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Confidential (FR) Class II FOMC

March 12, 1980

RECENT DEVELOPMENTS

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

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SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest Data			Percent Change from		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year earlier
					(At annual rate)	
Civilian labor force	Feb.	3-7-80	104.3	.4	2.3	1.8
Unemployment rate (%) 1/	Feb.	3-7-80	6.0	6.2	5.8	5.7
Insured unemployment rate (%) 1/	Feb.	3-7-80	3.1	3.2	3.0	3.1
Nonfarm employment, payroll (mil.)	Feb.	3-7-80	90.7	1.9	2.8	2.3
Manufacturing	Feb.	3-7-80	20.9	1.0	1.2	-.6
Nonmanufacturing	Feb.	3-7-80	69.8	2.1	3.3	3.2
Private nonfarm:						
Average weekly hours (hr.) 1/	Feb.	3-7-80	35.4	35.6	35.7	35.7
Hourly earnings ($) 1/	Feb.	3-7-80	6.45	6.42	6.33	6.00
Manufacturing:						
Average weekly hours (hr.) 1/	Feb.	3-7-80	40.1	40.3	40.1	40.6
Unit labor cost (1967=100)	Jan.	2-29-80	182.4	4.6	9.0	6.9
Industrial production (1967=100)	Jan.	2-15-80	152.7	3.2	1.3	.8
Consumer goods	Jan.	2-15-80	148.4	-4.0	-3.5	-1.5
Business equipment	Jan.	2-15-80	176.3	12.4	10.0	4.9
Defense & space equipment	Jan.	2-15-80	95.2	2.5	5.1	3.0
Materials	Jan.	2-15-80	156.6	3.8	.8	1.0
Consumer prices all items (1967=100)	Jan.	2-22-80	233.8	16.7	14.7	13.8
All items, excluding food & energy	Jan.	2-22-80	221.0	16.0	14.6	12.0
Food	Jan.	2-22-80	244.8	.0	8.3	8.7
Producer prices: (1967=100)						
Finished goods	Feb.	3-7-80	235.3	17.6	16.1	13.5
Intermediate materials, nonfood	Feb.	3-7-80	274.2	20.5	24.1	19.3
Crude foodstuffs & feedstuffs	Feb.	3-7-80	251.3	25.9	-6.0	4.0
Personal income ($ bil.) 2/	Jan.	2-19-80	2035.6	6.8	11.0	11.0
					(Not at annual rates)	
Mfrs. new orders dur. goods ($ bil.)	Jan.	3-4-80	81.5	4.8	6.3	2.3
Capital goods industries	Jan.	3-4-80	26.8	.6	11.6	10.8
Nondefense	Jan.	3-4-80	23.2	1.6	10.6	8.5
Defense	Jan.	3-4-80	3.6	-5.2	18.9	28.8
Inventories to sales ratio: 1/						
Manufacturing and trade, total	Dec.	3-4-80	1.41	1.42	1.41	1.39
Manufacturing	Jan.	3-4-80	1.53	1.56	1.54	1.49
Trade	Dec.	3-4-80	1.27	1.28	1.28	1.31
Ratio: Mfrs.' durable goods inventories to unfilled orders 1/	Jan.	3-4-80	.567	.567	.566	.561
Retail sales, total ($ bil.)	Feb.	3-10-80	79.0	-.7	3.3	11.1
GAF 3/	Feb.	3-10-80	16.7	-1.0	.1	11.8
Auto sales, total (mil. units.) 2/	Feb.	3-5-80	10.5	-6.9	11.7	-7.3
Domestic models	Feb.	3-5-80	7.7	-7.8	8.9	-16.4
Foreign models	Feb.	3-5-80	2.9	-4.4	20.1	31.0
Plant & Equipment expen. ($ bil.) 4/						
All Industries	1980	3-12-80	196.78	—	—	11.1
	1979-Q4	3-12-80	186.95	4.2	—	14.0
	1980-Q1	3-12-80	189.49	1.4	—	14.2
	1980-Q2	3-12-80	193.83	2.3	—	11.7
Capital Appropriations, Mfg.	1979-Q4	3-11-80	24,517	8.7	—	30.8
Housing starts, private (thous.) 2/	Jan.	2-19-80	1,420	-6.4	-17.0	-17.8
Leading indicators (1967=100)	Jan.	2-29-80	135.1	-.7	-2.7	-5.3

1/ Actual data used in lieu of percent changes for earlier periods.
2/ At annual rate.
3/ Excludes mail order houses.
4/ Planned-Commerce March 1980 Survey.

Economic activity apparently continued to expand in early 1980, as labor demand held firm and industrial production edged higher; a major exception was housing which declined further. In spite of weak income growth and continuing consumer pessimism, retail sales moved up strongly in January before declining in February. In addition, indicators of business spending continued to show strength. At the same time, prices at both the producer and the consumer levels accelerated further in early 1980.

Employment and Production

Labor demand was relatively well maintained in February. Nonfarm payroll employment rose 140,000 following an exceptionally large advance during the previous month. As in other recent months, hiring gains during February were concentrated in the trade and service sectors. Manufacturing employment showed little change as an increase at transportation equipment producers associated with some recovery of auto production was offset by a strike-related reduction in the petroleum industry. The factory workweek declined 0.2 hour to 40.1 hours.

Total employment, as measured by the household survey, also rose moderately in February. The jobless rate, which had increased in January, dropped 0.2 percent to 6 percent. No significant changes in the composition of unemployment were apparent in the February data.

Industrial production advanced 0.3 percent in January and is expected to show a similar increase for February. The continued rise anticipated for February was due mainly to a sharp increase in the output of automobiles, trucks, and parts from very low January levels.

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

	1978	1979			1980	
		H1	Q3	Q4	Jan.	Feb.
	- - - Average monthly changes - - -					
Nonfarm payroll employment[2]	334	249	59	146	349	141
Strike adjusted	318	254	62	158	292	202
Manufacturing	69	30	-38	-23	1	18
Durable	57	30	-8	-41	-15	59
Nondurable	12	1	-30	-18	16	-41
Construction	39	32	3	-37	110	-32
Trade, finance and services	169	132	77	103	227	172
Private nonfarm production workers	256	171	11	104	210	169
Manufacturing production workers	50	13	-46	-31	-41	38
Total employment[3]	270	137	284	136	-108	149
Nonagricultural	264	159	244	138	-19	92

1. Changes are from final month of preceding period to final month of period indicated.
2. Survey of establishments. Not strike adjusted, except where noted.
3. Survey of households.

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

	1978	1979			1980	
		H1	Q3	Q4	Jan.	Feb.
Total, 16 years and older	6.0	5.8	5.8	5.9	6.2	6.0
Teenagers	16.3	16.0	16.2	16.1	16.3	16.5
20-24 years old	9.5	8.8	9.2	9.4	10.1	9.5
Men, 25 years and older	3.4	3.2	3.3	3.4	3.7	3.6
Women, 25 years and older	5.1	4.9	4.7	4.8	4.9	4.9
White	5.2	5.0	5.1	5.1	5.4	5.3
Black and other	11.9	11.5	10.9	11.2	11.8	11.5
Fulltime workers	5.5	5.2	5.3	5.4	5.7	5.6
White collar	3.5	3.3	3.4	3.3	3.4	3.4
Blue collar	6.8	6.7	7.1	7.3	8.0	7.7

Outside the motor vehicle industry, little change appears to have occurred in most components of the index. Capacity utilization rates remained essentially unchanged during the first two months of the year from their reduced year-end levels.

Personal Income and Consumer Spending

Growth in total personal income slowed in January to about half the average monthly gain observed in the fourth quarter of 1979. Gains in wages and salaries were smaller than in previous months, reflecting moderate wage increases in January. In addition, farm proprietors' income was estimated to have declined. However, income growth in January was augmented by the payment of a special energy allowance ($4-1/2 billion at an annual rate), a factor which was only partially offset by a stepup in the taxable wage base for social security contributions (as measured in the national income accounts). The increase in disposable personal income reported for January was somewhat larger than the advances registered in recent months, but more than half of this increase represented the treatment in the income and product accounts of the payment of extraordinarily large tax refunds expected to be distributed this spring.

Despite the slower real income growth over the past year, consumer expenditures generally have continued to show strength. Unit auto sales receded somewhat in February from the rapid rate posted in January, but at a 10.6 million unit annual rate they remained appreciably above the fourth-quarter level. In February, customers received rebates on the purchase of a number of domestic models. Promotional advertising was strong, and the availability of some of the more popular

PERSONAL INCOME
(Based on seasonally adjusted annual rate data)

	1978	1979	1979 Q4	1979 Nov.	1979 Dec.	1980 Jan.
	- - Percentage change, at annual rates[1] - -					
Total personal income	12.9	11.1	12.1	13.8	12.1	6.8
Wage and salary disbursements	12.8	10.1	10.9	13.3	10.7	5.7
Private	14.0	10.8	11.1	15.0	12.5	5.0
Nominal disposable personal income	12.0	10.2	10.4	11.9	10.5	14.1
Real disposable personal income	4.2	.3	.6	3.6	.2	n.a.
	- - Changes in billions of dollars[2] - -					
Total personal income	$17.8	$16.5	$21.4	$22.8	$20.2	$11.4
Wage and salary disbursements	11.5	9.6	11.6	13.9	11.3	6.1
Private	10.1	8.4	9.7	12.7	10.7	4.3
Manufacturing	3.2	2.0	2.7	1.5	4.0	2.2
Other income	7.1	7.7	10.4	9.7	9.5	8.3
Transfer payments	1.5	2.9	2.0	1.1	2.7	6.2
Less: Personal contributions for social insurance	.8	.9	.6	.8	.6	3.0
Memorandum:						
Personal savings rate[3]	4.9	4.5	3.4	3.4	3.2	n.a.

1. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Changes for quarterly period are compounded rates of changes.
2. Average monthly change.
3. Equals the centered three-month moving average of personal savings as a percentage of the centered three-month moving average of disposable personal income.

fuel-efficient domestic models also improved. Import sales--at 2.9 million units--were off slightly from the record January rate, possibly because of reemerging inventory shortages for some models.

Nominal retail sales excluding auto outlets and stores selling mainly nonconsumer items declined 0.5 percent in February, following an upward revised increase of 2.5 percent in January. The February drop-off was fairly widespread, with sales at most major types of stores down from their January levels. Nominal outlays at gasoline stations continued to move up, reflecting sharply higher prices of fuel.

Surveys of consumer attitudes conducted in February continued to indicate the pessimistic mood generally evident since last spring. The Conference Board reported the third month-to-month decline in their composite index of confidence, with more consumers expressing concern about present economic conditions and employment opportunities. However, the Michigan survey for February indicated that attitudes toward buying conditions for cars had improved considerably. Respondents were clearly aware of the new car rebates and dealer incentive programs and answered in a follow-up question that "prices are lower" and "some good buys are available."

Residential Construction

New housing activity weakened further in January, with total private housing starts off an additional 6 percent from the December pace. This decline occurred in spite of weather conditions that generally were more favorable for building than in recent winters. Since the third quarter of 1979, starts have fallen more than 20 percent and permits have declined nearly 25 percent.

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

	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Dec.	1980 Jan.	1980 Feb.
Total sales	1.9	.5	4.2	2.2	.8	3.3	-.7
(Real)[1]	-1.0	-2.1	2.2	-.2	-.2	1.9	n.a.
Total, less auto and nonconsumption items	1.7	2.4	4.1	3.5	.5	2.5	-.5
GAF[2]	-.4	2.4	5.3	1.1	-2.2	3.5	-1.0
Durable	1.6	-2.7	5.1	-1.2	1.9	5.0	-1.1
Auto	3.6	-7.1	3.9	-2.2	1.9	7.0	-.2
Furniture & appliances	1.7	2.3	8.1	-1.8	-.2	5.4	-.6
Nondurable	2.1	2.3	3.7	4.0	.2	2.5	-.5
Apparel	-1.1	.8	5.8	-1.3	-.8	5.2	-2.0
Food	3.5	2.5	1.9	3.5	1.8	.8	-.8
General merchandise[3]	-1.0	3.1	4.0	3.1	-3.6	2.1	-.8
Gasoline	4.4	7.2	7.4	8.4	.3	5.4	2.6

1. BCD series 59.
2. General merchandise, apparel, furniture and appliance stores.
3. General merchandise excludes mail-order nonstores; mail-order sales are also excluded in the GAF composite sales summary.

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

	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Nov.	1979 Dec.	1980 Jan.	1980 Feb.
Total	11.6	10.7	10.8	9.8	9.4	10.6	11.3	10.5
Foreign-made	2.3	2.5	2.2	2.4	2.4	2.6	3.0	2.9
U.S.-made	9.3	8.1	8.6	7.4	7.0	8.0	8.3	7.7
Small	3.9	3.9	3.6	3.5	3.3	3.8	3.7	3.7
Intermediate & standard	5.4	4.1	4.9	4.0	3.8	4.2	4.6	4.0

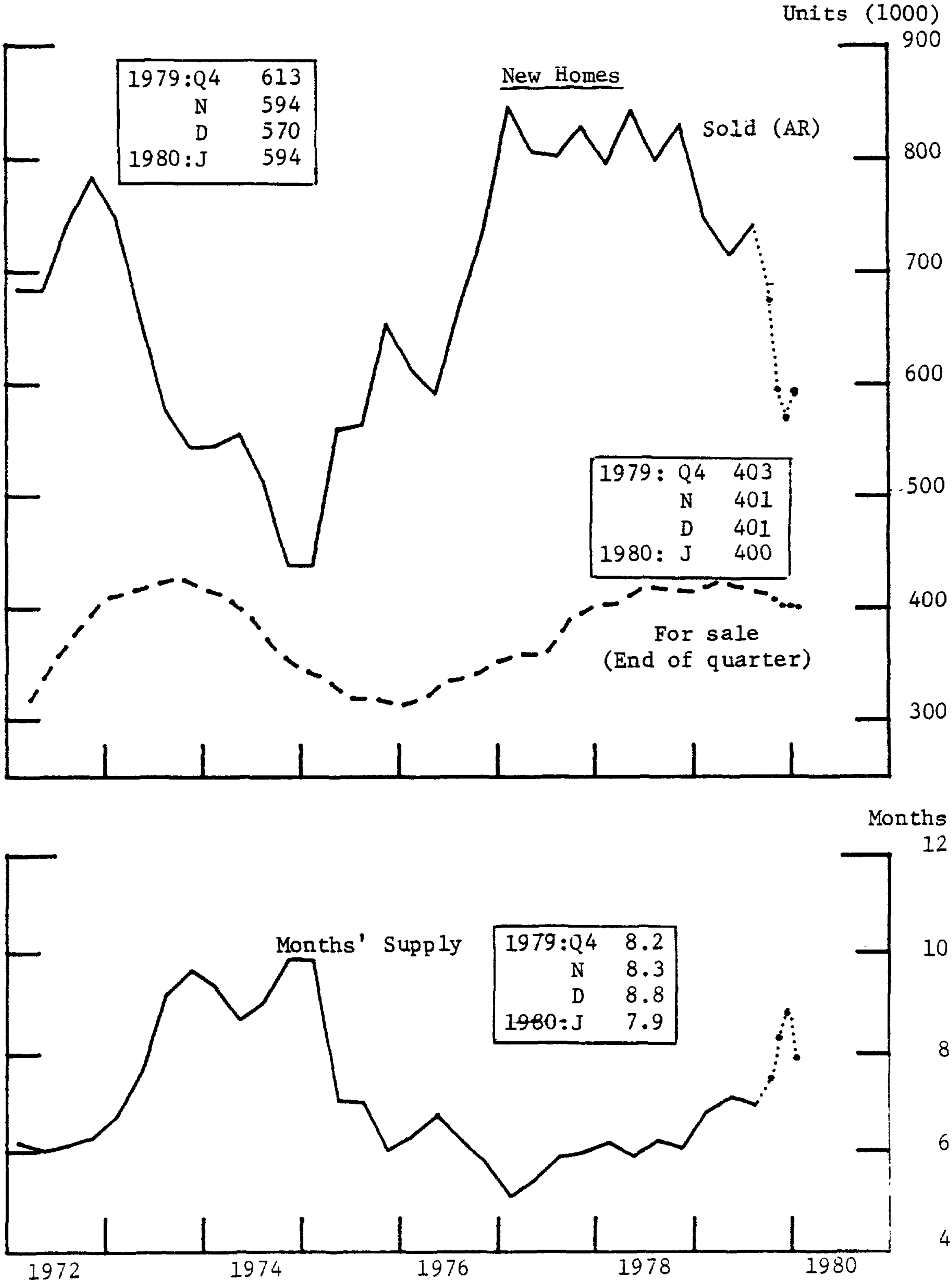
Note: Components may not add to totals due to rounding.

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

	1979						1980
	Annual	Q2	Q3	Q4	Nov.	Dec.	Jan.[1]
All units							
Permits	1.54	1.59	1.65	1.35	1.26	1.24	1.27
Starts	1.74	1.82	1.81	1.58	1.52	1.52	1.42
Single-family units							
Permits	0.97	1.03	1.02	.82	.75	.78	.77
Starts	1.19	1.26	1.23	1.05	.98	1.04	1.00
Sales							
New homes	.71	.71	.74	.61	.59	.57	.59
Existing homes	3.74	3.73	3.81	3.56	3.45	3.35	3.21
Multifamily units							
Permits	.57	.56	.64	.53	.51	.46	.50
Starts	.55	.56	.58	.53	.54	.48	.42
Mobile home shipments	.28	.28	.28	.26	.25	.24	n.a.

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

SALES AND INVENTORIES OF NEW SINGLE-FAMILY HOUSES
(Seasonally adjusted)



Data plotted quarterly through 1979-Q3, monthly thereafter.

The recent decline in activity has occurred in both multifamily and single-family units. In the multifamily sector, housing starts fell 12 percent in January (seasonally adjusted) to a three-year low. While starts of HUD-subsidized units (Section 8) have been relatively weak over the past two months, the bulk of the recent decline in multifamily starts has been in nonsubsidized units, reflecting in part the sharply increased costs associated with higher interest rates. Activity in the single family sector also has weakened considerably in recent months, with starts in January almost 17 percent lower than the 1979 average. Single family starts have declined substantially in all regions except the South, which continues to experience strong immigration.

New home sales rose 4 percent in January, but were still more than 20 percent below the pace last July. The reduced pace of construction in recent months has helped keep the stock of unsold units from escalating as it did prior to and during the 1973 sales slump. Nevertheless, the large reductions in sales last fall left builders with about 8 months' supply of unsold units at the end of January--well above the level one year ago. Existing home sales fell 4 percent in January; however, they remained about 50 percent higher than the rate experienced during the 1973 downturn in sales.

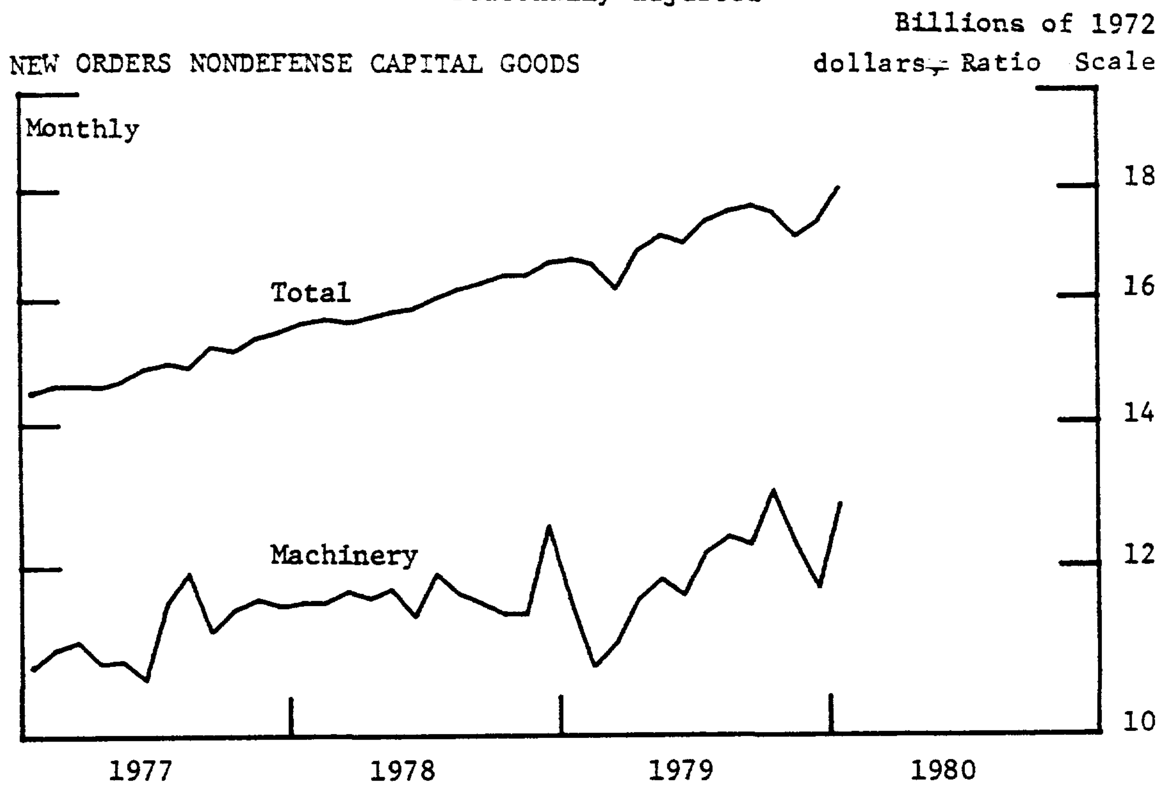
Business Fixed Investment

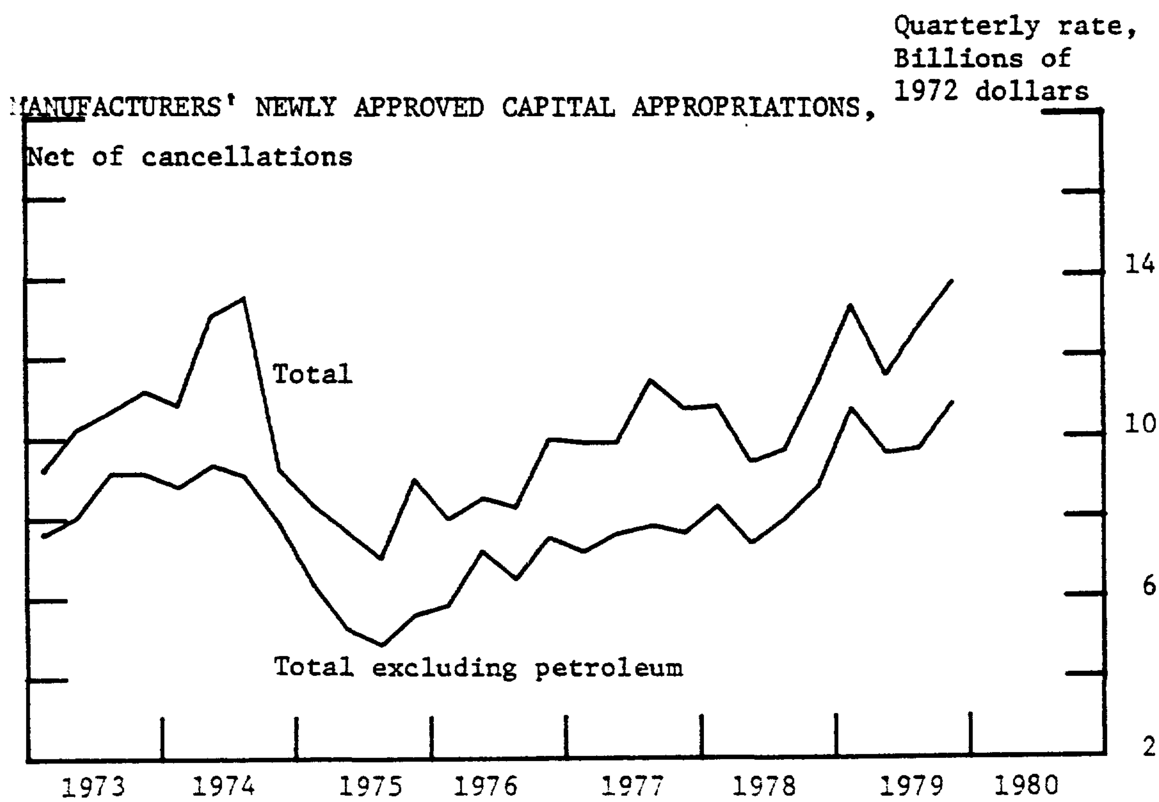
Business investment activity continued at a high rate during January, with most indicators showing substantial gains. Shipments of nondefense capital goods rose 3-1/2 percent--about the same as in December. Some of this rise, however, may have been due to an increase in the magnitude of the seasonal adjustment resulting from three years

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

	1979					1980	Jan. 1979 to Jan. 1980
	Q2	Q3	Q4	Nov.	Dec.	Jan.	
Nondefense capital goods shipments	-.6	5.4	0.8	-2.5	3.2	3.5	12.3
Nonresidential construction put-in-place	8.0	4.8	5.5	0.1	3.9	0.0	24.5
Building	10.9	5.1	7.0	0.3	5.3	3.7	38.2
Nonbuilding	4.3	4.4	3.6	-0.1	2.0	-5.1	8.3

CAPITAL SPENDING COMMITMENTS
Seasonally adjusted





of relatively severe weather. Business spending on motor vehicles also appears to have increased. The value of nonresidential construction put-in-place was unchanged in January, but remained 2-1/2 percent above the fourth quarter average.

Data for capital spending commitments suggest that investment will be well maintained in the near term. New orders for nondefense capital goods rose 1-1/2 percent in January, and bookings for nondefense machinery--usually considered a better guide to short-run underlying equipment demand--advanced 7 percent. Moreover, newly approved capital appropriations of large manufacturers, net of cancellations, rose 10 percent in the fourth quarter of 1979; excluding the volatile petroleum industry this indicator increased nearly 13 percent.

Indications from the commitments data for the last several months are broadly consistent with the latest Commerce survey of plant and equipment spending, taken in late January and February. The survey reports that business is planning to increase spending by 11.1 percent in 1980--virtually the same anticipation as that reported in the December Commerce survey. This planned increase in nominal spending suggests little change in real outlays in 1980, compared with an increase of about 7 percent in 1979.

Inventory Investment

Inventory investment in manufacturing picked up sharply in January, according to the most recently available data. The book value of these inventories rose at a record $50 billion annual rate following an advance of about $26 billion (annual rate) in the fourth quarter of last year; the largest increases were reported by producers of chemicals, nonelectrical machinery, and aircraft, missiles, and parts. Despite

BUSINESS INVENTORIES
(Billions of dollars; annual rate of change in seasonally adjusted book values)

	1978	1979				1980
		H1	Q3	Q4	Dec.	Jan.
Manufacturing and trade	41.5	52.7	45.5	35.0	20.2	n.a.
Manufacturing	18.1	32.6	28.3	25.8	20.4	50.1
Durable	13.7	25.0	16.9	21.8	12.5	28.6
Nondurable	4.4	7.7	11.4	4.0	7.8	21.5
Trade, total	23.5	20.1	17.2	9.2	-.2	n.a.
Wholesale	12.8	9.0	12.6	6.9	13.9	n.a.
Retail	10.7	11.1	4.6	2.3	-14.1	n.a.

DEALER STOCKS OF AUTOMOBILES
(Millions of units; seasonally adjusted, end of period)

	1978	1979			1980	
		H1	Q3	Q4	Jan.	Feb.
Total U.S.-made[1]	1.81	2.00	1.86	1.79	1.56	1.53
Standard	.46	.70	.54	.55	.41	n.a.
Intermediate	.56	.64	.54	.61	.51	n.a.
Compact	.54	.52	.57	.36	.38	n.a.
Sub-compact	.25	.14	.22	.27	.25	n.a.
Foreign-made	.70	.43	.42	.49	.41	n.a.

1. Includes U.S.-made Volkswagens.
n.a. - not available

this large rise in inventories the stock-sales ratio for manufacturers declined from 1.56 in December to 1.53 in January, as sales advanced sharply.

Auto inventories at dealers contracted somewhat further in February following the substantial quarter-million unit reduction in January. Dealer stocks of all U.S.-made automobiles declined 30,000 units as domestic auto sales remained somewhat above assemblies in February. Although stocks of most models have been brought back into line with sales, excess inventories still persist for certain models.

Federal Government Sector

The federal government's budget deficit for the month of January (not seasonally adjusted) was $4.6 billion, up from the $2.5 billion monthly level recorded a year earlier. Total spending was again above administration expectations, with most of the overrun occurring in the health, highway, interest, and income security areas. In addition, defense expenditures through the first four months of the current fiscal year continue to run above earlier agency expectations. Since the recent surge in spending has resulted in a breach of the $548 billion spending ceiling contained in the Second Concurrent Budget Resolution, the Congress cannot even debate any bill that would increase spending during this fiscal year until a third resolution is adopted.

On the revenue side of the budget, net federal tax receipts for January and February increased more than anticipated, mainly because of continued strength in withheld taxes and some initial delays this year in the processing of individual tax refunds. Available IRS data show that the average refund is almost 20 percent larger than a year earlier; this is consistent with the administration's projection that individual refunds during the first half of 1980 will be $43 billion, up $11 billion from the level registered last year. In view of the recent strength in receipts and the prospect for higher rates of inflation, the administration is expected to revise upward its initial fiscal year 1981 revenue projection of $600 billion.

A joint House-Senate conference committee has agreed on a bill imposing a "windfall" tax on the additional revenues that are expected to result from the phased decontrol of crude oil prices. The conference committee staff estimates that this "windfall" excise, effective March 1, will increase net receipts by $3.1 billion in fiscal year 1980 and $12.9 billion in 1981; over the 1980-1990 period, net revenues are expected to be augmented by $222.6 billion. The conferees included nonbinding guidelines in the bill specifying that the net revenues should be allocated as follows: 25 percent for aid to low-income households, 60 percent to income tax reductions, and 15 percent to energy and transportation programs.

State and Local Government Spending

In the state and local sector, spending was little changed in early 1980 from the fourth quarter rate as reduced payrolls were offset by higher construction expenditures. Employment in state and local governments moved down during the first two months of the year reflecting further cutbacks in public service jobs. Employment under the CETA program fell for the fifth consecutive month and now stands nearly 170,000 below the level at the beginning of fiscal year 1980.

Construction activity was unseasonably strong in January, in response to milder than average weather conditions in most regions of the country. Preliminary data indicate that the value of new construction put-in-place increased 9 percent during the month, following two months of sluggishness. In real terms, the January increase was one of the largest on record. The recent outlays continued to be concentrated in road work and in water and sewer projects.

Prices

Aggregate price measures accelerated in the beginning of 1980, in spite of a marked slowdown in food prices. In January, consumer prices rose 1.4 percent, a rate sharply higher than the average monthly increase experienced during 1979. Producer prices of finished goods rose 1.5 percent in February following a 1.6 percent jump in January; these rates of increase were also substantially above the average 1979 pace. Price increases were widespread across nonfood categories at both the producer and consumer levels, with the largest increases associated with rising prices for energy items and metals.

Food prices were unchanged at the retail level during January, and producer prices for finished foods declined in February for the second month in a row. Abundant supplies of fresh produce, bolstered by favorable weather conditions, were a key factor in reducing overall food price pressures early this year.

In contrast to food prices, prices of energy goods rose very sharply in January, as recent petroleum price hikes began showing up at retail. Gasoline prices, as measured in the CPI, reached an average level of $1.11 per gallon in January, and another sizable increase

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

	Relative importance[2] Dec. 1979	1978	1979	1979 Q4	1980 Jan.	1980 Feb.
Finished goods	100.0	9.2	12.5	12.9	18.9	17.6
Consumer foods	24.3	11.9	7.5	8.3	-9.7	-5.7
Consumer nonfood	47.4	8.4	17.8	17.3	33.6	34.7
Energy	10.3	8.0	62.7	45.6	52.8	89.4
Exc. energy	37.0	8.5	9.3	10.5	28.4	18.5
Capital equipment	28.4	8.0	8.7	9.4	19.8	8.4
Intermediate materials[3]	94.9	8.3	16.3	16.5	36.2	20.5
Exc. food and energy	81.3	8.9	12.8	13.1	33.0	13.7
Crude food materials	55.4	18.3	11.1	5.7	-46.0	25.9
Crude nonfood	44.6	15.6	26.6	30.0	33.2	38.3
Exc. energy	16.0	21.0	13.1	20.1	28.5	53.0

1. Changes are from final month of preceding period to final month of period indicated. Changes for other than monthly and yearly periods are compounded.
2. Relative importance weights are on a stage of processing basis.
3. Excludes intermediate materials for manufacturing food and animal feed.

RECENT CHANGES IN CONSUMER PRICES[1]
(Percentage change at annual rates; based on seasonally adjusted data)[2]

	Relative importance Dec. 1979	1978	1979	1979 Nov.	1979 Dec.	1980 Jan.
All items	100.0	9.0	13.3	12.2	14.7	16.7
Food	17.7	11.8	10.2	8.0	16.9	0.0
Energy[3]	10.3	8.0	37.4	11.0	27.2	55.5
All items less food and energy[3]	72.0	8.5	11.3	13.5	13.9	16.0
Commodities	34.5	7.6	8.8	11.4	11.3	14.3
Services	40.9	9.3	13.7	12.8	16.6	16.4
Memoranda:						
Gasoline	5.6	8.5	52.2	22.2	31.2	88.6
Homeownership	24.9	12.4	19.8	24.3	22.2	22.6

1. Based on index for all urban consumers.
2. Changes are from final month of preceding period to final month of period indicated. Changes for other than monthly and yearly periods are compounded.
3. Energy items: gasoline and motor oil, fuel oil and coal, gas and electricity.

apparently occurred in February. Energy items and a broad group of petroleum-based products were also a major factor in the acceleration of producer prices at all stages of processing.

Outside the food and energy categories, there has been a marked pickup in inflation rates during the past few months. Large price increases were posted in January for new and used cars, medical services, apparel, cigarettes, and public transportation. The rapid advance in producer prices excluding food and energy items was directly related to higher prices for metals and the pass-through of higher energy costs. In the CPI, homeownership costs registered a fourth consecutive monthly rise of about 2 percent.

Wages

Wage rates for nonfarm production workers, as measured by the index of average hourly earnings, increased 0.8 percent in February to a level about 8 percent above a year ago. Manufacturing wages rose somewhat faster in February than the average and now stand nearly 9 percent above a year earlier. Wage gains for workers included in the hourly earnings index have shown no significant trend over the past two years; however, the Employment Cost Index, which covers a broader group of nonfarm workers, indicated some acceleration in wages during 1979. According to this measure, pay rates rose 8-3/4 percent over 1979--about 1 percentage point more than during the previous year. During the fourth quarter, earnings rose at about the same rate for white-collar and blue-collar workers, but for the year as a whole pay advances for blue-collar workers averaged about 1/2 percent more than those for white-collar workers.

HOURLY EARNINGS INDEX[1]
(Percent change at compound annual rates; based on seasonally adjusted data)[2]

	Feb. 78 to Feb. 79	Feb. 79 to Feb. 80	1979 H1	1979 Q3	1979 Q4	1980 Jan.	1980 Feb.
Total private nonfarm	8.4	8.1	7.4	8.5	8.4	4.3	9.4
Manufacturing	8.4	8.9	8.9	8.1	9.0	3.1	11.7
Durable	8.7	8.8	9.1	7.9	8.0	2.0	13.1
Nondurable	7.9	9.1	8.4	8.6	10.6	5.2	9.1
Contract construction	8.1	6.5	7.1	6.6	4.8	-11.4	27.9
Transportation and public utilities	7.4	8.4	6.3	15.9	8.7	-.8	7.0
Total trade	9.2	8.0	7.5	7.2	7.3	16.5	4.9
Services	7.5	7.7	5.9	7.3	10.8	1.8	5.5

1. Excludes the effect of interindustry shifts in employment and fluctuations in overtime pay in manufacturing.
2. Changes for other than monthly and yearly periods are compounded.

EMPLOYMENT COST INDEX
(Percent change at compound annual rates, not seasonally adjusted)

	1978[1]	1979[1]	1979[2] Q1	1979[2] Q2	1979[2] Q3	1979[2] Q4
Total private nonfarm	7.7	8.7	8.2	7.8	8.7	10.0
By occupational group:						
White-collar workers	7.2	8.6	7.8	7.0	9.5	10.0
Blue-collar workers	8.2	9.0	7.8	9.5	8.2	10.4
Service workers	8.7	7.2	13.4	3.6	4.5	7.4

1. Percent change from fourth quarter of preceding year to fourth quarter of year indicated.
2. Percent change from previous quarter, expressed at a compounded annual rate.

APPENDIX A

DEFENSE-RELATED MANUFACTURING ACTIVITY*

Summary. Most indicators of defense-related activity in the manufacturing area have risen very sharply since 1977. (See table 1, which follows.) Some of this increased activity resulted from military contracts awarded prior to 1977 but most came from the very sharp rise in such contracts (especially for aircraft and parts) in the last half of 1977 and the first half of 1978. Largely as a result of these awards, there have been sharp increases in unfilled orders and inventories of defense goods beginning in the first half of 1978 and continuing through the second half of 1979, and somewhat smaller rises in production and shipments of defense-related items. Currently, defense goods unfilled orders are sufficient to maintain the advanced fourth quarter level of shipping activity for about 15 months, or until March 1981, even if no further orders are booked.

Long production times are involved in much of defense spending. As can be seen from the following table, in spite of the rapid increase in contract awards over late 1977 and early 1978, there was only a 7-1/2 percent rise in purchases, as measured in the national income and product accounts, by the end of 1978. The 18 percent gain in purchases that occurred over 1979 apparently reflected these earlier contract awards.

DEFENSE CONTRACTS AND SPENDING
(Indexes 1977-Q1 = 100)

	1977		1978		1979			
	H1	H2	H1	H2	Q1	Q2	Q3	Q4
A. Contract Awards	102.9	116.2	131.1	113.5	132.6	108.7	141.7	n.a.
B. Purchases, excluding compensation (NIPA basis)	101.5	104.4	106.5	107.6	111.7	116.6	122.1	127.5
Memo:								
C. Implicit Price Deflator for line B	102.5	106.3	111.4	114.4	118.4	120.2	124.7	129.1

* Prepared by James D. August, Economist, National Income Section, Division of Research and Statistics.

Contract Awards. Between the first quarter of 1977 and the third quarter of 1979 the value of total military prime contract awards reported by the Defense Department increased by about 42 percent. The value of contract awards for defense capital goods, a component of total contracts, rose 33 percent during the same period (see table 1). This latter category includes very substantial increases in awards for aircraft, ships, and electronic and communication equipment. Over this time span, awards for aircraft and parts averaged a little over one-third of the defense capital goods total; indeed, in 8 of the last 33 months, such awards were in excess of $1.5 billion.

Unfilled Orders and Shipments. Over the last 36 months the value of unfilled orders for defense capital goods has increased more than 50 percent with the bulk of the increase coming in 1978 and 1979. The ratio of unfilled orders to shipments--an indicator of average production lags--rose from a 12 months backlog in early 1977 to a peak of about 16 months in mid-1979 before tapering off just a bit in the waning months of the year (see table 2, which follows). The Census Bureau does not make available any industry breakdown for defense orders and shipments--defense and nondefense are combined in the industry detail. However, an examination of available data suggests that much of the runup in unfilled orders has been in aircraft and parts with a lesser amount in communication equipment.

Manufacturers' shipments of defense goods have increased rapidly in recent quarters probably reflecting the strength of aircraft orders. There also appears to have been some increase in shipments of communication equipment during the period, although the defense portion probably has been swamped by shipments to the private sector. There is a complicating factor in the shipbuilding sector since shipments are reported as value of work performed in a given period rather than actual shipments; with this qualification in mind, however, the data seem to indicate a moderate increase in defense-related shipbuilding activity in private yards.

Despite the rapid advance in defense activity recently, it appears that only in production of aircraft has a capacity problem developed and that stems primarily from difficulties in obtaining some rare metals, such as titanium. There is also a problem in producing forgings for engines and stampings for wings; in both of these areas lead times are very long. Capacity problems in this area hinge primarily on the urgency with which deliveries are desired.

Inventories. The increase in defense inventories over the three year period has also been quite substantial. Again, the industry detail suggests that the increases have mainly been in aircraft and parts and possibly some communication equipment. There is no detail available on inventories by stage of processing. One problem in analyzing the defense inventories is the aforementioned treatment of shipbuilding. When work is reported as done, that value is taken out of the inventory of the producer and added to federal purchases. Thus, the Defense Department technically can have purchased a fraction of a ship while the shipyard still has physical possession of the whole product.

Although there has been a substantial increase in defense goods inventories both absolutely and relative to shipments in the last two years, these stocks still account for only a small proportion of the book value of total business inventories (see table 2). A significant increase in this proportion only began in about mid-1979, and, at 2.2 percent at year end, the ratio was still well below the levels seen in the Vietnam era.

Comparison With Vietnam Era Activity. The sharp increases in the 2-1/2 years between 1977-Q1 and 1979-Q3 in prime contract awards, gross obligations incurred and defense purchases (NIPA basis) are nowhere near as large as those seen during a similar period in the Vietnam buildup. As can be seen in the following table, the current increases in obligations and purchases are less than half those of the Vietnam period while the rise in contract awards is about 60 percent of that during Vietnam.

COMPARISON OF SELECTED DEFENSE INDICATORS:
Vietnam Buildup vs. Today--First 2-1/2 Years

	Vietnam Buildup (Percent Change from 64-Q4 to 67-Q2)	Current Situation (Percent Change from 77-Q1 to 79-Q3)
Prime Contract Awards	76.1	48.4
Gross Obligations Incurred	55.0	22.4
Defense Purchases (NIPA)	47.0	19.0

Table 1

SELECTED INDICATORS OF DEFENSE-RELATED ACTIVITY
(Indexes: 1977-Q1 = 100; seasonally adjusted)

	Military Prime Contract Awards		Defense Capital Goods 3/				Production of Defense and Space Equipment 4/
	Total 1/	Defense Capital Goods 2/	New Orders	Unfilled Orders	Inventories	Shipments	
1977-H1	102.9	97.9	115.1	100.9	99.0	98.6	100.7
H2	116.2	103.3	142.8	103.6	98.8	100.0	100.7
1978-H1	131.1	124.5	161.5	118.8	104.7	106.7	103.8
H2	113.5	104.3	163.1	132.2	109.2	107.0	110.6
1979-H1	120.7	109.1	148.7	145.6	119.9	115.2	114.7
H2	--	--	158.9	149.7	136.5	118.8	116.2
1977-Q1	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Q2	105.7	95.7	130.1	101.8	98.0	97.1	101.3
Q3	107.6	103.5	99.7	99.5	99.1	99.0	101.8
Q4	124.8	103.1	185.9	107.7	98.4	101.0	99.5
1978-Q1	115.6	109.6	151.5	113.5	102.9	105.7	102.1
Q2	146.6	139.4	171.4	124.1	106.5	107.7	105.4
Q3	104.0	101.6	134.4	127.0	108.0	105.7	109.2
Q4	123.0	106.9	191.8	137.3	110.4	108.3	111.9
1979-Q1	132.6	120.2	151.8	143.8	117.6	114.7	114.6
Q2	108.7	98.0	145.5	147.3	122.1	115.6	114.7
Q3	141.7	132.8	149.2	146.9	129.3	114.9	115.1
Q4	--	--	168.6	152.4	143.7	122.6	117.2
1980:January	--	--	173.2	154.4	149.3	121.9	118.1

1/ This series contains prime contract awards for aircraft, missile and space systems, ships, weapons and ammunition, electronic and communication equipment, combat vehicles, other hard goods, soft goods, construction, services, educational and nonprofit institutions and small (under $10,000) contracts; it is published as series 525 in Business Conditions Digest (BCD).

2/ This series is composed of awards for aircraft, ships, missile and space systems, weapons and ammunition, electronic and communication equipment and combat vehicles. The series is derived from unpublished reports of the Department of Defense and is seasonally adjusted by FRB Staff.

3/ These series are published monthly in both BCD and the Survey of Current Business (SCB).

4/ This series is a component of the FRB Index of Industrial Production.

Table 2

DEFENSE-RELATED ACTIVITY: RATIOS[1/]
(Based on seasonally adjusted data)

	Unfilled Orders to Shipments	Inventories to Shipments	Defense Inventories as a Percent of Total Business Inventories
	---------(Months)---------		------(Percent)------
1977-Q1	12.1	2.52	2.0
Q2	12.7	2.54	1.9
Q3	12.2	2.52	1.9
Q4	12.9	2.45	1.9
1978-Q1	13.1	2.46	1.9
Q2	14.0	2.49	1.9
Q3	14.6	2.57	1.9
Q4	15.4	2.57	1.9
1979-Q1	15.2	2.59	1.9
Q2	15.5	2.67	2.0
Q3	15.6	2.84	2.0
Q4	15.1	2.95	--
1979-January	14.8	2.52	1.9
February	16.2	2.73	1.9
March	14.7	2.51	1.9
April	15.2	2.57	1.9
May	16.3	2.79	2.0
June	14.9	2.64	2.0
July	16.1	2.89	1.9
August	14.9	2.73	2.0
September	15.7	2.91	2.0
October	15.3	2.94	2.1
November	15.0	2.95	2.2
December	14.9	2.97	2.2
1980-January	15.2	3.05	--

1/ Quarterly ratios are average of monthly ratios.

III-T-1
SELECTED DOMESTIC FINANCIAL DATA

Indicator	Latest data: Period	Latest data: Level	Net Change from: Month ago	Net Change from: Three months ago	Net Change from: Year ago
		$ billions	Percent at annual rates		
Monetary and credit aggregates[1]					
Total reserves	February	43.1	-3.8	5.0	4.8
Nonborrowed reserves	February	41.4	-15.7	7.8	3.2
Money supply	February				
M-1A	February	376.2	11.6	7.1	7.5
M-1B	February	392.7	11.1	7.7	8.9
M-2	February	1545.1	9.7	8.1	9.4
M-3	February	1802.3	11.6	9.0	9.9
Time and savings deposits (Gross)	February	677.4	16.5	8.4	8.3
Thrift deposits (S&Ls + MSBs + Credit Unions) Total	February	667.3	0.7	2.0	6.1
Bank credit	February	1164.5	17.9	11.7	11.5

		Latest data: Period	Latest data: Percent or index	Net Change from: Month ago	Net Change from: Three month ago	Net Change from: Year ago
Market yields and stock prices						
Federal funds	wk. endg.	3/5/80	16.17	3.37	2.41	6.10
Treasury bill (90 day)	" "	3/5/80	14.62	2.53	3.04	5.21
Commercial paper (90-119 day)	" "	3/5/80	15.34	2.27	2.64	5.38
New utility issue Aaa	" "	3/7/80	14.02	1.06	2.80	4.41
Muncipal bonds (Bond Buyer) 1 day	1 day	3/6/80	8.94	1.23	1.77	2.59
FNMA auction yield (FHA/VA)		3/5/80	15.26	1.50	2.84	4.83
Dividend price ratio (common stocks)	wk. endg.	3/5/80	5.49	.26	-.04	.07
NYSE indix (12/31/65=50)	end of day	3/10/80	60.59	-5.24	-.76	5.63

	Period	Net Change or Gross Offerings: Latest data	Year ago	Year to date: 1980	Year to date: 1979
Credit demands					
Business loans at commercial banks[1]	February	5.9	4.4	11.0	10.0
Consumer instalment credit outstanding[1]	January	1.4	3.1	1.4	3.1
Mortgage debt outstanding (major holders)[1 3]	November	8.0	9.8	93.4*	102.8*
Corporate bonds (public offerings)	January	2.4e	1.3	2.4e	1.3
Municipal long-term bonds (gross offerings)	February	2.4e	2.6	5.4e	5.4
Federally sponsored agcy. (net borrowing)	January	2.4e	1.1	2.4e	1.1
U.S. Treasury (net cash borrowing)	January	5.2	3.3	5.2	3.3

1/ Seasonally adjusted.
2/ $ billions, not at annual rates.
3/ Includes comm'l banks, S&Ls, MSBs, life ins. cos, FNMA and GNMA.
* Year to date 1979 and 1978.
e - Estimated.

Interest rates have soared since the February 5 FOMC meeting. Yields on money market instruments have climbed 3 to 4 percentage points, an extraordinary movement in so short a period. Meanwhile, long-term bond rates, extending January's sharp ascent, have risen another 1/2 to 1-1/2 percentage points. Dealers occasionally found it necessary to slash bond prices by several points in order to attract appreciable retail demand, as traditional institutional buyers reportedly were shunning long-term fixed-income securities. Equities apparently benefitted from the swing in investor sentiment for a time, and share prices continued to advance until late February, despite the rise in interest rates; however, the stock market has dropped precipitously in the past two weeks.

Contributing to the rise of interest rates was the tightening of the federal funds market as the System raised the discount rate and reduced the supply of nonborrowed reserves in the face of accelerated growth in the monetary aggregates. However, the runup in bond rates appeared to owe more to a marked shift in expectations associated with outsized increases in major price indexes, indications of persistent buoyancy in consumer and business spending, and prospects for deficit-expanding increases in defense spending. Bond yields have shown signs of leveling off most recently, partly in response to reports of imminent anti-inflationary action by the government, but the markets have remained highly unsettled and volatile, with substantial intra-day price movements and relatively wide bid-asked spreads.

SELECTED FINANCIAL MARKETS QUOTATIONS
(percent)

	1974 High[1]	1979-1980[2] FOMC Oct.5	FOMC Jan.9	FOMC Feb.5	Mar.11	Change from: FOMC Oct.5	FOMC Jan.9	FOMC Feb.5
Short-term rates								
Federal funds[3]	13.55	11.91	13.94	12.80	16.61p	4.70	2.67	3.81
Treasury bills								
3-month	9.63	10.70	11.76	12.22	15.38	4.68	3.62	3.16
6-month	9.75	10.63	11.75	12.11	14.89	4.26	3.14	2.78
1-year	9.54	10.28	10.76	11.60	13.78	3.50	3.02	2.18
Commercial paper								
1-month	12.25	11.73	13.07	13.02	16.63	4.90	3.56	3.61
3-month	12.25	11.86	13.04	13.09	16.86	5.00	3.82	3.77
6-month	12.00	11.84	12.50	12.85	16.23	4.39	3.73	3.38
Large negotiable CDs[4]								
1-month	12.58	12.09	13.33	13.23	17.07	4.98	3.74	3.84
3-month	12.64	12.50	13.36	13.46	17.41	4.91	4.05	3.95
6-month	12.30	12.80	13.33	13.70	17.50	4.70	4.17	3.80
Eurodollar deposit[3]								
1-month	13.78	12.45	14.59	13.94	18.13p	5.68	3.54	4.19
3-month	14.01	12.79	14.56	14.29	18.70p	5.91	4.14	4.41
Bank prime rate	12.00	13.50	15.25	15.25	17.75	4.25	2.50	2.50
Intermediate- and long-term rates								
U.S. Treasury (constant maturity)								
3-year	8.84	10.01	10.68	12.10	13.61	3.60	2.93	1.51
10-year	8.14	9.60	10.58	11.73	12.41	2.81	1.83	.68
30-year	n.a.	9.36	10.29	11.64	12.12	2.76	1.83	.48
Municipal (Bond Buyer)[5]	7.15	6.64	7.32	7.52	8.94	2.30	1.62	1.42
Corporate Aaa								
New issue[6]	10.61	10.22	—	—	14.02p	3.80	—	—
Recently offered[7]	10.52	10.25	11.42	12.35	13.85p	3.60	2.43	1.50
Primary conventional mortgages[7]	10.03	11.35	12.85	12.85	14.00	2.65	1.15	1.15

	1974 Low[8]	FOMC Oct.5	FOMC Jan.9	FOMC Feb.5	Mar.11	FOMC Oct.5	FOMC Jan.9	FOMC Feb.5
Stock prices								
Dow-Jones Industrial	577.60	897.61	850.09	876.62	826.45	-71.16	-23.64	-50.17
NYSE Composite	32.89	63.39	62.72	65.83	61.33	-2.06	-1.39	-4.50
AMEX Composite	58.26	235.15	251.75	278.25	271.93	36.78	20.18	-6.32
NASDAQ (OTC)	54.87	152.29	151.60	162.20	144.56	-7.73	-7.04	-17.64

1. Statement week averages except where noted.
2. One-day quotes except as noted.
3. Averages for statement week closest to date shown.
4. Secondary market.
5. One-day quotes for preceding Thursday.
6. Averages for preceding week.
7. One-day quotes for preceding Friday.
8. Calendar week averages.

With the pronounced deterioration of long-term financing conditions, businesses continued to borrow heavily in shorter-term markets during February. Business demands on commercial banks--particularly for loan commitments--appear in part to have reflected efforts to tie down funds in anticipation of possible future constraints on credit availability. In the household sector, consumer installment and residential mortgage credit flows, which had slowed in earlier months, likely were further damped by a tightening of creditors' lending policies prompted by a continued erosion of interest rate margins and, at thrift institutions, by outflows of small time and savings deposits. The rise in borrowing costs also disrupted the financing plans of some states and localities, with statutory interest rates ceilings coming into play in certain instances. The volume of offerings of marketable securities by the U.S. Treasury meanwhile has been boosted by the need to offset redemptions of savings bonds and of nonmarketable issues to foreign official institutions, the latter related to efforts by some central banks to buttress their currencies in foreign exchange markets.

Monetary Aggregates and Bank Credit

Growth in M-1A surged to 11-1/2 percent at an annual rate in February. Although currency growth moderated somewhat from the very strong January pace, demand deposits rose sharply following virtually no change in January.[1] It appears that average growth of M-1A over the past

1. Early in the month, a big increase in demand deposits coincided with a large reduction in Treasury cash balances. Large shifts of funds between the government and private sectors often appear temporarily in weekly fluctuations of the money stock, but such shifts generally have only a small impact on monthly growth rates. Early Social Security payments may also have boosted M-1A slightly.

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

	1979 Q2	1979 Q3	1979 Q4	1980 Jan.[p]	1980 Feb.[e]	Feb. '79 to Feb. '80[e]
	---- Percentage Change at Annual Rates ----					
Money stock measures						
1. M-1A	7.8	8.8	4.7	3.6	11.6	7.5
2. M-1B	10.7	10.1	5.3	4.3	11.1	8.9
3. M-2	10.2	10.3	7.2	7.0	9.7	9.4
4. M-3	8.8	10.3	9.9	7.9	11.6	9.9
Selected components						
5. Currency	8.1	11.1	8.1	13.6	10.1	9.4
6. Demand deposits	7.6	8.0	3.4	-0.5	12.2	6.7
7. Other checkable deposits, NSA[2]	102.8	46.7	15.7	22.2	0.0	52.8
8. M-2 minus M-1B (9+10+11+14)	10.0	10.4	7.8	7.9	9.2	9.5
9. Overnight RPs and Eurodollars, NSA[3]	35.4	-4.7	-17.3	39.8	-43.4	1.7
10. Money market mutual fund shares, NSA	204.1	166.2	120.0	151.4	188.2	291.7
11. Savings deposits	-9.7	-1.5	-21.0	-13.2	-21.8	-11.9
12. at commercial banks	-7.4	-0.4	-15.1	-11.7	-16.1	-9.0
13. at thrift institutions	11.8	-2.5	-26.0	-14.6	-26.8	-14.4
14. Small time deposits	20.4	14.4	24.4	10.8	17.1	20.3
15. at commercial banks	22.5	21.5	28.5	26.2	29.1	27.6
16. at thrift institutions	19.3	10.4	22.3	2.0	10.1	15.2
17. Large time deposits	-4.8	9.5	30.3	15.9	25.9	12.9
18 at commercial banks, net[4]	-9.0	2.5	22.6	8.3	20.2	5.5
19. at thrift institutions	40.9	72.2	90.8	63.4	60.2	88.2
20. Term RPs, NSA	34.6	13.8	5.4	0.0	4.0	14.7
	—Average Monthly Change in Billions of Dollars—					
MEMORANDA:						
21. Managed liabilities at commercial banks (22+23)	1.8	9.5	-1.5	4.2	13.1	4.2
22. Large time deposits, gross	-3.0	4.3	2.2	1.1	6.0	1.4
23. Nondeposit funds	4.8	5.2	-3.7	3.1	7.1	2.8
24. Net due to related foreign institutions, NSA	3.6	2.9	-2.2	0.8	1.3	1.5
25. Other[5]	1.3	2.2	-1.4	4.0	5.8	1.3
26. U.S. government deposits at commercial banks[6]	1.0	0.6	-1.1	4.6	-1.5	0.2

1. Quarterly growth rates are computed on a quarterly average basis.
2. Consists of ATS and NOW balances at all institutions, credit union share draft balances, and demand deposits at mutual savings banks.
3. Overnight and continuing contract RPs issued to the nonbank public by commercial banks, net of amounts held by money market mutual funds, plus overnight Eurodollar deposits issued by Caribbean branches of U.S. member banks to U.S. nonbank customers.
4. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
5. Consists of nondeposit borrowings of commercial banks from nonbank sources, calculated as the sum of federal funds purchased, security RPs, other liabilities for borrowed money (including borrowings from the Federal Reserve), and loans sold less interbank borrowings.
6. Consists of Treasury demand deposits at commercial banks and Treasury note balances.
e--estimated. n.a.--not available. p--preliminary.

several months has been consistent with what money demand relationships suggest for this aggregate in a period of rapid expansion in nominal income and spending and sharp increases in money market yields. Because the interest-bearing component of M-1B was unchanged in February, growth of this broader transactions measure was slightly below that of M-1A.

M-2 expansion quickened to a 9-3/4 percent rate in February, up from 7 percent in January. Growth of the non-M-1B component of M-2--consisting of savings and small time deposits at all depositary institutions, shares of money market funds, and overnight RPs and Eurodollars--was somewhat faster in February than in the preceding month, but remained moderate. Inflows to small time deposits at all depositary institutions--apparently led again by MMCs and the new 2-1/2 year and over account--and to money market mutual funds strengthened in February (measured on a monthly average basis), while outflows from savings accounts accelerated. Indeed, at thrift institutions outflows from savings and fixed ceiling small time deposits exceeded inflows into variable ceiling accounts, and total savings and small time deposits declined, albeit at a slower rate than in January.

MMCs attracted $24.6 billion, net, during January at all depositary institutions (month-end basis, not seasonally adjusted). The commercial bank share of MMCs outstanding edged upward, extending the trend that began last March when the inter-institutional rate differential was eliminated (see table, page III-6). On the other hand, the distribution of January inflows to the new 2-1/2 year and over variable ceiling accounts--which have a 1/4 point differential and no legal minimum denominations--more

MARKET SHARES OF VARIABLE CEILING ACCOUNTS
(Based on not seasonally adjusted data)

	Total balances[1] (billions of dollars)	Market shares	
		Commercial banks (percent)	Thrift institutions (percent)
MMCs outstanding:			
March 1979[2]	135.7	30	70
December 1979	265.3	39	61
January 1980	289.9P	40P	60P
4-year and over variable ceiling accounts outstanding:			
December 1979	6.8P	28P	72P
2-1/2 year and over variable ceiling accounts issued in:			
January 1980	5.3P	32P	68P
Total variable ceiling accounts outstanding:			
January 1980[3]	302.0P	40P	60P

p--preliiminary.
1. Consists of deposits at commercial banks, mutual savings banks, and savings and loan associations.
2. On March 15 the 1/4-point rate advantage on MMCs at thrift institutions was removed for 6-month Treasury bill auction rates above 9 percent.
3. Assumes no early withdrawals from the 4-year and over variable ceiling accounts outstanding in December 1979.

closely resembled pre-March 1979 shares of the MMC market.[1] Commercial banks received 32 percent of the $5.3 billion January inflow to the 2-1/2-year accounts, after having acquired 28 percent of the 4-year and over variable ceiling deposits issued last year.

To restrain monetary growth, the System reduced nonborrowed reserves in February. Pressures in the federal funds market intensified late in the month and in early March, as the surge in deposits was reflected with a two week lag in larger required reserves. Borrowing from the discount window advanced from about $1.2 billion in January to nearly $1.7 billion in February and by the week ending March 5 borrowed reserves had expanded to $2.5 billion.

Total loans and investments at all commercial banks rose at an estimated 18 percent rate in February, up from 12-3/4 percent in January and well above the reduced fourth quarter pace. As in January, business lending by large banks (including agencies and branches of foreign institutions) paced the credit expansion. Business loans at small banks also expanded in February, after having declined in the preceding two months. Bank loans to finance companies registered a substantial increase in February, in part reflecting a decision by a leading finance company to turn to commercial banks in the latter part of the month instead of putting additional pressure on a highly sensitive commercial paper market. Among the major loan categories, only security loans fell, likely reflecting inventory cutbacks by security dealers. Bank investments accelerated to

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1. Effective March 1, 1980 an 11-3/4 percent cap was placed on the nominal ceiling rate payable on 2-1/2 year and over certificates at commercial banks; at thrifts the cap is 12 percent. In the absence of the cap on these accounts, the ceiling would have been 13-1/4 percent at commercial banks and 13-1/2 percent at thrifts in March.

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

		1979			1980		Feb. '79 to
		Q2	Q3	Q4	Jan.	Feb.[e]	Feb. '80[e]
		---------- Commercial Bank Credit ----------					
1.	Total loans and investments at banks[2]	11.9	15.8	3.4	12.8	17.9	11.5
2.	Investments	5.4	8.5	3.5	4.2	14.7	6.5
3.	Treasury securities	3.8	1.7	-5.9	-7.7	18.0	1.5
4.	Other securities	6.2	12.1	8.3	10.0	13.1	9.2
5.	Total loans[2]	14.2	18.2	3.3	15.8	19.0	12.9
6.	Business loans	16.6	22.7	5.8	20.9	23.8	17.2
7.	Security loans	38.1	8.7	-88.5	-19.7	-19.8	-16.6
8.	Real estate loans	13.0	14.7	14.2	12.9	13.2	14.5
9.	Consumer loans	12.4	7.5	5.5	6.6	n.a.	n.a.
		— Short- and Intermediate-Term Business Credit —					
10.	Total short- and intermediate-term business credit (sum of lines 13,14 and 15)	20.1	27.4	6.3	24.4	n.a.	n.a.
11.	Business loans net of bankers acceptances[1]	16.6	21.7	6.2	24.4	21.2	17.1
12.	Commercial paper issued by nonfinancial firms[3]	65.7	69.7	15.5	81.6	49.7	65.2
13.	Sum of lines 11 & 12	20.3	25.7	7.0	28.0	24.0	20.6
14.	Finance company loans to business[4]	17.7	9.4	4.0	-8.5	n.a.	n.a.
15.	Total bankers acceptances outstanding[4]	23.3	74.9	4.6	52.3	n.a.	n.a.

1. Average of Wednesdays for domestic chartered banks and average of current and preceding ends of months for foreign-related institutions.
2. Loans include outstanding amounts of loans reported as sold outright to a bank's own foreign branches, unconsolidated nonbank affiliates of the bank, the bank's holding company (if not a bank), and unconsolidated nonbank subsidiaries of the holding company.
3. Average of Wednesdays.
4. Based on average of current and preceding ends of months.
e—estimated. n.a.—not available.

a 14-3/4 percent annual rate in February, with bank holdings of Treasury securities increasing for the first time since October.

The growth in bank credit in February exceeded inflows of core deposits by a considerable margin, and banks increased their reliance on managed liabilities. Large time deposits rose $6 billion in February, substantially above the $1 billion issued in January. Estimated inflows of nondeposit funds of $7 billion during February also exceeded those of January. Most of this nondeposit inflow took the form of borrowings other than Eurodollars, as net Eurodollar borrowing from related foreign institutions has shown little tendency to return to the higher levels of the third quarter of last year, even after adjusting for the impact of diminished weekend reserve avoidance activities (discussed in an appendix to this section).

Business Finance

Besides borrowing heavily from commercial banks in February, nonfinancial businesses continued to tap the commercial paper market for a sizable amount of short-term funds. Growth in these two credit sources was 24 percent in February, down from the 28 percent rate in January, but far above the pace of 7 percent in the fourth quarter of last year.[1]

Demands for short- and intermediate-term credit have been bolstered by a reluctance of many corporations to borrow in the long-term market--as indicated by the small volume of industrial issues and a number of cancellations and postponements of scheduled bond issues--at a time when markets

1. By contrast, finance company business credit outstanding declined in January, mainly reflecting a further reduction in loans on automobile dealer inventories.

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

	1979 H1	1979 H2	1980 Jan.[p]	1980 Feb.[p]	1980 Mar.[f]
	-------- Seasonally adjusted --------				
Corporate securities--total	4,370	4,285	5,150	4,150	3,600
Publicly offered bonds	2,190	2,090	2,620	1,675	1,400
Privately placed bonds	1,460	1,065	900	900	900
Stocks	720	1,130	1,630	1,575	1,300
	------ Not seasonally adjusted ------				
Publicly offered bonds--total	2,280	2,005	2,400	1,400	1,600
By quality[1]					
Aaa and Aa	1,225	1,120	1,800	475	--
Less than Aa[2]	1,055	885	600	925	--
By type of borrower					
Utility	700	825	1,315	815	--
Industrial[3]	635	735	435	435	--
Financial	945	445	650	150	--

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

PUBLIC OFFERINGS OF NOTES AND BONDS BY NONFINANCIAL CORPORATIONS
(Billions of dollars)

	Public Utilities Total	Public Utilities Less than 10 years	Industrials[1] Total	Industrials[1] Less than 10 years	Less than 10 years as a percent of total nonfinancial
1974	11.3	3.4	9.0	2.0	26.6
1975	12.9	2.8	19.9	2.5	16.2
1976	8.1	--	9.9	1.5	8.3
1977	8.2	0.2	6.1	0.4	4.2
1978	7.2	--	4.9	0.3	2.5
1979	9.0	0.8	7.6	1.6	14.5
1979-Q1	1.8	0.1	0.8	00	3.9
Q2	2.6	0.4	2.3	0.4	16.3
Q3	1.4	--	2.8	0.7	16.7
Q4	3.3	0.3	1.7	0.6	18.0
1980-Jan.	1.3	0.2	0.2	0.2	26.7
Feb.	0.8	0.3	0.4	--	25.0

1. Excludes equipment trust certificates.

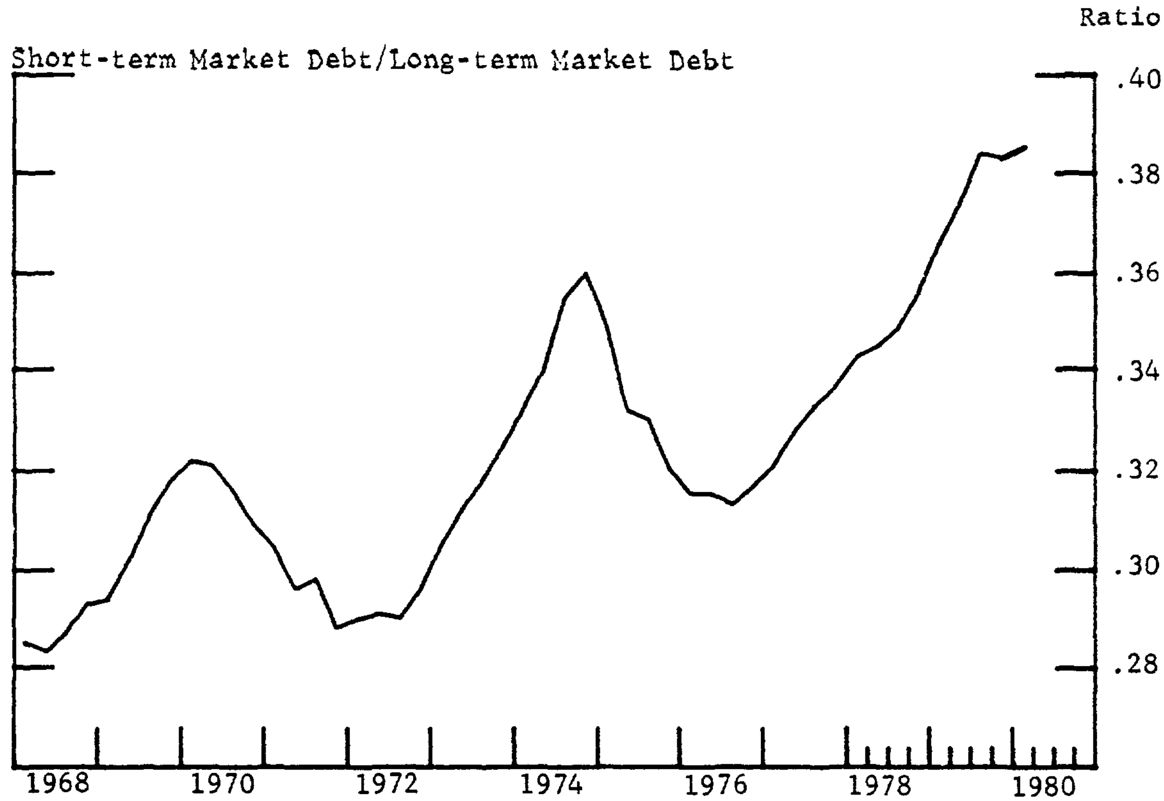
are highly unsettled and bond rates are at record levels. A shift in preferences toward short-term borrowing was confirmed by an informal Systemwide survey of commercial banks taken in early March. Moreover, there was growing evidence--also confirmed by the Systemwide survey--of businesses seeking larger credit lines and/or borrowing in anticipation of credit controls or other regulatory actions that might jeopardize the availability of funds in the future. Although the substantial increase in the prime rate may have tempered demands for bank loans by some firms late in February and early in March, its advance fell short of increases in most other money market rates.[1]

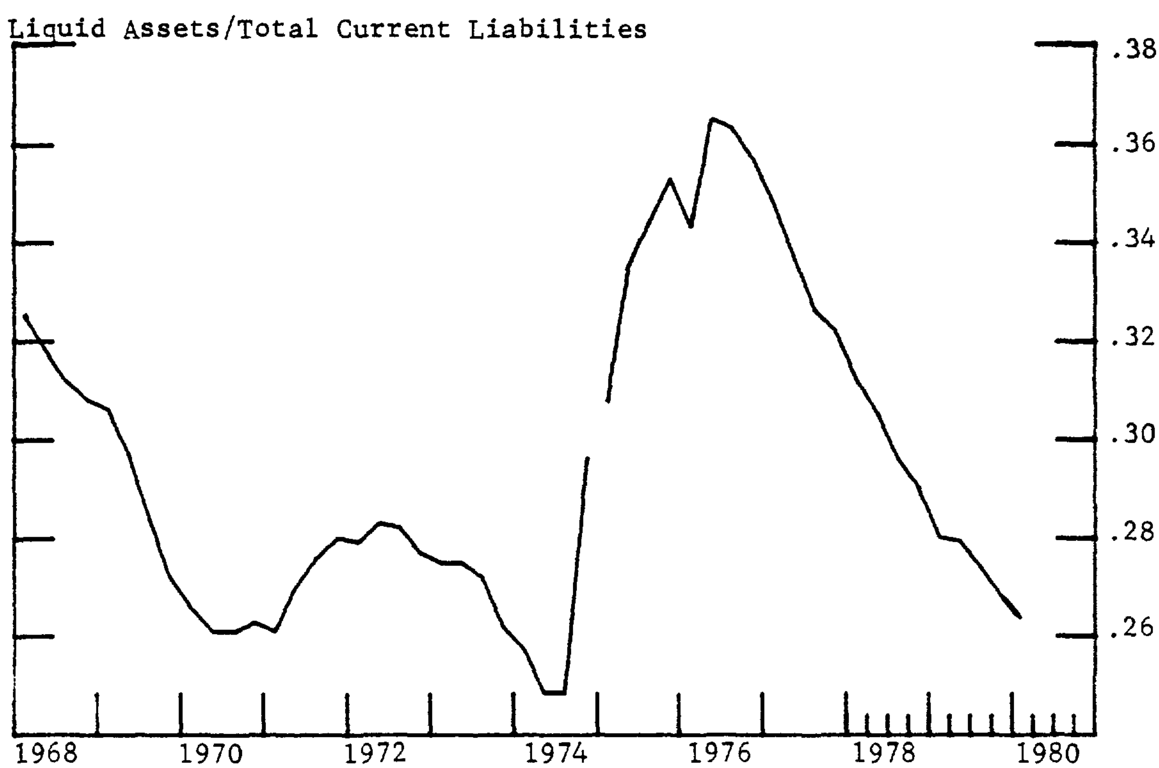
Gross public offerings of corporate bonds declined from $2.6 billion in January to less than $1.7 billion in February (seasonally adjusted), below the 1979 average. A restructuring of offerings toward shorter maturities has accompanied the deterioration of long-term market conditions since year-end. During January and February, nonfinancial debt offerings maturing in less than 10 years accounted for one-fourth of the total, up appreciably from 1979 and the largest share since 1974 (see table, page III-10).

The recent rapid growth in short-term borrowing by businesses, coupled with the slowing of longer-term borrowing, has contributed to a further erosion of corporate liquidity. The aggregate ratio of short-term debt to long-term debt appears likely in the current quarter to continue

1. The latest survey of Senior Loan Officer Opinion--taken in mid-February--indicates that even prior to the recent runup in money market rates and bank costs of funds, there had been a noticeable tightening in lending policies. The Greenbook supplement will contain a discussion of this survey.

LIQUIDITY MEASURES FOR NONFINANCIAL CORPORATIONS
(Seasonally adjusted)





Source: Flow of funds. Data for 1980-Q1 are preliminary.

its climb beyond the level experienced in 1974, while the ratio of liquid assets to current liabilities is nearing its 1974 low (see chart, page III-12). Nevertheless, corporations may continue to rely on short-term borrowing to a larger degree than usual--and can call upon an unprecedented amount of unused commitments at large commercial banks, amounting to almost $200 billion in January.[1]

The volume of new equity offerings was bolstered in January and February by share prices that, overall, reached an all-time high before turning down in late February. New common and preferred stock offerrings are estimated to have totaled about $1.6 billion (seasonally adjusted) in both months, well above last year's $920 million monthly average. Public utilities continue to account for a large portion of offerings, although new equity offerings by manufacturing and other industrial corporations have increased sharply in recent months. Many of these stock offerings have been by smaller industrial concerns.

Government Debt Markets

The Treasury raised $4.9 billion (not seasonally adjusted) of new money through sales of marketable debt during February. Of this amount, $2.6 billion was raised in the mid-quarter refunding, $1.7 billion was raised in regular weekly and monthly bill auctions, and the remaining $600 million was obtained from regular 2-year note issues. Nonmarketable debt, by contrast, declined during the month. Most of this decline was concentrated in savings bonds--which fell nearly $1 billion in February

1. Unused formalized credit lines--consisting mainly of term and revolving credit agreements--stood at $85 billion in January, up more than $10 billion from four months earlier. The remainder was in confirmed lines, which often do not contain a binding commitment to lend.

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

	1979			1980			
	H1	QIII	QIV	Jan.[e]	Feb.[e]	Mar.[f]	Apr.[f]
				Seasonally adjusted			
State and local government securities, gross offerings							
Total	5.01	5.53	5.77	4.91	4.82	4.95	5.22
Long-term	3.41	3.64	4.00	3.06	2.77	3.05	3.50
Short-term	1.60	1.89	1.77	1.85	2.05	1.90	1.72
U.S. government securities, net offerings							
U.S. Treasury[1]	3.28	1.69	4.05	5.34	4.08	10.77	-5.67
Sponsored agencies	2.22	0.73	2.70	2.70	1.61	3.07	1.86
				Not seasonally adjusted			
State and local government securities, gross offerings							
Total	5.43	5.26	5.26	4.40	4.10	5.10	7.20
Long-term	3.55	3.38	3.98	3.00	2.40	3.40	3.20
Short-term	1.88	1.88	1.28	1.40	1.70	1.70	4.00
U.S. government securities, net offerings							
U.S. Treasury[1]	1.97	2.17	6.14	4.43	7.55	12.00	-12.10
Sponsored agencies	2.09	1.31	2.48	2.31	0.62	2.92	1.69

e--estimate. f--forecast.
1. Marketable issues only.

following a $1.3 billion drop in January--and in holdings of foreign official institutions seeking to support their currencies on foreign exchange markets with sales of dollars.[1]

The sharp rate increases on Treasury securities of all maturities have been accompanied by wider bid-asked spreads and a larger range of bids in weekly auctions, as well as by greater day-to-day and intra-day volatility. Nevertheless, apart from a thinness in the coupon sector on those days when increases in yields were especially large, trading volume in the cash market generally has been well maintained. Trading has remained active in futures markets as well, except on those occasions when daily price limits have been hit. Primary Treasury security dealers as a group have avoided major losses by carrying short positions in coupons, and a recent special survey of major dealers indicated that none has incurred extraordinary losses during this recent period of market turbulence.

State and local governments responded to the jump in interest rates by cancelling or postponing about $600 million of bonds and another $150 million of short-term notes in February. Their borrowing totaled less than $5 billion for the second consecutive month. Most of the issues displaced were state agency revenue bonds or local general obligations. High interest rates, statutory interest rate ceilings, and unstable

1. Nonmarketable Treasury debt held by foreign official institutions declined about $400 million in February and their marketable holdings declined about $300 million. Then, in the first week of March, foreign official institutions liquidated another $1.2 billion of nonmarketable Treasury securities and $3.1 billion of marketable securities.

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

Period	Conventional home mortgages: Average rate on new commitments for 80% loans (percent)	Basis point change from month or week earlier	Spread[1] (basis points)	Percent of S&Ls[2] with mortgage funds in short supply
1979--High	12.90	--	+174	88
Low	10.38	--	+64	54
1979--Aug.	11.09	0	+160	77
Sept.	11.30	+21	+143	83
Oct.	11.64	+34	+79	83
Nov.	12.83	+119	+147	86
Dec.	12.90	+7	+132	85
1980--Jan.	12.88	-2	+118	85
Feb. 1	12.85	-4	+50	88
8	12.85	0	+5	84
15	12.88	+3	-29	81
22	13.03	+15	-113	85
29	13.59	+61	-24	84
Mar. 7	14.00	+41	+15	85

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

SECONDARY HOME MORTGAGE MARKET ACTIVITY

Period	FNMA auctions of forward purchase commitments: Conventional: Amount ($ millions) Offered	Conventional: Amount ($ millions) Accepted	Conventional: Yield to FNMA[1]	Government-underwritten: Amount ($ millions) Offered	Government-underwritten: Amount ($ millions) Accepted	Government-underwritten: Yield to FNMA[1]	Yields on GNMA-guaranteed mortgage-backed securities for immediate delivery[2]
1979--High	454	172	13.97	1,035	448	13.29	11.77
Low	19	18	10.92	37	19	10.42	9.51
1980-Feb. 4	161	73	13.67	525	240	13.76	12.53
11							12.74
19	251	75	14.57	644	324	15.21	13.72
25							13.65
Mar. 3	324	73	15.36	535	178	15.26	13.58
10							13.57

1. Average gross yield before deducting fee of 38 basis points for mortgage servicing. Data, based on 4-month FNMA purchase commitments, reflect the average accepted bid yield for home mortgages, assuming a prepayment period of 12 years for 30-year loan without special adjustment for FNMA commitment fees and related stock requirements. Mortgage amounts offered by bidders relate to total eligible bids received.
2. Average net yields to investors assuming prepayment in 12 years on pools of 30-year FHA-VA mortgages carrying the prevailing ceiling rate on such loans.

market conditions were given as reasons for their being withdrawn. The volume of bonds postponed because of unstable market conditions was relatively large, and in most cases proceeds had been earmarked for housing and electric power uses, projects that generally can be delayed or cancelled. Offerings of housing revenue bonds continued large in February, at $850 million, despite cancellations of about $200 million.

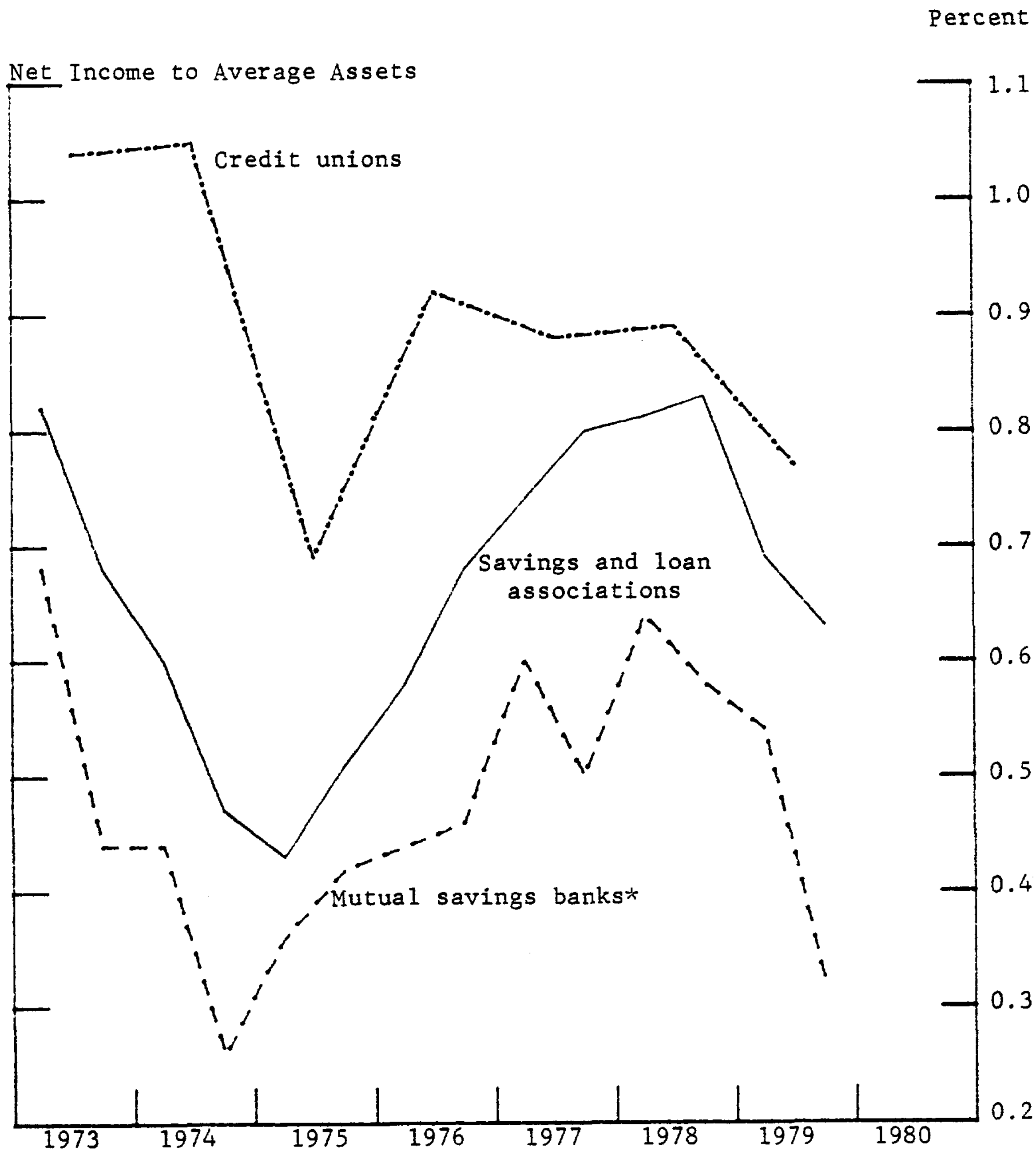
Mortgage Markets

Mortgage market conditions have tightened further in recent weeks. The average yield on new commitments for conventional home mortgages at sampled S&Ls increased more than 70 basis points in the last half of February and another 40 basis points in the first week of March to reach a record 14 percent. Moreover, press reports indicate that some S&Ls around the country have raised their mortgage rates above 15 percent--even as high as 17 percent--apparently to shut off loan demands in the face of uncertainty about deposit flows and credit conditions generally.

The most recent rise in mortgage yields has moved them back above yields on high-grade corporate bonds. The spread between the commitment rate on conventional mortgages and the Aaa utility bond index was 15 basis points in early March--still a small margin compared with the 100-plus basis point spreads of the past few years, but a marked readjustment from the deeply negative value reached briefly in the last half of February.

In an effort to align coupon rates on FHA/VA-underwritten home mortgages with changing market conditions, the Administration during February raised the ceiling rate on new loans in two steps from 11-1/2 to 13 percent. Nevertheless, in the March 3 auction of FNMA's forward

PROFITABILITY OF THRIFT INSTITUTIONS



Note: Previous postwar earnings lows for S&Ls and MSBs were .38 percent and .20 percent, respectively, recorded in the first half of 1967.

*MSB earnings data provided by the National Association of Mutual Savings Banks.

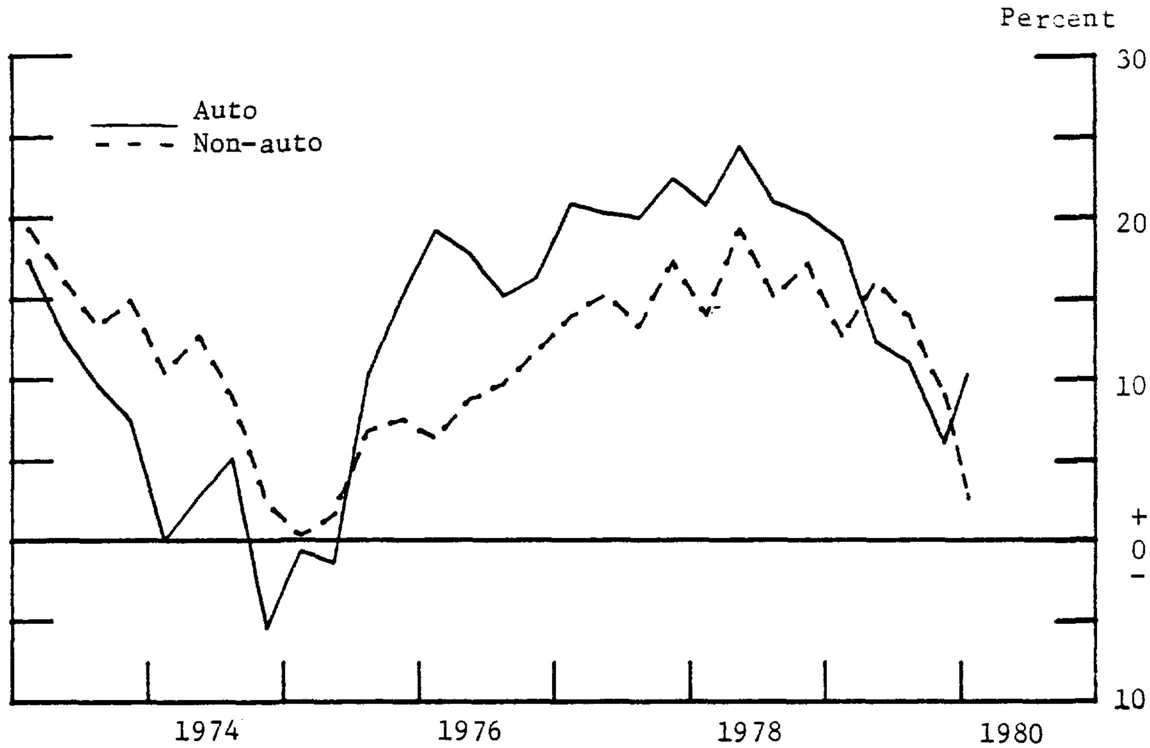
purchase commitments, the average discount on FHA/VA loan contracts bearing the new 13 percent ceiling rate exceeded 12 points.

Net mortgage lending at S&Ls rebounded slightly in January from the very low level in December. At the same time, however, loan commitments outstanding at S&Ls declined further--to $27.3 billion, down 16 percent from September. A special FHLB survey of 130 S&Ls indicates that about four-fifths of these institutions tightened their lending policies during the second half of February by becoming more selective in the loans that they would make as well as by raising rates. At commercial banks, where a sizable share of the lending probably has been for commercial construction projects, real estate loans grew at a 13 percent annual rate in February, about the same rate as in January and slightly below the appreciable pace of 1979.

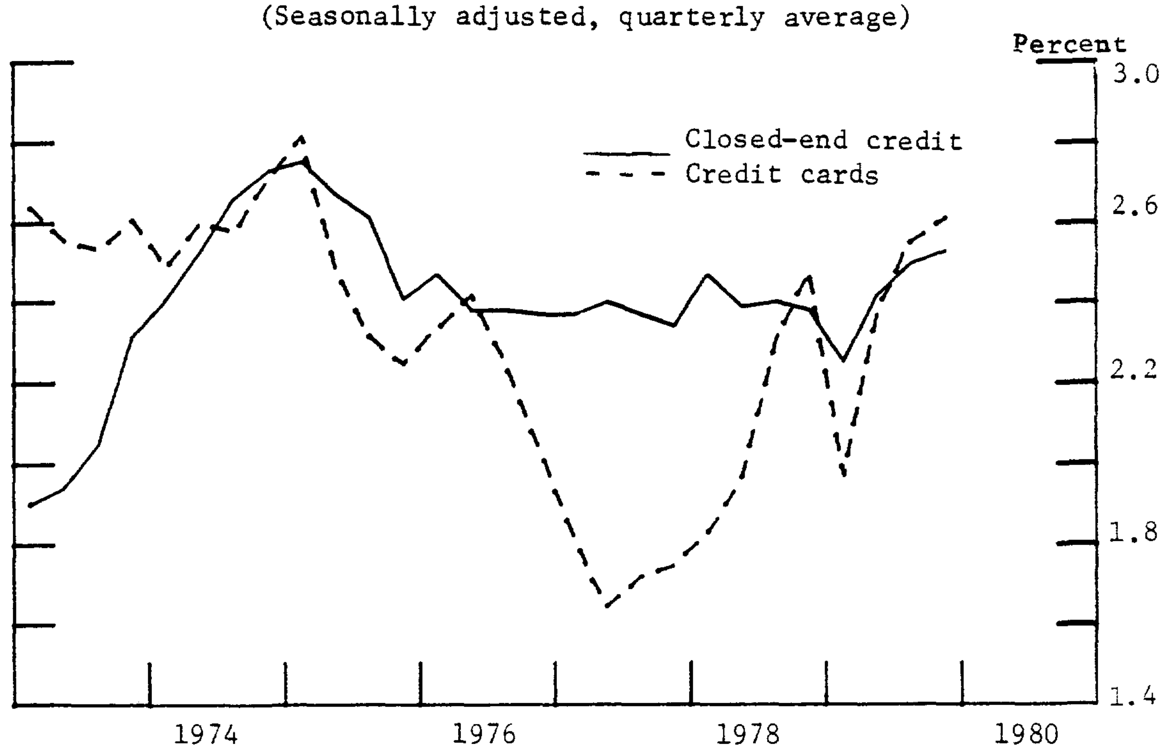
The profitability of thrift institutions declined significantly during 1979 (see chart, page III-18), owing to narrowed interest margins, and apparently has worsened in early 1980. Indeed, a good number of institutions are experiencing operating losses at the present time.[1] Moderate increases in returns on mortgages and other assets were accompanied by very sharp increases in costs of funds associated with heavier dependence on high-cost MMCs, large denomination time deposits, and nondeposit liabilities.[2] Nevertheless, the capital positions of S&Ls

1. About 10 percent of MSBs in New York State had income losses before security transactions in the fourth quarter of last year, while 20 percent had losses after security transactions.
2. While there is evidence suggesting that some institutions have incurred signficant losses by liquidating securities, thus far such liquidations do not appear to reflect an inability to obtain borrowed funds. Some commentators have suggested that operating losses might make it difficult for thrift institutions to continue selling large CDs and tapping other private credit sources.

RATE OF GROWTH IN AUTO AND NON-AUTO
CONSUMER INSTALLMENT CREDIT
(Seasonally adjusted annual rate)



DELINQUENCY RATES ON CREDIT CARD ACCOUNTS
AND CLOSED-END CREDIT AT COMMERCIAL BANKS
(Seasonally adjusted, quarterly average)



and MSBs have been relatively strong, at least in book value terms. Stated net worth of S&Ls relative to their assets was 5.6 percent in January, about the same level that has been maintained since 1976, while general reserve accounts of MSBs were 6.9 percent of assets in December, the highest figure in nearly five years.

Consumer Credit

Growth in consumer installment credit remained at an annual rate of about 5-1/4 percent in January. Automobile credit growth in January--at about a 10 percent annual rate--was only slightly above the fourth quarter pace but well below that of 1978, while the 3 percent expansion of non-auto installment credit in January was the slowest in more than four years (see chart, page III-20). In February, loans to individuals at large commercial banks were very weak.

Terms on consumer installment credit have recently tightened further. Average rates of interest on commercial bank installment loans, which have increasingly been limited by restrictive statutory ceilings, rose in the three months ending in early February (see table, page III-22). In addition, non-rate terms, including downpayments and minimum maturities, reportedly have been tightened, and the mid-February survey of senior bank lending officers indicated less willingness to make consumer installment loans. With costs of funds to lenders up sharply, recent trade reports indicate that consumer credit has become less available in a growing number of states.

Cost pressures on consumer lenders have prompted a variety of adjustments. One major bank has established a floating finance charge on certain consumer installment loans at 1 percentage point above the

CONSUMER INSTALLMENT CREDIT[1]

	1978	1979	1979 Q3	1979 Q4	1979 Dec.[r]	1980 Jan.
Total						
Change in outstandings						
Billions of dollars	44.8	35.5	37.3	23.8	16.2	16.5
Percent	19.4	12.9	12.8	7.9	5.3	5.3
Bank share (percent)	53.1	37.8	32.7	21.4	16.2	31.6
Extensions						
Billions of dollars	298.4	322.6	332.3	319.3	308.1	320.4
Bank share (percent)	47.8	46.4	45.9	44.9	44.3	45.4
Liquidations						
Billions of dollars	253.5	287.1	294.9	295.6	291.9	304.0
Ratio to disposable income	17.4	17.7	18.0	17.6	17.2	17.7
Automobile credit						
Change in outstandings						
Billions of dollars	19.6	12.6	12.1	6.8	8.2	11.7
Percent	23.6	12.3	11.0	6.0	7.2	10.1
Extensions						
Billions of dollars	89.0	91.9	94.2	87.5	85.6	93.4

1. Quarterly and monthly dollar figures and related percent changes are seasonally adjusted annual rates.
r--revised.

FINANCE RATES ON CONSUMER INSTALLMENT CREDIT AT COMMERCIAL BANKS
(Annual percentage rate, not seasonally adjusted)

Type	Finance rate Feb. 1979	Finance rate Nov. 1979	Finance rate Feb. 1980	Change in basis points Feb. 79- Nov. 79	Change in basis points Nov. 79- Feb. 80
New automobile	11.60	12.85	13.28	+125	+43
Mobile home	12.37	13.51	13.57	+114	+6
Other consumer goods					
24-month	13.59	14.39	14.69	+80	+30
12-month	13.90	14.56	14.88	+66	+32
Credit card	17.05	16.93	17.13	-12	+20

Federal Reserve discount rate; press reports indicate that creditors more generally are considering means of introducing greater flexibility in consumer loan pricing. On credit cards, interest rates have been raised, where not already at statutory ceilings, and some issuers have instituted or increased annual user fees. Some card plans have dropped cardholders with small credit lines, who are viewed as being their riskiest customers. Several major retail chains have moved to increase their credit card revenues by changing their formulas for calculating finance charges. In an effort to reduce their costly receivables, some other retailers have encouraged customers to use bank credit cards instead of in-house credit plans.

The burden of consumer installment debt, as measured by the ratio of repayments to disposable personal income, at 17.7 percent in January was above that of December and near the peak level of 18 percent recorded in the third quarter of 1979. Delinquency rates on commercial bank installment loans (overdue 30 days and longer) rose by the end of 1979 to the highest levels in more than four years. On longer-term household liabilities, average mortgage delinquency rates (60 days and longer) for several lender groups--as measured by the Mortgage Bankers Association series--edged up in the final quarter of 1979 for the third consecutive quarter. At S&Ls, however, mortgage delinquency rates in January were about unchanged from the low levels that prevailed throughout last year.

APPENDIX

WEEKEND RESERVE-AVOIDANCE ACTIVITY*

Weekend reserve-avoidance activity by member banks has fallen off substantially in the aftermath of the System's October monetary policy actions. The reduction in such activity has been reflected in a decline in the Eurodollar component of member banks' managed liabilities and in an increase in required reserves against net demand deposits. The change in bank behavior appears to be a result in part of the greater volatility of the federal funds rate since October 6, a by-product of the System's reserve-targeting strategy, and, to a lesser extent, of the marginal reserve program, which has lowered for some banks the potential savings from such transactions.

The Mechanics of Weekend Reserve Avoidance

Member banks that participate in weekend transactions arrange for inflows of clearinghouse funds on Friday. Because clearinghouse funds are not collected until the next business day--which typically is Monday--the banks are able to claim a cash item in the process of collection deduction or a due-from-bank deduction (hereafter referred to as "cash items" deductions) from their gross demand deposits for three statement days. This reduces net reservable demand deposits for a net of two statement days, because, as will be shown below, weekend transactions result in a corresponding increase in reservable demand deposits on either Thursday or Monday.[1]

The most common weekend transaction before October 6 was the Friday-Monday version. In the most typical form of the Friday-Monday transaction, the member bank on Friday arranges for its foreign branch to borrow clearinghouse funds from a U.S. branch or agency of a foreign bank. The member bank receives the funds from the U.S. branch or agency of the foreign bank, on behalf of its own foreign branch, reflecting the transaction on its own books as an increase in liabilities due to its own foreign branch and an increase in cash items. Net reservable demand deposits of the member bank thus decline by the amount of the cash-item deduction for three statement days, while net liabilities due to its own foreign branches rise by that amount for the same number of days. On Monday, the member bank collects good funds on its Friday borrowing of clearinghouse funds (thus losing its cash item deduction).[2]

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1. The deposits affected are primarily interbank. For other deposits affected, appropriate adjustments are made to prevent a distortion of the money stock figures. Since member banks typically have arranged such transactions with U.S. branches and agencies of foreign banks using their own foreign branches as intermediaries, these are often referred to as "weekend Eurodollar" transactions.

2. Meanwhile, the U.S. branch or agency of the foreign bank that lent clearinghouse funds on Friday covers its loan by borrowing in the federal funds market on Monday. The proceeds of this federal funds borrowing are then forwarded to its clearinghouse settling correspondent in order to cover the clearinghouse check issued on Friday.

It also repays the weekend borrowing arranged through its foreign branch. Because the repayment also is in clearinghouse funds, it will not be collected until the next day; as a result, the member bank's reservable demand deposits increase on Monday--above their Thursday level--by the amount of the clearinghouse payment. Thus, the net effect of this weekend transaction is to reduce reservable demand deposits for two statement days. Managed liabilities of the member bank increase by the amount of the due-to-own-foreign-branch liability for three statement days.

The other common form of weekend reserve-avoidance transactions is the Thursday-Friday version. In such a transaction, the member bank makes a loan to a U.S. branch or agency of a foreign bank in clearinghouse funds on Thursday, ordinarily using its own foreign branch as an intermediary. When the member bank makes the Thursday loan by issuing an officer's check drawn on itself, its reservable demand deposits increase that day by the amount of the loan. Because the loan is made through its own foreign branch, the member bank's net liabilities to its own foreign branches decline. On Friday, two events take place involving the member bank and the borrowing U.S. branch or agency of the foreign bank. First, the member bank delivers good funds to the borrower, simultaneously removing the officer's check from its books and thereby restoring its gross demand deposit balances to their initial level. Second, the U.S. branch or agency of the foreign bank repays the overnight loan to the member bank, using clearinghouse funds. When this occurs, the member bank adds to its cash-item deductions and restores its net borrowings from its own foreign branches to their initial level. Having larger cash item deductions on Friday, the member bank reduces its reservable demand deposits for three statement days--Friday through Sunday--leaving a net reduction for two days.[1] Managed liabilities have been reduced by the amount of the loan for one day.

Recent Behavior of Reserve-Avoidance Activity

In February (through the 27th), the above described weekend reserve-avoidance activity averaged $11.4 billion per statement week, about 60 percent of the September figure, which was typical of pre-October 6 levels (see table 1).[2] The reduced level of weekend reserve-avoidance activity has been reflected in an increase in the daily average

1. U.S. branches and agencies of foreign banks experience increases in their net demand deposits over the weekend in connection with weekend transactions. However, their reserve requirements generally are not affected because these institutions now typically face effective reserve requirements on their net demand deposits that are zero.
2. A measure of total avoidance activity during a statement week is given by subtracting member banks' net Eurodollar borrowings from their own foreign branches on Friday from those on Thursday. To estimate the Thursday-Friday component, one compares net borrowings on Thursday to those on the day before. The Friday-Monday component is the difference between total activity and Thursday-Friday activity.

of net reservable demand deposits of more than $2 billion and of required reserves of about $350 million.[1] Both types of weekend reserve avoidance activity have generally been reduced in the post-October 6th period, although the decline in the Friday-Monday version has been relatively the largest. Changes in incentives traceable to the marginal reserve program cannot, however, fully explain both reductions.

TABLE 1
WEEKEND RESERVE AVOIDANCE ACTIVITY
(Billions of dollars)

Average for four statement week periods ending	Total	Thursday-Friday	Friday-Monday
1979			
September 26	18.8	5.8	13.0
November 7	6.5	2.2	4.3
December 5	8.2	1.6	6.6
1980			
January 2	7.5	3.9	3.6
January 30	9.7	3.3	6.4
February 27	11.4	5.5	5.9

For a member bank, the Thursday-Friday transaction reduces managed liabilities, because it involves an increase in a member's gross claims on its own foreign branches. The Friday-Monday transaction, on the other hand, increases a member's managed liabilities by raising its gross liabilities to its own foreign branches. The reverse is true for a U.S. office of a foreign bank--that is, Thursday-Friday activity increases managed liabilities, while Friday-Monday activity reduces them. U.S. offices of foreign banks and large member banks--the two parties in weekend reserve avoidance activity--have both reduced their managed liabilities below base-period levels, but large member banks have, on average, developed a smaller proportional leeway. These member banks must consider the possible increase in costs of engaging in Friday-Monday transactions because of the marginal reserve requirement program. But, the relative positions of the U.S. offices of foreign banks and large member banks, all other things being equal, should have encouraged Thursday-Friday reserve-avoidance activity. The expectation that Thursday-Friday activity would increase reflects the fact that an expansion of this activity would ease the relatively tight position of member banks without exposing foreign banks to liabilities for marginal reserves.

1. The 16-1/4 percent reserve requirement rate on net demand deposits, times the $7.4 billion reduction in reserve-avoidance activity, times 2/7 (the fraction of the statement week for which net demand deposits are reduced).

The failure of Thursday-Friday activity to expand enough to offset the decline in Friday-Monday activity is probably traceable largely to increased volatility of the federal funds rate since October 6. Participation in weekend reserve-avoidance activity always involves overnight Eurodollar contracts in clearinghouse funds. Because contracts in clearinghouse funds are not settled until the next business day, an overnight Eurodollar purchase (sale) is the equivalent of a one-day forward purchase (sale) of federal funds with a single-day maturity, implying that participants are exposed to the risk that the federal funds rate will change on Monday. Increased volatility of the federal funds rate has made it riskier for banks to take an open position in federal funds, discouraging a large increase in Thursday-Friday activity and thereby reducing overall weekend reserve-avoidance activity. There is a conventional forward federal funds market in which a bank could square its position on the same day. However, available evidence indicates that a widening of spreads in this market has discouraged its use since October 6.

Impact on Eurodollar Borrowings of Member Banks

Weekend reserve-avoidance activity distorts reported data on Eurodollar borrowing. Eurodollar borrowings adjusted for weekend reserve-avoidance transactions (table 2, column 3) show a different time profile from the unadjusted data (column 1). Slightly more than two-thirds of the apparent $4.6 billion reduction in member banks' Eurodollar borrowings between September 1979 and February 1980 (shown in column 1 of table 2) can be accounted for by the reduction in weekend reserve-avoidance activity (shown in column 2). The adjusted data show that funds raised by member banks through their own foreign branches to support domestic credit activity advanced sharply through early December before receding in the next three months. Apparently, since early December, member banks have found it advantageous to finance domestic credit growth from domestic sources and to reduce their reliance on Eurodollar borrowing.

TABLE 2
ADJUSTMENT OF MONTHLY MEMBER-BANK EURODOLLAR BORROWING
FOR WEEKEND RESERVE-AVOIDANCE ACTIVITY
(Billions of dollars)

Average for four statement weeks ending	Daily net balances due to own foreign branches of member banks (1)	The contribution of weekend reserve avoidance to (1)[1] (2)	Member banks' net Eurodollar borrowings adjusted for weekend reserve avoidance (3) = (1) - (2)
1979			
September 26	11.4	5.2[2]	6.2
November 7	9.5	1.5	8.0
December 5	12.0	2.0[2]	10.0
1980			
January 2	5.9	1.0	4.9
January 30	7.0	2.3	4.7
February 27	6.8	2.1[2]	4.7

1. For a typical statement week, daily net Eurodollar borrowings are increased by three-sevenths of borrowings done as Friday-Monday reserve avoidance activity and lowered by one-seventh of borrowings done as Thursday-Friday activity.
2. Period included a three-day weekend. Over a three-day weekend, Friday-Monday activity enlarges daily borrowings by four-sevenths of the amount borrowed.

Foreign exchange markets

In late February and early March the dollar came in increasingly strong demand on exchange markets, triggered by a sharp rise of U.S. interest rates.

. As shown in the chart, the recent shift in exchange market sentiment in favor of the dollar has raised the dollar's average exchange value 5 percent above its low point of early January.

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The main reason for the dollar's recent strength has been the sharp rise in U.S. short-term interest rates and market expectations of further increases in U.S. rates as the Federal Reserve attempts to control the growth of U.S. monetary aggregates in the face of continued high inflation. An additional reason for the increased exchange market demand for dollars has been the growing evidence of rising inflation and widening payments deficits abroad. A number of foreign countries have recently moved to tighten monetary conditions in an attempt to contain domestic inflationary pressures and support the external values of their currencies. (See Foreign Economic Developments, p. 13.)

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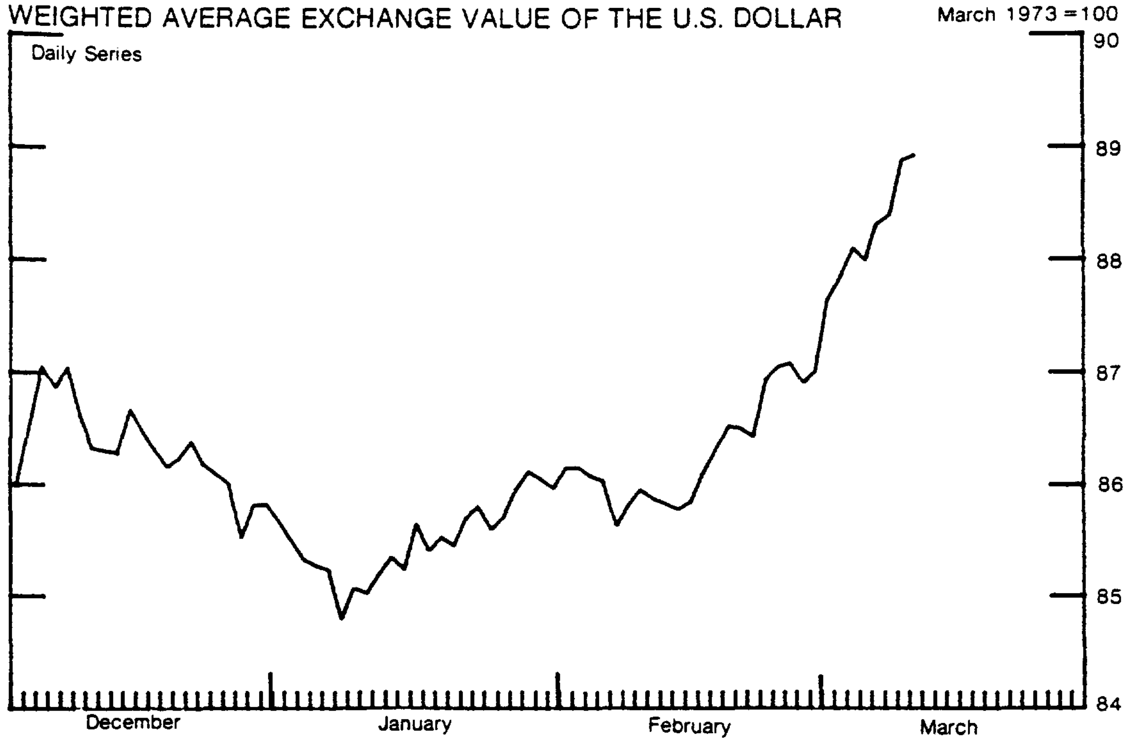

The currency that has been weakest against the dollar recently has been the Japanese yen. From early January to the end of February the yen depreciated by nearly 10 percent against the dollar. At the beginning of March Japanese authorities announced new measures designed to support the yen. The Bank of Japan said that it would increase its intervention support for the yen and that the Federal Reserve was prepared to provide intervention resources to Japan through the swap network and to intervene from time to time in New York on its own account as part of a multilateral effort to avoid an excessive decline of the yen. Since the announcement of the yen support measures, the Bank of Japan has succeeded in halting the decline of the yen

, the Desk has purchased $130 million equivalent of yen

which have been added to System balances

The Desk has

acquired nearly $2 billion equivalent of marks , and additional net mark purchases equivalent to $1 billion have been made over this period. Almost all of these $3 billion equivalent of marks have been used to repay System swap debt, which has been reduced to under $50 million equivalent.

Borrowing in international capital markets. Gross borrowing in international capital markets in 1979 appears to have been appreciably larger than in 1978, but because of higher repayments net borrowing may have risen by little over 5 percent. Activity in both the bank credit and bond markets became depressed late in the year, and was very low in early 1980. Spreads on Eurocredits have recently reversed their declining trend from 1976, and maturities of Eurocredits have shortened.

Gross borrowings announced last year reached $124 billion according to estimates by Morgan Guaranty Trust Co., an increase of 18 percent over 1978. Morgan Guaranty estimates that repayments (including advance refinancings) of Eurocredits and bonds, together with some doublecounting (see table), increased to $58-1/2 billion last year, reducing the amount of net credit extension to $65-1/2 billion, 7 percent above 1978. The gross borrowing figures show increases of 18 percent for both medium-term Eurocredits and international bond issues (Euro- and foreign). Gross borrowings by industrial countries (45 percent bank credits and 55 percent bond issues) rose a relatively small 10 percent in 1979, reflecting a big drop in Canadian borrowing from $10-1/2 billion to $6 billion. British borrowers also took less, but borrowers in most other major industrial countries had greater recourse to international capital markets. There was little increase in gross borrowings by OPEC countries; while Venezuela and Nigeria increased their borrowings, other OPEC countries reduced theirs as oil revenues soared. For the non-OPEC LDCs, total borrowings (93 percent in the form of credits) increased nearly 30 percent. Most of the principal borrowers in this

BORROWING IN INTERNATIONAL CAPITAL MARKETS
(Billions of dollars)

	1977 year	1978 year	1979 year	1979 Q-4	1980 Jan.-Feb.
I. Gross Borrowing	75.8	104.5	123.8	30.6	12.4
A. By type:					
Medium-term Eurocredits	41.8	70.2	82.8	22.1	6.5
Eurobonds	17.8	14.1	18.7	3.1	2.0
Foreign bonds	16.2	20.2	22.3	5.4	3.9
B. By country group					
Industrial	41.1	53.9	59.1	16.1	8.3
OPEC	8.2	12.0	13.0	2.8	1.1
Non-OPEC LDC	16.2	29.6	38.1	9.1	1.9
Communist	3.6	3.8	7.4	.8	.5
International org's.	6.6	5.2	6.2	1.7	.7
II. Repayments and Duplications	20.3	43.5	58.4	n.a.	n.a.
A. Eurocredits:					
Advance refinancings)	15.0	8.8	13.8	n.a.	n.a.
Scheduled repayments)		24.0	30.0	n.a.	n.a.
B. Bond repayments	5.3	8.0	10.0	n.a.	n.a.
C. Duplications (Eurobond issues by Eurobanks)	n.a.	2.7	4.6	n.a.	n.a.
III. Net Borrowing (I-II)	55.5	61.0	65.4	n.a.	n.a.

Source: Morgan Guaranty Trust Co.

group stepped up their borrowings, including Mexico and Brazil which remained the largest borrowers with gross takings of $8.7 billion and $7.2 billion, respectively. A doubling of borrowing by Communist countries in 1979 was the result of China entering the Eurocredit market for loans of $3.6 billion.

In the fourth quarter, the sharp increase in dollar interest rates after the Federal Reserve actions of October 6, and investors' increasing worry over accelerating inflation, discouraged new international bond issues. The rate of new issues slowed, and in the first two months of this year remained well below the average for the first three quarters of 1979. Because of current conditions, Eurobond issues this year have consisted almost exclusively of floating rate notes and convertible bonds. In the market for medium-term Eurocredits the much higher levels of Eurodollar rates beginning in October, the restrictions imposed by the Japanese authorities last autumn on the external lending of Japanese banks, and the uncertainties introduced by the freeze on Iranian official assets in U.S.-owned banks, began to slow the arrangement of new loans. This is not apparent from the total of credits announced in the fourth quarter but can be seen from the low levels of new loans announced in December and in January-February 1980. The monthly average of credits recorded by Morgan Guaranty was $3.7 billion for those three months, compared with an average of $7.4 billion in the first 11 months of last year.

After declining since 1976, spreads on medium-term Eurocredits appear to have widened slightly, particularly on LDC credits. Federal Reserve sample data show a rise in the unweighted average spread on all credits from .75 percent in the third quarter to .79 percent in the fourth, while for credits to non-OPEC LDCs alone the average spread rose from .80 to .91 percent. In the fourth quarter of 1976 these spreads had been 1.56 percent for the total sample and 1.90 percent for non-OPEC LDC credits. Another change in the terms on Eurocredits has been the shortening of maturities. For the total sample, the average unweighted maturity fell from 9.3 years in the third quarter to 8.5 years in the fourth; previously, the average maturity had lengthened from 5.7 years in the fourth quarter of 1976.

U.S. International Transactions

In January, the U.S. trade deficit grew to $54 billion at an annual rate (international accounts basis). A sharp increase in non-petroleum imports accounted for most of the deterioration. Imports of capital goods and consumer goods were particularly strong. However, automotive imports were little changed from November/December levels despite strong sales of fuel-efficient imported cars. The resulting fall in inventories as well as a sharp increase in reported exports from Japan suggest that U.S. auto imports may pick up in February and March. In January there were only small increases in imports of industrial supplies (nonoil); steel imports were little changed from November/December levels.

U.S. Merchandise Trade, International Accounts Basis
(billions of dollars, seasonally adjusted annual rates)

	1978	1979			1980	
	Year	Year	3Q	4Q	Dec.*r	Jan.*
EXPORTS	142.1	182.4	189.2	204.4	198.1	212.4
Agric.	29.9	35.4	38.3	41.9	43.4	40.9
Nonagric.	112.2	147.1	150.8	162.5	154.7	171.5
IMPORTS	175.8	211.5	218.4	236.0	241.2	266.5
Petroleum	42.3	60.0	66.5	75.5	82.6	80.9
Nonpetroleum	133.5	151.5	151.9	160.6	158.6	185.6
BALANCE	-33.7	-29.1	-29.3	-31.7	-43.0	-54.1

NOTE: Details may not add to totals because of rounding.
r/ Revised
*/ The monthly international accounts basis figures are rough estimates and are subject to considerable revision.

Oil imports declined in January, as a 7 percent fall in volume offset a 5 percent rise in price. Because of shipping lags, the unit value for petroleum imports in January ($26.18 per barrel) did not fully reflect OPEC price increases already announced. The volume (8.3 mmb/d) was somewhat below the average for the last half of 1979 (8.6 mmb/d). U.S. petroleum stocks continued to climb on a seasonally adjusted basis. Much of the increase was in gasoline stocks, which were low in November, but are now at above average levels.

Nonagricultural exports rose 7 percent in value in January, but most of the increase was concentrated in one commodity (numismatic coins); major commodity categories such as machinery and industrial supplies were little changed from December or fourth-quarter rates.

Agricultural exports declined somewhat (6 percent) from the very high December level, as longshoremen stopped loading grain intended for the Soviet Union. The outlook for agricultural exports in 1980 has been revised upward to $38 billion because of recent developments: cotton demand is exceptionally strong and a drought has cut Argentine feedgrain production.

Official reserves holdings in the United States of the G-10 countries plus Switzerland fell by $2 billion in January, partially reversing the $4 billion increase in December. In both months the net change in official assets mainly reflected German swaps with commercial banks, designed to influence German credit conditions, rather than exchange market intervention. In February and particularly in early March (through March 7), intervention resulted in a sharp net drop (about $6 billion) in the assets of the G-10 countries and Switzerland held at the FRBNY.

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

		1978 Year	1979 Year	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Nov.	1979 Dec.	1980 Jan.
1.	Trade balance 1/	-33,719	-29,126	-6,147	-7,747	-7,314	-7,918	-2,188	-3,586	-4,468
2.	Merchandise exports	142,055	182,423	41,300	42,744	47,288	51,091	16,927	16,511	17,742
3.	Merchandise imports	-175,774	-211,549	-47,447	-50,491	-54,602	-59,009	-19,115	-20,097	-22,210
4.	Change in net foreign positions of banking offices in U.S. (excl. liab.to foreign official inst.)	-14,975	14,849	14,557	5,053	538	-5,299	4,009	-13,074	8,980
	Through interbank transactions with									
5.	a) Own offices in foreign countries	4,943	20,982	15,140	6,954	8,132	-9,244	-1,838	-7,865	5,369
6.	b) Unaffiliated banking offices in foreign countries	-4,560	3,900	836	-1,209	-2,345	6,617	4,822	-2,501	4,077
	Through nonbank transactions									
7.	a) Claims on nonbanks in foreign countries (increase,-)	-16,434	-12,356	-1,018	-2,051	-5,257	-4,029	185	-2,834	675
8.	b) Liabilities to private nonbanks in foreign countries (inc. custody liab.)	1,076	2,323	-402	1,360	8	1,357	840	126	-1,141
9.	Private securities transactions,net (excl. U.S. Treas. Oblig.)	-712	-3,577	-576	-81	-2,080	-839	-484	-244	592
10.	Foreign net purchases of U.S. corp. bonds	1,127	307	1	279	6	22	-124	-23	196
11.	Foreign net purchases of U.S. corp. stocks	1,686	1,035	424	274	143	194	59	142	667
12.	U.S. net purchases (-) of foreign securities	-3,525	-4,919	-1,001	-634	-2,229	-1,055	-420	-363	-271
13.	Foreign net purchases of U.S. Treasury obligations 2/	3,866	7,381	5,119	-119	1,460	921	1,089	-198	2,228
14.	Change in foreign official reserve assets in U.S. (increase +)	31,400	-13,190	-8,082	-10,192	5,557	-473	-5,422	8,002	-3,693
	By Area									
15.	G-10 countries and Switzerland	29,951	-21,027	-7,096	-11,610	4,816	-7,138	-8,037	4,427	-2,142
16.	OPEC	-1,165	6,466	-1,472	346	1,624	5,969	1,908	2,319	-983
17.	All other countries	2,614	1,371	486	1,072	-883	696	707	1,256	-568
	By Type									
18.	U.S. Treasury securities	23,849	-21,051	-7,695	-12,623	5,036	-5,769	-7,186	3,842	1,530
19.	Other 3/	7,551	7,861	-387	2,431	521	5,296	1,764	4,160	-5,223
20.	Change in U.S. reserve assets (increase -)	662	-278	-3,008 4/	412	2,712	-394	-1,267	333	-2,034
21.	All other transactions and statistical discrepancy	13,478	23,941	-1,863	12,674	-873	14,002	4,263	8,767	-1,605
MEMO:										
	Current Account (bil. $. seasonally adj., annual rates)	-13.5	n.a.	1.7	-4.2	3.0	n.a.	n.a.	n.a.	n.a.

1/ International accounts basis, seasonally adjusted.
2/ Includes U.S. Treasury notes publicly issued to private foreign residents.
3/ Includes deposits in banks, commercial paper, bankers' acceptances, and borrowing under repurchases agreements.
4/ Includes $1,103 million of newly allocated SDR's.
*/ Less than $500,00.

OPEC holdings of official reserve assets in the United States declined by about $1 billion in January, after climbing almost $6 billion in the fourth quarter of 1979. Partial data for February indicate that OPEC holdings at the FRBNY increased about $1 billion. Part of the fourth-quarter increase was due to a shift of funds from a special account at Treasury to a special non-negotiable Treasury security held at the FRBNY. During these five months the net increase in OPEC official reserve assets in the United States has been small compared to the size of the OPEC trade surpluses.

Banks reported substantial net inflows in January, partially reversing the large net outflows reported in December. For the two months combined, the net outflow was about $4 billion. Part of this sharp reversal in bank flows was the counterpart to the opposite swings in official asset holdings; central bank swaps with commercial banks, designed to supply year end liquidity, were reversed in January. Partial data for February indicate that only moderate net inflows through interbank transactions have occurred in recent weeks.

A sharp decline in banks' claims on foreign nonbanks took place in January, in contrast to increases through most of 1979. Since the last large decrease in loans to foreign nonbanks was in January 1979, seasonal factors may be operating.

The Euro-dollar holdings of U.S. nonbanks through December remained at about the peak level reached in the summer of 1979. On the other hand, the CD holdings of open-ended money market mutual funds and short-term unit trusts have continued to grow. These holdings amounted to $9.6 billion in mid-February, as compared with $7.8 billion at the end of last year and $1.1 billion at the end of December 1978.

For 1979 as a whole, and for the fourth quarter in particular, the balancing item "all other transactions and statistical discrepancy" was extremely large and positive. Certain kinds of transactions are excluded from the table because of long lags before the data are available. These include net service income and capital flows between corporations and affiliated as well as unaffiliated foreigners. Preliminary data indicate a marked reduction in the flow of funds from U.S. corporations to their foreign affliates in the fourth quarter. Even taking into account the preliminary estimates of these transactions, the unreported net inflow in 1979 was very large.

Foreign Economic Developments. Inflation accelerated in foreign industrial countries between the end of last year and the early months of 1980. Although the pass-through of oil-price increases contributed substantially to the acceleration, a wide range of goods and services registered price increases. The most striking increases in consumer prices occurred in Italy, the United Kingdom, France and Sweden. In Japan the sharpest increases occurred in wholesale prices; the pass-through to consumer prices has continued to be relatively moderate, although the rise in consumer prices in January-February did speed up. Only in Canada, among the major industrial countries, have consumer price increases slowed somewhat recently.

Economic activity continues to show strength in some countries, particularly Japan and Italy; industrial production rose significantly in the most recent data for Japan, and in Italy there was a slight decline from very high levels. Domestic demand was a source of strength in these countries, although in Japan exports recently appear to have been the most vigorous sector. In Germany, industrial production has been flat from October to January, but at a relatively high level. In France, industrial production in November-December regained some of the ground lost in September-October. On the other hand, Canada and the United Kingdom both showed weak fourth quarter gains in GNP, with weak domestic demand accounting for the slowdown in Canada.

The virulence of inflation, and fears about exchange-rate weakness, prompted a series of discount-rate increases in February in a number of countries. Discount rates were raised in Germany, Japan, Belgium, Denmark and Switzerland. France also took steps to tighten

CONSUMER AND WHOLESALE PRICES IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change, from previous period or as indicated)

	1977	1978	1979	1978 Q3	1978 Q4	1979 Q1	1979 Q2	1979 Q3	1979 Q4	Latest 3 Months from: Previous 3 Months (at Ann. Rate)	Latest 3 Months from: Year Ago	Latest Month
Canada: CPI	8.0	8.9	9.1	2.5	1.6	2.3	2.6	2.0	2.3	9.7	9.6	Jan.
WPI	7.9	9.2	14.4	2.1	3.3	4.9	3.1	2.7	3.6	15.1	15.1	Dec.
France: CPI	9.5	9.2	10.6	2.7	2.1	2.2	2.8	3.2	2.8	12.2	12.1	Jan.
WPI	5.6	4.3	13.3	1.9	2.9	4.4	3.8	2.8	1.8	6.1	12.8	Jan.
Germany: CPI	3.9	2.6	4.0	-0.1	0.1	1.8	1.4	1.2	0.9	6.1	5.3	Feb.
WPI	1.8	-0.3	7.1	-0.6	0.1	3.4	3.3	1.7	1.1	8.5	10.3	Jan.
Italy: CPI	18.4	12.1	14.8	2.4	3.0	3.9	3.7	3.5	5.5	26.6	20.0	Feb.
WPI	17.4	8.4	15.5	1.8	2.2	4.4	4.6	4.3	5.6	24.6	21.3	Jan.
Japan: CPI	8.3	4.3	3.5	0.8	0.2	-0.2	2.2	0.9	1.9	6.8	6.5	Feb.
WPI	1.9	-2.5	7.3	-1.7	-0.6	1.9	4.1	4.9	3.3	24.6	19.4	Feb.
United Kingdom: CPI	15.8	8.3	13.4	1.7	1.7	3.1	3.7	6.7	2.8	13.6	17.7	Jan.
WPI	19.8	9.1	12.2	1.9	1.7	2.7	4.0	5.0	3.0	18.1	17.3	Feb.
United States: CPI	6.5	7.6	11.3	2.4	2.0	2.5	3.4	3.3	2.9	12.9	13.3	Jan.
WPI	6.1	7.7	11.0	1.7	2.3	3.3	2.5	2.6	3.6	15.4	12.9	Feb.

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

		1977	1978	1979	1978 Q4	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Aug.	1979 Sept.	1979 Oct.	1979 Nov.	1979 Dec.	1980 Jan.
Canada:	GNP	2.4	3.4	2.9	0.7	1.5	-0.6	1.1	0.2	*	*	*	*	*	*
	IP	4.0	5.3	4.9	2.6	1.4	-1.2	2.3	-0.3	-0.2	2.4	-1.1	-0.4	-1.3	n.a.
France:	GDP	3.0	3.5	3.6	1.8	0.2	0.4	1.9	0.7	*	*	*	*	*	*
	IP	2.0	1.9	3.9	1.8	0.0	0.5	4.6	-2.4	0.0	-1.4	-2.9	1.5	1.5	n.a.
Germany:	GNP	2.6	3.5	4.3	0.8	0.4	2.0	1.1	0.7	*	*	*	*	*	*
	IP	2.6	2.3	5.3	0.8	-0.3	3.4	1.9	0.0	-3.9	0.8	0.8	0.0	0.0	0.0
Italy:	GDP	2.0	2.6	n.a.	2.9	1.1	-0.7	1.0	n.a.	*	*	*	*	*	*
	IP	1.1	1.9	6.3	6.1	1.1	-2.6	1.4	7.8	-0.1	6.0	3.8	0.6	-1.3	0.8
Japan:	GNP	5.4	6.0	5.9	1.6	1.5	1.7	1.7	1.3	*	*	*	*	*	*
	IP	4.2	6.2	8.3	2.2	1.8	2.4	2.0	2.6	0.9	-1.5	2.6	1.2	-0.2	1.3
United Kingdom:	GDP	1.8	2.7	n.a.	-0.1	-1.0	3.7	-1.9	n.a.	*	*	*	*	*	*
	IP	3.7	3.8	2.6	-0.9	-0.8	5.2	-1.8	-0.5	-3.8	-0.6	0.8	1.6	-1.8	n.a.
United States:	GNP	5.3	4.4	2.3	1.4	0.3	-0.6	0.8	0.5	*	*	*	*	*	*
	IP	5.9	5.8	4.1	1.9	1.0	-0.2	0.2	0.0	-0.8	0.5	-0.1	-0.1	0.1	0.3

* GNP data are not published on monthly basis.

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

	1978	1979	1978 Q3	1978 Q4	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Nov.	1979 Dec.	1980 Jan.
Canada: Trade	3.1	3.4	0.6	0.7	0.6	0.6	0.9	1.3	0.5	0.6	0.2
Current Account	-4.6	-4.3	-1.2	-1.5	-1.2	-1.3	-1.0	-0.9	*	*	*
France: Trade[b]	0.6	-2.3	0.2	0.1	0.3	-0.4	-1.4	-1.2	-0.3	-0.2	-1.1
Current Account[b]	3.8	2.4	0.9	1.3	0.6	0.7	0.1	0.5	*	*	*
Germany: Trade	20.6	12.1	5.4	5.6	4.3	3.8	2.4	1.5	0.9	0.2	n.a.
Current Account[c]	8.9	-5.0	0.2	4.8	1.4	-1.1	-4.2	-1.1	-0.4	-0.3	-1.2
Italy: Trade	-0.2	-5.2	-0.8	0.5	-0.4	-0.7	-1.2	-2.8	-2.1	-0.7	n.a.
Current Account[c]	6.4	n.a.	2.5	1.7	1.1	2.1	3.9	n.a.	*	*	*
Japan: Trade	24.6	1.9	6.8	4.2	2.6	1.8	-0.9	-1.5	-0.7	-0.3	-0.1
Current Account	16.5	-8.6	4.5	1.7	0.3	-0.7	-3.8	-4.2	-1.7	-1.3	-1.1
United Kingdom: Trade[d]	-2.3	-7.3	-0.8	-0.2	-3.2	-1.4	-1.0	-1.6	-0.2	-0.6	-0.8
Current Account[d]	1.8	-5.1	0.5	1.1	-2.5	-0.8	-0.5	-1.5	-0.1	-0.4	-0.7
United States: Trade	-33.8	-29.1.	-7.9	-6.0	-6.1	-7.7	-7.3	-7.9	-2.0	-3.5	n.a.
Current Account	-13.5	n.a.	-3.2	0.1	0.4	-1.1	0.8	n.a.	*	*	*

a The current account includes goods, services, and private and official transfers.
b French annual data are not seasonally adjusted.
c Not seasonally adjusted.
d U.K. quarterly data do not reflect revisions in annual totals.
* Comparable monthly current account data are not published.

monetary conditions, and Japan raised reserve requirements in addition to raising the discount rate. The Bank of Canada has announced it will allow the discount rate to float, a move expected to lead to an increase in that rate.

The shift into current-account deficit for Japan and Germany in 1979 persisted into 1980; their combined current-account deficit in January was $2.4 billion. Recent data also indicate significant worsening of the trade account for France, Italy and the United Kingdom.

Individual Country Notes. Activity in Japan has continued to move ahead at a strong pace. Fourth quarter GNP grew 1.3 percent, a slight slowing from the third quarter pace, putting growth for the full year 1979 at 6 percent. Industrial production increased sharply in January to almost 10 percent above the year-earlier level. Furthermore, the most recent Bank of Japan and Economic Planning Agency surveys of corporations' production and spending plans tend to support the view that the current strength would continue relatively undiminished in the next several quarters; however, these surveys were taken before the latest monetary policy actions.

Inflation has accelerated since the beginning of the year. The combined increase in wholesale prices in January and February was 4-3/4 percent; the monthly increases were the largest in six years. Consumer price increases -- though strong, as well -- have remained moderate by comparison; the CPI advanced by 1-1/2 percentage points in the first two months of 1980 combined.

The authorities have reacted to the continued strong inflationary pressure and further weakness in the yen with the introduction of several measures designed to counteract these trends. On February 18, the discount rate was raised by a full percentage point to 7.25 percent, the fourth increase in the last year. The authorities also announced a general increase in required reserve ratios on most commercial bank deposits.

On March 2, following a decline in the yen's value below the 250¥/$ level, the Japanese government announced a package of yen-support measures, in cooperation with U.S., Swiss, and German authorities. The new Japanese measures, which are designed to encourage capital inflows, include: permission to Japanese banks to transfer funds to Japan from overseas branches, relaxation of controls on Japanese banks' medium and long-term foreign currency lending to residents, permission for private placement of yen-denominated bonds abroad, and liberalization of interest rates on official holdings of free yen.

In Germany, industrial production has remained unchanged at the relatively high levels reached late last year. Consumer spending slowed towards the end of last year, but investment has remained strong. The decline in the seasonally-adjusted unemployment rate was slightly reversed in December and January, but in February the rate once again reached its long-time low of 3.5 percent.

Inflation has accelerated since November; in January producer prices rose 1.5 percent; consumer prices rose 0.6 percent in January and 1 percent in February.

In response to the acceleration of inflation, and to maintain the strength of the DM, the Bundesbank on February 28 raised the discount rate (from 6 to 7 percent) and the lombard rate (from 7 to 8-1/2 percent). But, at the same time, rediscount quotas were increased and the ceiling on lombard credits was removed.

In the United Kingdom preliminary GDP data for the fourth quarter of 1979 showed a slight increase (0.4 percent) over the third quarter, as the increase in consumer demand was nearly offset by falls in fixed and inventory investment and in other demand components. The weakness of activity has continued into early this year, caused in part by the continuing strike against the nationalized sector of the steel industry, and most recent surveys point to a decline in activity in the current quarter. The unemployment rate rose from 5.3 percent in December to 5.7 percent in February.

The inflation rate accelerated in January, with both wholesale and retail prices rising 2.5 percent. Increased energy costs account for some of the price rise, but many other items, such as the cost of home ownership and government services, also increased.

After some improvement in November and December, the current account deficit widened to almost $700 million in January. A major factor in the deterioration was a sharp rise in silver imports.

In France industrial production in the fourth quarter of 1979 fell by 2-1/2 percent (seasonally adjusted) after a 4-1/2 percent rise in the third quarter. There was, however, an upward trend over the course of the fourth quarter, and Bank of France survey data indicate some growth in January.

Consumer prices rose 1.9 percent in January; this increase reflected the freeing of retail and wholesale margins and increases in the prices of public services and oil-products.

The Bank of France has tightened further credit controls by increasing the fraction, from 40 to 50 percent, of loans for exports, housing and other privileged activities that are subject to the credit ceilings effective April 1, 1980. It has also raised the intervention rates for one-month Treasury bills.

Economic activity in Italy showed great strength in the last quarter of 1979, with industrial production nearly 8 percent higher (not annual rate) than the third quarter level; capacity utilization in the fourth quarter reached its highest levels in over 5 years. Although the level of industrial production in December-January was down slightly, activity was still at a high level, and business surveys point to continued strength in the short-term.

The inflation rate accelerated early this year, after it had slowed at the end of last year. Both consumer and wholesale prices rose 3.3 percent in January; in February, consumer prices rose 1.7 percent. Although a large part of the January consumer-price increase reflected higher oil-product prices and public utility changes, as well as rent adjustments, the February increases were concentrated in other goods and services. A round of plant-level wage negotiations is beginning, and workers in major industries have made substantial wage claims.

The November deterioration of the trade account persisted into December, and the deficit for the two months averaged almost $1-1/2 billion (SA, customs basis; imports c.i.f.). Import values rose in part because of oil-price increases, but import volumes increased sharply, reflecting a surge in stockbuilding.

Real GNP in Canada grew moderately, at about 1/4 percent (seasonally adjusted), in the fourth quarter of 1979, after rising over 1 percent (seasonally adjusted) in the third quarter. This places year-over-year growth for 1979 at 2.9 percent compared with 3.4 percent in 1978. The fourth-quarter slowdown was largely the result of a decline in real personal expenditure and government spending, and a slowdown in fixed investment. The fourth quarter marked the fifth consecutive quarter of substantial business inventory accumulation. The stockbuilding during the fourth quarter reflected in part the weakness of consumer spending on durables in Canada and the United States.

Consumer price increases slowed in December and January as Canada has not had the inflationary pressure of oil-price increases experienced elsewhere because of controls on well-head prices; however, these well-head prices are due to be raised somewhat during 1980.

On March 11 the Bank of Canada announced that it will allow the discount rate to float 0.25 percent above the average weekly tender rate for the 91-day Treasury bill. Although the Bank has stated that this does not represent a change in monetary policy, but rather in operating procedures, the timing of the action reflects the recent weakening of the Canadian dollar and the expected increase in Canadian interest rates. Until last week, the Canadian dollar had not declined, despite a sharp movement in the interest rate differential in favor of U.S. dollar assets.

In the Netherlands real activity continues to be strong while the inflation rate has accelerated. The government on January 10, 1980 imposed a two-month wage freeze because of the failure of tripartite talks among unions, business and government to reach agreement on real wage increases in 1980. The government has revised the 1980 budget in order to cut expenditures, but failure to accept more substantial cuts provoked the resignation of the Finance Minister. In Belgium, in response to the acceleration of inflation and the need to maintain the value of the Belgian franc within the EMS, a discount rate increase, from 10.5 to 12 percent, was announced on February 27. In Denmark the discount rate was increased from 11 to 13 percent on February 18 because of higher foreign interest rates and the need to preserve the Danish krone's position within the EMS. The Swiss National Bank also raised its discount rate, from 2 to 3 percent, on February 28, because of accelerating inflation (to a 5 percent annual rate) and higher foreign interest rates.