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Part 2

July 1, 1987

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

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Economic activity continues to advance at a moderate rate, with a stronger export performance apparently countering the sluggishness in consumer demand. Employment gains have remained healthy this year, and manufacturing output resumed an upward course in May. Increases in both consumer and producer prices were moderate in May, after sizable increases earlier in the year that were related in large part to a rebound in crude oil prices.

Employment and Unemployment

Recent labor market data indicate a continuation of strong hiring trends, and the unemployment rate—which dropped sharply in April—held steady at 6.3 percent in May. Gains in nonfarm payroll employment so far this year have run considerably above the average 1986 pace. As has been the case during much of the current expansion, services have accounted for most of the rise in employment so far this year. However, manufacturing employment also has picked up, with small but fairly steady gains since the fourth quarter of last year. Among specific industries, employment has increased this year in printing, rubber, textiles, lumber, and furniture, while declining in transportation equipment and electrical machinery. Construction employment, which posted healthy advances earlier this year, has since fallen, reflecting weakness in the housing sector.

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

	1986	1986 Q4	1987 Q1	1987 Mar.	1987 Apr.	1987 May
			--Average monthly changes--			
Nonfarm payroll employment[2]	159	176	254	179	280	123
Manufacturing	-14	12	8	9	16	5
Durable	-17	-2	0	-3	-2	0
Nondurable	4	14	8	12	18	5
Construction	13	-4	32	-6	-16	-20
Trade	31	19	57	5	80	24
Finance and services	110	101	124	108	118	113
Total government	30	42	18	42	62	-3
Private nonfarm production workers	105	106	199	114	166	59
Manufacturing production workers	-7	18	6	9	16	14
Total employment[3]	174[e]	217	244	-14	467	612

1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments.
3. Survey of households.
e--Adjusted by Board staff to eliminate distortions caused by the introduction of revised population estimates.

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

	1986	1986 Q4	1987 Q1	1987 Mar.	1987 Apr.	1987 May
Civilian, 16 years and older	7.0	6.9	6.7	6.6	6.3	6.3
Teenagers	18.3	17.8	17.9	18.1	17.4	17.7
20-24 years old	10.7	10.5	10.4	10.2	10.1	9.8
Men, 25 years and older	5.4	5.4	5.2	5.1	4.8	4.9
Women, 25 years and older	5.5	5.3	5.1	5.0	4.7	4.7
White	6.0	6.0	5.7	5.6	5.4	5.3
Black	14.5	14.1	14.2	13.9	13.0	13.8
Fulltime workers	6.6	6.5	6.3	6.2	5.9	5.9
Memo:						
Total national[1]	6.9	6.8	6.6	6.5	6.2	6.2

1. Includes resident Armed Forces as employed.

Industrial Production and Capacity Utilization

Industrial production has risen at a moderate pace so far in 1987. The advance reflects, in part, a firming in output of business equipment, which lagged in 1985 and 1986. In particular, computer production rose at an annual rate of nearly 14 percent during the first five months of this year; output of some other high-tech capital goods, such as medical instruments and scientific and optical goods, also has registered strong gains in recent months. At the same time, output of construction supplies and home goods has leveled off since the turn of the year after strong gains in the second half of 1986.

Auto assemblies, which fell sharply during March and April, edged still lower in May to an annual rate of 7.1 million units. Despite the reduced rate of production, dealers' stocks rose further in May. Assemblies apparently totaled nearly 7 million units at an annual rate in June, about the same as the pace of sales during the first 20 days of the month, and they are scheduled to remain low through the third quarter. Barring an autonomous surge in sales, producers likely will introduce a new round of sales incentives later this summer—but at this point, the bigger firms appear to be willing to run with high stocks pending a clarification of strike prospects.

Capacity utilization in manufacturing, mining, and utilities increased 0.2 percentage point in May to 79.6 percent. Overall, utilization in industry has shown little net change since December. The utilization rate in manufacturing rose 0.3 percentage point in May to 80.2 percent, close to the average rate over the past 20 years. Compared with historical averages, operating rates are relatively low

INDUSTRIAL PRODUCTION
(Based on seasonally adjusted data)

	1986[1]	1986 Q4	1987 Q1	1987 Apr.	1987 May
	--Annual rate--			--Monthly rate--	
Total Index	1.1	3.2	3.3	-.1	.5
Products	1.7	3.4	3.6	-.4	.6
Final products	.5	2.8	4.3	-.5	.6
Consumer goods	3.0	3.2	4.7	-.8	.6
Durable consumer goods	3.8	7.9	9.2	-2.6	.8
Nondurable consumer goods	2.7	1.7	3.2	-.1	.6
Equipment	.4	1.2	4.0	-.1	.5
Business	-1.0	-1.6	4.6	-.1	.5
Defense and space	4.7	9.8	2.2	-.1	.5
Oil and gas drilling	-51.2	48.8	3.2	-1.4	4.1
Intermediate products	5.7	5.5	1.2	-.1	.5
Construction supplies	5.7	6.2	4.4	-.5	.5
Materials	.0	3.0	2.9	.4	.4
Durable goods	-.8	4.3	3.9	-.1	.2
Nondurable goods	6.4	5.2	5.2	1.1	.5
Energy materials	-4.4	-1.8	-1.3	.9	.7

1. From fourth quarter of previous year to fourth quarter of year indicated.

CAPACITY UTILIZATION IN INDUSTRY
(Percent of capacity, seasonally adjusted)

	1978-80 High	1982 Low	1967-86 Avg.	1984 High	1987 Apr.	1987 May
Total industry	86.9	69.5	81.5	81.8	79.4	79.6
Manufacturing	86.5	68.0	80.6	81.3	79.9	80.2
Durable	86.3	63.7	78.6	79.8	76.5	76.7
Nondurable	87.0	74.4	83.5	84.3	85.1	85.3
Mining	95.2	76.9	87.1	86.6	73.7	73.7
Utilities	88.5	78.0	87.5	85.8	79.4	80.4
Industrial materials	89.1	68.4	82.3	82.9	78.8	79.0
Metal materials	93.6	45.7	77.8	70.8	68.3	68.7
Paper materials	97.3	79.9	91.6	98.6	95.1	95.7
Chemical materials	87.9	63.3	80.8	78.5	85.0	85.2

AUTO SALES, PRODUCTION, AND INVENTORIES
(Millions of units at an annual rate, FRB seasonals)

	1986	1987		1987	
	Q4	Q1	Apr.	May	June
Total auto sales[2]	11.3	9.7	10.8	9.7	--
Domestic	7.7	6.9	7.7	6.7	7.1[1]
Imported	3.7	2.8	3.1	2.9	--
Domestic production	7.5	7.9	7.2	7.1	6.9[e]
Dealers' stocks	1.54	1.81	1.80	1.85	--
Days' supply[3]	61	80	72	84	--
Total light truck sales[4]	4.5	4.2	4.8	4.4	--
Domestic	3.5	3.4	3.8	3.5	--
Imported[5]	1.0	.8	1.0	.9	--

1. First twenty days.
2. Components may not add to totals due to rounding.
3. Days' supply for the quarter are based on end-of-quarter stocks and average sales for the quarter.
4. Trucks having gross weight 10,000 pounds or less.
5. About 1 percent of imported trucks have gross weight above 10,000 pounds.
e--Estimated.

for durable manufacturing, particularly in the machinery industries. By contrast, utilization in nondurable manufacturing has been above its historical average, especially in textiles and paper.

Personal Income and Consumption

Nominal income growth so far this year has been stronger than in 1986, but with consumer prices accelerating, growth in real income, on average, has been relatively slow. Growth in nominal personal income in April and May, at an average monthly rate of about $10-1/2 billion, was about the same as the 1986 average, but well below the strong first-quarter pace. The deceleration in income relative to the first quarter mainly reflects smaller gains in wages and salaries and the absence of sizable subsidy payments to farmers. Interest income has continued to grow at a rapid pace.

Disposable income has been extraordinarily volatile in recent months, owing mainly to an enormous increase in tax payments in April associated with one-time effects of the Tax Reform Act of 1986. In May, when tax payments returned to a more normal level, disposable income in real terms probably advanced to a level slightly above the first-quarter average. The personal saving rate, which fell almost to zero in April, returned to 3.3 percent in May, about the same as in the first quarter.

At the same time, rising household wealth still appears to be providing support for consumption. Since the last Greenbook, gains in the stock market have added about $200 billion to the net worth of households, for a total of $800 billion since the end of 1986.

Growth in real consumer spending, which outpaced income gains through much of 1986, has lagged thus far this year. Total auto sales

PERSONAL INCOME
(Average monthly change; billions of dollars)

	1986	1986 Q3	1986 Q4	1987 Q1	1987 Mar.r	1987 Apr.r	1987 Mayp
Total personal income	10.4	8.7	11.6	22.1	11.9	13.0	7.9
Wages and salaries	7.0	8.3	9.1	13.2	7.8	7.0	8.8
Private	5.2	6.2	7.1	10.3	5.8	5.0	6.7
Other labor income	.9	1.0	.8	.8	.8	2.7	-1.0
Proprietors' income	1.7	.9	3.5	2.5	-.9	-4.9	-8.0
Farm	-.8	-2.1	2.5	.1	-2.7	-6.7	-11.0
Rent, dividends and interest	-.9	-3.2	-3.0	5.0	4.4	4.7	5.2
Transfer payments	2.4	2.3	1.6	2.6	.3	3.8	3.6
Less: Personal contributions for social insurance	.7	.6	.5	1.9	.4	.5	.5
Less: Personal tax and nontax payments	3.2	4.6	6.4	-3.2	4.0	95.3	-92.3
Equals: Disposable personal income	7.2	4.1	5.2	25.3	8.0	-82.5	100.3
Memo: Real disposable income	3.0	-4.1	-.7	8.9	-2.5	-81.8	—

r--Revised.
p--Preliminary.

PERSONAL CONSUMPTION EXPENDITURES
(Percent change from preceding period)

	1986[1]	1986 Q4	1987 Q1	1987 Mar.[r]	1987 Apr.[r]	1987 May[p]
		--Annual rate--		--Monthly rate--		
Personal consumption expenditures	5.7	3.0	4.3	.0	.6	.1
Durable goods	11.4	-10.6	-18.5	-.8	2.4	-1.5
Excluding motor vehicles	10.7	13.4	3.7	-1.6	.4	-.1
Nondurable goods	1.9	3.2	8.9	-.5	.2	.1
Services	6.8	7.0	8.3	.5	.5	.4
Memo:						
Real personal consumption expenditures	4.0	-.4	-1.1	-.4	.2	--
Excluding motor vehicles	3.7	2.9	2.3	-.4	-.1	--
Personal saving rate (percent)	3.8	2.5	3.5	3.4	.1	3.3

1. Percent change from fourth quarter of previous period to fourth quarter of period indicated.
r--Revised.
p--Preliminary.

dropped back in May to 9.7 million units at an annual rate—the same sluggish pace as in the first quarter, when sales had been depressed by year-end tax law changes. By contrast, sales of light trucks, most of which are purchased by consumers, were down a bit in May, but the level of sales was up 4-1/2 percent from the first-quarter average. Meanwhile, spending on other goods has been lackluster. In constant dollars, outlays for durables other than autos have been flat, on balance, since the fourth quarter of last year, while spending for nondurables in recent months was no higher than in mid-1986. In the service sector, real consumer outlays posted a strong gain in the first quarter, but apparently have moderated recently to a pace similar to that in 1986.

Business Fixed Investment

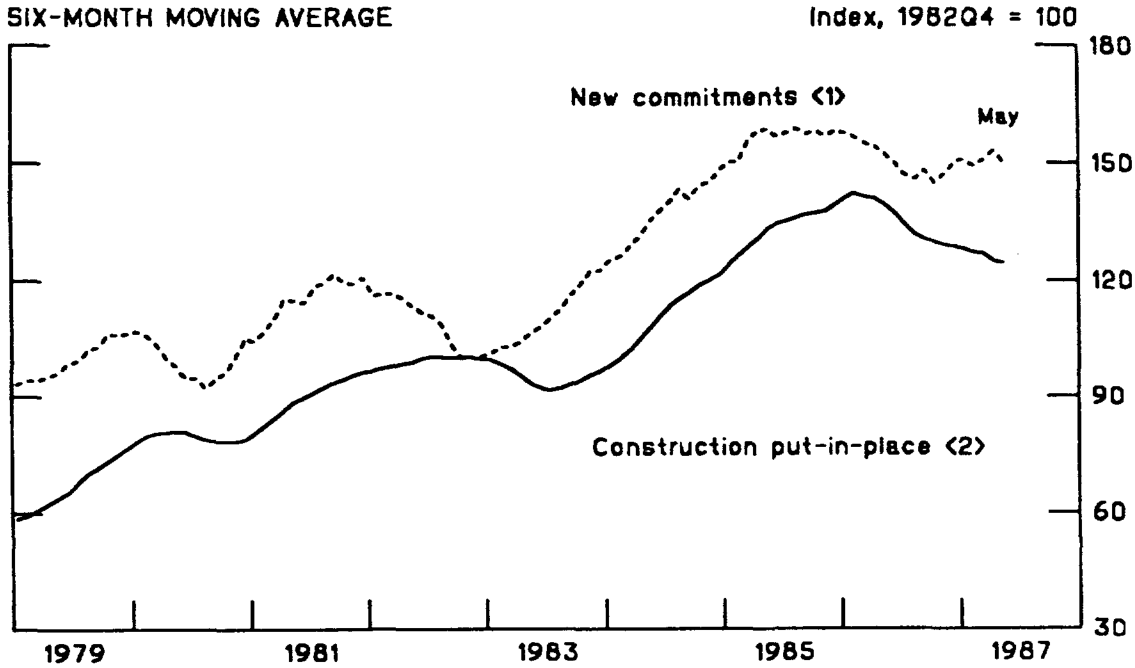
Spending for business fixed investment, in real terms, appears to have rebounded moderately in the second quarter, after a tax-induced annual rate of decline of nearly 10 percent in the first quarter. On the equipment side, nominal shipments of nondefense capital goods were flat in April and fell in May; however, because of earlier advances, the average level of shipments during these two months was almost 2 percent above the first-quarter average. In addition, the value of nonresidential construction put in place (which excludes petroleum drilling) leveled off in April and advanced 2 percent in May after having fallen sharply in the first quarter.

Advance indicators of future investment spending recently have shown some signs of improvement. Excluding the aircraft group, the average level of new orders for nondefense capital goods in April and May was 3.7 percent above the first-quarter average. For nonresidential

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

	1986 Q4	1987 Q1	1987 Mar.	Apr.	May
Producers' durable equipment					
Nondefense capital goods					
Shipments	3.2	-3.2	2.1	-.1	-1.3
Aircraft	17.7	-13.7	14.8	-5.6	-14.9
Excl. aircraft	1.5	-1.8	.5	.7	.5
Office and computing equip.	-2.2	-3.3	-2.7	3.2	3.8
All other categories	2.4	-1.4	1.2	.1	-.3
Orders	6.2	-3.8	2.0	3.3	5.6
Aircraft	78.0	-26.2	14.6	2.4	50.1
Excl. aircraft	-1.7	.6	.3	3.5	-1.2
Office and computing equip.	-5.2	-10.3	2.9	9.4	-3.4
All other categories	-.8	3.4	-.3	2.1	-.7
Sales of heavy-weight trucks (thousands of units, A.R.)	274	277	316	314	335
Nonresidential structures					
Nonresidential construction	.1	-3.8	-1.5	0	2.0
Commercial building	.8	-5.4	-1.5	-2.4	1.9
Office	-1.1	-5.2	-3.2	-5.3	2.9
Other commercial	.5	-5.6	.3	.3	0.9
Industrial building	5.5	-13.8	-6.3	1.3	4.6
Public utilities, institutional, and other	-2.6	-.2	-1.8	2.9	1.2
Rotary drilling rigs in use	9.4	-1.0	3.0	-1.7	3.7

Nonresidential Construction and New Commitments



<1> Sum of contracts (from F.W.Dodge) and permits (from Census) for industrial, commercial, and institutional construction.
<2> Includes only the building components of nonresidential construction, i.e., industrial, commercial, institutional, and hotels and motels.

Surveys of Plant and Equipment Expenditures
(percent change from previous year)

		Planned for 1987		
	1986	Commerce (Apr.-May)	McGraw-Hill (Apr.-May)	Merrill Lynch (Apr.-early June)
All Business	-2.0	3.1	3.3	3.3
(Previous survey[1])		(3.0)	(2.0)	(-2.0)
Manufacturing	-7.0	2.2	3.7	6.0
Durables	-5.7	2.6	2.4	4.9
Nondurables	-8.2	1.9	4.9	7.1
Nonmanufacturing	1.2	3.6	3.0	1.6
All Business excluding petroleum and mining	1.6	3.8	3.7	3.8

1. The previous Commerce Department and McGraw-Hill surveys were taken during January through March of this year, while the previous Merrill Lynch survey was taken during September and October of 1986.

construction, new commitments have trended up slightly since mid-1986, with the rise concentrated in the institutional category. Nevertheless, high vacancy rates continue to damp construction of office buildings.

Recent surveys of plant and equipment spending by the Commerce Department, McGraw-Hill, and Merrill Lynch report that firms expect nominal outlays in 1987 to be about 3 percent higher than in 1986, slightly more than was indicated by the previous set of surveys. The current spending plans represent a significant turnaround from the 2 percent drop in the outlays estimated to have occurred in 1986. About half of this improvement stems from a leveling off of investment outlays by petroleum and mining firms, which had plunged last year. The surveys indicate a pickup in outlays by manufacturing companies, with firms favoring modernization over expansion by a ratio of more than two to one. As recently as 1980, the ratio was about fifty-fifty.

Nevertheless, given the weakness of actual expenditures so far this year, the pace of spending would have to accelerate sharply to achieve the increase in outlays indicated by the surveys. Indeed, a 3 percent increase in 1987 outlays implies, in terms of a straight-line path, nominal spending growth at more than a 13 percent annual rate for the rest of the year. All three surveys have tended to overestimate spending gains in recent years, with the average bias ranging from 0.8 to 1.6 percentage points.

Inventories

The inventory data for the second quarter, while still quite limited, indicate a more moderate rate of accumulation than in the first quarter. In the auto sector, the data on unit stocks through May show a sharp slowing after the first-quarter bulge, although inventories remained at high levels. Excluding autos, manufacturing and trade stocks rose moderately in April, at an annual rate of about $8.8 billion in real terms, and inventories apparently are in line with sales in most sectors.

Manufacturers' inventory stance has remained conservative this year. Factory stock accumulation over the first four months of this year, in constant dollars, averaged only $2 billion at an annual rate. In May, manufacturers' stocks in current dollars rose $9 billion at an annual rate, and the inventory-sales ratio remained unchanged from April. In the trade sector, nonauto inventories, in real terms, expanded in April at about the same moderate pace as during the first quarter; overall, the inventory position of wholesalers and nonauto retailers has been little changed since January.

Housing Markets

Housing activity has slumped in response to the backup in mortgage rates during the spring. Housing starts fell in May for a third month, as single-family construction dropped about 8 percent, to 1.13 million units at an annual rate. Moreover, sales of new single-family homes fell about 15 percent in May from a downward-revised April level. New home sales appear to have been damped by the rise in conventional mortgage interest rates, which jumped 1-1/2 percentage points from March

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

	1986 Q3	1986 Q4	1987 Q1	1987 Mar.	1987 Apr.r	1987 Mayp
Current Cost Basis:						
Total	-4.4	-1.1	41.2	30.5	14.8	--
Manufacturing	-11.7	-.7	7.7	-5.3	8.3	9.0
Wholesale	5.9	-4.9	8.8	1.9	2.4	--
Retail	1.4	4.5	24.8	33.9	4.1	--
Automotive	-11.3	5.2	19.9	16.5	1.8	--
Ex. auto	12.6	-.7	4.8	17.4	2.3	--
Constant Dollar Basis:						
Total	-11.2	-9.6	29.9	25.2	7.4	--
Manufacturing	-6.5	-3.3	1.3	-6.9	4.5	--
Wholesale	8.3	-4.3	2.3	-3.7	-4.8	--
Retail	-13.1	-2.0	26.4	35.8	7.7	--
Automotive	-22.0	-1.1	23.6	25.6	-1.1	--
Ex. auto	8.9	-.9	2.8	10.2	8.8	--

INVENTORIES RELATIVE TO SALES[1]

	Range in Preceding 12 months:[2] low	high	1986 Q3	1986 Q4	1987 Q1	1987 Mar.	1987 Apr.r	1987 Mayp
Current Cost Basis:								
Total	1.47	1.58	1.53	1.50	1.51	1.49	1.50	--
Manufacturing	1.61	1.75	1.69	1.65	1.65	1.62	1.64	1.64
Wholesale	1.21	1.32	1.28	1.25	1.24	1.22	1.22	--
Retail	1.44	1.59	1.50	1.51	1.58	1.55	1.55	--
Automotive	1.33	2.12	1.54	1.64	2.03	1.91	1.90	--
Ex. auto	1.42	1.49	1.49	1.47	1.46	1.45	1.45	--
Constant Dollar Basis:								
Total	1.45	1.56	1.50	1.48	1.50	1.48	1.49	--
Manufacturing	1.62	1.74	1.69	1.66	1.66	1.64	1.66	--
Wholesale	1.22	1.34	1.29	1.26	1.24	1.22	1.22	--
Retail	1.35	1.51	1.40	1.42	1.50	1.48	1.49	--
Automotive	1.12	1.89	1.33	1.41	1.80	1.70	1.69	--
Ex. auto	1.40	1.45	1.43	1.42	1.42	1.42	1.43	--

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.

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

	1986	1986		1987	1987		
	Annual	Q3	Q4	Q1	Mar.	Apr.	May[p]
All units							
Permits	1.75	1.73	1.73	1.68	1.72	1.60	1.48
Starts	1.81	1.76	1.70	1.80	1.73	1.67	1.62
Single-family units							
Permits	1.07	1.08	1.08	1.15	1.15	1.06	1.01
Starts	1.18	1.15	1.16	1.26	1.21	1.22	1.13
Sales							
New homes	.75	.69	.71	.72	.72	.72	.62
Existing homes	3.57	3.59	3.89	3.61	3.68	3.56	3.74
Multifamily units							
Permits	.68	.66	.65	.54	.57	.54	.47
Starts	.63	.61	.54	.54	.52	.44	.49
Mobile home shipments	.24	.24	.24	.23	.23	.23	n.a.

p—Preliminary estimates.
n.a.—Not available.

to May. Sales of existing houses rebounded in May, and were little different from the average pace during the preceding six months.

Despite an uptick in May, multifamily starts were down 10 percent from the first-quarter average. Multifamily construction has trended down since early 1986, reflecting near-record rental vacancy rates and last year's tax law changes.

Housing activity has been characterized by wide regional disparities, particularly between the South and the Northeast. Housing demand remains relatively weak in the South, largely reflecting depressed conditions in the energy sector. In that region total housing starts have declined for more than a year, and housing prices have risen considerably less than the national average. By contrast, in the Northeast housing starts rose about 9 percent in the first quarter; price increases for both new and existing houses have been much larger than in other regions; and rental vacancy rates, although up slightly in the first quarter, remain well below the national average.

Federal Government

Last week Congress passed a budget resolution that provides a blueprint for subsequent FY1988 appropriations and other spending and revenue legislation. The resolution specifies no growth in real military spending authority, further reductions in domestic spending, and a $19 billion tax increase. The nature of the tax rise was not specified, but the level of defense appropriations is contingent upon enactment of the revenue measure. The resolution states that if the President fails to sign the necessary tax legislation, the appropriation for defense will be cut $7 billion. Another $7 billion deficit reduction is assumed to result from early repayment of loans made by the Rural Electrification Administration. By forgiving current prepayment penalties, it is anticipated that these loans will be repaid in FY1988, with borrowers likely refinancing in the private market.

Under CBO's economic and technical assumptions, the congressional resolution falls about $26 billion short of meeting the Gramm-Rudman-Hollings deficit target of $108 billion. However, the resolution meets the deficit target under the assumptions made by OMB in February. Nevertheless, neither the CBO nor the OMB assumptions reflect more recent data, and reports suggest that revisions incorporating this information would push the FY1988 deficit estimates up roughly $10 billion.

In contrast, estimates of the budget deficit for the current fiscal year have remained at about $170 billion. Preliminary data for June give additional evidence that the increase in corporate tax payments resulting from tax reform is less than had been anticipated. The increase may have been muted by the safe-harbor rules that have permitted corporations some leeway in April and June in meeting payments due under the new tax law.[1] Meanwhile, after surprisingly large bulges in January and April, receipts for individual nonwithheld taxes appear to have conformed to a more typical pattern in June. The June figures

1. Apparently, many corporations have been unable to accurately calculate their tax liabilities because the IRS has not yet issued explanations of the relevant provisions in the 1986 Tax Reform Act. The safe-harbor ruling allows corporations to assume that this year's annualized taxable income will equal 120 percent of their taxable income in the preceding year. However, tax payments after July 1 will need to be large enough to make up for temporary shortfalls that arise from the safe-harbor provisions.

for individual tax revenues suggest that the runups experienced earlier in the year reflected mostly increases in receipts from capital gains, probably induced by the Tax Reform Act of 1986.

Recent information also indicates that outlays are continuing to grow moderately. Through the first eight months of the current fiscal year, outlays were up only 2 percent compared with the same period a year earlier. The rise in defense spending has slowed to 3-1/4 percent, compared with the average rate of 9 percent during the previous three years. Also, the effects of spending cuts on many discretionary domestic programs and the leveling off of interest payments appear to have offset much of the rise in outlays for social insurance programs.

State and Local Government Sector

Real purchases of goods and services by state and local governments probably rose further, on balance, early in the second quarter. Employment jumped 55,000 in April, the largest rise in six months, and edged up further in May. However, real outlays for construction in April and May, on average, were slightly below the first-quarter level.

The financial situation remained uncertain in many states as the fiscal year ended on June 30 for all but four states. Several states have been reporting greater-than-expected tax collections, particularly in April, evidently reflecting the large volume of capital gains realized at the end of 1986. In California, for example, the Commission on State Finances estimated in June that the state received $1.4 billion more in revenue than was estimated just three months earlier; other states that underestimated receipts include New York, Connecticut, Vermont, Iowa, and Maine. In contrast, many other states, particularly in the oil patch, continue to experience budgetary pressures. On balance, a small surplus of operating and capital accounts is expected for the sector as a whole in the fiscal year just ended.

Prices

Inflation rates moderated in May, in large part owing to a deceleration in energy and apparel prices. Even so, the May increases—0.3 percent for both the CPI and the PPI for finished goods—continue to reflect some acceleration from the 1986 pace.

Increases in retail energy prices, which boosted the first-quarter CPI, slowed in April and May. Although the runup in crude oil prices this winter already has been reflected in retail prices, crude oil costs have risen about a dollar further over the past two months. This suggests some additional increase in consumer energy prices during the next month or two. OPEC agreed in late June to limit its output to a total of 16.6 barrels per day for the rest of the year, close to recent levels of production. Even allowing for some output in excess of the announced quota, it appears that OPEC's decision probably will help to keep prices firm.

Consumer food prices rose 0.5 percent in May, mainly reflecting large increases for meats and fresh vegetables. At the farm level, livestock prices rose rapidly through May, but price changes in spot markets since the May PPI indicate a leveling off for these commodities. Moreover, meat production is expected to increase later this year, and futures prices for hogs and, to a lesser extent, for cattle continue to indicate lower prices by the fall. The May CPI for fruits and vegetables

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

	Relative Importance Dec. 1986	1986	1986 Q3	1986 Q4	1987 Q1	1987 Apr.	1987 May
			--Annual rate--			-Monthly rate-	
All items[2]	100.0	1.1	2.0	2.5	6.2	.4	.3
Food	16.2	3.8	8.4	4.1	2.5	.3	.5
Energy	7.4	-19.7	-21.0	-9.9	26.1	.3	.2
All items less food and energy	76.4	3.8	3.7	3.7	5.2	.5	.3
Commodities	26.1	1.4	2.6	1.4	5.1	.6	.3
Services	50.3	5.2	4.3	5.1	5.3	.4	.3
Memorandum:							
CPI-W[3]	100.0	.7	1.7	2.2	6.3	.5	.4

1. Changes are from final month of preceding period to final month of period indicated.
2. Official index for all urban consumers.
3. Index for urban wage earners and clerical workers.

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

	Relative Importance Dec. 1986	1986	1986 Q3	1986 Q4	1987 Q1	1987 Apr.	1987 May
			--Annual rate--			-Monthly rate-	
Finished goods	100.0	-2.3	-.4	1.8	3.9	.7	.3
Consumer foods	26.3	2.9	11.2	1.0	-6.7	1.5	1.4
Consumer energy	8.6	-38.0	-42.7	-12.5	57.6	2.1	.0
Other consumer goods	40.6	3.0	2.3	4.4	3.4	.2	-.2
Capital equipment	24.5	2.1	2.0	3.4	.1	.3	.1
Intermediate materials[2]	95.0	-4.5	-1.5	-1.2	8.0	.3	.4
Exc. energy	82.9	.1	1.5	1.2	3.3	.2	.4
Crude food materials	42.5	-1.4	18.1	-2.7	-11.3	4.3	4.8
Crude energy	40.9	-27.5	-19.6	-.5	41.2	1.7	2.7
Other crude materials	16.6	1.7	-24.1	8.5	16.3	.7	2.4

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

IMPORT AND DOMESTIC PRICES--SELECTED MEASURES

	1985	1986	1987
Import Price Measures	-Percent change to Q1 from a year earlier-		
BEA			
Non-oil imports (fixed-weight)1	-2.7	2.3	5.5
Capital goods, exc. autos	-6.6	2.4	9.6
Autos	1.4	7.9	7.8
Consumer goods, exc. autos	.2	2.7	7.9
Durable	-2.9	4.4	9.1
Industrial supplies and materials, exc. petroleum	-6.0	-4.3	.5
Domestic Price Measures	-Percent change to May from a year earlier-		
CPI			
Commodities less food, energy, and used cars2	3.0	2.3	3.6
PPI			
Finished consumer goods less food and energy	2.4	2.4	2.7
Capital equipment	2.2	1.8	2.0
Intermediate materials less food and energy	.7	-.6	2.1
Crude materials less food and energy	-9.2	-1.2	5.5

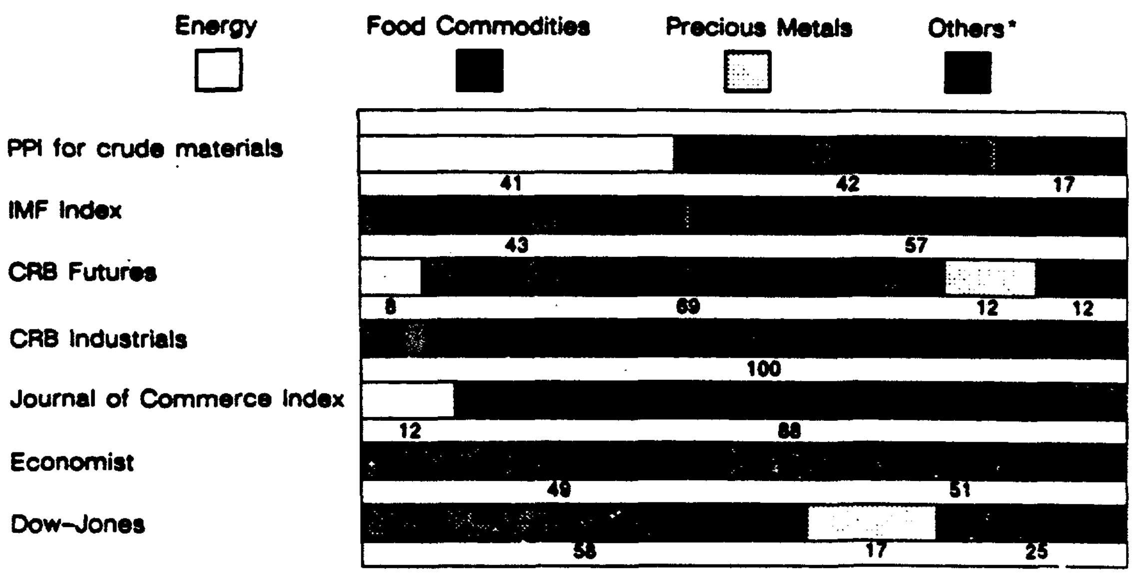
1. Calculated by Federal Reserve from BEA series. Includes items not listed.
2. Unpublished series.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last Obser-vation	Percent change[2] 1986 Year	1986 To Aug. 12	1986 Aug. 12 to Dec. 30	1987 To May 12	1987 May 12 to date
1. PPI for crude materials[3]	May	-9.0	-9.2	.3	10.0	n.a.
1a. Ex. food and energy	May	1.6	-2.9	4.7	6.5	n.a.
1b. Ex. food and energy, seas. adj.[4]	May	1.6	n.a.	n.a.	7.0	n.a.
2. IMF commodity index[3]	May	-7.9	-10.3	2.6	9.0	n.a.
2a. Metals	May	-.5	-2.9	2.5	10.0	n.a.
2b. Nonfood agric.	May	8.5	-4.1	13.1	14.3	n.a.
3. Commodity Research Bureau						
3a. Futures prices	June 29	-9.1	-10.7	1.8	11.8	-3.5
3b. Industrial spot prices	June 23	5.1	-10.6	17.6	9.0	1.4
4. Journal of Commerce industrials	June 29	-1.4	-9.4	8.7	8.9	2.9
5. Economist (U.S. dollar index)	June 23	-4.7	-7.2	2.7	17.3	-2.5
5a. Industrials	June 23	5.8	-2.1	8.0	19.4	.7
6. Dow-Jones Spot	June 29	-8.9	-6.7	-2.4	13.4	-2.3

1. Not seasonally adjusted.
2. Change is measured to end of period, from last observation of previous period.
3. Monthly observations. IMF index includes items not shown separately.
4. BLS's revised seasonal adjustment procedures for this series--because of problems with previous methods--are only available for 1987.
n.a.--Not available.

Index Weights



*Forest products, industrial metals, and other industrial materials.

was up sharply for a second month, with sizable increases for a variety of items. However, the prices received by growers fell sharply in April and May, providing some hope for an easing of price increases at the retail level during the summer.

Excluding food and energy items, the CPI rose 0.3 percent in May, following gains of 0.5 percent in each of the two preceding months. A slowdown in apparel prices, which rose very rapidly earlier in the year, more than accounted for the moderation. So far this year, the prices of consumer commodities other than food and energy have risen, on average, about 0.4 percent per month, compared with an average monthly pace of about 0.1 percent last year. This acceleration, which has been evident for several commodity groups, reflects, in part, an increase in import prices, and also a swing in used car prices. Nonenergy service prices have risen at an average monthly rate of 0.4 percent so far this year, similar to that in 1986.

To date, there is only limited evidence of domestic producers marking up their prices as import prices go up. The PPI for finished goods less food and energy was little changed, on balance, from March to May, and has risen at an annual rate of 2 percent since December, less than the 1986 pace. However, at earlier stages of processing, domestic price increases have accelerated. The PPI for intermediate materials (also excluding food and energy) has picked up to about a 3-1/2 percent rate so far this year. This index edged down from mid-1985 to mid-1986, and rose about 1 percent at an annual rate in the second half of last year. Petroleum-based materials—such as industrial chemicals and plastic resins—have been boosted by the passthrough of higher crude oil prices. In addition, prices of primary nonferrous metals have continued to recover on world markets, responding to the lower exchange value of the dollar as well as to tighter supplies, worsened in some cases by strikes and other disruptions. In addition, high levels of capacity utilization have contributed to rapid price increases for woodpulp, paperboard, and packaging.

The PPI for crude nonfood materials less energy turned up late last year and has risen about 7 percent (not annual rate) since last December; this followed declines over most of the preceding two years. A similar pattern is apparent in the commodity price indexes based mainly on industrial materials. The recovery in the Journal of Commerce and CRB spot price indexes for industrial materials, which started in the latter part of last year, has retraced most of the declines that had occurred since 1984. These indexes have registered increases since the PPI pricing date in the second week of May. By contrast, the Dow Jones spot price index and the CRB futures index were down, on balance, reflecting declines for feeds and precious metals.

Wages

Available measures of labor costs show moderation in wage inflation. Wage rates, as measured by the hourly earnings index for production and nonsupervisory workers, remained flat in May after a small increase in April. Wage increases in transportation and public utilities were offset by declines in manufacturing, especially in the nondurable goods industries. Over the past 12 months, the hourly earnings index for the private nonfarm economy rose 2-1/4 percent, while that for manufacturing rose only 1.1 percent. (More comprehensive data on compensation and labor costs will not be available until late July and early August.)

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

	1985	1986	1986 Q4	1987 Q1	1987 Apr.	1987 May
Hourly earnings index, wages of production workers[1]					--monthly-- rate	
Total private nonfarm	3.1	2.3	3.3	2.1	.2	.0
Manufacturing	3.3	1.7	1.4	1.5	.4	-.5
Contract construction	1.6	2.2	6.1	-2.7	.0	.3
Transportation and public utilities	3.0	2.8	3.6	3.2	.0	.6
Trade	2.1	1.8	2.9	.7	.3	.3
Services	4.2	3.1	4.7	4.2	.2	.2
Employment cost index, compensation of all persons[2]						
Total	3.9	3.2	--	3.1	--	--
By occupation:						
White collar	4.8	3.5	--	3.7	--	--
Blue collar	3.2	2.7	--	2.1	--	--
Service workers	3.0	3.1	--	2.9	--	--
By bargaining status:						
Union	2.6	2.1	--	1.6	--	--
Nonunion	4.6	3.6	--	3.6	--	--
Employment cost index, wage and salaries of all persons[2]						
Total	4.1	3.1	--	3.2	--	--
Major collective bargaining agreements[3]						
First-year wage adjustments	2.3	1.2	--	.9	--	--
Total effective wage change	3.3	2.3	--	1.6	--	--
Labor costs and productivity, all persons[1]						
Compensation per hour	3.9	2.6	2.7	.0	--	--
Output per hour	.2	.7	-1.5	.5	--	--
Unit labor costs	3.7	1.8	4.2	-.5	--	--

1. Changes are from final quarter of preceding period to final quarter of period indicated at a compound annual rate; seasonally adjusted data.
2. Four-quarter changes.
3. Agreements covering 1,000 or more workers; not seasonally adjusted.

III-T-1

SELECTED FINANCIAL MARKET QUOTATIONS[1]

(Percent)

	1986		1987			Change from:	
	June highs	Oct. lows	FOMC Mar. 31	FOMC May 19	Jun. 30	FOMC Mar. 31	FOMC May 19
Short-term rates							
Federal funds[2]	6.90	5.75	6.11	6.78	6.75	.64	-.03
Treasury bills[3]							
3-month	6.52	5.04	5.61	5.78	5.73	.12	-.05
6-month	6.57	5.05	5.74	6.27	5.91	.17	-.36
1-year	6.62	5.25	5.78	6.80	6.30	.52	-.50
Commercial paper							
1-month	6.87	5.64	6.39	6.95	6.86	.47	-.09
3-month	6.81	5.60	6.31	7.07	6.89	.58	-.18
Large negotiable CDs[3]							
1-month	6.88	5.59	6.30	6.97	6.86	.56	-.11
3-month	6.91	5.57	6.30	7.15	6.90	.60	-.25
6-month	6.97	5.57	6.31	7.41	7.06	.75	-.35
Eurodollar deposits[4]							
1-month	7.01	5.79	6.38	6.81	7.00	.62	.19
3-month	7.01	5.79	6.36	7.10	7.06	.70	-.04
Bank prime rate	8.50	7.50	7.50	8.25	8.25	.75	—
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	7.86	6.41	6.79	8.27	7.76	.97	-.51
10-year	8.39	7.28	7.51	8.89	8.38	.87	-.51
30-year	7.93	7.53	7.81	9.06	8.51	.70	-.55
Municipal revenue[5] (Bond Buyer index)	8.57	7.30	7.11	8.20	8.10	.99	-.10
Corporate--A utility Recently offered	9.70	9.32	9.05	10.26e	10.01e	.96	-.25
Home mortgage rates[6]							
S&L fixed-rate	10.76	9.89	9.07	10.48	10.35	1.28	-.13
S&L ARM, 1-yr.	8.65	7.98	7.53	7.87	7.88	.35	.01

	1986	1987			Percent change from:	
	Highs	March highs	FOMC May 19	Jun. 30	March highs	FOMC May 19
Stock prices						
Dow-Jones Industrial	1955.57	2372.59	2221.28	2418.53	1.94	8.88
NYSE Composite	145.75	171.08	157.93	171.07	-.01	8.32
AMEX Composite	285.19	339.31	325.07	338.13	-.35	4.02
NASDAQ (OTC)	411.16	439.64	408.15	424.67	-3.41	4.05

1. One-day quotes except as noted.
2. Averages for two-week reserve maintenance period closest to date shown. Last observation is the average to date for the maintenance period ending July 1, 1987.
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

The anxieties that drove down securities prices and disrupted financing patterns in the weeks preceding the May 19 FOMC meeting have eased considerably. Citicorp's announcement of large loan-loss provisions and word that Chairman Volcker would be stepping down prompted only transitory market setbacks as U.S. financial markets benefited from generally buoyant demand for the dollar on the exchange markets.

Treasury bond yields have fallen about 1/2 percentage point from their peak levels at the time of the FOMC meeting, offsetting more than one-third of the April-May backup; other long-term rates peaked a bit later but have fallen considerably from their highs (corporate rates by about 25 basis points and municipals by about 60 basis points). Short-term yields have dropped 1/8 to 3/8 of a point in most cases, against a backdrop of an unchanged federal funds rate of 6-3/4 percent.

Monetary data have reflected an unwinding of the buildup in balances that occurred in connection with April tax payments. M1 is estimated to have contracted slightly on balance over May and June, and M2 grew only a little over the two months, moving further below its 1987 target range. Meanwhile, M3 increased moderately on the strength of bank managed liabilities and stands near the bottom end of the annual growth cone.

Averaging out some sharp month-to-month fluctuations, net borrowing by the domestic nonfinancial sectors appears to have picked up a bit on a seasonally adjusted basis during the second quarter. Federal borrowing increased somewhat despite a small quarterly surplus, as the Treasury allowed its cash balance to build up; issuance of coupon securities has been substantial, but a sizable volume of bills has been permitted to run

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

	1985:Q4 to 1986:Q4	1987 Q1	1987 Q2pe	1987 Apr.	1987 May	1987 Junepe	Growth from Q4 1986 to June 1987pe
	------ Percentage change at annual rates ------						
1. M1	15.3	13.1	6-3/4	17.7	4.5	-7	8-1/4
2. M2	8.9	6.3	2-3/4	6.0	0.6	3	4-1/4
3. M3	8.8	6.4	4-1/2	5.9	4.9	7	5-1/2
							Levels in billions of dollars May 1987
Selected components							
4. Currency	7.5	10.1	6-1/2	7.7	8.3	6	190.2
5. Demand deposits	11.6	2.5	1	18.8	0.0	-19	304.0
6. Other checkable deposits	28.5	29.7	14-1/4	24.9	7.2	-2	252.3
7. M2 minus M1[2]	6.9	3.9	1-1/4	1.9	-0.8	7	2086.7
8. Overnight RPs and Eurodollars, NSA	14.7	10.9	-23-3/4	-3.2	-20.8	13	73.8
9. General purpose and broker/dealer money market mutual fund shares, NSA	17.3	6.2	1-1/4	1.1	-8.5	6	210.3
10. Commercial banks	6.8	6.0	-1-1/4	-1.9	-6.2	5	900.4
11. Savings deposits, SA, plus MMDAs, NSA[3]	16.0	13.4	1	2.4	-9.4	2	543.3
12. Small time deposits	-4.2	-4.9	-4-1/2	-8.3	-1.3	10	357.1
13. Thrift institutions	4.3	3.9	5-1/4	5.3	2.8	6	911.9
14. Savings deposits, SA, plus MMDAs, NSA[3]	12.0	14.3	9-3/4	10.0	4.5	2	425.4
15. Small time deposits	-1.2	-4.6	1-1/2	1.2	1.2	10	486.5
16. M3 minus M2[4]	8.3	6.8	11-1/4	5.3	22.4	24	715.5
17. Large time deposits	3.0	2.9	9-1/2	12.0	13.2	16	459.6
18. At commercial banks, net[5]	2.7	9.7	18-1/2	27.7	18.4	19	310.6
19. At thrift institutions	3.4	-9.7	-8	-19.1	2.4	9	149.0
20. Institution-only money market mutual fund shares, NSA	30.3	0.9	-11-1/2	-25.4	-18.8	-7	81.8
21. Term RPs, NSA	28.3	14.4	55-1/2	86.2	69.9	27	96.3
22. Term Eurodollars, NSA	2.7	38.1	10-1/2	-47.1	57.5	51	89.7
	-- Average monthly change in billions of dollars --						
MEMORANDA:							
23. Managed liabilities at commercial banks (24+25)	2.0	8.4	6-1/4	2.0	14.3	2	532.1
24. Large time deposits, gross	0.6	2.8	6-1/4	5.7	6.4	7	366.2
25. Nondeposit funds	1.4	5.6	0	-3.7	7.9	-5	165.9
26. Net due to related foreign institutions, NSA	0.6	4.4	1	-3.7	10.2	-4	0.5
27. Other[6]	0.8	1.2	-1	0.0	-2.3	-1	165.4
28. U.S. government deposits at commercial banks[7]	0.4	-1.2	3-1/4	3.0	5.5	1	26.1

1. Dollar amounts shown under memoranda 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 May and June 1987 at rates of 16.0 percent and 6 percent, respectively. At thrift institutions, savings deposits excluding MMDAs increased during May and June 1987 at rates of 17.5 percent and 14 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.
pe--preliminary estimate

off. Borrowing by state and local governments was weaker for the quarter, despite some rebound in bond offerings after the market strengthened in June. Household debt growth bulged in April as borrowers rushed to close on about-to-expire mortgage commitments received before rates climbed, and as consumers relied more heavily on installment credit at a time when large tax payments were crimping household cash flow; for the quarter as a whole, net borrowing by households probably significantly exceeded the slow pace of the first quarter, which reflected year-end tax factors. Net business borrowing has been moderate; although shorter-term credit sources were tapped more heavily during the quarter, there was a clear shift back to bond issuance with the easing in long-term rates over the past month.

Monetary Aggregates and Bank Credit

Growth in the monetary aggregates generally has weakened again since the tax-related pickup in April. Between the end of last year and mid-1987, growth in M1 and M2 receded to about one-half the rates for all of 1986 and growth in M3 was about two-thirds of last year's pace. As a result, the velocities of M2 and M3 increased during the first half, and the extended decline of M1 velocity was virtually halted in the second quarter.

Contributing to the slower expansion of M1 and M2 this year has been the increasing opportunity cost of holding deposits. Interest rates on retail deposits, especially those for the most liquid monetary components, have adjusted rather slowly to the increases in market rates which began last fall. For example, the spread between the six-month Treasury bill rate and rates on NOW accounts at banks reached more than 150 basis points in May, the widest spread since April 1986.

M1 recorded only a small advance in May, and likely contracted in June at an annual rate of 7 percent or more. Both demand deposits and other checkable deposits apparently declined last month, the latter for the first time since the early 1980s. The weakening in transactions deposits in May was partly attributable to the clearance of checks sent to the IRS for April 15 tax payments, but no special factor seems to have contributed significantly to the contraction in June. (The Greenbook supplement will present updated estimates for June and the second quarter.)

M2 was essentially unchanged in May and is estimated to have expanded only a little in June. The nontransactions component fell marginally on a month-average basis in May, evidently owing to the effects of tax payments on checkable MMDAs and money market mutual fund shares (neither of which is seasonally adjusted in the monetary data). In contrast, June growth in the non-M1 component likely recovered to around a 7 percent annual rate, helped by the first substantial inflows into small time deposits in more than a year. The resumption of growth in small time deposits was encouraged by a steepening of the offering-rate curve for retail deposits. This has altered the composition of inflows to M2-type deposits, and probably accounted also for much of the May-June slowdown in savings deposit growth and the continued weakness in MMDAs (see chart on page III-20).

Substitution of small time deposits for more liquid core deposits was particularly evident in the Boston and New York Districts, where a well-publicized "rate war" on small time deposits has been waged. Between the weeks of May 11 and June 15, small time deposits at all institutions in these Districts grew at a rate more than three times that in other Districts, and those at commercial banks—which have been the most prominent combatants—grew at a rate more than ten times that of banks in other Districts. However, the growth rate of core deposits at all depository institutions in Districts 1 and 2 was only marginally higher than that in Districts 3 through 12, suggesting that much of the strength of small time inflows in the Northeast is attributable to substitution from other types of accounts.

RETAIL DEPOSIT GROWTH, WEEKS OF MAY 11 THROUGH JUNE 15[1]

District and institutional grouping	Small time deposits		Core deposits[2]	
	Inflow (billion $)	Growth rate (percent)	Inflow (billion $)	Growth rate (percent)
All institutions				
Districts 1 and 2	3.6	2.1	4.1	.9
Districts 3 - 12	4.8	.6	10.3	.6
Commercial banks				
Districts 1 and 2	2.8	5.5	3.0	1.5
Districts 3 - 12	1.6	.5	6.7	.8

1. Not annualized or seasonally adjusted. Weekly data immediately prior to May 11 were distorted by unusual tax-related activity.
2. Core deposits are defined here to include MMDAs, OCDs, savings deposits, and small time deposits.

Although these strong inflows helped bring growth in small time deposits at banks even with that at thrifts in June, for the year as a whole thrifts have relied far more heavily on small time deposits than have banks. Since January, small time deposits at banks have run off by more than $4 billion; at thrifts they have risen by $3-3/4 billion. This strength of small time deposits at thrifts may reflect in part the success of these institutions in encouraging skittish owners of large time deposits to shift funds into smaller deposits fully covered by the $100,000 insurance limit; so far this year, depositors at thrifts have withdrawn $4 billion (net) of large time deposits.

M3 growth was held down in May as banks drew on roughly $10 billion in net borrowings from their foreign offices and increases in Treasury

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

	1986	1987					Levels in bil. of dollars
	Q4	Q1	Q2[p]	Apr.	May	June[p]	June[p]
	Commercial Bank Credit						
1. Total loans and securities at banks	8.4	7.0	8.4	11.9	7.4	5.8	2171.1
2. Securities	6.0	2.4	6.8	7.5	11.2	1.6	518.5
3. U.S. government securities	20.2	5.7	5.9	5.7	16.3	-4.5	318.9
4. Other securities	-14.5	-2.8	8.4	10.4	2.4	12.1	199.6
5. Total loans	9.1	8.4	9.0	13.3	6.3	7.1	1652.6
6. Business loans	18.5	7.6	4.1	4.8	4.1	3.5	557.4
7. Security loans	-39.3	-3.1	35.5	166.1	-44.0	-8.6	41.7
8. Real estate loans[2]	16.3	17.9	19.3	16.1	19.6	21.3	537.3
9. Consumer loans[2]	5.3	2.1	2.0	3.8	0.4	1.9	315.7
10. Other loans	-20.5	0.0	1.6	15.6	-1.1	-9.5	200.5
	Short- and Intermediate-Term Business Credit						
11. Business loans net of bankers acceptances	18.8	8.1	3.3	3.7	3.3	2.8	551.5
12. Loans at foreign branches[3]	-27.3	-2.4	-17.2	36.8	-71.4	-15.2	15.6
13. Sum of lines 11 & 12	17.2	7.9	2.6	4.7	1.1	2.1	567.0
14. Commercial paper issued by nonfinancial firms	-19.1	-13.0	17.6	40.5	28.6	-16.2	80.5
15. Sums of lines 13 & 14	12.3	5.3	4.4	9.0	4.5	-0.2	647.5
16. Bankers acceptances: U.S. trade related[4,5]	-16.9	2.5	n.a.	33.9	11.0	n.a.	33.1 (May)
17. Line 15 plus bankers acceptances: U.S. trade related	10.8	5.1	n.a.	10.4	4.8	n.a.	680.7 (May)
18. Finance company loans to business[3]	11.2	14.7	n.a	16.8	n.a.	n.a.	180.8 (Apr)
19. Total short- and intermediate-term business credit (sum of lines 17 & 18)	10.9	7.0	n.a.	11.7	n.a.	n.a.	858.8 (Apr)

n.a.--not available.
p--preliminary
1. Average of Wednesdays.
2. June growth rates for real estate and consumer loans are adjusted for series breaks caused by earlier reporting errors for home equity loans.
3. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
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.

balances to finance a reduced rate of credit expansion. Despite a runoff of large time deposits at troubled thrifts, particularly in the Southwest, and slow growth at banks with sizable holdings of energy-related loans, overall growth in large time deposits remained brisk in May. Large time deposits accelerated further in June and, with the somewhat faster expansion estimated for M2, M3 growth is estimated to have climbed to a 7 percent rate in June.

Growth of bank credit has tapered off after an April spurt, slowing to a 7-1/2 percent annual pace in May and moderating further in June, according to preliminary estimates. Slower loan growth in May was partly offset by substantial net acquisitions of U.S. government securities, but, according to early estimates, both loans and investments grew at a reduced pace in June. Among loan categories, real estate lending remained an island of strength throughout the second quarter. Consumer loans were about unchanged in May and probably in June as well. Business loan growth slowed to a 4 percent rate in May and apparently dwindled further in June; moreover, part of the growth in business loans in May represented a shifting to U.S. offices of loans usually booked by U.S. banks at their foreign branches.

Corporate Finance

Bond offerings by nonfinancial corporations picked up when the market rallied in June. At the same time, short-term borrowing generally weakened: net issuance of commercial paper by nonfinancial firms evaporated in the early weeks of June and, as noted above, business loans at commercial banks manifested little growth. For the second quarter as a whole, however, gross issuance of bonds by nonfinancial corporations was the lightest in nearly two years, and net business borrowing in the aggregate, though probably up

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

	1986 Year	1986 Q4	1987 Q1	1987 Q2P	1987 Apr.P	1987 MayP	1987 June.P
Corporate securities - total[1]	28.23	30.56	29.69	23.14	23.80	19.48	26.17
Public offerings in U.S.	24.52	27.52	26.77	21.16	21.70	17.20	24.60
Stocks--total[2]	5.15	5.98	5.50	5.42	4.17	5.70	6.40
Nonfinancial	2.51	2.97	2.74	3.48	3.35	3.20	3.90
Utility	.64	.82	.74	.57	.42	.40	.90
Industrial	1.87	2.15	2.00	2.91	2.93	2.80	3.00
Financial	2.64	3.01	2.76	1.94	.82	2.50	2.50
Bonds--total[1]	19.37	21.54	21.27	15.74	17.53	11.50	18.20
Nonfinancial	9.65	8.21	8.94	5.98	5.13	5.00	7.80
Utility	3.61	3.69	2.04	1.52	1.63	.73	2.20
Industrial	6.04	4.52	6.90	4.46	3.50	4.27	5.60
Financial	9.72	13.33	12.33	9.77	12.41	6.50	10.40
By quality[3]							
Aaa and Aa	4.68	4.41	3.29	2.01	1.95	1.32	2.75
A and Baa	5.92	5.23	7.28	4.68	3.83	3.37	6.85
Less than Baa	3.45	3.06	3.06	2.91	2.70	3.39	2.65
No rating (or unknown)	.20	.15	.07	.28	.15	.30	.40
Memo items:							
Equity-based bonds[4]	.86	.30	1.37	1.28	1.67	.92	1.25
Mortgage-backed bonds	4.16	6.73	7.27	5.20	8.75	2.80	4.05
Variable-rate notes	1.02	2.44	2.37	1.23	1.08	1.67	.95
Bonds sold abroad - total	3.56	2.77	2.86	1.73	1.88	2.02	1.30
Nonfinancial	1.49	.95	1.08	.95	.94	1.52	.40
Financial	2.07	1.82	1.78	.78	.94	.50	.90
Stocks sold abroad - total	.15	.27	.06	.25	.22	.26	.27
Nonfinancial	.09	.22	.06	.24	.20	.26	.27
Financial	.06	.05	.00	.01	.02	.00	.00

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 or Standard and Poors if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.
4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.

from the volume of the first quarter, remained below the average pace for the year 1986. Bond issuance by utilities in the second quarter was especially anemic, suggesting a continued slowing in refunding issues; in 1986, most of the refundings were by utilities. In the Euro market, where rate increases on dollar-denominated debt issues were reportedly even steeper than on domestic issues owing to generally negative views of European investors toward the dollar, issuance by nonfinancial corporations dropped in June from the volumes of the first quarter and last year.

Bond offerings by financial firms also picked up in June, paced by a heavy volume of mortgage-backed securities. Some of the new issues contained a floating-rate tranche as part of a multiclass collateralized mortgage obligation (CMO).[1] The IRS ruled that, beginning June 15, floating-rate CMOs could be offered through a real estate mortgage investment conduit (REMIC), and because REMIC securities qualify as mortgage investments for thrift institutions while regular CMOs do not, the ruling is expected to increase the attractiveness of floating-rate tranches to thrifts. Offerings of securities backed by automobile loans and credit card receivables also strengthened in June.

In the equity markets, prices have risen substantially since the last FOMC meeting, with major indexes reaching new highs. Market prices of large

1. In a collateralized mortgage obligation (CMO), the payment stream of the underlying mortgage assets is manipulated to create "tranches" of securities with different payment characteristics and expected maturities. When one or more of these tranches bears a floating rate, the resulting interest rate risk is either shifted to one or more of the other tranches or, more commonly, embedded in the residual value of the CMO to its owner. The latter arrangement requires that the CMO be overcollateralized sufficiently to guarantee that even if short-term rates were to rise substantially, payments on the floating-rate tranche could continue to be met. To put a limit on the amount of necessary overcollateralization, the floating rates are almost always capped.

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

	1987				
	Q1	Q2[e]	Apr.	May	June[e]
Treasury financing					
Total surplus/deficit(-)	-58.5	3.4	38.7	-35.7	.5
Means of financing deficit:					
Net cash borrowing from the public	27.6	29.5	9.1	13.0	7.4
Marketable borrowings/ repayments(-)	16.7	20.4	3.3	11.9	5.2
Bills	-20.4	-17.4	-5.6	-5.5	-6.3
Coupons	37.1	37.8	8.9	17.4	11.5
Nonmarketable	10.9	9.0	5.7	1.1	2.2
Decrease in the cash balance	21.9	-31.1	-46.7	22.6	-7.0
Memo: Cash balance at end of period	9.0	40.1	55.7	33.1	40.1
Other[2]	9.1	-1.8	-1.0	.1	-0.9
Federally sponsored credit agencies, net cash borrowing[3]	-2.1	7.2	1.3	2.3	3.6
FHLBs	3.3	7.0	2.5	1.3	3.2
FNMA	-1.9	-.3	-1.9	.7	.9
Farm Credit Banks	-5.1	-1.3	-.2	-.2	-.9
FHLMC	.5	.6	.2	.2	.2
SLMA	1.1	1.2	.7	.3	.2

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

bank stocks have generally outpaced the broad-based indexes as investors appear to have reacted favorably to increased provisions for loan-loss reserves. Gross equity offerings of nonfinancial firms have increased this quarter, but the rise appears to have been more than offset by larger share retirements from mergers and other corporate restructurings.

Treasury and Sponsored Agency Financing

The total budget of the federal government is estimated to have been roughly in balance in the second quarter of 1987, after a $59 billion deficit in the previous quarter. The unusually pronounced cutback in the deficit is attributable mainly to very large payments of nonwithheld taxes by individuals in April that were generated by substantial capital gains realized in late 1986. Corporate tax payments in April and June were increased by tax reform, but these gains appear to have been smaller than widely expected. This shortfall may have occurred because the new law does not become fully applicable until the September payment; it also could reflect a smaller net effect of the tax law on corporate liabilities than previously thought.

The Treasury borrowed almost $30 billion, net, from the public in the second quarter, substantially increasing its cash balance to a level of $40 billion at quarter-end. It raised $38 billion of new cash through marketable coupon issues, while continuing to pay down bills--more than $17 billion, net. Issuance of nonmarketable debt raised $9 billion in funds in the quarter; of this amount, about $6-1/2 billion was obtained from the state and local government series.

Net borrowing by the federally sponsored credit agencies in the second quarter is estimated at $7.2 billion after a net paydown of $2 billion in the first quarter. The Federal Home Loan Banks accounted for most of the new funds raised in the second quarter as they accommodated heavy demand for advances by thrifts. Fannie Mae probably retired a small amount of debt on net on the heels of a nearly $2 billion paydown in the first quarter; the agency had shifted some of its anticipated borrowing forward into 1986 in response to favorable year-end market conditions, and borrowing needs were still comparatively light in the second quarter.

The Farm Credit Banks also continued to pay down debt, in view of further writeoffs of bad loans, slack demand for new credit, and the withdrawal of creditworthy borrowers able to find more favorable terms through other channels. These banks have had to pay an increasing premium on their securities over the past few months, as quality spreads in general have widened and as specific concerns about the FCBs may have mounted. Spreads between rates on 3- and 6-month issues of the FCBs and comparable Treasury securities were about 90 and 120 basis points at the pricing in June, compared with spreads of 70 to 75 basis points in April. They had been in the 25 to 35 basis point range as recently as January.

Municipal Securities Market

Gross offerings of long-term municipal securities snapped back sharply in June when rates turned downward. With rates still well above their levels earlier in the year, however, the volume of refunding issues remained light, and the overall pickup in offerings was almost entirely attributable to financings to raise new capital.

Although new-capital issues were heavier in the second quarter as a whole than in the first, the pace of such offerings remained well below that of recent years. A considerable amount of unspent funds remains from those earlier financings, but the comparative sluggishness this year also reflects tax reform provisions that narrowed the definition of public-purpose debt and tightened arbitrage restrictions. In addition, private-purpose offerings have been constrained by lower caps on volume.

GROSS OFFERINGS OF MUNICIPAL SECURITIES
(Monthly rates, not seasonally adjusted, billions of dollars)

	1985	1986	1987				
	Year	Year	Q1	Q2p	Apr.	Mayp	Junep
Total tax-exempt	19.81	14.04	10.86	8.94	9.63	5.70	11.50
Short-term[1]	1.96	1.79	.56	1.84	2.78	.25	2.50
Long-term	17.85	12.25	10.30	7.10	6.85	5.45	9.00
Refundings[2]	4.85	5.29	7.24	2.37	3.61	1.51	2.00
New capital	13.00	6.96	3.06	4.73	3.24	3.94	7.00
Total taxable	.03	.38	.27	.19	.36	.01	.25

p--preliminary.
1. Does not include tax-exempt commercial paper.
2. Includes all refunding bonds, not just advance refundings.

Short-term municipal offerings (13 months or less) rose in June, notwithstanding delay by the State of California of at least $1.0 billion of revenue anticipation notes pending final determination of the state's budget. Included in the June note volume was a $785 million offering from Los Angeles County that, with $100 million of it denominated in New Zealand dollars, became the first state or local government security denominated in a foreign currency. Interest on the issue is tax-exempt, while increases in the principal due to exchange rate fluctuations are taxable. The county has avoided currency risk by arranging swap agreements into dollars in June and back into New Zealand dollars next year when the notes mature.

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

	Mortgage transactions		Net change in mortgage assets[1]		
	Originations (1)	Sales (2)	Total (3)	Mortgage loans (4)	Mortgage-backed securities (5)
1986-July	23.5	16.3	3.3	.9	2.4
Aug.	23.1	17.0	1.2	1.3	-.1
Sept.	23.6	19.3	3.1	-3.4	6.4
Oct.	25.3	17.0	6.5	2.0	4.5
Nov.	22.5	16.0	6.0	1.7	4.3
Dec.	28.6	12.1	4.3	1.4	3.0
1987-Jan.	20.1	13.7	1.1	-3.0	4.1
Feb.	21.3	12.1	0	-.7	.8
Mar.	22.6	11.5	1.9	1.1	.9
Apr.	23.5	14.8	8.9	1.7	7.2

1. Net changes are adjusted to account for structural changes caused by mergers, acquisitions, liquidations, terminations, or de novo institutions. Prior to January 1987, mortgage assets held by FSLIC-insured institutions, as reported to the FHLB Board, excluded loans in process and other contra assets. Since then, however, these mortgage data have been reported by thrifts to include contra assets. As a result, the net changes in mortgage assets since the beginning of this year reflect the new gross reporting procedure implemented by the FHLB Board.

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

Period	Total	GNMAs	FHLMCs	FNMAs	Memo: FNMA and FHLMC swap issues
1986-Q2	19.2	7.0	7.5	4.7	8.5
Q3	27.3	10.0	10.4	6.8	10.9
Q4	27.3	10.7	11.0	5.6	11.1
1987-Q1	23.8	10.4	8.2	5.2	10.7
1987-Jan.	25.2	10.6	8.2	6.4	11.0
Feb.	22.2	9.7	7.8	4.7	10.2
Mar.	24.0	10.7	8.6	4.6	10.9
Apr.	28.2	11.9	9.3	7.0	13.4
May p	19.3	3.5	8.7	7.1	14.1

p--preliminary.

Mortgage Markets

Interest rates quoted on commitments for fixed-rate conventional home mortgages have declined almost 1/2 percentage point from their peaks reached shortly after the last FOMC meeting; nonetheless, in late June they still stood about 1-1/4 percentage points above the nine-year lows recorded in March. In comparison, interest rates on adjustable-rate mortgage commitments have been fairly stable in recent months. The average rate on Treasury-indexed ARMs has declined about 1/8 percentage point since the FOMC last met. Thus, the spread between fixed and adjustable mortgage rates is still about a percentage point greater than in March.

Home mortgage borrowing was quite heavy in April, when the jump in mortgage rates prompted borrowers to press for closings on earlier low-rate loan commitments. Loan originations at FSLIC-insured thrifts in April were the fourth highest on record, and their holdings of mortgage assets increased almost $9 billion, including a record $7.2 billion in mortgage-backed securities. With the runup in rates, thrift institutions apparently chose to swap newly originated loans for securities in order to borrow against the securities rather than sell the below-market-rate loans at a loss.

Mortgage lending activity probably tapered off later in the quarter, however, as older, low-rate commitments expired. Mortgage bankers surveyed weekly by HUD reported a falloff in new applications for conventional and FHA mortgages between early April and mid-June, although the decline appeared to moderate with the recent pullback in rates.

Issuance of mortgage pass-through securities guaranteed by GNMA declined substantially in May, while the volume of FNMA- and FHLMC-related

CONSUMER INSTALLMENT CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)						Net change (billions of dollars)		Memo: Outstandings (billions of dollars)
			1986	1987	1987		1987		1987
	1985	1986	Q4	Q1r	Mar.r	Apr.p	Mar.r	Apr.p	Apr.p
Total[1]	17.1	10.5	4.6	1.5	.7	6.1	.32	2.93	582.8
Total, excluding auto	14.9	5.7	.6	1.1	-.9	7.3	-.26	2.03	335.7
Selected types									
Auto	20.7	17.8	10.1	1.7	1.1	4.4	.23	.90	247.2
Revolving	22.5	10.6	5.5	.6	-4.4	12.7	-.50	1.43	136.6
All other	10.6	2.6	-2.7	1.3	3.6	3.6	.59	.60	199.1
Selected holders									
Commercial banks	15.7	8.1	4.1	.5	-.8	6.3	-.17	1.38	263.3
Finance companies	26.3	20.7	2.9	-1.3	.4	9.2	.04	1.04	137.1
Credit unions	9.9	8.0	8.1	3.7	1.2	4.6	.07	.30	78.9
Savings institutions[2]	30.0	10.7	9.5	10.0	9.3	1.9	.46	.09	59.6

1. Includes items not shown separately.
2. Savings and loans, mutual savings banks, and federal savings banks.
r—revised. p—preliminary.

CONSUMER INTEREST RATES
(Annual percentage rate)

			1987				
	1985	1986	Jan.	Feb.	Mar.	Apr.	May
At commercial banks[1]							
New cars (48 mo.)	12.91	11.33	...	10.35	...	...	10.24
Personal (24 mo.)	15.94	14.83	...	14.11	...	...	14.00
Credit cards	18.69	18.26	...	18.11	...	...	17.93
At auto finance cos.[2]							
New cars	11.98	9.44	11.65	10.78	10.59	10.81	10.69
Used cars	17.59	15.95	14.62	14.56	14.40	14.49	14.45

1. Average of "most common" rate charged for specified type and maturity during the first week of the mid-month of each quarter.
2. Average rate for all loans of each type made during the month regardless of maturity.

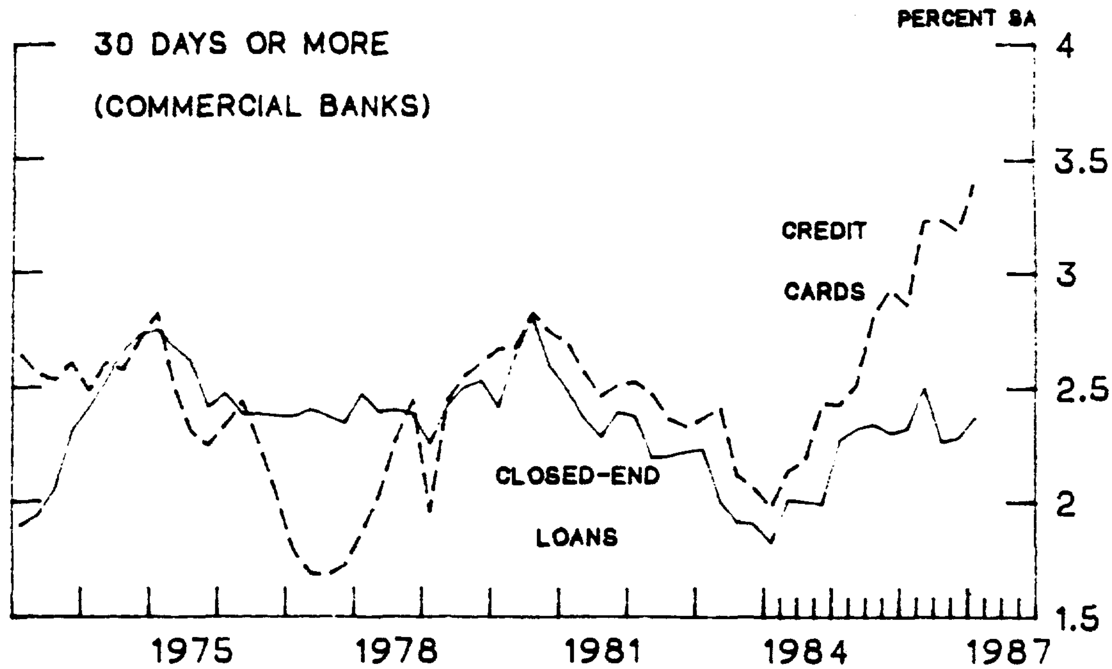
issues was little changed. After the VA ceiling rate was increased in mid-April, and again on May 11, lenders who had "locked-in" commitments at low rates took advantage of a standard clause in FHA/VA mortgage contracts that releases the lender from a commitment in the event of a change in the VA mortgage rate ceiling. Faced with rates substantially higher than they had expected, many borrowers apparently chose not to go ahead with the financing, thereby reducing the supply of new FHA/VA mortgages available for conversion into new GNMA pass-throughs. In contrast, because conventional mortgage contracts typically do not include a bailout clause, issuance of FHLMC and FNMA pass-throughs remained strong.

Consumer Installment Credit

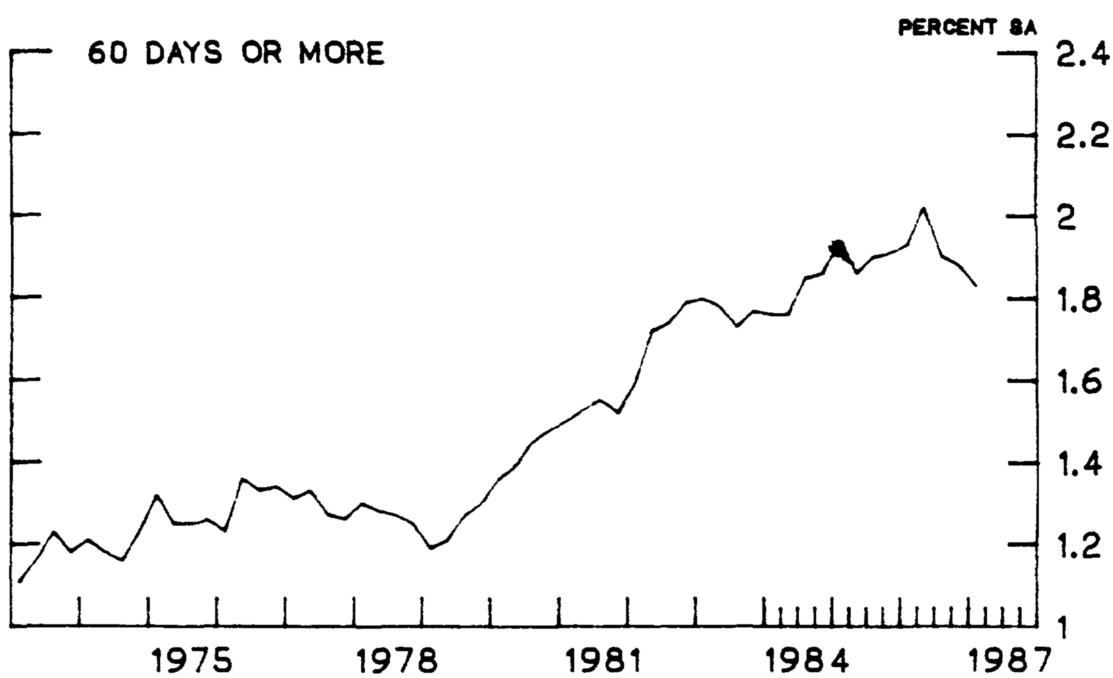
Consumer installment credit, which had grown quite slowly for several months, picked up in April but apparently expanded little further in May. Consumer borrowing at commercial banks, retailers, and gasoline companies (accounting for about half of total outstandings) declined at a 1-1/2 percent annual rate in May, after rising at a 6-1/4 percent pace in April. Revolving credit was the strongest component in April, perhaps reflecting a rise in charge activity as other funding sources were drawn on to meet unusually large tax payments; its growth appears to have been minimal again in May.

Consumer installment credit advanced at only a 2 percent pace in the six months through April. Besides the more sluggish behavior of consumer outlays, this subdued growth in credit reflects significant shifts into home equity lines of credit. Aggregate data on outstanding home equity loans are not available, but some information on the prevalence and usage of equity-secured lines was collected recently in a Board-sponsored survey

DELINQUENCY RATES ON CONSUMER LOANS



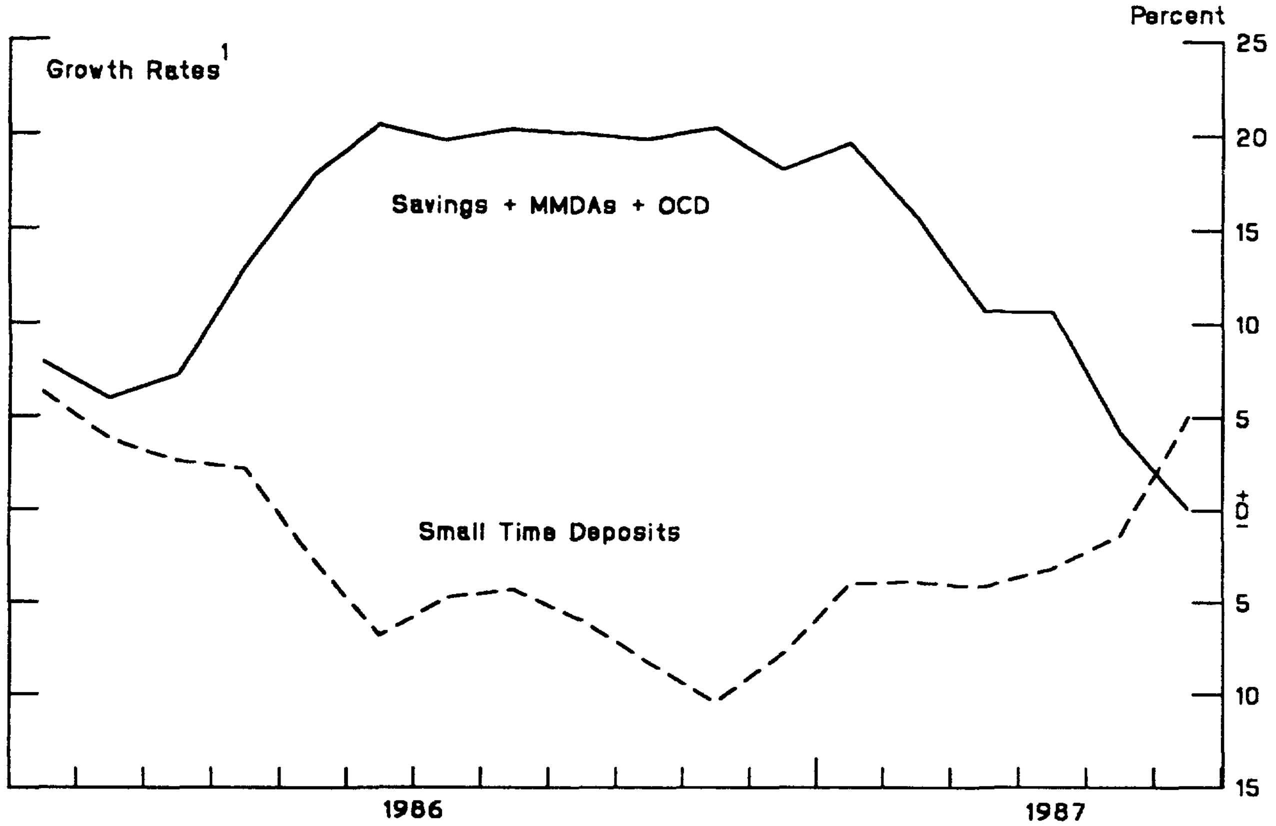
DELINQUENCY RATES ON HOME MORTGAGES

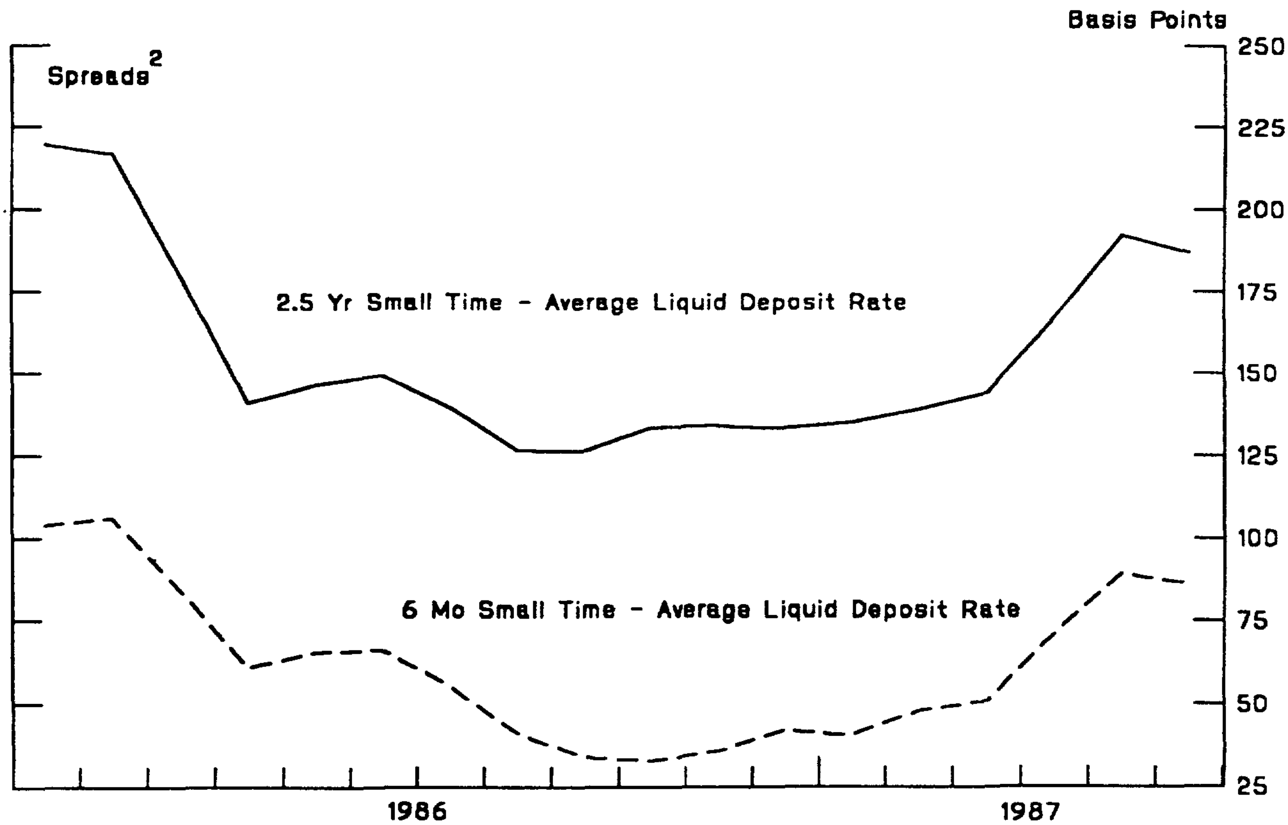


of households by the University of Michigan. Of all households covered, only 4 percent actually had home equity lines of credit, most of which had been issued by banks or thrift institutions and established in 1986 or early 1987. The most popular use of these lines has been to pay down existing debts (mainly credit cards), followed closely by spending for home improvement. Thirty percent of lineholders had not activated their lines at all. The average credit line was well below the amount of home equity available, and outstanding balances (for accounts in use) were less than half the credit line.

Measures of collection experience on consumer borrowing presented a mixed picture in the first quarter. The delinquency rate on closed-end consumer loans at banks increased a bit to 2.4 percent, about the midpoint of its range over the past 14 years, while delinquencies on bank credit cards climbed to a series high of 3.4 percent. Delinquencies at auto finance companies edged up during the quarter to about the 1986 average rate—high for recent years but well below the levels of 1979-80. Mortgage loans past due 60 days or more continued to fall off from the record level reached in the second quarter of 1986, but remain elevated by historical standards.

Growth of Retail Deposits and Deposit Rate Spreads





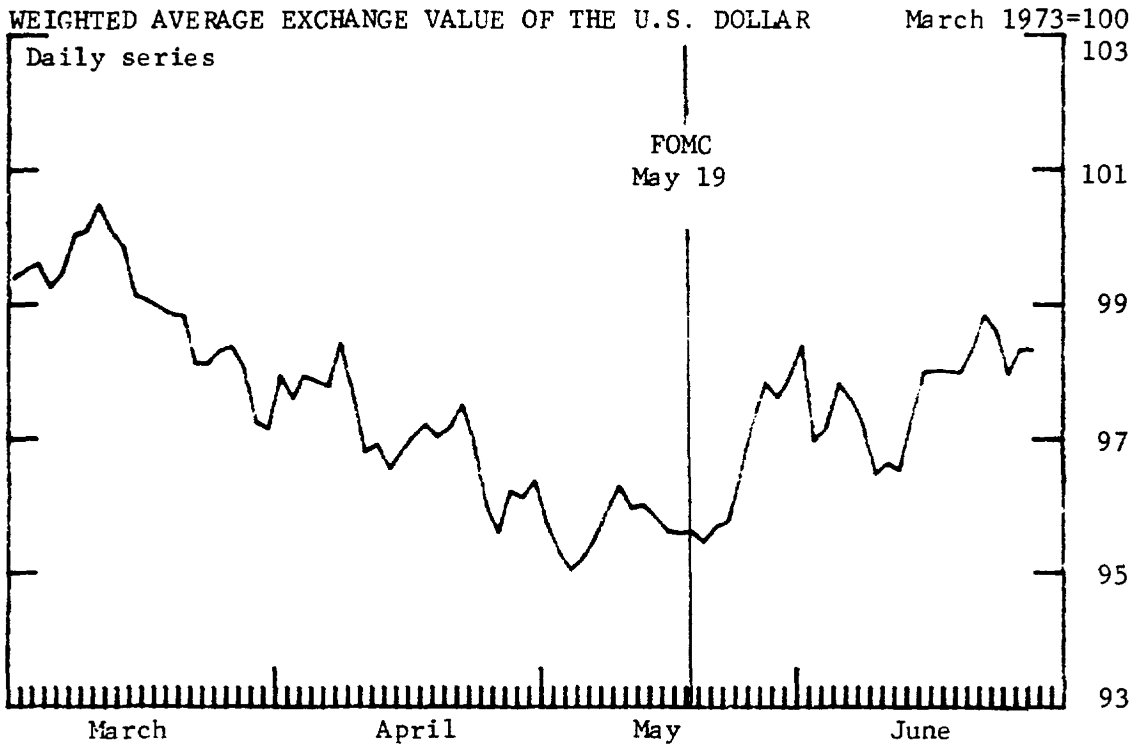
1. Based on a 2-month moving average of retail deposits at commercial banks and thrift institutions.
2. Spreads are based on rates paid at commercial banks. Average liquid deposit rate is a weighted average of NOW, MMDA and savings rates.

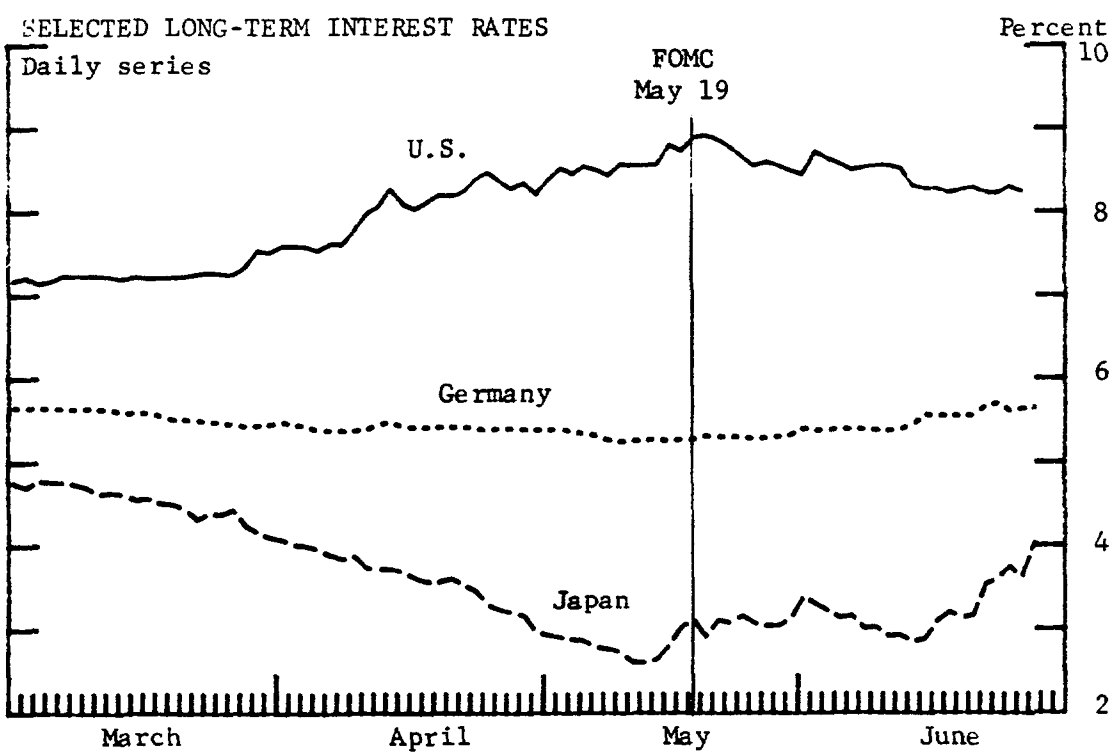
Note : June data are estimated.

Foreign Exchange Markets

Despite reports of continuing negative sentiment for the long-term, selling pressure on the dollar abated during the intermeeting period. Since May 19, the weighted-average value of the dollar has risen about 2-3/4 percent, on balance, with the dollar firming nearly 5 percent against the yen and 2-3/4 percent against the mark. The dollar rose sharply in late May amid somewhat easier monetary conditions in Germany and Japan and continuing perceptions that U.S. monetary conditions had tightened somewhat in late April. Further impetus was given to the dollar following the release of the Japanese budget package. A temporary dip occurred after the announcement of Chairman Volcker's resignation in early June, and some selling pressure emerged in the runup to the Venice Summit. But the dollar subsequently rose to its recent highs on better-than-expected economic data for U.S. inflation, production, and payments imbalances. It has since retreated somewhat amid rumors of central bank intervention to restrain the dollar, as some market participants reportedly concluded that specific target ranges had been agreed to in Venice and that the dollar was approaching the upper limit of these ranges.

Even as the dollar strengthened over the period, long-term interest-rate differentials between U.S. and foreign securities narrowed sharply. Differentials between U.S. and German rates have decreased about 90 basis points to a level of about 275 basis points, and the U.S.-Japanese differential declined about 120 basis points to a level of about 460 basis points. The rise of long-term interest rates


WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR
March 1973=100
Daily series
FOMC
May 19
103
101
99
97
95
93
March
April
May
June


SELECTED LONG-TERM INTEREST RATES
Percent
Daily series
FOMC
May 19
U.S.
Germany
Japan
10
8
6
4
2
March
April
May
June

in Japan may reflect reported concerns that recent money growth might prompt some future monetary restraint. Short-term interest-rate differentials have moved in the same direction as the long-term interest-rate differentials, though less sharply. The weighted-average of foreign three-month interest rates rose about 10 basis points, while the rates on 3-month Treasury bills were about unchanged and on U.S. 90-day CDs fell about 25. In other interest-rate developments, French authorities lowered the money-market intervention rate and the 7-day repurchase rate 1/4 point during this period to 7-1/2 percent and 8 percent, respectively. These cuts took place as upward pressure on the franc moved it closer to the top of the EMS bilateral parity grid.

. On May 19, the Desk purchased $133 million against marks to counter selling pressure that had arisen following the announcement by Citibank that it would increase its loan-loss reserves by $3 billion. In the only other occurrence of intervention by U.S. authorities during this period, the Desk purchased $410 million against marks and $103 million against yen following the announcement on June 2 of Chairman Volcker's resignation.

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The dollar price of gold dropped about 4-1/2 percent since the beginning of this period, to a level of $449.50, while silver prices retreated about 22 percent to a level of $7.26.

<u>U.S. bank lending to foreigners in the first quarter</u>. U.S.-chartered banks' claims on foreigners rose $4.1 billion in nominal terms in the first quarter of 1987. However, after adjustment for the effect of a 6.3 percent decline in the average exchange value of the dollar on the dollar value of nondollar claims, total claims on foreigners at constant exchange rates are estimated to have declined by $3 billion. Revised data show that nominal claims for 1986 fell $200 million, and exchange rate adjusted claims fell $9 billion.

The nominal value of claims on non-OPEC developing countries rose $0.6 billion in the first quarter. This included an increase in claims of $0.3 billion in Latin America and a $0.2 billion on Asia and Africa. The increase in claims on Latin America was more than accounted for by a $0.4 billion recorded increase in claims on Brazil during the first quarter. This increase appears to reflect in large part interest accrued on Brazilian loans that was not paid after the suspension of interest payments on medium- and long-term debts to banks that was announced on February 20. As these loans are placed on a non-accrual accounting basis, which will take place by the end of the second quarter of 1987, a <u>recorded</u> reduction in claims on Brazil may appear in the data, if banks subtract this accrued interest from their reported balance sheets.

OECD data on publically announced medium- and long-term international bank loans show a strong increase in new syndicated bank loans so far in 1987. For the first five months of the year, syndicated lending increased by $74 billion on an annual basis, 27 percent greater than such lending for the year 1986. Press accounts have drawn attention to renewed interest in syndicated loans on the part of borrowers from major industrial countries, particularly those

CLAIMS ON FOREIGNERS OF U.S.-CHARTERED BANKS
(billions of dollars)

	Changes (no sign = increase)					
	1985 Year	1986 Year	1986 Q3	1986 Q4	1987 Q1	Outstanding 3/31/87
Total, all countries	-13.8	-0.2	0.1	0.3	4.1	395.8
Non-OPEC developing countries	-6.7	-5.8	-1.8	-0.4	0.6	100.2
of which:						
(Latin America)	-3.1	-1.4	-0.3	0.0	0.3	72.8
(Asia and Africa)	-3.3	-4.4	-1.7	-0.2	0.2	27.4
OPEC countries	-3.3	-2.1	-0.6	-0.5	0.7	20.2
Eastern Europe	-0.2	-1.0	-0.6	-0.2	-0.1	3.1
Smaller developed countries	-3.2	-4.3	-1.2	-3.3	0.1	26.2
G-10 countries	0.4	9.6	-1.0	-0.8	5.1	163.2
Offshore banking centers	-0.2	0.1	5.1	2.9	0.0	65.5
Miscellaneous	-0.4	3.2	0.2	2.6	-2.3	17.5
Memorandum: Total, adjusted for exchange rate changes (staff estimates)	-29	-9	7	0	-3	

wanting to raise large amounts quickly in order to finance acquisitions. Over three-quarters of the announced loans in the OECD's data was to borrowers in the G-10 countries.

Although Morgan Guaranty was the lead manager for a $5 billion syndicated credit for British Petroleum in March, a transaction that will probably be reflected in second quarter U.S. bank claims, the first quarter data do not as yet confirm large-scale U.S. bank participation in syndicated lending. Nominal claims on the G-10 countries increased by $5.1 billion in the first quarter. However, valuation and seasonal effects may have accounted for a large portion of the increase. Moreover, syndicated credits are not necessarily fully drawn down on the date of their public announcement, and would not be reflected in the U.S. bank claims data until dispersements are made. It is, nevertheless, possible that the behavior of U.S. banks has changed and that they are not bidding for as large a share of traditional international syndicated loans as they have in the past.

U.S. International Financial Transactions

Official reserve assets held in the United States by the foreign G-10 countries continued to increase strongly in April,

. (See the Summary of U.S. International Transactions table, line 4.) Draw-downs of OPEC reserves continued,

. Partial information for May from the FRBNY indicates that G-10 reserves in the United States continued to increase,

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The bulk of the increase in official reserve assets in the United States in April, as well as in the first quarter, was in the form of holdings of U.S. Treasury securities. (See line 4b.) Almost half of the increase in Treasury securities consisted of bills and certificates, while somewhat more than half was bonds and notes. Private foreigners, in contrast, sold almost $7 billion net in U.S. Treasury securities (mostly bonds and notes) in the first four months of 1987. (See line 3.) Japanese residents sold $3.1 billion net in April, after selling $1.7 billion net in the first quarter.

Foreign private inflows through other securities transactions (line 2) in April continued at almost the same rate as in 1986 and the first quarter of 1987, although below the high March levels. Foreign private purchases of U.S. corporate bonds (line 2a) were down somewhat, and are unlikely to recover soon since new issue activity in the Eurobond markets has been deterred by higher interest rates since

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

	1985 Year	1986 Year	1986 Q2	1986 Q3	1986 Q4	1987 Q1	1987 Feb.	1987 Mar.	1987 Apr.
Private Capital									
Banks									
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	33.6	20.3	-8.4	12.8	6.5	10.3	-2.8	1.5	-4.3
Securities									
2. Private securities transactions, net	43.0	67.0	21.5	17.5	15.2	17.1	5.3	8.0	4.9
a) foreign net purchases (+) of U.S. corporate bonds	46.0	53.7	16.0	12.8	12.1	8.6	2.6	3.9	3.4
b) foreign net purchases (+) of U.S. corporate stocks	4.8	18.0	7.0	4.5	0.3	10.2	3.3	5.3	3.3
c) U.S. net purchases (-) of foreign securities	-7.9	-4.6	-1.5	0.3	2.8	-1.7	-0.6	-1.2	-1.8
3. Foreign net purchases (+) of U.S. Treasury obligations	20.5	8.5	3.8	0.7	-3.0	-1.7	8.7	-0.5	-5.0
Official Capital									
4. Changes in foreign official reserves assets in U.S. (+ = increase)	-2.0	33.0	14.6	14.6	1.6	15.7	1.9	11.8	7.2
a) By area									
G-10 countries (incl. Switz.)	-0.4	30.8	11.2	14.5	1.2	15.5	2.2	11.2	6.6
OPEC	-6.9	-8.1	-2.3	-2.9	-4.7	-2.8	-1.8	-0.3	-0.7
All other countries	5.3	10.3	5.8	3.0	5.0	2.9	1.5	0.9	1.2
b) By type									
U.S. Treasury securities	-0.8	34.5	14.5	12.2	4.6	12.1	0.6	10.0	6.4
Other 1/	-1.1	-1.5	0.1	2.4	-3.0	3.5	1.3	1.8	0.7
5. Changes in U.S. official reserve assets (+ = decrease)	-3.9	0.3	-0.0	0.3	0.1	2.0	*	1.3	2.7
Other transactions (Quarterly data)									
6. U.S. direct investment (-) abroad	-17.3	-28.0	-7.5	-5.7	-3.8	-10.0	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	19.0	25.1	4.5	6.1	12.6	3.4	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow) 2/ 3/	5.6	-8.7	-5.7	-1.2	-3.0	2.3	n.a.	n.a.	n.a.
9. U.S. current account balance 3/	-116.4	-141.4	-33.0	-36.6	-38.0	-37.1	n.a.	n.a.	n.a.
10. Statistical discrepancy 3/	17.9	23.9	10.2	-8.5	11.8	-2.0	n.a.	n.a.	n.a.
MEMO:									
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-124.4	-147.7	-33.6	-37.1	-38.6	-38.3.	n.a.	n.a	n.a.

1. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
2. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking and official transactions not shown elsewhere. In addition, it includes amounts resulting from revisions of the data in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.
3. Includes seasonal adjustment for quarterly data.
* Less than $50 million.
NOTE: Details may not add to total because of rounding.

March. Foreign purchases of U.S. corporate stock (line 2b) were still strong in April, but below the March peak rate. Japanese residents have purchased $5 billion net in U.S. stocks in the first four months of 1987, more than they purchased in all of 1986. U.S. purchases of foreign securities (line 2c) increased somewhat in April.

The large net inflow reported by banks in the first quarter of 1987 was partially reversed in April (line 1), largely because of net outflows to affiliated banks outside the United States. As indicated on the International Banking Data table (line 1), these inflows resumed in May. For the first five months of 1987 as a whole, large net inflows from own foreign offices were concentrated at the large money-center banks. They were probably related both to the placement of large sums by foreign central banks in the Euromarkets during this period and to variations in the funding needs of banks in the United States; apart from April, core deposit growth has been slow.

Another notable development in recent months has been the rapid growth of international intermediation denominated in currencies other than the dollar. Foreign-currency denominated claims on and liabilities to foreigners at banks in the United States (many of them foreign-based) grew by almost 25 percent in the first quarter of 1987; valuation changes resulting from the depreciation of the dollar explain only part of this increase. (However, foreign-currency claims and liabilities remain a small percentage of total claims and liabilities.) Foreign-currency denominated Eurobonds issued by U.S. corporations increased from 22 percent of new Euro-issues by U.S. corporations in 1985 to 28 percent in 1986 and 36 percent in the first five months of 1987. In the Eurobond markets as a whole, dollar-denominated bonds accounted for only about one-third of new issues in the first five

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1982	1983	1984	1985	1986	1987				
	Dec.	Dec.	Dec.	Dec.	Dec.	Jan.	Feb.	Mar.	Apr.	May
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	49.1	44.5	33.0	28.2	22.3	18.3	15.3	9.1	12.8	2.7
(a) U.S.-chartered banks	40.0	40.5	32.1	32.4	31.7	26.6	24.7	21.6	23.1	15.8
(b) Foreign-chartered banks	9.1	4.0	.9	-4.2	-9.4	-8.3	-9.4	-12.4	-10.3	-13.1
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	15.8	18.6	20.7	18.7	16.8	15.8	16.5	16.0	16.4	15.7
3. Eurodollar Holdings of U.S. Nonbank Residents 1/	112.6	124.3	117.4	111.9	123.2	129.4	131.7	134.9	131.9	136.1

1. Includes term and overnight Eurodollars held by money market mutual funds.

Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices. Line 2 is an average of daily data. Line 3 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.

months of 1987, compared with more than half in 1986 and about two-thirds in 1985. In the U.S. domestic bond market, there were 20 foreign-currency denominated bond issues by U.S. corporations in the first quarter, equivalent to $1.3 billion.

The Department of Commerce recently released data on U.S. international transactions in the first quarter of 1987. Direct investment abroad (line 6 on the Summary of U.S. International Transactions table) was unusually large: reinvested earnings were inflated by unrealized currency translation gains associated with the depreciation of the dollar and there were substantial repayments of intercompany debt to Netherlands Antilles finance affiliates, largely related to the retirement of Eurobonds that had been issued in earlier years by these affiliates. Additional bond retirements and outflows to Netherlands Antilles finance affiliates are likely this year since the Treasury Department just renounced (effective January 1, 1988) the tax treaty with the Netherlands Antilles, subjecting future interest payments associated with Eurobonds issued there before mid-1984 to a withholding tax. The statistical discrepancy (line 10) and foreign private purchases of U.S. Treasury securities (line 3) do not match the data as published by the Department of Commerce in June because of the correction of a large error in reports of net purchases of U.S. Treasury securities by the World Bank.

Merchandise Trade

Measured on a seasonally-adjusted, balance-of-payments basis, the merchandise trade deficit in the first quarter was $153 billion (AR) -- virtually the same as the deficit in the fourth quarter of last year (see tables below). The April trade deficit, measured on a not-seasonally-adjusted, Census basis, was somewhat smaller than the monthly average for the first quarter. The staff estimates that on a seasonally-adjusted, balance-of-payments basis the April trade deficit will be $140 billion.

U.S. MERCHANDISE TRADE
(Billions of dollars, annual rate)
Balance-of-payments basis, seasonally adjusted

	Exports			Imports			
	Total (1)	Ag. (2)	Nonag. (3)	Total (4)	Oil (5)	Non-oil (6)	Balance (7)
Years							
1984	220	38	182	332	57	275	-112
1985-r	216	30	186	338	50	288	-122
1986-r	224	27	197	369	34	335	-144
Quarters							
1985-4r	214	28	186	358	56	302	-145
1986-1r	216	28	187	355	41	314	-140
2r	228	25	202	362	31	332	-135
3r	226	27	200	375	32	343	-149
4r	228	28	200	383	32	350	-154
1987-1	233	26	207 1/	386	35	351	-153

1/ The Department of Commerce estimates that, when it corrects a data error, the value of non-agricultural exports for January will fall by about $1.5 billion (AR).

U.S. MERCHANDISE TRADE
(Billions of dollars, monthly, annual rate)

(Census basis, revised statistical month, not-seasonally-adjusted)

		Exports, fas	Imports, cif	Balance
Quarter				
(three month average)				
	1987-Q1	224.6	388.4	-163.9
Months				
	Jan.	197.1	344.3	-147.2
	Feb.	223.9	404.7	-180.8
	Mar.	252.8	416.3	-163.6
	Apr.	241.7	401.5	-159.8

For the first quarter of 1987, non-agricultural exports increased by 3.5 percent from the fourth-quarter value. The increase was in industrial supplies (especially lumber and chemicals), in consumer goods, and in exports of automobile parts to Mexico and other non-Canadian destinations. Exports of machinery continued at about the same elevated rate as in the fourth quarter (about 5 percent above levels recorded a year earlier). A similar pattern of expansion of exports appears in the April data. Some items, such as general machinery and chemicals, showed continued growth from March and first-quarter values.

The growth in non-agricultural exports is attributed primarily to the increased international competitiveness of U.S. exports resulting from the decline in the exchange value of the dollar; income growth abroad in 1986 and early 1987 has been relatively sluggish. Most of the increase in non-agricultural exports in the first quarter went to Canada and to Western Europe, increasing in each case by 8 percent. In addition, even though the appreciation of the yen has brought no improvement in U.S. exports to Japan, U.S. exports to Korea and

Singapore expanded by 15-20 percent in the first quarter, suggesting a substitution toward U.S. suppliers.

Agricultural exports declined somewhat in the first quarter of 1987 from strong fourth-quarter levels, particularly because of a fall in the volume of soybean exports. But they were up in April, buoyed by increased shipments of corn to the USSR. Overall, however, the performance of agricultural exports has been anemic over the past year. Agricultural prices have continued to fall, bringing the total decline since the first quarter of 1986 to 12 percent. Moreover, non-tariff barriers covering nearly 40 percent of agricultural trade and increased production world-wide suggest that shifts in the competitiveness of U.S. agricultural exports that result from lower support prices and the decline in the dollar may not lead to a sustained improvement in export volume.

The value of oil imports increased by 8 percent in the first quarter, but fell back in April. The price of imported oil has continued to rise, as OPEC countries have acted to limit oil production and raise prices. Prices were up 23 percent in the first quarter, and rose again in April, bringing the total price rise since December 1986 to $3.80 per barrel. However, the increase in price was partly offset by a 12 percent decline in the volume imported in the first quarter and a further decline in April (see table).

OIL IMPORTS

Oil Imports*	Year 1985[r]	Year 1986[r]	1986r Q1	1986r Q2	1986r Q3	1986r Q4	1987 Q1
Value (Bil. $, SAAR)	50.39	33.76	40.90	30.50	31.61	32.04	34.76
Price ($/BBL)	26.33	14.18	21.45	13.16	11.39	12.74	15.63
Volume (mbd, SA)	5.24	6.52	5.23	6.36	7.61	6.90	6.09

*/ As published in the balance-of-payments accounts.

For non-oil imports, a similar pattern emerges of price increases and volume declines. In the first quarter, price increases barely offset a decline in volume, resulting in virtually no increase in the value of non-oil imports. For April, the value of non-oil imports fell.

Across product categories, small increases in the value of imports in the first quarter were recorded in industrial supplies (particularly paper, building materials, and steel), machinery, automotive parts (from Japan, Mexico, and Canada), and consumer goods (especially textiles). For April, the overall decline in the value of non-oil imports was offset by increases in passenger cars (especially from Japan as a new quota-year began), and consumer goods (especially apparel).

Prices of non-oil imports have continued to rise, with the strongest increases in the first quarter in capital goods, consumer goods, and automotive products (see table). Increases in certain categories of imports result in large part from the delayed passing-through of the change in the value of the dollar into import prices. Prices of imports of capital goods have been rising steadily throughout 1986, as a majority of these imports come from countries whose currencies have been rising the most against the dollar -- namely Western Europe and Japan. Evidence that profit margins have been squeezed to levels last seen in the late 1970s suggests that price increases will continue.

Non-oil Import Price Measures
(BLS prices, surveyed last month of each quarter)
(Percent change from previous period, annual rate)

	1985		1986				1987
	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Consumer goods	3.2	-2.0	9.1	3.1	0.0	4.6	4.5
Clothing	2.7	1.5	-3.0	5.1	8.0	4.4	19.0
Textiles	3.6	1.2	-4.0	5.6	9.2	4.3	16.8
Automotive Products	1.9	18.8	15.1	11.8	6.7	9.6	7.4
Capital Goods	5.2	10.0	11.2	22.4	10.0	4.8	16.8

Quantitative restrictions are also an important determinant of import prices. In particular, price hikes for autos result from both exchange rate effects and the Japanese voluntary restraint agreement. Recent price increases for textiles and apparel probably results more from the broadened protection of the recently renegotiated Multifiber Arrangement and various bilateral agreements with significant suppliers.

Current Account

The current account improved slightly in the first quarter of 1987 from the rate recorded in the fourth quarter of 1986 (see table). There were small improvements in the balances on merchandise trade and military transactions and a reduction in unilateral transfers (largely U.S. government grants to developing countries). Offsetting these gains was a reduction in net direct investment income as the increase in income receipts from abroad was more than offset by increases in income payments on a higher level of foreign direct investment in the United States. In addition, capital gains on U.S. direct investment holdings fell and capital gains on foreign direct investment in the United States turned around in the first quarter from losses in the fourth quarter of 1986. These gains are due primarily to valuation changes associated with movements in the foreign exchange value of the dollar.

U.S. CURRENT ACCOUNT
(Billions of dollars, SAAR)

	1986r Year	1986 Q4r	Q1	$ Change Q1-Q4
1. Trade balance	-144.3	-154.4	-153.3	1.1
2. Exports	224.4	228.1	232.8	4.7
3. Imports	368.7	382.5	386.2	3.7
4. Investment income, net	20.8	18.0	15.3	-2.7
5. Direct investment, net	30.9	32.8	30.9	-1.9
6. Capital gains or losses 1/	10.1	14.0	8.5	-5.5
7. Other direct investment income	20.7	18.8	22.3	3.5
8. Portfolio income, net	-10.0	-14.7	-15.5	-0.7
9. Military, net	-3.7	-2.0	0.8	2.8
10. Other services, net	1.5	3.1	1.1	-2.0
11. Unilateral transfers	-15.7	-16.6	-12.4	4.2
12. Current Account Balance	-141.4	-151.9	-148.5	3.4
Memo:				
Statistical discrepancy, not AR	23.9	11.8	-2.0 2/	

1/ Gains or losses on foreign currency denominated assets owing to their revaluation at current exchange rates, and other valuation adjustments. Plus = gains; minus = losses.
2/ Statistical discrepancy has been revised from published figures because of incorrect reporting by the IBRD.

Developments in the Foreign Industrial Countries

Economic activity in the foreign industrial countries has generally remained sluggish so far this year although real GNP increased sharply in Japan and the United Kingdom during the first quarter. In France growth of output continued to be weak. In Germany both real GNP and industrial production fell sharply in the first quarter although industrial production rebounded somewhat in April. In Italy real GDP declined in the first quarter, and in Canada expansion in industrial production declined in April after strong growth in the first quarter. Consumer price inflation remained relatively low abroad, but has recently increased slightly in Japan, France, Canada, and Italy. Trade and current account surpluses are very large in Japan and Germany, but data on trade volumes show continued adjustment of exports and imports to the higher values of the yen and the German mark. Meanwhile, trade balances improved in the United Kingdom and Canada, and deteriorated sharply in France and Italy.

Individual Country Notes.

In Japan, real GNP grew 4.9 percent (s.a.a.r.) in the first quarter following a revised 2.9 percent increase in the fourth quarter of 1986. Growth in private consumption expenditure and plant and equipment spending more than offset a decline in government consumption spending. Real exports on a national income basis rose as real imports fell, resulting in a substantial net stimulus to growth from the external sector. Other more recent economic indicators present a mixed picture. On the positive side were increases in April and May in retail sales and an increase in April in housing starts, both suggesting a continuation of moderate growth. On the negative side

REAL GNP AND INDUSTRIAL PRODUCTION IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change from previous period, seasonally adjusted) 1/

	Q4/Q4 1985	Q4/Q4 1986	1986 Q2	1986 Q3	1986 Q4	1987 Q1	1987 Jan.	1987 Feb.	1987 Mar.	1987 Apr.	1987 May	Latest 3 months from year ago 2/
Canada												
GDP	3.9	1.6	.7	.2	.1	n.a.	*	*	*	*	*	1.6
IP	5.2	-1.4	-.9	-1.2	.9	2.2	.0	1.2	.7	-1.0	n.a.	1.3
France												
GNP	1.8	2.4	1.4	.5	.5	.1	*	*	*	*	*	2.5
IP	2.0	-.3	1.3	1.3	-1.3	-.3	-2.0	3.0	1.0	-1.0	n.a.	1.0
Germany												
GNP	2.2	2.4	2.6	.7	-.1	-.8	*	*	*	*	*	2.4
IP	3.4	.6	1.4	.7	-.8	-2.8	-3.4	3.2	-2.2	3.6	n.a.	-.8
Italy												
GNP	2.1	2.5	2.7	.0	.3	-.4	*	*	*	*	*	2.6
IP	1.0	2.8	1.5	-3.4	1.6	3.0	1.0	3.1	2.1	-2.1	n.a.	1.2
Japan												
GNP	4.2	2.0	.9	.7	.7	1.2	*	*	*	*	*	3.7
IP	.9	-.7	.2	-.5	-.6	1.7	-.5	-.2	1.6	-1.6	-.6	.4
United Kingdom												
GNP	2.6	3.5	.3	.7	1.0	1.3	*	*	*	*	*	3.3
IP	4.5	1.4	.2	1.3	-.7	1.7	.4	2.8	-.5	.3	n.a.	2.5
United States												
GNP	2.9	2.0	.2	.7	.3	1.2	*	*	*	*	*	2.3
IP	1.8	1.1	-.5	.5	.8	.8	-.2	.6	.1	-.1	.5	2.6

1. Asterisk indicates that monthly data are not available.
2. For quarterly data, latest quarter from year ago.

CONSUMER AND WHOLESALE PRICES IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change from previous period) 1/

	Q4/Q4 1985	Q4/Q4 1986	1986 Q1	1986 Q2	1986 Q3	1986 Q4	1987 Q1	1987 Q2	1987 Mar.	1987 Apr.	1987 May	1987 June	Latest 3 months from year ago
Canada													
CPI	4.2	4.3	1.2	.8	1.2	1.0	.9	n.a.	.4	.4	.6	n.a.	4.4
WPI	2.5	.3	.9	-1.5	.2	.7	.3	n.a.	.2	.4	.2	n.a.	1.3
France													
CPI	4.8	2.1	.1	.7	.6	.7	1.2	n.a.	.1	.5	.2	n.a.	3.4
WPI	1.9	-3.5	-.7	-1.4	-.7	-.7	.7	n.a.	*	*	*	*	-2.2
Germany													
CPI	1.8	-1.0	.0	-.3	-.5	-.3	.6	.4	.0	.2	.1	.1	.1
WPI	-1.1	-9.0	-2.1	-2.6	-2.9	-1.6	-.2	n.a.	.0	.1	.0	n.a.	-5.4
Italy													
CPI	8.6	4.7	1.8	1.1	.6	1.2	1.3	1.0	.4	.3	.4	.4	4.2
WPI	5.9	-2.4	-.5	-1.8	-.8	.7	1.5	n.a.	.1	.5	.1	n.a.	1.5
Japan													
CPI	2.0	.1	.3	.3	-.5	.0	-.3	1.2	.4	.9	.2	-.2	.4
WPI	-3.7	-10.5	-2.4	-4.2	-2.8	-1.5	-.5	n.a.	.2	-.6	-.2	n.a.	-6.0
United Kingdom													
CPI	5.5	3.4	.7	1.3	.1	1.3	1.2	n.a.	.2	1.2	.1	n.a.	4.1
WPI	5.2	4.2	1.4	1.6	.4	.7	1.3	n.a.	.3	.5	.3	n.a.	3.6
United States													
CPI (SA)	3.5	1.3	.4	-.3	.6	.7	1.3	n.a.	.4	.4	.3	n.a.	3.6
WPI (SA)	1.4	-1.8	-1.2	-1.2	-.1	.7	.7	n.a.	.4	.7	.3	n.a.	2.3

1. Asterisk indicates that monthly data are not available.

TRADE AND CURRENT ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES 1/
(Billions of U.S. dollars, seasonally adjusted except where otherwise noted)

	1985	1986	1985	1986				1987	1987			
			Q4	Q1	Q2	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
<u>Canada</u>												
Trade	12.8	7.3	2.9	1.8	2.0	1.6	2.0	2.2	1.0	.8	1.2	n.a.
Current account	-.4	-6.5	-.7	-2.0	-1.4	-1.4	-1.6	n.a.	*	*	*	*
<u>France</u>												
Trade	-2.6	.1	-.4	.4	-.8	.0	.4	-1.0	-.1	-.5	-.6	-.9
Current account	.1	3.5	.6	1.1	.3	1.2	.9	.2	*	*	*	*
<u>Germany</u>												
Trade (NSA)	25.4	52.3	9.1	9.5	12.5	14.1	16.2	15.1	5.7	5.5	4.9	5.9
Current account (NSA)	13.9	36.4	7.0	6.9	8.3	8.1	13.2	10.6	3.6	4.5	3.4	4.2
<u>Italy</u>												
Trade	-12.0	-2.1	-3.5	-2.4	-.0	.8	-.4	-1.8	-.9	-.4	-.9	n.a.
Current account (NSA)	-3.5	4.6	-.7	-3.3	1.3	5.4	1.2	n.a.	*	*	*	*
<u>Japan</u>												
Trade	46.1	82.5	14.8	15.9	20.4	23.6	22.5	23.6	8.2	6.9	7.1	6.4
Current account 2/	49.2	85.5	15.1	15.9	21.6	23.8	24.3	24.5	8.4	7.3	7.4	n.a.
<u>United Kingdom</u>												
Trade	-2.6	-12.4	-.4	-2.1	-2.4	-4.3	-3.7	-1.8	-.3	-.7	-.8	n.a.
Current account	3.9	-1.6	.7	.6	.2	-1.4	-1.1	1.0	.6	.3	.2	n.a.
<u>United States</u>												
Trade 2/	-122.1	-144.3	-36.1	-35.0	-33.6	-37.1	-38.6	-38.3	*	*	*	*
Current account	-116.4	-141.4	-32.3	-33.0	-33.8	-36.6	-38.0	-37.1	*	*	*	*

1. The current account includes goods, services, and private and official transfers. Asterisk indicates that monthly data are not available.
2. Annual data are subject to revisions and therefore may not be consistent with quarterly and/or monthly data.

were declines in industrial production in April and May and an increase in May in the unemployment rate to a new record level of 3.2 percent (s.a.).

Although consumer prices rose in the second quarter above the level a year ago, the all-commodities index of wholesale prices has continued to decline and in the three months ending in May were 6 percent below the year-earlier level. Preliminary reports of this years' average wage settlement indicated an increase in wages of 3.6 percent, one percentage point below last years' wage increase. In addition, import prices were 11.6 percent lower in April from year-earlier levels. Japan's trade surplus narrowed in May, bringing the cumulative trade surplus for the first five months to $89.1 billion (s.a.a.r.). Export volume dropped 6 percent while import volume rose 3 percent in May from year-earlier levels. The cumulative current account surplus for the first four months of 1987 totaled $95.9 billion (s.a.a.r.).

More than three months behind schedule, the Japanese parliament in May passed a budget for FY 1987 that maintains the generally austere fiscal stance that has characterized recent years. In the face of strong opposition to the sales tax portion of the tax reform proposal, the Liberal Democratic Party (LDP) agreed to exclude the entire tax reform package from the regular budget and to allow a parliamentary committee to consider the issue. The committee will be empowered to adopt, modify or abandon the sales tax. On May 29, Japan announced a 6 trillion yen ($42 billion) "Emergency Economic Package" to stimulate its economy. The size of the package is equivalent to 1.8 percent of nominal GNP. At the heart of the package is 5 trillion yen ($35 billion) in public sector outlays, of which nearly one-half are designated as public works projects financed by the central government. Tax reductions amounting to at least 1 trillion yen ($7 billion) in the fiscal year (ending in March 31, 1988) constitute the balance of the planned stimulus measures. The Ministry of Finance has proposed a supplementary budget to provide the financing for the measures contained in the package. The budget provides for additional issue of construction bonds plus some use of revenues from the sales of shares in Nippon Telephone and Telegraph to finance that part of the economic package that is increased central government spending. The supplementary budget will be presented to an extraordinary session of the Diet that will convene in early July. The 1 trillion yen tax cut has been deferred to a second supplementary budget due later this year.

In Germany real GNP dropped 3.1 percent (s.a.a.r.) in the first quarter. Construction spending plummeted more than 40 percent, due to unusually severe weather, and private consumption expenditures declined due to a decrease in automobile sales, the result of the expiration at the end of the year of tax incentives for car buyers. Exports declined, but imports declined even more, resulting in a positive net external contribution to GNP growth. Data for April suggest that some rebound in economic activity may be underway. In that month industrial production rose 3.6 percent (s.a.), with construction rebounding and other manufacturing output showing strength. New orders rose 4.8 percent (s.a.) largely on the strength of foreign orders, which in turn rose 8.5 percent to return to the level reached in April 1986. The consumption climate index recovered the ground it lost earlier this year, suggesting some underlying strength in private consumption.

Similarly, business sentiment strengthened but remained below its year-earlier level. In addition, the rate of unemployment in May fell to 8.8 percent from 8.9 percent in April.

Consumer prices rose in June to a level about equal to June 1986. Through April, import prices declined at an annual rate of 0.6 percent, compared with a pace of 11.4 percent in the second half of last year. This slowdown in the pace of price declines is also evident in wholesale and producers prices.

The trade surplus in May was $5.9 billion (n.s.a.), bringing the cumulative trade surplus through May to $25.9 billion, compared with $18 billion for the same period of last year. The cumulative current account surplus through May was $18.2 billion, compared with $13 billion a year ago. The volume of exports through April this year was 2 percent below a year ago, while the import volume had risen by 2.5 percent.

In the United Kingdom Prime Minister Thatcher's Conservative government easily won an additional five-year term in the June 11 parliamentary elections. The re-elected government has announced that the existing macroeconomic policy framework will be continued. Legislative proposals for the new parliament include reform of the education and municipal tax systems and a loosening of rent controls.

In Canada, the government introduced in Parliament a proposal for comprehensive tax reform to take effect January 1988. Reform will proceed in two stages, the first altering the personal and corporate income tax systems (by lowering rates and broadening the bases) and the second substituting a national sales tax (yet to be defined) for a manufacturers' sales tax. Overall, the proposal is being sold as revenue neutral and reduces personal income taxes while increasing corporate income taxes and sales taxes. Although the government has a large majority in both houses, tax reform is such a volatile issue that the government cannot be certain of getting it through Parliament.

Economic Situation in Major Developing Countries

Brazil has announced a broad ranging package of stabilization measures amid hopes that the plan will win approval of the IMF and break the deadlock with the commercial banks. Mexico's current account and international reserves have shown considerable strength in the first four months of the year. Commitments to Argentina's new money package with the commercial banks now exceed 96 percent of the $1.95 billion sought. The World Bank suspended disbursements to Peru in early May. In June, policy disagreements led to the ouster of the president and the general manager of Peru's central bank and to the subsequent resignation of the Prime Minister and Minister of Finance. The Philippine authorities have announced that they will not seek to reopen the loan negotiations with commercial banks, reversing their April statement that they intended to do so. The Cote d'Ivoire, which has been hurt by recent declines in export prices, has suspended service payments on its external debt pending negotiations with its creditors. Panama, which is seeking a restructuring of its debt to official creditors, has suspended service payments on such debt pending a Paris Club agreement.

Individual Country Notes. In mid-June, Brazil's President Sarney and Finance Minister Bresser announced a broad ranging package of stabilization measures. The package included a 9.5 percent increase in the cruzado price of the dollar (in addition to continued daily mini-devaluations), a price freeze for a maximum of 90 days (after sharp increases in public sector prices), a new program of wage restraint, a 6-month deferral of several large government investment projects, the elimination of the wheat subsidy, increased central bank control of money growth, and an end to its ability to finance subsidies and development programs. The devaluation appears to restore the competitiveness of the exchange rate. The new wage policy involves a freeze of up to 90 days, termination of the salary trigger (although wages will be increased at the end of June for May inflation up to a maximum of 20 percent), and no adjustment for inflation for the first half of June, which implies a substantial reduction in real wages. Official pronouncements following introduction of the new program indicate that Brazil hopes that the new economic plan will win some form of approval by the IMF and break the deadlock with the commercial banks. An IMF mission is visiting Brazil and talks with commercial banks are scheduled for later in July. Since the plan was announced, nominal interest rates have fallen dramatically, with real rates remaining stable, and the stock market has rallied.

In light of Brazil's new adjustment program, Paris Club creditors agreed to postpone from mid-July to mid-September the date by which Brazil must meet certain conditions in order to reschedule principal payments due in the first half of 1987. On July 1, Brazil announced that it was unable to make principal payments to the Paris Club in 1987, but would continue to make interest payments.

There are signs that Brazil's trade surplus is strengthening. In April the trade surplus was $520 million, only slightly smaller than the trade surplus for all of the first quarter. In May, the trade surplus jumped again to $950 million. There are reports of weakness in industrial activity. This weakness has resulted in significant lay-offs over the last several weeks.

In the first four months of 1987, Mexico's current account was in surplus by nearly $2 billion, and reserves, excluding gold, rose by nearly $6 billion, including the initial $3 billion net drawing on the new bank loans at the end of April. In the first five months of 1987, the merchandise trade surplus was about $4.4 billion, more than twice as high as in the same period in 1986. Petroleum exports were up by 35 percent and non-oil exports by 24 percent; imports were down by 10 percent. Exports of manufactured goods were especially strong, with a rise of 47 percent. Some signs of economic recovery have appeared, but first-quarter manufacturing production was still about 3-3/4 percent lower than a year earlier, a decline large enough to meet the condition for the activation of the $500 million contingency growth facility that is part of the bank financing package. In May, the peso price of the dollar rose by 7 percent and consumer prices by 7.5 percent. During the latest 12 months, consumer prices have risen by 125 percent and the peso price of the dollar by 136 percent. Interest rates on time deposits, which were reduced steadily from early March to mid-May, have remained unchanged since then. At the end of June, the rate on 90-day deposits was 90.85 percent, giving an effective annual yield of 140 percent. Treasury bill rates have moved in a narrow range since mid-May. At the June 23 auction, the rate on 91-day bills was 98.3 percent, giving an effective annual yield of 141 percent. Mexico has met the performance criteria of its IMF stand-by arrangement through March 31.

As of the end of June, commitments to Argentina's new money package with the commercial banks were over 96 percent of the $1.95 billion sought. The monthly rate of increase in consumer prices, which averaged 7.4 percent during the first quarter of 1987, fell to 3.4 percent in April and 4.2 percent in May when the CPI was 103 percent higher than a year earlier. Real ex-post interest rates on free-rate bank loans remain very high--about 3 percent monthly or 40 percent annually at the end of May. In the first half of 1987, Argentina's fiscal deficit including central bank operating losses appears to have been about 6 percent of GDP, compared with the 4 percent ceiling specified in its IMF stand-by arrangement. Argentina may also have had difficulty meeting performance criteria for Treasury outlays, domestic credit, and real interest rates on regulated-rate deposits. The Fund staff has completed a mid-term review of compliance with the stand-by arrangement and the Argentine authorities appear to be cooperating in getting the program back on track. A Compensatory Financing Facility disbursement is expected by mid-July to pay off the official bridge loan of $500 million that Argentina received in early March.

The World Bank suspended disbursements to Peru in early May after arrears had lengthened to more than 75 days. Peru had stopped making interest payments to the World Bank in line with its policy of not making debt service payments to creditors that are not expected to provide net new financing. On June 12, President Garcia forced the resignation of the president of the Central Bank and of its general manager over a disagreement regarding the management of the country's exchange rate. In late June, Luis Alva Castro, Prime Minister and Finance Minister, also resigned reportedly because of concern over declining international reserves and excessive government spending. President Garcia is being advised to stimulate the economy and to protect the reserves, which, excluding gold, are equivalent to less than four months' imports of goods and services, by further reducing payments to foreign creditors. Since the second half of 1985, Peru has restricted debt service payments to the equivalent of 10 percent of merchandise exports. In the first quarter of 1987, real GDP was nearly 14 percent higher than a year earlier but virtually unchanged from the fourth quarter of 1986. There are some indications of a slowdown after the first two months of 1987.

On June 10, the Philippine authorities announced that they would not seek to reopen the loan negotiations with commercial bank creditors that were concluded in late March. This reverses a previous statement that they intended to do so in view of a slightly lower spread granted to Argentina. The Philippine economy, which began to recover in the second half of 1986, continued to grow in the first quarter of this year, with real GDP up 5.8 percent over the same period a year earlier. The rate of inflation has remained low, with the April CPI up only 1 percent over April 1986. During the first four months of this year, imports rose faster than exports, and the trade deficit increased to $252 million from $193 million in the same period a year earlier.

The Cote d'Ivoire announced in late May that it could no longer service its external debt on existing terms and that it was suspending payments on it pending negotiations with creditors to revise its external financing arrangements. It took this action in view of the recent decline in prices for coffee and cocoa, its principal exports. The country's current account deficit is projected to rise this year to about $700 million (6 percent of GDP) from $120 million in 1986.