	79.6	79.5
Durable goods materials	60.9	79.3	77.1	75.8	75.8	76.2	75.5
Metal materials	45.7	68.7	68.4	67.1	66.4	67.7	67.2
Nondurable goods materials	70.6	80.7	80.7	81.7	81.7	81.6	81.9
Energy materials	82.2	87.5	87.5	86.0	86.2	85.6	86.2

slightly below the third-quarter rate. As a result of the strike against Chrysler, October auto production will fall short of earlier expectations, but Chrysler plans to make up for this shortfall in November.

While output of total products advanced at a 3 percent pace during the past year, materials production has sagged, and in September was 1.5 percent below the level of a year earlier. Durable goods materials have been particularly weak, owing largely to a sharp cutback in the production of semiconductors. The output of energy materials also has shown no growth as a result of declines in the oil and gas extraction and coal mining industries. Competition from abroad has contributed substantially to the depressed production levels in many of the domestic materials industries, although technological changes (such as the design of lighter-weight products) also have been a factor.

The industrial capacity utilization rate declined 0.3 percentage point in September, reversing the August increase. During the past year, capacity utilization has slipped 1.5 percentage points; utilization in the materials industries has dropped by 3.2 percentage points with durable goods materials leading the way, declining by 5.3 percentage points.

Employment and Unemployment

Employment expanded at a moderate pace in the third quarter, but job growth continued to be unbalanced across industries. In September, total payroll employment rose 128,000, about one-half as much as the gains posted in July and August. Employment continued to expand throughout most of the private service sector in September, and hiring remained fairly brisk at construction sites. However, manufacturing employment fell 110,000, bringing the cumulative job loss since January to about 340,000. Manufacturing

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

			1985			1985		
	1983	1984	Q1	Q2	Q3	July	Aug.	Sept.
			-Average monthly changes-					
Nonfarm payroll employment[2]	293	327	273	188	214	234	280	128
Strike adjusted	293	329	267	182	220	225	313	123
Manufacturing	79	52	-26	-43	-44	-47	26	-111
Durable	61	45	-17	-30	-38	-51	24	-87
Nondurable	18	7	-9	-12	-6	4	2	-24
Construction	25	29	28	28	29	22	25	40
Trade	85	106	91	77	52	33	76	47
Finance and services	103	106	150	94	125	96	170	109
Total government	4	17	20	23	48	128	6	10
Private nonfarm production workers	260	253	182	130	144	103	244	85
Manufacturing production workers	73	33	-33	-47	-26	-32	23	-69
Total employment[3]	331	270	282	-250	391	492	310	372
Nonagricultural	338	266	290	-175	445	505	343	488

1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments. Strike-adjusted data noted.
3. Survey of households.

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

			1985			1985		
	1983	1984	Q1	Q2	Q3	July	Aug.	Sept.
Civilian, 16 years and older	9.6	7.5	7.3	7.3	7.2	7.3	7.0	7.1
Teenagers	22.4	18.9	18.5	18.3	18.2	19.5	17.3	17.8
20-24 years old	14.5	11.4	11.1	11.3	11.0	11.2	10.7	11.0
Men, 25 years and older	7.8	5.7	5.4	5.4	5.3	5.4	5.2	5.3
Women, 25 years and older	7.2	6.0	6.0	6.1	6.0	5.9	5.9	6.0
White	8.4	6.5	6.3	6.3	6.2	6.4	6.2	6.1
Black	19.5	15.9	15.5	15.0	14.8	15.0	14.0	15.3
Fulltime workers	9.5	7.2	7.0	6.8	6.8	7.0	6.7	6.8
Memo:								
Total national[1]	9.5	7.4	7.2	7.2	7.1	7.2	6.9	7.0

1. Includes resident Armed Forces as employed.

job losses in September were concentrated in the durable goods industries, particularly machinery and electrical equipment, which have accounted for almost half of this year's reduction in factory employment. Job declines in September also were reported in motor vehicles, but these partially represented workers out on strike; in addition, there appeared to be difficulties in seasonally adjusting auto employment data during the model changeover period. Small declines were reported in most other manufacturing industries. Despite the drop in manufacturing employment, the factory workweek edged up further to 40.7 hours, its highest level in more than a year.

In the household survey, recent job gains have been larger than those reported in the payroll survey, reversing the pattern evident during the first half of the year. In September, household employment was up 370,000 but was accompanied by an even larger increase in the labor force. As a result, the civilian unemployment rate edged back up to 7.1 percent in September after a drop of 0.3 percentage point in August.

Personal Income and Consumer Expenditures

Income growth this year has fallen well below its 1984 pace. Wage and salary disbursements in the service sector have held up well, but manufacturing payrolls have been on a plateau, and there have been sizable declines in farm and interest income. So far this year, real disposable income has risen at an annual rate of only 0.7 percent.

In September, nominal personal income advanced just 0.3 percent with the rise in private wages and salaries accounting for all of the increase. The September income data showed a further decline in interest income, a loss in farm income, and a drop in rental income that was associated with hurricane damage to residential properties.

PERSONAL INCOME AND EXPENDITURES
(Based on seasonally adjusted data)

	1984	1985 Q1	1985 Q2	1985 Q3	1985 July	1985 Aug.	1985 Sept.
- - Percentage changes at annual rates[1] - -							
Total Personal Income							
Nominal	9.2	6.3	4.0	3.1	5.0	4.0	3.8
Real[2]	5.8	3.0	1.0	.8	3.3	2.9	2.6
Disposable Personal Income							
Nominal	8.9	1.6	11.2	-2.0	5.0	2.5	1.9
Real	5.6	-1.6	8.2	-4.2	3.5	1.3	1.3
Expenditures							
Nominal	7.5	8.6	7.8	7.2	3.1	14.0	14.4
Real	4.2	5.2	4.8	4.8	1.6	12.7	13.9
- - Changes in billions of dollars[3] - -							
Total personal income	21.0	14.8	6.5	11.2	13.1	10.5	10.1
Wages and salaries	11.4	9.9	8.7	9.4	2.3	10.8	15.0
Private	9.6	7.0	7.0	7.4	0.3	8.8	13.2
Manufacturing	2.6	.7	.0	.8	-0.1	2.1	.4
Other income	10.6	8.5	-1.5	2.7	10.9	.6	-3.3
Disposable personal income	17.2	-5.8	19.7	7.1	11.3	5.6	4.3
Expenditures	14.1	11.9	16.4	22.1	6.5	29.2	30.5
Durables	2.4	-.6	-.3	12.9	3.0	20.5	15.1
Motor vehicles and parts	.7	-.4	-.5	11.9	4.2	17.1	14.4
Furn. and household equip.	1.1	-.3	.4	.3	-1.0	1.4	.5
Other durables	.6	.1	-.2	.7	-.2	2.0	.3
Nondurables	4.3	1.6	4.4	3.6	1.7	1.5	7.5
Clothing and shoes	1.1	.6	-.1	-.1	-2.3	1.9	.0
Gasoline and oil	-.2	.9	.4	.6	.2	1.1	1.5
Services	7.5	10.8	12.3	5.6	1.8	7.2	7.8
Personal saving rate (percent)	6.1	4.5	5.1	2.9	3.8	2.9	1.9

1. Annual changes 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. Total personal income is deflated by the personal consumption expenditure deflator.
3. Average monthly changes are from the final month of the preceding period to the final month of period indicated; monthly figures are changes from the preceding month.

Despite the slow growth of real income this year, consumer spending remained brisk in the third quarter, primarily because of the surge in auto purchases. Sales of domestically-produced cars were at a 11-1/4 million unit annual rate in September and sales of imported cars rose to 3 million units. However, in the first 20 days of October, the expected "payback" in auto sales from the earlier response to interest and price discounts was evident: sales of domestic units dropped to a 6.2 million unit annual rate.

Outlays for discretionary purchases other than cars generally have been lackluster in recent months. Spending for furniture and appliances, clothing, and "other durables" (including jewelry, recreational equipment and other luxury items) was nearly unchanged during the third quarter. This weakness in expenditures is consistent with the slowing that has occurred in income growth. However, with overall spending boosted by the transitory spurt in auto sales, the saving rate dropped further--to around 3 percent in the third quarter.

The consumer surveys of the Michigan Survey Research Center and the Conference Board both reported slight declines in their composite measures of confidence because of a little more pessimism about the future; however, favorable responses to questions about purchase plans for automobiles, appliances, and homes moved higher last month to near-record levels. Households responding to the survey continued to explain their buoyant buying plans by citing price discounts and the availability of lower interest rates--attitudes that may have been affected by the auto sales incentives in place at the time.

RETAIL SALES
(Seasonally adjusted percentage change)

	1985 Q1	1985 Q2	1985 Q3	1985 July	1985 Aug.	1985 Sept.
Total sales	1.6	2.7	2.2	.6	2.3	2.7
(REAL)[1]	1.1	2.3	--	.6	2.4	--
Total less automotive group, nonconsumer stores, and gasoline stations	1.1	1.3	.9	.6	1.1	.6
GAF[2]	1.1	1.5	.3	.0	2.5	-.6
Durable	2.5	4.3	4.6	.7	4.6	6.2
Automotive group	4.4	5.6	7.0	.2	6.6	9.6
Furniture and appliance	1.1	2.0	.0	-.2	.6	1.4
Nondurable	1.1	1.7	.9	.6	1.0	.6
Apparel	1.1	3.3	.3	-.9	2.1	.6
Food	1.3	1.4	1.1	.6	-.3	2.5
General merchandise[3]	1.0	.6	.5	.5	3.5	-1.9
Gasoline stations	-.6	5.1	-.4	.0	.8	.4

1. BCD series 59. Data are available approximately 3 weeks following the retail sales release.
2. General merchandise, apparel, furniture and appliance stores.
3. General merchandise excludes mail order nonstores; mail order sales are also excluded in the GAF grouping.

AUTO SALES, PRODUCTION, AND INVENTORIES
(Millions of units; FRB seasonally adjusted annual rates)

	1985 Q1	1985 Q2	1985 Q3	1985 June	1985 July	1985 Aug.	1985 Sept.	1985 Oct.
Total auto sales[1]	10.9	10.9	12.3	10.5	10.4	12.4	14.2	
Imports	2.4	2.7	2.9	2.8	2.9	2.8	3.0	
Domestic	8.5	8.3	9.4	7.7	7.5	9.5	11.2	6.2[2]
Domestic production	8.4	8.0	8.2	8.0	8.3	8.3	8.1	
Domestic inventories	1.49	1.51	1.31	1.51	1.60	1.55	1.31	
Days' supply[3]	55	56	51	60	66	50	36	

1. Components may not add to totals due to rounding.
2. First 20 days.
3. Days' supply for the quarter are based on end-of-quarter stocks and average sales for the quarter.

Business Fixed Investment

Business fixed investment slumped in the third quarter. Although quarterly growth rates have been erratic this year, on average, business investment spending rose at only a 2-1/2 percent annual rate, compared to the 16 percent gain posted in 1984.

Shipments of nondefense capital goods fell 4-1/2 percent in September, and were flat for the third quarter as a whole. Excluding aircraft and parts--much of which reflects exports and intermediate inputs rather than domestic outlays for producers' durable equipment--third-quarter shipments declined 1-3/4 percent. All other things equal, the September decline in shipments would lead the Commerce Department to revise down its preliminary estimate of a 3-1/2 percent (annual rate) drop in real third-quarter equipment spending. In contrast to the weakness in shipments, business spending for motor vehicles advanced sharply in the third quarter and, on balance, have accounted virtually for all of the growth in equipment spending this year.

Outlays for nonresidential structures also have softened in recent months after sizable gains in the first half of the year. Although the value of nonresidential construction put in place was up 1 percent in August, this gain failed to offset the declines of the preceding three months; real outlays for nonresidential structures fell at a 7-3/4 percent annual rate in the third quarter, with declines widespread.

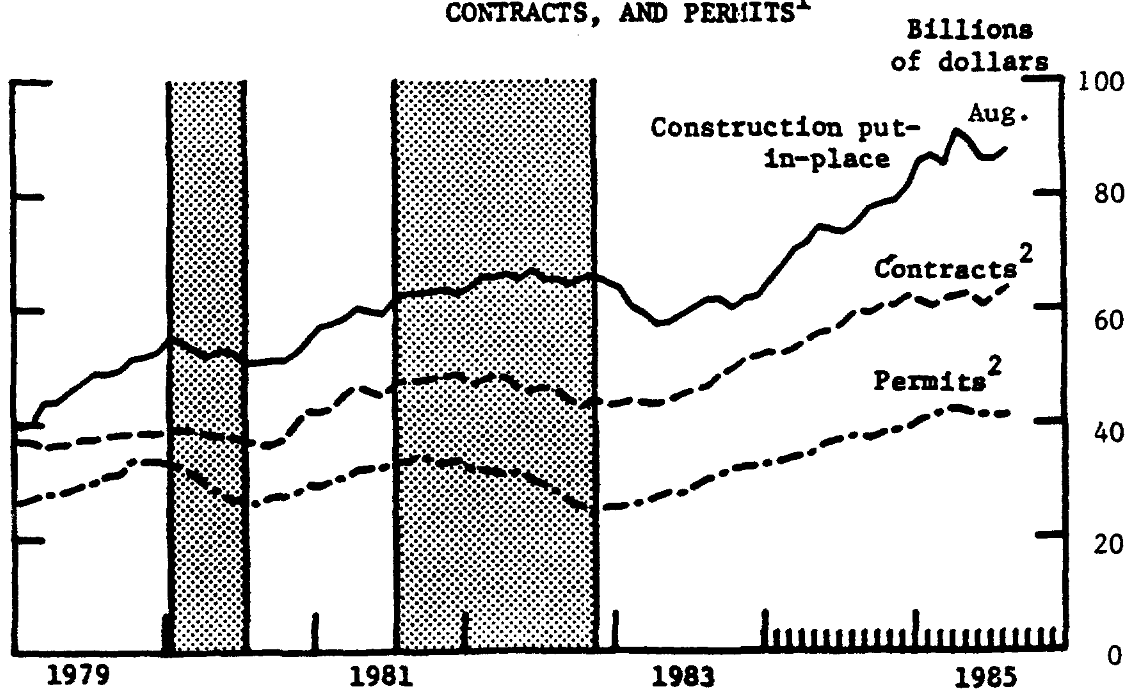
Indicators of fixed investment point to sluggish spending in the near term. New orders for nondefense capital goods, excluding aircraft and parts, rose 1-3/4 percent in the third quarter, but are little changed so far this year. While total equipment spending is likely to be

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

	1985			1985		
	Q1	Q2	Q3	July	Aug.	Sept.
Producers' durable equipment						
Nondefense capital goods						
Shipments	-3.5	2.6	.0	-1.6	2.8	-4.5
Excluding aircraft and parts	-3.9	3.2	-1.8	-3.7	2.0	-3.1
Office and store machinery	-7.0	7.0	-7.4	-10.8	-1.0	4.8
Orders	1.7	-1.6	5.1	-4.6	3.3	4.7
Excluding aircraft and parts	3.1	-4.1	1.7	-3.2	.1	.9
Office and store machinery	25.6	-20.3	4.8	-8.6	11.0	-7.1
Imports of capital goods excluding autos[1]	11.2	-2.3	--	-7.9	.7	--
Exports of capital goods excluding autos[1]	5.1	-5.5	--	-.9	-1.0	--
Sales of heavy-weight trucks (thousands of units, A.R.)	312	276	264	246	216	329
Nonresidential structures						
Nonresidential construction	8.2	3.7	--	-.6	1.0	--
Commercial building	11.1	1.6	--	-.3	2.4	--
Office	9.3	1.9	--	.1	-1.1	--
Other commercial	13.3	1.1	--	-.9	6.5	--

1. The data on imports and exports of capital goods do not reflect the recent revisions to the trade data by the Commerce Department.

NONRESIDENTIAL CONSTRUCTION, CONTRACTS, AND PERMITS[1]



1. Source: F.W. Dodge and Census.
2. Six-month moving average.

weak, spending for new computer equipment is expected to be boosted somewhat in the fourth quarter as IBM begins to deliver its new mainframe computer. For construction, the leveling off this year of new commitments suggests that future spending growth will be limited.

The fall McGraw-Hill survey of capital spending plans indicated that businesses expected to reduce their nominal outlays about 1 percent next year. Declines in planned spending were especially pronounced in electrical utilities, motor vehicles, and mining. Most other industries planned slight increases in nominal spending for next year. Given the tendency of the fall McGraw-Hill survey to underpredict spending during economic expansions, actual capital spending may turn out to be somewhat stronger than is now indicated. However, even when this error history is taken into account, the survey results point to sluggish capital outlays.

Business Inventories

Recent data suggest that, with the exception of auto dealers, businesses generally have been keeping their stocks in line with sales. Inventory investment by manufacturers and nonauto retailers has been minimal since last spring. At the manufacturing level, constant-dollar inventories declined at a $2 billion annual rate in August, returning to their level of the first quarter of this year. With August shipments up slightly from the first-quarter average, however, the inventory-sales ratio for manufacturing was somewhat below the level that has prevailed through much of this year.

Excluding automobiles, retail inventories also were little changed in August. In particular, the inventory position of department stores and apparel outlets has not changed much in the past several months. Stocks at

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

	1984	1985		1985		
	Q4	Q1	Q2	June	July[r]	Aug.[p]
Book Value Basis:						
Total	31.8	21.3	3.6	22.6	5.4	-25.0
Manufacturing	4.7	1.8	-2.0	9.3	-7.7	-4.2
Wholesale	6.4	6.6	6.5	17.6	4.3	-3.9
Retail	20.7	12.9	-.9	-4.3	8.8	-17.0
Automotive	11.7	8.7	-1.3	5.2	-10.8	-16.0
Ex. auto	9.0	4.1	.4	-9.5	19.6	-.9
Constant Dollar Basis:						
Total	11.5	15.0	3.1	8.2	5.9	-3.6
Manufacturing	-.1	2.1	.5	4.9	2.4	-2.0
Wholesale	3.5	2.8	3.5	5.7	-1.2	5.4
Retail	8.1	10.1	-1.0	-2.4	4.7	-7.1
Automotive	5.0	6.2	-.6	2.2	-4.1	-7.2
Ex. auto	3.1	3.9	-.4	-4.6	8.7	.2

INVENTORIES RELATIVE TO SALES[1]

	Cyclical Reference Points[2]		1984	1985		1985		
Book Value Basis:	81 low	82 high	Q4	Q1	Q2	June	July[r]	Aug.[p]
Total	1.39	1.53	1.37	1.38	1.37	1.39	1.37	1.34
Manufacturing	1.60	1.77	1.48	1.48	1.47	1.47	1.47	1.45
Wholesale	1.06	1.28	1.16	1.17	1.17	1.22	1.19	1.17
Retail	1.36	1.43	1.41	1.42	1.38	1.39	1.39	1.35
Automotive	1.59	1.88	1.51	1.54	1.45	1.46	1.42	1.28
Ex. auto	1.29	1.35	1.39	1.39	1.36	1.37	1.38	1.37
Constant Dollar Basis:								
Total	1.62	1.75	1.55	1.56	1.55	1.57	1.56	1.53
Manufacturing	1.91	2.11	1.77	1.78	1.78	1.78	1.78	1.76
Wholesale	1.34	1.52	1.37	1.38	1.38	1.43	1.40	1.39
Retail	1.34	1.44	1.36	1.38	1.35	1.36	1.36	1.32
Automotive	1.49	1.81	1.40	1.47	1.39	1.40	1.36	1.22
Ex. auto	1.28	1.37	1.35	1.36	1.34	1.34	1.36	1.35

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

these stores were about the same as in July, and only 0.4 percent higher than the first-quarter level.

The surge in auto sales in late August and September depleted dealers' stocks of 1985 models, and the carry-over of 1985 model inventories into the fourth quarter was considerably less than usual. Although new car production is scheduled to remain near third-quarter levels, sales are expected to drop sharply in the fourth quarter, thus setting the stage for a sizable buildup in dealers' stocks.

Housing Markets

Housing construction was weak in September, despite continued signs that demand for owner-occupied homes generally has been on an uptrend as the year has progressed. Total private housing starts fell 9-1/2 percent in September, with declines registered in both the multifamily and the single-family sectors. For the third quarter as a whole, housing starts were off 6 percent. In contrast, newly-issued permits have been rising for four consecutive quarters. To some extent, the relative strength in permits is explained by a geographic shift in activity out of areas of the nation that do not require building permits to permit-issuing regions.

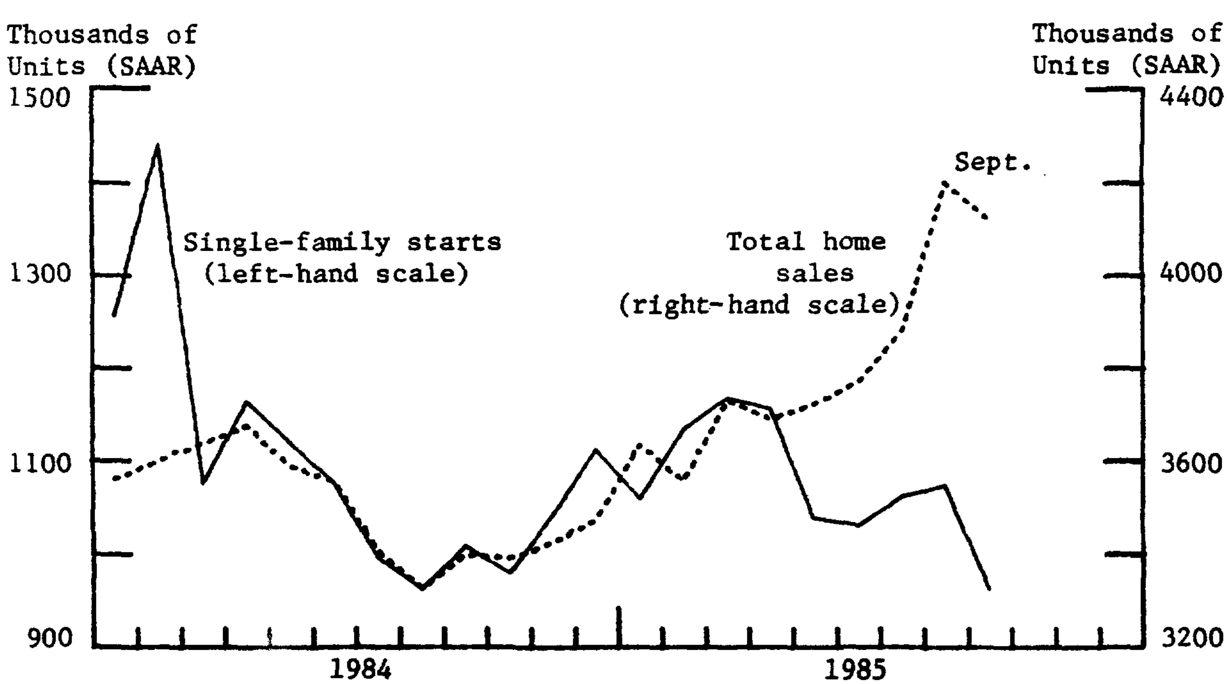
In September, all regions showed reduced levels of starts activity, but the largest declines were registered in the South and the West. None of the regions has shown a marked expansion in building in response to the decline in mortgage rates that has occurred since the spring. Moreover, housing starts in the South seem to have been on a general downtrend since early 1984. This weakness probably can be attributed to overbuilding during the early 1980s boom as well as to difficulties in the energy and agriculture sectors, on which several state economies in the region are dependent.

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

	1984	1985			1985		
	Annual	Q1	Q2	Q3[1]	July	Aug.	Sept.[1]
All units							
Permits	1.68	1.67	1.73	1.76	1.69	1.78	1.80
Starts	1.75	1.80	1.77	1.66	1.66	1.75	1.58
Single-family units							
Permits	.92	.94	.95	.97	.97	.99	.94
Starts	1.08	1.12	1.08	1.03	1.06	1.07	.96
Sales							
New homes	.64	.67	.68	.71	.74	.70	.68
Existing homes	2.87	2.97	3.05	3.36	3.14	3.50	3.44
Multifamily units							
Permits	.76	.73	.78	.79	.73	.79	.86
Starts	.67	.67	.70	.63	.60	.67	.62
Mobile home shipments	.30	.28	.28	n.a.	.29	.29	n.a.

1. Preliminary estimates.
n.a.--not available.

SINGLE-FAMILY HOUSING MARKET



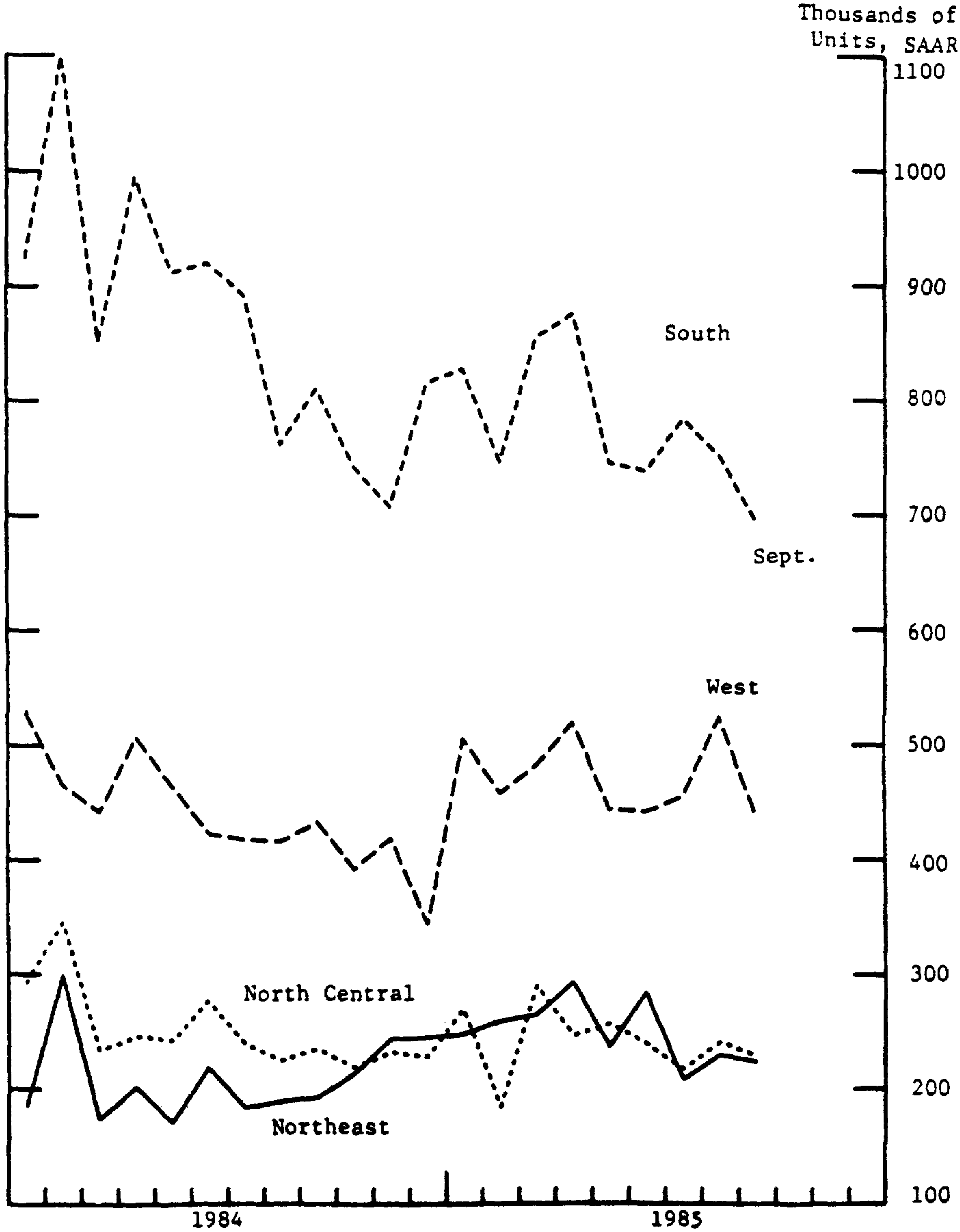
Nonetheless, other indicators of housing activity continue to suggest that demand has picked up in the single-family market. Existing home sales increased substantially in the third quarter, and new home sales continued to improve. Moreover, the University of Michigan survey of consumer sentiment showed that homebuying attitudes rose to their highest level on record in the quarter just ended. With sales of new homes up, and homebuilders apparently remaining cautious in their production decisions, the rise in stocks of unsold units have been brought to a halt in recent months, after a steady accumulation for more than two years.

In the multifamily sector, starts were down 7-3/4 percent in September and 9-1/2 percent for the third quarter as a whole. These declines followed a very strong second-quarter pace--the second highest building rate in more than a decade--and brought activity more in line with underlying market conditions. In the multifamily rental market, the rental vacancy rate rose once again in the third quarter to 8.3 percent--the highest since 1967. Moreover, the market for condominiums and cooperatives has been characterized by slow sales and a large stock of unsold units, reflecting a heavy volume of completions coming to market from earlier starts.

Federal Sector

Federal purchases (NIPA basis) rose sharply in the third quarter. A combination of high farm production and depressed agricultural prices led to a substantial diversion of grain to government stockpiles, with real purchases by the Commodity Credit Corporation jumping to more than $5 billion at an annual rate. In addition, real spending on defense surged 20 percent at an annual rate, following a 7 percent rise in the previous quarter. Quarterly changes in defense purchases tend to be erratic, and spurts in

HOUSING STARTS BY REGION



spending at the end of the fiscal year have occurred in the past. However, the unusual strength over the past six months suggests that several problems that inhibited defense payments earlier in the year may be abating. These problems include delays in deliveries owing to poor quality control by contractors and the controversy surrounding instances of overpricing of spare parts and other items. In addition, a reversal of spending shortfalls from earlier budget authority may be bolstering the current level of defense outlays.

On a unified budget basis, the federal deficit rose to a record $203 billion in fiscal 1985 ($212 billion including off-budget items). Unified receipts reached $734 billion, $68 billion above the previous year. However, spending totaled $937 billion, an increase of $95 billion. In addition to strong outlay growth for defense and agricultural programs, interest outlays were up substantially reflecting the additional stock of debt outstanding. Also, the outlay total included a one-time $14 billion expenditure for retirement of HUD-guaranteed housing project notes.

Congress must still pass a number of bills before the FY1986 budget resolution targets are enacted and considerable uncertainty exists regarding ultimate spending levels. Action on budget-related bills has been slowed by the debate surrounding the debt ceiling and the Gramm-Rudman balanced budget amendment. However, a reconciliation bill, which packages a number of program changes aimed at meeting the resolution targets, was passed in the House; a corresponding Senate bill has been reported to the floor. There are considerable differences between the House and Senate bills, and the administration has expressed reservations about a number of provisions. Meanwhile, the thirteen FY1986 appropriation bills have moved along slowly--

SELECTED MEASURES OF LABOR COSTS IN THE NONFARM BUSINESS SECTOR
(Percentage change at annual rates)

	1982	1983	1984	1985 Q1	1985 Q2	1985 Q3	1985 to Date
Hourly earnings index, wages of production workers[1]							1984-Q4 to 1985-Q3
Total private nonfarm	6.1	4.0	3.1	3.5	3.2	1.1	2.6
Manufacturing	6.0	2.8	3.3	5.2	3.5	2.0	3.6
Nonmanufacturing	6.2	4.5	3.0	2.8	3.0	.7	2.2
Employment cost index, wages and salaries of all persons[2]							1984-Q4 to 1985-Q3
Total	6.3	5.0	4.2	4.7	4.3	5.3	4.8
By occupation:							
White collar	6.5	6.0	4.4	5.7	4.9	5.9	5.5
Blue collar	5.6	3.8	3.6	3.8	4.1	4.7	4.2
Service workers	8.5	4.6	6.2	.3	2.0	6.3	2.8
By bargaining status:							
Union	6.5	4.6	3.4	2.7	4.3	3.6	3.5
Nonunion	6.1	5.2	4.5	5.8	4.3	6.0	5.4
Employment cost index, compensation of all persons[2]							
Total	6.4	5.7	4.9	5.0	3.3	5.2	4.5
Major collective bargaining agreements[3]							First nine mos. 1985
First-year wage adjustments	3.8	2.6	2.4	--	--	--	2.3
Total effective wage change	6.8	4.0	3.7	--	--	--	2.9
Labor costs and productivity, all persons[1]							1984-Q4 to 1985-Q3
Compensation per hour	7.2	3.9	4.3	5.0	3.4	3.9	4.1
Output per hour	1.4	3.9	2.4	-3.1	1.2	1.2	-.2
Unit labor costs	5.8	.0	1.9	8.4	2.1	2.7	4.4

1. Changes are from final quarter of preceding period to final quarter of period indicated. Quarterly and year-to-date changes at compound rates. Seasonally adjusted data.
2. Changes are from final month of preceding period to final month of period indicated. Quarterly changes at compound rates; not seasonally adjusted.
3. Agreements covering 1,000 or more workers; not seasonally adjusted.

only one bill has been sent to the President, and of the remaining twelve bills, the House has passed ten, while the Senate has passed only six. Here again, House and Senate versions of many bills contain significant differences that need to be resolved in conference and eventually sent on to the President.

State and Local Sector

State and local government real outlays for goods and services rose at a 5 percent annual rate in the third quarter, following a 6.8 percent increase during the spring. Real outlays for construction have advaned rapidly so far this year, and during the first three quarters of this year have averaged nearly 6 percent above their 1984 level. Increases in construction have been concentrated in the renovation and building of educational facilities, streets and highways, and water and sewer systems.

Gains in state and local government receipts have not kept pace with the exceptionally strong outlay growth. Although not all the data are available, partial estimates indicate that in the third quarter the surplus of the combined operating and capital accounts stood at its lowest level since early 1983.

Wages and Labor Costs

Measures of wage inflation have been mixed recently and, on the whole, continue to suggest no change in wage trends so far this year. The employment cost index for wages and salaries increased 4-3/4 percent over the past 12 months, up from 4.1 percent in 1984. The acceleration occurred in the service-producing sector, where employment gains have been particularly strong this year. At the same time, the hourly earnings index, a less comprehensive measure covering only production and nonsupervisory employees, has advanced at an annual rate of 2-1/2 percent so far this year, down from last year's rate and well below the pace of the employment cost index. Since 1982, the employment cost index has consistently risen more rapidly than the hourly earnings index, apparently because it includes the larger wage increases that have been received by white-collar workers and because it is corrected for shifts in the occupational distribution of employment.

The moderate wage and salary increases in 1985 have been accompanied by considerably slower rates of growth in employee benefit costs. The rise in the employment cost index for total compensation of 4-3/4 percent over the past twelve months was about the same as the increase in the index for wages and salaries. This is the first time since 1981, when the employment cost index began to include benefit data, that the growth of fringe benefit costs has not exceeded wage growth. The recent moderation of fringe benefits appears to be the result of efforts by employers to negotiate lower-cost health insurance plans, as well as a decline in contributions to pension plans, which became overfunded as financial assets appreciated greatly in value during the last few years.

Wage adjustments reached in collective bargaining agreements this year have continued to be restrained. First-year adjustments for 1.6 million of the 7 million workers in major bargaining units (those covering 1,000 or more employees) averaged 2.3 percent during the first nine months of 1985, about equal to the record low reached during 1984. Overall union wage inflation--which includes deferred increases and COLA payments as well as initial adjustments--averaged 3.7 percent at an annual rate in the first nine months of 1985, equal to its pace in 1984. Recently, the United Auto

Workers and Chrysler Corporation reached an agreement following the eight-day strike. The agreement provides increases in wages of 2-1/4 percent in the first year and a 2-1/4 percent lump sum payment in the second year, bringing workers at Chrysler to wage parity with other U.S. autoworkers. In addition, Chrysler workers will receive a 3 percent pay hike in 1987, when the rest of the industry will be negotiating a new contract. The new Chrysler agreement also includes an immediate lump sum payment to partially compensate for past wage and benefit concessions and retains a generous COLA.

Despite the continued moderate growth in hourly compensation, unit labor costs accelerated over the first three quarters of this year, as the cyclical rebound in labor productivity waned. Output per hour in the nonfarm business sector dropped sharply early in the year when production decelerated markedly; it has risen at a 1-1/4 percent annual rate in the past two quarters as labor demand has moderated and output growth has picked up. The recent rise is in line with staff estimates of the current trend in labor productivity.

<u>Prices</u>

Over the first three quarters of 1985, most aggregate measures of inflation show some slowing from the rates posted in 1984, reflecting downward pressures in the food and energy sectors as well as for a number of other goods. In September, the consumer price index for all urban consumers rose 0.2 percent for the fifth consecutive month, down somewhat from the average monthly change earlier this year and during 1984. The producer price index for finished goods fell 0.6 percent last month and has been essentially flat since the beginning of the year.

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

	Relative Importance Dec. 1984	1984	1985 Q1	1985 Q2	1985 Q3	1985 Aug.	1985 Sept.
			--Annual rate--			--Monthly rate--	
All items[2]	100.0	4.0	4.1	3.3	2.3	.2	.2
Food	18.7	3.8	2.6	-.9	1.8	.0	.3
Energy	11.5	.2	-.8	9.6	-4.3	-.6	-.2
All items less food and energy[3]	69.8	4.7	5.5	3.4	3.5	.3	.2
Commodities	26.3	3.1	6.6	-1.4	.8	.1	.3
Services	43.5	5.6	5.0	6.4	5.0	.5	.2
Memorandum:							
CPI-W[4]	100.0	3.5	4.0	3.1	1.8	.2	.2

1. Changes are from final month of preceding period to final month of period indicated.
2. Official index for all urban consumers, based on a rental equivalence measure for owner-occupied housing after December 1982.
3. Data not strictly comparable. Before 1983, they are based on unofficial series that exclude the major components of homeownership; beginning in 1983, data include a rental equivalence measure of homeowners costs.
4. Index for urban wage earners and clerical workers, based on a rental equivalence measure for owner-occupied housing after December 1984.

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

	Relative Importance Dec. 1984	1984	1985 Q1	1985 Q2	1985 Q3	1985 Aug.	1985 Sept.
			--Annual rate--			--Monthly rate--	
Finished goods	100.0	1.7	.5	1.5	-2.3	-.3	-.6
Consumer foods	24.4	3.5	-3.0	-8.2	-1.5	-.7	-.9
Consumer energy	11.5	-4.1	-21.3	25.9	-11.8	-1.6	-.1
Other consumer goods	42.4	2.2	6.5	1.3	.0	.0	-.5
Capital equipment	21.6	1.8	6.2	1.9	-1.5	.2	-.6
Intermediate materials[2]	95.1	1.7	-2.5	1.1	-1.2	-.1	.1
Exc. energy	80.1	2.1	-1.0	1.2	-1.2	-.1	-.1
Crude food materials	53.0	-1.2	-24.9	-1[illegible].9	-20.5	-3.8	-.7
Crude energy	31.7	-1.3	-13.1	[illegible]9	-3.3	-.9	.4
Other crude materials	15.4	-3.4	-13.3	[illegible].4	-4.5	-1.2	-.6

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

For food, retail prices rose 0.3 percent in September, as prices of meats turned up for the first time this year. Although prices at the farm level were down in September, and have now fallen for nine consecutive months, there probably will be a sharp rebound in farm prices in the October PPI. Cattle prices in some markets have risen about 20 percent since their mid-September low, and hog prices have advanced sharply. These increases appear to be associated with a drop in meat production, as preliminary data for early October indicate that output has fallen below year-ago levels. Because price declines for livestock earlier this year were not fully passed on to consumers, there probably is room in the marketing sector to absorb a large part of the recent price advances. The latest futures prices for cattle and hogs suggest that cash prices will increase further in the near term and then decline somewhat in the first half of 1986.

Energy prices edged down further in September at the retail level, as a drop in pump prices of gasoline more than offset higher prices of home heating oil. Stocks of distillate oil are lean, and, with the approach of the heating season, spot prices of petroleum products have recovered notably since midsummer.

Prices of other goods have been relatively flat, on balance, at the producer and consumer levels after their sharp first-quarter increases. In September, the consumer and capital equipment components of the PPI were both down about 1/2 percent, essentially reflecting the effect on manufacturers' prices of incentive financing and price discount programs for

1985-model cars and trucks.[1] In contrast to this year's pattern for goods, the CPI for services other than energy, although slowing in September, has been rising at a 5-1/2 percent rate so far this year, the same pace as during 1984.

The moderation associated with food, energy, and other consumer goods also was reflected in BEA's preliminary third-quarter estimates of their fixed-weighted inflation measures.[2] The fixed-weighted price index for gross domestic business product slowed to a 2.6 percent annual rate, from 3.7 percent in the second quarter, owing to a swing in the energy component. The GNP deflator shows a different pattern, accelerating to 3.3 percent in the third quarter from 2.6 percent in the second quarter. This arose from compositional shifts in demand, associated mainly with imports and business fixed investment, which raised the third- and reduced the second-quarter deflator.

1. The October PPI will reflect the higher prices of 1986-model cars and trucks, adjusted for the estimated cost of quality changes, as well as the effects of changes in financing arrangements and liquidation allowances. The CPI is less affected by those factors, because auto financing is included separately among private transportation services (with a small weight) and the prices of new-model cars are phased in over several months in accordance with sales.
2. The BEA indexes reflect changes in quarterly averages, in contrast to the three-month changes shown in the CPI and PPI tables.

III-T-1

SELECTED FINANCIAL MARKET QUOTATIONS[1]

(Percent)

	1982/1983 Cyclical low	1984 Highs	1985 March highs	1985 June lows	1985 FOMC Oct.	1985 Oct. 29	Change from: 1984 highs	Change from: FOMC Oct.
Short-term rates								
Federal funds[2]	8.46	11.63	8.58	7.38	7.91	8.08	-3.55	.17
Treasury bills[3]								
3-month	7.08	10.67	8.80	6.66	7.03	7.21	-3.46	.18
6-month	7.62	10.77	9.13	6.81	7.19	7.33	-3.44	.14
1-year	7.73	11.13	9.25	6.98	7.39	7.45	-3.68	.06
Commercial paper								
1-month	8.00	11.42	8.94	6.95	7.80	7.80	-3.62	--
3-month	7.97	11.35	9.12	7.01	7.78	7.79	-3.56	.01
Large negotiable CDs[3]								
1-month	8.08	11.52	8.89	7.09	7.84	7.83	-3.69	-.01
3-month	8.12	11.79	9.29	7.18	7.87	7.90	-3.89	.03
6-month	8.20	12.30	9.92	7.30	7.97	7.92	-4.38	-.05
Eurodollar deposits[4]								
1-month	8.68	11.89	8.89	7.45	7.90	8.00	-3.89	.10
3-month	8.71	12.20	9.58	7.50	8.01	8.13	-4.07	.12
Bank prime rate	10.50	13.00	10.50	9.50	9.50	9.50	-3.50	--
Treasury bill futures								
Dec. 1985 contract			10.30	7.12	7.06	7.04	--	-.02
Mar. 1986 contract			10.58	7.47	8.41	8.27	--	-.14
Intermediate- and long-term rates								
U.S. Treasury (constant maturity)								
3-year	9.33	13.49	11.22	8.73	9.25	9.19	-4.30	-.06
10-year	10.12	13.99	12.02	9.83	10.29	10.11	-3.88	-.18
30-year	10.27	13.94	11.97	10.23	10.55	10.37	-3.57	-.18
Municipal revenue (Bond Buyer index)	9.21	11.44	10.25	9.10	9.74[5]	9.47[5]	-1.97	-.27
Corporate--A utility Recently offered	11.64	15.30	13.23	11.50	11.86e	11.55e	-3.75	-.31
Home mortgage rates								
S&L fixed-rate	12.55	14.68	13.29	12.05	12.17[6]	12.07	-2.61	-.10
S&L ARM, 1-yr.	n.a.	12.31	11.14	9.83	9.49[6]	9.48	-2.83	-.01

	1983 Highs	1984 Lows	1985 Highs	1985 FOMC Oct.	1985 Oct. 29	Percent change from: 1984 lows	Percent change from: FOMC Oct.
Stock prices							
Dow-Jones Industrial	1287.20	1086.57	1369.29	1340.95	1368.73	26.0	2.1
NYSE Composite	99.63	85.13	113.49	106.77	109.19	28.3	2.3
AMEX Composite	249.03	187.16	237.49	224.23	227.97	21.8	1.7
NASDAQ (OTC)	328.91	225.30	307.77	281.77	291.12	29.2	3.3

1. One-day quotes except as noted.
2. Averages for two-week reserve maintenance period closest to date shown. Last observation is the average-to-date for the maintenance period ending September 25, 1985.
3. Secondary market.
4. Averages for statement week closest to date shown.
5. One-day quotes for preceding Thursday.
6. One-day quotes for preceding Friday.
e--estimated

Growth in the monetary aggregates has abated in October to rates well below those recorded in the third quarter. Averaging through volatile week-to-week movements, M1 likely will be little changed this month from its September level, while M2 probably will post only a small increase. These developments would leave M1 still well above its second-half target range but M2 just within its long-run range. The moderate growth projected for M3 this month would hold it in the middle part of its 1985 range.

Money stock behavior apparently continues to have little impact on market expectations; since the last FOMC meeting traders have focused more on incoming economic news and have attempted to discern the implications of the September G-5 agreement for domestic and foreign economic policies. Net movements in interest rates have been small, with private short-term yields about unchanged and some easing in the long end of the market.

Overall debt growth has been reduced a bit recently, in part by the constraint on Treasury borrowing imposed by the federal debt ceiling. The supply of short-term Treasury securities in the market has been augmented, however, by official sales associated with intervention activity to influence exchange rates, and any general impact of reduced federal borrowing has been offset by the continued large budget deficit and resultant rundown in Treasury cash balances at depository institutions. Borrowing in the tax-exempt market meanwhile has remained heavy, especially private purpose and advance refunding issues that would be barred after year-end under the President's tax reform plan; tax-exempt rates, though still high relative to other bond yields, have declined somewhat more in

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

	1983:Q4 to 1984:Q4	1985 Q2	1985 Q3	1985 July	1985 Aug.	1985 Sept.	Growth from Q4 1984 to Sept. 1985
	------- Percentage change at annual rates ------						
1. M1	5.2	10.2	15.0	9.3	20.3	11.3	12.6 (14.9)[2]
2. M2	7.7	5.3	10.2	8.5	11.1	7.0	9.3
3. M3	10.4	5.2	7.8	4.3	9.2	9.7	8.2
							Levels in billions of dollars Sept. 1985
Selected components							
4. Currency	7.2	6.7	9.1	6.6	12.3	5.7	167.9
5. Demand deposits	1.1	8.6	11.9	0.9	14.3	12.7	266.8
6. Other checkable deposits	10.5	16.1	25.9	24.7	38.9	14.9	171.0
7. M2 minus M1[3]	8.6	3.8	8.7	8.3	8.2	5.6	1916.6
8. Overnight RPs and Eurodollars, NSA	7.3	-28.7	18.7	-9.5	67.2	9.1	66.5
9. General purpose and broker/dealer money market mutual fund shares, NSA	17.0	-0.7	3.9	2.7	6.1	-2.0	176.4
10. Commercial banks	8.1	9.3	7.8	6.7	2.2	3.6	828.6
11. Savings deposits, SA, plus MMDAs, NSA[4]	5.2	11.8	19.2	19.6	15.7	10.6	445.8
12. Small time deposits	11.1	6.5	-4.4	-7.1	-13.3	-4.1	382.8
13. Thrift institutions	7.3	6.5	3.9	3.6	1.0	-0.6	844.2
14. Savings deposits, SA, plus MMDAs, NSA[4]	-3.6	10.4	16.4	21.0	22.0	6.9	352.1
15. Small time deposits	15.5	4.0	-4.5	-8.1	-13.7	-5.6	492.1
16. M3 minus M2[5]	22.1	4.8	-1.5	-12.0	1.2	21.0	635.2
17. Large time deposits	26.0	6.4	-3.3	-12.2	3.7	19.9	428.2
18. At commercial banks, net[6]	16.0	8.3	-3.2	-9.0	8.6	22.9	272.7
19. At thrift institutions	48.8	2.6	-2.8	-16.9	-3.9	14.8	155.6
20. Institution-only money market mutual fund shares, NSA	33.6	7.7	1.3	-37.6	-25.8	-24.5	62.3
21. Term RPs, NSA	45.6	16.2	-12.1	-35.9	44.4	33.9	69.2
22. Term Eurodollars, NSA	-8.3	-12.1	-16.5	-27.6	-4.7	14.2	77.1
	— Average monthly change in billions of dollars —						
MEMORANDA:							
23. Managed liabilities at commercial banks (24+25)	4.7	-2.5	2.3	-7.6	6.1	8.5	446.3
24. Large time deposits, gross	3.2	-1.0	1.1	-3.6	1.8	5.2	330.2
25. Nondeposit funds	1.5	-1.5	1.2	-4.0	4.3	3.3	116.1
26. Net due to related foreign institutions, NSA	0.9	-1.3	1.3	-4.3	7.2	1.1	-30.2
27. Other[7]	0.5	-0.2	-0.1	0.2	-2.8	2.2	146.3
28. U.S. government deposits at commercial banks[8]	0.2	1.9	-0.7	7.5	-8.2	-1.4	15.3

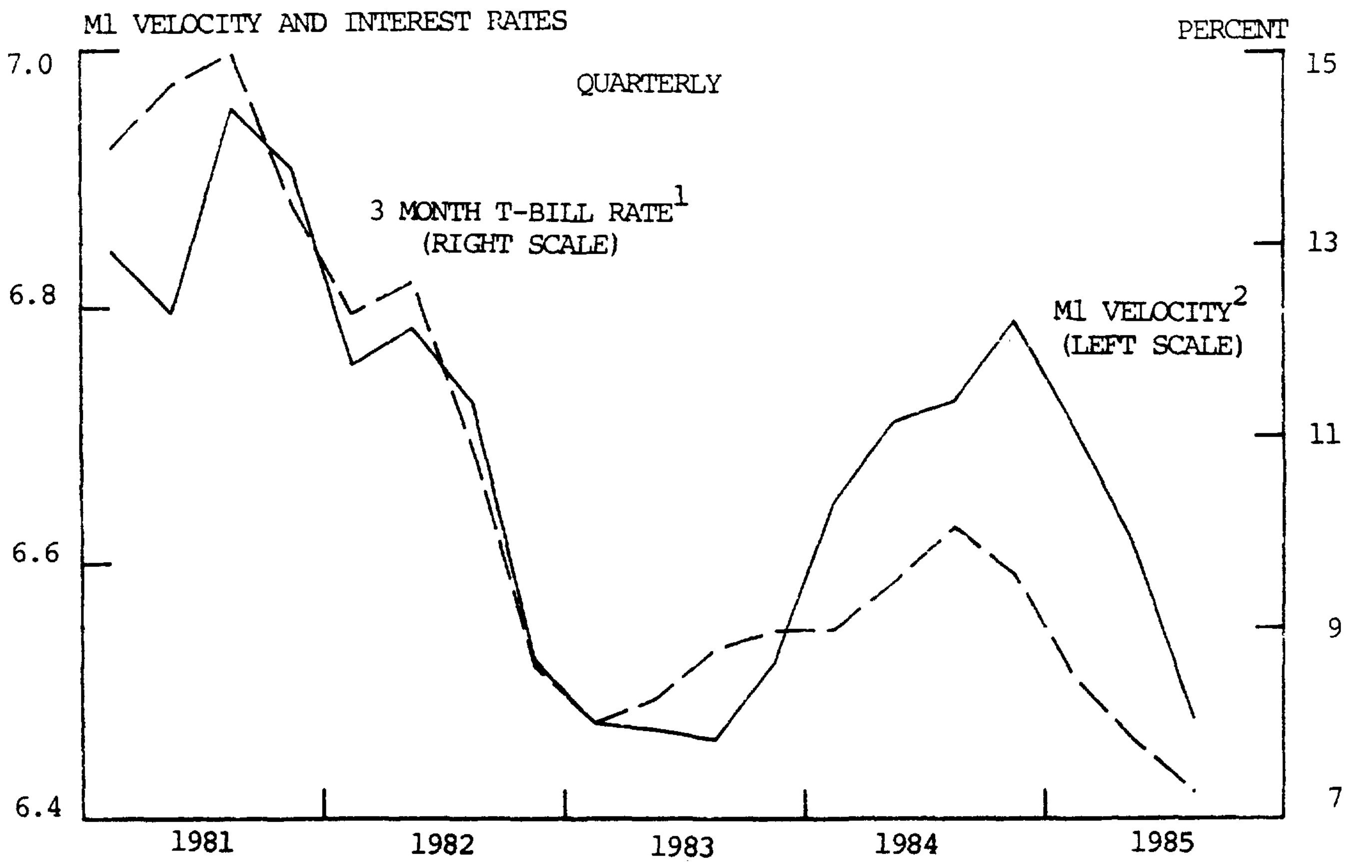
1. Quarterly growth rates are computed on a quarterly average basis. Dollar amounts shown under memoranda for quarterly changes are calculated on an end-month-of-quarter basis.
2. Figure in parentheses calculated from Q2 1985 base.
3. Nontransactions M2 is seasonally adjusted as a whole.
4. Growth rates are for savings deposits, seasonally adjusted, plus money market deposit accounts (MMDAs), not seasonally adjusted. Commercial bank savings deposits excluding MMDAs increased during August and September 1985 at rates of 9.7 percent and 3.9 percent respectively. At thrift institutions, savings deposits excluding MMDAs increased during August and September 1985 at rates of 22.9 percent [illegible] 5.1 percent respectively.
5. The non-M2 component of M3 is seasonally adjusted as a [illegible].
6. Net of large-denomination time deposits held by money [illegible] mutual funds and thrift institutions.
7. Consists of borrowings from other than commercial banks [illegible] the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for [illegible] owed money (including borrowings from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
8. Consists of Treasury demand deposits and note balances at commercial banks.

recent weeks as market participants evidently have been attracted by the perceived opportunity to reap capital gains when supply falls off early in 1986.

In the private sector, corporate bond issuance has slackened in the past couple of months and net short-term borrowing by nonfinancial firms has been weak--despite continued heavy share retirements in connection with mergers, takeovers, and stock repurchase programs. The basic needs of nonfinancial corporations for external funding were reduced through the third quarter by a runoff in inventories. In contrast, the surge in auto sales likely buoyed consumer loan demand through September; available evidence points to a substantial drop-off in installment borrowing this month. Mortgage credit demands intensified during the summer, as home sales surged, with especially strong flows through the mortgage-backed securities market.

Monetary Aggregates and Bank Credit

The growth of M1 tapered down to an 11-1/4 percent annual rate in September and has been close to zero in October. The pattern of M1 growth over the last two months was affected by Hurricane Gloria. Reports from the New York and Boston districts indicate that the hurricane-related closings of businesses and banks on September 27, a Friday, left many depositors unable to move funds out of demand accounts to make either disbursements or investments. As a result, demand deposit figures were inflated over the weekend, accounting for perhaps one-half of the 12-3/4 percent growth in such deposits during September and contributing 2 to 3 percentage points to M1 growth in that month. The subsequent unwinding of these involuntary holdings then depressed M1 in October.



1. Treasury bill rate is a two-quarter moving average.
2. Velocity for 1981 is not adjusted for the shifts into M1 that year that resulted from nationwide authorization of NOW accounts.

Growth of M1 in the third quarter at a 15 percent annual rate implies an even faster decline in velocity than occurred in the first half of the year. Historical patterns suggest that a factor pushing velocity lower was the earlier drop in interest rates, which left most money market rates in the third quarter at their lowest average levels in about seven years. The velocity decline nevertheless was considerably greater than that predicted by econometric models of money demand.

M2 growth slowed to a 7 percent annual rate in September and appears to have eased further in October, reflecting decelerations both in its nontransactions component and in M1. Growth of retail nontransactions deposits remained sluggish in September; increases in savings deposits and MMDAs were smaller than in July and August and the declines in small time deposits were of lesser size. The rise in overnight RPs and Eurodollars moderated in September, and M2-type money fund balances fell. In October, the slower growth in M2 reflected primarily the lower figure for M1, but the growth of the nontransactions component also declined because of a runoff in overnight RPs and Eurodollars; the retail nontransactions components strengthened with the growth again mainly in the more liquid types of instruments.

The slightly faster growth of M3 in September stemmed from its non-M2 component, which rose at a 21 percent annual rate after essentially no change in the preceding month. An important source of this increase was large time deposits, as commercial banks boosted their issuance and thrift institutions again became net issuers. The growth of managed liabilities has remained strong in October, as banks' demands have been increased by the slower growth of core deposits and the sharp decline in U.S. government deposits.

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

		1985						Levels in bil. of dolla
		Q1	Q2	Q3	July	Aug.	Sept.	Sept.
		Commercial Bank Credit						
1.	Total loans and securities at banks	10.3	9.1	8.6	10.1	6.9	8.7	1838.0
2.	Securities	5.5	7.3	12.2	15.8	7.5	12.9	423.6
3.	U.S. government securities	10.3	-0.4	10.1	8.9	-0.4	7.1	272.5
4.	Other securities	-3.4	16.7	18.3	8.3	22.3	23.5	151.1
5.	Total loans	11.7	10.3	7.6	8.5	6.8	7.4	1414.4
6.	Business loans	10.6	2.6	2.9	1.2	3.2	4.2	487.4
7.	Security loans	17.8	87.8	-19.0	9.0	-107.2	45.8	38.1
8.	Real estate loans	10.9	12.0	11.0	12.1	11.7	8.9	408.3
9.	Consumer loans	17.4	14.7	11.5	15.0	10.9	8.2	279.3
		Short- and Intermediate-Term Business Credit						
10.	Business loans net of bankers acceptances	9.5	3.7	2.8	-0.2	3.5	5.2	484.1
11.	Loans at foreign branches[2]	-46.9	21.3	-6.1	-12.1	-49.0	44.7	19.5
12.	Sum of lines 10 & 11	7.2	4.3	2.5	-0.5	1.2	6.7	503.6
13.	Commercial paper issued by nonfinancial firms[3]	-6.0	33.8	-1.5	0.0	43.0	-45.9	77.9
14.	Sums of lines 12 & 13	5.4	8.0	2.0	-0.2	6.8	-0.6	581.5
15.	Bankers acceptances: U.S. trade related[4,5]	-5.5	-12.2	-12.6	-27.4	-7.0	-3.5	33.9
16.	Line 14 plus bankers acceptances: U.S. trade related	4.6	6.9	1.1	-2.0	6.1	-0.8	615.4
17.	Finance company loans to business[4]	21.4	8.0	n.a.	3.4	7.5	n.a.	144.1 (Aug.)
18.	Total short- and intermediate-term business credit (sum of lines 16 & 17)	7.7	7.0	n.a.	-0.8	6.4*	n.a.	759.9 (Aug.)

n.a.--not available.
p--preliminary
1. Average of Wednesdays for domestically chartered banks and average of current and preceding ends of months for foreign-related institutions.
2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
3. Average of Wednesdays.
4. Based on average of current and preceding ends of month.
5. Consists of acceptances that finance U.S. imports, U.S. exports and domestic shipment and storage of goods.

Bank credit expanded at an 8-3/4 percent annual rate in September, above the August pace but still a bit below the growth rate in the first half of the year. The bulk of a net increase in bank holdings of U.S. government securities reflected a buildup in trading accounts at the beginning of September. Growth in other securities remained strong, probably representing continued large acquisitions of tax-exempt securities.

Total loans grew at about the subdued August pace. Real estate and consumer loans both slowed in September from the double-digit rates that had characterized much of the year to that point; the 8 percent rise in consumer loans was the slowest in more than two years, and at least in part reflected a diversion of new-car loans to auto finance companies in response to promotional interest rates. By contrast, business loans picked up a bit, although remaining sluggish, and the erratic security loan category rebounded in September. Early data for large banks in October show business loans declining and growth of consumer loans slowing further.

Business Finance

Overall business credit demand weakened in September and October: short-term borrowing remained sluggish, and total bond volume was below its elevated levels of the summer months despite record issuance in foreign markets in October. Business loans at commercial banks and commercial paper, taken together, declined slightly in September and grew at only about a 2 percent annual rate in the third quarter. Commercial paper issuance by nonfinancial firms has picked up in October, but this probably has been at least partially offset by a weakening in loans from commercial banks. Short-term borrowing would have been even weaker recently were it not for its use in financing merger activity.

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

	1984	1985					
	Year	Q1	Q2	Q3P	Aug.P	Sept.P	Oct.e
Corporate securities - total[1]	9.88	12.32	16.95	15.65	19.21	13.80	16.60
Public offerings in U.S.	8.00	9.35	14.69	12.73	14.80	11.60	10.60
Stocks—total[2]	1.89	2.21	3.28	3.15	3.50	2.80	2.60
Nonfinancial	1.08	1.12	1.98	1.48	1.70	1.40	1.10
Utility	.22	.43	.50	.30	.20	.50	.30
Industrial	.86	.70	1.48	1.18	1.50	.90	.80
Financial	.81	1.08	1.30	1.67	1.80	1.40	1.50
Bonds--total[1]	6.11	7.14	11.41	9.58	11.30	8.80	8.00
By industry							
Nonfinancial	2.80	4.14	5.78	4.87	5.85	3.80	4.00
Utility	.87	.79	1.35	1.59	2.60	1.55	1.70
Industrial	1.93	3.35	4.43	3.28	3.25	2.25	2.30
Financial	3.31	3.00	5.63	4.71	5.45	5.00	4.00
By quality[3]							
Aaa and Aa	1.85	1.23	2.70	2.51	2.85	1.45	2.60
A and Baa	2.11	3.97	5.33	3.76	4.80	4.20	2.70
Less than Baa	1.09	.94	1.65	1.36	1.70	.85	.90
No rating (or unknown)	.25	.27	.46	.27	.25	.30	.30
Memo items:							
Equity based bonds[4]	.63	.46	1.10	.81	1.02	.44	.20
Mortgage-backed bonds	.81	.73	1.27	1.68	1.70	2.00	1.50
Variable-rate notes	.72	.99	1.50	.41	.66	.25	.55
Bonds sold abroad - total	1.88	2.98	2.26	2.92	4.41	2.20	6.00
Nonfinancial	.84	1.06	1.01	1.26	1.60	1.07	2.50
Financial	1.04	1.92	1.25	1.66	2.81	1.13	3.50

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

Earlier in the summer, light short-term credit demands were associated with heavy issuance of longer-term corporate bonds. In September and early October, however, gross bond issuance by nonfinancial corporations moderated, although relative to historical standards it could still be viewed as substantial. The increase in corporate bond rates from their summer lows may have discouraged firms from issuing long-term debt; by early October, corporate bond rates had risen as much as 60 basis points above their trough in July. In recent weeks they have edged down and volume has picked up.

While bond volume by nonfinancial corporations decelerated, financial firms remained active issuers in the bond market. A large portion of the financial bond volume in recent months is attributable to strong growth in collateralized mortgage obligations (CMOs). Thrift institutions were responsible for much of the third-quarter strength, while issuance by the finance subsidiaries of residential builders surged in September and October. By issuing CMOs, thrift institutions can raise funds by liquefying their holdings of low interest rate mortgages without recording a capital loss, and builders can receive cash for their home sales while maintaining installment-sale tax benefits. Financial bond volume also has been boosted recently by the finance subsidiaries of automobile manufacturers as they fund low-rate loans made under their recent sales promotions.

The Dow Jones Industrial Average set new records in mid-October, after rising about 5-1/2 percent since late September. Other, more broadly based, indexes also have shown gains, but remain below levels reached in July. This discrepancy between the Dow and other indexes is largely attributable to exceptional gains in the price of General Foods,

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

	FY85	1985 Q3	Q4[e]	Aug.	Sept.	Oct.[e]
Treasury financing						
Combined surplus/deficit(-)	-211.9	-49.9	-72.5	-27.6	-.8	-28.2
Means of financing deficit:						
Net cash borrowing from the public	197.3	46.1	73.2	16.2	6.0	11.1
Marketable borrowings/ repayments(-)	173.0	37.3	62.8	13.2	3.5	6.4
Bills	27.5	2.4	15.7	2.9	-3.1	5.3
Coupons	145.5	34.9	47.1	10.3	6.6	1.1
Nonmarketable	24.3	8.8	10.4	3.0	2.5	4.7
Decrease in the cash balance	13.3	6.9	2.3	12.3	-5.3	14.4
Memo: Cash balance at end of period	17.1	17.1	14.8	11.8	17.1	2.7
Other[2]	1.3	-3.1	-3.0	-.9	.1	2.7
Federally sponsored credit agencies, net cash borrowing[3]	21.4	5.0	5.0	3.1	1.3	1.9
FHLBs	6.8	2.5	2.5	1.7	1.4	.9
FNMA	11.6	2.2	2.5	1.1	.4	.8
Farm Credit Banks	-4.0	-.9	-1.0	.0	-.9	-.2
FHLMC	4.6	.8	.5	.2	.1	.2
SLMA	2.4	.4	.5	.1	.3	.2

e--staff estimate.
1. Data reported on a not seasonally adjusted, payment basis.
2. Includes checks issued less checks paid, accrued items and other transactions.
3. Excludes mortgage pass-through securities issued by FNMA and FHLMC.

one of the 30 Dow industrials, which was boosted by a tender offer from Philip Morris. The more general leveling in stock prices since the summer has contributed to a slight falloff in new stock offerings. Gross stock issuance averaged about $2-3/4 billion in September and October, compared with monthly issuance of about $3-1/4 billion in the second and third quarters. This gross issuance continues to be swamped by retirements through mergers and other restructurings; indeed, it appears that gross retirements this year may exceed the record volume of 1984.

U.S. Government Securities Market

The staff is projecting a combined (on- and off-budget) deficit of $72-1/2 billion in the fourth quarter as a whole. The deficit will be financed by a record amount of borrowing from the public, particularly through marketable coupon issues. Progress to date in accomplishing the needed financing has been inhibited by the delay in congressional approval of an increase in the debt ceiling.

By the second week of October, the Treasury's cash balance was exhausted, forcing it to utilize a complex transaction involving the Federal Financing Bank and government trust funds in order to auction $5 billion of cash management bills. The Treasury could make further use of this technique to raise an additional $5 to $10 billion of marketable issues. The prospect of an extended delay in congressional action led the Treasury to announce that it also will take the unusual step of disinvesting government trust funds at the beginning of November.[1] This

1. The Senate passed debt ceiling legislation, which was amended to include balanced budget provisions--the Gramm-Rudman Balanced Budget Amendment--on October 10. The House went directly into conference with the Senate on this legislation because it had already passed a debt ceiling bill. Numerous questions and differences of view about the amendment exist among conferees, however. Thus, a time-consuming conference is likely and the final results remain uncertain.

noncash paydown, which reduces government debt, provided room for the Treasury to conduct this week its postponed end-of-quarter refunding, which comprises $17-3/4 billion of coupon securities (maturities of 4, 7, and 20 years) and represents all new cash. Assuming the debt ceiling is raised in November, the Treasury soon thereafter will conduct its normal midquarter refunding and probably also offer some cash management bills.[1]

Net borrowing by the federally sponsored credit agencies totaled $5.0 billion in the third quarter, about in line with the quarterly average over the past year or so. Demand for Federal Home Loan Bank advances by thrift institutions was strong, but the FHLBs met a good portion of this demand by drawing down liquid assets. Borrowing by Fannie Mae moderated in the third quarter; its gross purchases of mortgages have been maintained, but it has been selling more mortgages from its portfolio in the form of pass-through securities. Fannie Mae recently reported further income gains in the third quarter, marking the second consecutive quarter of positive net income.

The Farm Credit Banks recorded a paydown in their outstanding debt of about the same magnitude as in previous quarters, and paydowns have continued into the current quarter. The System recently reported a net loss of $522 million for the third quarter and $426 million for the first nine months of the year. Net interest income again was positive, but it

1. The Treasury's compressed financing activity has generated questions about possible interest rate pressures. However, with the fairly standard pattern of Treasury auctions of coupon securities in recent years and a general consensus on the total amount of funding over periods of a quarter or two, markets seem able to discount temporary distortions and seasonal bulges in the supply of new issues. For example, last fall, auctions of 7- and 20-year securities also were postponed because of debt ceiling problems and were part of a compressed Treasury financing schedule. Interest rates were not subject to unusual pressure around the auction date, and the revised Treasury schedule seemed to have little effect on the downward trend in rates evident during this period.

was more than offset by provisions for loan losses and financial assistance to Production Credit Associations, principally in the Omaha Farm Credit District. Substantial further losses are likely if financial conditions in agriculture deteriorate commensurate with current Department of Agriculture price projections.

Spreads between the yields on Farm Credit securities and Treasuries have edged up recently in conjunction with unfavorable news coverage. The most recent 6-month issue of the Farm Credit Banks was sold at a spread of 83 basis points over Treasury bills at the end of September but it is expected that the next issue of 6-month Farm Credit securities at the end of October may have a spread of about 100 basis points as many investors may wish to run off their holdings of maturing securities. Yield spreads for other agencies have widened a bit but by much less than for the Farm Credit System. The Federal Home Loan Banks recently issued 1- and 3-year securities with interest rates about 30 basis points above Treasury securities of comparable maturities, a spread 10 to 15 basis points greater than normal. The spreads on securities of the FHLBs widened after reports that they may provide funding to a proposed corporation established to acquire assets that the FSLIC had taken over from liquidated institutions.

Tax-Exempt Securities Market

Gross issuance of tax-exempt bonds picked up in October from the advanced $13 billion monthly average in the third quarter. The volume of refunding bonds again was heavy, spurred by interest rate levels well below those in previous years and the prospect that advance refundings will be prohibited next year under tax-reform legislation. Large volumes of new capital also were raised in October by other issuers anxious to come to market before year-end. Apart from concerns about tax-reform constraints on private-purpose financings, issuers of single-family housing, industrial development, and student loan bonds each face state-by-state annual volume caps. Unless interest rates increase sharply, most of these issuers are expected to attempt to exhaust this year's tax-exempt borrowing authority. Thus far, interest rate pressures reportedly have been lessened by strong demand from investors who normally concentrate their purchases in the taxable market; apparently, they anticipate that a contraction in the supply of municipals after the end of this year will boost the prices of tax-exempt securities, creating the potential for capital gains.

GROSS OFFERINGS OF TAX-EXEMPT SECURITIES
(Monthly rates, not seasonally adjusted, billions of dollars)

	1984	1985					
	Year	Q1	Q2	Q3p	Aug.	Sept.p	Oct.e
Total	10.60	9.16	16.11	15.69	15.88	13.50	16.30
Short-term[1]	1.71	.83	3.45	2.70	.92	1.50	1.30
Long-term	8.89	8.33	12.66	12.99	14.96	12.00	15.00
Refundings[2]	1.05	1.88	3.89	4.10	4.38	3.50	5.00
New capital	7.84	6.45	8.77	8.89	10.58	8.50	10.00
Total housing	1.69	1.46	1.93	2.06	1.38	2.00	2.10
Single-family[3]	1.12	.64	1.16	1.11	.96	1.00	1.20

p--preliminary. e--staff estimate.
1. Does not include tax-exempt commercial paper.
2. Includes all refunding bonds, not just advance refundings.
3. Data from the Department of Housing and Urban Development.

Among traditional municipal market investors, commercial banks have been actively purchasing tax-exempt securities in the last two months and are expected to continue to do so until year-end. An improved earnings performance, with the associated demand for more tax shelters, has been one factor leading to increased purchases by commercial banks. Potential changes in the tax laws are another element. Under current tax provisions, banks can deduct from their gross income 80 percent of the interest expenses on liabilities that finance their acquisition of tax-exempt securities. Under the Treasury's tax reform proposal, banks would lose this cost-of-carry interest deduction on tax-exempt bonds purchased after the end of this year.

Money market and other mutual funds also have purchased tax-exempt securities actively this year. Total assets of tax-exempt money market funds were $40 billion at mid-October, up from $24 billion at the end of 1984. These mutual funds purchase primarily variable-rate demand obligations and large amounts of short-term tax and revenue anticipation note.

Mortgage Market

Mortgage lending appears to have picked up in recent months, reflecting in part the sharply higher level of home sales. Savings and loan associations are beginning to play a larger role in financing the expansion of mortgage flows. Total mortgage assets of FSLIC-insured thrift institutions expanded $8-1/2 billion in August, by far the largest gain since the summer of 1984. This increase included a $3 billion net addition of mortgage-backed securities to their portfolios, after net sales totaling about $10 billion in the first seven months of the year. Improved earnings and capital positions, as well as slow growth in the first half of the year, allow institutions more latitude for growth in the second half of the year under the FHLBB's new marginal net worth requirements.

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

Period	Total	GNMAs	FHLMCs	FNMAs	Memo: FNMA and FHLMC swap issues	Memo: Total issues less swaps
1984-Q1	4.9	2.7	.9	1.3	1.6	3.3
Q2	4.0	2.3	1.1	.5	1.5	2.5
Q3	5.1	2.2	1.4	1.5	2.7	2.4
Q4	6.0	2.0	2.8	1.2	3.5	2.5
1985-Q1	6.4	2.7	2.4	1.3	3.0	3.4
Q2 r	7.5	3.3	2.8	1.5	3.3	4.2
Q3 p	10.1	4.1	3.5	2.5	4.6	5.5
1985-Mar.	6.6	2.8	2.8	1.1	3.3	3.3
Apr.	6.4	2.6	2.0	1.9	3.3	3.1
May	7.8	3.6	3.2	1.0	3.2	4.6
June	8.4	3.6	3.3	1.5	3.5	4.9
July	9.6	3.9	4.2	1.5	4.1	5.5
Aug. r	9.0	4.2	2.7	2.2	3.9	5.1
Sep. p	11.6	4.4	3.5	3.7	5.8	5.8

r--revised. p--preliminary.

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

	Mortgage commitments		Net change in mortgage assets[1]		
	New (1)	Outstanding[2] (2)	Total (3)	Mortgage loans (4)	Mortgage-backed securities (5)
1985-Jan.	16.9	69.1	3.5	4.3	-.9
Feb.	16.1	68.5	3.2	2.5	.6
Mar.	16.0	67.7	5.1	5.0	.1
Apr.	16.5	66.1	4.1	4.9	-.8
May	16.8	65.5	1.7	2.9	-1.2
June	16.3	66.1	-2.2	2.7	-5.0
July r	17.6	66.2	1.8	4.7	-2.9
Aug. p	20.9	66.0	8.4	5.4	3.0

1. Data are adjusted to account for structural changes through mergers, acquisitions, liquidations, terminations, or de novo institutions.
2. End of month. Includes loans in process.
r--revised. p--preliminary.

Issuance of pass-through securities was at a record pace in September. Fannie Mae's pass-through sales have increased sharply from the levels earlier in the year. A large portion of this issuance is in the form of swaps with mortgage originators. In addition, Fannie Mae recently has started selling more of its own mortgages by issuing pass-through securities, to assist in restructuring its portfolio.

Issuance of GNMA-guaranteed securities also has strengthened in recent months, reflecting a shift toward FHA-insured and VA-guaranteed loans. These federally underwritten mortgages have become particularly attractive to home buyers seeking mortgages with high loan-to-value ratios, because qualification standards for conventional loans have been tightened and insurance premiums on such mortgages have been raised during recent months. On the investor side of the GNMA market, mutual funds that restrict their portfolios to government securities in general, or GNMA securities predominantly, have grown rapidly in recent quarters, but they still account for a small share of the total pass-through security market.

The large volume of pass-through issuance is consistent with a shift toward fixed-rate mortgages, because ARMs still are a minor factor in the mortgage-backed security market. FHLBB survey data show that in early September adjustable-rate mortgages comprised only 48 percent of all conventional home loans closed—near the smallest share of the past two years, and down from 56 percent during the summer. This shift to fixed-rate mortgages has occurred despite an initial-rate advantage on ARMs of about 250 basis points. Homebuyers appear to be gravitating to fixed-rate mortgages because these instruments are available at rates near their five-year lows and typically involve smaller mortgage insurance premiums than ARMs with the same loan-to-value ratio.

CONSUMER INSTALLMENT CREDIT

	1983	1984	1985 Q1	1985 Q2	1985 June	1985 July	1985 Aug.
	-------- Percent rate of growth, SAAR --------						
Change in outstandings--total	14.6	20.0	21.8	18.9	12.7	15.0	15.0
By type:							
Automobile credit	13.4	20.6	22.0	21.9	17.0	14.8	15.4
Revolving credit	17.7	23.9	30.0	17.6	-.8	9.6	10.5
All other[1]	14.0	17.5	17.3	16.8	15.8	18.1	17.0
	---------- Billions of dollars, SAAR ----------						
Change in outstandings--total	48.7	76.8	98.4	90.2	62.7	75.0	75.7
By type:							
Automobile credit	16.9	29.5	37.9	39.9	32.2	28.4	29.8
Revolving credit	12.4	19.6	28.5	17.9	-.9	10.3	11.2
All other[1]	19.5	27.8	32.1	32.4	31.4	36.3	34.7
By major holder:							
Commercial banks	19.5	40.4	54.9	38.6	20.3	21.9	21.2
Finance companies	9.3	9.3	16.6	21.9	14.6	19.6	28.5
All other	20.0	27.1	27.0	29.7	27.8	33.5	26.1
	----------- Annual percentage rate -----------						
Interest rates							
At commercial banks[2]							
New cars, 48 mos.	13.92	13.71	13.37	13.16	n.a.	n.a.	12.72
Personal, 24 mos.	16.68	16.47	16.21	16.09	n.a.	n.a.	15.84
Credit cards	18.78	18.77	18.85	18.74	n.a.	n.a.	18.62
At auto finance companies[3]							
New cars	12.58	14.62	13.85	11.95	12.06	12.46	10.87
Used cars	18.74	17.85	17.86	17.80	17.77	17.49	17.57

1. Includes primarily personal cash loans, home improvement loans, mobile home loans, and sales finance contracts for non-automotive consumer durable goods.
2. Average of "most common" rates charged, on loans of specified type and maturity, during the first week in the middle month of each quarter.
3. Average rate for all loans of each type made during the period, regardless of maturity.
n.a.--not available.

Consumer Installment Credit

Consumer installment credit expanded at a 15 percent annual rate in August, unchanged from July. Growth in the two months was off noticeably from the roughly 20 percent annual rate experienced over the previous 1-1/2 years. Automobile loans expanded a bit more rapidly in August than in July, with a strong increase in loans at finance companies more than offsetting slower growth at commercial banks and credit unions. The finance company share of loans outstanding was boosted by the reduced-rate financing incentives offered on a broad range of 1985 models during the last 10-day selling period of that month by all of the major manufacturers through their captive finance companies; the share held by commercial banks dropped sharply as a result. Growth in revolving credit picked up a bit in August to a 10.5 percent annual rate, but remained well below the very rapid advances posted during the January-May period.

Preliminary data for commercial banks in September show a further slowing in the growth of consumer installment loans. However, this slowing likely reflects an additional shift of auto loans from banks to finance companies.

Foreign Exchange Markets

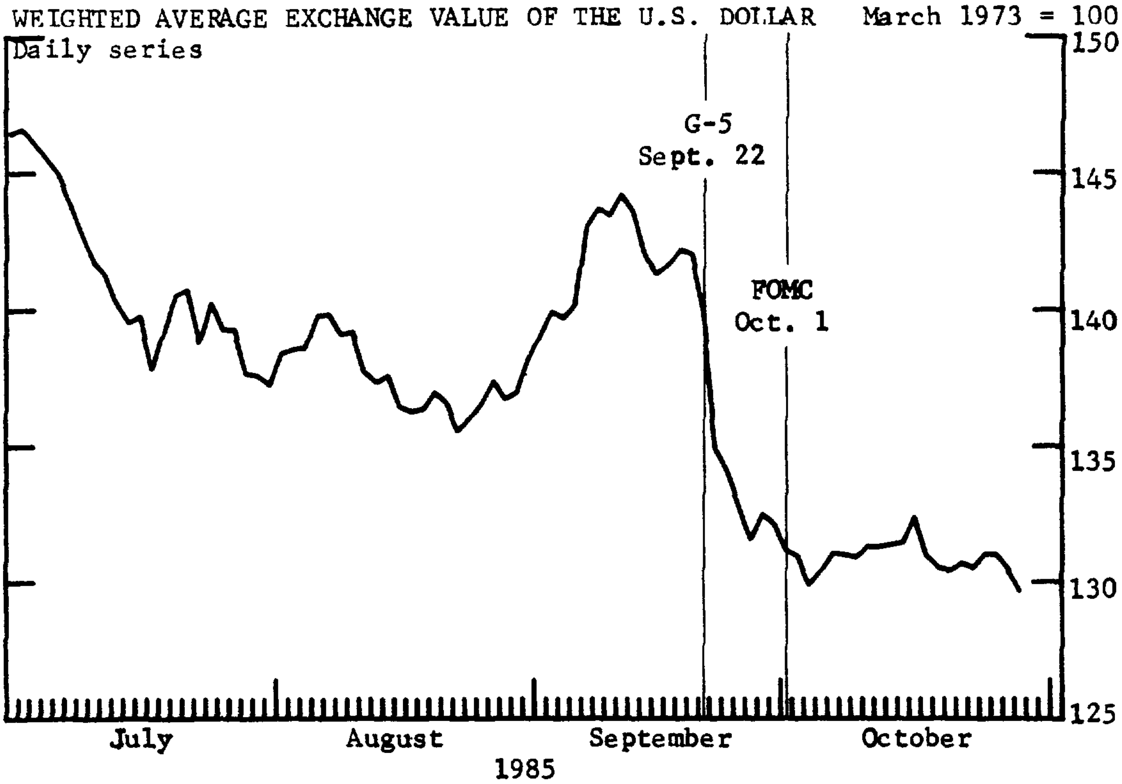
The trade-weighted value of the dollar, shown in the upper panel of the chart, has declined 2-3/4 percent further on balance since the last FOMC meeting, bringing its net depreciation to 7-1/2 percent since the G-5 announcement of September 22. As the chart's bottom panel illustrates, since the G-5 announcement, the dollar has depreciated most against the yen, which market participants correctly perceive to be the focus of G-5 concern. The dollar has declined nearly 12 percent against the yen, but only 8 percent vis-a-vis the mark and 5 percent in terms of sterling.

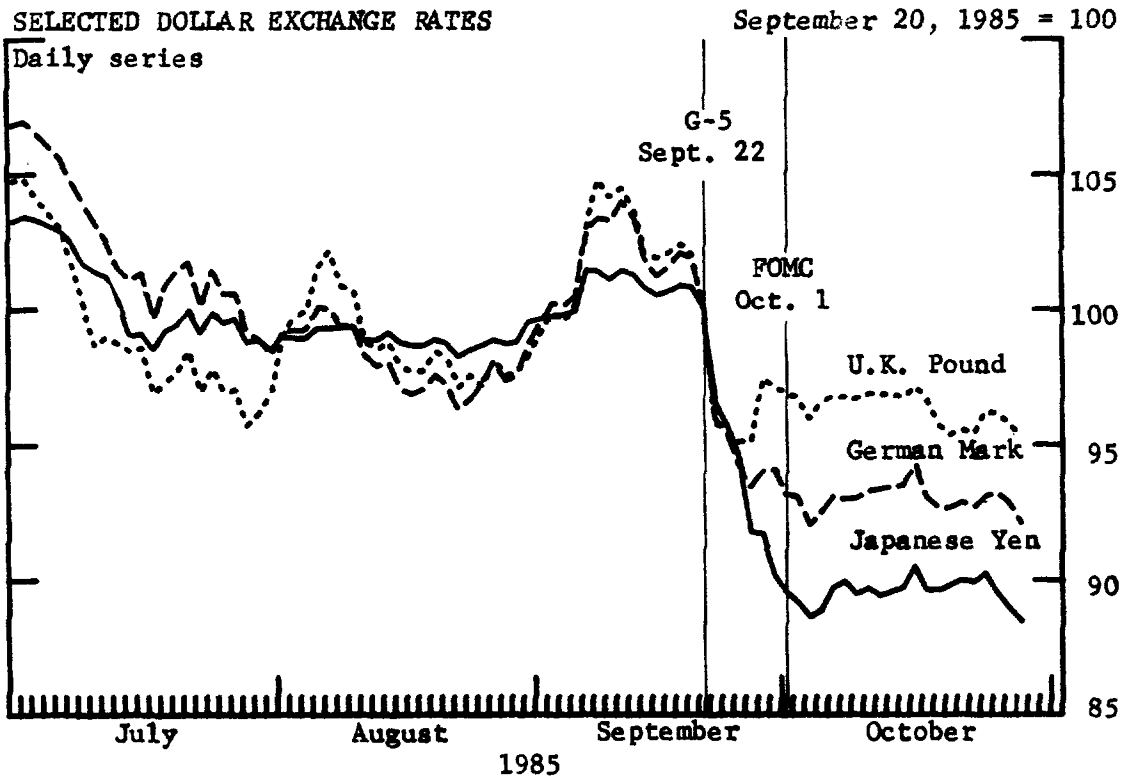
The dollar's weighted value fell nearly 2-1/2 percent during the first week of October, as market participants remained concerned about potentially forceful central bank sales of dollars and looked to the IMF/World Bank meetings in Seoul for further announcements by G-5 officials. The dollar firmed somewhat when reports from Seoul suggested that G-5 authorities were satisfied with the dollar's level and that no significant policy changes to back up the intervention effort were imminent.

The dollar subsequently traded in a narrow range.

. Data on the U.S. economy, meanwhile, presented a slightly weaker picture than the market reportedly expected. The dollar's steadiness in the face of these influences was consistent with dealer reports of strong commercial and investment demand for dollars, particularly from Japanese investors.

Chart 1


WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR
March 1973 = 100
Daily series
G-5
Sept. 22
FOMC
Oct. 1
150
145
140
135
130
125
July
August
September
October
1985


SELECTED DOLLAR EXCHANGE RATES
September 20, 1985 = 100
Daily series
G-5
Sept. 22
FOMC
Oct. 1
U.K. Pound
German Mark
Japanese Yen
105
100
95
90
85
July
August
September
October
1985

Near the end of the intermeeting period, the dollar began again to weaken, declining initially versus the yen when the Bank of Japan indicated that in the context of efforts to support the yen, it would not be appropriate for the Bank to accommodate the season's strong demands for liquidity as it usually does. Interest rates on yen money-market instruments responded with sharp increases, and yen bond yields rose steeply as well, even though Japanese officials denied they were changing policy or trying to guide interest rates permanently higher. The dollar's falloff broadened to include the other major currencies in association with some increase in interest rates in German and British credit markets and declines in U.S. interest rates. In the context of the Bank of Japan's actions, market participants conjectured that G-5 authorities might be embarking on a coordinated effort to narrow U.S.-foreign interest-rate differentials in a "second phase" of the program to depress the value of the dollar.

U.S. International Financial Transactions

U.S. corporations continued to raise substantial amounts in the Eurobond markets in September and the first half of October. While foreign currency and dual currency issues were still appearing, they were down from the August peak. FNMA issued dual currency (yen-dollar) bonds in the Euromarket and Y30 billion (about $140 million) in bonds in the U.S. domestic market, the first fixed-rate foreign-currency denominated bond to be issued in the domestic market by a U.S. borrower. The resulting foreign currency exposure for FNMA was eliminated through swaps. The minimum denomination for the domestic issue was 1 million yen (about $4600), in contrast to the much larger minimum denominations of certain other recent foreign currency issues that were clearly targeted at U.S. institutional investors.

Also of note was the $500 million floating rate Euronote issued in October by Citicorp, priced at 0.225 percent over one-month LIBID. Despite its large size, it apparently sold well, indicating that certain U.S. banks continue to be able to raise large sums in the Euromarkets. The 25 largest U.S. banks have raised almost $8 billion through the issue of Eurobonds in the first 10 months of 1985. In contrast, U.S.-based banks have reduced somewhat the CDs outstanding at their London branches.

Turning now to the Summary Table of U.S. International Transactions, the net capital inflows corresponding to the large U.S. current account deficit are not apparent in the data currently available for August. Inflows of official capital were small (lines 4 and 5) and net private securities transactions (line 2) were less than $2 billion. Private foreigners sold over $3 billion dollars net of U.S. Treasury securities in August (line 3). This was more than accounted for by the World Bank, which shifted the composition but not the overall size of its dollar portfolio. The sale of almost $4.5 billion in Treasury and Agency securities by the IBRD was accompanied by about a $2.5 billion increase in IBRD deposits at banks in the United States (mostly IBFs), accounting for the bulk of the $3 billion bank-reported inflow (line 1).

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

	1983 Year	1984 Year	1984 Q1	1984 Q2	1984 Q3	1984 Q4	1985 Q1	1985 Q2	1985 June	1985 July	1985 Aug.
Private Capital											
Banks											
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	13.4	22.0	12.9	0.7	9.6	-1.2	15.8	-1.2	-4.9	7.4	3.0
Securities											
2. Private securities transactions, net	1.6	7.9	2.2	-0.2	0.3	5.7	7.0	5.0	1.7	4.0	1.7
a) foreign net purchases (+) of U.S. corporate bonds	2.2	13.8	0.5	0.6	2.6	10.1	10.6	6.7	1.8	4.4	1.8
b) foreign net purchases (+) of U.S. corporate stocks	6.4	-0.8	1.0	-0.1	-1.0	-0.8	-1.1	0.4	0.3	0.6	0.7
c) U.S. net purchases (-) of foreign securities	-7.0	-5.1	0.7	-0.7	-1.3	-3.6	-2.5	-2.1	-0.4	-1.1	-0.8
3. Foreign net purchases (+) of U.S. Treasury obligations 1/	8.7	22.5	1.4	6.5	5.1	9.5	2.7	5.1	2.6	3.2	-3.3
Official Capital											
4. Changes in foreign official reserve assets in U.S. (+ = increase)	5.2	2.6	-3.0	-0.8	-0.6	7.0	-10.7	7.9	4.1	2.9	0.4
a) By area											
G-10 countries (incl. Switz.)	6.4	3.1	2.3	-0.7	-0.8	2.2	-5.5	6.1	2.6	3.9	0.6
OPEC	-8.5	-5.3	-2.8	-2.4	-0.6	0.6	-1.7	-2.0	0.5	-0.2	-1.1
All other countries	7.3	4.9	-2.6	2.4	0.8	4.3	-3.6	3.8	1.0	-0.7	0.8
b) By type											
U.S. Treasury securities	7.0	4.7	-0.3	-0.3	-0.6	5.8	-7.2	8.7	4.6	3.9	-0.7
Other 2/	-1.7	-2.1	-2.8	-0.5	**	1.2	-3.5	-0.8	-0.6	-1.0	1.1
5. Changes in U.S. official reserve assets (+ = decrease)	-1.2	-2.7	-0.7	-0.6	-0.8	-1.1	-0.2	-0.4	-0.1	0.2	-0.1
Other transactions (Quarterly data)											
6. U.S. direct investment (-) abroad	-4.9	-4.5	-3.1	2.0	2.0	-5.4	1.9	-4.1	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	11.3	22.5	3.3	9.3	5.2	4.7	2.1	4.9	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow) 3/ 4/	-1.8	6.5	1.3	5.7	0.7	-0.7	-5.3	5.0	n.a.	n.a.	n.a.
9. U.S. current account balance 4/	-41.6	-101.5	-19.1	-24.5	-32.5	-25.5	-30.3	-31.8	n.a.	n.a.	n.a.
10. Statistical discrepancy 4/	9.3	24.7	4.8	1.9	11.0	7.0	17.0	8.9	n.a.	n.a.	n.a.
MEMO:											
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-61.1	-108.4	-25.6	-25.7	-32.5	-24.6	-29.6	-33.0	11.9	-9.6	-8.7

1. Includes U.S. Treasury notes publicly issued to private foreign residents.
2. Includes deposits in banks, commercial paper, acceptances, & borrowing under repurchase agreements.
3. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking and official transactions not shown elsewhere.
4. Includes seasonal adjustment for quarterly data.
* Less than $50 million.
NOTE: Details may not add to total because of rounding.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1981	1982	1983	1984		1985				
	Dec.	Dec.	Dec.	June	Dec.	Mar.	June	July	Aug.	Sept.
1. Net Claims of U.S. Banking Offices (excluding IBFs) on Own Foreign Offices	7.8	32.9	39.3	32.2	25.4	26.0	27.6	30.8	25.6	22.4
2. Net Claims of U.S. Banking Offices on Own IBFs 1/	11.8	16.2	5.2	4.4	7.8	6.1	8.1	8.9	6.9	9.1
3. Sum of lines 1 and 2 of which:	19.6	49.1	44.5	35.2	33.2	32.1	35.7	39.8	32.5	31.5
(a) U.S.-chartered banks	22.3	40.0	40.5	33.6	32.1	30.6	33.4	39.3	33.6	31.5
(b) Foreign-chartered banks	-2.6	9.1	4.0	1.6	1.1	1.6	2.2	.4	-1.1	*
4. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	13.2	15.8	18.6	19.9	20.7	19.2	20.2	19.6	19.3	19.5
5. Eurodollar Holdings of U.S. Nonbank Residents 2/	95.5	112.6	124.2	124.3	117.4	118.7	109.5	107.4	108.7	110.1

1. Corresponds to net claims of international banking facilities (IBFs) on all foreign residents, including all banks whether related or not, and all nonbanks.
2. Include terms and overnight Eurodollars held by money market mutual funds.
*/ Less than 50 million.

Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactionsaccounts. Line 1 is an estimate constructed as the residual of line 3 minus line 2. Line 2 is data for the last Wednesday of the month for the sample of monthly IBF reporters. Line 3 is an average of daily data reported to the Federal Reserve byU.S. banking offices. Line 4 is an average of daily data. Line 5 is the month-end value for data through September 1983. For dates after September 1983, the overnight portion is an average of daily data and the term portion is an average of Wednesday data.

U.S. Merchandise Trade

The published merchandise trade deficit was smaller in August than in July, and for the two-month period on average it was $110 billion, SAAR, substantially smaller than the deficit recorded in the second quarter; most of the change was in imports. These data, however, need to be assessed with an extra amount of caution.

Preliminary calculations of revisions anticipated in the monthly trade data suggest that the level of merchandise imports for July will end up being much larger than the currently published figures imply; revisions for August data will be available with the release of September trade figures on October 31.

The revisions involve recompiling trade data beginning in 1983 to reflect the actual month of entry for imports and the month of shipment for exports. In currently published data the carry-over of documents received too late for inclusion in the appropriate statistical month has become very large and varies in size from month-to-month. Current practice calls for late documents to be just added to the current month's figures. For the August data, this carry-over amounted to 47 percent of the value of imports and 11 percent of the value of exports. The size of the revisions anticipated suggest that at some point there will be a significant revision in the quarterly pattern of net trade in the GNP account and in the international transactions account. A rough estimate of a revised trade balance is shown in the table below. The corrections to the data tend to eliminate some, but not all, of the wide variability in the reported monthly export and import figures.

U.S. MERCHANDISE TRADE[1]/

	Year 1984	1984 Q4	1985 Q1	Q2	July/Aug	July	Aug.
Value (Bil. $, SAAR)							
Exports	220.3	225.4	222.8	213.0	210.7	209.2	212.1
Agricultural	38.4	38.3	33.5	28.3	25.9	24.6	27.2
Nonagricultural	181.9	187.2	189.4	184.6	184.8	184.6	184.9
Imports	328.6	323.6	341.0	345.0	320.4	324.7	316.1
Oil	57.5	56.8	45.2	52.8	46.1	47.0	45.2
Nonoil	271.1	266.9	295.7	292.2	274.3	277.7	270.9
Trade Balance	-108.3	-98.2	-118.1	-132.0	-109.7	-115.5	-104.0
(Estimated Revised Trade Balance)	(-112.5)	(-120.0)	(-111.0)	(-121.5)	(n.a.)	(-149.5)	(n.a.)
Volume (Bil 72$, SAAR)							
Exports							
Agricultural	16.3	17.3	15.3	13.1	12.3	11.6	13.0
Nonagricultural	63.0	64.7	64.4	62.3	63.4	63.0	63.8
Imports							
Oil	5.3	5.3	4.3	5.1	4.6	4.7	4.5
Nonoil	104.0	102.0	115.9	115.3	107.8	109.5	106.1

1/ International transactions and GNP basis. Monthly data are estimated.

Published data for total imports in July and August were notably lower than imports in the previous several months. Large declines from second-quarter levels were reported for industrial supplies (particularly steel), machinery (especially business machines), aircraft, durable consumer goods, and trucks and automotive parts from Canada. In addition, the value of oil imports fell by 13 percent. The decline in oil imports was in both volume and price. See the table below. Taking a somewhat longer perspective, the value of total imports for the first 8 months of 1985 was 2½ percent higher than for the same period a year ago; at the same time import prices on average declined nearly 5 percent.

OIL IMPORTS

	Year 1984	1984 Q4	1985 Q1	1985 Q2	1985 J/A	1985 July	1985 August
Volume (mbd, SA)	5.62	5.62	4.61	5.40	4.87	4.92	4.80
Price ($/BBL)	27.95	27.59	26.86	26.97	26.00	26.13	25.78
Value (Bil. $, SAAR)	57.48	56.79	45.22	52.78	46.10	46.98	45.23

Exports in July-August were little changed from the second-quarter rate. A decline in exports of agricultural products and machinery was largely offset by an increase in aircraft exports. The value of exports in July-August was 5 percent lower than the level recorded a year earlier despite a small increase in export prices and continued growth of economic activity abroad. An important factor in this weakness in exports is the continuing lagged effects of the dollar's sharp appreciation through early 1985.

Foreign Economic Developments. Economic growth has been moderate but uneven in the major foreign industrial countries. The trade weighted average of industrial production for the major six foreign industrial countries rose 1.6 percent (s.a.) in July above its level in the second quarter; this is 3.2 percent above what it was in July 1984. Industrial production fell in Japan in August and September. In August, industrial production fell in Germany, and it was roughly unchanged in the United Kingdom and Italy. Inflation abroad continues to be moderate, with most countries experiencing gains in the recent data. The balance of trade continues to be in surplus in Japan, Germany, and Canada. Italy saw a strong improvement in its trade balance in the most recent data, while in the United Kingdom and France the trade balance deteriorated slightly.

Individual Country Notes. In Japan, recent data suggest a continued slowing of the rate of economic growth. Japanese industrial production fell 1.3 percent (s.a.) in August and 1.1 percent (s.a.) in September to a level 3.5 percent above what it had been a year earlier. Retail sales declined by 1.4 percent (s.a.) in August, but new housing starts rose in September after having declined in the five previous months.

The Tokyo consumer price index rose 2.7 percent during the 12 months ending in October, up 0.5 percent from the equivalent rate recorded in September. Japan's external surpluses continued at record rates. For the first eight months of 1985, the cumulative trade surplus was $51 billion (s.a.a.r.), compared with $44 billion for all of 1984.

October 30, 1985

REAL GNP AND INDUSTRIAL PRODUCTION IN MAJOR INDUSTRIAL COUNTRIES
(PERCENTAGE CHANGE FROM PREVIOUS PERIOD, SEASONALLY ADJUSTED)

	Q4/Q4 1983	Q4/Q4 1984	1984 Q4	1985 Q1	1985 Q2	1985 Q3	1985 MAY	1985 JUNE	1985 JULY	1985 AUG.	1985 SEP.	LATEST 3 MONTHS FROM YEAR AGO+
CANADA												
GNP	7.1	4.3	.8	.9	1.0	N.A.	*	*	*	*	*	4.5
IP	16.1	4.4	-.1	.2	.8	N.A.	-.3	1.7	1.9	N.A.	N.A.	3.5
FRANCE												
GDP	1.1	1.7	-.1	-.3	.6	N.A.	*	*	*	*	*	1.4
IP	2.4	1.3	-1.5	-.8	.8	N.A.	1.5	-1.5	3.1	.0	N.A.	.8
GERMANY												
GNP	3.1	2.7	.8	-1.2	1.4	N.A.	*	*	*	*	*	3.2
IP	6.0	3.6	1.4	-1.2	1.6	N.A.	.9	1.7	2.4	-2.8	N.A.	7.8
ITALY												
GDP	2.2	1.7	-.6	.8	.8	N.A.	*	*	*	*	*	2.1
IP	1.7	1.8	-1.8	1.8	.3	N.A.	1.3	2.8	-3.8	.2	N.A.	.5
JAPAN												
GNP	3.9	6.5	2.4	.2	1.9	N.A.	*	*	*	*	*	5.2
IP	8.6	10.6	2.7	-.7	2.7	-.1	2.4	-2.0	1.7	-1.3	-1.1	4.7
UNITED KINGDOM												
GDP	3.7	2.6	1.4	1.1	1.2	N.A.	*	*	*	*	*	4.9
IP	5.4	-.5	1.0	2.1	2.3	N.A.	.4	-.3	-1.5	.5	N.A.	4.7
UNITED STATES												
GNP	6.3	5.7	1.0	.1	.5	.8	*	*	*	*	*	2.4
IP	14.3	7.2	-.2	.5	.3	.3	.0	.2	-.2	.6	-.1	1.0

* DATA NOT AVAILABLE ON A MONTHLY BASIS.

+ IF QUARTERLY DATA, LATEST QUARTER FROM YEAR AGO.

October 30, 1985

CONSUMER AND WHOLESALE PRICES IN MAJOR INDUSTRIAL COUNTRIES
(PERCENTAGE CHANGE FROM PREVIOUS PERIOD)

	Q4/Q4 1983	Q4/Q4 1984	1984 Q2	1984 Q3	1984 Q4	1985 Q1	1985 Q2	1985 Q3	1985 JULY	1985 AUG.	1985 SEP.	1985 OCT.	LATEST 3 MONTHS FROM YEAR AGO
CANADA													
CPI	4.6	3.7	.9	.9	.7	1.2	1.1	.9	.3	.2	.2	N.A.	4.0
WPI	3.5	3.6	1.2	.5	.3	1.0	.7	N.A.	.0	-.0	N.A.	N.A.	2.2
FRANCE													
CPI	9.8	6.8	1.8	1.7	1.4	1.4	1.8	.9	.4	.1	.1	N.A.	5.7
WPI	14.6	10.5	2.9	2.2	1.6	1.6	.7	N.A.	-.7	-.4	N.A.	N.A.	4.5
GERMANY													
CPI	2.7	2.0	.5	.0	.7	1.1	.6	-.3	-.2	-.3	.1	.0	1.9
WPI	.9	1.0	.8	-1.4	.0	1.9	.9	-2.1	-1.2	-.7	.3	N.A.	.7
ITALY													
CPI	13.0	8.8	2.1	1.4	2.2	2.6	2.2	1.1	.3	.2	.4	N.A.	8.5
WPI	9.1	8.8	2.2	1.2	1.9	2.7	2.2	N.A.	-.3	.0	N.A.	N.A.	7.5
JAPAN													
CPI	1.9	2.4	.6	-.2	1.2	.6	.5	.2	.5	-.9	1.0	1.2	2.5
WPI	-3.3	.5	-.1	.8	-.3	.4	-.7	-1.0	-.4	-.4	-.3	N.A.	-1.6
UNITED KINGDOM													
CPI	5.1	4.8	2.0	.9	1.2	1.3	3.4	.3	-.2	.3	-.1	N.A.	6.3
WPI	5.6	6.0	2.3	.6	1.3	1.7	2.0	.5	.2	.1	.3	N.A.	5.6
UNITED STATES													
CPI (SA)	3.2	4.1	.9	.9	.9	.8	1.0	.6	.2	.2	.2	N.A.	3.3
WPI (SA)	.8	1.7	.4	.0	.1	.2	.5	-.2	.3	-.3	-.6	N.A.	.6

October 30, 1985

TRADE AND CURRENT ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES 1/
(BILLIONS OF U.S. DOLLARS; SEASONALLY ADJUSTED)

			1984			1985			1985			
	1983	1984	Q2	Q3	Q4	Q1	Q2	Q3	JUNE	JULY	AUG.	SEP.
CANADA												
TRADE	14.4	15.9	4.0	4.0	4.4	4.0	3.4	N.A.	.7	.2	.8	N.A.
CURRENT ACCOUNT	1.4	1.7	.3	.5	.9	.6	.3	N.A.	*	*	*	*
FRANCE												
TRADE 2/	-5.9	-2.7	-1.2	.4	-.3	-1.1	-.4	-.7	.2	-.4	.0	-.3
CURRENT ACCOUNT 2/	-4.9	-.1	-.4	.9	.1	-.8	.5	N.A.	*	*	*	*
GERMANY												
TRADE	16.4	18.8	3.2	5.0	6.3	4.5	6.2	N.A.	2.1	2.6	N.A.	N.A.
CURRENT ACCOUNT (NSA)	4.2	5.8	-.1	-.9	6.0	1.7	3.1	2.1	-.1	.8	-.3	1.5
ITALY												
TRADE	-7.9	-10.7	-2.9	-1.4	-4.2	-3.8	-3.7	N.A.	-1.6	-.3	-.0	N.A.
CURRENT ACCOUNT (NSA)	.8	-3.2	-1.0	1.3	-1.7	N.A.	N.A.	N.A.	*	*	*	*
JAPAN												
TRADE 2/	31.3	44.1	10.6	9.9	13.7	11.5	13.0	N.A.	4.4	4.5	4.8	N.A.
CURRENT ACCOUNT	21.0	35.0	8.8	7.2	11.7	9.4	12.1	N.A.	4.2	4.1	3.9	N.A.
UNITED KINGDOM												
TRADE	-.8	-5.7	-1.8	-2.1	-1.6	-1.5	-.3	-.6	-.3	-.1	-.3	-.3
CURRENT ACCOUNT 2/	4.4	1.3	-.2	-.5	.5	-.6	1.5	1.0	.3	.5	.3	.3
UNITED STATES												
TRADE	-62.0	-108.3	-25.6	-32.5	-24.6	-29.5	-33.0	N.A.	-11.9	-9.6	-8.7	N.A.
CURRENT ACCOUNT	-40.8	-101.5	-24.5	-32.5	-25.5	-30.3	-31.8	N.A.	*	*	*	*

1/ THE CURRENT ACCOUNT INCLUDES GOODS, SERVICES AND PRIVATE AND OFFICIAL TRANSFERS.
2/ QUARTERLY DATA ARE SUBJECT TO REVISION AND ARE NOT CONSISTENT WITH ANNUAL DATA.

* COMPARABLE MONTHLY CURRENT ACCOUNT DATA ARE NOT PUBLISHED.

During the same period, the cumulative current account surplus was $44 billion (s.a.a.r.), while it was $35 billion in 1984.

In an effort to blunt growing protectionist pressure and in light of commitments made during the G-5 meeting on September 22, Prime Minister Nakasone announced on October 15 a package of measures designed to stimulate domestic demand. These measures seek to encourage domestic investment by promoting plant and equipment purchases, housing and real estate development, local government borrowing for public works, and consumer borrowing. The government estimates that these measures will increase Japan's gross national product next year by 1-1/4 percent and that they will generate a $2 billion increase in Japanese imports over the next twelve months. These official estimates are probably too optimistic, since the measures cited fail to include substantial fiscal stimulation. Tax reform proposals are currently being studied for fiscal year 1986, but preliminary indications are that any tax measures will be revenue neutral.

Industrial production in Germany fell in August, but the two month average for July and August was 2.4 percent above that of the second quarter and 4 percent above the average of July and August of 1984. Survey information on business conditions and order volume data, covering both domestic and foreign goods, suggest some improvement in outlook. The Bundesbank reports continued advances in corporate profits this year and increased purchases of machinery and equipment, especially in the investment goods sector. The level and the rate of unemployment fell slightly in September.

The consumer price index has barely moved between March and October. The year-over-year rate of increase was 2 percent in October, with falling import prices contributing to the stability in consumer prices. In addition, wage increases have been low and unit costs have been flat so far this year.

The cumulative current account surplus through September was $7 billion (n.s.a.), while it was roughly in balance for the same period of last year. This improvement is entirely the result of the increase in the trade surplus.

A tax cut of about DM 11 billion, equivalent to 0.7 percent of nominal GNP, will become effective at the beginning of 1986. The government has so far withstood considerable pressure to reduce taxes by an additional DM 10 billion. Further tax reductions are planned for fiscal year 1988.

The index of industrial production in the United Kingdom rose 0.5 percent (s.a.) in August, after having fallen during the previous two months. When adjusted for unusually low oil production, the level of industrial production appears unchanged during the summer. Real consumption, however, rose 3.2 percent (s.a.a.r.) in the third quarter, indicating continued moderate GDP growth.

The sharp acceleration in U.K. price inflation that took place in the spring now appears to have abated. Retail prices were flat between June and September, and the twelve-month inflation rate in September declined to 5.9 percent. The U.K. trade deficit was $2.5 billion (s.a.a.r.) in the third quarter. The cumulative trade deficit for the first three quarters of 1985 was \$3.2 billion (s.a.a.r.) and the cumulative current account surplus during the same period was \$2.7 billion (s.a.a.r.). The trade deficit in 1984 was \$5.7 billion.

The year-over-year growth of £M3 in September exceeded 14 percent, well above its 5 to 9 percent target rate. Chancellor of the Exchequer Nigel Lawson stated on October 17 that the government is prepared to tolerate such growth during the 1985/86 fiscal year because other indicators suggest that monetary conditions are not untowardly loose. The government, however, has not abandoned £M3 as a monetary policy target and will set a £M3 target next year. Chancellor Lawson announced that the government was renouncing the technique of overfunding as a means of controlling the money supply. Overfunding takes place when the Bank of England sells more long-term government debt than is needed for the government's budget requirements, typically offsetting the effect of these additional debt sales on market liquidity through the purchase of commercial bills. Lawson said further that Bank of England will instead rely on short-term interest rates to control monetary conditions. This statement has been widely interpreted as being consistent with a policy of continued high interest rates.

Economic activity in France has strengthened slightly in recent months. After declining in June, industrial production rose to an average level for July and August that was 2.5 percent (s.a.) above that for the second quarter. The September survey of manufacturers shows increased production, and the unemployment rate in September declined to 10.4 percent (s.a.), the lowest in ten months.

French consumer prices increased only 0.1 percent in September, the same increase as in August. The rate of inflation over the preceding twelve months was 5.3 percent, down about 1 percent since the start of the year. This decline is attributable in part to lower import prices. Inflation is thus only slightly above the government's revised target of 5 percent by the end of this year.

The balance of trade was in deficit in September after having been in balance in August. Imports rose more quickly in value than exports in September, resulting in a deficit of $0.3 billion (s.a.). Through September the cumulative trade deficit was $2.9 billion (s.a.a.r.), slightly above the $2.7 billion deficit recorded in all of 1984.

Gross domestic product in Canada increased 1 percent in July bringing the twelve-month increase to 3.8 percent. Automobile and automobile parts accounted for much of the rise in GDP. Industrial production increased 1.9 percent (s.a.) in July, owing to a large increase in manufacturing output. The unemployment rate fell a further 0.2 percent to 10.1 percent in September. The unemployment rate has declined 1.1 percent since January.

Inflation remains moderate in Canada. Consumer prices increased 0.2 percent in September, bringing the twelve-month inflation rate to 4.1 percent, slightly higher than in August. The wholesale price index declined in August, leaving wholesale prices only 2.1 percent above year-earlier levels. Meanwhile, Canada's trade surplus increased in August after a sharp decline in July. The cumulative surplus during the first eight months of this year was $12.5 billion (s.a.a.r.), compared with $15.9 billion during all of 1984.

On September 30, the Government of Canada announced the closure of Northland Bank after attempts to save it had failed. The government also appointed a Supreme Court Justice to conduct an inquiry into the events leading to the liquidation of Canadian Commercial Bank and that of Northland Bank, which had occurred on September 1. In the wake of these failures, Mercantile Bank of Canada, the country's eighth largest bank, has faced increasing liquidity problems. The National Bank of Canada announced that it is willing to take over Mercantile Bank. Even though there are rumors that Continental Bank and Bank of British Columbia are also experiencing liquidity problems, concern about the stability of the Canadian banking system as a whole has moderated.

Industrial production in Italy in July and August was 1.5 percent (s.a.) below its average in the second quarter. This is 0.6 percent (s.a.) below its level in July and August of last year, and Italy's industrial production is still below the peak achieved at the beginning of 1982.

The twelve-month rate of inflation as measured by the consumer price index in September was 8.3 percent (n.s.a.), the lowest such figure in more than a decade. The wholesale price index in August was 6.9 percent (n.s.a.) above its level of a year earlier.

The trade account improved in July and August. The trade deficit was $0.3 billion (s.a.) as compared with $1.3 billion (s.a.) during July and August 1984.

Prime Minister Craxi's government fell on October 17, in the wake of the hijacking of the Achille Lauro and the subsequent decision to release Abu Abbas. The Republican Party withdrew from Craxi's coalition, and Finance Minister Visentini, who was responsible for significant tax reforms aimed at lowering Italy's chronic deficit, left the government as a result. On October 21, President Cossiga asked Craxi to form a new coalition, and it is still too early to judge the effect that a new government will have on Italy's economic policies.

Economic Situation in Major Developing Countries. Argentina was found in compliance with the end-July IMF performance tests, but some difficulties may arise with the end-September tests. Real activity has continued to expand in Brazil, but negotiations between Brazil and the IMF remain stalled. Mexico is out of compliance with its IMF program, but following the earthquakes, it will receive up to $800 million in emergency assistance from the IMF, the World Bank, and the Inter-American Development Bank. Venezuela has made progress in registering its private external debt, but the signing of its rescheduling agreement has been further delayed by disputes over the documentation. The Peruvian government has refused to receive a routine IMF mission and has suggested the possibility that Peru will withdraw from the IMF. The Philippines has not yet met the qualitative program targets for the second IMF program review, but the IMF will probably accept the policy actions proposed by the Philippine government. When the review is completed the third tranche of the IMF loan and the second disbursement of the country's new money facility will become available.

Individual Country Notes. Argentina was found in compliance with the end-July IMF performance tests. This triggered the disbursement on September 30 of SDR 235 million from the IMF and $2.2 billion from the new $4.2 billion commercial bank loan. On the same date Argentina completed the repayment of the 12-country bridge loan obtained last June, paid the overdue $750 million balance of the 1982 commercial bank bridge loan, brought interest on public sector debt to banks current up to early September, and made payments on certain other arrears. Compliance with the end-September IMF performance tests is still being assessed, but there are indications that some deviations may have occurred. In September, inflation continued to decelerate with consumer prices rising by only 2 percent. The average monthly yield on 30-day unregulated deposits at private banks declined about 140 basis points from mid-September to mid-October. Factors contributing to this included a 600 basis-point decline in the rate on central bank paper that banks must hold against these deposits, reduction in the reserve requirements against unregulated deposits, and an increase in the volume of such deposits that the banks may accept. On September 24, the Argentine Congress completed action on the forced savings plan that is projected to augment public sector revenues by about 0.6 percent of GDP. The need to accumulate austral balances in order to begin payments into the forced savings plan contributed to an appreciation of the austral in the parallel exchange market. In mid-October, the spread between the parallel and official exchange rates was about 12.5 percent, compared with around 17 percent in mid-September.

Following the September earthquakes, Mexico obtained a six-month postponement of a $950 million prepayment on its 1983 bank loan, which it had promised to make during the fourth quarter under the multi-year debt restructuring agreement signed earlier this year. Emergency assistance from the IMF, the World Bank, and the Inter-American Development Bank totaling up to $800 million will more than cover the impact of the earthquakes on the 1985 current account, which has been estimated at about $700 million. In effect, the earthquakes have handed Mexico an international reserve cushion at a time when it was facing a persistent outflow of capital and the loss of about $900 million in IMF drawings because of deviations from the IMF program's performance tests. For 1986, the Mexican authorities are seeking gross financing to cover a projected current account deficit of $1 billion, and a $2-3/4 billion rebuilding of reserves. Commercial banks are being asked to provide $2-3/4 billion--$2.5 billion on a net basis. Mexico and the IMF have begun discussions on a new stand-by arrangement.

Effective October 1, Mexican Treasury bill rates, which had been market determined for nearly three years, began to be announced before each auction. By this action, the authorities hoped to lower the Treasury bill rate in order to reduce the cost of servicing the domestic debt, which, this year, is exceeding original projections by the equivalent of 2-1/2 percent of GDP, owing to an unanticipated rise in domestic interest rates. Initial auctions under the new system have resulted in replacing only about one third of the amount of maturing bills. The Bank of Mexico absorbed part of the difference and the rest was redeemed. Such an approach cannot long be continued without bringing about an upsurge of inflation and capital flight.

In Brazil, real economic activity has continued to recover in 1985. Industrial production for the first eight months was about 7 percent higher than a year earlier, reflecting rapid growth of domestic demand. The external trade surplus has continued at a $12 billion annual rate, an amount sufficient to finance interest obligations and other external service payments without access to new bank financing. Inflationary forces gathered strength during the third quarter--the fiscal deficit exceeded expectations and growth of the monetary base accelerated, showing a 17 percent increase in September. The impasse continues between the Brazilian government and the IMF management over negotiation of a lower fiscal deficit for 1986 and a credible plan for deceleration of inflation.

Peru's new government has taken further measures in an attempt to restrict imports, stimulate production, and at the same time contain inflation. In early October, a ban was announced on imports of some 500 products, along with removal of the value-added tax on basic necessities. Interest rates were reduced for the third time since the new government took office at the end of July, wages were increased for the second time, and the price freeze was broadened to cover gasoline and utilities. In his speech to the U.N. General Assembly, President Garcia raised the possibility that Peru will withdraw from the IMF. The government has refused to receive a routine IMF mission, and is now in arrears to the Fund. Interest arrears on the public sector's debt to banks are now about $375 million and some exceed one year.

The Venezuelan multi-year rescheduling agreement is tied up in disputes over the documentation. The Venezuelans have requested the inclusion of a clause in the agreement that would allow the terms to be reconsidered if unforeseen circumstances cause them to be unable to meet payments. Problems with the registration of private sector debt, which previously held up the signing, are nearly resolved. The Venezuelan government hopes the agreement will be signed by the end of the year.

On October 7, the Philippines obtained from its creditor banks the eighth extension of a 90-day moratorium on the repayment of principal on non-trade external debt to banks. While the Philippines is still out of compliance with its IMF program, it appears that Fund management is close to accepting the policy changes proposed by the Philippine government. This would allow the program to resume. When this review is satisfactorily completed, the Philippines will be able to draw the third IMF tranche of SDR 106 million, and to receive the second disbursement of $175 million under the $925 million new money facility.