Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

---

[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Confidential (FR) Class III FOMC

February 6, 1985

RECENT DEVELOPMENTS

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

TABLE OF CONTENTS

DOMESTIC FINANCIAL DEVELOPMENTS—continued

Tables

Chart

Tables

Charts

SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest data			Percent change from		
	Period	Release date	Data	Preceding period	Three periods earlier	Year earlier
				(At annual rates)		
Civilian labor force	Jan.	02-01-85	114.9	4.3	3.0	2.3
Unemployment rate (%)[1]	Jan.	02-01-85	7.4	7.2	7.3	8.0
Insured unemployment rate (%)[1]	Oct.	01-24-85	2.8	2.7	2.7	3.3
Nonfarm employment, payroll (mil.)	Jan.	02-01-85	96.0	4.4	3.6	3.9
Manufacturing	Jan.	02-01-85	19.8	1.4	3.0	3.0
Nonmanufacturing	Jan.	02-01-85	76.2	5.1	3.7	4.2
Private nonfarm:						
Average weekly hours (hr.)[1]	Jan.	02-01-85	35.2	35.3	35.1	35.4
Hourly earnings ($)[1]	Jan.	02-01-85	8.44	8.47	8.38	8.21
Manufacturing:						
Average weekly hours (hr.)[1]	Jan.	02-02-85	40.6	40.7	40.4	40.9
Unit labor cost (1967=100)	Dec.	01-31-85	83.0	.0	-2.4	-8.2
Industrial production (1967=100)	Dec.	01-15-85	166.2	7.3	2.9	6.4
Consumer goods	Dec.	01-15-85	163.7	6.6	5.2	3.8
Business equipment	Dec.	01-15-85	188.5	9.0	4.5	12.7
Defense & space equipment	Dec.	01-15-85	143.1	11.0	10.3	13.8
Materials	Dec.	01-15-85	162.3	5.9	-1.2	5.0
Consumer prices all items (1967=100)	Dec.	01-23-85	315.9	2.3	3.1	3.9
All items, excluding food & energy	Dec.	01-23-85	307.0	3.1	3.4	4.7
Food	Dec.	01-23-85	306.6	3.9	3.7	3.8
roducer prices: (1967=100)						
Finished goods	Dec.	01-11-85	292.6	.8	1.6	1.8
Intermediate materials, nonfood	Dec.	01-11-85	326.8	-1.8	1.5	1.6
Crude foodstuffs & feedstuffs	Dec.	01-11-85	261.1	-2.3	14.1	-.9
Personal income ($ bil.)[2]	Dec.	01-18-85	3,118.0	6.4	6.5	9.0
				(Not at annual rates)		
Mfgrs. new orders dur. goods ($ bil.)	Dec.	01-31-85	101.0	-2.9	2.4	2.6
Capital goods industries	Dec.	01-31-85	34.2	-8.7	-.7	5.2
Nondefense	Dec.	01-31-85	25.5	-6.0	-8.4	2.4
Defense	Dec.	01-31-85	8.7	-16.0	32.0	14.4
Inventories to sales ratio:[1]						
Manufacturing and trade, total	Nov.	01-31-85	1.36	1.37	1.35	1.32
Manufacturing	Dec.	01-31-85	1.48	1.49	1.50	1.40
Trade	Nov.	01-14-85	1.25	1.26	1.25	1.22
Ratio: Mfgrs.' durable goods inventories to unfilled orders[1]	Dec.	01-31-85	.553	.549	.542	.537
Retail sales, total ($ bil.)	Dec.	01-15-85	110.8	-.1	2.4	8.2
GAF[3]	Dec.	01-15-85	24.2	1.7	3.2	11.9
Auto sales, total (mil. units.)[2]	Jan.	02-05-85	11.3	4.1	13.7	3.0
Domestic models	Jan.	02-05-85	8.5	5.5	19.1	1.5
Foreign models	Jan.	02-05-85	2.8	-.1	-.1	8.0
Housing starts, private (thous.)[2]	Dec.	01-17-85	1,587	2.1	-5.7	-6.3
Leading indicators (1967=100)	Dec.	01-31-85	164.9	-.2	-.2	.9

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

Activity strengthened at the end of last year, and the economy entered 1985 with renewed momentum. Production gains were widespread in December, after inventory imbalances apparently were substantially reduced earlier in the quarter, and preliminary estimates suggest factory output continued to grow relatively strongly in January. Consumer spending increased in the fourth quarter, bolstered by good gains in income and pre-Christmas price discounting. Business investment spending was strong, although less robust than in earlier year. Employment registered sizable increases during the fourth quarter and again in January, while both wage and price inflation remained moderate.

Industrial Production and Capacity Utilization

Industrial production increased 0.6 percent in December, and thus made up all of its September-October decline. The December rise was broadly based, in contrast to the 0.4 percent November increase, which was concentrated in the automotive category. The output of consumer goods rose 0.6 percent, while production of business equipment was up 0.7 percent. Automobile assemblies increased to an 8.1 million unit annual rate in December and rose to an 8-3/4 million unit rate in January. Capacity utilization for total industry increased to 81.9 percent in December, but remained below its level of last summer.

Preliminary data indicate that industrial production increased around 1/2 percent in January, with particularly large gains in the motor vehicle, steel, and electric utility industries.

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

	1984	1984 Q2	1984 Q3	1984 Q4	1984 Nov.	1984 Dec.	1985 Jan.
					-Average	monthly	changes-
Nonfarm payroll employment[2]	303	359	224	285	337	167	348
Strike adjusted	305	366	216	298	342	194	306
Manufacturing	56	54	-4	65	32	92	23
Durable	48	46	15	49	24	67	18
Nondurable	8	8	-19	16	8	25	5
Construction	31	64	10	26	14	56	70
Trade	88	85	61	117	187	13	162
Finance and services	96	122	63	96	86	78	79
Total government	15	7	72	-21	20	-78	15
Private nonfarm production workers	232	307	115	245	293	154	229
Manufacturing production workers	36	35	-15	43	8	72	9
Total employment[3]	270	423	1	293	283	341	118
Nonagricultural	266	402	17	271	118	290	183

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

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

	1984	1984 Q2	1984 Q3	1984 Q4	1984 Nov.	1984 Dec.	1985 Jan.
Civilian, 16 years and older	7.5	7.5	7.4	7.2	7.1	7.2	7.4
Teenagers	18.9	18.8	18.6	18.4	17.8	18.8	18.9
20-24 years old	11.4	11.5	11.4	10.9	11.0	10.9	10.9
Men, 25 years and older	5.7	5.7	5.5	5.4	5.4	5.4	5.5
Women, 25 years and older	6.0	5.9	6.0	5.8	5.7	5.6	6.1
White	6.5	6.5	6.4	6.2	6.1	6.2	6.4
Black	15.9	16.0	15.8	15.1	15.1	15.0	14.9
Fulltime workers	7.2	7.1	7.1	7.0	6.9	6.9	7.1
Memo:							
Total national[1]	7.4	7.4	7.3	7.1	7.0	7.1	7.3

1. Includes resident Armed Forces as employed.

Employment and Unemployment

Labor demand strengthened in the fourth quarter and continued to increase in January, as nonfarm payroll employment rose a substantial 350,000. The largest gain last month took place at retail trade establishments, but employment growth also was strong in services and construction, where unseasonably mild weather boosted hiring in both December and early January. Employment growth was considerably more moderate in manufacturing industries, which added 23,000 workers to payrolls in January, after a large increase in December. Gains were concentrated in the automobile and electrical equipment industries. The manufacturing workweek edged down to 40.6 hours in January, but remained above its fourth-quarter average.

Despite the continued rise in labor demand, the civilian unemployment rate edged up to 7.4 percent in January. Much of the increase occurred among adult women, whose jobless rate rose to 6.1 percent from 5.8 percent in the fourth quarter; the unemployment rate for adult men was essentially unchanged.

Personal Income and Consumption

Reflecting the continued gains in employment, income growth remained strong in the fourth quarter. Personal income rose $16.4 billion in December, about the same as the October-November average monthly increase. Wage and salary disbursements jumped $18 billion, while there was only a small increase in interest income, and a $5 billion decline in transfer payments associated with a change in the payment date of military retirement benefits.

Real personal consumption expenditures rose 4 percent in the fourth quarter, after little change in the third quarter. Real spending picked up during the Christmas season, reflecting in part widespread price discounting.

PERSONAL INCOME AND EXPENDITURES
(Based on seasonally adjusted data)

		1984				
	1984	Q2	Q3	Q4	Nov.	Dec.
	- Percentage changes at annual rates[1] -					
Total Personal Income						
Nominal	9.3	9.1	8.7	7.2	7.7	6.4
Real[2]	5.9	6.8	4.1	4.6	7.1	7.3[e]
Disposable Personal Income						
Nominal	9.1	8.6	8.4	6.8	6.6	4.7
Real	5.7	6.3	3.9	4.2	6.0	6.3[e]
Expenditures						
Nominal	7.6	10.2	5.0	6.5	11.5	14.0
Real	4.2	7.9	.7	3.9	10.8	15.7[e]
	- Changes in billions of dollars[3] -					
Total personal income	21.5	22.0	20.6	16.6	19.7	16.4
Wages and salaries	11.3	13.2	8.3	11.3	13.8	18.3
Private	9.5	11.8	6.5	9.9	12.2	16.6
Manufacturing	2.5	1.9	1.2	3.2	3.2	5.1
Other income	11.2	9.5	12.9	6.0	6.7	-.5
Disposable personal income	17.7	16.8	18.2	12.1	14.4	10.4
Expenditures	14.9	24.9	11.9	13.7	22.7	28.0
Durables	2.1	6.8	-2.9	5.1	4.7	10.6
Nondurables	5.3	8.0	4.0	4.3	6.5	15.4
Services	7.5	10.0	10.9	4.4	11.4	2.2
Personal saving rate (percent)	6.1	5.7	6.3	6.3	6.4	5.7

e--Staff estimate.
1. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Changes for quarterly periods are compounded rates of change; monthly changes are not compounded.
2. Total personal income is deflated by the personal consumption expenditure deflator.
3. Average monthly changes are from the final month of the preceding period to the final month of period indicated; monthly figures are changes from the preceding month.

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

	1984 Q3	1984 Q4	1984 Oct.	1984 Nov.	1984 Dec.
Total sales	-.9	2.5	.5	2.0	-.1
(Real)[1]	-1.3	2.0	.1	2.0	-.2
Total, less automotive, gasoline and nonconsumer stores	.5	1.8	-1.0	1.6	-.6
GAF[2]	-.6	3.6	-1.9	3.3	1.7
Durable	-2.4	4.8	3.7	2.3	-.9
Automotive group[3]	-4.4	5.5	5.9	2.1	-2.3
Furniture & appliances	1.4	5.3	.0	1.0	2.8
Nondurable	.0	1.3	-1.2	1.8	.4
Apparel	-3.2	3.5	-2.6	5.5	1.0
Food	1.0	.7	-1.3	1.4	-.9
General merchandis[4]	-.3	3.1	-2.3	3.4	1.6
Gasoline stations	-3.4	2.0	.7	1.5	-1.4

1. BCD series 59. Data are available approximately three weeks following the retail sales release.
2. General merchandise, apparel, furniture and appliance stores.
3. Sales of the automotive group frequently differ from sales of new cars on a unit basis because of broader coverage (e.g. parts, used cars, and servicing), seasonal factors, and sampling.
4. General merchandise excludes mail-order nonstores.

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

	1984 Q3	1984 Q4	1984 Oct.	1984 Nov.	1984 Dec.	1985 Jan.
Total sales[1]	10.3	10.3	10.0	10.0	10.9	11.3
Imports	2.4	2.8	2.8	2.8	2.8	2.8
Domestic	7.9	7.5	7.2	7.2	8.1	8.5
Small	3.7	3.5	3.2	3.5	3.7	4.1
Intermediate & standard	4.2	4.0	3.9	3.7	4.2	4.4
Domestic production	7.5	7.7	7.0	7.9	8.1	8.8[e]
Small	3.6	3.6	3.3	3.7	3.9	n.a.
Intermediate & standard	3.9	4.1	3.7	4.2	4.2	n.a.
Domestic inventories	1.32	1.44	1.33	1.43	1.44	n.a.
Days' supply[2]	51	59	57	61	55	n.a.

1. Components may not add to totals due to rounding.
2. Quarterly days' supply are based on end of quarter stocks and average sales for the quarter.
e--estimated
n.a.--not available

Outlays for discretionary items such as general merchandise, apparel, and furniture and appliances (GAF) increased strongly, while spending for services was relatively weak, apparently because unseasonably warm weather in December lowered electricity and natural gas consumption.

The strong demand for new cars continues to be an important factor supporting consumer spending. Sales of domestic autos rose sharply in the December-January period--averaging at an 8.5 million unit annual rate--1 million units above the strike-depressed levels of the preceding two months. Sales of imported cars have remained strong at a 2.8 million unit pace.

Survey readings of consumer confidence fell in December but remained high by historical standards. The decline in the Michigan Survey reflected a more pessimistic outlook for the economy over the next five years. The drop in the Conference Board index, however, was reversed in the more recent survey taken in January. Compared with earlier in the recovery, fewer households in both surveys expressed plans to purchase homes, automobiles, and major appliances, but on balance, the responses were still quite favorable.

Business Fixed Investment

Business fixed investment continued to grow briskly in the fourth quarter, although at a slower pace than in the first three quarters of 1984. For equipment, shipments of nondefense capital goods rose 0.7 percent in December and 2.1 percent in the fourth quarter as a whole. However, the growth was spread unevenly across different types of equipment. Shipments of computing and other high-technology electronic equipment increased 5.7 percent, while shipments of heavy industrial machinery were flat. Spending on nonresidential construction increased substantially in the fourth quarter

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

	1984				
	Q3	Q4	Oct.	Nov.	Dec.
<u>Producers' durable equipment</u>					
Nondefense capital goods					
Shipments	2.7	2.1	-4.3	2.8	0.7
Orders	-1.1	-4.9	-8.8	6.9	-6.0
Excl. office and computing equipment	.5	-4.3	-9.0	4.4	4.5
Unfilled orders	1.7	-2.4	-.8	-.1	-1.4
Imports of capital goods excluding autos	23.1	-14.3	-15.2	1.0	n.a.
Sales of heavy-weight trucks (thousands of units, A.R.)	252	316	256	345	348
<u>Nonresidential structures</u>					
Nonresidential construction	1.3	5.3	1.8	1.3	3.7
Commercial building	2.3	12.0	5.3	2.0	6.6
Value of nonresidential building					
Permits	-1.0	n.a.	19.3	19.1	n.a.
Contracts	2.9	10.0	19.3	6.7	-2.9

with a particularly rapid rise in commercial and industrial buildings; some weakness, however, was evident in the public utility and institutional sectors.

Near-term commitments for future spending have been mixed. After little growth in the third quarter, the value of contracts and permits for nonresidential building increased strongly in the fourth quarter. In contrast, new orders for nondefense capital goods fell in December and are now below the average level during the second and third quarters of 1984. The drop in December, however, reflected an unusually sharp decline in new orders for office and computing machinery, which probably is temporary.

Business Inventories

Investment in business inventories slowed markedly in late fall, largely in response to the earlier weakness in orders and sales. In November, stocks at all manufacturing and trade establishments were about unchanged in real terms, compared with a $20 to $25 billion increase in preceding months. Shipments and sales picked up in November, after remaining virtually flat from August to October, and helped to lower the inventory-sales ratio for all manufacturing and trade to 1.54 from the October high of 1.56.

In the manufacturing sector, inventory levels have not increased on balance since September, helped by cutbacks in production. In November, factory stocks declined in real terms for the first time in ten months, and preliminary book-value data indicate that another decline probably occurred in December.

At the retail level, strong sales in November helped to correct imbalances that had cropped up in late summer and early fall. Nonauto retail inventories were reduced at an annual rate of $4 billion in real terms,

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

	1984 Q2	1984 Q3	1984 Q4	1984 Oct.	1984 Nov.r	1984 Dec.p
Book value basis						
Total	56.3	54.4	--	40.6	8.4	--
Manufacturing	40.4	30.8	2.5	14.9	-7.1	-.3
Wholesale trade	10.1	16.8	--	6.2	10.3	--
Retail trade	5.8	6.7	--	19.5	5.2	--
Automotive	-4.3	1.8	--	7.3	10.3	--
Ex. auto	10.1	4.9	--	12.1	-5.1	--
Constant dollar basis						
Total	19.7	24.3	--	18.1	.8	--
Manufacturing	13.8	13.0	--	4.2	-4.0	--
Wholesale trade	4.1	8.8	--	2.2	4.2	--
Retail trade	1.7	2.5	--	11.8	.6	--
Automotive	-3.0	.4	--	6.0	4.8	--
Ex. auto	4.7	2.1	--	5.8	-4.2	--

r--revised estimates.
p--preliminary estimates.

INVENTORIES RELATIVE TO SALES[1]

	Cyclical Reference Points[2] 1981 Low	Cyclical Reference Points[2] 1982 High	1984 Q2	1984 Q3	1984 Q4	1984 Oct.	1984 Nov.r	1984 Dec.p
Book value basis								
Total	1.39	1.53	1.33	1.36	--	1.37	1.36	--
Manufacturing	1.60	1.77	1.47	1.49	1.49	1.50	1.49	1.48
Wholesale trade	1.06	1.28	1.09	1.14	--	1.16	1.16	--
Retail trade	1.36	1.44	1.34	1.37	--	1.37	1.34	--
Automotive	1.59	1.88	1.37	1.46	--	1.42	1.43	--
Ex. auto	1.29	1.36	1.33	1.35	--	1.35	1.32	--
Constant dollar basis								
Total	1.62	1.75	1.51	1.55	--	1.56	1.54	--
Manufacturing	1.91	2.11	1.76	1.79	--	1.79	1.77	--
Wholesale trade	1.34	1.52	1.30	1.36	--	1.36	1.37	--
Retail trade	1.34	1.44	1.31	1.34	--	1.36	1.34	--
Automotive	1.49	1.81	1.27	1.32	--	1.36	1.38	--
Ex. auto	1.28	1.37	1.33	1.34	--	1.36	1.33	--

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

lowering their inventory-sales ratio to the May-June level. General merchandise and apparel stores, whose stocks became particularly burdensome in early fall, were able to pare their stocks considerably. Nonetheless, their November inventory-sales ratios were still high relative to last spring, and further inventory corrections apparently took place at some of these stores in December.

Auto dealers' stocks in December were little changed from the November level as both assemblies and sales of domestic cars reached 8 million units. Although the inventory positions of many dealers improved during the fourth quarter, the supply of some General Motors cars remained tight at year end. However, the step-up of assembly schedules in the first quarter should help to alleviate this situation.

Housing Markets

Housing activity picked up slightly at the end of the fourth quarter, but the improvement was not felt in all segments of the market. Housing starts posted small gains in November and December, owing to increases in the single-family component, but total starts remained below a 1.6 million unit annual rate (chart). For the fourth quarter as a whole, starts were off 6 percent from the reduced third-quarter pace.

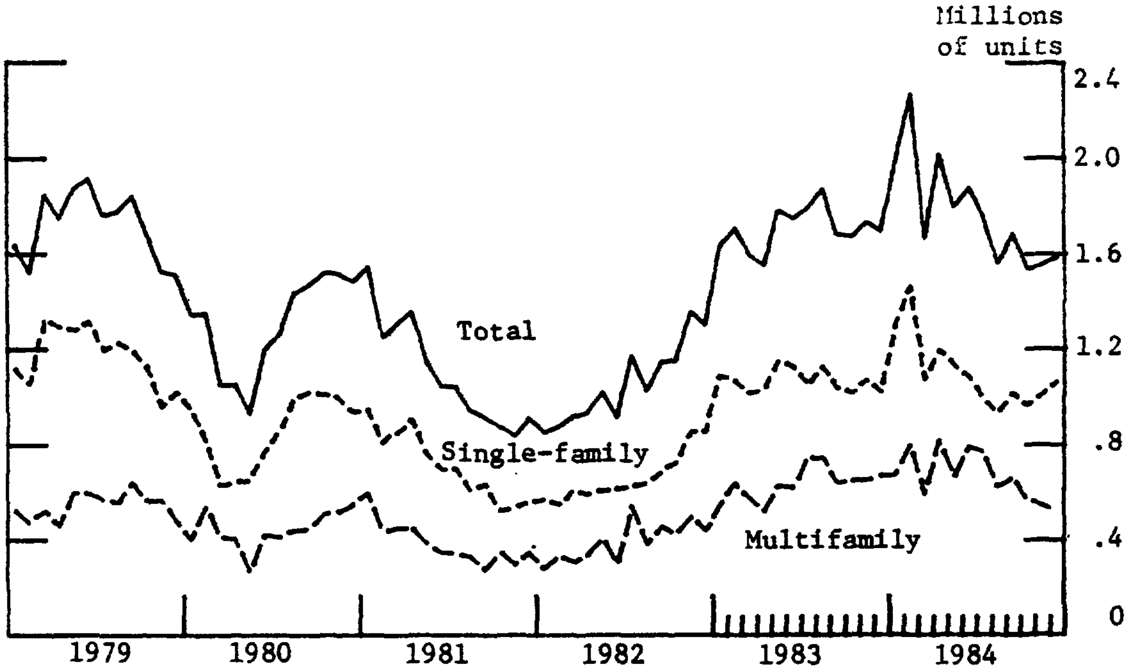
Single-family starts turned up at year-end, rising about 5 percent in both November and December. This improvement was accompanied by an upturn in sales of existing homes, but new home sales remained flat despite lower mortgage interest rates. Builders have been carrying moderately high inventories of single-family dwellings, and as a result, have been relatively cautious in their production decisions.

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

	1984	1984					
	Annual	Q2	Q3	Q4	Oct.	Nov.	Dec.[1]
All units							
Permits	1.64	1.76	1.50	1.53	1.42	1.59	1.59
Starts	1.74	1.90	1.66	1.56	1.54	1.55	1.59
Single-family units							
Permits	.89	.93	.82	.81	.79	.82	.82
Starts	1.08	1.14	.98	1.01	.96	1.01	1.06
Sales							
New homes	.64	.63	.61	.62	.65	.59	.61
Existing homes	2.87	3.04	2.71	2.77	2.65	2.82	2.85
Multifamily units							
Permits	.75	.83	.68	.72	.62	.77	.77
Starts	.66	.76	.68	.55	.57	.55	.52
Mobile home shipments	n.a.	.29	.29	n.a.	.30	.29	n.a.

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

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



In the multifamily sector, construction activity continued to decline in the fourth quarter, with starts falling to a 550,000 unit average annual rate. Overbuilding in some key markets contributed to a further increase in the average vacancy rate for multifamily rental housing, which reached 7.6 percent in the fourth quarter--a ten-year high. Incentives to undertake rental housing projects--about two-thirds of total multifamily starts--also may have been hurt by release of the Treasury tax plan, which raised uncertainty about the future tax treatment of rental property.

Federal Government

The federal government recorded a deficit of $72 billion (unified basis) during the first three months of fiscal 1985, about $9 billion larger than the comparable figure a year earlier. Although receipts rose about $17 billion, outlays grew $26 billion. The relatively rapid rise of spending reflected the retirement of previously tax-exempt HUD project notes[1], as well as large year-over-year increases in national defense spending, interest outlays, and agricultural support payments.

The strength of defense spending in the fourth quarter contributed to a 14 percent (annual rate) jump in real federal government purchases (NIA basis). Changes in the defense component have been erratic in recent quarters and are likely to remain volatile, owing to the variability of delivery times for major weapons systems. However, on average, growth of real defense spending over the near-term can be expected to be at about the same 6 to 7 percent annual pace as in the last two years.

1. The one-time outlay for retirement of HUD project notes was $6.8 billion in the October-December period and will total roughly $13 billion over fiscal 1985. These short-term, tax-exempt notes originally were issued by local public housing authorities and were guaranteed by HUD. Because the tax-exempt status of the notes has become questionable, HUD is required to borrow from the Treasury to retire the notes as they come due this fiscal year.

The administration submitted its fiscal 1986 budget to Congress on February 4, and a detailed analysis appears as an appendix to the Greenbook supplement. The administration's budget figures are based on assumptions of real GNP growth of about 4 percent per year during the 1985-1990 period and a gradual decline in inflation from 4-1/4 percent in 1985 to around 3-1/2 percent by 1990.

The administration's estimate of the federal government deficit (including off-budget outlays) in FY 1985 is now $222 billion, $42 billion above their projection of last August. About a third of this increase in the current year's deficit estimate results from the inclusion of HUD project note payments, while another third reflects the effects of the pause last year in economic activity. The remainder is split between the impact of legislation enacted before Congress adjourned last fall and a number of technical changes to prior estimates. The estimate of the budget deficit for FY 1986, which incorporates $50 billion in recommended spending cuts from the current services baseline, is $179 billion. Over the longer-term horizon, the administration's projections show deficits declining to about $90 billion by FY 1990. However, these lower deficits depend on sizable additional spending cuts; on a current services basis, the administration's projections remain in the $220 to $240 billion range throughout the period.

State and Local Sector

Growth in real outlays for goods and services by state and local governments slowed appreciably in the fourth quarter to a 2 percent annual rate, after an average 4 percent growth rate during the first three quarters of the year. Most of the deceleration came in outlays for construction, which were flat in the fourth quarter. However, this followed the largest three-quarter gain in construction spending in 30 years, and for 1984 as a whole, real outlays for structures rose nearly 17 percent.

Based on preliminary data, the surplus of the state and local sector operating and capital budget apparently increased somewhat in the fourth quarter after a sharp reduction in the third quarter. The recent improvement largely was the result of a significant rise in revenues, reflecting an increase in the growth of personal and sales tax receipts, as well as a jump in federal grants.

Exports and Imports

The merchandise trade deficit narrowed considerably in December, lowering the deficit for the fourth quarter to $92 billion, its smallest level in 1984. The sharp reduction in the trade deficit occurred as imports fell back toward their first-half average from the extraordinarily high level of the third quarter. Part of the swing in imports during the second half of 1984 may have been associated with an adjustment of inventories, as businesses cut back on both their domestic production and orders from abroad. Nonetheless, the level of imports continued to reflect the effects of the high and rising exchange value of the dollar and the strong U.S. demand for foreign products. The small increase in exports in the fourth quarter occurred mainly in agricultural goods, especially in grain shipments to the USSR.

Non-oil import prices were essentially unchanged in the fourth quarter, as the exchange value of the dollar continued to rise. The price of imported oil declined by about 40 cents per barrel in the fourth quarter. (Further discussion of international economic developments is included in Section IV.)

Prices

Moderate labor costs, low-priced imports, and falling energy prices continued to hold down the rate of inflation in the closing months of 1984. The consumer price index rose only 0.2 percent in both November and December. The producer price index for finished goods edged up 0.1 percent in December, after a 0.5 percent increase the preceding month, and was up only 1.8 percent for all of 1984. More recently, freezing weather has damaged fruit and vegetable crops in Florida, which may cause a spurt in food prices in the near term. However, in the past, the price effects of such weather-related disturbances proved to be short-lived and normally were reversed within a few months.

As measured by the CPI, inflation in 1984 was little different from the preceding year. Food prices advanced 3.8 percent, while the energy component edged up slightly after a small decline in 1983. The prices of other goods and services rose somewhat less rapidly last year than in 1983, as small price increases or declines were posted in most major commodity categories. Excluding used cars, prices of nonfood nonenergy commodities advanced only 2-1/4 percent in 1984 after a 3-1/4 percent increase in 1983. Used car prices had increased rapidly over the first half of 1984 before declining in the second half. Service prices accelerated in 1984, with relatively large increases in categories such as rent, auto finance charges, and telephone services.

Wages and Labor Costs

Wage inflation in the private nonfarm economy leveled off during the second half of 1984 at a fairly moderate rate, according to a variety of measures. The hourly earnings index for production and nonsupervisory

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

	Relative Importance Dec. 1983	1983	1984	1984 H1	1984 Q3	1984 Q4	1984 Nov.	1984 Dec.
				--Annual rate--			--Monthly rate--	
All items[2]	100.0	3.8	4.0	4.1	4.5	3.1	.2	.2
Food	18.7	2.6	3.8	4.0	3.4	3.7	.2	.3
Energy	11.9	-.5	.2	-.3	1.7	-.2	.2	-.5
All items less food and energy[3]	69.4	4.9	4.7	4.9	5.4	3.5	.3	.3
Commodities[3]	26.5	5.0	3.1	3.6	4.0	1.1	.0	.2
Services[3]	42.9	4.8	5.6	5.6	6.2	5.0	.4	.4
Memorandum:								
CPI-W[4]	100.0	3.3	3.5	2.5	7.5	1.8	.1	.2

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

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

	Relative Importance Dec. 1983	1983	1984	1984 H1	1984 Q3	1984 Q4	1984 Nov.	1984 Dec.
				--Annual rate--			--Monthly rate--	
Finished goods	100.0	.6	1.8	2.6	.4	1.7	.5	.1
Consumer foods	24.0	2.3	3.8	3.4	3.3	5.2	.7	.5
Consumer energy	12.0	-9.2	-4.1	-.6	-16.7	2.9	.6	-1.3
Other consumer goods	41.9	1.9	2.2	2.9	2.5	.5	.5	.1
Capital equipment	22.2	1.9	2.1	3.1	2.9	-.5	.2	.2
Intermediate materials[2]	94.8	1.4	1.7	3.1	-1.0	1.5	.3	-.2
Exc. energy	79.5	3.0	2.0	2.9	.4	2.0	.3	.0
Crude food materials	52.8	8.0	-.9	-6.1	-4.9	14.9	4.9	-.2
Crude energy	31.3	-4.6	-1.0	1.1	1.0	-7.0	-.9	-.6
Other crude materials	15.9	15.5	-3.3	9.0	-14.0	-14.6	-1.5	-.9

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

workers rose at a 2-3/4 percent annual rate in both the third and fourth quarters. A more comprehensive measure, the employment cost index (ECI) for wages and salaries, advanced at a 5 percent annual rate in the fourth quarter after an unusually small change the quarter before. On average, the second-half increase in the ECI was at a 4 percent rate--a bit less than during the first half of the year.

Over the course of 1984 as a whole, wage inflation slowed about 1 percentage point. That deceleration came mainly from industries receiving the largest increases in 1983--namely, those in the private service-producing sector of the economy. Wage increases for white-collar workers, many of whom are employed in service-oriented industries, slowed substantially during the past year, although increases for managers and professional and technical workers were still rising almost 6 percent annually. Among blue-collar workers, on the other hand, wage adjustments averaged 3-1/2 percent in 1984, or about the same as the year before.

New union settlements were quite moderate again last year. Wage adjustments under contracts signed in 1984 will average 2.4 percent in the first contract year and 2.3 percent annually over the contract life, (excluding COLAs)--record lows in the 17-year history of these series. As a result of the smaller settlements reached during the past three years, deferred adjustments that are scheduled to be paid in 1985 will decline further. The unprecedented incidence of wage cuts and freezes since 1981 has narrowed the average differential between union and nonunion wage levels about 1-1/2 to 2 percentage points. That narrowing contrasts sharply with the experience

SELECTED MEASURES OF LABOR COSTS IN THE NONFARM BUSINESS SECTOR
(Percentage change at annual rates; based on seasonally adjusted data)

	1982	1983	1984	1984 Q1	1984 Q2	1984 Q3	1984 Q4
Hourly earnings index, wages of production workers							
Total private nonfarm	6.1	3.9	3.0	3.5	3.2	2.7	2.8
Manufacturing	6.0	2.7	3.3	3.8	3.0	3.1	3.4
Contract construction	5.4	1.5	.8	2.3	1.9	-.7	.0
Transportation and public utilities	6.1	4.3	2.9	3.7	3.1	2.7	2.3
Trade	5.4	4.7	2.5	2.7	2.5	2.0	2.7
Services	7.0	4.9	3.8	3.3	4.9	3.9	3.2
Employment cost index, wages and salaries of all persons[2]							
Total	6.3	5.0	4.1	4.4	4.3	2.7	5.0
By occupation:							
White collar	6.5	6.0	4.4	3.8	6.0	2.4	5.2
Blue collar	5.6	3.8	3.6	4.6	2.8	2.0	4.9
Service workers	8.5	4.6	6.2	6.2	3.3	8.8	6.2
By union status							
Union	6.5	4.6	3.4	5.3	3.4	1.6	4.6
Nonunion	6.1	5.2	4.5	4.0	4.6	3.7	5.7
Major collective bargaining agreements[3]							
First-year wage adjustments	3.8	2.6	2.4	--	--	--	--
Total effective wage change	6.8	4.0	3.7	--	--	--	--
Labor costs and productivity, all persons[1]							
Compensation per hour	7.2	3.9	4.2	6.1	3.7	3.6	3.5
Output per hour	1.4	3.9	2.2	2.9	5.5	-1.1	1.7
Unit labor costs	5.8	.0	1.9	3.1	-1.7	4.7	1.8

1. Changes are from final quarter of preceding period to final quarter of period indicated. Quarterly changes at compound rates.
2. Seasonally adjusted by the Board staff. Changes are from final month of preceding period to final month of period indicated. Quarterly changes at compound rates.
3. Agreements covering 1,000 or more workers; not seasonally adjusted.

of the 1970s and early 1980s when the union-nonunion differential widened perhaps 10 percentage points.

Meanwhile, productivity growth resumed in the fourth quarter after a brief retrenchment associated with the slowdown in economic activity last summer. When output was growing rapidly during the first half of 1984, productivity in the nonfarm business sector advanced at a 4-1/4 percent annual rate. But as output growth decelerated, labor productivity fell in the third quarter and then picked up to a 1.7 percent rate of increase last quarter. Over the year as a whole, the generally favorable productivity performance, coupled with another moderate increase in hourly compensation, held the rise in unit labor costs to less than 2 percent.

SELECTED FINANCIAL MARKET QUOTATIONS[1]

(Percent)

	1982/1983	1984			1985	Change from:	
	Cyclical low	Highs	FOMC Nov. 7	FOMC Dec. 18	Feb. 5	1984 highs	FOMC Dec. 18
Short-term rates							
Federal funds[2]	8.42	11.63	9.80	8.34	8.32	-3.31	-.02
Treasury bills							
3-month	7.08	10.67	8.55	7.81	8.14	-2.53	.33
6-month	7.62	10.77	8.86	7.98	8.25	-2.52	.27
1-year	7.73	11.13	9.11	8.30	8.44	-2.69	.14
Commercial paper							
1-month	8.00	11.42	8.99	8.06	8.40	-3.02	.34
3-month	7.97	11.35	9.05	8.13	8.39	-2.96	.26
Large negotiable CDs[3]							
1-month	8.08	11.52	9.13	8.18	8.41	-3.11	.23
3-month	8.13	11.79	9.23	8.29	8.50	-3.29	.21
6-month	8.20	12.30	9.39	8.47	8.66	-3.64	.19
Eurodollar deposits[4]							
1-month	8.68	11.89	9.60	8.53	8.19	-3.70	-.34
3-month	8.71	12.20	9.75	8.79	8.31	-3.89	-.48
Bank prime rate	10.50	13.00	12.00	11.25	10.50	-2.50	-.75
Treasury bill futures							
Mar. 1985 contract	9.05	12.57	9.16	8.17	8.21	-4.36	.04
Dec. 1985 contract	10.86	13.20	10.23	9.43	9.51	-3.69	.08
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	9.33	13.49	11.05	10.24	10.37p	-3.12	.13
10-year	10.12	13.99	11.72	11.29	11.30p	-2.69	.01
30-year	10.27	13.94	11.63	11.35	11.30p	-2.64	-.05
Municipal revenue (Bond Buyer index)	9.21	11.44	10.62	10.44	9.81[5]	-1.63	-.63
Corporate—A utility Recently offered	11.64	15.30	13.08e	12.80e	12.58e	-2.72	-.22
Home mortgage rates							
S&L fixed-rate	12.55	14.68	13.74	13.18	12.93[6]	-1.75	-.25
FNMA ARM, 1-yr.	10.49	13.70	11.55	10.80	10.50[6]	-3.20	-.30

	1982	1983	1984		1985	Percent change from:	
	Lows	Highs	FOMC Nov. 7	FOMC Dec. 18	Feb. 5	FOMC Nov. 7	FOMC Dec. 18
Stock prices							
Dow-Jones Industrial	776.92	1287.20	1233.22	1211.57	1285.23	4.2	6.1
NYSE Composite	58.80	99.63	97.46	96.78	104.42	7.1	7.9
AMEX Composite	118.65	249.03	212.29	204.00	226.72	6.8	11.1
NASDAQ (OTC)	159.14	328.91	249.75	243.44	282.72	13.2	16.1

1. One-day quotes except as noted.
2. Averages for two-week reserve maintenance period closest to date shown. Last observation is for maintenance period ended January 30, 1985.
3. Secondary market.
4. Averages for statement week closest to date shown.
5. One-day quotes for preceding Thursday.
6. One-day quotes for preceding Friday.
e--estimated.

The monetary aggregates continued to grow rapidly in December and January, probably in response to lower interest rates and renewed strength in the economy. In recent days, money market rates have firmed noticeably, evidently reflecting concerns that the System might be moving to a less accommodative stance. Earlier in the intermeeting period, most short-term rates had held at about the levels reached around the time of the December FOMC meeting, as conditions in reserves markets continued relatively steady. Federal funds have traded mostly in an 8 to 8-3/8 percent range, just above the 8 percent discount rate (down from 8-1/2 percent) established on December 21.

Long-term rates generally have fallen since mid-December, as oil market developments and other price news seem to have contributed to a lowering of inflation expectations. Though flattened a bit, the still substantial upward slope of the term structure of rates suggests continued uncertainty about the longer-term inflation outlook as well as concern about the budget deficit and expectations of renewed strength in private credit demands with the pickup in economic activity.

Aggregate borrowing by nonfinancial firms has been comparatively light: short-term business borrowing was very weak in January, and bond offerings have been well below last fall's average pace. What response there has been among corporations to the drop in bond rates has occurred in the Euromarket, where financial firms have dominated a heavy volume of offerings thus far this year. Available information on household borrowing suggests that growth in consumer installment credit remained very strong in January; home mortgage borrowing has yet to show any clear pickup,

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

NOTE: THESE DATA DO NOT REFLECT ANNUAL SEASONAL AND BENCHMARK REVISIONS.

	1984 Q2	1984 Q3	1984 Q4	1984 Nov.	1984 Dec.	1985 Jan.p	Growth from Q4 1983 to Q4 1984
	------- Percentage change at annual rates ------					(Rounded)	
1. M1	6.2	4.5	2.0	8.6	11.1	11	5.0
2. M2	6.9	6.2	9.4	15.1	15.3	12	7.5
3. M3	10.5	8.3	10.7	15.6	14.0	10	9.9
							Levels in billions of dollars Dec. 1984
Selected components							
4. Currency	7.2	7.6	4.4	2.3	3.8	11	158.0
5. Demand deposits	3.4	0.2	-0.6	9.4	12.7	4	248.3
6. Other checkable deposits	9.9	8.8	4.3	12.9	16.2	23	143.0
7. M2 minus M1[2]	7.1	6.7	11.7	17.0	16.7	12	1821.9
8. Overnight RPs and Eurodollars, NSA[3]	-7.5	-1.4	0.0	29.6	-16.5	65	57.5
9. General purpose and broker/dealer money market mutual fund shares, NSA	15.5	10.6	29.1	50.1	43.6	34	168.1
10. Commercial banks	6.7	7.3	10.5	15.7	16.6	12	777.3
11. Savings deposits, SA, plus MMDAs, NSA[4]	4.9	-3.4	11.8	27.1	28.1	34	389.6
12. Small time deposits	8.6	18.4	9.2	5.0	5.3	-11	387.7
13. Thrift institutions	6.2	7.7	9.5	8.9	8.7	8	824.1
14. Savings deposits, SA, plus MMDAs, NSA[4]	2.5	-13.2	-3.8	3.8	7.7	20	314.7
15. Small time deposits	8.9	22.7	18.2	12.0	9.3	0	509.4
16. M3 minus M2[5]	26.0	16.7	16.0	17.4	8.7	4	610.9
17. Large time deposits	31.6	26.1	14.2	10.2	16.0	10	409.7
18. At commercial banks, net[6]	24.3	21.4	8.6	-5.9	-0.5	-5	260.9
19. At thrift institutions	46.4	35.7	24.5	39.8	46.1	36	148.8
20. Institution-only money market mutual fund shares, NSA	8.1	9.7	97.4	140.2	90.6	48	62.7
21. Term RPs, NSA	41.8	15.3	24.3	34.3	-63.3	-22	64.6
22. Term Eurodollars, NSA	6.6	-26.8	-24.1	22.6	21.0	24	81.5
	— Average monthly change in billions of dollars --						
MEMORANDA:							
23. Managed liabilities at commercial banks (24+25)	7.0	2.5	4.1	6.6	-2.6	0	437.7
24. Large time deposits, gross	7.9	0.0	2.4	0.6	1.4	1	319.9
25. Nondeposit funds	-0.9	2.5	1.7	6.0	-4.0	-1	117.8
26. Net due to related foreign institutions, NSA	0.9	-0.4	1.1	-0.4	1.5	-6	-31.9
27. Other[7]	-1.8	2.9	0.6	6.4	-5.5	5	149.7
28. U.S. government deposits at commercial banks[8]	-1.3	1.2	-0.4	8.7	-1.6	-1	15.4

1. Quarterly growth rates are computed on a quarterly average basis. Dollar amounts shown under memoranda for quarterly changes are calculated on an end-month-of-quarter basis.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Overnight and continuing contract RPs issued to the nonbank public by commercial banks plus overnight Eurodollar deposits issued by branches of U.S. banks to U.S. nonbank customers, both net of amounts held by money market mutual funds. Excludes retail RPs, which are in the small time deposit component.
4. Growth rates are for savings deposits, seasonally adjusted, plus money market deposit accounts (MMDAs), not seasonally adjusted. Commercial bank savings deposits excluding MMDAs declined during December 1984 and January 1985 at rates of 10.6 and 21 percent respectively. At thrift institutions, savings deposits excluding MMDAs decreased in December 1984 at a rate of 4.2 percent and increased in January 1985 at a rate of 5 percent.
5. The non-M2 component of M3 is seasonally adjusted as a whole.
6. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.
7. Consists of borrowings from other than commercial banks in the form of federal funds purchased securities sold under agreements to repurchase and other liabilities for borrowed money (including borrowings from the Federal Reserve and unaffiliated foreign banks), loans sold to affiliates, loan RPs and other minor items. Data are partially estimated.
8. Consists of Treasury demand deposits at commercial banks and Treasury note balances.
p--preliminary.

although market reports suggest that the continuing downtrend in mortgage rates is resulting in a firming of demand. Borrowing in the tax-exempt market has declined substantially in early 1985 because private-purpose issues were rushed to the market late in 1984 to beat new restrictions. At the same time, the federal government has continued to borrow heavily to finance its deficit.

Monetary Aggregates and Bank Credit

> Note on the monetary data: Annual benchmark and seasonal factor revisions are in process. The data reported here are on an unrevised basis. A discussion of revisions to the monetary aggregates will be included in the Bluebook.

In January, M1 growth continued at about the brisk pace of December. Balances in Super NOW accounts may have been boosted by the January 1 reduction in the minimum denomination on these accounts from $2500 to $1000, but inflows appear to have come mainly from regular NOW accounts. The recent acceleration in M1 is consistent with models of money demand, given interest rate declines since late summer and the pickup in economic growth.

M2 expansion in January was off a bit from the exceptionally rapid pace in November and December. Strength in the nontransactions component of M2 continued to be concentrated in MMDAs and money market mutual funds. In addition, overnight RPs and Eurodollars, which had run off in December, rebounded strongly in January. Savings deposits declined again in January, and small time deposits, which had been decelerating in previous months from the very rapid pace of the summer, also contracted.

M2 growth in January does not appear to have been boosted by the reduction in the minimum balance on MMDAs, but seems to have been related

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

NOTE: THESE DATA REFLECT BENCHMARK, SEASONAL, AND DEFINITIONAL REVISIONS.

		1984[2]					1985	Levels in bil. of dollars
		Q2	Q3	Q4	Nov.	Dec.	Jan.p	Dec.
		Commercial Bank Credit						
1.	Total loans and securities at banks[3]	9.2	9.5	9.6	12.8	9.2	7	1713.8
2.	Securities	-9.8	6.6	0.6	7.5	-1.5	5	400.5
3.	U.S. government securities	-11.2	6.8	3.4	11.2	3.7	-6	260.2
4.	Other securities	-7.3	6.3	-4.5	0.9	-11.0	23	140.3
5.	Total loans[3]	15.7	10.5	12.4	14.4	12.6	8	1313.3
6.	Business loans[3]	18.5	7.5	8.2	13.0	1.3	1	468.6
7.	Security loans	-13.6	4.2	36.1	-4.0	47.7	19	31.4
8.	Real estate loans	13.8	11.4	11.2	11.8	11.3	9	374.8
9.	Consumer loans	21.5	14.3	16.1	16.3	20.4	18	251.0
		Short- and Intermediate-Term Business Credit						
10.	Business loans net of bankers acceptances	18.4	7.9	8.3	12.0	3.4	2	465.2
11.	Commercial paper issued by non-financial firms[4]	64.8	47.5	51.7	54.2	26.7	-49	73.4
12.	Sum of lines 10 & 11	23.3	12.4	13.7	17.5	6.5	-5	538.6
13.	Line 12 plus loans at foreign branches[5]	23.4	12.3	14.1	18.8	8.0	-3	559.9
14.	Total bankers acceptances outstanding[6]	47.3	-16.0	-31.9	-43.5	-27.4	n.a.	72.7
15.	Line 13 plus total bankers acceptances outstanding	26.5	8.4	8.3	11.1	3.8	n.a.	632.5
16.	Finance company loans to business[6]	8.4	12.9	n.a.	15.8	n.a.	n.a.	n.a.
17.	Total short- and intermediate-term business credit (sum of lines 15 and 16)	23.8	9.0	n.a.	12.0	n.a.	n.a.	n.a.

n.a.—not available. p—preliminary.
1. Average of Wednesdays for domestically chartered banks and average of current and preceding ends of months for foreign-related institutions.
2. Growth rates beginning 1984 have been estimated after adjusting for major changes in reporting panels and definitions that caused breaks in series at the beginning of January. Data should be regarded as highly preliminary.
3. 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.
4. Average of Wednesdays.
5. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
6. Based on average of current and preceding ends of month.
7. Growth rates for total loans and investments. total loans, business loans, and real estate loans have been adjusted to eliminate effects of loan reclassifications and of loan transfers from Continental Illinois National Bank to the FDIC.
8. Reporting panel change in October 1984 reduced reported acceptances by $400 million. Growth rates have been adjusted to eliminate this break in series.

primarily to continued favorable yield spreads. Since late last summer, offering rates on MMDAs and money funds have lagged declines in market rates significantly more than those on small time deposits. Consequently, MMDAs and money funds have recorded strong inflows, while inflows to small time deposits have weakened. More recently, the mix between money funds and MMDAs has shifted, with inflows to money funds tending to moderate and inflows to MMDAs strengthening as the yield spread between the two types of accounts has narrowed and as MMDAs may have been boosted slightly by the new minimum balance requirements.

M3 growth also slowed only moderately in January from the brisk pace of the preceding two months. The continuing strength in this aggregate primarily reflected growth of its M2 component, as the non-M2 components slowed or registered declines. In January, inflows to institution-only money funds increased at a much reduced pace from recent months as yield relationships became less favorable. Large time deposits at commercial banks (net of money fund holdings) contracted again, partly because of a reduced need by banks for managed liabilities in view of strong inflows to core deposits. Term Eurodollars and term RPs registered declines in January; the decline in term RPs partly reflected the unwinding of a holiday-related bulge in December.

Commercial bank credit is estimated to have decelerated further to a 7 percent annual rate of growth in January, as holdings of securities increased, while loan growth slowed. The increase in securities was in the non-U.S. government category, and probably was a reflection of the year-end surge in tax-exempt bond issuance. Business loans were virtually flat for the second straight month, while real estate lending slowed a bit

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

		1984					1985
	1983	H1	Q3	Q4P	Nov.p	Dec.p	Jan.p
Corporate securities - total[1]	8.94	7.63	10.98	13.10	15.62	9.00	11.85
Public offerings in U.S.	8.24	6.38	8.75	10.29	12.00	6.70	6.75
Stocks--total[2]	4.30	2.06	1.64	1.78	2.41	1.00	1.40
Nonfinancial	3.07	1.19	.84	1.13	1.47	.50	.90
Utility	.80	.25	.17	.21	.22	.20	.30
Industrial	2.27	.94	.66	.92	1.25	.30	.60
Financial	1.23	.87	.80	.65	.94	.50	.50
Bonds--total[1]	3.94	4.32	7.11	8.51	9.59	5.70	5.35
By industry							
Nonfinancial	2.04	1.71	3.29	4.50	4.91	3.05	2.35
Utility	.95	.55	.87	1.48	2.13	.75	1.00
Industrial	1.08	1.16	2.42	3.02	2.78	2.30	1.35
Financial	1.90	2.61	3.82	4.01	4.68	2.65	3.00
By quality[3]							
Aaa and Aa	1.15	1.07	2.23	2.59	3.73	1.80	1.35
A and Baa	1.58	1.48	2.78	2.79	1.71	1.85	3.20
Less than Baa	.49	.68	1.19	1.85	2.00	1.35	.50
No rating (or unknown)	.37	.25	.32	.33	.33	.45	.20
Memo items:							
Equity based bonds[4]	.75	.31	.57	1.30	1.56	.42	.15
Mortgage-backed bonds	.36	1.68	.60	.97	1.85	.25	.10
Variable rate notes	.32	.55	1.29	.50	1.16	.22	.35
Bonds sold abroad - total	.70	1.25	2.23	2.81	3.62	2.30	5.10
Nonfinancial	.33	.65	.95	1.09	1.81	.72	1.90
Financial	.37	.60	1.28	1.72	1.81	1.58	3.20

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

from the December pace. Consumer loans also decelerated a bit, but still expanded at a very rapid rate.

In December, and throughout the second half of 1984, business loan growth was held down by strong competition from the commercial paper market. However, in January commercial paper of nonfinancial businesses contracted sharply even with a continued wide spread between paper rates and the bank prime. As a result, the sum of total business loans at domestic and foreign offices of U.S. banks plus commercial paper, which had grown rapidly in recent months, contracted in January.

Business Finance

Longer-term business borrowing also has been comparatively restrained recently, despite a further decline in bond yields to almost 3 percentage points below their 1984 highs. Indeed, total business borrowing seems to be running surprisingly low, given still substantial merger activity layered on top of what probably is an appreciable gap between capital spending and internal funds.

New issues of nonfinancial firms in the domestic bond market during December and January were less than half the volume in the preceding two months--although well above the pace in the first half of last year. During most of the intermeeting period, many firms were apparently anticipating still further interest rate declines--as evidenced not only by the moderate volume but also by the shortened maturities of the bonds issued. In the past two months, only one-fifth of domestic and foreign offerings of nonfinancial debt had maturities as long as 20 years, compared with about three-eighths in the prior three months.

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

	1984		1985		
	Q4	Dec.	Jan.p	Feb.f	Q1f
Treasury financing					
Combined surplus/deficit(-)	-71.5	-14.6	-10.1	-23.7	-65.1
Means of financing deficit:					
Net cash borrowing from the public	64.2	24.1	13.2	15.8	48.7
Marketable borrowings/ repayments(-)	60.2	22.5	11.9	15.2	46.3
Bills	17.6	9.2	.1	2.3	13.5
Coupons	42.6	13.3	11.8	12.9	32.8
Nonmarketable	4.0	1.6	1.3	.6	2.4
Decrease in the cash balance	12.8	-12.0	-8.2	11.7	7.8
Memo: Cash balance at end of period	17.6	17.6	25.8	14.1	9.8
Other[2]	-5.5	2.5	5.1	-3.8	8.6
Federally sponsored credit agencies, net cash borrowing[3]	3.5	1.0	1.9	.9	4.5
FHLB	-.1	-.8	.0	.0	.0
FNMA	3.6	2.6	1.4	.7	3.5
Farm Credit Banks	-1.9	-1.0	.3	-1.0	-.5
FHLMC	1.4	.1	.0	1.0	1.0
SLMA	.5	.1	.2	.2	.5

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

Volume in both domestic and overseas markets, however, continued to be buoyed by financial offerings. In the last two months, banks have accounted for nearly 50 percent of these offerings, compared with about 25 percent in 1984 as a whole. Nonetheless, the pace of domestic issues by financial firms has eased from the fall, partly because GNMA yields have fallen relative to other securities since November, making CMO issuance by securities firms unprofitable.

Total Eurodollar offerings of financial and nonfinancial firms were a record in January as a number of late December issues had been deferred when interest rates turned up temporarily after Christmas. A strong increase in floating-rate note issues by U.S. banks was coupled with a flood of offerings in the Euro-yen market--mainly by nonfinancial firms, and generally for swapping into dollar liabilities. The Euro-yen market has been quite active since the Japanese relaxed restrictions on December 1.

Equity issuance has slowed of late even though the gains in bond market prices have been more than matched by those of stock prices. Major stock price indexes have increased 8 percent or more over the intermeeting period, and the NYSE composite and Dow Jones Industrial indexes have hit new highs. Net equity issuance by nonfinancial firms apparently is continuing negative, owing to the redemption of outstanding shares in mergers and share repurchases.

Government Finance

Federal sector. The staff is projecting a combined (on- and off-budget) deficit of $65 billion for the first quarter. To meet its financing requirements, the Treasury is expected to borrow around $49 billion, net, and to reduce its cash balance over the quarter by about

$8 billion. So far in the current quarter, the Treasury has raised $12-1/4 billion through marketable borrowing. It is expected to meet most of its remaining needs in auctions of coupon issues, although net bill financing is expected to be substantial.

On January 15, the Treasury announced its STRIPS program to facilitate separate book-entry ownership and trading of coupon payments and principal of selected note and bond issues. This program enables market participants to create zero-coupon instruments that are direct obligations of the U.S. Treasury. The 10-year notes and 30-year bonds in the February refunding package will be the first Treasury securities eligible for this program. The Treasury also announced, as part of the STRIPS program, that the 30-year bond to be issued in the February refunding will have a full 30 years of call protection. Previous 30-year bonds have had only 25 years of call protection.

Borrowing by the federally sponsored credit agencies slowed sharply in the fourth quarter and is not expected to pick up much in the first quarter of 1985. The Federal Home Loan Banks are expected to raise no new money this quarter, after repaying debt, on net, in December; demand by savings and loan associations for FHLB advances has slackened since September.[1] In contrast, FNMA borrowed heavily in the fourth quarter to fund its acquisitions of mortgages and has continued its rapid pace of borrowing so far in the first quarter. The Farm Credit Banks have been running off debt in recent months as the demand for loans by the agricultural sector has weakened considerably; the declines in farm

1. Demand for FHLB advances was strong in the second quarter and most of the third in part because of the funding problems of FCA's American Savings and Loan subsidiary.

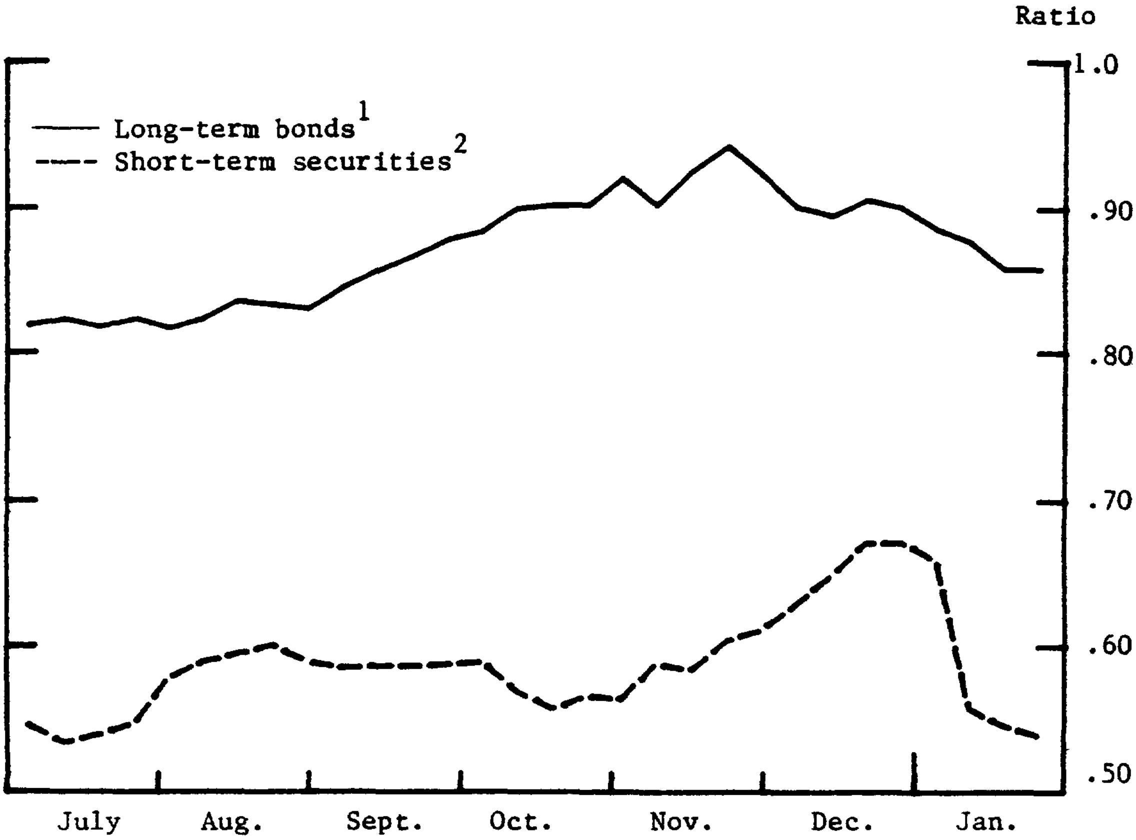
income and land values have left farmers with heavy debt burdens. and loan defaults have increased. Thus far, the financial stress in the agricultural sector has had little effect on the Farm Credit System. The System as a whole will report profits in 1984 and its capital position is strong, although a few of the Federal Intermediate Credit Banks have reported financial difficulty. The debt securities sold by the Farm Credit System in the financial markets have not carried an additional risk premium.

State and local sector. Issuance of tax-exempt bonds has fallen substantially since the turn of the year. In January, offerings of long-term tax-exempt securities totaled around $6.7 billion at a seasonally adjusted monthly rate, following a record monthly average of $11 billion in the fourth quarter. In the short-term market, offerings of tax-exempt notes remained light owing to the continued absence of HUD project notes.

In the long-term market, major offerings early this year have included general obligation bonds and highway and public utility revenue bonds. In contrast, the volume of industrial development bonds and single-family mortgage revenue bonds has been small, reflecting both the 1985 restrictions and volume caps imposed by the Deficit Reduction Act as well as the large volume of anticipatory financing late last year.

With the slowdown in supply and easing in general market conditions, interest rates on municipal bonds have fallen noticeably. The Bond Buyer 30-year revenue bond index, at 9.81 percent, is now 63 basis points below its level at the time of the December FOMC. Reductions in rates on long-term taxable securities have been less steep in recent months, and the ratio of tax-exempt to taxable yields has come down substantially from its high near year-end.

RATIOS OF TAX-EXEMPT TO TAXABLE YIELDS



1. Bond Buyer revenue bond index to Treasury 30-year constant maturity bond yield.

2. Merrill Lynch series on 6-month TANs, RANs, and BANs to 6-month Treasury bill rate converted to coupon basis.

GROSS OFFERINGS OF TAX-EXEMPT SECURITIES
(Monthly totals or monthly averages; billions of dollars)

	1983	1984	1984 Q3	1984 Q4[e]	1984 Dec.[e]	1985 Jan.[e]
	------------Seasonally adjusted-----------					
Total	10.39	10.82	12.18	12.19	9.40	7.60
Long-term	7.20	8.20	9.81	11.04	8.50	6.70
Short-term[1]	3.19	2.62	2.37	1.15	.90	.90
	-----------Not seasonally adjusted---------					
Total	10.39	10.82	11.36	13.09	12.20	6.20
Long-term	7.20	8.20	8.91	12.06	11.50	5.50
Refundings[2]	1.17	.97	.77	1.06	.80	--
Single-family housing[3]	.92	1.08	2.69	1.25	1.00	.07
Short-term[1]	3.19	2.62	2.45	1.03	.70	.70

e--estimate.
1. These figures do not include tax-exempt commercial paper.
2. Includes all refunding bonds.
3. Data from the Department of Housing and Urban Development.

The supply of variable-rate demand notes, which (though nominally long-term securities) put substantial pressure on short-term rates in the fourth quarter, has virtually dried up since the December 31 deadline for certain types of private-purpose issues. As a result, rates on 3- and 6-month tax-free notes have dropped 85 to 120 basis points since late December, while yields on Treasury bills, for example, have risen. Thus the ratio of tax-exempt to taxable short-term yields has fallen considerably more since the end of last year than the ratio for bonds.

Mortgage Markets

Costs of housing finance have continued to decline, on balance, since the last FOMC meeting. Interest rates have dropped on many new and older construction loans, in line with the two cuts in the bank prime rate. On new mortgage commitments, contract interest rates at S&Ls for

MORTGAGE ACTIVITY AT FEDERALLY INSURED SAVINGS AND LOAN ASSOCIATIONS[1]
(Billions of dollars, seasonally adjusted)

	Mortgage commitments		Net change in mortgage assets		
	New (1)	Outstanding[2] (2)	Total (3)	Mortgage loans (4)	Mortgage-backed securities (5)
1984-Apr.	16.9	62.6	9.6	7.2	2.3
May	18.6	65.1	9.9	7.7	2.2
June	17.5	65.9	9.8	7.5	2.3
July	17.0	66.4	8.2	7.5	.6
Aug.	15.4	65.9	8.2	5.8	2.4
Sept.	15.0	66.0	5.6	5.2	.5
Oct.	15.6	64.9	5.4	5.0	.4
Nov.	15.5	64.0	4.7	5.5	-.8
Dec. p	15.4	64.5	3.5	2.5	1.0

p--preliminary.
1. Insured S&Ls account for approximately 98 percent of the assets of all operating S&Ls. Net changes in mortgage assets reflect adjustments to account for conversions of S&Ls to savings banks.
2. End of month. Includes loans in process.
Note: Data revised due to new seasonal adjustment factors.

NEW ISSUES OF FEDERALLY GUARANTEED MORTGAGE PASS-THROUGH SECURITIES
(Monthly averages, millions of dollars, n.s.a.)

Period	All issues	GNMAs	FHLMCs	FNMAs	Memo: FNMA and FHLMC swap issues
1983-Q1	7122	3841	1955	1326	2204
Q2	7368	4753	1392	1223	1880
Q3	7619	4835	1544	1240	2115
Q4	5733	3403	1673	657	1954
1984-Q1	4892	2745	886	1261	1638
Q2	4020	2343	1133	545	1497
Q3	5130	2206	1428	1496	2659
Q4	5953	1992	2747	1214	3493
Aug.	5799	2373	1564	1862	3317
Sept.	4153	1921	1140	1092	2085
Oct.	6153	2473	2569	1111	3401
Nov.	4668	1432	1996	1240	2683
Dec. r	7038	2071	3675	1292	4394
1985-Jan. p	5007	2154	1860	993	2214

p--preliminary. r--revised.

conventional fixed-rate home loans fell 27 basis points to 12.93 percent--the lowest level since June 1983 and 175 basis points below the recent high registered last summer. Initial rates offered by S&Ls on new ARM commitments declined more sharply. Thus, the spread between fixed- and adjustable-rate mortgages has widened to about 230 basis points, still well below last year's high in June. As a result of the decline in rates on fixed-rate mortgages as well as the narrower rate spread favoring adjustable-rate over fixed-rate loans during recent months, the volume of ARMs has fallen markedly. In early January, ARMs accounted for only about 50 percent of the total conventional closings.

ARM loan volume has been substantial for some time, despite its recent decline. Staff estimates suggest that ARM originations at major lenders rose from about 541 thousand loans in 1982 to nearly 1.6 million loans in 1984. Although the precise distribution of these loans by adjustment period is unknown, a large number of ARMs undoubtedly are experiencing the first scheduled interest rate adjustment. Many ARMs were originated at initial promotional discounts below typical program interest rates. As these ARMs come up for adjustment, their contract rates may be changed somewhat to reflect the expiration of initial discounts as well as interim movements in such underlying indexes as short-term Treasury securities or thrifts' costs of funds.

Demand for new mortgage loans in December apparently continued to be relatively subdued, despite the recent decline in rates. At federally insured S&Ls, however, trends were mixed through the end of the year. In December, new commitments to originate mortgage loans were down a bit but remained above September's low. Total new commitment volume, including

CONSUMER INSTALLMENT CREDIT

	1983	1984	1984 Q3	1984 Q4	1984 Oct.	1984 Nov.	1984 Dec.
	Percent rate of growth, SAAR						
Change in outstandings--total	11.3	21e	16.2	20e	16.8	21.0	22e
By type:							
Automobile credit	8.7	n.a.	16.7	n.a.	17.4	19.8	n.a.
Revolving credit	15.5	n.a.	15.2	n.a.	20.0	22.5	n.a.
All other[1]	10.1	n.a.	16.2	n.a.	14.9	21.3	n.a.
	Billions of dollars, SAAR						
Change in outstandings--total	48.3	82e	69.6	91e	75.3	95.4	102e
By type:							
Automobile credit	13.6	n.a.	26.1	n.a.	28.3	32.7	n.a.
Revolving credit	12.9	n.a.	13.1	n.a.	18.0	20.6	n.a.
All other[1]	21.7	n.a.	30.4	n.a.	29.1	42.1	n.a.
By major holder:							
Commercial banks	23.4	n.a.	28.8	n.a.	33.1	29.8	n.a.
Finance companies	5.0	n.a.	14.9	n.a.	14.3	20.6	n.a.
All other	19.9	n.a.	25.9	n.a.	27.9	45.0	n.a.
	Annual percentage rate						
Interest rates							
At commercial banks[2]							
New cars, 48 mos.	13.92	n.a.	13.91	n.a.	n.a.	13.91	n.a.
Personal, 24 mos.	16.50	n.a.	16.63	n.a.	n.a.	16.63	n.a.
Credit cards	18.78	n.a.	18.82	n.a.	n.a.	18.82	n.a.
At auto finance companies[3]							
New cars	12.58	14.62	14.95	15.22	15.18	15.24	15.24
Used cars	18.74	17.84	17.95	18.28	18.19	18.30	18.34

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

agreements to purchase loans, was virtually unchanged, while the backlog of total mortgage commitments outstanding edged up for the first time in three months. S&L net acquisitions of mortgage loans in December were reduced owing in part to substantial swaps of mortgages for mortgage-backed securities--some of which apparently were sold to buyers outside the S&L industry.

Issuance of federally underwritten mortgage-backed securities subsided in January. New issues of GNMA-guaranteed securities were slightly above their reduced fourth-quarter pace, and swapping activity at both FHLMC and FNMA dropped following hectic year-end transaction volume.

Consumer Credit

In December, growth of outstanding consumer installment debt may have exceeded the 21 percent annual pace of November. Data for commercial banks suggest a continuation of the strong rise in January.

Consumer installment credit growth has been substantial over the past two years. The 34 percent increase in total outstandings since December 1982 has been larger than in any of the preceding five economic upswings, while growth in personal consumption expenditures has been only a bit faster than average. In part, the more rapid rise in debt likely has reflected a cyclical pickup in new loan extensions coupled with an abnormally weak uptrend in repayments reflecting low lending activity during 1980-82.

The most rapid increases in consumer credit during 1984 were registered primarily at savings and loans, mutual savings banks, commercial banks, and credit unions. Consumer credit at thrift institutions has been growing at a pace of more than 25 percent a year since 1981, reaching 45 percent in 1984. In part, this sharp advance from relatively low initial levels reflected the improving economy and the expanded lending powers granted by the DIDMCA. Commercial bank net lending increases also have been sizable in the last couple of years, following very little growth in the preceding two years, as auto loans and credit card operations grew markedly.

The average contract rate on new-auto loans at captive finance companies was little changed in December, remaining at 15.24 percent. This rate had been moving up steadily since last March; by the end of 1984, it stood 132 basis points above its year-earlier level. Meanwhile, the average maturity of new-car loans lengthened by nearly four full months during 1984--reaching 50.2 months by year-end--and the average loan size increased by 6 percent to $9,707. Consequently, the average monthly payment edged up last year to $263 in December, as increases in the cost and size of loans outweighed the effect of the longer maturity.

Foreign Exchange Markets

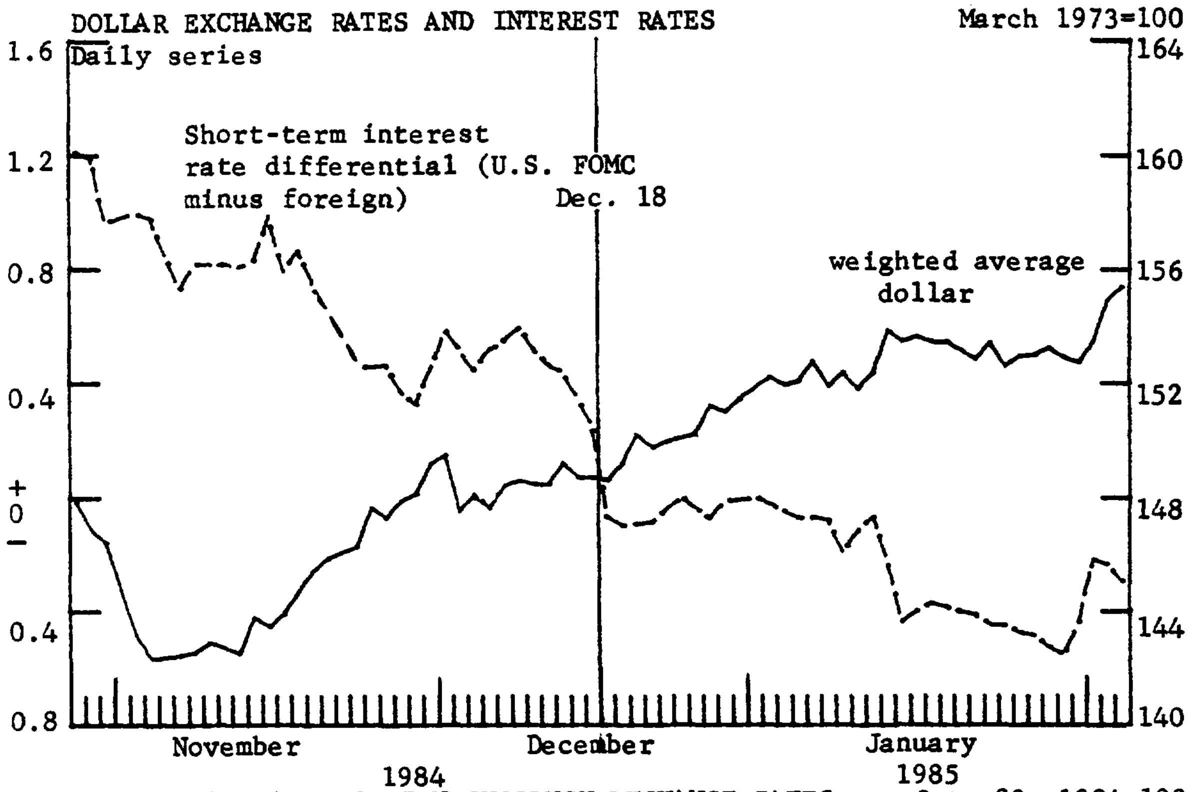
Since the last FOMC meeting, the trade-weighted value of the dollar, shown in the top panel of Chart 1, has appreciated more than 4-1/4 percent to a new record level in nominal and real terms. The dollar is at or near peak levels for the floating rate period on a bilateral basis against most major currencies.

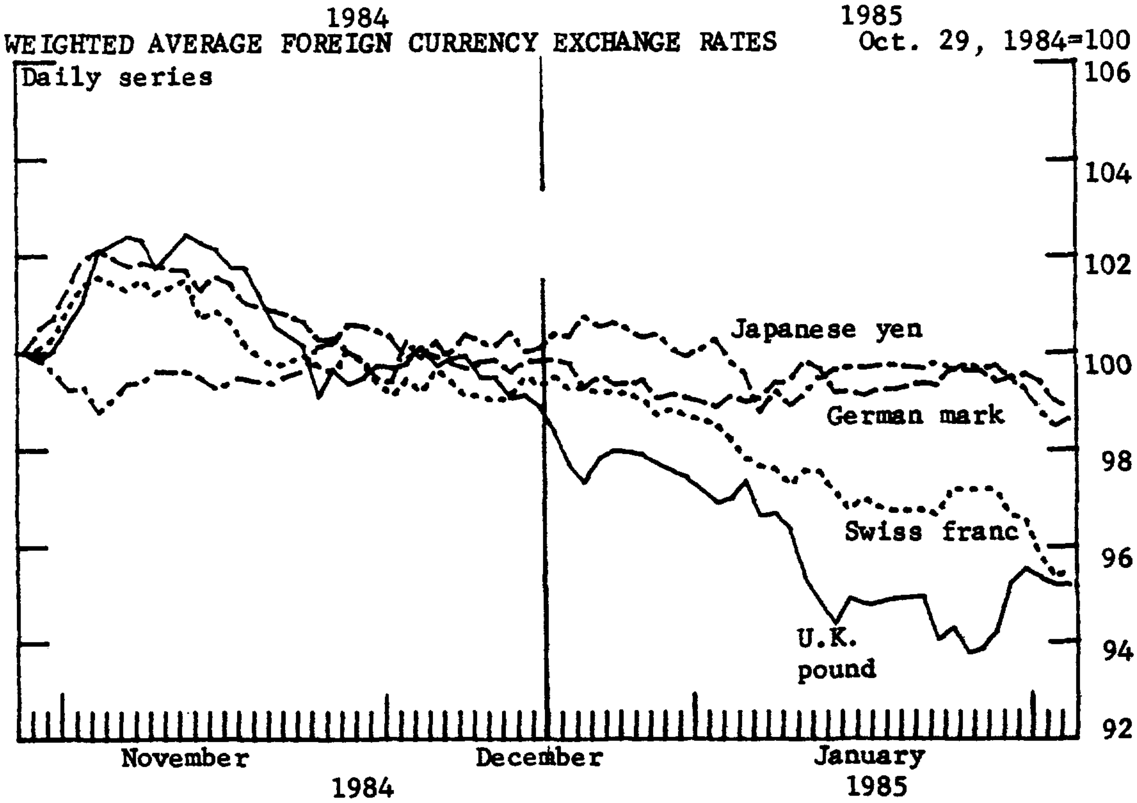
Part of the dollar's continued strength derives from recent indications that U.S. economic growth in the last quarter of 1984 and the first quarter of 1985 is somewhat more robust than earlier anticipated, while U.S. inflation has not shown signs of accelerating. The pace of economic activity abroad has not been uniform across countries, with Japanese growth exceeding that of the European economies.

As can also be seen in the top panel of Chart 1, the dollar's appreciation has occurred while the short-term nominal interest differential in favor of assets denominated in U.S. dollars has decreased. The spread of long-term U.S. yields over those of comparable foreign assets has narrowed slightly. In the past week, however, dollar interest rates have risen sharply relative to foreign rates, despite increases in some European interest rates.

The dollar's recent appreciation has been particularly strong in terms of sterling and the Swiss franc, which have declined about 7 percent against the dollar. Because of their differential weakness against the dollar, the pound and Swiss franc have depreciated more than 3-1/2 percent on balance over the past seven weeks, while the mark and

Chart 1 2/6/85


DOLLAR EXCHANGE RATES AND INTEREST RATES
March 1973=100
Daily series
Short-term interest rate differential (U.S. minus foreign)
FOMC Dec. 18
weighted average dollar
1.6
1.2
0.8
0.4
+
0
-
0.4
0.8
164
160
156
152
148
144
140
November
December
January
1984
1985


WEIGHTED AVERAGE FOREIGN CURRENCY EXCHANGE RATES
Oct. 29, 1984=100
Daily series
Japanese yen
German mark
Swiss franc
U.K. pound
106
104
102
100
98
96
94
92
November
December
January
1984
1985

yen declined only 1 and 1-1/2 percent in terms of their respective trade-weighted indices.

Sterling has been under particularly strong downward pressure throughout the intermeeting period, largely because of the general softness of world oil prices. With North Sea oil exports currently representing about 20 percent of the total value of U.K. exports, the pound has been strongly influenced by the recent weakness in spot market prices for North Sea Brent crude.

Compounding the negative impact on sterling of oil was an acceleration of speculative selling of the pound in early January when statements by the British authorities were interpreted as indicating an unwillingness to take any action to halt the pound's slide. The British government initially appeared reticent to force up interest rates in the face of 13 percent unemployment, and substantial foreign exchange market intervention was at variance with the Thatcher government's long-standing view that intervention should be limited to smoothing operations. Starting in mid-January, however, the Bank of England proceeded to raise its money market dealing rates on three occasions, for a total increase of 4-3/8 percentage points to a level of about 14 percent by the end of January. After the final jump in the official British dealing rates by a surprising 2 percentage points, the pound began to strengthen, recovering more than 1 percent in the last week of January from its record low level against the dollar. U.K. short-term interest rates have also eased somewhat in the past week, confirming the expectation that the surge in U.K. interest rates will be short-lived. Finally, although little concrete progress has yet been reported in the 11-month old coal miners' strike, there is a bit more optimism that negotiations may resume in the near future.

Within the EMS, the Belgian franc, which had been at the bottom of the EMS band for much of 1984, has risen to the middle of the band. This relaxing of exchange market pressure has permitted the Belgian authorities to repay fully their FECOM debt and, in recent weeks, they have reported a series of small adjustments in the currency composition of their reserves. The Danish krone has now risen to the top of the EMS band, and its spread above the guilder at the bottom has exceeded 2 percent in recent weeks,

.

. The G-5 statement on January 17, reiterating the Williamsburg Summit commitment to undertake coordinated intervention "as necessary," heightened market concern over the possibility of sizable concerted sales of dollars. The subsequent series of highly visible and occasionally coordinated sales of dollars by a number of central banks sometimes appeared to thwart the dollar's rise, but only temporarily. In the past week, widely perceived coordinated intervention by the Bundesbank and the

System failed to stem the dollar's brisk ascent to new record levels on an effective basis and against most currencies. Since the last FOMC meeting, the Desk has made total dollar sales against foreign currencies of $241.5 million, evenly split for the accounts of the System and Treasury. Of that total, sales of $192.7 million were made against marks, while $48.8 million were made against yen.

U.S. International Financial Transactions

There were large recorded capital inflows into the United States through a wide variety of channels in October and November, 1984. As shown on the summary table of U.S. International Transactions, these inflows included net increases in foreign official reserve assets in the United States, net foreign private purchases of U.S. corporate bonds and Treasury securities, as well as net inflows reported by banks.

Increases in official reserve assets in the United States totaled $5 billion in October and November and were spread among the G-10 countries and certain less developed countries. Latin American official holdings in the United States (excluding OPEC members) increased by $1.0 billion, adding to the $1.3 billion increase in the first nine months of the year, and reflecting improvement in their external positions. On the other hand official holdings of the OPEC countries continued to decline, bringing the total decline for the year through November to $8.2 billion. Partial data from the FRBNY indicate that official reserve assets in the United States also increased substantially in December, but declined in January.

Net foreign private purchases of U.S. corporate bonds, most of which were new issues of Eurobonds, totaled $6.3 billion in October and November. There were also large new issues of Eurobonds by U.S. corporations in December and January, including approximately $1.3 billion equivalent denominated in Japanese yen. These latter issues illustrate the effect of changes in regulation and taxation on patterns of international intermediation. The Japanese government broadened the list of permitted foreign issuers of Euroyen bonds to include U.S. and other corporate borrowers, as of December 1. This action opened up new arbitrage

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

	1983 Year	1984 11 mos.	1984 Q1	1984 Q2	1984 Q3	1984 Sept.	1984 Oct.	1984 Nov.
Private Capital								
Banks								
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	13.3	31.3	13.0	-0.6	10.9	9.5	-1.7	9.7
a) with own foreign offices	7.0	3.6	*	1.3	-3.7	2.7	-0.3	6.3
b) all other	6.4	27.8	13.0	-1.8	14.6	6.8	-1.4	3.4
Securities								
2. Private securities transactions, net	1.7	6.3	2.2	-0.2	0.3	-0.2	2.1	1.9
a) foreign net purchases (+) of U.S. corporate bonds	2.2	9.8	0.3	0.6	2.6	1.3	4.1	2.2
b) foreign net purchases (+) of U.S. corporate stocks	6.4	-0.2	1.2	*	-1.0	-0.6	-0.5	0.1
c) U.S. net purchases (-) of foreign securities	6.9	-3.4	0.6	-0.8	-1.3	-0.8	-1.5	-0.4
3. Foreign net purchases (+) of U.S. Treasury obligations 1/	8.3	18.4	1.4	6.6	5.1	-3.4	3.3	2.0
Official Capital								
4. Changes in foreign official reserve assets in U.S. (+ = increase)	5.2	0.6	-3.0	-0.7	-0.7	-3.9	2.7	2.3
a) By area								
G-10 countries (incl. Switz.)	6.4	4.1	2.3	-0.7	-0.8	-2.3	1.4	1.9
OPEC	-8.5	-8.2	-2.8	-2.4	-0.7	-0.9	0.2	-2.5
All other countries	7.3	4.6	-2.5	2.3	0.8	-0.7	1.2	2.8
b) By type								
U.S. Treasury securities	7.0	2.4	-0.2	-0.3	-0.6	-1.4	0.3	3.2
Other 2/	-1.8	-1.9	-2.7	-0.5	-0.1	5.2	2.3	-0.9
5. Changes in U.S. official reserve assets (+ = decrease)	-1.2	-2.7	-0.7	-0.6	-0.8	-0.1	-0.2	-0.4
Other transactions (Quarterly data)								
6. U.S. direct investment (-) abroad	-4.9	n.a.	-3.5	2.1	1.1	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	11.3	n.a.	2.4	8.8	4.3	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow) 3/ 4/	-2.9	n.a.	1.9	6.0	2.1	n.a.	n.a.	n.a.
9. U.S. current account balance 4/	-41.6	n.a.	-19.7	-24.7	-32.9	n.a.	n.a.	n.a.
10. Statistical discrepancy 4/	9.3	n.a.	6.0	3.3e	10.6	n.a.	n.a.	n.a.
MEMO: U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-61.1	n.a.	-25.9	-25.7	-32.9	-10.5	-7.9	-9.0

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

opportunities. Interest payments on Euroyen bonds issued by non-Japanese corporations are not subject to the Japanese withholding tax, nor are interest payments on Eurodollar bonds issued by Japanese companies. But Euroyen issues by Japanese companies are subject to withholding. In effect, a Japanese firm can obtain fixed-rate Euroyen debt that is not subject to withholding by issuing Eurodollar bonds and swapping interest and principal payments with a U.S. corporation that has issued Euroyen bonds. An additional incentive for these arrangements is provided by Japanese regulations that limit the percentage of portfolios that Japanese institutional investors may invest in foreign assets. Purchases of Eurodollar bonds issued by Japanese companies do not count as foreign assets, and, because of strong demand from Japanese investors, Japanese companies can borrow at lower rates in the Eurodollar bond market than comparable U.S. companies. The Japanese government, in response to the rapid growth of these currency swaps since the beginning of December, has proposed, as of April 1, to exempt Euroyen issues of Japanese companies from the withholding tax. This action would tend to reduce the cost savings available to U.S. corporations through swaps with Japanese corporations.

The heavy issue of Eurobonds by U.S. commercial banks in 1984 also reflects, in part, the impact of regulation. Of the almost $6 billion issued by the 25 largest bank holding companies in 1984, about half included mandatory convertible features. These issues added to primary capital under Federal Reserve guidelines and improved capital adequacy. In January, the twenty-five largest banks issued an additional $1.9 billion in Eurobonds; again most issues were floating rate notes and included convertible features that allowed the funds raised to count as primary capital.

Net purchases of U.S. Treasury securities by private foreigners were also very large in October and November. Of the $5.3 billion purchased, $2.0 billion were specially targeted for foreigners. Information on secondary market trading indicates that these specially targeted issues are now yielding about the same as regular Treasuries. Under these circumstances it seems unlikely that the Treasury will be able to realize substantial cost savings through additional issues of specially targeted securities in the immediate future. Overall, net foreign private purchases of U.S. Treasury securities reached a record $18.4 billion in the first eleven months of 1984.

Net international capital inflows into banks in the United States totaled about $8 billion in October and November. As shown on line 3 of the table on International Banking Data, the $3 billion reduction in monthly average net claims of banks on their own foreign offices and IBFs between September and December followed a reduction of $8 billion earlier in the year. The bulk of these inflows consisted of withdrawals by regional banks of placements made in the Eurodollar interbank markets in 1982 and early 1983.

For much of 1984, 22 of the largest 23 banks (excluding Continental) could not increase their Eurodollar borrowings substantially without subjecting the additional borrowing to the Eurocurrency reserve requirement. Despite this fact, evidence from interest rate relationships does not indicate that the operation of the Eurocurrency reserve requirement increased the cost of funds to U.S.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1981	1982	1983				1984				1985
	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.	Jan. 3/
1. Net Claims of U.S. Banking Offices (excluding IBFs) on Own Foreign Offices	7.8	32.9	49.2	43.6	44.1	39.3	35.3	32.2	30.2	25.4	n.a.
2. Net Claims of U.S. Banking Offices on Own IBFs 1/	11.8	16.2	14.6	12.8	10.5	5.2	4.1	4.4	6.3	7.8	n.a.
3. Sum of lines 1 and 2 of which:	19.6	49.1	63.8	56.4	54.6	44.5	39.4	36.6	36.3	33.2	39.0
(a) U.S.-chartered banks	22.3	40.0	53.7	49.9	48.7	40.8	36.9	34.7	35.7	32.1	36.4
(b) Foreign-chartered banks	-2.6	9.1	10.0	6.5	5.9	3.7	2.5	1.9	.6	1.1	2.6
4. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	13.2	15.8	16.9	17.3	17.3	18.7	18.5	19.9	20.2	20.7	20.7
5. Eurodollar Holdings of U.S. Nonbank Residents 2/	95.5	112.6	116.4	120.4	121.3	126.4	128.0	123.2	121.1	115.7	115.2

1. Corresponds to net claims of international banking facilities (IBFs) on all foreign residents, including all banks whether related or not, and all nonbanks.
2. Includes term and overnight Eurodollars held by money market mutual funds.
3. Through January 21, 1985.

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

banks significantly. Although banks bound by the Eurocurrency reserve requirement have an incentive to substitute Federal Funds for borrowings in the Eurodollar interbank markets, Federal Funds rates have not risen relative to Eurodollar rates. Arbitrage by banks not bound by the Eurocurrency reserve requirement has been sufficient so that no significant differential has appeared to date between rates for funds in these two markets.

In January (through the 21st) net claims of banks in the United States on their foreign offices were $6 billion on average higher than in December. These outflows were concentrated at large banks and probably reflect, in part, strong core deposit growth combined with weak business loan demand at domestic offices.

U.S. Merchandise Trade

With a substantial reduction in the trade deficit in December, the deficit for the fourth quarter was smaller than in any other quarter of 1984. For the year 1984, the deficit was $108 billion, more than $45 billion larger than a year earlier.

Exports increased somewhat in the fourth quarter from third-quarter rates. Much of the rise in value was in agricultural shipments, primarily grain exports to the Soviet Union. The USSR purchased an exceptionally high 13.2 million metric tons (MMT) of grain in the third quarter, which resulted in a doubling of the volume of U.S. grain shipments to the USSR in the fourth quarter (to 8.2 MMT). The current grain agreement calls for annual purchases by the USSR of a minimum of 9 MMT and a maximum of 12 MMT of grain from the United States. President Reagan has agreed to allow the USSR to purchase up to 22 MMT of grain in the agreement-year ending

U.S. MERCHANDISE TRADE 1/

	Years		1984				
	1983	1984	Q1	Q2	Q3	Q4	Dec.
Value (Bil. $, SAAR)							
Exports	200.3	220.3	215.7	218.2	221.9	225.3	228.6
Agricultural	36.6	38.4	41.4	37.2	36.3	38.6	41.3
Nonagricultural	163.6	181.9	174.3	180.9	185.7	186.7	187.4
Imports	261.3	327.9	318.9	321.4	354.3	316.8	306.6
Oil	53.8	57.3	55.4	59.6	57.8	56.4	51.0
Nonoil	207.5	270.5	263.5	261.8	296.4	260.4	255.6
Trade Balance	-61.1	-107.6	-103.3	-103.2	-132.4	-91.5	-78.0
Volume (Bil 72$, SAAR)							
Exports							
Agricultural	16.3	16.2e	17.0	15.1	15.4	16.9e	n.a.
Nonagricultural	57.3	62.9e	60.6	62.6	64.5	64.4e	n.a.
Imports							
Oil	4.9	5.3e	5.1	5.5	5.4	5.3e	.
Nonoil	81.9	103.8e	102.3	100.4	113.3	99.3e	n.a.

r/ Revised. e/ Based on unit value indexes through November.
1/ International transactions and GNP basis.

September 30, 1985; as of January 24, the USSR has ordered 14.0 MMT of which 10.5 MMT have been shipped. The fourth-quarter rise in the value of agricultural exports occurred despite a drop in export prices. The weakening of agricultural export prices, which resumed last July, is a consequence of record harvests in many parts of the world.

The small increase in nonagricultural exports in the fourth quarter from the third quarter occurred as increases in some commodity categories (e.g., petroleum products, business machines, and aircraft) were largely offset by declines in other items (e.g., coal, automotive parts to Canada, and gold). However, compared with the level of exports a year earlier, the volume of nonagricultural exports increased by a notable 9-1/2 percent (4Q/4Q). By area, the rise in nonagricultural exports over the year was fairly broadly based; shipments expanded at about the overall average rate to Canada, Western Europe, Asia (Hong Kong, Korea, Singapore, and Taiwan), and Latin America excluding Mexico. The value of nonagricultural exports to Mexico (which account for about 5 percent of all U.S. shipments) increased by 50 percent (4Q/4Q) from low 1983 levels. Nonagricultural exports to Japan (which account for about 9 percent of all U.S. shipments) were about the same in 1984 as in 1983 (4Q/4Q).

Nonoil imports in the fourth quarter dropped from the extraordinarily high rate recorded in the third quarter. Nonetheless, nonoil imports in the fourth quarter continued to be strongly affected by the strength of U.S. economic activity and the high exchange value of the dollar; nonoil imports were nearly 15 percent higher than a year earlier (4Q/4Q) with most of the change in volume. Year over year, the value of nonoil imports increased by 30 percent. The increase was spread broadly over the major commodity categories -- capital goods (especially business machines and other electronic products), industrial supplies, consumer goods, and automotive products (half of the increase in this category was from Canada).

The volume of oil imported in the fourth quarter was slightly less than the average rates for both the second and third quarters; the volume dropped sharply in December to 5.1 million barrels per day. The average price of imported oil was about 30 cents per barrel less than in the third quarter. Ample supply and moderate demand have put downward pressure on world oil prices since mid-1984.

OIL IMPORTS

	Years		1984				
	1983	1984	Q1	Q2	Q3	Q4	Dec.
Volume (mbd, SA)	5.20	5.60	5.40	5.76	5.66	5.59	5.09
Price ($/BBL)	28.42	27.95	28.05	28.26	27.91	27.59	27.37
Value (Bil. $, SAAR)	53.80	57.32	55.41	59.61	57.84	56.42	51.01

Foreign Economic Developments. Economic activity in the major foreign industrial countries continued at an uneven pace into the fourth quarter, after relatively strong real GNP growth rates were seen in the third quarter of last year. Industrial production in the three months to November was above its year-ago level in all countries. The strongest advance in production was recorded by Japan with over 10 percent, followed by Canada with 5 percent and the continental European countries with 2 to 4 percent. In the United Kingdom, where the coal miners' strike is in its eleventh month, industrial production in recent months has barely regained its level of late 1983.

Inflation abroad has continued to slow. The rates of increase of consumer price indices in December 1984 from a year earlier were the lowest since the late 1960s or early 1970s in all countries except in Japan, where the rate in 1983 was lower than in 1984. The gains made against inflation last year were strongest in those countries (Italy, France) that still have relatively high inflation rates.

The Bank of England, in response to strong downward pressure on sterling, raised its money market dealing rates by 4-3/8 percentage points in three steps between January 11 and 28. The Bundesbank, on January 31, raised its Lombard rate from 5.5 to 6.0 percent. The Dutch Central Bank raised its official rate also by one-half of one percentage point.

Individual Country Notes. The pace of economic activity in Japan increased in the fourth quarter after a slowdown in the previous quarter. Industrial production in the fourth quarter rose 2.9 percent

February 6, 1985

REAL GNP AND INDUSTRIAL PRODUCTION IN MAJOR INDUSTRIAL COUNTRIES

(PERCENTAGE CHANGE FROM PREVIOUS PERIOD, SEASONALLY ADJUSTED)

	Q4/Q4 1983	Q4/Q4 1984	1984 Q1	Q2	Q3	Q4	1984 AUG.	SEP.	OCT.	NOV.	DEC.	LATEST 3 MONTHS FROM YEAR AGO+
CANADA												
GNP	7.1	N.A.	.8	.8	1.9	N.A.	*	*	*	*	*	4.8
IP	16.1	N.A.	.6	.8	3.1	N.A.	-.6	-2.0	-.1	2.2	N.A.	4.9
FRANCE												
GDP	.8	N.A.	.8	-.4	.8	N.A.	*	*	*	*	*	1.9
IP	1.8	N.A.	1.3	-1.0	2.8	N.A.	.0	-3.7	2.3	-1.5	N.A.	2.1
GERMANY												
GNP	3.0	N.A.	1.2	-2.0	2.2	N.A.	*	*	*	*	*	2.8
IP	6.0	4.5	.6	-4.7	5.6	3.1	-1.8	-.4	3.6	.3	.8	4.5
ITALY												
GDP	1.0	N.A.	.9	.7	1.1	N.A.	*	*	*	*	*	3.3
IP	1.7	N.A.	1.0	.5	1.9	N.A.	1.5	1.1	-2.5	-1.2	N.A.	2.9
JAPAN												
GNP	3.9	N.A.	1.4	1.8	.7	N.A.	*	*	*	*	*	5.4
IP	8.6	10.8	3.2	2.8	1.5	2.9	.7	-1.0	3.3	.3	-.4	10.8
UNITED KINGDOM												
GDP	4.0	N.A.	.7	-.8	.3	N.A.	*	*	*	*	*	1.4
IP	5.1	N.A.	-.4	-2.0	.2	N.A.	.1	1.5	1.3	-.2	N.A.	.2
UNITED STATES												
GNP	6.3	5.6	2.4	1.7	.4	1.0	*	*	*	*	*	5.6
IP	15.0	6.3	2.7	2.1	1.6	-.2	.1	-.6	-.3	.4	.6	6.3

* DATA NOT AVAILABLE ON A MONTHLY OR QUARTERLY BASIS.

+ IF (ERLY DATA, LATEST QUARTER FROM YEAR AGO.

February 6, 1985

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

	Q4/Q4 1983	Q4/Q4 1984	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 Q3	1984 Q4	1984 OCT.	1984 NOV.	1984 DEC.	1985 JAN.	LATEST 3 MONTHS FROM YEAR AGO
CANADA													
CPI	4.6	3.7	1.6	.9	1.2	.9	.9	.7	.2	.6	.1	N.A.	3.7
WPI	3.5	3.6	.9	.4	1.6	1.2	.5	.3	.1	.4	.2	N.A.	3.6
FRANCE													
CPI	9.8	6.8	2.1	1.9	1.7	1.8	1.7	1.4	.7	.3	.2	N.A.	6.8
WPI	14.6	10.4	3.7	3.6	3.4	2.9	2.1	1.6	.5	.1	.1	N.A.	10.4
GERMANY													
CPI	2.7	2.0	1.0	.5	.9	.5	.0	.7	.6	.1	.1	N.A.	2.0
WPI	.9	1.0	.9	1.2	1.7	.8	-1.4	.0	.9	-.6	.1	N.A.	1.0
ITALY													
CPI	12.8	8.8	2.3	3.5	2.9	2.1	1.2	2.2	1.0	.6	.7	1.0	8.6
WPI	9.1	9.3	2.3	3.3	3.2	2.2	1.2	2.3	.9	.2	1.4	N.A.	9.3
JAPAN													
CPI	1.9	2.4	-.2	1.4	.9	.6	-.2	1.2	.7	-.4	.2	1.0	2.7
WPI	-3.3	.5	.2	-.6	.1	-.1	.8	-.3	-.3	-.2	.1	N.A.	.5
UNITED KINGDOM													
CPI	5.1	4.8	1.3	1.1	.6	2.0	.9	1.2	.6	.3	-.1	N.A.	4.8
WPI	5.6	6.0	.8	1.3	1.8	2.3	.6	1.2	.5	.3	.2	N.A.	6.0
UNITED STATES													
CPI (SA)	3.2	4.0	1.0	1.1	1.2	.9	.9	.9	.4	.2	.2	N.A.	4.0
WPI (SA)	.9	1.7	.6	.4	1.1	.3	.1	.1	-.2	.5	.1	N.A.	1.7

February 6, 1985

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

	1983	1984	1983 Q3	1983 Q4	1984 Q1	1984 Q2	1984 Q3	1984 Q4	1984 SEP.	1984 OCT.	1984 NOV.	1984 DEC.
CANADA												
TRADE	14.4	N.A.	3.1	3.5	3.6	4.2	4.1	N.A.	1.5	1.7	1.4	N.A.
CURRENT ACCOUNT	1.4	N.A.	-.2	.0	.0	.5	.5	N.A.	*	*	*	*
FRANCE												
TRADE 2/	-5.9	-2.4	-.6	-.2	-1.5	-1.1	.4	-.1	.1	-.4	.1	.2
CURRENT ACCOUNT 2/	-4.9	-.2	.1	.2	-.7	-.7	.7	.5	*	*	*	*
GERMANY												
TRADE	16.4	18.8	3.7	3.4	4.3	3.2	5.0	6.3	1.7	2.2	2.1	1.9
CURRENT ACCOUNT (NSA)	4.1	6.0	-2.3	3.7	.7	-.2	-.6	6.0	.0	2.0	2.0	2.1
ITALY												
TRADE	-7.8	N.A.	-2.1	-1.3	-2.5	-3.0	-1.6	N.A.	-.6	-1.0	-2.3	N.A.
CURRENT ACCOUNT (NSA)	.6	N.A.	1.5	-.1	-1.7	-1.0	N.A.	N.A.	*	*	*	*
JAPAN												
TRADE 2/	31.2	44.5	8.5	8.2	10.0	11.1	10.1	13.2	3.9	4.0	5.2	4.0
CURRENT ACCOUNT	21.0	35.0	5.7	5.5	7.2	9.2	7.4	11.1	3.0	3.4	4.3	3.5
UNITED KINGDOM												
TRADE	-.8	-5.7	-.4	-.0	-.2	-1.8	-2.1	-1.5	-1.0	-1.1	-.1	-.2
CURRENT ACCOUNT 2/	4.4	.1	1.2	.9	.6	-.5	-.6	.6	-.5	.1	.3	.2
UNITED STATES												
TRADE	-61.1	-107.8	-17.5	-19.4	-25.9	-25.9	-33.1	-22.9	-10.5	-7.9	-8.5	-6.5
CURRENT ACCOUNT	-41.6	N.A.	-11.8	-17.2	-19.7	-24.7	-32.9	N.A.	*	*	*	*

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

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

(s.a.), following a 1.5 percent increase in the third quarter. Personal consumption spending appears to be picking up, as retail sales in December rose by 2.1 percent (s.a.). Private plant and equipment investment also continues to show a healthy rate of increase, especially in high technology industries. After a 6-1/4 percent (s.a.) jump in October, housing starts declined by almost 2 percent in November. New housing starts in the first 11 months of 1984 were 4.4 percent above their year-earlier level.

Consumer prices in 1984 rose by only 2.4 percent (Q4/Q4) despite the pick-up in activity. The increase in the inflation rate in the fourth quarter reflects seasonal factors. Wholesale price inflation remains about zero.

Both the trade and current accounts showed record surpluses last year of, respectively, $44 and $35 billion. The value of exports in 1984 was up by almost 16 percent, with exports to the United States accounting for almost 75 percent of the increase. Sales to Latin America rose by about 35 percent. Imports rose by about 8-1/2 percent last year, with imports of manufactured goods being especially strong (up 21 percent).

On January 25, the long-term prime rate was cut from 7.6 to 7.4 percent. For several months, long-term rates have declined gradually, while short-term rates have remained flat. The Bank of Japan has indicated that its policy is to maintain the discount rate to avoid any weakening of the yen. Unconfirmed reports indicate that the Ministry of Finance (MoF) has decided to permit five major city banks to issue convertible bonds for the first time, provided that only Eurobonds are issued and that the funds raised are used only for expansion of bank capital or investment in plant and equipment. The banks on the other hand are reportedly interested in such issues as a way of funding Euroyen lending and are anticipating that the MoF will decide soon to permit medium- and long-term Euroyen lending. At present, the MoF limits Euroyen lending to a term of one year or less.

German real GNP grew 1.9 percent in the fourth quarter according to provisional data to a level 3.2 percent above the fourth quarter of 1983. The strength of this result reflects continued rebounding from last summer's strike. Industrial production has shown a similar pattern of rebounding from low levels last summer. The GNP data for the fourth quarter point to exports as a source of strength, followed by investment in equipment. Private consumption has remained subdued, and construction continues to show weakness. The rate of unemployment was 9.2 percent (s.a.) in January, only slightly below its peak in mid 1983. Consumer price inflation has been very moderate, although the monthly rate (n.s.a.) in January was 0.6 percent. Compared to January of last year, the index was 2.1 percent higher. Producers and wholesale prices are showing similarly moderate increases, but import prices have been accelerating more strongly, to a level almost 6 percent above a year ago.

Reflecting the strong surge of exports in the second half of last year, the 1984 trade balance showed a record surplus of almost $19 billion. The current account surplus for 1984 was $6 billion, compared to $4.1 billion in 1983.

On January 31, the Bundesbank raised its Lombard rate from 5.5 to 6.0 percent. This move is consistent with its recently tightened monetary target although the Bundesbank has emphasized the technical reason of placing the Lombard rate above the overnight rate. In December, the Bundesbank had lowered its monetary growth target for 1985 to 3-5 percent from 4-6 percent in 1984.

Real GDP (average measure) in the United Kingdom grew 1.1 percent (s.a.a.r.) in the third quarter while the index of industrial production recovered in October and November to the level reached prior to the onset of the ongoing coal miners' strike. To date, the effect of the 10-1/2 month strike on coal-using industries has been limited; and, although the production of coal has been substantially reduced, it appears that coal supplies will be adequate to meet winter needs.

The U.K. unemployment rate reached a peak of 13 percent (s.a.) in January. The retail price index fell slightly in December, lowering its twelve-month change to 4.6 percent. The U.K. trade deficit was $5.7 billion in 1984 reflecting, in part, decreased net exports of energy products as a result of the coal miners' strike. The current account was near balance, compared with a $4.4 billion surplus in 1983.

The Bank of England increased its money market dealing rates by 1 percentage point on January 11 and by 1-3/8 percentage points on Monday, January 14, as sterling reached record lows both against the dollar and on a trade-weighted basis. The Bank also took the unusual step of posting its Minimum Lending Rate (at 12 percent) on January 14 prior to increasing its dealing rates. The posted MLR was to hold only for one day and the Bank subsequently returned to its normal practice of not posting its MLR. Further rises in market interest rates associated with a renewed weakening of the pound led the Bank to increase its money market dealing rates by an additional 2 percentage points on January 28. On February 5, the Bank's shortest-term money market dealing rate was 13-7/8 percent; the clearing banks' base rate was 14 percent.

On January 22, the U.K. government released a white paper setting out its plans to squeeze public spending in order to make way for tax cuts. Real public expenditure is scheduled to fall by 1 percent in 1985/86 and then be held constant for the following two fiscal years. The detailed 1985/86 budget will be presented to Parliament in March.

Continuing trends that prevailed throughout 1984, recent data indicate that economic activity in France has been weak, the inflaiton rate has declined, and the trade and current accounts have moved from deficit toward surplus. Industrial production declined by 1.5 percent (s.a.) in November, reversing most of the increase of the previous month, and leaving industrial production for September-November 2.1 percent above its year-earlier level. The unemployment rate rose to 10.5 percent at the end of 1984, compared with a 9.3 percent rate at the end of 1983.

Consumer prices increased by only 0.3 percent (n.s.a.) in November and 0.2 percent in December, reducing the year-over-year inflation rate at the end of 1984 to 6.8 percent. This is above the government's original inflation target of 5 percent for the year, but still represents a substantial reduction from the previous year's 9.8 percent inflation rate.

The current account in the fourth quarter was in surplus by $500 million (s.a.). For 1984 as a whole, the current account was in deficit by only $200 million, compared with deficits of $4.9 billion in 1983 and $12.1 billion in 1982.

Canadian third-quarter real GNP increased at an annual rate of 7.6 percent after an average pace of 3.3 percent in the first half of the year. Although growth in private investment increased in 1984, capital formation has been extremely low over the last six or seven quarters. Even with recent increases, gross fixed capital formation in the third quarter was about 12 percent below the peak reached in 1981. Industrial production increased 2.2 percent in November to a level 5.5 percent above November 1983. Unemployment stood at 10.8 percent in December, two percentage points below the peak in December 1982.

Inflation continued to be moderate in 1984. Consumer prices in December were only 3.7 percent above year-earlier levels, matching the inflation rates in 1971 and 1972. This slower rate of inflation compares favorably with last year's pace of 4.6 percent. In addition, inflation in Canada's industry selling price index in October was also a moderate 3.4 percent. Canada's trade surplus increased in November to $15 billion on a cumulative basis, compared to $13.2 billion for the comparable period a year before. The current account showed a cumulative surplus of $1 billion for the first three quarters of 1984 compared to a $1.4 billion surplus for all of 1983.

Although the new Conservative government has stirred broad debate about tax reform and free trade with the United States, it is doubtful that a consensus will emerge soon. While some budget cuts will probably be made, the new government is moving with caution on campaign promises of budgetary discipline.

The recovery in Italy moderated somewhat in the fourth quarter of 1984. Industrial production dropped in October and November, but preliminary data show a slight upturn in December; the yearly average of Italian industrial production was 3.5 percent higher in 1984 than in 1983. The year-over-year rate of increase of consumer prices in January 1985 was 8.6 percent, compared with 12.5 percent in January 1984. The official November household survey indicates that consumers feel that inflation has moderated and expect it to continue to do so in the next year.

Italy's trade account deteriorated sharply in November, registering one of the largest monthly deficits in history at $2.3 billion (s.a.); the trade account deficit in the first 11 months of 1984 was $10.4 billion compared with $6.9 billion in the same period in 1983. Exports of petroleum products, accounting for eight percent of the value of total Italian exports, decreased by 51 percent between November 83 and November 1984. There also has been some concern that the lira may be overvalued with respect to other currencies in the European Monetary System.

The Visentini tax reform has been promulgated by decree law and has survived a vote of confidence in the Senate. The tax reform is expected to raise tax collections by an amount equivalent to about 13 percent of the 1984 budget deficit. However, the 1985 budget calls for an increase in the public sector deficit, although the share of the deficit in GDP is expected to decline from more than 15 percent in 1984 to about 14 percent in 1985. On January 4, Italian authorities lowered the discount rate from 16.5 percent to 15.5 percent. The rate had been lowered in February 1984 and raised in September 1984.

Debt Situation in Selected Developing Countries

On December 28, Argentina received IMF Executive Board approval of an SDR 1.42 billion 15-month stand-by credit in support of its economic stabilization program and of an SDR 275 million Compensatory Financing Facility (CFF) drawing. The Board acted after receiving assurances that sufficient external financing would be available to cover Argentina's 1984-85 financing gap. (However, commitments to the new money package are still short of the $4.2 billion target.) Given approval of the IMF package and substantial commitments to bank financing, the U.S. Treasury activated on December 28 a $500 million bridge loan announced earlier. The Treasury funds, augmented by $100 million supplied by Mexico and $250 million drawn from Argentine reserves, helped Argentina to repay $850 million of public sector interest arrears to the banks before the end of 1984. The Treasury loan was repaid partly on January 3 from the proceeds of the CFF credit and partly on January 15 from the first disbursement of the IMF stand-by credit. A Paris Club restructuring of $2.1 billion in principal and interest owed to official creditors, in arrears and falling due in 1985, was agreed upon on January 16. The monthly rate of Argentine inflation (measured by the CPI), which had declined to 15 percent in November, the lowest rate since January 1984, rose again to nearly 20 percent in December and is expected to be about 24 percent in January. The official peso price of the dollar rose apace with the CPI in December and (if current expectations about the January CPI increase are realized) also in January. The free market premium for the dollar, which narrowed in late November and especially in the first three weeks of December (after Argentina reached agreement with its bank advisory committee on a 1984-85 financing package), increased again in late December and January, reaching 28.5 percent on January 25 before declining to 19.1 percent at the end of the month. Money was very tight in December when unregulated rates on unsecured loans exceeded 50 percent per month, but conditions eased considerably thereafter and the unsecured loan rate fell to about 23 percent on January 23. Moreover, recent adjustments in public sector prices lagged behind the rate of inflation in January.

On December 14, the IMF approved an SDR 615 million, 18-month, stand-by arrangement for the Philippines, culminating negotiations that had continued off and on since September 1983. On December 20 the Paris Club agreed to reschedule approximately $1.1 billion in Philippine external debts to official creditors. During the first week of 1985 the Philippines fell out of compliance with the IMF program by failing to meet the performance criterion for reserve money (a type of monetary base concept). The central bank plans to sell bills in order to reduce the amount of reserve money below the ceiling set for the end of March 1985. Failure to observe that ceiling would probably mean that the Philippines could not make a second drawing on the IMF stand-by arrangement. On January 25, Banco Filipino--the Philippines' largest savings bank with some 3.7 million depositors--was placed under receivership and its deposit accounts were transferred to the government-owned Philippine National Bank, following a determination by the Monetary Board that the bank was insolvent.

The minimum wage in Mexico was increased by 30 percent effective January 1, bringing it to a level 56 percent higher than in January

1984. The next increase in the minimum wage is expected to be around mid-year. The size of the January wage increase and the magnitude of the announced 1985 public sector deficit, which is larger in relation to GDP than envisaged for this year in the original IMF-approved economic stabilization program, suggest that the resolve of the authorities to follow through on their adjustment program in the macroeconomic area may have weakened. This tendency may be intensified by the approach of mid-term congressional elections in July 1985. In 1985, the Mexican authorities project a real GDP growth of 3-4 percent (after a 2-3 percent growth rate in 1984) and an inflation rate of 35 percent on a December-to-December basis (after a 59 percent inflation rate in 1984). However, the recent fiscal policy and wage policy measures point to inflation of perhaps 45 percent in 1985. In 1984, Mexico's current account surplus is estimated at about $4.5 billion and total international reserves (excluding gold) rose by a similar amount.

Colombia has been unable to complete negotiations with banks on a refinancing package for Banco de Colombia. The Colombian authorities are continuing to discuss their overall financial needs for 1985-86 with the banks, the IMF, and the IBRD; a bank committee has been formed to advise Colombia on this problem. After a recent meeting, the committee informed Colombia that the country's financing package was not saleable without a formal IMF program. Since mid-December, new taxes have been approved by the Colombian Congress, gasoline prices and utility rates have been increased significantly, and public sector wages have been raised by 8 percentage points less than the most recent 12-month increase in the consumer price index. Some public investments have also been postponed. A special session of the legislature is to consider further expenditure containment measures. An IMF staff team is expected to visit Colombia in February to assess the country's adjustment measures.

In Venezuela, some progress appears to have been made in the registration of private sector debt and the payment of interest arrears. By December 31, the Venezuelan authorities had made decisions concerning the validity of some $6.5 billion of the total $8-$10 billion in private sector debts. While only $300 million in interest arrears was actually paid by the end of the year, the progress in debt registration was sufficient for Venezuela and its creditor banks to begin discussion on January 31 of the terms sheet for the multi-year rescheduling agreement negotiated last September. Venezuela expects the rescheduling agreement to be completed sometime this July. Real GDP declined by 1.9 percent in 1984. At the same time, the inflation rate increased to an estimated 15 percent during the year (December to December). The public sector deficit, which was 4.7 percent of GDP in 1983, showed a surplus of 5.4 percent of GDP for 1984. Venezuela's current account surplus was about $4.4 billion, somewhat higher than its 1983 surplus.

Brazil is not requesting new money from banks in 1985, in part because its gross reserves (excluding gold) at the end of last year were approximately $12 billion. Instead, Brazil and the commercial banks are negotiating a multi-year rescheduling under which $45 billion of debt coming due to public and private sector debtors between 1985 and 1991 would be rescheduled, and spreads would be reduced from the close to 2 percentage points spread now prevailing. Brazil's IMF program for this year is expected to go to the IMF Executive Board on March 10. Brazil registered a trade surplus of $13 billion in 1984; the value of exports grew some 23 percent while imports fell 9 percent. The current account registered a surplus of $200 million (excluding $700 million of re-invested profits). The general price index increased by 10.5 percent in December and 12.6 percent in January. Economic activity has shown continued signs of strength and real GDP is expected to grow 4-5 percent this year, after growing by 4 percent in 1984. Growth in the monetary base in December 1984 was 37 percent, the largest monthly increase ever recorded. It now appears that Brazil exceeded the ceiling for the nominal public sector borrowing requirement for the end of 1984, largely because of the greater than expected inflation, and also may have missed the end-year target for the operational public sector borrowing requirement (adjusted for inflation). Brazil's domestic economic performance in 1984 calls into question the credibility of the 1985 IMF program and the successful completion in the short run of its debt rescheduling with the commercial banks.

Peru, which has been out of compliance with its IMF program since June 1984, paid about $50 million in overdue interest owed to banks in early January, bringing interest current through early July 1984. Peru's interest arrears to banks are now approximately $300 million. The new finance minister has developed a plan to reduce the fiscal deficit and eliminate external arrears by end-1985, but the unrealistic assumptions that form the basis for the current fiscal budget and the hesitancy of Peru's president to authorize austerity moves prior to the April 28 election tend to undermine the credibility of the current government.

Chile is continuing its negotiations with the IMF over a new stand-by arrangement; issues to be resolved include the size of the public sector and current account deficits. A real depreciation of about 17 percent since September 1984 and a rise in the price of copper in January 1985 have improved Chile's external prospects. However, concerns over the availability of funding from multilateral development banks complicate Chile's efforts to finance a current account deficit that may be little changed from the $1.7 billion deficit registered in 1984.