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October 31, 1986

SUPPLEMENT  
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the  
Federal Open Market Committee

By the Staff  
Board of Governors  
of the Federal Reserve System

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## SUPPLEMENTAL NOTES

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### THE DOMESTIC NONFINANCIAL ECONOMY

#### New home sales

Sales of new homes rose 11 percent in September to a 690,000 annual rate. The increase in September, together with upward revisions to figures for July and August, brought third-quarter sales to 670,000, well below the high first-half average but about the same as the pace for 1985 as a whole.

The average price of new homes sold in September was \$114,000, up 11 percent from one year earlier. The inventory of unsold new homes registered a small increase in the third quarter, reaching 357,000 units, but remains within the range of recent quarterly observations.

#### Manufacturers' inventories

The book value of manufacturers' inventories fell \$8 billion at an annual rate in September, after a \$14 billion decline in the previous month. Factory shipments rose 1.5 percent last month, and the inventory-to-shipments ratio for all manufacturing fell from 1.44 to 1.41, the lowest since November 1985.

Inventories at durable goods industries rose at a \$2 billion annual rate in September. The September rise, only the second in the past 15 months, reflected a sharp increase in aircraft stocks. Outside of aircraft and parts, the nonelectrical machinery (primarily office and computing machinery) and steel industries continued to report book-value inventory reductions in September, but stocks at other durable goods industries appear to have

remained stable. Among nondurable goods industries, inventories of food products and petroleum both fell sharply. With petroleum prices fluctuating over the summer, it is not clear to what extent the drop in that industry's book value inventories may reflect price developments.

For the third quarter as a whole, factory inventories fell at a \$6-1/2 billion annual rate in book value terms—only slightly different from the drop that BEA had assumed when the preliminary GNP estimates for the third quarter were prepared.

## THE MARKET FOR NEW HOUSES

	1985	1986		1986		
		Q2 <sup>r</sup>	Q3 <sup>p</sup>	July <sup>r</sup>	Aug. <sup>r</sup>	Sept. <sup>p</sup>
<u>Sales Volume</u>						
(Thousands of units, SAAR)	688	796	670	695	624	690
<u>Sales Price</u>						
Average (\$1,000, NSA)	100.8	112.0	114.9	116.3	113.8	114.1
(Percent change from year earlier)	(3.3)	(11.4)	(14.3)	(17.0)	(14.7)	(11.2)
Median (\$1,000, NSA)	84.3	92.1	92.4	93.5	91.6	91.7
(Percent change from year earlier)	(5.4)	(9.3)	(11.1)	(13.9)	(10.0)	(8.4)
<u>Inventory</u>						
Units for sale						
(Thousands of units, end of period)	349	340	357	349	354	357
Months' supply						
(At current sales rate)	6.2	5.2	6.4	6.2	6.8	6.3

Note: Months' supply data derived by Census Bureau by seasonal adjustment of the ratio of homes for sale to homes sold. It may, therefore, not agree with the seasonally adjusted components shown on the table.

r--revised.

p--preliminary.

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

	1985	1986			1986		
	Q4	Q1	Q2	Q3	July	Aug. <sup>r</sup>	Sept. <sup>p</sup>
Book Value Basis:							
Total	17.6	20.1	2.9	--	35.8	-7.9	--
Manufacturing	-8.6	-9.3	-4.6	-6.4	2.4	-13.7	-7.9
Wholesale	6.1	4.5	6.9	--	11.5	11.8	--
Retail	20.1	24.9	.6	--	21.9	-6.0	--
Automotive	19.9	15.1	-1.4	--	20.1	-9.9	--
Ex. auto	.2	9.8	2.0	--	1.8	3.9	--
Constant Dollar Basis:							
Total	11.0	29.8	1.6	--	22.8	-4.6	--
Manufacturing	-10.5	-5.3	1.0	--	10.1	-11.5	--
Wholesale	3.6	6.8	4.6	--	17.0	19.4	--
Retail	17.8	28.3	-4.0	--	-4.3	-12.4	--
Automotive	15.9	17.2	-1.8	--	-6.0	-15.0	--
Ex. auto	1.9	11.0	-2.3	--	1.7	2.6	--

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

	Cyclical Reference Points <sup>2</sup> 81 low 82 high		1985	1986			1986		
			Q4	Q1	Q2	Q3	July	Aug. <sup>r</sup>	Sept. <sup>p</sup>
Book Value Basis:									
Total	1.39	1.53	1.36	1.38	1.39	--	1.38	1.38	--
Manufacturing	1.60	1.77	1.42	1.43	1.43	1.42	1.44	1.44	1.41
Wholesale	1.06	1.28	1.18	1.20	1.23	--	1.22	1.23	--
Retail	1.37	1.46	1.43	1.47	1.45	--	1.45	1.42	--
Automotive	1.57	1.90	1.65	1.78	1.70	--	1.72	1.63	--
Ex. Auto	1.31	1.37	1.37	1.38	1.38	--	1.37	1.36	--
Constant Dollar Basis:									
Total	1.58	1.72	1.54	1.55	1.54	--	1.53	1.52	--
Manufacturing	1.88	2.04	1.72	1.72	1.70	--	1.70	1.71	--
Wholesale	1.26	1.45	1.30	1.31	1.32	--	1.30	1.31	--
Retail	1.38	1.49	1.48	1.52	1.48	--	1.47	1.44	--
Automotive	1.54	1.90	1.66	1.83	1.74	--	1.73	1.56	--
Ex. auto	1.31	1.41	1.44	1.44	1.41	--	1.40	1.40	--

1. Ratio of end-of-period inventories to average monthly sales for the period.

2. Highs and lows are specific to each series and are not necessarily coincidental.

r—Revised estimates.

p—Preliminary estimates.

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

October 31, 1986

	1984:Q4 to		1986				Growth from Q4 1985 to Oct. 1986 <sup>pe</sup>
	1985:Q4	Q2	Q3	Aug.	Sept.	Oct. <sup>pe</sup>	
----- Percentage change at annual rates -----							
1. M1	11.9	15.8	17.4	20.8	9.9	15	14-1/2
2. M2	8.7	10.4	11.2	11.1	7.4	10	9
3. M3	7.7	9.0	10.1	8.9	8.8	6	9
Levels in billions of dollars Sept. 1986							
<u>Selected components</u>							
4. Currency	7.5	6.2	7.3	10.1	5.4	10	179.8
5. Demand deposits	8.6	15.2	14.4	14.6	1.6	5	292.2
6. Other checkable deposits	22.3	25.6	31.2	39.4	25.6	34	215.1
7. M2 minus M1 <sup>2</sup>	7.7	8.7	9.1	7.9	6.6	8	2047.5
8. Overnight RPs and Eurodollars, NSA	20.0	-2.3	28.3	41.8	-30.7	55	72.3
9. General purpose and broker/dealer money market mutual fund shares, NSA	9.3	27.3	13.8	3.6	11.4	29	202.2
10. Commercial banks	9.1	5.7	6.3	5.5	7.1	5	881.5
11. Savings deposits, SA, plus MMDAs, NSA <sup>3</sup>	19.0	13.2	18.5	19.5	20.6	21	508.9
12. Small time deposits	-0.6	-3.1	-9.0	-12.6	-10.9	-18	372.6
13. Thrift institutions	5.1	7.3	5.9	4.1	1.2	2	892.6
14. Savings deposits, SA, plus MMDAs, NSA <sup>3</sup>	13.7	13.8	18.9	17.1	10.1	20	393.7
15. Small time deposits	-0.4	2.6	-3.7	-5.7	-5.7	-12	498.9
16. M3 minus M2 <sup>4</sup>	3.8	3.4	6.0	0.0	14.0	-9	683.9
17. Large time deposits	5.7	-1.8	-1.1	5.1	-2.1	-9	446.8
18. At commercial banks, net <sup>5</sup>	5.1	-8.8	-3.0	7.3	-2.6	-11	281.1
19. At thrift institutions	6.8	11.0	2.4	2.2	-2.2	-7	165.7
20. Institution-only money market mutual fund shares, NSA	11.1	39.2	30.9	51.1	53.5	3	84.4
21. Term RPs, NSA	-4.0	19.3	15.2	9.6	41.2	-5	78.4
22. Term Eurodollars, NSA	-4.9	6.1	-6.5	-9.1	36.8	-42	80.6
-- Average monthly change in billions of dollars --							
<u>MEMORANDA:</u>							
23. Managed liabilities at commercial banks (24+25)	2.5	-5.5	3.9	5.9	4.0	-12	484.3
24. Large time deposits, gross	1.0	-2.6	0.7	4.2	-0.6	-3	342.0
25. Nondeposit funds	1.5	-2.9	3.2	1.7	4.6	-9	142.3
26. Net due to related foreign institutions, NSA	0.4	-1.7	-0.2	0.0	5.2	-8	-25.0
27. Other <sup>6</sup>	1.1	-1.2	3.4	1.8	-0.7	-1	167.3
28. U.S. government deposits at commercial banks <sup>7</sup>	0.2	0.9	-0.8	-1.6	2.9	-3	16.0

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. Growth rates are for savings deposits, seasonally adjusted, plus money market deposit accounts (MMDAs), not seasonally adjusted. Commercial bank savings deposits excluding MMDAs increased during September and October 1986 at rates of 36.0 percent and 38 percent, respectively. At thrift institutions, savings deposits excluding MMDAs increased during September and October 1986 at rates of 15.6 percent and 25 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.
6. Consists of borrowings from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowings from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
7. Consists of Treasury demand deposits and note balances at commercial banks.

p--preliminary

pe--preliminary estimate



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

	1986						Levels in bil. of dollars October <sup>P</sup>
	Q1	Q2	Q3 <sup>p</sup>	Aug.	Sept.	Oct. <sup>P</sup>	
----- Commercial Bank Credit -----							
1. Total loans and securities at banks	9.3	3.9	13.0	13.8	11.5	3	2033.6
2. Securities	2.0	4.9	31.6	29.0	28.2	0	494.7
3. U.S. government securities	-5.3	7.9	28.1	23.1	13.2	18	298.6
4. Other securities	12.8	0.7	36.8	40.0	51.2	-26	196.1
5. Total loans	11.6	3.6	7.3	8.9	6.1	5	1538.9
6. Business loans	5.3	2.0	1.7	4.0	0.7	5	513.0
7. Security loans	102.7	-62.7	14.1	-16.1	-5.4	-112	39.9
8. Real estate loans	13.1	13.3	13.6	14.7	11.4	11	470.6
9. Consumer loans	11.0	6.7	5.6	4.7	7.4	5	310.1
10. Other loans	7.3	-1.6	8.4	19.4	9.5	13	205.3
----- Short- and Intermediate-Term Business Credit -----							
11. Business loans net of bankers acceptances	5.2	1.0	1.7	4.0	0.0	5	507.7
12. Loans at foreign branches <sup>2</sup>	0.0	-21.5	9.1	-19.9	13.5	-20	17.7
13. Sum of lines 11 & 12	5.1	0.2	2.0	3.2	0.7	4	525.4
14. Commercial paper issued by nonfinancial firms <sup>3</sup>	-14.4	-10.3	10.6	60.1	-5.6	25	87.3
15. Sums of lines 13 & 14	2.1	-1.3	3.2	10.9	-0.2	7	612.7
16. Bankers acceptances: U.S. trade related <sup>4,5</sup>	-6.2	16.3	2.4	-7.1	0.0	n.a.	33.4 (Sept.)
17. Line 15 plus bankers acceptances: U.S. trade related	1.7	-0.3	3.1	9.8	0.0	n.a.	642.6 (Sept.)
18. Finance company loans to business <sup>4</sup>	16.4	3.8	n.a.	5.3	n.a.	n.a.	159.5 (Aug.)
19. Total short- and intermediate- term business credit (sum of lines 17 & 18)	4.6	0.5	n.a.	8.9	n.a.	n.a.	801.9 (Aug.)

n.a.--not available.

p--preliminary

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

2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.

3. Average of Wednesdays.

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

5. Consists of acceptances that finance U.S. imports, U.S. exports and domestic shipment and storage of goods.

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

Sh	erm rates	1984	1985	1986		Change from:		
		Highs	March highs	April lows	FOMC Sept. 23	Oct. 30	April lows	FOMC Sept. 23
	Federal funds <sup>2</sup>	11.63	8.58	6.95	5.83	5.86	-1.09	.03
	Treasury bills <sup>3</sup>							
	3-month	10.67	8.80	5.77	5.25	5.18	-.59	-.07
	6-month	10.77	9.13	5.81	5.41	5.24	-.57	-.17
	1-year	11.13	9.25	5.79	5.49	5.38	-.41	-.11
	Commercial paper							
	1-month	11.42	8.94	6.42	5.78	5.69	-.73	-.09
	3-month	11.35	9.12	6.30	5.75	5.62	-.68	-.13
	Large negotiable CDs <sup>3</sup>							
	1-month	11.52	8.89	6.51	5.81	5.60	-.91	-.21
	3-month	11.79	9.29	6.39	5.81	5.60	-.79	-.21
	6-month	12.30	9.92	6.35	5.82	5.60	-.75	-.22
	Eurodollar deposits <sup>4</sup>							
	1-month	11.89	8.89	6.59	6.01	5.93	-.66	-.08
	3-month	12.20	9.58	6.55	5.96	5.94	-.61	-.02
	Bank prime rate	13.00	10.50	8.50	7.50	7.50	-1.00	--
In	mediate- and long-term rates							
	U.S. Treasury (constant maturity)							
	3-year	13.49	11.22	6.49	6.77	6.52	.30	-.25
	10-year	13.99	12.02	6.98	7.58	7.31	.33	-.27
	30-year	13.94	11.97	7.14	7.76	7.61	.47	-.15
	Municipal revenue <sup>5</sup> (Bond Buyer index)	11.44	10.25	7.55	7.57	7.30	-.25	-.27
	Corporate--A utility Recently offered	15.30	13.23	9.15	9.64	9.46	.31	-.18
	Home mortgage rates <sup>6</sup>							
	S&L fixed-rate	14.68	13.29	9.86	10.07	9.95	.09	-.12
	S&L ARM, 1-yr.	12.31	11.14	8.41	8.19	8.03	-.38	-.16
		1984	1985	1986	1986		Percent change from:	
		Lows	March lows	Record highs	FOMC Sept. 23	Oct. 30	Record highs	FOMC Sept. 23
	Stock prices							
	Dow-Jones Industrial	1086.57	1247.35	1919.71	1797.81	1878.34	-2.16	4.47
	NYSE Composite	85.13	102.46	145.75	135.60	140.26	-3.77	3.43
	AMEX Composite	187.16	222.28	285.19	262.65	264.62	-7.22	.75
	NASDAQ (OTC)	225.30	276.18	411.16	353.37	361.05	-12.19	2.17

1. One-day quotes except as noted.
2. Averages for two-week reserve maintenance period to date shown. Last observation is the average to date for the maintenance period ending November 5, 1986.
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--estimate

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INTERNATIONAL DEVELOPMENTS

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Foreign Exchange Markets

Japanese officials announced a cut in the Bank of Japan's discount rate from 3.5 to 3.0 percent, effective from November 1. This reduction is the fourth one since January 30. The most recent cut was from 4.0 to 3.5 percent on April 21.

The dollar moved up sharply in reaction to Thursday's better-than-expected U.S. trade figures and then to the rumors and news that the Bank of Japan was lowering its discount rate. The announcement of an accord between Treasury Secretary Baker and Japanese Finance Minister Miyazawa in which they concurred that the realignment of the dollar-yen exchange rate since the Plaza agreement is now broadly consistent with underlying fundamentals provided further impetus for the dollar. The dollar's weighted-average value had risen by mid-day Friday to a level about 1-3/4 percent above its value at the last FOMC meeting.

U.S. Merchandise Trade -- September.

The U.S. merchandise trade deficit in September was \$12.6 billion (\$151 billion at an annual rate), smaller than recorded in either July or August according to Commerce Department Census Basis figures. For the third quarter as a whole the deficit was slightly larger than in the second quarter. These data are not seasonally adjusted, include insurance and freight charges for imports (CIF value) and are subject to large revisions. Data on the commodity composition of trade flows in the third quarter, on a revised basis, will be available next week.

U.S. Merchandise Trade  
Billions of dollars, annual rates

	Not Seasonally Adjusted, Census Basis						BOP Basis Seasonally Adjusted Balance
	Unrevised			Revised			
	Exp.	Imp.	Bal.	Exp.	Imp.	Bal.	
	CIF	CIF		CIF	CIF		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<u>Year</u>							
1985	213	362	-149	213	357	-145	-124
<u>Quarters</u>							
1985 - 1	225	350	-125	220	338	-118	-100
2	217	369	-152	219	360	-140	-121
3	201	355	-153	199	353	-153	-127
4	209	373	-164	212	378	-167	-149
1986 - 1	215	389	-174	212	364	-152	-146
2	218	380	-162	221	384	-163	-144
3	211	387	-176	205*	386*	-181*	-150*e
<u>Months</u>							
1986 - Apr.	216	360	-145	216	387	-171	-155e
May	209	380	-171	219	377	-158	-140e
June	229	399	-170	229	388	-159	-135e
July	213	429	-216	208	401	-193	-160e
Aug.	211	371	-160	203	371	-168	-140e
Sept.	210	361	-151	n.a.	n.a.	n.a.	n.a.

e/ FR staff estimate.

\*/ Average of July and August.

Source: U.S. Department of Commerce.

Import and Export Prices -- 1986-Q3.

Prices of nonoil imports rose 12.2 percent at an annual rate in the third quarter, according to BLS figures. This was a stronger rate of increase than in the second quarter and nearly as strong as in the first quarter. There were strong rises in import prices for most major trade categories, but the price of oil imports declined further in the third quarter.

Export prices declined fairly sharply in the third quarter, primarily because of a steep drop in the price of agricultural exports; there were smaller declines in prices of chemicals, crude materials, and fuel exports. Moderate price increases were recorded for prices of machinery and transportation equipment and for other manufactured goods exports.

BLS Price Indexes for  
Merchandise Exports and Imports  
 (% change, AR)

	1985		1986		
	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
<u>BLS Price Indexes</u>					
Exports	-4.0	.8	1.2	-1.2	-6.4
Imports	-.4	5.7	-22.1	-21.9	2.9
Oil	-6.2	-1.0	-78.2	-81.0	-39.8
Nonoil	1.6	9.6	14.5	4.6	12.2