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December 11, 1985

## **RECENT DEVELOPMENTS**

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Prepared for the Federal Open Market Committee

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

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SELECTED DOMESTIC NONFINANCIAL DATA  
(Seasonally adjusted)

|  | Period | Latest data  |         | Percent change from |                       |              |
|--|--------|--------------|---------|---------------------|-----------------------|--------------|
|  |        | Release date | Data    | Preceding period    | Three periods earlier | Year earlier |
| (At annual rates)  |        |              |         |                     |                       |              |
| Civilian labor force   | Nov.   | 12-06-85     | 116.1   | -1.0                | 2.7                   | 1.7          |
| Unemployment rate (%) <sup>1</sup>   | Nov.   | 12-06-85     | 7.0     | 7.1                 | 7.0                   | 7.1          |
| Insured unemployment rate (%) <sup>1</sup>                                   | Aug.   | 11-07-85     | 2.8     | 2.8                 | 2.8                   | 2.7          |
| Nonfarm employment, payroll (mil.)   | Nov.   | 12-06-85     | 98.8    | 2.2                 | 3.2                   | 3.0          |
| Manufacturing  | Nov.   | 12-06-85     | 19.4    | 1.9                 | .2                    | -.9          |
| Nonmanufacturing   | Nov.   | 12-06-85     | 79.4    | 2.3                 | 3.9                   | 4.0          |
| Private nonfarm:   |        |              |         |                     |                       |              |
| Average weekly hours (hr.) <sup>1</sup>                                      | Nov.   | 12-06-85     | 35.0    | 35.1                | 35.1                  | 35.2         |
| Hourly earnings (\$) <sup>1</sup>  | Nov.   | 12-06-85     | 8.67    | 8.64                | 8.60                  | 8.42         |
| Manufacturing:   |        |              |         |                     |                       |              |
| Average weekly hours (hr.) <sup>1</sup>                                      | Nov.   | 12-06-85     | 40.7    | 40.7                | 40.6                  | 40.5         |
| Unit labor cost (1967=100)   | Oct.   | 12-02-85     | 83.3    | .0                  | -5.2                  | -6.3         |
| Industrial production (1977=100)   | Oct.   | 11-15-85     | 124.9   | .0                  | 2.6                   | 1.8          |
| Consumer goods   | Oct.   | 11-15-85     | 121.8   | 3.0                 | 5.7                   | 2.8          |
| Business equipment   | Oct.   | 11-15-85     | 143.2   | 2.5                 | 5.4                   | 2.9          |
| Defense & space equipment  | Oct.   | 11-15-85     | 176.9   | -4.1                | 6.9                   | 8.2          |
| Materials  | Oct.   | 11-15-85     | 113.7   | -2.1                | -.4                   | -.4          |
| Consumer prices all items (1967=100)   | Oct.   | 11-22-85     | 324.6   | 3.7                 | 2.7                   | 3.2          |
| All items, excluding food & energy   | Oct.   | 11-22-85     | 318.1   | 6.4                 | 4.4                   | 4.2          |
| Food   | Oct.   | 11-22-85     | 310.6   | 2.7                 | 2.3                   | 1.7          |
| Producer prices: (1967=100)  |        |              |         |                     |                       |              |
| Finished goods   | Oct.   | 11-15-85     | 294.3   | 10.3                | -.1                   | 1.1          |
| Intermediate materials, nonfood  | Oct.   | 11-15-85     | 324.2   | .0                  | .0                    | -.6          |
| Crude foodstuffs & feedstuffs  | Oct.   | 11-15-85     | 230.6   | 75.2                | 6.0                   | -8.3         |
| Personal income (\$ bil.) <sup>2</sup>                                       | Oct.   | 11-21-85     | 3,220.5 | 4.9                 | 4.0                   | 4.6          |
| (Not at annual rates)  |        |              |         |                     |                       |              |
| Mfgs. new orders dur. goods (\$ bil.)  | Oct.   | 12-04-85     | 104.4   | -2.1                | .1                    | 8.2          |
| Capital goods industries   | Oct.   | 12-04-85     | 33.1    | -11.2               | -8.6                  | 8.9          |
| Nondefense   | Oct.   | 12-04-85     | 27.2    | -7.1                | 1.8                   | 7.6          |
| Defense  | Oct.   | 12-04-85     | 6.0     | -26.3               | -37.7                 | 15.7         |
| Inventories to sales ratio: <sup>1</sup>                                     |        |              |         |                     |                       |              |
| Manufacturing and trade, total   | Sept.  | 12-11-85     | 1.35    | 1.34                | 1.39                  | 1.37         |
| Manufacturing  | Oct.   | 12-04-85     | 1.43    | 1.46                | 1.47                  | 1.49         |
| Trade  | Sept.  | 12-11-85     | 1.26    | 1.26                | 1.31                  | 1.26         |
| Ratio: Mfgs.' durable goods inven-<br>tories to unfilled orders <sup>1</sup> | Oct.   | 12-04-85     | .538    | .538                | .547                  | .549         |
| Retail sales, total (\$ bil.)  | Oct.   | 11-14-85     | 115.5   | -3.3                | 1.0                   | 6.0          |
| GAP <sup>3</sup>   | Oct.   | 11-14-85     | 25.5    | -.2                 | 3.2                   | 6.5          |
| Auto sales, total (mil. units.) <sup>2</sup>                                 | Nov.   | 12-04-85     | 9.7     | 1.7                 | -21.3                 | -2.8         |
| Domestic models  | Nov.   | 12-04-85     | 6.4     | 1.9                 | -33.0                 | -11.8        |
| Foreign models   | Nov.   | 12-04-85     | 3.3     | 1.3                 | 18.1                  | 20.6         |
| Housing starts, private (thous.) <sup>2</sup>                                | Oct.   | 11-19-85     | 1,760   | 10.8                | 5.8                   | 12.5         |
| Leading indicators (1967=100)  | Oct.   | 12-02-85     | 171.1   | .3                  | 1.5                   | 4.2          |

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

2. At annual rates.

3. Excludes mail order houses.

## DOMESTIC NONFINANCIAL DEVELOPMENTS

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Economic activity appears to be expanding at a moderate pace in the current quarter, although probably less rapidly than the upwardly-revised 4.3 percent annual rate of increase in real GNP reported for the third quarter. In particular, labor market data showed continued expansion in October and November. Prices increased faster in October than in previous months, but the pickup does not appear to represent a fundamental acceleration in the pace of inflation.

### Employment

Gains in nonfarm payroll employment averaged 270,000 in October and November, equal to the third-quarter pace. Much of the employment growth occurred in the services and finance industries, where hiring has expanded at a healthy pace this year. However, manufacturing employment also rose, increasing by almost 75,000 jobs, strike-adjusted, in October and November, the first two-month gain since the end of 1984. In addition, the factory workweek remained at a high level.

In the household survey, employment gains averaged just under 200,000 in October and November. The civilian unemployment rate, which has held fairly steady since August, edged down in November to 7.0 percent.

Information on industrial production in November is scheduled for release on December 13 and will be discussed in the Greenbook Supplement.

CHANGES IN EMPLOYMENT<sup>1</sup>  
(Thousands of employees; based on seasonally adjusted data)

|   | 1984 | 1985 |      |     | 1985  |      |      |
|---|------|------|------|-----|-------|------|------|
|   |      | Q1   | Q2   | Q3  | Sept. | Oct. | Nov. |
| -Average monthly changes-               |      |      |      |     |       |      |      |
| Nonfarm payroll employment <sup>2</sup> | 327  | 273  | 188  | 248 | 240   | 354  | 182  |
| Manufacturing                           | 52   | -26  | -43  | -40 | -83   | 63   | 30   |
| Strike adjusted                         | 51   | -26  | -43  | -31 | -73   | 62   | 11   |
| Durable                                 | 45   | -17  | -30  | -37 | -70   | 47   | 20   |
| Nondurable                              | 7    | -9   | -12  | -3  | -13   | 16   | 10   |
| Construction                            | 29   | 28   | 28   | 28  | 33    | 24   | 5    |
| Trade                                   | 106  | 91   | 77   | 50  | 39    | 94   | -22  |
| Finance and services                    | 106  | 150  | 94   | 127 | 110   | 111  | 153  |
| Total government                        | 17   | 20   | 23   | 80  | 109   | 57   | -1   |
| Private nonfarm production workers      | 253  | 182  | 130  | 148 | 101   | 241  | 163  |
| Manufacturing production workers        | 33   | -33  | -47  | -27 | -58   | 53   | 36   |
| Total employment <sup>3</sup>           | 270  | 282  | -250 | 391 | 372   | 323  | 60   |
| Nonagricultural                         | 266  | 290  | -175 | 445 | 488   | 273  | 79   |

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)

|                              | 1984 | 1985 |      |      | 1985  |      |      |
|------------------------------|------|------|------|------|-------|------|------|
|                              |      | Q1   | Q2   | Q3   | Sept. | Oct. | Nov. |
| Civilian, 16 years and older | 7.5  | 7.3  | 7.3  | 7.2  | 7.1   | 7.1  | 7.0  |
| Teenagers                    | 18.9 | 18.5 | 18.3 | 18.2 | 17.8  | 20.1 | 18.4 |
| 20-24 years old              | 11.4 | 11.1 | 11.3 | 11.0 | 11.0  | 10.9 | 11.1 |
| Men, 25 years and older      | 5.7  | 5.4  | 5.4  | 5.3  | 5.3   | 5.3  | 5.2  |
| Women, 25 years and older    | 6.0  | 6.0  | 6.1  | 6.0  | 6.0   | 5.6  | 5.5  |
| White                        | 6.5  | 6.3  | 6.3  | 6.2  | 6.1   | 6.1  | 5.9  |
| Black                        | 15.9 | 15.5 | 15.0 | 14.8 | 15.3  | 15.0 | 15.9 |
| Fulltime workers             | 7.2  | 7.0  | 6.9  | 6.9  | 6.8   | 6.7  | 6.7  |
| Memo:                        |      |      |      |      |       |      |      |
| Total national <sup>1</sup>  | 7.4  | 7.2  | 7.2  | 7.1  | 7.0   | 7.0  | 6.9  |

1. Includes resident Armed Forces as employed.

Personal Consumption Expenditure and Income

Personal consumption expenditures fell almost 1 percent in October (not at an annual rate). Sharply lower auto sales more than accounted for this decline, as finance and price concessions on 1985 models ended. Demand for domestic cars remained sluggish in November, with sales at only a 6.4 million unit annual rate. Auto production has substantially outpaced sales during the past two months, and a sizable inventory accumulation has occurred. As a result, domestic auto makers have announced incentive programs on selected models in an effort to trim stocks. However, the incentives are not as widespread as those in August and September and probably will have only a limited impact on purchases. Sales of foreign cars in November remained strong at a 3.3 million unit annual rate.

Excluding autos, the increase in personal consumption expenditures in October outpaced income growth, as it has for much of the year. As a result of strong household spending, the personal saving rate has fallen from 6.2 percent at the end of 1984 to 3.0 percent in October. Relative to last year, growth in labor income has slowed, particularly in the manufacturing sector; moreover, nonlabor income has been flat this year, as farm income has plunged and interest income has edged down. Part of the drop in the saving rate may reflect the tendency for consumption to show a damped response in the short run to the volatile swings in farm income.

PERSONAL INCOME AND CONSUMPTION  
(Percent change at annual rate, excepted as noted;  
based on current dollars, seasonally adjusted data)

|                                      | 1985   |       |       | 1983-Q4 | 1984-Q4   |
|--------------------------------------|--------|-------|-------|---------|-----------|
|                                      | Aug.   | Sept. | Oct.  | 1984-Q4 | Oct. 1985 |
| Personal income                      | 3.0    | 4.1   | 4.9   | 9.2     | 4.0       |
| Labor income <sup>1</sup>            | 6.0    | 7.7   | 4.8   | 8.0     | 5.8       |
| Manufacturing, wages and salaries    | 4.8    | .5    | 6.4   | 7.4     | 2.4       |
| Nonmanufacturing, wages and salaries | 6.3    | 9.6   | 4.4   | 7.8     | 6.7       |
| Nonlabor income <sup>2</sup>         | -3.0   | -3.1  | 5.2   | 11.4    | .6        |
| Transfer payments                    | -10.2  | 4.3   | 7.3   | 3.2     | 6.2       |
| Farm income                          | -167.4 | -32.4 | 133.3 | 69.9    | -59.2     |
| Interest income                      | -4.0   | -3.7  | -3.2  | 17.5    | -1.9      |
| Disposable personal income           | 1.6    | 2.5   | 4.3   | 8.9     | 3.1       |
| Personal consumption expenditures    | 12.8   | 14.0  | -10.9 | 7.5     | 6.2       |
| Saving rate <sup>3</sup>             | 2.7    | 1.8   | 3.0   | 6.2     | 3.0       |

1. Wage and salary disbursements plus other labor income.
2. Includes transfer payments, rent, dividends, interest, and proprietor profits.
3. Level in percent, end of period.

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

|                               | 1985 |      |      | 1985 |       |      |      |
|-------------------------------|------|------|------|------|-------|------|------|
|                               | Q1   | Q2   | Q3   | Aug. | Sept. | Oct. | Nov. |
| Total auto sales <sup>1</sup> | 10.9 | 10.9 | 12.3 | 12.4 | 14.2  | 9.6  | 9.7  |
| Imports                       | 2.4  | 2.7  | 2.9  | 2.8  | 3.0   | 3.3  | 3.3  |
| Domestic                      | 8.5  | 8.3  | 9.4  | 9.5  | 11.2  | 6.3  | 6.4  |
| Domestic production           | 8.4  | 8.0  | 8.2  | 8.3  | 8.1   | 7.6  | 7.8  |
| Domestic inventories          | 1.49 | 1.51 | 1.31 | 1.55 | 1.31  | 1.48 | 1.59 |
| Days' supply <sup>2</sup>     | 55   | 56   | 50   | 50   | 36    | 73   | 76   |

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

Moreover, the NIPA definition of personal income excludes capital gains, which have been substantial in 1985 as a result of the rally in stock and bond markets.

### Business Fixed Investment

Investment spending in the aggregate remains sluggish, following a real decline of 3.7 percent at an annual rate in the third quarter. In the equipment category, a decline in auto purchases in the current quarter is expected to offset a rise in shipments of nondefense capital goods. In October, shipments of nondefense capital goods increased 4-1/2 percent to a level 2-3/4 percent above the third-quarter average. The pickup was widespread, with electrical machinery showing the largest increase among the major components.

Shipments of office and computing equipment were up 1-1/2 percent in October. However, there is uncertainty as to how much of the expected increase in deliveries of IBM Sierra mainframe computers took place in that month. Regardless of Sierra, the recent data on computer orders and shipments is indicative of general sluggishness in the industry.

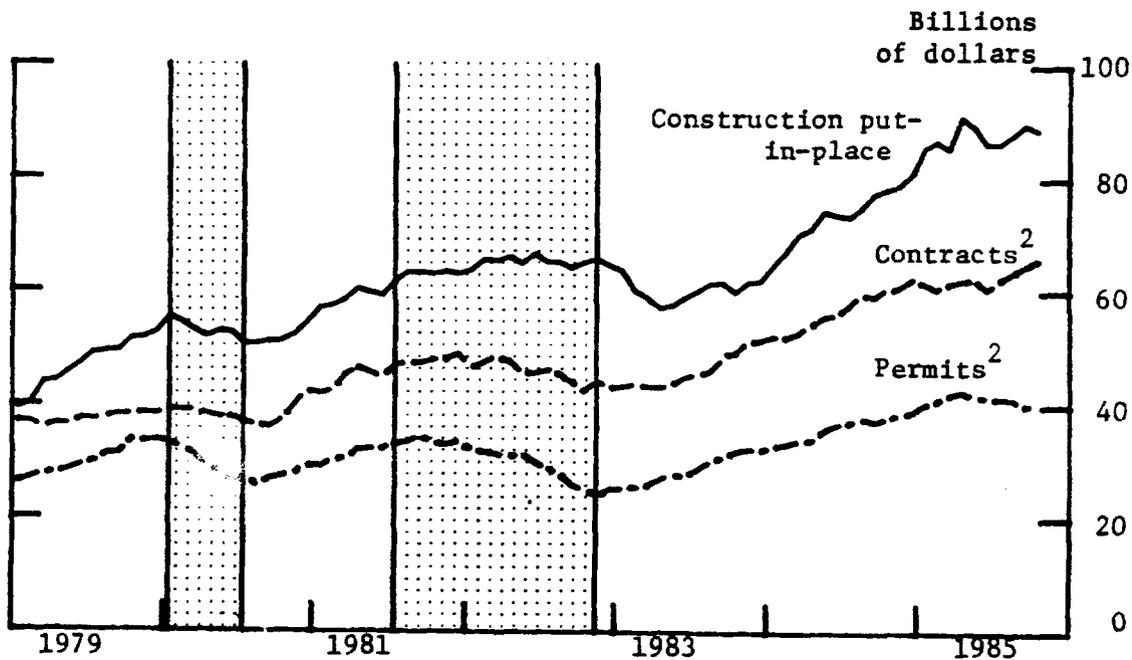
Outlays for nonresidential structures have shown little change in recent months. The value of nonresidential construction put in place declined 0.9 percent in October, offsetting a 1 percent advance in September. For all major categories of structures except institutional buildings, the October level of spending is below the peaks reached last spring.

Indicators of fixed investment point to sluggish spending in the near term. New orders for nondefense capital goods, excluding aircraft and parts, fell 5-1/2 percent in October, but on balance the behavior of

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

|  | 1985 |       |      | 1985 |       |       |
|--|------|-------|------|------|-------|-------|
|  | Q1   | Q2    | Q3   | Aug. | Sept. | Oct.  |
| <u>Producers' durable equipment</u>                        |      |       |      |      |       |       |
| Nondefense capital goods                                   |      |       |      |      |       |       |
| Shipments  | -3.5 | 2.6   | .2   | 2.8  | -3.8  | 4.5   |
| Excluding aircraft and parts                               | -3.9 | 3.2   | -1.4 | 2.0  | -1.8  | 3.9   |
| Office and store machinery                                 | -7.0 | 7.0   | -7.4 | -1.0 | 4.7   | 1.5   |
| Orders   | 1.7  | -1.6  | 5.6  | 3.3  | 6.1   | -7.1  |
| Excluding aircraft and parts                               | 3.1  | -4.1  | 2.3  | .1   | 2.9   | -5.6  |
| Office and store machinery                                 | 25.6 | -20.3 | 5.3  | 11.0 | -5.7  | -4.9  |
| Imports of capital goods<br>excluding autos                | 11.2 | -2.5  | -.9  | .8   | 21.6  | -14.9 |
| Exports of capital goods<br>excluding autos                | 5.1  | -5.5  | -1.4 | -1.0 | 1.8   | -6.1  |
| Sales of heavy-weight trucks<br>(thousands of units, A.R.) | 312  | 276   | 264  | 216  | 329   | 253   |
| <u>Nonresidential structures</u>                           |      |       |      |      |       |       |
| Nonresidential construction                                | 8.2  | 3.7   | -1.0 | .9   | 1.0   | -.9   |
| Commercial building  | 11.1 | 1.6   | -.1  | 3.0  | 2.6   | -2.3  |
| Office   | 9.3  | 1.9   | -1.4 | -1.7 | 1.2   | .1    |
| Other commercial   | 13.3 | 1.1   | 1.4  | 8.7  | 4.1   | -4.8  |

NONRESIDENTIAL CONSTRUCTION,  
CONTRACTS, AND PERMITS<sup>1</sup>



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

bookings during the past few months appears to be an extension of the generally flat pattern evident since mid-1984. For nonresidential construction, outlays from existing projects likely will continue to rise in the near term, but this year's leveling off of new commitments suggests that spending growth in 1986 will be limited.

The Merrill Lynch survey of capital spending plans, conducted in late August and September, indicated that businesses expect to increase nominal outlays 3 percent next year. These figures are somewhat stronger than the spending plans reported earlier in McGraw-Hill's fall survey, which showed a 1 percent decline. On average, both surveys tend to under-predict spending during economic expansions; adjusting for these systematic biases, the surveys are broadly consistent with flat real capital spending in 1986.

### Housing Markets

The pace of new residential construction picked up in October, as total private housing starts rose 11 percent to a 1.76 million unit annual rate. Starts of single-family houses jumped in October to a seasonally adjusted annual rate of 1.1 million units, the highest level since April. Existing home sales edged up in October to a 3.49 million unit annual rate, almost 4 percent above the average pace in the third quarter; new home sales, however, posted a disappointing drop.

In the multifamily sector, starts were up 3 percent in October, but remained in the somewhat reduced range registered in the third quarter. With markets for both rental units and condominiums characterized by excess supply, activity in this sector has continued to be supported by record

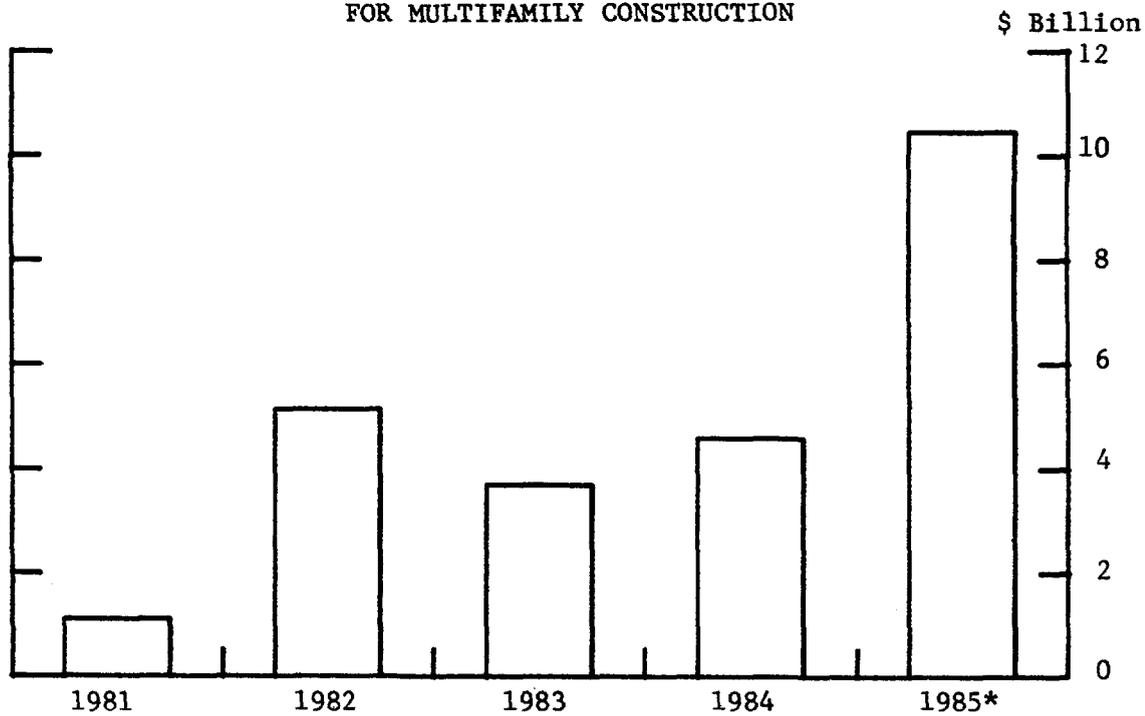
PRIVATE HOUSING ACTIVITY  
(Seasonally adjusted annual rates, millions of units)

|                       | 1984   | 1985 |      |                 | 1985 |       |                   |
|-----------------------|--------|------|------|-----------------|------|-------|-------------------|
|                       | Annual | Q1   | Q2   | Q3 <sup>1</sup> | Aug. | Sept. | Oct. <sup>1</sup> |
| All units             |        |      |      |                 |      |       |                   |
| Permits               | 1.68   | 1.67 | 1.73 | 1.76            | 1.78 | 1.80  | 1.68              |
| Starts                | 1.75   | 1.80 | 1.77 | 1.66            | 1.74 | 1.59  | 1.76              |
| Single-family units   |        |      |      |                 |      |       |                   |
| Permits               | .92    | .94  | .95  | .97             | .99  | .95   | .95               |
| Starts                | 1.08   | 1.12 | 1.08 | 1.03            | 1.06 | .97   | 1.12              |
| Sales                 |        |      |      |                 |      |       |                   |
| New homes             | .64    | .67  | .68  | .72             | .71  | .69   | .65               |
| Existing homes        | 2.87   | 2.97 | 3.05 | 3.36            | 3.50 | 3.45  | 3.49              |
| Multifamily units     |        |      |      |                 |      |       |                   |
| Permits               | .76    | .73  | .78  | .79             | .79  | .86   | .72               |
| Starts                | .67    | .67  | .70  | .63             | .68  | .62   | .64               |
| Mobile home shipments | .30    | .28  | .28  | .29             | .29  | .28   | n.a.              |

1. Preliminary estimates.

n.a.--not available.

STATE AND LOCAL MORTGAGE REVENUE BONDS  
FOR MULTIFAMILY CONSTRUCTION



\* 1985 estimate based on the first 11 months.

volume of below-market financing provided through state and local government tax-free bonds. Issuance of such securities has been averaging just over \$10 billion at an annual rate through the first 11 months of 1985. This was well above last year's pace and double the previous high seen in 1982. Should a new tax bill be passed, authority for such financing likely will be reduced, if not eliminated. Anticipation of such a curtailment probably accounts for the heavy issuance of these securities in recent months.

### Business Inventories

Inventory investment, on balance, continued to reflect a cautious stance on the part of most businesses. In September, stocks in all manufacturing and trade rose at an annual rate of \$4.2 billion in real terms, following an average accumulation of \$3.2 billion in the preceding three months, and the nonauto inventory-sales ratio, while up slightly in September, remained well within the range set over the past year.

In October, the book value of manufacturing inventories fell by \$23.5 billion at an annual rate. Stocks of finished goods declined \$8.3 billion, as manufacturers evidently stepped up shipments faster than production. In addition, inventories at earlier stages of processing were reduced, partly in response to weakness in orders. Overall, the ratio of inventories to sales in the manufacturing sector fell to 1.43, its lowest level in 18 months.

In the trade sector, real nonauto inventories rose \$7.6 billion at an annual rate in September--about the same pace as in July and August. Although general merchandise stores and apparel dealers did report relatively large accumulations in August and September, there is little

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

|                        | 1985 |      |      | 1985  |                    |                   |
|------------------------|------|------|------|-------|--------------------|-------------------|
|                        | Q1   | Q2   | Q3   | Aug.  | Sept. <sup>r</sup> | Oct. <sup>p</sup> |
| Book Value Basis:      |      |      |      |       |                    |                   |
| Total                  | 21.3 | 3.6  | -2.5 | -23.2 | 10.4               | --                |
| Manufacturing          | 1.8  | -2.0 | -6.6 | -4.2  | -7.9               | -23.5             |
| Wholesale              | 6.6  | 6.5  | -2.0 | -4.1  | -6.4               | 12.9              |
| Retail                 | 12.9 | -.9  | 6.2  | -14.9 | 24.6               | --                |
| Automotive             | 8.7  | -1.3 | -6.6 | -17.3 | 8.3                | --                |
| Ex. auto               | 4.1  | .4   | 12.8 | 2.3   | 16.4               | --                |
| Constant Dollar Basis: |      |      |      |       |                    |                   |
| Total                  | 15.0 | 3.1  | 1.8  | -2.7  | 4.2                | --                |
| Manufacturing          | 2.1  | .5   | .3   | -1.5  | .2                 | --                |
| Wholesale              | 2.8  | 3.5  | 2.0  | 6.0   | 1.4                | --                |
| Retail                 | 10.1 | -1.0 | -.4  | -7.2  | 2.7                | --                |
| Automotive             | 6.2  | -.6  | -5.9 | -8.7  | -3.5               | --                |
| Ex. auto               | 3.9  | -.4  | 5.4  | 1.5   | 6.2                | --                |

INVENTORIES RELATIVE TO SALES<sup>1</sup>

|   | 1985   |         |      | 1985 |                    |                   |      |      |
|---|--------|---------|------|------|--------------------|-------------------|------|------|
|   | Q1     | Q2      | Q3   | Aug. | Sept. <sup>r</sup> | Oct. <sup>p</sup> |      |      |
| Cyclical<br>Reference Points <sup>2</sup> |        |         |      |      |                    |                   |      |      |
| Book Value Basis:                         | 81 low | 82 high |      |      |                    |                   |      |      |
| Total                                     | 1.39   | 1.53    | 1.38 | 1.37 | 1.36               | 1.34              | 1.35 | --   |
| Manufacturing                             | 1.60   | 1.77    | 1.48 | 1.47 | 1.46               | 1.45              | 1.46 | 1.43 |
| Wholesale                                 | 1.06   | 1.28    | 1.17 | 1.17 | 1.17               | 1.16              | 1.17 | 1.19 |
| Retail                                    | 1.36   | 1.43    | 1.42 | 1.38 | 1.37               | 1.35              | 1.34 | --   |
| Automotive                                | 1.59   | 1.88    | 1.54 | 1.45 | 1.30               | 1.29              | 1.21 | --   |
| Ex. Auto                                  | 1.29   | 1.35    | 1.39 | 1.36 | 1.39               | 1.37              | 1.38 | --   |
| Constant Dollar Basis:                    |        |         |      |      |                    |                   |      |      |
| Total                                     | 1.62   | 1.75    | 1.56 | 1.55 | 1.54               | 1.53              | 1.53 | --   |
| Manufacturing                             | 1.91   | 2.11    | 1.78 | 1.78 | 1.77               | 1.75              | 1.77 | --   |
| Wholesale                                 | 1.34   | 1.52    | 1.38 | 1.38 | 1.39               | 1.38              | 1.39 | --   |
| Retail                                    | 1.34   | 1.44    | 1.38 | 1.35 | 1.32               | 1.32              | 1.29 | --   |
| Automotive                                | 1.49   | 1.81    | 1.47 | 1.39 | 1.18               | 1.21              | 1.10 | --   |
| Ex. auto                                  | 1.28   | 1.37    | 1.36 | 1.34 | 1.36               | 1.35              | 1.36 | --   |

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.

indication of the widespread overstocking at trade establishments that was evident at this time last year.

One major exception to the generally lean inventory picture is the domestic automobile sector. After sharp drawdowns in late August and September, auto dealers' stocks of domestic cars rose substantially in October and November. Dealer inventories now are at about the level that prevailed in the summer before sales and financing discounts became widespread.

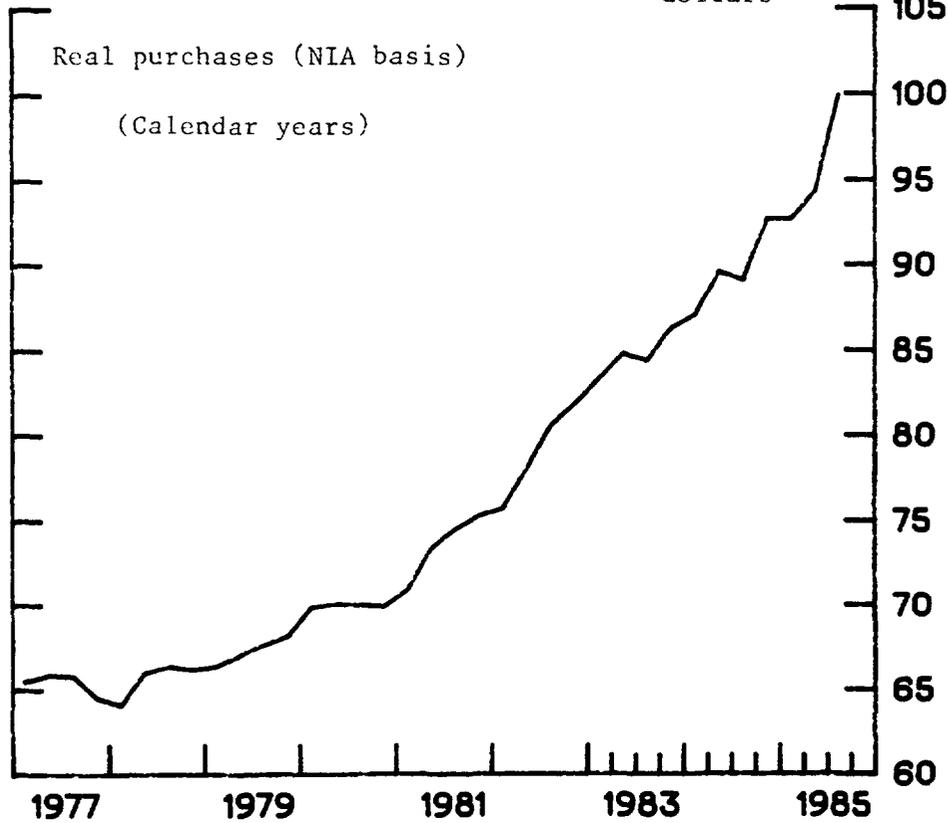
### Federal Sector

Real federal government purchases rose rapidly in the third quarter. Abundant harvests and depressed farm prices apparently added a large quantity of grain to government stockpiles. The latest figures show real CCC purchases were \$6 billion at an annual rate last quarter and qualitative reports suggest that spending this quarter will continue to be high. In the third quarter, real defense purchases climbed sharply; and for the six-month period beginning in April such spending rose at a 16 percent annual rate. Furthermore, budget outlays for national defense in October point to a continuation of high levels of spending in the fourth quarter.

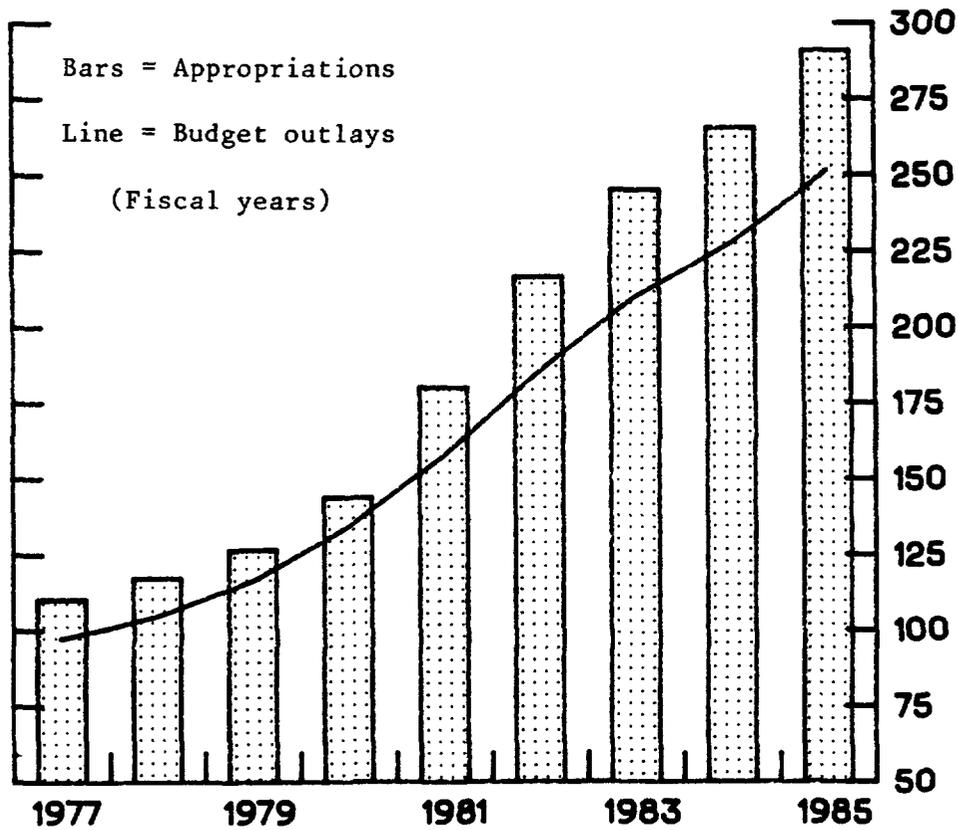
The surge in real defense purchases in the second and third quarters took place in all major spending categories. Sizable real expenditure increases were registered for construction, research and development, and other types of services. The military equipment grouping, which includes aircraft, missiles, ships, electronics, vehicles, and other military hardware, accounted for nearly half of the rise.

# NATIONAL DEFENSE MEASURES

Billions of 1972 dollars



Billions of dollars



NATIONAL DEFENSE APPROPRIATIONS AND SPENDING  
(Fiscal years, billions of dollars)

|                | Budget request <sup>1</sup> | Congressional appropriation | Budget outlays <sup>1</sup> | NIA purchases <sup>2</sup> |
|----------------|-----------------------------|-----------------------------|-----------------------------|----------------------------|
| 1977           | 112.4                       | 110.2                       | 97.2                        | 91.5                       |
| 1978           | 121.4                       | 117.2                       | 104.5                       | 97.8                       |
| 1979           | 128.4                       | 126.5                       | 116.3                       | 108.2                      |
| 1980           | 138.2                       | 143.9                       | 134.0                       | 126.2                      |
| 1981           | 161.8                       | 180.0                       | 157.5                       | 147.1                      |
| 1982           | 226.3                       | 216.5                       | 185.3                       | 173.2                      |
| 1983           | 263.0                       | 245.0                       | 209.9                       | 196.5                      |
| 1984           | 280.5                       | 265.2                       | 227.4                       | 215.4                      |
| 1985           | 313.4                       | 290.9                       | 251.4                       | 240.4                      |
| Memo:<br>1986* | 322.2                       | 302.4                       | n.a.                        | n.a.                       |

1. Figures are the request in the administration's budget published the January before the fiscal year began. For 1982, the Reagan proposal is shown. The Carter budget request was \$200.3 billion.

2. The difference in level between NIA purchases and budget outlays reflects primarily the treatment of military retirement contributions and payments. The outlay figures include the retirement contributions, while the NIA data do not. After the revision of NIA data later this month, defense purchases will include military retirement contributions. As a result, the difference in levels between budget outlays and purchases will narrow. Other differences in the budget and NIA concepts result from the treatment of the timing of certain payments; however, timing differences tend to be more important for interpreting quarterly data.  
n.a.—Not available.

\*As estimated in the Congressional Budget Resolution passed August 1, 1985. Final action on FY1986 appropriations has not been completed.

Although quarterly NIA figures tend to be volatile, several factors indicate that defense spending in the near term can be maintained at the high levels of recent quarters. For example, unfilled orders for defense capital goods at manufacturers have continued to trend up; at the end of October the backlog of orders was nearly 15 percent above a year earlier. More fundamentally, as shown in the table, appropriations have risen sharply in recent years, even though they were scaled back from administration requests. Outlay increases, however, have lagged appropriations as may be seen in the lower panel of the chart.

Part of the lag in outlays is due to a shift in the mix of spending to areas with long lead times: equipment spending has risen to 31 percent of total defense purchases compared with 25 percent in 1977, and outlays increasingly have reflected obligations incurred over several years. Indeed, the proportion of FY1986 spending resulting from prior year contracts and obligations is expected to be nearly 40 percent of the total; in 1977, only 19 percent of national defense outlays were from budget authority in previous years. Quality control problems and reports of over-pricing by defense contractors may have contributed to some delay in expenditures, and such controversies continue to be a source of uncertainty for the rate of spending.

Congressional action on the FY1986 budget continues to be slow, owing in part to the debate concerning a permanent increase in the debt ceiling and the Gramm-Rudman amendment. At present, three of the thirteen appropriation bills have been enacted, and a fourth was vetoed by the President. Further action remains on the nine other bills. Meanwhile, a continuing resolution, which expires on December 12, is providing temporary

FY1986 funding. A related budget measure, the reconciliation bill that would enact many of the savings contained in the FY1986 budget resolution passed last August, is in conference.

### State and Local Sector

Recent data on balance suggest a tapering off of growth in real outlays of state and local governments following two quarters of vigorous increases. Although employment figures show continued growth, real construction put-in-place in October actually was down a bit from its third quarter level, following two quarters of exceptionally strong gains in construction activity.

Some slowing in overall spending is to be expected in light of budgetary developments in the state and local sector. The sector as a whole reported a \$3 billion surplus in its combined operating and capital account (excluding social insurance trust funds) in the third quarter, its smallest surplus since the deficits associated with the 1981-82 recession. Nearly half the states ended their fiscal year (in June) with only a slight surplus or a deficit. As a result, with requirements to balance general funds budgets nearly universal, several states have instituted program cutbacks or hiring freezes.

### Wages and Labor Costs

Measures of wage inflation have continued to be mixed in recent months, with the low rates of wage growth reported in the hourly earnings index at odds with the somewhat higher rates reported in the employment cost index. However, on the whole, wage inflation appears to have leveled off this year, after decelerating sharply in 1983 and 1984.

The hourly earnings index, which measures wages of production and nonsupervisory workers, rose 0.3 percent in November to a level only 0.6 percent above the third-quarter average. Wage increases in all major industries have been quite moderate in recent months. So far this year, this measure of wage inflation has risen 2.9 percent, about the same increase posted over the course of 1984.

An alternative measure, the employment cost index, has risen by 4.8 percent over the first three quarters of 1985, probably reflecting larger increases for its more broadly-based sample of white-collar workers.

Revised data also indicate that productivity in the nonfarm business sector rose 2.1 percent at an annual rate in the third quarter. However, over the first three quarters of 1985 combined, productivity shows little change, and unit labor costs have risen at a 4 percent annual rate over this period. Costs rose more slowly earlier in the recovery, when output was increasing rapidly and productivity gains were higher.

### Prices

Measures of price inflation were higher in October than in previous months, reflecting developments in the automobile and farm sectors. The consumer price index for all urban consumers rose 0.3 percent, similar to its average pace so far this year but above the low 0.2 percent monthly rate that prevailed from May through September. The producer price index for finished goods jumped 0.9 percent in October, reversing its August and September declines.

HOURLY EARNINGS INDEX<sup>1</sup>  
 (Percentage change; based on seasonally adjusted data)<sup>2</sup>

|  | 1984 | 1985            |     |      | 1985             |      |      |
|--|------|-----------------|-----|------|------------------|------|------|
|  |      | Q1              | Q2  | Q3   | Sept.            | Oct. | Nov. |
|  |      | --Annual rate-- |     |      | --Monthly rate-- |      |      |
| Total private nonfarm                  | 3.1  | 3.5             | 3.2 | 2.0  | .6               | -.2  | .3   |
| Manufacturing                          | 3.3  | 5.2             | 3.5 | 2.0  | -.1              | .1   | .4   |
| Durable                                | 3.1  | 5.9             | 3.4 | 2.3  | -.1              | .1   | .4   |
| Nondurable                             | 3.7  | 4.0             | 3.8 | 1.5  | -.1              | .3   | .6   |
| Contract construction                  | 1.3  | 5.2             | -.1 | -1.2 | .4               | -.4  | -.5  |
| Transportation and<br>public utilities | 2.9  | 2.7             | 2.9 | 2.3  | .7               | -.1  | .1   |
| Finance, Insurance,<br>and Real Estate | 3.6  | 5.4             | 2.5 | 2.8  | 1.5              | -.3  | .3   |
| Total trade                            | 2.6  | 1.8             | 2.1 | 1.2  | .9               | -.5  | .6   |
| Services                               | 4.0  | 2.1             | 5.7 | 3.8  | 1.1              | -.3  | .4   |

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

2. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Quarterly changes are compounded annual rates.

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

|   | 1982 | 1983 | 1984 | 1985 |     |     | 1985                    |
|---|------|------|------|------|-----|-----|-------------------------|
|   |      |      |      | Q1   | Q2  | Q3  | to<br>Date              |
| <u>Hourly earnings index, wages of production workers<sup>1</sup></u>       |      |      |      |      |     |     | 1984-Q4 to<br>1985-Q3   |
| Total private nonfarm   | 6.1  | 4.0  | 3.1  | 3.5  | 3.2 | 2.0 | 2.9                     |
| 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 | 2.0 | 2.6                     |
| <u>Employment cost index, wages and salaries of all persons<sup>2</sup></u> |      |      |      |      |     |     | 1984-Q4 to<br>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                     |
| <u>Employment cost index, compensation of all persons<sup>2</sup></u>       |      |      |      |      |     |     |                         |
| Total   | 6.4  | 5.7  | 4.9  | 5.0  | 3.3 | 5.2 | 4.7 <sup>3</sup>        |
| <u>Major collective bargaining agreements<sup>3</sup></u>                   |      |      |      |      |     |     | First nine<br>mos. 1985 |
| First-year wage adjustments   | 3.8  | 2.6  | 2.4  | --   | --  | --  | 2.3                     |
| Total effective wage change   | 6.8  | 4.0  | 3.7  | --   | --  | --  | 3.7                     |
| <u>Labor costs and productivity, all persons<sup>1</sup></u>                |      |      |      |      |     |     | 1984-Q4 to<br>1985-Q3   |
| Compensation per hour   | 7.2  | 3.9  | 4.3  | 5.0  | 3.4 | 3.7 | 4.1                     |
| Output per hour   | 1.4  | 3.9  | 2.4  | -3.1 | 1.2 | 2.1 | .0                      |
| Unit labor costs  | 5.8  | .0   | 1.9  | 8.4  | 2.1 | 1.6 | 4.0                     |

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. September 1984 to September 1985.

Food prices accounted for about one third of the rise in the producer price index for finished goods. This was due to a sharp rebound in meat prices, reflecting a tightening of livestock supplies, which also was responsible for the 6-1/4 percent rise in crude food prices. With cattle prices still on the rise in recent weeks and crop prices rebounding a bit from the depressed levels of early autumn, crude food prices probably will register a further substantial increase in November. At the consumer level, meat prices also rose markedly in October, but price declines in other categories held the overall increase for food to .2 percent.

The October price reports also reflected auto-related developments. The CPI less food and energy items was up 0.5 percent, after an unusually small September increase of 0.2 percent. In October, higher prices on 1986-model cars and the ending of many financing concessions boosted both the commodity and service categories. Price increases for cars and trucks had an even sharper impact on the PPI for finished goods less food and energy, essentially accounting for the swing from a decline in September to an 0.8 percent increase in October. Because the PPI reflects the prices charged (received) by manufacturers, net of discounting of any kind, the October increase picked up the change from 1985-model prices, heavily discounted through incentive financing and other programs, to higher-priced 1986 models.<sup>1</sup> Apart from cars and trucks, prices of other finished consumer goods and of capital equipment were not much changed overall in the October PPI.

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1. In the CPI, however, the prices of new-model cars are phased in gradually, reflecting the pattern of sales to consumers; and, as indicated above, auto financing is included separately under private transportation services. Moreover, the CPI includes the prices of imported as well as of domestically-produced cars.

RECENT CHANGES IN CONSUMER PRICES  
(Percentage change; based on seasonally adjusted data)<sup>1</sup>

|  | Relative<br>Importance<br>Dec. 1984 | 1984 | 1985          |      |      | 1985           |      |
|--|-------------------------------------|------|---------------|------|------|----------------|------|
|  |                                     |      | Q1            | Q2   | Q3   | Sept.          | Oct. |
|  |                                     |      | -Annual rate- |      |      | -Monthly rate- |      |
| All items <sup>2</sup>                         | 100.0                               | 4.0  | 4.1           | 3.3  | 2.3  | .2             | .3   |
| Food   | 18.7                                | 3.8  | 2.6           | -9   | 1.8  | .3             | .2   |
| Energy   | 11.5                                | .2   | -8            | 9.6  | -4.3 | -.2            | -.8  |
| All items less food and<br>energy <sup>3</sup> | 69.8                                | 4.7  | 5.4           | 3.4  | 3.5  | .2             | .5   |
| Commodities <sup>3</sup>                       | 26.3                                | 3.1  | 6.6           | -1.4 | .8   | .3             | .4   |
| Services <sup>3</sup>                          | 43.5                                | 5.6  | 5.0           | 6.4  | 5.0  | .2             | .6   |
| Memorandum:                                    |                                     |      |               |      |      |                |      |
| CPI-W <sup>4</sup>                             | 100.0                               | 3.5  | 4.0           | 3.1  | 1.8  | .2             | .3   |

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)<sup>1</sup>

|                                     | Relative<br>Importance<br>Dec. 1984 | 1984 | 1985          |       |       | 1985           |      |
|-------------------------------------|-------------------------------------|------|---------------|-------|-------|----------------|------|
|                                     |                                     |      | Q1            | Q2    | Q3    | Sept.          | Oct. |
|                                     |                                     |      | -Annual rate- |       |       | -Monthly rate- |      |
| Finished Goods                      | 100.0                               | 1.7  | .5            | 1.7   | -2.4  | -.6            | .9   |
| Consumer foods                      | 24.4                                | 3.5  | -3.0          | -8.1  | -1.6  | -.9            | 1.4  |
| Consumer energy                     | 11.5                                | -4.1 | -21.3         | 27.3  | -12.8 | -.1            | -.2  |
| Other consumer goods                | 42.4                                | 2.2  | 6.5           | 1.4   | -.2   | -.5            | .8   |
| Capital equipment                   | 21.6                                | 1.8  | 6.2           | 1.6   | -1.2  | -.6            | 1.0  |
| Intermediate materials <sup>2</sup> | 95.1                                | 1.7  | -2.5          | 1.1   | -1.2  | .1             | .0   |
| Exc. energy                         | 80.1                                | 2.1  | -1.0          | 1.2   | -1.2  | -.1            | .0   |
| Crude food materials                | 53.0                                | -1.2 | -24.9         | -20.4 | -19.9 | -.7            | 6.3  |
| Crude energy                        | 31.7                                | -1.3 | -13.1         | 4.4   | -4.7  | .4             | -.3  |
| Other crude materials               | 15.4                                | -3.3 | -13.3         | 3.1   | -4.2  | -.6            | .5   |

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

2. Excludes materials for food manufacturing and animal feeds.

To date, there is little evidence of any runup in prices owing to the weaker dollar. Non-oil import prices were essentially flat in the third quarter, the latest period for which data are available, following three quarters of decline. More recently, price increases have been announced by Japanese firms for a number of manufactured products, including autos and electronic items. However, partly offsetting these developments, commodity prices have declined, on balance, in recent weeks.

III-T-1  
SELECTED FINANCIAL MARKET QUOTATIONS<sup>1</sup>  
(Percent)

|  | 1982/1983       | 1984    | 1985           |              |                      |                    | Change from:  |              |
|--|-----------------|---------|----------------|--------------|----------------------|--------------------|---------------|--------------|
|  | Cyclical<br>low | Highs   | March<br>highs | June<br>lows | FOMC<br>Nov.         | Dec. 10            | 1984<br>highs | FOMC<br>Nov. |
| <b>Short-term rates</b>                  |                 |         |                |              |                      |                    |               |              |
| Federal funds <sup>2</sup>               | 8.46            | 11.63   | 8.58           | 7.38         | 8.09                 | 8.04               | -3.59         | -.05         |
| Treasury bills <sup>3</sup>              |                 |         |                |              |                      |                    |               |              |
| 3-month                                  | 7.08            | 10.67   | 8.80           | 6.66         | 7.24                 | 7.17               | -3.50         | -.07         |
| 6-month                                  | 7.62            | 10.77   | 9.13           | 6.81         | 7.32                 | 7.24               | -3.53         | -.08         |
| 1-year                                   | 7.73            | 11.13   | 9.25           | 6.98         | 7.38                 | 7.23               | -3.90         | -.15         |
| Commercial paper                         |                 |         |                |              |                      |                    |               |              |
| 1-month                                  | 8.00            | 11.42   | 8.94           | 6.95         | 7.88                 | 7.86               | -3.56         | -.02         |
| 3-month                                  | 7.97            | 11.35   | 9.12           | 7.01         | 7.78                 | 7.79               | -3.56         | .01          |
| Large negotiable CDs <sup>3</sup>        |                 |         |                |              |                      |                    |               |              |
| 1-month                                  | 8.08            | 11.52   | 8.89           | 7.09         | 7.80                 | 7.88               | -3.64         | .08          |
| 3-month                                  | 8.12            | 11.79   | 9.29           | 7.18         | 7.80                 | 7.88               | -3.91         | .08          |
| 6-month                                  | 8.20            | 12.30   | 9.92           | 7.30         | 7.81                 | 7.88               | -4.42         | .07          |
| Eurodollar deposits <sup>4</sup>         |                 |         |                |              |                      |                    |               |              |
| 1-month                                  | 8.68            | 11.89   | 8.89           | 7.45         | 7.96                 | 8.15               | -3.74         | .19          |
| 3-month                                  | 8.71            | 12.20   | 9.58           | 7.50         | 8.00                 | 8.11               | -4.09         | .11          |
| 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                 | 7.13               | —             | .07          |
| Mar. 1986 contract                       |                 |         | 10.58          | 7.47         | 7.20                 | 6.91               | —             | -.29         |
| <b>Intermediate- and long-term rates</b> |                 |         |                |              |                      |                    |               |              |
| U.S. Treasury (constant maturity)        |                 |         |                |              |                      |                    |               |              |
| 3-year                                   | 9.33            | 13.49   | 11.22          | 8.73         | 9.02                 | 8.50               | -4.99         | -.52         |
| 10-year                                  | 10.12           | 13.99   | 12.02          | 9.83         | 9.93                 | 9.36               | -4.63         | -.57         |
| 30-year                                  | 10.27           | 13.94   | 11.97          | 10.23        | 10.18                | 9.65               | -4.29         | -.53         |
| Municipal revenue<br>(Bond Buyer index)  | 9.21            | 11.44   | 10.25          | 9.10         | 9.40                 | 9.14 <sup>5</sup>  | -2.30         | -.26         |
| Corporate—A utility<br>Recently offered  | 11.64           | 15.30   | 13.23          | 11.50        | 11.47 <sup>e</sup>   | 11.03 <sup>e</sup> | -4.27         | -.44         |
| Home mortgage rates                      |                 |         |                |              |                      |                    |               |              |
| S&L fixed-rate                           | 12.55           | 14.68   | 13.29          | 12.05        | 12.01                | 11.50 <sup>6</sup> | -3.18         | -.51         |
| S&L ARM, 1-yr.                           | n.a.            | 12.31   | 11.14          | 9.83         | 9.30                 | 9.30 <sup>6</sup>  | -3.01         | —            |
|  | 1983            | 1984    | 1985           |              | Percent change from: |                    |               |              |
|  | Highs           | Low     | Highs          | FOMC<br>Nov. | Dec. 10              | 1984<br>lows       | FOMC<br>Nov.  |              |
| <b>Stock prices</b>                      |                 |         |                |              |                      |                    |               |              |
| Dow-Jones Industrial                     | 1287.20         | 1086.57 | 1499.20        | 1396.67      | 1499.20              | 38.0               | 7.3           |              |
| NYSE Composite                           | 99.63           | 85.13   | 117.72         | 111.07       | 117.72               | 38.3               | 6.0           |              |
| AMEX Composite                           | 249.03          | 187.16  | 249.03         | 230.24       | 240.64               | 28.6               | 4.5           |              |
| NASDAQ (OTC)                             | 328.91          | 225.30  | 328.91         | 295.25       | 317.29               | 40.8               | 7.5           |              |

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 December 18, 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

## DOMESTIC FINANCIAL DEVELOPMENTS

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After pausing in October, M1 resumed its brisk expansion. The narrow money measure grew at a 13 percent annual rate in November. The broader aggregates also accelerated considerably in November--but mostly because of the resurgence of M1, as household saving apparently remained limited and perhaps was directed to an unusual degree toward investments in bonds and bond funds. Increases in M2 and M3 were moderate and, in contrast to the marked overshoot for M1, both of these aggregates remained within their longer-run target ranges.

Pressures on reserve positions of depository institutions have not changed appreciably since the last FOMC meeting, and federal funds have traded mainly in the vicinity of 8 percent. Other short-term rates have been essentially unchanged, or up slightly, but this has not prevented the bond markets from registering a substantial rally that has pushed long-term rates to their lowest levels in several years. Bond traders evidently interpreted the FOMC's acceptance of the M1 overshoot as indicating that the System likely would not tighten reserve provision in the absence of evidence of strong economic growth or emerging inflationary pressures; many also were encouraged by congressional efforts to settle on some version of the Gramm-Rudman deficit-reduction proposal.

Overall debt growth appears to have picked up recently, particularly in the longer-term sector. Following congressional action in mid-November to raise the federal debt ceiling, the Treasury came to the market with an unprecedented burst of borrowing. Merger-related financing contributed to increased business borrowing in November, which boosted business loans at banks and issuance of commercial paper and long-term bonds. In the

MONETARY AGGREGATES  
(Based on seasonally adjusted data unless otherwise noted)<sup>1</sup>

|  | 1983:Q4<br>to |       | 1985 |       |       | Nov. <sup>pe</sup> | Growth from<br>Q4 1984 to<br>Nov. 1985 <sup>pe</sup> |
|--|---------------|-------|------|-------|-------|--------------------|--|
|  | 1984:Q4       | Q2    | Q3   | Sept. | Oct.  |                    |  |
| ----- Percentage change at annual rates -----                                |               |       |      |       |       |                    |  |
| 1. M1  | 5.2           | 10.2  | 15.0 | 11.9  | -1.6  | 13                 | 11-1/2 (12.0) <sup>2</sup>                           |
| 2. M2  | 7.7           | 5.3   | 10.2 | 7.1   | 2.1   | 6                  | 8-1/2  |
| 3. M3  | 10.4          | 5.2   | 8.1  | 10.1  | 3.9   | 5                  | 7-3/4  |
| Levels in billions<br>of dollars<br>Oct. 1985                                |               |       |      |       |       |                    |  |
| <u>Selected components</u>   |               |       |      |       |       |                    |  |
| 4. Currency  | 7.2           | 6.7   | 9.1  | 5.7   | 6.4   | 8                  | 168.8  |
| 5. Demand deposits   | 1.1           | 8.6   | 11.9 | 12.3  | -12.6 | 10                 | 264.0  |
| 6. Other checkable deposits  | 10.5          | 16.1  | 26.1 | 17.1  | 7.7   | 22                 | 172.4  |
| 7. M2 minus M1 <sup>3</sup>  | 8.6           | 3.8   | 8.7  | 5.5   | 3.3   | 4                  | 1922.2   |
| 8. Overnight RPs and Eurodollars, NSA  | 7.3           | -28.7 | 19.3 | 9.1   | 18.0  | 20                 | 67.6   |
| 9. General purpose and broker/dealer money<br>market mutual fund shares, NSA | 17.0          | -0.7  | 4.1  | -0.7  | 0.7   | -3                 | 176.7  |
| 10. Commercial banks   | 8.1           | 9.3   | 7.8  | 3.6   | 3.8   | 7                  | 831.2  |
| 11. Savings deposits, SA,<br>plus MMDAs, NSA <sup>4</sup>                    | 5.2           | 11.8  | 19.2 | 10.6  | 9.7   | 14                 | 449.4  |
| 12. Small time deposits  | 11.1          | 6.5   | -4.4 | -4.1  | -3.1  | 0                  | 381.8  |
| 13. Thrift institutions  | 7.3           | 6.5   | 3.9  | -0.7  | 2.4   | 3                  | 845.9  |
| 14. Savings deposits, SA,<br>plus MMDAs, NSA <sup>4</sup>                    | -3.6          | 10.4  | 16.7 | 7.2   | 11.6  | 7                  | 356.0  |
| 15. Small time deposits  | 15.5          | 4.0   | -4.6 | -6.6  | -4.1  | 0                  | 489.9  |
| 16. M3 minus M2 <sup>5</sup>   | 22.1          | 4.8   | -0.1 | 22.2  | 10.9  | -2                 | 643.9  |
| 17. Large time deposits  | 26.0          | 6.3   | -3.0 | 20.5  | 13.4  | 12                 | 433.3  |
| 18. At commercial banks, net <sup>6</sup>                                    | 16.0          | 8.3   | -3.1 | 23.8  | 18.9  | 12                 | 277.2  |
| 19. At thrift institutions   | 48.8          | 2.6   | -2.8 | 15.6  | 3.1   | 12                 | 156.1  |
| 20. Institution-only money market<br>mutual fund shares, NSA                 | 33.6          | 7.7   | 1.3  | -24.5 | 19.3  | 23                 | 63.3   |
| 21. Term RPs, NSA  | 45.6          | 16.2  | -9.2 | 51.6  | 0.0   | 41                 | 70.3   |
| 22. Term Eurodollars, NSA  | -8.3          | -12.1 | -8.5 | 7.7   | -12.2 | -17                | 78.8   |
| -- Average monthly change in billions of dollars --                          |               |       |      |       |       |                    |  |
| <u>MEMORANDA:</u>  |               |       |      |       |       |                    |  |
| 23. Managed liabilities at commercial<br>banks (24+25)                       | 4.7           | -2.4  | 2.4  | 8.4   | 6.8   | 4                  | 453.2  |
| 24. Large time deposits, gross   | 3.2           | -1.0  | 1.2  | 5.2   | 4.1   | 2                  | 334.4  |
| 25. Nondeposit funds   | 1.5           | -1.4  | 1.2  | 3.2   | 2.7   | 2                  | 118.8  |
| 26. Net due to related foreign<br>institutions, NSA                          | 0.9           | -1.3  | 1.3  | 1.0   | 3.6   | -1                 | -26.6  |
| 27. Other <sup>7</sup>   | 0.5           | -0.2  | -0.1 | 2.2   | -0.9  | 2                  | 145.4  |
| 28. U.S. government deposits at commercial<br>banks <sup>8</sup>             | 0.2           | 1.9   | -0.7 | -1.4  | -11.5 | 9                  | 3.8  |

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 October and November 1985 at rates of 4.8 percent and 3 percent respectively. At thrift institutions, savings deposits excluding MMDAs increased during October and November 1985 at rates of 14.9 percent and 9 percent respectively.

5. The non-M2 component of M3 is seasonally adjusted as a whole.

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

7. Consists of borrowings from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowings from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.

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

pe--preliminary estimate

tax-exempt market, bond offerings rose to a record in November; refunding bonds accounted for a full 40 percent of the total. Issuers--in many cases representing private interests--took advantage of the lower rates and rushed to avoid tax law changes that could become effective after year-end.

Mortgage loan demand, too, apparently has been bolstered by lower long-term interest rates. The mortgage-backed securities market has continued to boom, with broadening investor participation; meanwhile, data through October suggest a rising trend of thrift-institution lending. Consumer credit growth moderated early in the fourth quarter, after most special auto financing programs ended. Delinquency rates on consumer credit have been rising toward historically high levels, and personal bankruptcies are at a postwar high; yet banks report little effort thus far to tighten standards on consumer loans.

#### Monetary Aggregates and Bank Credit

M1 growth rebounded in November to a 13 percent annual rate, more than double its average September-October pace.<sup>1</sup> Much of the strength in M1 last month reflected a pickup in the growth of other checkable deposits (OCDs) to a rate approaching the robust summer pace. Demand deposits also contributed to the November rise in M1. Perhaps one-quarter of the month's expansion in demand deposits--but less than one-tenth of total M1 growth--can be attributed to a computer malfunction affecting Treasury security operations at the Bank of New York on November 21. The shutdown prevented the transfer of a large volume of securities to the purchasers, leaving in demand accounts a portion of the funds that were to be used as payment.

<sup>1</sup>. The acceleration of narrow money may be overstated due to seasonal adjustment difficulties; estimates based on concurrent seasonal adjustment procedures indicate that narrow money grew at a 10 percent clip in November, as compared with an average 8 percent annual rate during the previous two months.

M2 growth also picked up in November, reflecting the surge in M1, leaving this measure in the upper part of its long-run range. The non-M1 component of M2 has grown at a sluggish pace in recent months, with much of the weakness concentrated in taxable M2-type money market mutual funds and small time deposits. Some investors reportedly have been drawing on money fund balances--and perhaps reducing their deposits--to finance purchases of bonds and stocks, either directly or through mutual funds. Bond funds and unit trusts have grown dramatically this year, and probably have been attracting funds from savers who are seeking to maintain their interest income in the face of declining deposit rates.

Small time deposits--which account for roughly half of non-M1 M2--were unchanged in November, following runoffs during the preceding several months. Some of the variation in growth of small time deposits and other interest-bearing deposits in 1985 may have stemmed from changes in the relative yields on these types of deposits. In the spring months, when offering rates on small time deposits were substantially above rates available on MMDAs and OCDs, small time deposits rose. In the summer, by contrast, the rate advantage of small time deposits narrowed and these accounts experienced net outflows. But in recent months the rate spread has again widened and runoffs of small time deposits have ebbed.

M3 expanded at a 5 percent annual rate in November, which kept this aggregate near the middle of its 1985 target range. Growth in M3 was entirely due to its M2 component; its non-M2 component edged down overall despite continued rapid expansion of large time deposits. At commercial banks, demands for managed liabilities were limited by a \$9 billion inflow of U.S. Treasury deposits after the temporary extension of the federal debt

ceiling. Thrift institutions, by contrast, have been relying heavily on managed liabilities--including Home Loan Bank advances and other borrowings--to finance their asset growth in recent months.

Total bank credit rose at a 17 percent annual rate in November, the largest monthly increase since 1980. Growth in securities holdings was especially strong. Banks acquired a sizable volume of the Treasury securities that came to market in November, after running off a large amount in October, presumably in association with the reduced issuance of government securities in that month. The strength in the "other securities" category reflected sizable acquisitions of tax-exempt issues. Loan growth at banks also increased sharply, particularly business and consumer lending.

#### Business Finance

Merger-related financing and lower interest rates spurred a pickup in overall business credit growth in November. Short-term business borrowing from banks and in the commercial paper market rose at a combined 16-1/2 percent annual rate. At the same time, given the decline in long-term rates, firms borrowed heavily in both the corporate and tax-exempt bond markets.

Four large mergers were completed in November at a cost to the surviving firms of almost \$13 billion. In addition, there were some smaller acquisitions and a heavier flow of share repurchases. Virtually all these share retirements were financed initially with short-term debt, and they accounted for nearly all of the net increase in bank business loans and much of the substantial increase in commercial paper outstanding. In the bond market, about a third of total issuance in November refinanced earlier mergers.

Almost half of November's total nonfinancial bond volume, including issues sold abroad, was 30-year straight debt, contributing to a lengthening

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

|  | 1985  |       |       |       |       |        | Levels in<br>bil. of dollars<br>Nov. P |
|--|-------|-------|-------|-------|-------|--------|--|
|  | Q1    | Q2    | Q3    | Sept. | Oct.  | Nov. P |  |
| ----- Commercial Bank Credit -----   |       |       |       |       |       |        |  |
| 1. Total loans and securities<br>at banks  | 10.4  | 9.3   | 8.6   | 8.2   | 2.0   | 16.9   | 1870.3                                 |
| 2. Securities  | 5.7   | 5.5   | 12.4  | 13.7  | 1.1   | 30.5   | 435.6                                  |
| 3. U.S. government securities  | 10.4  | 0.0   | 9.0   | 7.5   | -13.6 | 23.6   | 275.3                                  |
| 4. Other securities  | -3.1  | 16.1  | 18.8  | 25.1  | 27.8  | 42.6   | 160.3                                  |
| 5. Total loans   | 11.9  | 10.4  | 7.4   | 6.6   | 2.4   | 12.6   | 1434.6                                 |
| 6. Business loans  | 10.1  | 2.6   | 2.4   | 3.7   | -0.5  | 9.6    | 490.9                                  |
| 7. Security loans  | 17.8  | 87.8  | -19.0 | 45.8  | -6.3  | 0.0    | 37.9                                   |
| 8. Real estate loans   | 11.2  | 12.4  | 11.2  | 8.3   | 13.5  | 12.2   | 418.7                                  |
| 9. Consumer loans  | 18.1  | 14.9  | 11.1  | 7.8   | 4.3   | 10.2   | 283.7                                  |
| ----- Short- and Intermediate-Term Business Credit -----                             |       |       |       |       |       |        |  |
| 10. Business loans net of bankers<br>acceptances                                     | 9.4   | 3.6   | 2.2   | 4.7   | -0.7  | 9.2    | 487.2                                  |
| 11. Loans at foreign branches <sup>2</sup>   | -46.9 | 17.0  | -4.1  | 38.3  | -18.6 | 12.6   | 19.3                                   |
| 12. Sum of lines 10 & 11   | 7.0   | 4.0   | 2.0   | 6.0   | -1.2  | 9.1    | 506.5                                  |
| 13. Commercial paper issued by<br>nonfinancial firms <sup>3</sup>                    | -6.0  | 33.8  | -1.5  | -45.9 | 58.5  | 63.2   | 86.0                                   |
| 14. Sums of lines 12 & 13  | 5.1   | 7.9   | 1.5   | -1.2  | 6.8   | 16.6   | 592.5                                  |
| 15. Bankers acceptances: U.S. trade<br>related <sup>4,5</sup>                        | -5.5  | -12.2 | -1.1  | 21.0  | -20.6 | n.a.   | 34.3 (Oct)                             |
| 16. Line 14 plus bankers acceptances:<br>U.S. trade related                          | 4.5   | 6.7   | 1.4   | 0.2   | 5.1   | n.a.   | 618.7 (Oct)                            |
| 17. Finance company loans to business <sup>4</sup>                                   | 21.4  | 8.0   | 3.6   | 0.0   | n.a.  | n.a.   | 144.1 (Sept)                           |
| 18. Total short- and intermediate-<br>term business credit (sum of<br>lines 16 & 17) | 7.6   | 6.9   | 1.8   | 0.0   | n.a.  | n.a.   | 760.1 (Sept)                           |

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.

in debt maturities. While lower bond rates evidently were strong stimulants to nonfinancial volume, issuance by financial firms slowed, reflecting in part a moderation in the number of new CMOs.

Stock prices have rallied during the intermeeting period, with a rise of 6-7 percent in broadly based indexes and a total gain since the beginning of the year of around 25 percent. The aggregate value of stock market wealth this year has risen by more than \$300 billion, net of stock retirements. Prices have benefited from lower interest rates and a stronger profit outlook. New issue volume initially showed little response to the recent price gains, but began to pick up in early December.

#### U.S. Government Securities Market

The federal debt ceiling disrupted financing of the deficit from late September through November. After exhausting its cash balance in the second week of October, the Treasury shifted government trust fund investments from Treasury securities to debt issues of the Federal Financing Bank; the Treasury later took the additional step of paying down some trust fund investments. Both of these actions lessened its debt subject to the ceiling and permitted new funds to be raised. These techniques kept the government running until November 14, when the Congress approved a temporary increase in the debt ceiling.

The Treasury quickly utilized its new borrowing authority. The day after the congressional action, the Treasury sold \$22 billion of cash management bills, which provided funding until the Treasury could market its postponed coupon securities and conduct its regular bill auctions. All told, beginning on November 15, the Treasury came to the market on nine consecutive business days, selling \$100 billion of new securities and

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

|   | 1984 | 1985  |       |                 |                    |                   |                   |
|---|------|-------|-------|-----------------|--------------------|-------------------|-------------------|
|   | Year | Q1    | Q2    | Q3 <sup>P</sup> | Sept. <sup>P</sup> | Oct. <sup>P</sup> | Nov. <sup>P</sup> |
| Corporate securities - total <sup>1</sup> | 9.88 | 12.32 | 16.95 | 15.44           | 13.21              | 18.47             | 17.20             |
| Public offerings in U.S.                  | 8.00 | 9.35  | 14.69 | 12.50           | 11.01              | 11.50             | 13.20             |
| Stocks--total <sup>2</sup>                | 1.89 | 2.21  | 3.28  | 2.94            | 2.22               | 2.30              | 2.80              |
| Nonfinancial                              | 1.08 | 1.12  | 1.98  | 1.44            | 1.22               | 1.00              | 1.50              |
| Utility                                   | .22  | .43   | .50   | .19             | .16                | .20               | .20               |
| Industrial                                | .86  | .70   | 1.48  | 1.25            | 1.06               | .80               | 1.30              |
| Financial                                 | .81  | 1.08  | 1.30  | 1.50            | 1.00               | 1.30              | 1.30              |
| Bonds--total <sup>1</sup>                 | 6.11 | 7.14  | 11.41 | 9.56            | 8.79               | 9.20              | 10.40             |
| By industry                               |      |       |       |                 |                    |                   |                   |
| Nonfinancial                              | 2.80 | 4.14  | 5.78  | 4.88            | 3.85               | 4.80              | 6.30              |
| Utility                                   | .87  | .79   | 1.35  | 1.59            | 1.59               | 2.85              | 1.30              |
| Industrial                                | 1.93 | 3.35  | 4.43  | 3.29            | 2.26               | 1.95              | 5.00              |
| Financial                                 | 3.31 | 3.00  | 5.63  | 4.68            | 4.94               | 4.30              | 4.10              |
| By quality <sup>3</sup>                   |      |       |       |                 |                    |                   |                   |
| Aaa and Aa                                | 1.85 | 1.23  | 2.70  | 2.53            | 1.52               | 2.40              | 2.00              |
| A and Baa                                 | 2.11 | 3.97  | 5.33  | 3.79            | 4.28               | 3.65              | 4.70              |
| Less than Baa                             | 1.09 | .94   | 1.65  | 1.35            | .82                | .90               | 2.15              |
| No rating (or unknown)                    | .25  | .27   | .46   | .24             | .24                | .45               | .35               |
| Memo items:                               |      |       |       |                 |                    |                   |                   |
| Equity based bonds <sup>4</sup>           | .63  | .46   | 1.10  | .81             | .44                | .24               | .60               |
| Mortgage-backed bonds                     | .81  | .73   | 1.27  | 1.65            | 1.93               | 1.80              | 1.20              |
| Variable-rate notes                       | .72  | .99   | 1.50  | .41             | .25                | .49               | .35               |
| Bonds sold abroad - total                 | 1.88 | 2.98  | 2.26  | 2.94            | 2.20               | 6.97              | 4.00              |
| Nonfinancial                              | .84  | 1.06  | 1.01  | 1.26            | 1.07               | 2.82              | 1.40              |
| Financial                                 | 1.04 | 1.92  | 1.25  | 1.68            | 1.13               | 4.15              | 2.60              |

p--preliminary.

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.

2. Includes equity issues associated with debt/equity swaps.

3. Bonds categorized according to Moody's bond ratings. Excludes mortgage-backed bonds.

4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.

raising \$27-1/4 billion of new funds. In addition, Treasury issuance of nonmarketable state and local government securities surged in November, reflecting purchases made from proceeds of a record volume of tax-exempt refunding bonds.

The debt ceiling began again to pose problems for the Treasury on December 6, when the temporary extension of the ceiling expired. Consequently, the regular weekly bill auction scheduled for December 9 was postponed. If the Gramm-Rudman amendment is not passed and signed on December 11, Congress is expected to enact a further temporary extension of the debt ceiling to permit financing on December 12, when the Treasury would otherwise exhaust its cash balance.

Borrowing by the federally sponsored agencies appears to have picked up in the current quarter from a relatively low level in the third quarter. The largest change in borrowing is attributable to the Farm Credit Banks. After consistently paying down debt in preceding quarters, the Banks are expected to have raised a small volume of new funds during the fourth quarter, primarily through short-term discount notes. These new funds are being used to build the liquidity position of the Banks; loans at these institutions are continuing to decline, because of both reduced demand and write-offs of bad loans. Borrowing by Freddie Mac and Sallie Mae also is estimated to have strengthened in the fourth quarter, while borrowing by Fannie Mae and the Home Loan Banks is about unchanged.

Interest rate spreads between sponsored-agency and Treasury securities have narrowed recently. In late November, the Federal Home Loan Banks issued 2- and 3-year securities at rates of 15 to 20 basis points over Treasuries. This contrasts with spreads of 30 to 40 basis points on

TREASURY AND AGENCY FINANCING<sup>1</sup>  
(Total for period; billions of dollars)

|  | 1985  |       |       |       |       |
|--|-------|-------|-------|-------|-------|
|  | Q3    | Q4e   | Oct.  | Nov.P | Dec.e |
| <u>Treasury financing</u>  |       |       |       |       |       |
| Combined surplus/deficit(-)  | -49.9 | -77.8 | -27.1 | -31.6 | -19.1 |
| Means of financing deficit:  |       |       |       |       |       |
| Net cash borrowing<br>from the public  | 46.1  | 80.2  | 11.3  | 45.4  | 23.5  |
| Marketable borrowings/<br>repayments(-)  | 37.3  | 62.6  | 6.6   | 39.4  | 16.6  |
| Bills  | 2.4   | 16.0  | 5.5   | 8.1   | 2.4   |
| Coupons  | 34.9  | 46.6  | 1.1   | 31.3  | 14.2  |
| Nonmarketable  | 8.8   | 17.6  | 4.7   | 6.0   | 6.9   |
| Decrease in the cash<br>balance  | 6.9   | 2.0   | 15.3  | -8.3  | -4.9  |
| Memo: Cash balance<br>at end of period   | 17.1  | 15.1  | 1.8   | 10.1  | 15.0  |
| Other <sup>2</sup>   | -3.1  | -4.4  | .5    | -5.5  | .6    |
| <u>Federally sponsored credit<br/>agencies, net cash<br/>borrowing<sup>3</sup></u> |       |       |       |       |       |
| FHLBs  | 2.5   | 2.0   | .9    | .5    | .6    |
| FNMA   | 2.2   | 2.5   | .9    | .8    | .8    |
| Farm Credit Banks  | -1.8  | .3    | 1.0   | .6    | -1.3  |
| FHLMC  | *     | .5    | .1    | .2    | .2    |
| SLMA   | .6    | 1.0   | .6    | .3    | .1    |

p--preliminary. 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.

similar issues in September and October, when investors were more concerned that the Home Loan Banks would be tapped for large sums to fund the subsidiary of the FHLB system set up to dispose of assets acquired by FSLIC. Also in late November, the Farm Credit Banks sold new 6-month and 18-month securities with rates about 80 basis points above the returns on Treasuries --down about 20 basis points from the spread earlier in the month. These spreads narrowed an additional 15 to 20 basis points in early December, after Senate passage of a bill to strengthen the Farm Credit System.

#### Tax-Exempt Market

Issuance of tax-exempt bonds has increased dramatically because of the approaching effective date of proposed tax law changes and the further decline in interest rates. Gross offerings of long-term tax-exempt bonds reached a record of \$22 billion in November, well above the strong volumes of the preceding several months.

The administration's tax reform package, as well as the bill recently reported by the House Ways and Means Committee, would restrict the types of debt eligible for tax-exempt status and would apply to all bonds issued after the end of this month. Although the effective date could be changed and the prospects of any tax legislation are uncertain, many issuers have been unwilling to jeopardize the tax-exempt status of their bonds by issuing in 1986. While the administration's proposal is considerably more restrictive, both packages would limit the use of tax-exempt debt for private purposes and would further restrict advance refunding issues and the potential for arbitrage earnings.

Refunding bond issuance especially has been stimulated by the combination of potential tax law changes and low interest rates. Offerings of

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

|                            | 1984  |       | 1985 |       |       |       |                   |                   |
|----------------------------|-------|-------|------|-------|-------|-------|-------------------|-------------------|
|                            | Year  | Q4    | Q1   | Q2    | Q3    | Sept. | Oct. <sup>p</sup> | Nov. <sup>e</sup> |
| Total                      | 10.60 | 15.75 | 9.16 | 16.11 | 16.01 | 13.93 | 20.30             | 23.00             |
| Short-term <sup>1</sup>    | 1.71  | 1.14  | .83  | 3.45  | 2.65  | 1.32  | 1.30              | 1.00              |
| Long-term                  | 8.89  | 14.61 | 8.33 | 12.66 | 13.36 | 12.61 | 19.00             | 22.00             |
| Refundings <sup>2</sup>    | 1.05  | 1.34  | 1.88 | 3.89  | 4.07  | 3.08  | 7.00              | 8.00              |
| New capital                | 7.84  | 13.27 | 6.45 | 8.77  | 9.29  | 9.53  | 12.00             | 14.00             |
| Total housing              | 1.69  | 2.36  | 1.56 | 1.95  | 2.18  | 1.98  | 1.79              | 2.40              |
| Single-family <sup>3</sup> | 1.12  | 1.42  | .62  | 1.15  | 1.13  | .98   | 1.08              | 1.00              |

p--preliminary. e--staff estimate.

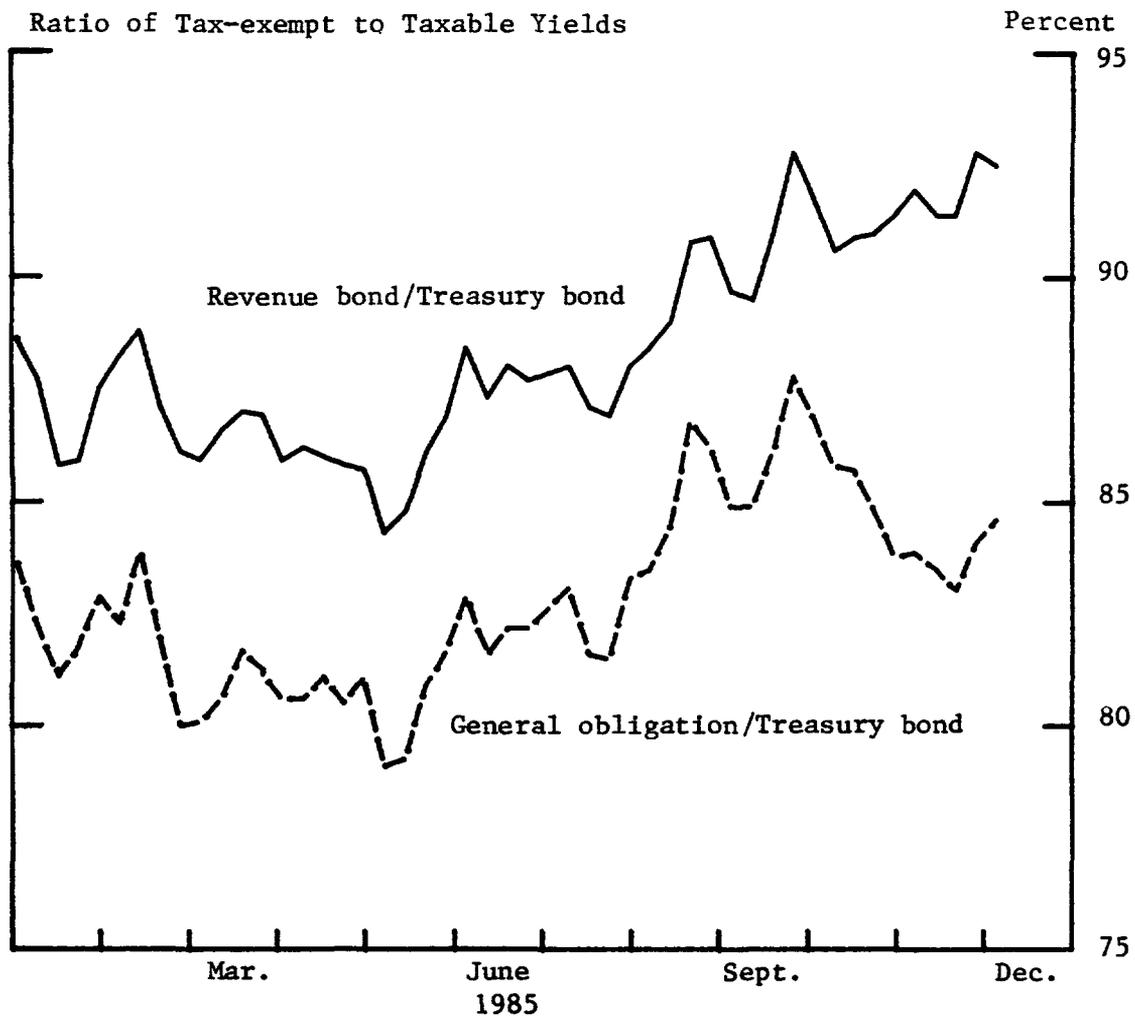
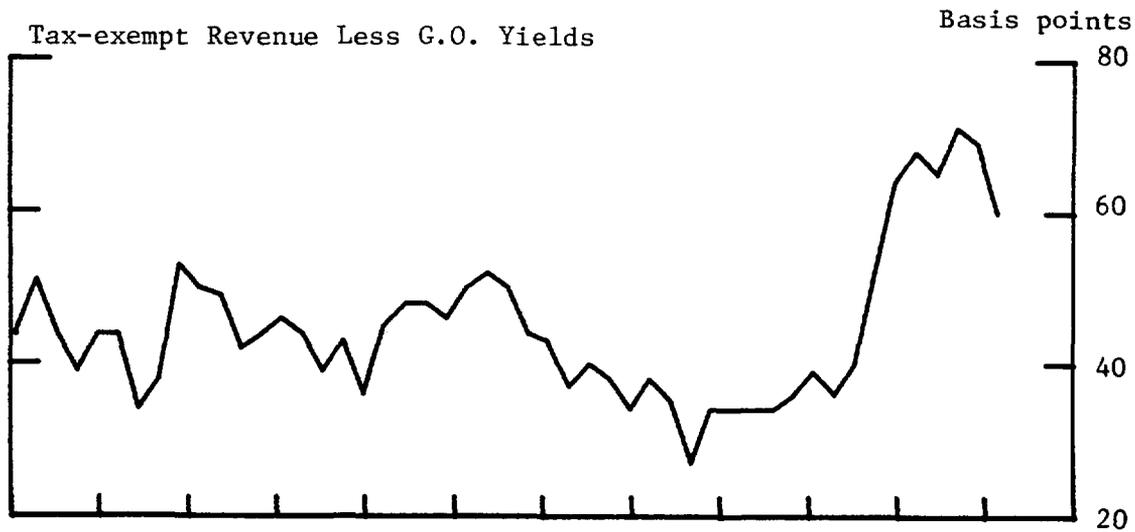
1. Does not include tax-exempt commercial paper.
2. Includes all refunding bonds, not just advance refundings.
3. Data from the Department of Housing and Urban Development.

these bonds during the spring and summer were brisk at around \$4 billion per month, but surged to \$8 billion in November. For the year as a whole, refundings, including both immediate and advance refinancings, could account for a record 30 percent of total tax-exempt bond offerings.

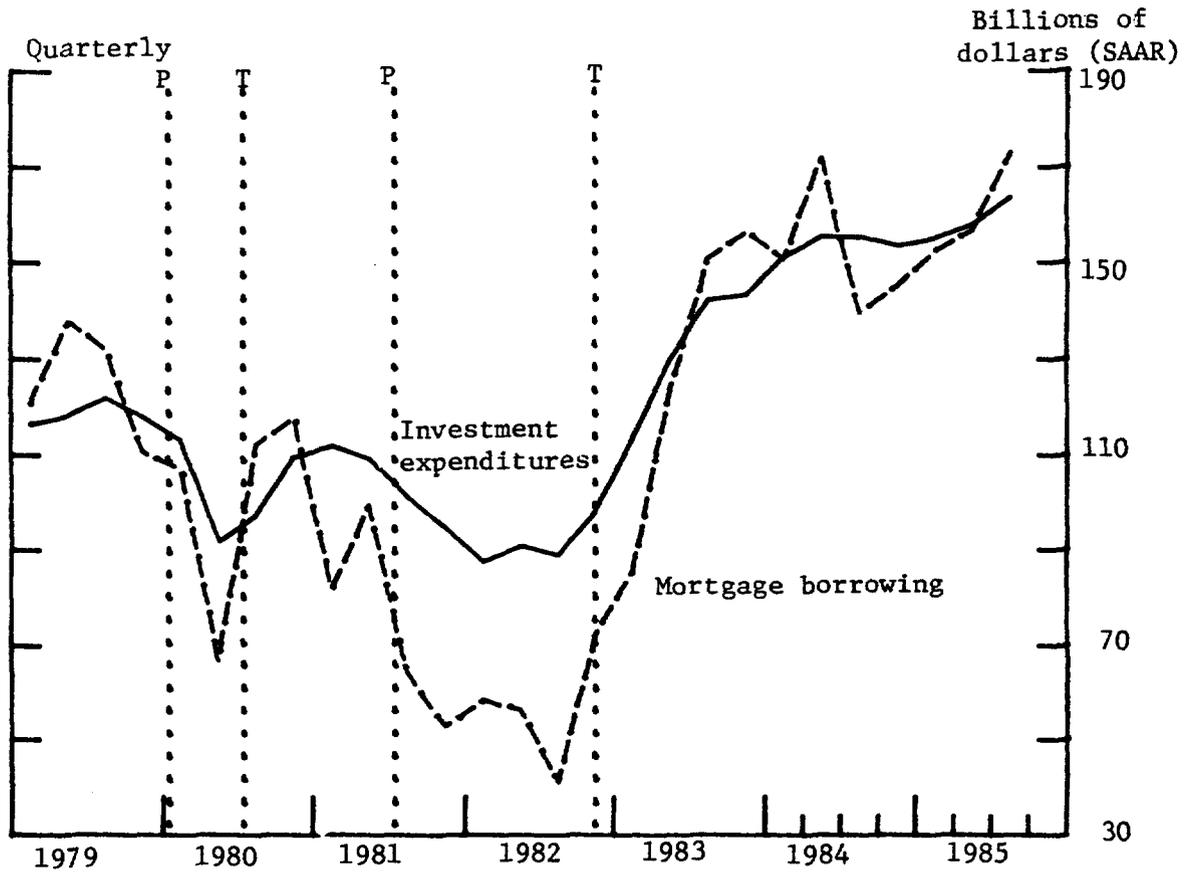
A broadly based increase in demand for tax-exempt bonds has enabled their yields to decline with other longer-term rates despite the sharp rise in supply. Yields have dropped particularly on general obligation bonds, which have accounted for nearly a third of tax-exempt offerings in recent months. Large purchases by commercial banks have boosted demand for G.O. bonds. Under either of the two current tax reform packages, banks stand to lose the 80 percent deduction allowed for the interest expense incurred in carrying tax-exempt bonds purchased after December 31.

Owing in part to the surge in bank purchases of G.O.s, the spread between revenue bond and G.O. yields had widened to the largest margin in several years before narrowing some in recent weeks. The ratio of tax-exempt revenue bond yields to taxable rates has remained quite high, while

SELECTED YIELD RELATIONSHIPS



RESIDENTIAL INVESTMENT AND BORROWING



yields on G.O.s relative to Treasury bonds declined for much of the autumn before turning up late last month.

### Mortgage Markets

Interest rates on home mortgages have declined by nearly 1/2 percentage point in both the primary and the secondary markets since the last FOMC meeting. At S&Ls, contract interest rates on new commitments for fixed-rate conventional home mortgages have dropped to 11-1/2 percent, more than 3 percentage points below their August 1984 peak.

The latest decline in commitment rates on fixed-rate mortgages exceeded the movement in ARM rates. On these variable-cost financing arrangements, which have continued to account for about half of aggregate conventional home mortgage originations, initial contract interest rates on new commitments at S&Ls for one-year contracts have been unchanged, on balance, since early November. Initial rate spreads favoring ARMs thus have narrowed to the smallest margin since March of this year.

With interest rates easing, growth in residential mortgage credit picked up during the third quarter to a seasonally adjusted annual rate of about 11 percent, according to preliminary estimates. Net credit demands again increased by somewhat more than residential investment expenditures, apparently owing to funding of a stepped-up volume of existing-home transactions, along with some additional borrowing against housing equity. A growing, but still quite limited, portion of mortgage activity so far this year has been attributable to second (junior) loans, according to FHLMC estimates. Commercial banks, it is believed, have been supplying the largest volume of second mortgage funds through real-estate-secured equity lines of credit and other programs.

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 | Total issues less swaps |
| 1985-Q1   | 6.4   | 2.7   | 2.4    | 1.3   | 3.0                        | 3.4                     |
| Q2        | 7.5   | 3.3   | 2.8    | 1.5   | 3.3                        | 4.2                     |
| Q3 r      | 10.4  | 4.1   | 3.8    | 2.5   | 4.7                        | 5.7                     |
| 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    | 9.1   | 4.2   | 2.7    | 2.2   | 3.9                        | 5.2                     |
| Sep. r    | 12.6  | 4.4   | 4.5    | 3.7   | 6.1                        | 6.5                     |
| Oct. p    | 10.7  | 5.8   | 2.7    | 2.2   | 3.7                        | 7.0                     |
| Nov. p    | 12.9  | 6.0   | 3.9    | 2.9   | 5.6                        | 7.3                     |

r--revised. p--preliminary.

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

|           | Mortgage commitments |                          | Net change in mortgage assets <sup>1</sup> |                |                            |
|-----------|----------------------|--------------------------|--|----------------|----------------------------|
|           | New                  | Outstanding <sup>2</sup> | Total                                      | Mortgage loans | Mortgage-backed securities |
|           | (1)                  | (2)                      | (3)  | (4)            | (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      | 18.0                 | 66.3                     | 2.1  | 5.4            | -3.4                       |
| Aug.      | 21.4                 | 66.0                     | 8.0  | 4.5            | 3.5                        |
| Sept.     | 21.5                 | 65.9                     | 7.4  | 3.7            | 3.7                        |
| Oct. p    | 22.7                 | 65.5                     | 7.4  | 6.9            | .5                         |

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.

p--preliminary.

Residential mortgage lending during the third quarter was bolstered by a surge in loan pooling arrangements; in October, issuance of mortgage passthrough securities slowed somewhat but then bounced up to a new high in November. Meanwhile, total mortgage asset holdings at FSLIC-insured thrifts continued to grow briskly in October, and loan originations jumped sharply to a record volume. Even heavier thrift mortgage originations are apt to be forthcoming, judging from an additional rise in new mortgage commitments during October. Commercial bank lending on all kinds of real estate strengthened in October and remained almost as active during November.

The FHA adjustable-rate mortgage program, initiated in August 1984, recently has gathered considerable momentum. Trade sources suggest that investors, viewing prospects for the containment of inflation as more favorable, have become less concerned about the restrictive interest rate cap on FHA ARMs. (The FHA ARM annual rate cap is only one percentage point; many conventional ARMs carry caps of two points.) Moreover, tightened standards in the private mortgage insurance industry and elsewhere, which have limited the availability of high loan-to-value ratio conventional ARMs, have made FHA ARMs look more attractive to both lenders and borrowers.

#### Consumer Installment Credit

Growth of consumer installment credit slowed to a 15 percent annual rate in October, primarily reflecting the end of special financing incentives that had strongly stimulated auto lending by finance companies in late August and throughout September.

Credit difficulties in the household sector have been increasing rapidly in recent quarters. In the third quarter, delinquencies continued to rise on both closed-end consumer installment credit at commercial banks

CONSUMER INSTALLMENT CREDIT

|  | 1983  | 1984  | 1985  |       | 1985  |       |                    |
|--|-------|-------|-------|-------|-------|-------|--------------------|
|  |       |       | Q2    | Q3    | Aug.  | Sept. | Oct.               |
| ----- Percent rate of growth, SAAR ----- |       |       |       |       |       |       |                    |
| Change in outstandings--total            | 14.6  | 20.0  | 18.9  | 18.8  | 13.6  | 27.1  | 15.2               |
| By type:                                 |       |       |       |       |       |       |                    |
| Automobile credit                        | 13.4  | 20.6  | 21.9  | 24.5  | 13.6  | 44.0  | 21.5               |
| Revolving credit                         | 17.7  | 23.9  | 17.6  | 14.1  | 10.5  | 21.9  | 16.5               |
| All other <sup>1</sup>                   | 14.0  | 17.5  | 16.8  | 15.8  | 15.2  | 13.7  | 8.4                |
| ----- Billions of dollars, SAAR -----    |       |       |       |       |       |       |                    |
| Change in outstandings--total            | 48.7  | 76.8  | 90.2  | 94.0  | 68.7  | 138.4 | 79.5               |
| By type:                                 |       |       |       |       |       |       |                    |
| Automobile credit                        | 16.9  | 29.5  | 39.9  | 47.1  | 26.5  | 86.5  | 43.8               |
| Revolving credit                         | 12.4  | 19.6  | 17.9  | 15.1  | 11.2  | 23.7  | 18.2               |
| All other <sup>1</sup>                   | 19.5  | 27.8  | 32.4  | 31.9  | 31.0  | 28.2  | 17.5               |
| By major holder:                         |       |       |       |       |       |       |                    |
| Commercial banks                         | 19.5  | 40.4  | 38.6  | 29.3  | 21.2  | 45.0  | 17.5               |
| Finance companies                        | 9.3   | 9.3   | 21.9  | 41.6  | 28.5  | 76.9  | 37.7               |
| All other                                | 20.0  | 27.1  | 29.7  | 23.0  | 19.1  | 16.5  | 24.3               |
| ----- Annual percentage rate -----       |       |       |       |       |       |       |                    |
| Interest rates                           |       |       |       |       |       |       |                    |
| At commercial banks <sup>2</sup>         |       |       |       |       |       |       |                    |
| New cars, 48 mos.                        | 13.92 | 13.71 | 13.16 | 12.72 | 12.72 | n.a.  | 12.39 <sup>3</sup> |
| Personal, 24 mos.                        | 16.68 | 16.47 | 16.09 | 15.84 | 15.84 | n.a.  | 15.61 <sup>3</sup> |
| Credit cards                             | 18.78 | 18.77 | 18.74 | 18.62 | 18.62 | n.a.  | 18.57 <sup>3</sup> |
| At auto finance companies <sup>4</sup>   |       |       |       |       |       |       |                    |
| New cars                                 | 12.58 | 14.62 | 11.95 | 10.72 | 10.87 | 8.84  | 9.97               |
| Used cars                                | 18.74 | 17.85 | 17.80 | 17.46 | 17.57 | 17.31 | 17.21              |

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. Data for November, 1985.

4. Average rate for all loans of each type made during the period, regardless of maturity.

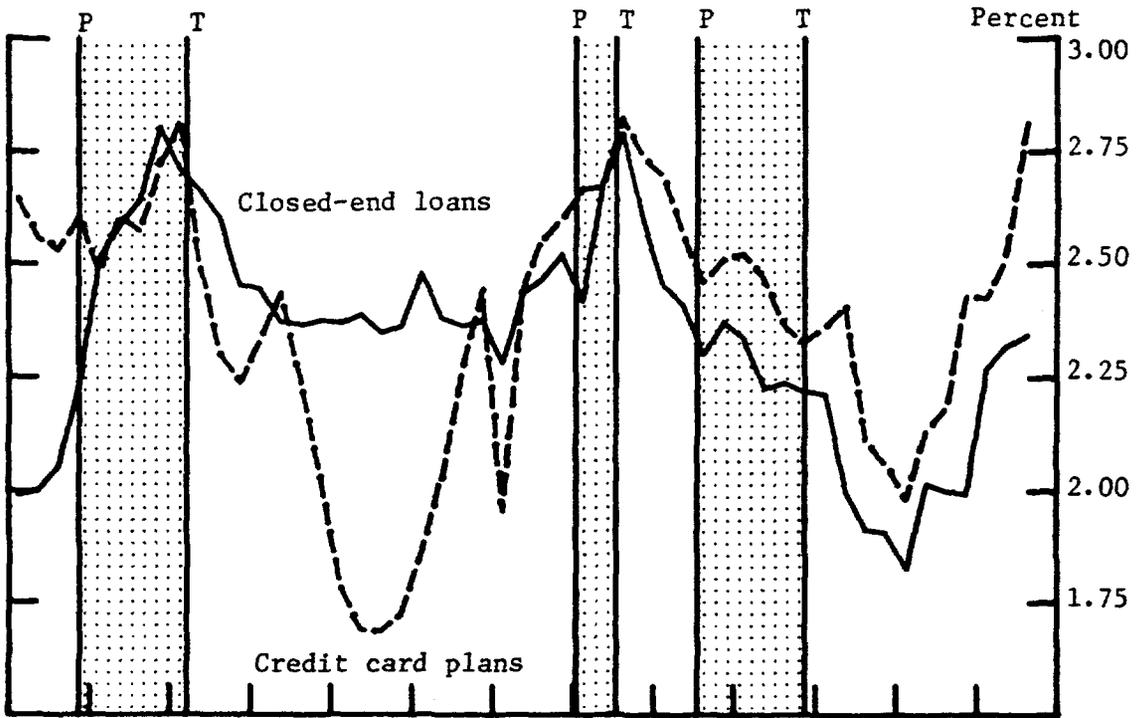
n.a.--not available.

and auto loans at finance companies; the delinquency rate on bank credit card plans has reached its previous highs (see chart on page III-20). Banks sampled in the Survey of Senior Loan Officer Opinion reported experiencing some increase in delinquency rates on consumer credit during 1985, but as of early November, only a few of them had taken or planned to take actions to tighten credit standards or to increase collection efforts.

In the mortgage credit area, delinquencies on first-mortgage home loans turned up in the third quarter but remained a bit below the record high rate--nearly 2 percent of all loans past due 60 days or more--reached in the first quarter. Repayment difficulties on second mortgages generally have stayed below the level of delinquencies on either consumer installment loans at banks or on first-mortgage home loans.

Consistent with the trends in loan delinquencies, the number of personal bankruptcies per thousand households reached a new high during the third quarter of 1985. The bankruptcy ratio has risen sharply throughout this year, after declining in most of the two immediately preceding years. No legal or administrative changes have occurred that would help account for the recent uptrend, unlike the period after late 1979 when personal bankruptcy filings were boosted by major revisions in the bankruptcy code in addition to a business cycle downturn.

DELINQUENCY RATES ON COMMERCIAL BANK CONSUMER INSTALLMENT CREDIT  
(Past due 30 days or more, seasonally adjusted)



NUMBER OF PERSONAL BANKRUPTCIES PER THOUSAND HOUSEHOLDS  
(Seasonally adjusted)



Foreign Exchange Markets

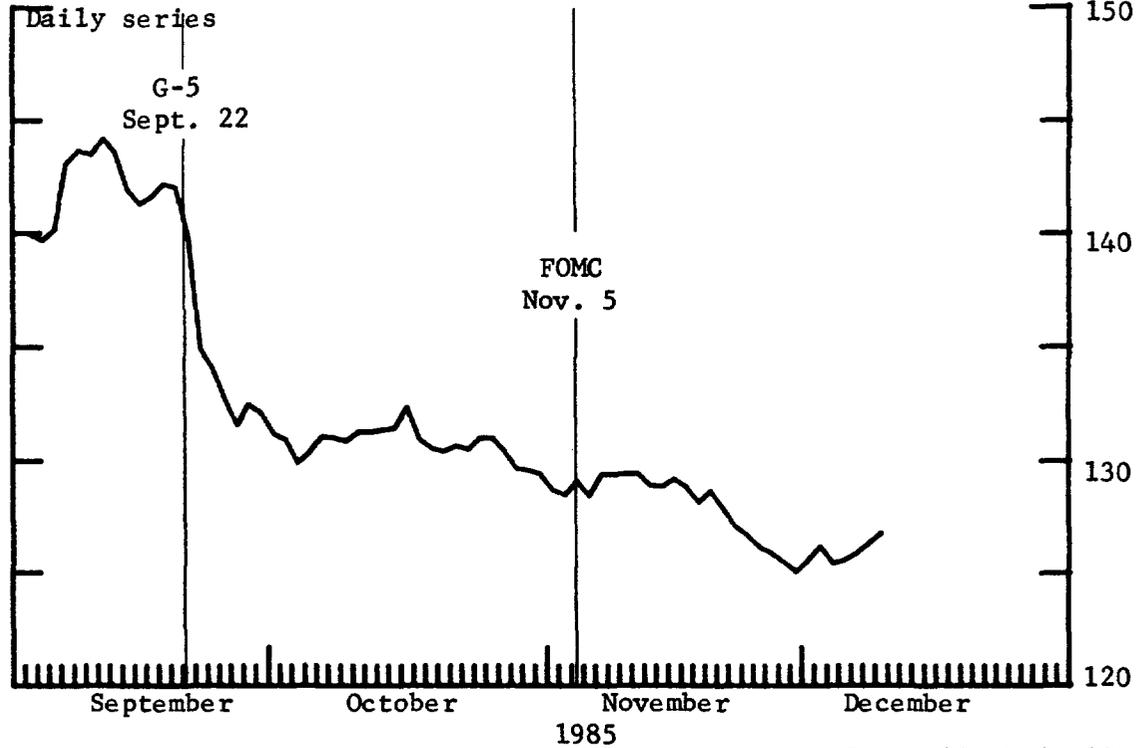
The trade-weighted value of the dollar has declined 1-1/4 percent further since the last FOMC meeting, to a level 9 percent below its level just prior to the G-5 announcement on September 22. Although, on balance, since September 22, the dollar has depreciated more against the yen than against the other currencies, since the last FOMC meeting the dollar has registered a larger decline vis-a-vis the German mark than against the yen. As shown in the lower panel of the chart, over the intermeeting period the dollar fell 2-1/2 percent against the mark, while easing 2 percent against the yen.

During the first half of November, movements in the dollar-yen bilateral rate were the most pronounced among the major currencies. With the decision in late October by the Bank of Japan not to accommodate fully the seasonal liquidity demand in the fourth quarter, both short and long-term interest rates on yen securities had risen about 100 basis points. Subsequent statements by Governor Sumita reaffirming the Bank of Japan's commitment to a strong yen led market participants to anticipate a further sustained firming in rates, and interest rates on longer maturities climbed an additional 50 basis points, further narrowing the differential between U.S. and Japanese long-term rates.

After mid-November, however, rates on long-term yen securities declined. With the Japanese yen trading briefly below 200 yen per dollar for the first time in more than 4-1/2 years and reports that commercial interests in Japan were concerned about the effects of too sharp an appreciation in the yen, ambiguous statements by Japanese

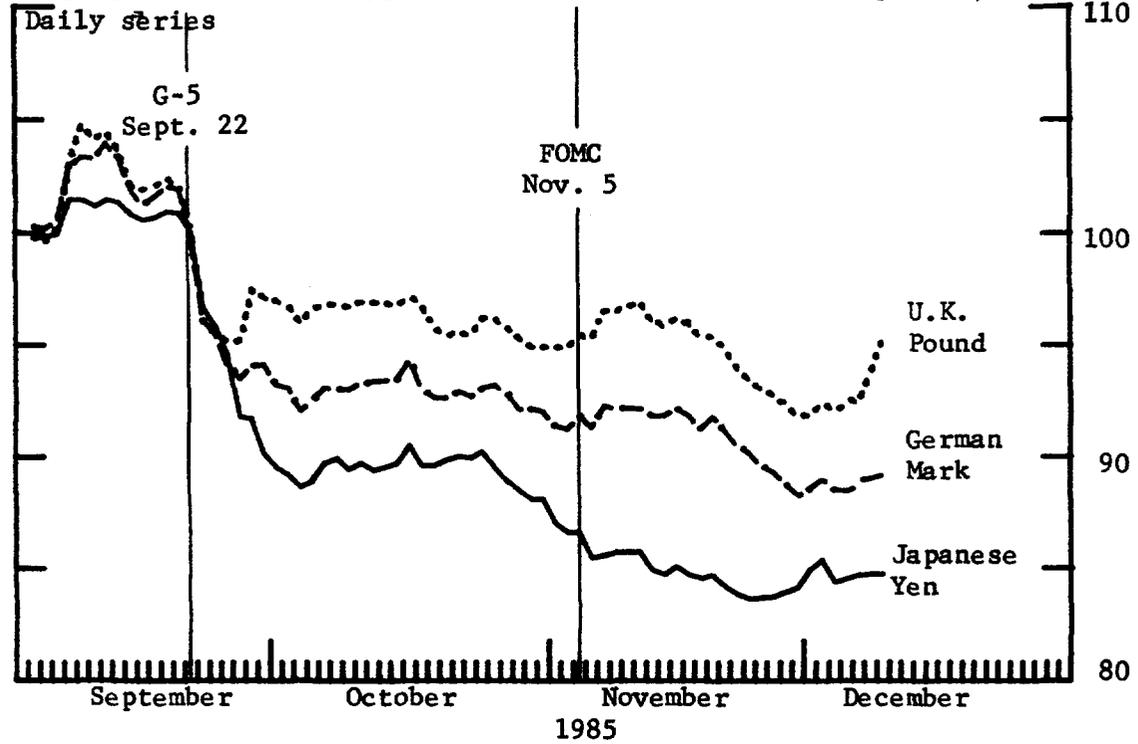
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March 1973=100

WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



SELECTED DOLLAR EXCHANGE RATES

Sept. 20, 1985=100



officials that they would like to see the yen stabilize at a high level were interpreted by market participants as indications that perhaps the yen had reached an acceptable level, reducing the need for continued upward pressure on interest rates. Rates on long-term yen securities fell nearly 80 basis points in the latter half of November compared with a 30 basis point decline in U.S. long-term rates, and the dollar firmed somewhat against the yen. In contrast, European long-term interest rates were little changed. As a result, the recent declines in U.S. rates have eroded somewhat the long-term interest rate differential favoring U.S. dollar securities over mark securities. Long-term interest rates in the United Kingdom, which have been above U.S. rates, now exceed U.S. rates by an even larger margin.

Recently, the dollar has firmed on a weighted-average basis.

statements by Governor Sumita indicating that he expects to see central banks move towards a managed float strengthened the view in the market that the central banks might act to provide a floor for the dollar. Last week, sterling fell sharply -- depreciating 4-1/2 percent against the dollar -- on reports that OPEC will cut its prices to maintain its market share. Relative to the last FOMC meeting, the pound has depreciated 1 percent against the dollar as the earlier gain associated with the favorable movements in interest rate differentials was more than reversed in the past week.

With respect to other currencies, trading in pesos in New York has been suspended since November 5 when Mexican authorities introduced new rules governing foreign banks' operations in pesos. These regulations were intended to stem capital flight from Mexico, which had been

stimulated by the government's policy of pegging the Treasury-bill rate at relatively unattractive yields and by expropriation of urban property following the September earthquakes. Since mid-November, the peso has appreciated about 7 percent in quotes for the free rate by Mexican exchange houses as the announcement of planned reductions in the budget deficit and the decision to join GATT were received favorably in the market. In contrast, the controlled rate for the peso has been depreciated at an accelerating rate, narrowing the extent to which the value of the controlled peso exceeds that of the free one.

The Canadian dollar initially weakened as market participants expected that difficulties at several Canadian banks in October would foster an accommodative monetary stance. Recently, pressure on the Canadian dollar has intensified with the release of Canadian international reserve figures, which implied that roughly \$700 million in intervention had been done with the Canadian dollar nevertheless continuing to weaken. On a bilateral basis, the Canadian dollar is now only fractionally above its all-time low against the dollar of February

1985

. Over

the past few weeks, however, short-term interest rates in Canada have firmed somewhat, suggesting that the Bank of Canada also is using monetary policy to support its currency.

U.S. International Financial Transactions

The recorded net foreign capital inflow in September and October corresponding to the continued large current account deficit occurred through sizable private foreign net purchases of U.S. Treasury securities, large foreign net purchases of bonds issued in the Euromarkets by U.S. corporations and moderate net inflows into the domestic offices of U.S. banks. (See the Summary Table on U.S. International Transactions.)

Foreign net purchases of U.S. Treasury securities totalled more than \$9 billion over the two-month period of September and October, up sharply from the preceding months. This amount reflected continued heavy net purchases by Japanese investors and a large purchase by the World Bank. Reports from market participants suggest that the Japanese played a somewhat smaller role in the purchase of new issues in November.

Foreign net purchases of bonds issued by U.S. corporations totalled \$8.5 billion during the September-October period (line 2a), an increase from the already heavy pace of these purchases recorded earlier this year. Data on issuance of bonds by U.S. corporations in the Euromarket indicate that nearly one quarter of the total issuance over the period was denominated in foreign currencies, though in most cases the use of swaps in conjunction with bond issuance eliminated the foreign currency exposure of the U.S. residents issuing these securities. Preliminary data for November indicate some decline in the rate of issuance of Eurobonds by U.S. corporations.

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

|   | 1983  | 1984   | 1984  |       |       |       | 1985  |       |      |      |       |      |
|---|-------|--------|-------|-------|-------|-------|-------|-------|------|------|-------|------|
|   | Year  | Year   | Q1    | Q2    | Q3    | Q4    | Q1    | Q2    | Q3   | Aug. | Sept. | Oct. |
| <b>Private Capital</b>  |       |        |       |       |       |       |       |       |      |      |       |      |
| <b>Banks</b>  |       |        |       |       |       |       |       |       |      |      |       |      |
| 1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)                    | 13.4  | 22.0   | 12.7  | 0.7   | 9.6   | -1.2  | 15.7  | -0.9  | 8.2  | 4.6  | -4.3  | 9.3  |
| <b>Securities</b>   |       |        |       |       |       |       |       |       |      |      |       |      |
| 2. Private securities transactions, net   | 1.6   | 7.6    | 2.1   | -0.3  | 0.3   | 5.6   | 7.0   | 4.9   | 9.9  | 2.6  | 3.4   | 4.3  |
| 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   | 10.3 | 1.9  | 4.0   | 4.5  |
| b) foreign net purchases (+) of U.S. corporate stocks   | 6.4   | -0.8   | 1.0   | -0.1  | -1.0  | -0.7  | -1.1  | 0.4   | 1.4  | 0.7  | 0.1   | 0.6  |
| c) U.S. net purchases (-) of foreign securities   | -7.0  | -5.4   | 0.6   | -0.8  | -1.3  | -3.8  | -2.5  | -2.2  | -1.8 | 0.1  | -0.7  | -0.8 |
| 3. Foreign net purchases (+) of U.S. Treasury obligations 1/                                      | 8.3   | 23.0   | 1.9   | 6.6   | 5.1   | 9.4   | 2.2   | 5.1   | 7.8  | -3.2 | 7.9   | 1.4  |
| <b>Official Capital</b>   |       |        |       |       |       |       |       |       |      |      |       |      |
| 4. Changes in foreign official reserve assets in U.S. (+ = increase)                              | 5.2   | 2.6    | -3.1  | -0.7  | -0.6  | 7.0   | -10.6 | 7.9   | 2.5  | 0.4  | -0.9  | -0.9 |
| a) By area  |       |        |       |       |       |       |       |       |      |      |       |      |
| G-10 countries (incl. Switz.)   | 6.4   | 3.1    | 2.3   | -0.7  | -0.8  | 2.2   | -5.5  | 6.1   | 2.4  | 0.5  | -2.0  | -1.5 |
| OPEC  | -8.5  | -5.4   | -2.8  | -2.5  | -0.7  | 0.6   | -1.6  | -2.0  | -2.0 | -1.1 | -0.8  | 0.6  |
| All other countries   | 7.3   | 4.9    | -2.7  | 2.5   | 0.8   | 4.3   | -3.5  | 3.9   | 2.1  | 1.1  | 1.9   | *    |
| b) By type  |       |        |       |       |       |       |       |       |      |      |       |      |
| U.S. Treasury securities  | 7.0   | 4.7    | -0.3  | -0.3  | -0.6  | 5.8   | -7.2  | 8.7   | -0.1 | -0.7 | -3.4  | -3.3 |
| Other 2/  | -1.7  | -2.1   | -2.8  | -0.5  | *     | 1.2   | -3.5  | -0.8  | 2.6  | 1.1  | 2.5   | 2.4  |
| 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 | -0.1 | -0.2  | -2.9 |
| <b>Other transactions (Quarterly data)</b>  |       |        |       |       |       |       |       |       |      |      |       |      |
| 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.  | 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.  | n.a. |
| 8. Other capital flows (+ = inflow) 3/ 4/   | -1.4  | 6.3    | 1.2   | 5.6   | 0.7   | -0.5  | -4.8  | 5.5   | n.a. | 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.  | 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.  | n.a. |
| <b>MEMO:</b>  |       |        |       |       |       |       |       |       |      |      |       |      |
| 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 | n.a. | -8.7 | n.a.  | n.a. |

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.

The very large issuance of Eurobonds during September-October have been influenced by changes in market participants' expectations about the future course of interest rates due to developments in the U.S. government securities market. Prospects for an extremely large offering of U.S. Treasury securities in November when the debt ceiling was due to be temporarily relaxed, may have led to expectations of a rise in interest rates and thereby stimulated the issuance of corporate bonds in October. In addition, the decline in the slope of the yield curve since September, which in part may reflect the expectation of progress by the U.S. government in reducing its fiscal deficit in the longer run, may have induced some firms to issue bonds so as to restructure their liabilities in favor of longer-maturity obligations.

Domestic offices of U.S. banks experienced a net inflow of \$5 billion during the two month period ending in October (see line 1). The large net inflow for October primarily reflects a \$6.5 million reduction of the net claims of domestic offices on their foreign affiliates; this, in turn, may be the result of the banks' response to a decline in Treasury deposits experienced prior to the relaxation of the debt ceiling in November.

After rising gradually during much of the third quarter, foreign official reserve assets held in the United States fell in September and October.

Data on foreign official holdings at the Federal Reserve Bank of New York show a moderate decline for November.

INTERNATIONAL BANKING DATA  
(Billions of dollars)

|  | 1981 | 1982  | 1983  | 1984  |       | 1985  |       |       |       |         |
|--|------|-------|-------|-------|-------|-------|-------|-------|-------|---------|
|  | Dec. | Dec.  | Dec.  | June  | Dec.  | Mar.  | June  | Sept. | Oct.  | Nov. 3/ |
| 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  | 22.4  | 23.6  | n.a.    |
| 2. Net Claims of U.S. Banking Offices on Own IBFs <u>1/</u>                    | 11.8 | 16.2  | 5.2   | 4.4   | 7.8   | 6.1   | 8.1   | 9.1   | 4.3   | n.a.    |
| 3. Sum of lines 1 and 2  |      |       |       |       |       |       |       |       |       |         |
| of which:  | 19.6 | 49.1  | 44.5  | 35.2  | 33.2  | 32.1  | 35.7  | 31.5  | 27.9  | 29.0    |
| (a) U.S.-chartered banks   | 22.3 | 40.0  | 40.5  | 33.6  | 32.1  | 30.6  | 33.4  | 31.5  | 29.5  | 30.4    |
| (b) Foreign-chartered banks  | -2.6 | 9.1   | 4.0   | 1.6   | 1.1   | 1.6   | 2.2   | *     | -1.6  | -1.5    |
| 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  | 19.5  | 19.4  | 19.6    |
| 5. Eurodollar Holdings of U.S. Nonbank Residents <u>2/</u>                     | 95.5 | 112.6 | 124.3 | 123.5 | 117.5 | 118.9 | 109.5 | 112.6 | 110.5 | 108.4   |

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.

3. Through November 25, 1985.

\*/ Less than 50 million (+).

Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. 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 by U.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

Revised U.S. merchandise trade data on an international transactions basis were released on Wednesday, December 11, for the period 1983 through the third quarter of 1985. The table below summarizes the new trade patterns. The trade deficit increased to \$133 billion at an annual rate in the third quarter. Exports declined for the third quarter in a row. While the decline in agricultural exports was relatively moderate from the second to the third quarter, agricultural exports have dropped 33 percent since the fourth quarter of 1984. Nonagricultural exports decreased by a small amount in the third quarter. Imports rose in the third quarter to a level almost equal that of the fourth quarter of last year. Oil imports declined slightly from the second to the third quarter which only partly offset the rise in nonoil imports. A more complete description of trade developments on a revised basis will be included in the Greenbook Supplement.

Trade data for the month of October are available only on an unrevised basis, and uncertainty about the size of the carry-over of late documents makes it impossible to assess October imports at this time. Exports in October were slightly less than in September or for the average of the third quarter. This appears to be true whether revised or unrevised data are used. The largest declines in exports were in chemicals, machinery, trucks to Canada, and aircraft.

The revised data recompile the trade figures to reflect the actual month of entry for imports and the month of shipment for exports. In previously published data, late documents were just added to the current month's figures. For example, of the (unrevised) value of imports

reported last month for October, 35 percent actually occurred in earlier months; this percentage of carry-over has varied during the months of 1985 from 35 to 55 percent for imports and from 7 to 13 percent for exports. The net effect of the revisions has been to reduce substantially the volatility of quarterly merchandise trade data. Monthly data, however, still move about quite a bit, particularly for imports. These revised data will be incorporated in the press release on U.S. international transactions (probably December 16) and in the comprehensive revision of the GNP accounts scheduled for release on December 20.

December 11, 1985

Revised U.S. Merchandise Trade 1/  
(billions of dollars, seasonally adjusted annual rates)

|                 | <u>Exports</u> |               |                  | <u>Imports</u> |            |               | <u>Trade Balance</u> |
|-----------------|----------------|---------------|------------------|----------------|------------|---------------|----------------------|
|                 | <u>Total</u>   | <u>Agric.</u> | <u>Nonagric.</u> | <u>Total</u>   | <u>Oil</u> | <u>Nonoil</u> |                      |
| <u>Years</u>    |                |               |                  |                |            |               |                      |
| 1980            | 224.3          | 42.2          | 182.1            | 249.8          | 79.4       | 170.4         | -25.5                |
| 1981            | 237.1          | 44.0          | 193.1            | 265.1          | 77.8       | 187.3         | -28.0                |
| 1982            | 211.2          | 37.2          | 174.0            | 247.7          | 61.3       | 186.4         | -36.5                |
| 1983 r          | 201.7          | 37.2          | 164.5            | 268.9          | 55.0       | 213.9         | -67.2                |
| 1984 r          | 219.9          | 38.3          | 181.6            | 334.0          | 57.5       | 276.5         | -114.1               |
| 1985-9 months   | 215.0          | 29.1          | 185.9            | 328.6          | 48.1       | 280.4         | -113.6               |
| <u>Quarters</u> |                |               |                  |                |            |               |                      |
| 1983 - 1-r      | 198.1          | 35.4          | 162.8            | 233.7          | 42.7       | 191.0         | -35.5                |
| 2-r             | 196.2          | 35.3          | 160.9            | 259.7          | 55.1       | 204.6         | -63.5                |
| 3-r             | 200.0          | 37.6          | 162.4            | 282.8          | 65.3       | 217.4         | -82.8                |
| 4-r             | 212.5          | 40.5          | 172.1            | 299.6          | 56.9       | 242.7         | -87.0                |
| 1984 - 1-r      | 213.9          | 39.9          | 174.0            | 312.4          | 55.5       | 256.8         | -98.5                |
| 2-r             | 218.2          | 37.9          | 180.3            | 336.7          | 59.8       | 276.9         | -118.5               |
| 3-r             | 222.6          | 36.6          | 186.0            | 338.5          | 57.0       | 281.5         | -115.9               |
| 4-r             | 225.0          | 38.9          | 186.1            | 348.5          | 57.8       | 290.7         | -123.5               |
| 1985 - 1-r      | 221.2          | 32.7          | 188.5            | 315.0          | 41.9       | 273.1         | -93.8                |
| 2-r             | 214.5          | 28.5          | 186.0            | 328.8          | 52.3       | 276.6         | -114.3               |
| 3-r             | 209.2          | 26.1          | 183.2            | 341.8          | 50.2       | 291.6         | -132.6               |
| <u>Months</u>   |                |               |                  |                |            |               |                      |
| 1985 - Jan.-r   | 218.7          | 34.6          | 184.1            | 328.2          | 47.3       | 280.9         | -109.5               |
| Feb.-r          | 225.9          | 33.7          | 192.2            | 301.4          | 34.1       | 267.3         | -75.5                |
| Mar.-r          | 219.0          | 29.9          | 189.1            | 315.5          | 44.4       | 271.2         | -96.5                |
| Apr.-r          | 210.0          | 32.1          | 177.9            | 336.8          | 52.3       | 284.5         | -126.8               |
| May -r          | 221.2          | 27.0          | 194.2            | 343.2          | 57.4       | 285.9         | -122.0               |
| June-r          | 213.3          | 26.3          | 186.0            | 306.5          | 47.1       | 259.4         | -94.2                |
| July-r          | 206.3          | 24.4          | 182.0            | 348.7          | 53.2       | 295.5         | -142.4               |
| Aug.-r          | 209.7          | 26.5          | 183.3            | 339.9          | 46.9       | 292.9         | -130.1               |
| Sept.-r         | 211.6          | 27.4          | 184.2            | 336.8          | 50.5       | 286.4         | -125.2               |

1/ International transactions basis; all data were revised December 11, 1985.

Foreign Economic Developments. Economic growth in the major foreign industrial countries continues to be moderate. Although the pace of recovery in Japan has slowed, economic activity in Canada and Germany shows signs of increasing strength. Industrial production in France and Italy, however, remains weak. Inflation abroad has been moderate and has declined in recent months in both France and the United Kingdom. German inflation remains very low. On average, the external positions of the major foreign industrial countries have strengthened from last year. None of the major foreign industrial countries had a trade deficit during the last month for which data was available, reflecting improvements in British, French, and Italian trade figures. The current account in both Japan and Germany continues to be in substantial surplus. The Canadian current account, however, was in deficit in the third quarter, the first quarterly deficit in two years.

Individual Country Notes. In Japan, preliminary data indicate that GNP grew 2.6 percent (s.a.a.r.) in the third quarter, consistent with continued but slower growth than that experienced last year. The index of industrial production rose 1.3 percent (s.a.) in October, partially reversing declines experienced during the two preceding months; average IP for the three months ending in October was 3.1 percent above its year-earlier level. Retail sales rose by 1.0 percent (s.a.) in October, and new housing starts rose in September and October after falling in the five preceding months. In October, new housing starts were 5.4 percent above their year-earlier level.

The Tokyo consumer price index rose 2.7 percent during the 12 months ending in October, up 0.5 percent from the equivalent rate

DECEMBER 11, 1985

REAL GNP AND INDUSTRIAL PRODUCTION IN MAJOR INDUSTRIAL COUNTRIES  
(PERCENTAGE CHANGE FROM PREVIOUS PERIOD, SEASONALLY ADJUSTED) 1/

|                       | Q4/Q4<br>1983 | Q4/Q4<br>1984 | 1984 |      |     |     | 1985 |      |      |      |      | LATEST 3 MONTHS<br>FROM YEAR AGO 2/ |
|-----------------------|---------------|---------------|------|------|-----|-----|------|------|------|------|------|-------------------------------------|
|                       |               |               | Q4   | Q1   | Q2  | Q3  | JUNE | JULY | AUG. | SEP. | OCT. |                                     |
| <b>CANADA</b>         |               |               |      |      |     |     |      |      |      |      |      |                                     |
| GNP                   | 7.1           | 4.3           | .8   | .9   | 1.0 | 1.6 | *    | *    | *    | *    | *    | 4.4                                 |
| IP                    | 16.1          | 4.4           | -.1  | .2   | .9  | 2.8 | 1.9  | 1.8  | -.1  | -.1  | NA   | 3.8                                 |
| <b>FRANCE</b>         |               |               |      |      |     |     |      |      |      |      |      |                                     |
| GNP                   | 1.1           | 1.7           | -.1  | -.3  | .9  | .6  | *    | *    | *    | *    | *    | 1.1                                 |
| IP                    | 2.4           | 1.3           | -1.5 | -.8  | .8  | 2.0 | -1.5 | 3.1  | .0   | -1.5 | NA   | .5                                  |
| <b>GERMANY</b>        |               |               |      |      |     |     |      |      |      |      |      |                                     |
| GNP                   | 3.1           | 2.7           | .8   | -1.2 | 1.4 | NA  | *    | *    | *    | *    | *    | 3.2                                 |
| IP                    | 6.0           | 3.5           | 1.4  | -1.0 | 1.6 | 1.8 | 1.7  | 2.4  | -3.2 | .6   | 1.8  | 3.4                                 |
| <b>ITALY</b>          |               |               |      |      |     |     |      |      |      |      |      |                                     |
| GNP                   | 2.2           | 1.7           | -.6  | .8   | .8  | NA  | *    | *    | *    | *    | *    | 2.1                                 |
| IP                    | 1.7           | 1.8           | -1.8 | 1.8  | .3  | -.8 | 2.8  | -3.8 | .9   | .7   | NA   | -.5                                 |
| <b>JAPAN</b>          |               |               |      |      |     |     |      |      |      |      |      |                                     |
| GNP                   | 3.9           | 6.5           | 2.4  | .2   | 1.9 | NA  | *    | *    | *    | *    | *    | 5.2                                 |
| IP                    | 8.6           | 10.6          | 2.7  | -.7  | 2.7 | -.1 | -2.0 | 1.7  | -1.3 | -1.1 | 1.3  | 3.1                                 |
| <b>UNITED KINGDOM</b> |               |               |      |      |     |     |      |      |      |      |      |                                     |
| GNP                   | 3.7           | 2.6           | 1.4  | 1.1  | 1.2 | NA  | *    | *    | *    | *    | *    | 4.9                                 |
| IP                    | 5.6           | -.4           | 1.0  | 2.1  | 2.3 | -.0 | -.3  | -.6  | .3   | 1.5  | NA   | 5.5                                 |
| <b>UNITED STATES</b>  |               |               |      |      |     |     |      |      |      |      |      |                                     |
| GNP                   | 6.3           | 5.7           | 1.0  | .1   | .5  | 1.1 | *    | *    | *    | *    | *    | 2.7                                 |
| IP                    | 14.3          | 7.2           | -.2  | .5   | .3  | .4  | .2   | -.2  | .7   | -.1  | .0   | 1.4                                 |

1. ASTERISKS INDICATE THAT DATA ARE NOT AVAILABLE ON A MONTHLY BASIS.

2. FOR QUARTERLY DATA, LATEST QUARTER FROM YEAR AGO.

DECEMBER 11, 1985

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

|                       | Q4/Q4<br>1983 | Q4/Q4<br>1984 | 1984 |      |     | 1985 |     |      | 1985 |      |      |      | LATEST 3 MONTHS<br>FROM YEAR AGO |
|-----------------------|---------------|---------------|------|------|-----|------|-----|------|------|------|------|------|----------------------------------|
|                       |               |               | Q2   | Q3   | Q4  | Q1   | Q2  | Q3   | AUG. | SEP. | OCT. | NOV. |                                  |
| <b>CANADA</b>         |               |               |      |      |     |      |     |      |      |      |      |      |                                  |
| CPI                   | 4.6           | 3.7           | .9   | .9   | .7  | 1.2  | 1.1 | .9   | .2   | .2   | .3   | NA   | 4.1                              |
| WPI                   | 3.5           | 3.6           | 1.2  | .5   | .3  | 1.0  | .7  | .2   | .0   | .1   | .3   | NA   | 2.4                              |
| <b>FRANCE</b>         |               |               |      |      |     |      |     |      |      |      |      |      |                                  |
| CPI                   | 9.8           | 6.8           | 1.8  | 1.7  | 1.4 | 1.4  | 1.8 | .9   | .1   | .1   | .4   | NA   | 5.3                              |
| WPI                   | 14.6          | 10.5          | 2.9  | 2.2  | 1.6 | 1.6  | .7  | -1.2 | -.7  | -.8  | -.5  | NA   | 1.4                              |
| <b>GERMANY</b>        |               |               |      |      |     |      |     |      |      |      |      |      |                                  |
| CPI                   | 2.7           | 2.1           | .5   | -.0  | .7  | 1.1  | .6  | -.3  | -.3  | .1   | -.2  | NA   | 2.0                              |
| WPI                   | .9            | 1.0           | .8   | -1.4 | .0  | 1.9  | .9  | -2.1 | -.7  | .3   | -.9  | NA   | .4                               |
| <b>ITALY</b>          |               |               |      |      |     |      |     |      |      |      |      |      |                                  |
| CPI                   | 13.0          | 8.8           | 2.1  | 1.4  | 2.2 | 2.6  | 2.2 | 1.1  | .2   | .4   | 1.2  | .7   | 8.4                              |
| WPI                   | 9.1           | 8.9           | 2.2  | 1.2  | 1.9 | 2.7  | 2.2 | -.1  | .0   | .5   | NA   | NA   | 6.9                              |
| <b>JAPAN</b>          |               |               |      |      |     |      |     |      |      |      |      |      |                                  |
| CPI                   | 1.9           | 2.4           | .6   | -.2  | 1.2 | .6   | .5  | -.2  | -.9  | 1.0  | 1.2  | NA   | 2.5                              |
| WPI                   | -3.3          | .5            | -.1  | .8   | -.3 | .4   | -.7 | -1.0 | -.4  | -.3  | -1.4 | NA   | -2.3                             |
| <b>UNITED KINGDOM</b> |               |               |      |      |     |      |     |      |      |      |      |      |                                  |
| CPI                   | 5.1           | 4.8           | 2.0  | .9   | 1.2 | 1.3  | 3.4 | .3   | .3   | -.1  | .2   | NA   | 5.8                              |
| WPI                   | 5.6           | 6.0           | 2.3  | .6   | 1.3 | 1.7  | 2.0 | .5   | .1   | .3   | .2   | .4   | 5.3                              |
| <b>UNITED STATES</b>  |               |               |      |      |     |      |     |      |      |      |      |      |                                  |
| CPI (SA)              | 3.2           | 4.1           | .9   | .9   | .9  | .8   | 1.0 | .6   | -.2  | -.2  | .3   | NA   | 3.2                              |
| WPI (SA)              | .8            | 1.7           | .4   | .0   | .1  | .2   | .6  | -.2  | -.3  | -.6  | .9   | NA   | .7                               |

IV-15

DECEMBER 11, 1985

TRADE AND CURRENT ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES 1/  
(BILLIONS OF U.S. DOLLARS, SEASONALLY ADJUSTED EXCEPT WHERE OTHERWISE NOTED)

|                                | 1983  | 1984   | 1984  |       |       | 1985  |       |       | 1985  |       |       |      |
|--------------------------------|-------|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|
|                                |       |        | Q2    | Q3    | Q4    | Q1    | Q2    | Q3    | JULY  | AUG.  | SEP.  | OCT. |
| <b>CANADA</b>                  |       |        |       |       |       |       |       |       |       |       |       |      |
| TRADE CURRENT ACCOUNT          | 14.4  | 15.8   | 4.0   | 4.0   | 4.4   | 4.0   | 3.4   | 2.3   | .2    | .8    | 1.3   | 1.6  |
|                                | 1.4   | 1.7    | .3    | .5    | .9    | .6    | .0    | 1.1   | ✕     | ✕     | ✕     | ✕    |
| <b>FRANCE</b>                  |       |        |       |       |       |       |       |       |       |       |       |      |
| TRADE CURRENT ACCOUNT          | -5.9  | -2.7   | -1.2  | .4    | -.3   | -1.1  | -.4   | -.7   | -.4   | .0    | -.3   | .1   |
|                                | -4.9  | -.1    | -.4   | .9    | .1    | -.8   | .5    | NA    | ✕     | ✕     | ✕     | ✕    |
| <b>GERMANY</b>                 |       |        |       |       |       |       |       |       |       |       |       |      |
| TRADE CURRENT ACCOUNT (NSA) 2/ | 16.4  | 18.8   | 3.2   | 5.0   | 6.3   | 4.5   | 6.2   | 6.9   | 2.6   | 1.8   | 2.4   | 2.3  |
|                                | 4.2   | 5.8    | -.1   | -.9   | 6.0   | 1.7   | 3.1   | 2.1   | .8    | -.3   | 1.5   | NA   |
| <b>ITALY</b>                   |       |        |       |       |       |       |       |       |       |       |       |      |
| TRADE CURRENT ACCOUNT (NSA)    | -7.9  | -10.7  | -2.9  | -1.4  | -4.2  | -3.8  | -3.7  | -.3   | -.3   | -.0   | .1    | NA   |
|                                | .8    | -3.2   | -1.0  | 1.3   | -1.7  | NA    | NA    | NA    | ✕     | ✕     | ✕     | ✕    |
| <b>JAPAN</b>                   |       |        |       |       |       |       |       |       |       |       |       |      |
| TRADE 2/<br>CURRENT ACCOUNT 2/ | 31.3  | 44.1   | 10.6  | 9.9   | 13.7  | 11.5  | 13.0  | 13.7  | 4.5   | 4.8   | 4.4   | 5.2  |
|                                | 21.0  | 35.0   | 8.8   | 7.2   | 11.7  | 9.4   | 12.1  | 12.0  | 4.1   | 3.9   | 4.0   | 4.5  |
| <b>UNITED KINGDOM</b>          |       |        |       |       |       |       |       |       |       |       |       |      |
| TRADE CURRENT ACCOUNT 2/       | -1.1  | -5.7   | -1.8  | -2.1  | -1.6  | -1.4  | -.3   | -.7   | -.1   | -.3   | -.3   | .0   |
|                                | 4.4   | 1.3    | -.2   | -.5   | .5    | -.6   | 1.5   | .9    | .4    | .2    | .2    | .6   |
| <b>UNITED STATES</b>           |       |        |       |       |       |       |       |       |       |       |       |      |
| TRADE 2/<br>CURRENT ACCOUNT    | -62.0 | -108.3 | -25.6 | -32.5 | -24.6 | -29.5 | -33.0 | -32.7 | -11.5 | -10.5 | -10.7 | NA   |
|                                | -40.8 | -101.5 | -24.5 | -32.5 | -25.5 | -30.3 | -31.8 | NA    | ✕     | ✕     | ✕     | ✕    |

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1. THE CURRENT ACCOUNT INCLUDES GOODS, SERVICES, AND PRIVATE AND OFFICIAL TRANSFERS.  
2. ANNUAL OR QUARTERLY DATA ARE SUBJECT TO REVISIONS AND THEREFORE MAY NOT BE CONSISTENT WITH QUARTERLY OR MONTHLY DATA.

✕ COMPARABLE MONTHLY OR QUARTERLY CURRENT ACCOUNT DATA ARE NOT PUBLISHED.

recorded in September. Japan's external surpluses continued at record rates. For the first ten months of 1985, the cumulative trade surplus was \$52 billion (s.a.a.r.) and the corresponding cumulative current account surplus was \$46 billion (s.a.a.r.). The current account surplus in 1984 was \$35 billion.

In the context of the September 22 G-5 initiative, the Bank of Japan on October 24 moved to foster a further strengthening of the yen exchange rate by announcing that it would not fully accommodate expected heavy seasonal demands for liquidity in the fourth quarter. Following the announcement, short-term and long-term interest rates rapidly rose by more than 100 and 150 basis points, respectively. Although long-term interest rates have subsequently declined somewhat, short-term interest rates have remained firm. These interest rate hikes, if sustained, could dampen the impact of the mid-October demand stimulus package on Japan's external balance.

Industrial production in Germany rose 1.8 percent (s.a.) in October, bringing average IP for the three months ending in October to 3.4 percent above its year-earlier level. In addition, early indications are that GNP growth in the third quarter was relatively strong; and survey data on the business climate, investment intentions, and order books all point to relatively strong demand. There are some signs of improvement in the labor market. Employment has been rising since the summer and part-time employment, which can be viewed as partial unemployment, has decreased markedly in the presence of rising registered job openings. The unemployment rate, however, remained at 9.2 percent (s.a.) in November.

Consumer prices have barely changed since March and in November were only 1.8 percent above their year-earlier levels. Unit labor costs are currently below their level of a year ago.

Through October, the cumulative current account surplus was \$9 billion (n.s.a.) compared with less than \$2 billion during the corresponding period last year. Most of the improvement has been associated with a growing trade surplus.

Economic activity in France remains weak and inflation continues to decline. Industrial production fell 1.5 percent (s.a.) in September and was unchanged from its year-earlier level. Real GDP in the third quarter increased by 2.4 percent (s.a.a.r) but was up only 1.1 percent on a year-over-year basis. Consumer prices increased only 0.4 percent (n.s.a.) in October as the twelve-month inflation rate eased to 5 percent, down from 6-1/2 percent at the beginning of the year. Wholesale prices fell 0.5 percent (n.s.a.) in October, and were unchanged from their year-earlier levels.

The trade balance moved into surplus by \$120 million (s.a.) in October. For the first ten months of the year, the cumulative trade deficit was \$2.5 billion (s.a.a.r.), slightly less than that experienced last year.

Over the past few months, French officials have outlined their plans for the conduct of monetary policy in 1986. In order to take account of the ongoing process of financial innovation, the existing monetary aggregates, M1, M2, and M3, will be redefined and a new broader aggregate, L, will be introduced. Open market operations will replace quantitative credit controls as the main method of implementing monetary

policy by 1987. This year's monetary target of 4-6 percent growth of M2R will be replaced in 1986 by a target of 3-5 percent growth of redefined M3. French authorities have indicated that the two targets are considered roughly equivalent in terms of monetary ease or tightness. (This year's target apparently will be exceeded slightly.) Aspects of the proposed new monetary policy procedures remain unclear, and further modifications appear likely as the changes are implemented next year.

Preliminary data suggest that real GDP (output measure) in the United Kingdom rose 2.0 percent (s.a.a.r.) in the third quarter to 3.7 percent above its year-earlier level. About half of the third quarter growth resulted from the aftereffects of the ending in March of the coal miners' strike. The average index of industrial production was unchanged between the second and third quarters, although IP rose strongly in September.

The sharp acceleration in U.K. price inflation that took place in the spring has abated. Retail prices rose only 0.3 percent (n.s.a.) between June and October, lowering the twelve-month inflation rate to 5.4 percent. However, the underlying rate of increase in average earnings rose to 7-1/4 percent in September. The U.K. trade account was in balance in October while the current account was in surplus. The cumulative trade deficit for the first ten months of 1985 was \$3.1 billion (s.a.a.r.) and the corresponding cumulative current account surplus was \$2.8 billion. The trade deficit in 1984 was \$5.7 billion.

In his recent Autumn Statement, delivered to Parliament on November 12, Chancellor of the Exchequer Nigel Lawson indicated that real

government expenditures would grow an estimated 0.7 percent in fiscal 1986/87 and then remain (nearly) constant during the subsequent two fiscal years. The Public Sector Borrowing Requirement is expected to fall from 2-1/4 percent of GDP in fiscal 1985/86 to 2 percent in fiscal 1986/87, in part because increased sales of nationalized industries would help finance the deficit. Although Chancellor Lawson did not reveal the government's tax plans, private commentators have suggested that the fiscal goals articulated in the Autumn Statement would be consistent with a tax cut in fiscal 1986/87 amounting to a little over 1/2 percent of GDP. However, a substantial decline in oil prices, by lowering associated tax revenues, could significantly reduce the scope for income tax cuts if the government adheres to its PSBR targets.

Real GNP in Canada increased 6.6 percent (s.a.a.r.) in the third quarter, after average growth of about 4 percent in the first two quarters of 1985. This rise, which resulted from a strong increase in final domestic demand, was fairly widespread among sectors. The unemployment rate was 10.2 percent (s.a.) in November, slightly below its third quarter average.

Inflation in Canada continued at a moderate pace. Consumer prices increased 0.3 percent in October and the twelve-month inflation rate rose slightly to 4.2 percent. The industry selling price increased 0.2 percent in September, bringing the twelve-month inflation rate in wholesale prices to 2.4 percent. The Canadian trade account remained in surplus in October; for the first ten months of the year, the cumulative trade surplus was \$11.3 billion (s.a.a.r.). Canada's current account

deficit was \$4.4 billion (s.a.a.r.) in the third quarter, the first quarterly deficit in two years.

The Continental Bank of Canada arranged a C\$ 2.9 billion support package in November from the big-six chartered banks and the Bank of Canada. This action was taken to restore confidence in Continental after 20 percent of its deposits were withdrawn in October. Continental's problems stemmed from market uncertainty and confusion over recent failures of the Canadian Commercial Bank and Northland Bank and the announced merger of the Mercantile Bank with the National Bank of Canada. According to a recent audit conducted by the big-six banks for the Inspector General, Continental Bank "is engaged in normal lending practices and ...is a viable institution."

Industrial production in Italy rose slightly in September. The index of industrial production in the third quarter was 0.5 percent below its level in the same quarter in 1984. The official government survey conducted in September showed that consumer confidence is at its highest level in the last several years.

The consumer price index rose 0.7 percent (n.s.a.) in November to 8.6 percent above its year-earlier level, the same twelve month inflation rate as experienced last year. In September, the wholesale price index (n.s.a.) was 6.4 percent above its level in September 1984. Rates of increase of the wholesale price index have been steadily lower in the last six months. The trade account showed a tiny surplus in September, lowering the trade deficit in the third quarter to \$1.1 billion (s.a.a.r), compared with a deficit of \$15.1 billion (s.a.a.r.) in the first half of the year.

By surviving a vote of confidence, Prime Minister Craxi's government is now the longest standing one in the history of the Republic. Craxi is taking advantage of his strengthened political position by trying to push the 1986 budget through Parliament before December 31.

Economic Situation in Major Developing Countries. Economic growth and export performance in the major developing countries have slowed somewhat on average in 1985 following a strong performance in 1984. In Argentina, the economic slowdown preceded the introduction of the anti-inflationary "Austral Plan" in June, which set the stage for the signing in August of a revised IMF standby agreement and commercial bank loan package. By late November, these new funds enabled Argentina to become fully current on interest obligations on public sector debts to banks for the first time in more than three years. Mexico's economy grew rapidly in the first half of 1985 -- stimulated by a fiscal deficit that was sharply higher than in 1984 -- but GDP growth slowed during the second half of the year. The current account appears to have deteriorated from a surplus of \$4 billion in 1984 to a deficit of about \$800 million in 1985, owing to weak prices for oil exports, a slowdown in the U.S. economy, and the failure to maintain a competitive exchange rate until after the devaluation of the peso in July 1985. In Venezuela, domestic activity remained weak due to the combination of a weakening of the oil market and a restrictive government fiscal policy that produced another public sector surplus in 1985. In contrast, Brazil's economy expanded vigorously, as real GDP growth surged to about 7 percent in 1985. Export volume declined only slightly, and the trade surplus has continued at a \$12 billion annual rate. However, inflation remains high, reflecting the government's inability to reduce the fiscal deficit and its unwillingness to accept targets for reduction of that deficit that would satisfy the IMF.

Individual Country Notes. Argentina's interest payments on public sector debts to banks have become current for the first time in more

than three years. On November 26, Argentina received the second disbursement from the \$4.2 billion bank loan signed last August, amounting to \$800 million, and simultaneously paid \$340 million to eliminate the remaining arrears. The next disbursement, for \$600 million, is contingent on Argentina having drawn the IMF stand-by tranche linked to end-September performance criteria. Since some of the criteria were not met, disbursements totalling \$850 million from the IMF and the commercial banks, originally scheduled for November and December, will not take place until early 1986.

In the past four months, the consumer price index has increased at an annual rate of about 32 percent. This compares with a rise of more than 1,100 percent in the 12 months ended last June. A tightening of domestic credit conditions in November has contributed to an appreciation of the austral in the free market. The free market premium for the dollar, which had peaked at around 19 percent on October 25, fell to around 6 percent on December 10.

The Mexican authorities announced in late November a budget for 1986 that would reduce the public sector deficit to 4.9 percent of GDP in 1986 from an officially expected 9.6 percent in 1985. The 1986 deficit target is the same as that originally set for 1985 under Mexico's suspended IMF program. The 1986 official forecast is for real economic growth to slow to no more than 1 percent from about 3 percent in 1985 and for the inflation rate to fall to the 45-50 percent range from the 60 percent level this year. However, the large deviations from the public sector deficit target that occurred in 1985 and the mounting demands for stimulation of the economy and for large wage increases cast doubts on whether the authorities will follow through on the announced

plans. Mexico also decided in late November to join GATT, signaling a long-term commitment to a policy of increased trade liberalization long resisted by many Mexican political leaders and businessmen. The next test of that commitment will be Mexico's ability to negotiate a trade policy sector loan from the World Bank that might give Mexico access to new, fast-disbursing balance of payments financing from both the World Bank and commercial banks in 1986.

The government instituted a policy in early October of attempting to hold down Mexico's interest rates on Treasury bills in order to reduce the cost of servicing the government debt. However, the policy was a failure and the rate on 91-day bills has been increased by 700 basis points since mid-October. To facilitate government financing and to limit money creation, the commercial banks were required in November not to increase their loans to the private sector beyond the October 31 level. On November 5, the Bank of Mexico imposed new restrictions on peso accounts of foreign banks in Mexican banks partly to prevent their use in transferring funds out of the country and partly to stop foreign banks from acting as intermediaries in the growing inter-company loan market where the government contended that their activities interfered with the conduct of monetary policy. The new measures effectively ended trading in pesos in U.S. markets.

Real GDP in Brazil appears to have grown by about 7 percent in 1985. Inflation, which had slowed to about 9 percent per month in September and October, surged to a 15 percent monthly rate in November bringing prices to a level 230 percent higher than a year earlier. On November 19, the government announced the liquidation of three banks. The government effectively guaranteed the \$160 million in short-term

credits provided to these institutions' foreign branches. However, the government has said that it will not guarantee about \$450 million in loans and deposits in these banks' Brazilian offices, and foreign banks are upset about the Brazilian government's plans of something less than full compensation for the foreign creditors along with some domestic creditors. At the end of November the government announced new projections of its fiscal position for 1985 and 1986. For 1985, the operational deficit is now projected at about 2.8 percent of GNP, 2.4 percentage points higher than projected by the government when certain budget cuts were announced in July 1985. For 1986, the government has set a target of reducing the operational deficit to 0.5 percent of GDP. Some of the revenue measures would not be permanent, however, such as the sale of some government-owned enterprises. Brazilian officials have stated recently that they have no need for an IMF program in the near future because of Brazil's strong external position. Without an IMF program, and with relations with foreign banks complicated by the recent liquidations of Brazilian commercial banks, it may be difficult for Brazil to negotiate a rescheduling with commercial banks and a continued maintenance of interbank and trade credit lines. Nevertheless, Brazil intends to try.

Chile met all but one of the performance criteria under its end-September IMF program review. Net international reserves of the Central Bank were lower than targeted because of delays in the signing of Chile's bank financing package. A waiver was granted, however, and a drawing from the IMF was made on November 15. The bank financing package was formally signed on November 1, with the first disbursement of the \$1.1 billion new money facility expected by the end of the year.

The Colombian government declared a 35-day economic emergency after the November 13 volcanic eruption in order to speed assistance to affected areas. The eruption caused major damage to local agriculture and infrastructure, but is not expected to have a significant effect on the overall performance of the Colombian economy. Colombia's commercial bank jumbo loan will be signed in mid-December. Disbursements on the loan will be delayed into 1986, and Colombia will probably receive a commercial bank bridge loan in late December.

In mid-November, the Philippines and the IMF management concluded their negotiations on a revision of the 18-month standby agreement originally signed in December 1984. Along with agreement on new quantitative performance criteria for December 1985 and March 1986, there was also agreement on non-quantitative performance criteria, including tax reform, exchange system policy, the budget deficit, and reform of government monopolies in the sugar and coconut sectors. The IMF Board is expected to approve the revised stand-by program on December 20, and the Philippines will become eligible to draw SDR 212 million from the IMF. This will clear the way for the Philippines to borrow an additional \$175 million under the facility for \$925 million of new money from commercial banks approved earlier in the year. The first \$400 million tranche from that facility was drawn in August.

November 26 the Venezuelan government announced that it had reached agreement with its bank advisory committee on the major issues that have held up the signing of Venezuela's debt rescheduling agreement. Venezuela expects that the final signing will take place in about two months.