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CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

**Prepared for the
Federal Open Market Committee**

By the Staff

**BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM**

October 18, 1967

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SUMMARY AND OUTLOOK

Outlook for economic activity

The preponderance of evidence continues to favor a rising rate of economic expansion in terms of real output and a continuation of inflationary pressures. In the third quarter, GNP rose at an annual rate of 7.7 per cent in current dollars and over 4 per cent in real terms despite the absence of any push from consumer spending on goods.

Investment in business fixed capital rose moderately, reversing a two quarter decline, and housing outlays rose strongly. Modest inventory accumulation occurred at the manufacturing level but the rise was partially offset by a decline in distributor's stocks, according to still incomplete data. Government spending continued its uptrend, although defense spending rose less than anticipated earlier.

In the consumer area, the supply of new autos was too small to furnish any real test of the strength of underlying demands. Non-durable goods sales were more sluggish than earlier data had indicated and lower than seems consistent with the continued rise in incomes. Indeed, after allowance for higher prices, real takings of consumer goods in the third quarter were virtually unchanged from the second quarter.

Despite the limited rise in consumer dollar outlays for goods last quarter, the main danger of excessive demand acting to reinforce existing cost-push inflationary pressures seems to lie in the area of consumer demand. Apart from the effects of work stoppages,

disposable income will continue to accelerate unless its advance is retarded by a tax increase. The rate of saving which has been maintained at an unusually high level since late 1966 is now about 7 per cent of disposable income. This high rate may reflect prevailing uncertainties about price increases and taxes, but it is also providing a reservoir of purchasing power which may be released later without warning.

Housing starts continued to show a marked rising trend in recent months, reaching an annual rate of 1.45 million units in September and a quarterly average over 50,000 higher than we had anticipated. The September rate of starts may continue into the present quarter. If so, residential construction activity in the fourth quarter may be somewhat higher than the estimate shown in the GNP projection.

Although both industrial and consumer prices rose briskly in the third quarter, there is little evidence thus far of any attempt to accumulate inventories as a hedge against inflation, a development which may be explained by the continued high level of inventory-sales ratios in a number of industries, along with the high cost of carrying stocks, and uncertainties still associated with the proposed tax surcharge.

Outlook for prices and resource use

With the auto, copper, and steel trucking strikes still in effect and with crude oil output continuing downward, industrial production in October is likely to hold at the reduced September rate of 156.3 per cent, or even decline somewhat further. Apart from defense

industries, there appeared to be little offset in September to the output curtailments in strike-affected sectors and in crude oil.

If the strikes are settled before the end of this month, industrial production should recover sharply in November and December, both to make up for strike-losses and to meet the expected broad pick-up in consumer demands. Industrial production is projected at 159 for the quarter, which implies a level of about 161 in December.

Manufacturing capacity utilization declined to a new 1967 low of 83.2 per cent in September, bringing the third quarter average down to slightly less than 84 per cent. For the current quarter the projected rise in production will be little more than the rate at which capacity is expanding and the utilization rate will hold at about 84 per cent.

The flurry of price increases for industrial commodities, which began in July and continued through early October, may be subsiding temporarily pending settlement of current strikes and clarification of the demand outlook. Of particular importance will be a test of auto and household durable goods markets, which will also affect steel demands. Improved supplies as well as the imminence of seasonal slackening in activity have brought partial reversal of earlier sharp price increases for lumber, plywood, and gasoline in recent weeks; and steel scrap prices have weakened.

However, sustained upward wage and labor cost pressures are likely, as a result of expected large wage settlements in a tight labor market. Partly counterbalancing this continuing source of upward price

pressure is the current and prospective sizable margin of unutilized manufacturing capacity. But even if the recent rate of increase in wholesale prices of industrial commodities slows, there is little assurance of a corresponding step-down in the increase for consumer products at retail for upward cost pressures have apparently been stronger at retail than at wholesale. Over the next few months, average prices of foods and foodstuffs are likely to show little change at wholesale but to creep up at retail.

Banking outlook

Demands for bank credit from private sectors of the economy are expected to remain relatively moderate over the balance of the year. Business loan demands are unlikely to be very strong, as inventory accumulation and capital outlays are not expected to grow rapidly. However, a continued upward drift in capital market rates could begin to divert business borrowers back to banks, given current levels of bank lending rates, and the anticipatory borrowing now evident in capital markets could also be extended to banks.

Cash needs of the U.S. Government are likely to be the principal source of bank credit demands in the months ahead. As a result of further Treasury cash financings in November and December, banks will probably continue to add substantially to their holdings of Treasury issues. Banks will probably also be fairly active buyers of State and local government securities in view of the highly attractive yields emerging. Moreover, State and local governments may be forced

to rely more on short-term issues especially attractive to banks, in light of the possible congestion in capital markets. Finally, banks are likely to continue expanding security loans in providing the short-term financing necessary to market absorption of Treasury and other security issues.

Total demand deposits are likely to increase further as banks meet credit demands. In recent months such deposits have been rising rapidly partly in reflection of the faster pace of economic activity and partly in consequence of Treasury financing through tax and loan credits. Moreover, the expansion of private demand balances has also likely been associated with desires for liquidity in periods of uncertainty about the course of developments in financial markets.

Growth in time and savings deposits other than large CD's will probably be in the neighborhood of recent rates--which in turn were only somewhat below the pace of earlier this year--provided there is no further sharp rise in market yields. CD growth is expected to maintain its recent modest expansion. Bank interest in such instruments, and also in Euro-dollars, is likely to become more avid only if business loan demands shows a sharp spurt or if banks become convinced that short-term interest rates will press even closer against the Regulation Q ceilings.

Capital markets outlook

The renewed advance of bond yields triggered by the recent downgrading of prospects for enactment of a tax increase seems likely to carry at least somewhat further unless these prospects are changed.

As expectations of generally higher yields have spread, the actions of both borrowers and lenders thus far have tended to reinforce the rate uptrend. Institutional investors are holding back in the commitment of available funds, and an increasing number of major business corporations are reverting to the anticipatory borrowing pattern that ballooned the supply of publicly-offered bonds so sharply last summer. Underwriters report a substantial increase in the number of additional firms now hoping to cover their long-term financing requirements this year. While it is not yet clear whether additions to the near term calendar will rebuild new issue volume to the \$1.7 billion monthly average level reached in the summer, October offerings are now expected to be at least \$400-500 million larger than the \$925 million September total.

As bond yields have advanced generally, some State and local government borrowers have either chosen, or been forced by rate ceilings, to postpone or cut back scheduled borrowing. Additional actions of this type seem likely in the period ahead, but their interest rate effects will probably be counteracted by offsetting additions to the calendar from other borrowers seeking to get ahead of the expected rate advances and from the sharp build-up expected in the volume of industrial revenue bonds.

U.S. Government financing needs also will continue to exert upward interest rate pressure. The Treasury is expected to announce the terms of its mid-November refunding in a week. While the maturing issue is relatively small in size, the financing is likely to be more than routine since the Treasury will probably take the opportunity to

raise part of their remaining fourth quarter cash requirement and may include an intermediate-term issue in the financing package.

In mortgage markets, upward rate pressures can also be expected to persist, as advancing bond yields continue to divert funds of diversified institutional lenders away from mortgages. Moreover, further widening of rate spreads favoring short- and intermediate-term market securities over claims at depository-type institutions could begin to make more serious inroads into savings growth at thrift institutions. The pace of such net savings inflows has already moderated somewhat from the record second quarter rate.

International developments

More complete data confirm earlier estimates that the U.S. payments deficit on the liquidity basis was at a \$2-1/2 billion annual rate in the third quarter. The near-term outlook is for continuation of the deficit at about that rate, with renewed expansion in merchandise exports matched by an upturn in imports, and with little change in net outflows of U.S. capital.

In Germany, business activity has turned up rather strongly since mid-year, judging from data through August on industrial production, new orders, unemployment, and imports. Real gross domestic product in Germany, which had declined from mid-1966 to mid-1967, is now expected to increase by about 4-1/2 per cent from the second half of 1967 to the second half of 1968, in spite of tax increases that will take effect in January. Recovery in Germany will help to spark a more general pickup in continental Europe, which should ultimately strengthen U.S. and U.K. exports.

Unfortunately, the stimulus to British exports may not begin to show up for some time. Further deterioration in the British foreign trade balance in September, when exports declined again, provoked renewed market pessimism about the prospects for sterling, and the U.K. trade figures for October may be adversely affected by dock strikes that began in mid-September and have not yet been settled. Thus the position of sterling remains sensitive to confidence factors, and also to the pull of any increase in U.S. and Euro-dollar interest rates.

In recent weeks, advances in sterling money market rates have diminished somewhat the interest incentive for movements out of sterling into the Euro-dollar market. And if U.S. CD rates stay near present levels and Euro-dollar rates remain firm, U.S. banks may not actively seek to attract additional foreign funds through their foreign branches in the weeks ahead.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per Cent Change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Yrs. Ago*
Civilian labor force (mil.)	Sept '67	77.8	77.7	76.0	2.3	4.5
Unemployment (mil.)	"	3.2	3.0	2.8	11.7	- 2.0
Unemployment (per cent)	"	4.1	3.8	3.7	--	--
Nonfarm employment, payroll (mil.)	"	66.1	66.2	64.4	2.6	7.8
Manufacturing	"	19.2	19.4	19.3	- 0.8	5.2
Other industrial	"	8.1	8.1	8.1	0.3	2.8
Nonindustrial	"	38.8	38.7	37.0	5.0	10.3
Industrial production (57-59=100)	"	156.3	157.8	157.7	- 0.9	8.5
Final products	"	156.6	158.1	156.3	0.2	9.0
Materials	"	155.7	157.1	159.2	- 2.2	7.5
Wholesale prices (57-59=100) ^{1/}	Aug '67	106.1	106.5	106.8	- 0.7	3.1
Industrial commodities (FR)	"	105.4	105.2	104.5	0.9	3.0
Sensitive materials (FR)	"	100.2	100.0	103.9	- 3.6	- 2.8
Farm products, foods & feeds	"	105.2	107.3	111.3	- 5.5	1.8
Consumer prices (57-59=100) ^{1/}	"	116.9	116.5	113.8	2.7	6.3
Commodities except food	"	109.4	109.1	106.6	2.6	4.5
Food	"	116.6	116.0	115.8	0.7	5.9
Services	"	128.2	127.7	123.0	4.2	8.7
Hourly earnings, mfg. (\$)	Sept '67	2.85	2.86	2.75	3.6	8.4
Weekly earnings, mfg. (\$)	"	116.40	116.05	114.24	1.9	7.7
Personal income (\$ bil.) ^{2/}	"	633.5	631.5	594.1	6.6	14.1
Corporate profits before tax (\$ bil.) ^{2/}	QII '67	78.9	79.0	83.6	- 5.6	4.4
Retail sales, total (\$ bil.)	Sept '67	26.7	26.6	25.7	3.8	12.4
Autos (million units) ^{2/}	"	8.1	7.5	8.6	- 6.2	- 9.1
GAF (\$ bil.)	"	6.4	6.4	6.1	4.4	14.5
Selected leading indicators:						
Housing starts, pvt. (thous.) ^{2/}	"	1,457	1,403	1,048	39.0	- 1.0
Factory workweek (hours)	"	40.7	40.7	41.4	- 1.7	- 0.7
New orders, dur. goods (\$ bil.)	Aug '67	23.4	23.7	23.5	- 0.7	8.6
New orders, nonel. mach. (\$ bil.)	"	4.0	3.6	3.8	5.1	19.6
Common stock prices (1941-43=10)	Sept '67	95.81	94.49	77.81	23.1	7.2
Inventories, book val. (\$ bil.)	Aug '67	137.8	137.4	130.0	6.0	17.1
Gross national product (\$ bil.) ^{2/}	QIII '67	790.1	775.1	748.8	5.5	14.5
Real GNP (\$ bil., 1958 prices) ^{2/}	"	671.6	664.7	654.8	2.6	8.2

* Based on unrounded data. ^{1/} Not seasonally adjusted. ^{2/} Annual rates.

SELECTED DOMESTIC FINANCIAL DATA

	Week ended	4-week	Last 6 months	
	Oct. 13	average	High	Low
Money Market <u>1/</u> (N.S.A.)				
Federal funds rate (per cent)	4.06	4.03	4.70	3.45
U.S. Treas. bills, 3-mo., yield (per cent)	4.57	4.51	4.57	3.41
U.S. Treas. bills, 1-yr., yield (per cent)	5.19	5.16	5.19	3.84
Net free reserves <u>2/</u> (\$ millions)	151	217	574	109
Member bank borrowings <u>2/</u> (\$ millions)	145	117	353	43
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds <u>1/</u>	5.52	5.46	5.52	4.44
20-year U.S. Treas. bonds <u>1/</u>	5.28	5.23	5.28	4.57
Corporate new bond issues, Aaa <u>1/</u>	6.07	5.98	6.14	5.39
Corporate seasoned bonds, Aaa <u>1/</u>	5.76	5.70	5.76	5.11
Municipal seasoned bonds, Aaa <u>1/</u>	3.83	3.83	3.87	3.50
FHA home mortgages, 30-year <u>3/</u>	6.60	6.60	6.60	6.29
Common stocks, S&P composite series <u>4/</u>				
Prices, closing (1941-43=10)	96.00	96.74	97.26	89.79
Dividend yield (per cent)	3.05	3.03	3.25	3.01

	Latest month	Amount	3-month average	Change from year earlier			
				Latest 3-month month average	Latest 3-month month average		
New Security Issues (N.S.A., \$ millions)							
Corporate security offerings <u>5/</u>	Oct. '67 ^e /	2,200	2,108	1,371	815		
State & local govt. public offerings	Oct. '67 ^e /	1,050	991	295	184		
Comm. & fin. co. paper (net change in outstandings)	Aug. '67 ^e /	-228	-84	-880	-550		
	Latest month	Out-standings Latest month	Change		Annual rate of change from		
			Latest month	3-month average	Pre-ceding month	3 months ago	12 months ago
		(\$ billions)			(per cent)		
Banking (S.A.)							
Total reserves <u>1/</u>	Sept. '67	24.30	0.20	0.23	10.0	11.7	7.4
Credit proxy <u>1/</u>	"	268.4	2.3	3.1	10.3	14.2	9.3
Bank credit, total <u>6/</u>	"	339.3	2.2	4.8	7.8	17.7	9.7
Business loans	"	83.2	0.2	0.3	2.9	4.9	6.5
Other loans	"	136.5	1.8	1.8	16.0	16.8	6.6
U.S. Govt. sec.	"	61.7	-0.2	1.9	-3.9	41.5	12.4
Other securities	"	57.9	0.4	0.7	8.3	15.1	19.9
Total liquid assets <u>1/</u> <u>6/</u>	"	639.5	4.4	5.5	8.3	10.6	6.7
Demand dep. & currency <u>1/</u>	"	179.3	0.2	1.0	1.3	7.0	5.2
Time & sav. dep., comm. banks <u>1/</u>	"	178.9	1.7	2.2	11.4	15.1	13.7
Savings, other thrift instit. <u>6/</u>	"	181.4	1.7	1.6	11.4	10.6	8.9
Other <u>6/</u> <u>7/</u>	"	99.9	0.8	0.7	9.7	9.0	-4.9

N.S.A. -- not seasonally adjusted.

S.A. -- seasonally adjusted.

e. Estimated by F.R.B. 1/ Average of daily figures. 2/ Average for statement week ending Oct. 11. 3/ Latest figure is for Aug. 4/ End of week closing prices.5/ Corporate security offerings include both public and private bonds and stocks.6/ Month-end data. 7/ U.S. savings bonds and U.S. Government securities maturing within 1 year.

U.S. BALANCE OF PAYMENTS
(In millions of dollars)

	1 9 6 6			1 9 6 7				
	QII	QIII	QIV	QI	QII	July	Aug.	Sept.
Seasonally adjusted								
Goods and services, net <u>1/</u>	1,353	1,151	1,084	1,349	1,300			
Trade balance <u>2/</u>	956	802	722	999	1,136	330	470	
Exports <u>2/</u>	7,181	7,382	7,402	7,691	7,723	2,570	2,590	
Imports <u>2/</u>	-6,225	-6,580	-6,680	-6,692	-6,587	-2,240	-2,120	
Services balance	397	349	362	350	164			
Remittances and pensions	-245	-278	-246	-264	-390			
Govt. grants & capital <u>3/</u>	-988	-759	-724	-1,205	-931			
U.S. private capital	-1,135	-932	-1,165	-958	-1,130			
Direct investments	-1,006	-900	-1,003	-622	-684			
Foreign securities	9	-50	-83	-263	-171			
Banking claims	-88	89	44	62	-176			
Other	-50	-71	-123	-135	-99			
Foreign capital, nonliquid	1,091	376	780	824	1,215			
Official foreign accts.	298	172	425	397	759			
Long-term deposits	284	88	373	309	605			
U.S. Govt. liab.	14	84	52	88	154			
Int'l. institutions <u>4/</u>	300	38	15	64	95			
Other <u>5/</u>	493	166	340	363	361			
Errors and omissions	-198	277	-148	-284	-576			
Balances, with and without seasonal adjustment (- deficit)								
Liquidity balance, S.A.	-122	-165	-419	-538	-512			
Seasonal component	-27	-530	-47	303	319			
Balance, N.S.A.	-149	-695	-466	-235	-193	-483	-388	-307
Official settlements bal.	-175	861	-18	-1,827	-814			
Seasonal component	-210	-456	-180	545	132			
Balance, N.S.A. <u>6/</u>	-385	405	-198	-1,282	-682	-188	430	
Reserve changes, N.S.A. (decrease -)								
Total monetary reserves	-68	-82	6	-1,027	419	-50	381	44
Gold stock	-209	-173	-121	-51	-15	-33	-61	2
Convertible currencies	163	426	173	-1,007	424	-19	443	38
IMF gold tranche	-22	-335	-46	31	10	2	-1	4

1/ Equals "net exports" in the GNP.

2/ Balance of payments basis which differs a little from Census basis.

3/ Net of scheduled and non-scheduled repayments.

4/ Long-term deposits and Agency securities.

5/ Includes some foreign official transactions in securities.

6/ Differs from liquidity balance by counting as receipts (+) increases in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increases in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

Gross national product. The rise in GNP in the third quarter amounted to \$15 billion, annual rate, according to the first official estimates. Although an increase of this magnitude has appeared in the Greenbook for the last two months, there are differences of composition between our earlier projections and the latest estimates. Most important is that more of the rise reflects price increases than we anticipated. Also, consumer expenditures for nondurable goods, on the basis of revised retail sales data, increased much less than indicated earlier. As a result, the increase in private final sales was less than we had projected and this was offset in total GNP by modest accumulation of inventories rather than small decumulation.

Despite these changes, and making the same assumption as earlier about the limited nature of auto and other strikes, we see little reason to modify our estimate of a \$20 billion rise in current dollar GNP for the fourth quarter. This implies a step-up in the rate of growth in real GNP from 4 per cent to 6 per cent. The GNP deflator is assumed to continue to increase at about the advanced third quarter rate, partly because of a prospective Federal pay raise. The third quarter increase in the deflator included very sharp increases in the construction and government deflators as well as a pronounced step-up in the consumption deflator in line with recent consumer price developments.

The potential for consumer spending is still very strong, and almost all other major sectors of final demand are expected to increase in the present quarter. Inventory building is also likely to take place at a little faster rate than in the third quarter.

In the third quarter, unit auto sales were well maintained despite stock shortages and price increases, but a real test of the market of the 1968 models is yet to come. Buying of furniture and appliances has not yet shown clear signs of the recovery we have been predicting. Nondurable goods sales advanced modestly in the third quarter and all the rise can be accounted for by price increases. (Retail sales were revised down sharply in July and August and showed little improvement in September, according to advance estimates.)

Sluggishness in nondurable goods sales recently is surprising in view of the rapid advance in wages and salaries. Although a major part of the 7.5 per cent annual rate of rise in personal income in the third quarter was offset by increases in prices and tax payments, real income as well as money income has been growing steadily this year. Consumers are electing to save a relatively high proportion of after-tax income, however, as is indicated by a continuation of the personal saving rate at about 7 per cent in the third quarter. We have estimated the 7 per cent saving rate will continue in the fourth quarter because of continuing uncertainties affecting consumer attitudes.

We have estimated that new domestic car sales will rise to a rate of about 8.3 million units not far above the rate in the third quarter. Because of higher prices, however, auto and parts purchases may rise by over 2 billion dollars. Consumer nondurable sales are projected to increase faster than in the third quarter although the rise is less than in our previous projection.

Housing starts have continued to rise, and in September were about 1.46 million at an annual rate--the same rate as for the year 1965 as a whole. In view of the rapidity of the recovery from the fourth quarter of 1966, as well as the relatively high cost of mortgage borrowing, starts may level off in the fourth quarter at about the September rate. Reflecting this levelling off and also the high proportion of apartments--less expensive than single family units--started this spring and summer, the fourth quarter expenditure increase for residential construction is likely to be less than the \$2.3 billion rise in the third quarter.

Expenditures for business fixed capital rose in the third quarter by \$1.4 billion, following two quarters of decrease. This increase was larger than the \$1 billion rise shown in the August Commerce-SEC anticipated expenditures, and was apparently centered in nonmanufacturing industries, particularly the airlines. The third quarter estimate was based on data supplementary to the survey, and it suggests some further expansion in the fourth quarter. In addition

in view of the sharp rise in construction costs recently, we have upped somewhat our earlier estimate of the fourth quarter increase in business fixed investment.

The rise in Federal defense expenditures slowed drastically last quarter; defense outlays increased only \$1.4 billion, the smallest rise since the beginning of the Vietnam build-up. This slowing conforms to the Budget estimates plus the \$4 billion supplemental, and thus may indicate a much reduced rate of growth in the future. However, the chances still favor a Federal workers' pay raise, retroactive to October 1, which will cause a much larger increase in defense outlays this quarter. Nondefense outlays will also reflect a pay raise, plus an increase in expenditures for crop surpluses.

Inventory data now available for July and August reveal a sharp rise in the book value of manufacturerers' stocks, virtually all in the business and defense equipment and motor vehicles industries. A substantial part of the latter reflects the accumulation of automobile parts and materials in manufacturers' hands prior to the delivery of the new models to dealers, and a significant proportion of this may reflect an inadequate seasonal adjustment this summer when the model changeover was advanced. In view of recent declines in distributors' inventories, which may well have accelerated in September because of the auto strike and a sizable valuation adjustment for rising prices, the accumulation of total nonfarm inventories on a GNP basis is now estimated by Commerce at a rate of only \$1.1 billion in the third quarter.

In the current quarter our projection includes \$1.5 billion of nonfarm stock-building, though this remains an area of great uncertainty. The increase in inventories of defense products and machinery and equipment is likely to slow. However, at retail, nonautomotive stocks are assumed to rise further, as they did in July and August. Moreover, if our assumptions with respect to auto strikes are realized, the sharp third quarter decline on this account will not be repeated.

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GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income
figures are billions of dollars, with quarterly figures at annual rates)

	1966	1967 Proj.	1966		1967			Proj. IV
			III	IV	I	II	IIIp	
Gross National Product	743.3	785.4	748.8	762.1	766.3	775.1	790.1	810.0
Final sales	729.9	782.6	737.4	743.6	759.2	774.6	788.6	808.0
Private	575.6	605.3	579.7	581.9	588.8	599.6	609.7	622.9
Personal consumption expenditures	465.9	492.9	470.1	473.8	480.2	489.7	495.8	506.0
Durable goods	70.3	72.7	70.9	70.6	69.4	72.5	73.0	76.0
Nondurable goods	207.5	218.2	209.5	210.3	214.2	217.2	219.0	222.5
Services	188.1	202.0	189.8	192.9	196.6	200.0	203.8	207.5
Gross private domestic investment	118.0	109.5	116.4	122.2	110.4	105.1	109.8	112.6
Residential construction	24.4	24.2	23.7	20.9	21.4	23.1	25.4	26.8
Business fixed investment	80.2	82.5	81.2	82.8	81.9	81.5	82.9	83.8
Change in business inventories	13.4	2.8	11.4	18.5	7.1	.5	1.5	2.0
Nonfarm	13.7	2.6	12.0	19.0	7.3	.6	1.1	1.5
Net Exports	5.1	5.6	4.6	4.3	5.3	5.3	5.6	6.3
Gov't. purchases of goods & services	154.3	177.3	157.7	161.7	170.4	175.0	178.9	185.1
Federal	77.0	90.8	79.5	81.5	87.1	89.5	91.4	95.3
Defense	60.5	73.2	63.0	65.6	70.2	72.5	73.9	76.4
Other	16.5	17.6	16.6	15.9	16.8	17.0	17.5	18.9
State & local	77.2	86.5	78.1	80.2	83.3	85.4	87.6	89.8
Gross National Product in constant (1958) dollars	652.6	669.7	654.8	661.1	660.7	664.7	671.6	681.8
GNP Implicit deflator (1958=100)	113.9	117.3	114.4	115.3	116.0	116.6	117.7	118.8
Personal income	584.0	627.1	589.3	601.6	612.9	619.1	630.7	645.5
Wage and salaries	394.6	424.1	399.6	407.4	414.7	418.3	425.9	437.3
Disposable income	508.8	545.0	512.4	522.0	532.7	540.0	547.9	559.5
Personal saving	29.8	37.9	29.2	34.6	38.8	36.0	37.8	39.1
Saving rate (per cent)	5.9	7.0	5.7	6.6	7.3	6.7	6.9	7.0
Corporate profits before tax	83.8	80.6	84.0	83.9	79.0	78.9	80.5*	83.9
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	143.2	152.0	145.6	148.6	149.1	148.1	152.9*	157.7
Expenditures	142.9	165.2	146.3	151.9	160.9	162.8	166.4	170.5
Surplus or deficit (-)	.3	-13.2	-.7	-3.3	-11.9	-14.7	-13.5*	-12.8
Total labor force (millions)	78.9	80.8	79.1	79.8	80.3	80.2	81.1	81.6
Armed forces "	3.1	3.5	3.2	3.3	3.4	3.5	3.5	3.5
Civilian labor force "	75.8	77.3	76.0	76.5	76.9	76.7	77.7	78.1
Unemployment rate (per cent)	3.8	3.8	3.8	3.7	3.7	3.8	3.9	3.8
Nonfarm payroll employment (millions)	64.0	66.1	64.3	65.0	65.7	65.7	66.1	66.7
Manufacturing	19.2	19.4	19.3	19.5	19.5	19.3	19.2	19.4
Industrial production (1957-59=100)	156.3	157.3	157.6	158.8	157.0	155.8	156.9	159.3
Capacity utilization, manufacturing (per cent)	90.5	84.9	90.6	89.8	87.0	84.8	83.8	84.0
Housing starts, private (millions A. R.)	1.17	1.30	1.08	.92	1.12	1.21	1.41**	1.45**
Sales new U.S.-made autos (millions, A. R.)	8.38	7.86	8.47	8.13	7.33	7.83	8.01	8.25

* Projected

** Housing starts figures shown here reflect revised data for July and August and the preliminary estimates for September. The residential construction investment figures above are based on 1.35 million housing units, SAAR, for 67-III and 1.39 million units for 67-IV.

CONFIDENTIAL -- FR

October 18, 1967

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1966	1967 Proj.	1966		1967			Proj. IV
			III	IV	I	II	IIIp	
----- In Billions of Dollars -----								
Gross National Product	59.4	42.1	12.1	13.3	4.2	8.8	15.0	19.9
Final sales	55.4	52.7	14.7	6.2	15.6	15.4	14.0	19.4
Private	37.5	29.7	8.2	2.2	6.9	10.8	10.1	13.2
GNP in constant (1958) dollars	35.9	17.1	5.5	6.3	-.4	4.0	6.9	10.2
Final sales	32.1	27.2	8.3	-0.3	10.1	10.3	5.9	9.7
Private	21.9	12.2	4.4	-2.8	3.7	7.1	4.1	6.9
---- In Per Cent; Quarterly Changes are at Annual Rates ----								
Gross National Product	8.7	5.7	6.6	7.1	2.2	4.6	7.7	10.1
Final sales	8.2	7.2	8.1	3.4	8.4	8.1	7.2	9.8
Private	7.0	5.2	5.7	1.5	4.7	7.3	6.7	8.7
Personal consumption expenditures	7.6	5.8	7.4	3.1	5.4	7.9	5.0	8.2
Durable goods	6.5	3.4	15.8	-1.7	-6.8	17.9	2.8	16.4
Nondurable goods	8.5	5.2	4.6	1.5	7.4	5.6	3.3	6.4
Services	6.9	7.4	7.5	6.5	7.7	6.9	7.6	7.3
Gross private domestic investment	9.9	-7.2	-7.1	19.9	-38.6	-19.2	17.9	10.2
Residential construction	-9.6	-0.8	-32.6	-47.3	9.6	31.8	39.8	22.0
Business fixed investment	12.8	2.9	12.7	7.9	-4.3	-2.0	6.9	4.3
Gov't purchases of goods & services	13.1	14.9	17.2	10.1	21.5	10.8	8.9	13.9
Federal	15.3	17.9	24.6	10.1	27.5	11.0	8.5	17.1
Defense	20.8	21.0	31.5	16.5	28.0	13.1	7.7	13.5
Other	-1.2	6.7	0.0	-16.9	22.6	4.8	11.8	32.0
State & local	10.9	12.0	10.0	10.8	15.5	10.1	10.3	10.0
GNP in constant (1958) dollars	5.8	2.6	3.4	3.8	-.2	2.4	4.2	6.1
Final sales	5.3	4.3	5.2	-0.2	6.3	6.3	3.6	5.8
Private	4.4	2.4	3.4	-2.2	2.9	5.5	3.1	5.2
GNP Implicit deflator	2.7	3.0	3.2	3.1	2.4	2.1	3.8	3.7
Personal income	8.6	7.4	8.3	8.3	7.5	4.0	7.5	9.4
Wage and salaries	9.9	7.5	9.6	7.8	7.2	3.5	7.3	10.7
Disposable income	7.8	7.1	7.2	7.5	8.2	5.5	5.8	8.5
Corporate profits before tax	9.5	-3.8	1.9	-.5	-23.4	-0.5	8.1*	16.9
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.7	6.1	11.3	8.2	1.3	2.7	13.0*	12.6
Expenditures	15.8	15.6	22.8	15.3	23.7	4.7	8.8	9.9
Nonfarm payroll employment	5.3	3.3	3.8	4.4	4.3	0.0	2.4	3.6
Manufacturing	6.1	1.0	4.2	4.1	0.0	-4.1	-2.1	4.2
Industrial production	9.0	0.6	6.2	3.0	-4.5	-3.1	2.8	6.1
Housing starts, private	-20.4	11.1	-62.5	-59.3	87.0	32.1	66.1**	11.3**
Sales new U.S.-made autos	-4.4	-6.2	33.6	-15.8	-39.6	27.3	9.2	11.9

* Projected

** Housing starts figures shown here reflect revised data for July and August and the preliminary estimates for September. The residential construction investment figures above are based on 1.35 million housing units, SAAR, for 67-III and 1.39 million units for 67-IV.

Industrial production. In September, the Board's index of industrial production declined 1.5 points to 156.3 per cent of the 1957-59 average--reversing a large part of the summer run-up.

The September decline reflected primarily curtailment of output in the auto and steel industries (together these took 1.3 points out of the index) as a result of work stoppages which are still in effect and which are therefore holding the total index down in October. Another downward influence in September was the initiation of cutbacks in domestic crude oil production--which had increased sharply in July and August when mid-East oil supplies were restricted; this cutback--reflecting improvement in mid-East supplies--continued, at a faster pace, in early October. Moreover, the copper strike, which reduced metal mining sharply in July and August, is still in effect causing some further curtailment in September and perhaps also in October.

Expansionary effects were only minor in September. Output of defense equipment continued to expand, but this accounted for less than 0.1 percentage index point. Production of business equipment remained at about the July-August level, with truck output curtailed moderately because of the Ford strike. Output of appliances, TV and radios, which (in part owing to settlement of a strike that had limited June output) had increased sharply in July and August to the highest level of the year, was about unchanged in September. Nondurable goods production also remained stable, at a level equal to last December's high.

Manufacturing capacity utilization. The operating rate for manufacturing fell to 83.2 per cent in September, well below the previous low for the year of 84.0 recorded in July and 84.4 per cent in August. The decline was largely due to strikes in the automobile and steel hauling industries. Utilization rates for both primary and advanced products moved downward but the decline was somewhat greater in the advanced products industries where the auto strike had a direct effect.

Spare capacity exists in most manufacturing industries. Manufacturers of aircraft and electric power generating equipment continue to operate at unusually high rates. Utilization rates are relatively high in petroleum refining and in the rubber industry where producers are still making up for output lost on account of the recent strike.

UTILIZATION RATES

Industry	June	July	August	September
Manufacturing	84.1	84.0	84.4	83.2
Primary products	82.0	81.7	82.8	81.8
Advanced products	85.6	85.6	85.5	85.1

Unit auto sales and inventories. Dealer deliveries of new domestic automobiles in the first ten days of October declined one-fourth from a year earlier. Excluding Ford sales, which have been unusually low because of the strike, the total sales decline was 4 per cent. Both General Motor's and Chrysler sales were down somewhat, but

it is difficult to judge the significance of this because of the earlier model introduction dates this year. It appears, however, that GM and Chrysler are not benefiting materially from the strike at Ford.

For September, the seasonally adjusted annual rate of sales of domestic units was 8.1 million units, down 6 per cent from a year ago. The stock of autos available at the beginning of October was one-fifth below a year ago, owing largely to the strike.

The table below shows the seasonally adjusted days' supply of new domestic autos based on end-of-month stocks and daily selling rates for that month. The days' supply available at the beginning of September and October of this year was 6 per cent and 12 per cent lower, respectively, than last year but was about the same as in 1965.

SEASONALLY ADJUSTED DAYS' SUPPLY OF NEW DOMESTIC AUTOS

	1965	1966	1967
August 31	46	48	45
September 30	46	51	45
October 31	48	60	--

Used car sales in September were unchanged from a year earlier while stocks were off 7 per cent. Auction prices of used cars have been strong the last several months and have not shown their usual seasonal decline.

Sales of imported cars in September were up about 8 per cent from a year ago, but this increase was small compared to recent months. For the first 8 months of this year, sales were 18 per cent above the comparable months of 1966. The slower recent pace is expected to persist for a time because of reported supply limitations.

Consumer credit. Consumer borrowing has picked up in recent months, following a very slow period in the spring, but net increases in outstanding instalment credit continue to be modest. The rise in outstandings in the second quarter--\$698 million or \$2.8 billion annual rate--was the smallest since the final quarter of 1961. The third quarter rate moved up to an estimated \$3.5 billion, but this was less than half that of a year earlier and substantially below the record \$8 billion rate reached in the third quarter of 1965.

Repayments on old instalment debt recently have been in a strong uptrend. In the third quarter alone, consumers increased their repayments by a half billion dollars over the second quarter, which itself was a half billion over the first. In contrast, the average quarterly increase during 1966 was less than a quarter billion dollars. As a consequence, the ratio of repayments to disposable income has now recovered to the high point of early 1966, when it stood at 14.4 per cent.

REPAYMENTS ON CONSUMER INSTALMENT DEBT

	Quarterly increases (millions of dollars)	Ratio to dispo- sable income (per cent)
1966 - Q1	434	14.4
Q2	154	14.4
Q3	279	14.3
Q4	109	14.2
1967 - Q1	281	14.1
Q2	537	14.3
Q3	500e	14.4e

Most of the sluggishness in the consumer credit expansion this year has been a reflection of developments in the auto sector. Through the first 8 months, auto credit outstanding was expanding at an annual rate of only \$216 million, only one-tenth the \$2.3 billion rate for the corresponding period in 1966. Meanwhile, auto terms continue relatively easy but typical downpayment and maturity requirements are not being breached to any important extent. In most cases it still takes about 20 per cent down to purchase a new car and the maturity is set at 36 months. But the proportion of customers getting the "more favorable" terms is creeping up again.

Demand for nonauto goods credit has been relatively strong all year, in part because of increased credit card activity at banks. Personal loan volume has also been well maintained although increases have not been as rapid or large as might be expected given the increases in consumer spending on services. Many lenders have been finding that there is less demand for personal loans to finance travel, vacation, and other service expenditures, now that credit cards have become a handy

Retail sales. Retail sales, which on the basis of revised figures showed no change between June and August, rose fractionally in September according to advance estimates.

For the third quarter as a whole, sales at nondurable goods stores rose only about half a per cent. Expenditures for food consumed at home, which account for about one-third of the total, were sluggish, despite a considerably higher level of prices in the third quarter than the second. On the other hand, expenditures for restaurant meals, prices of which have risen at a very fast clip over the past year, have continued to rise strongly. The general merchandise group and apparel stores have shown very modest increases, and fell in September according to the advance estimates.

Durable goods sales have also shown little strength, the 4 per cent advance in the third quarter arising almost entirely from higher sales in the automotive group.

Downward revisions of retail sales estimates were unusually large in July and August. At the time of the last Greenbook, sales of nondurable goods for those two months appeared to be almost \$3 billion higher, at an annual rate, than the revised numbers now shown.

Business inventories. The preliminary July showing of a slight further decline in business inventories has been converted, as a result of a sizable upward revision in manufacturers' inventories and a moderate boost for wholesalers', into an increase totaling about \$250 million. In August, according to preliminary figures, the over-all book value increase was even larger--about \$375 million.

Manufacturers now show accumulation averaging almost \$500 million in July and August--reversing abruptly the declining trend in the first half of the year which culminated in sizable liquidation in June. The July-August accumulation occurred in the durable goods sector (nondurables showed small net liquidation), and within that sector it was concentrated mainly in the defense and business equipment sector and in the motor vehicle industry. Of the \$1 billion plus accumulation during the two months in the durable sector the defense and business equipment industries accounted for roughly 50 per cent, the motor vehicle industry, 40 per cent, and remaining industries, 10 per cent. The bulk of the increase was in work-in-process. For the auto industry, the sharp spurt in stocks undoubtedly reflected in part inadequate seasonal adjustments.

Liquidation of wholesale and retail trade inventories continued in July and August. Moderate declines in both months at the retail level were caused by continued sharp reductions in auto dealer stocks. Apart from autos, retail stocks rose in July and August.

New and unfilled orders for durable goods. New orders for durable goods declined 1.3 per cent in August from the level of the previous month according to preliminary figures released by the Census Bureau. An earlier Census release had shown August orders to be down 2.3 per cent. The upward revisions were fairly evenly distributed throughout the list of industries.

The August decline was centered in the volatile aircraft sector where orders were off 35 per cent. Orders for durable goods exclusive of aircraft were up 2.5 per cent. Orders for primary metals were down but machinery, fabricated metals, and other durable goods showed increases. The special machinery and equipment grouping was up 4 per cent for the fifth increase in the last six months.

Unfilled orders were virtually unchanged according to the revised figures. Aircraft backlogs declined 2 per cent because of the sharp drop in new orders. Backlogs were up moderately in most other industries.

Construction and real estate. Value of new construction put in place, which had been revised upward by 1 per cent for both July and August, moved higher in September. Reflecting the substantial, further recovery in housing starts in recent months, outlays for residential construction continued to pace the advance as shown in the table. While still about 7 per cent below the recent peak in January of 1966, the rate for the residential group was the highest in more than a year.

Private nonresidential construction outlays, unlike residential construction expenditures, have shown relatively little change in recent months from the reduced rate reached last April, and in September they were still about a tenth below the peak reached last January. Within this sector, industrial construction outlays have fluctuated irregularly above their recent low in April and a further decline in commercial construction activity has been offset by increases in expenditures for hospitals and other types of nonresidential buildings and related

structures. Public construction in September remained near its February peak and was appreciably above a year earlier.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	September 1967 (\$billions) <u>1/</u>	Per cent change from	
		August 1967	September 1966
Total	77.1	+1	+4
Private	50.1	+1	--
Residential	24.8	+1	+9
Nonresidential	25.3	--	-8
Public	27.0	--	+13

1/ Seasonally adjusted annual rates; preliminary. Data for the most recent month (September) are available under a confidential arrangement with the Census Bureau. Under no circumstances should any public reference be made to them.

In the current reappraisal of Federal spending evoked by Congressional resistance to a tax increase, some cut-backs in military building plans have already been made by the Administration in recent weeks and some tentative proposals to modify certain other Federal building programs, including those for highways have also been publicized. Indications are, however, that the effect of such adjustments--to the extent that they will be made--will not be felt until some time in 1968. Consequently, the prospect is that public construction will

play at least a neutral role in over-all activity during the near term and that, with prices continuing to rise, total construction will reach a new high before the year-end.

Seasonally adjusted housing starts, which had already advanced sharply further during the summer months, continued upward in September, to a seasonally adjusted annual rate of 1.46 million. The September advance, which was not expected on technical grounds, raised the average for the third quarter as a whole to 1.41 million, a sixth above the improved second quarter average and the highest rate since the first quarter of 1966. A major factor in the further rise in September was a very substantial recovery in starts in the Northeast from a temporarily reduced August rate. This more than offset declines in all other regions except the West.

Seasonally adjusted building permits also rose further in September. Most of the rise was concentrated in multifamily units, which advanced 5 per cent after an upward revision for August.

PRIVATE HOUSING STARTS AND PERMITS

	September 1967 (Thousands of units) 1/	Per cent change from	
		Aug. 1967	September 1967
Starts	1,457	+ 4	+39
1 - family	917	+ 5	+32
2- or more-family	540	+ 2	+52
Northeast	285	+64	+45
North Central	315	-16	+18
South	564	- 1	+31
West	293	+ 4	+91
Permits	1,159	+ 3	+57
1 - family	646	+ 1	+44
2- or more-family	513	+ 5	+76

1/ Seasonally adjusted annual rates; preliminary.

While mortgage costs have reversed direction in recent months and home prices have continued upward, the dollar volume of sales of existing homes in August were running a fifth above its reduced year-earlier level, according to the National Association of Real Estate Boards. In the case of sales of speculatively built new homes (data currently available only through July) also show appreciable year-to-year improvement, though at a seasonally adjusted rate no higher than last May. A factor in this development has been the relatively limited supply of available new homes. Although the basic demand potential for single family units as well as that for multifamily units has continued to grow, speculative builders so far this year generally have been reluctant or unable to build ahead of the market in the face of the rising discounts on Government-supported as well as conventional mortgages in certain states. As a result, seasonally adjusted stocks of new houses last summer remained at the unusually low level reached in April, and the ratio of total stocks (including those under construction) to sales held at less than 4 months' supply--quite low for the series.

Labor market. The labor market continued firm in September despite some apparently rather dramatic figures to the contrary, including both a drop in employment and a sharp rise in unemployment. But nonfarm employment would have risen further had it not been for the auto and teachers' strikes. The rise of three-tenths of a point in the unemployment rate to 4.1 per cent in September reflected the fact that

an unusually large number of adult women entered the labor force with a consequent sharp rise both in their employment and in their unemployment rate. In fact, the reported sudden rise in labor force participation among adult women may reflect no more than the difficulties of accurately adjusting for certain changes in concepts and for the effect of new questions introduced in the household series in 1967.

More important than these aggregate measures were underlying indications of continued labor market tightness. The unemployment rate for adult men was down one-tenth of a point in September to an extremely low 2.3 per cent, and for nonwhite men declined to 3.5 per cent--the lowest rate since these data became available over a decade ago. The unemployment rate for teenagers--although extremely high--remained virtually unchanged over the month. Similarly, the rate of insured unemployment--which tends to be particularly sensitive to activity in the industrial sector of the economy--was down by three-tenths of a point in September to 2.4 per cent of workers covered, almost back to its low level a year earlier. Hours of work generally held firm in September. Another measure of labor demand--the index of help wanted advertising--rose again.

Nonfarm employment. The nonfarm employment picture in September was one of selective strength. Nonfarm employment declined 116,000 to 66.1 million but about 235,000 more strikers were off payrolls in mid-September than in August. After allowance for this, nonfarm employment showed a gain of over 100,000, with all of the

increase in services, trade, and the Federal Government. The non-industrial sectors have provided virtually all of the 1.7 million net increase in nonfarm jobs over the year.

Manufacturing. In manufacturing, after allowance for strikes, little additional strength was evident. Factory jobs declined by 180,000, with the durable goods sector accounting for most of the drop. The Ford strike resulted in a sharp drop in employment in transportation equipment and moderate declines in the steel, fabricated metal, and electrical equipment industries.

Construction employment in September was unchanged for the third successive month at a level slightly below a year earlier. However, there was a significant lengthening in the average workweek which suggests that employers may be responding to increases in residential construction.

Nonindustrial employment. In contrast to the industrial sectors, private services in September continued to show consistently large increases in employment. Job growth in medical and health services accounted for one-third of the 45,000 increase in all services in September, and for over 40 per cent of the 560,000 rise since September 1966. After a mid-summer lull, employment in retail trade moved up again, and total trade employment in September was 400,000 above a year earlier. Finance has also shown a steady increase; employment was 150,000 higher than a year ago. However, the upward momentum in the public sector was interrupted. Disputes between teachers

and school boards in several cities involved about 60,000 persons during the survey week and eliminated the usual increase in State and local government employment, which averaged 50,000 a month last year.

The employment picture in October is again likely to be a mixed one. The settlement of the teachers' disputes should result in a brisk rebound of State and local government employment, but the continuation of the Ford strike through the mid-October survey week suggests that manufacturing employment will again be weak, particularly since there are likely to be some secondary effects apparent in the October figures. Secondary layoffs would also affect the unemployment figures, since persons laid off as a result of a strike are counted as unemployed, although the strikers are not. Unemployment insurance claims figures suggest that some 15,000 workers had been laid off by the end of the first week in October as a result of the strike.

Productivity. Data on output per manhour for both the total private and private nonfarm economy incorporating the regular annual revisions of gross national product, employment and hours were recently made available through the second quarter of 1967. Over-the-year, rates of productivity increase trended downward from mid-1966 through the first quarter of 1967. There was a modest rebound in real private output in the second quarter of 1967, accompanied by a sharp pick-up in productivity.

PRODUCTIVITY IN TOTAL PRIVATE AND
PRIVATE NONFARM INDUSTRIES 1/
Per Cent Change from a Year Ago

	Total Private	Private Nonfarm
1966 - I	3.9	3.8
II	3.8	3.2
III	2.5	1.9
IV	2.0	1.5
1967 - I	0.5	0.1
II	1.9	1.2

1/ Real private gross national product per manhour.

The second quarter productivity spurt reflected largely a downward adjustment of manhours by employers, reacting to reduced rates of growth. Manufacturing employment declined by over 200,000 in the second quarter; construction was off by 100,000; and employment gains were smaller than usual in other sectors and with workweeks also reduced, total private manhours fell by 5.7 per cent (annual rate)

from the first to the second quarter. In conjunction with the modest rise in output, this resulted in a sharp pick-up in productivity between the first and second quarters. The last time such a sharp rise in productivity occurred was in the second quarter of 1961--also immediately following a decline in real private output.

However, despite the gain from the first quarter, productivity increases from a year earlier were still relatively small in the second quarter--1.9 per cent for the total private economy and 1.2 per cent for the nonfarm sector. The average productivity growth rates for the total private, and private nonfarm sectors were 3.4 and 3.0 per cent, respectively, during the 1962-1966 period. With private output expected to continue to expand at a more rapid rate, an acceleration of year-to-year gains in productivity is in prospect.

Wholesale Prices. Prices of industrial commodities at wholesale increased 0.2 per cent from mid-August to mid-September, according to the BLS preliminary estimate, bringing the rise from mid-July to 0.5 per cent, or an annual rate of 3 per cent. As a result of a number of announced price increases to be effective after mid-September, a further appreciable rise in the BLS industrial average appears likely by October 10 (the October pricing date).

The rise over the past 3 months encompasses a wide array of industrial materials and products, beginning with petroleum and products, silver, rubber products, and building materials in July, and then extending to steel mill products, copper products, some basic chemicals, metal working machinery, and 1968 models of motor vehicles, TV, and

appliances. A number of the latter increases--particularly those for 1968 autos and some chemicals and steel products--will appear for the first time in the October price index.

Increases for building materials played a significant role in the recent run-up--ranging from lumber and plywood to glass, gypsum products, and various metal items. Price advances for lumber and plywood were particularly large during the summer, when drought and forest fires in the Northwest curtailed logging operations and lumber production. In recent weeks, improved supplies have reportedly resulted in partial reversal of the earlier sharp price increases for lumber and plywood. Moreover, gasoline prices--which had also contributed to the summer advance--have been declining with the usual seasonal fall-off in consumption. These declines coupled with a dearth of announcements of new price increases quite recently suggest a possible slowing in the rate of advance of industrial prices until settlement of the current strikes--which are depressing industrial production and incomes--permits better judgment of both demand and cost pressures on prices.

Prices of farm products have declined considerably since mid-year as a result mainly of bumper harvests of most grains and fresh vegetables and maintenance of hog marketings at unexpectedly high levels. Cattle slaughter and beef production have eased below a year earlier and prices have moved up fairly steadily. For all livestock and products combined, including red meat, poultry, eggs, and dairy products, the near-term outlook still is for some reduction in market supplies from earlier advanced levels and for stability or perhaps some strengthening

in prices; in the longer-run, ample supplies and low prices for feeds should encourage hog raising and cattle feeding and larger market supplies of meat.

Farm production in 1967. Uncertainty about the size of the nation's crop harvest has been allayed by the favorable October 1 report. Although early frost in the North and hurricane "Beulah" in the South trimmed yields of late maturing crops in these areas, a record output 17 per cent above the 1957-59 average is assured. Pasture conditions on October 1 better than a month earlier and a year earlier assure good grazing for livestock.

Crops of wheat, corn, sorghum grain, soybeans, and rice are of record size. Their prices have been falling since mid-year and on September 15 were well below year earlier levels as shown in the table. Crops expected to be of less than record size include cotton, oats, barley, rye, flaxseed, peanuts, dry beans, potatoes and deciduous and citrus fruits. Cash prices of these commodities showed little reaction to the October Crop Report with the exceptions of potatoes and citrus fruits. Potato futures declined sharply in response to the report and frozen orange concentrate futures increased. Fall potato prospects increased 3 per cent from September. The short 1967-68 citrus crop apparently caught traders unaware. Hurrican damage in Texas and last spring's frost and drought in Florida reduced crop prospects to about the size of the light 1965-66 crop.

The 8.1 million bale cotton crop is the smallest since 1921 for two reasons: (1) unusually large participation in the acreage diversion program, and (2) unfavorable weather cut yields by 14 per cent.

Meat production has been running well above relatively short 1966 output through September but margins over a year ago have been narrowing since mid-year. In September, pork production was 9 per cent above a year earlier, poultry meat 8 per cent above, and beef a little below. Net farm value of pork and frying chickens was down about one-sixth from last September and beef was 5 per cent higher. Milk production averaged slightly under a year earlier through September. The September price at wholesale was also slightly under a year earlier. Apparently, milk prices supported at levels a fourth above 1965-66 levels have discouraged consumption. Through August, the Commodity Credit Corporation had bought surplus milk products equivalent to 8 per cent of production. Last year, CCC purchases were negligible.

On the strength of the September 21 pig crop survey showing September 1 numbers down 1 per cent from a year earlier, the USDA is forecasting fourth quarter pork production at near year-earlier levels with possibly a dip below late in the quarter. If this production is realized, hog prices are likely to stay close to a year ago, too. Cattle feeders report that they had 2 per cent more cattle on feed on October 1 than a year earlier and that they intend to market 2 per cent more cattle in the fourth quarter than last year. With marketings this close to a year earlier, fourth quarter per capita supplies of fed beef will be no larger than a year ago. Accordingly, USDA analysts assessing fourth quarter price prospects for fed cattle lean toward continued stability at present levels, in part because demand for fed beef tends to be weakened by strong seasonal competition from pork and turkey in the fourth quarter.

1967 OUTPUT AND SEPTEMBER FARM PRICES
OF SELECTED COMMODITIES

	1967 Output <u>1/</u> (millions)	Farm price Sept. 15, 1967 (per unit)	Per cent change from 1966	
			Output	Price
Crops				
Wheat, all	1,554 bu.	\$ 1.39	19	-19
Corn	4,717 bu.	1.12	15	-17
Sorghum grain	789 bu.	1.02	10	- 5
Soybeans	994 bu.	2.53	7	-15
Cotton	8 bales	103.80 <u>3/</u>	-16	1
Vegetables				
Fresh, for fall mkt.	28 cwt.	4.22	11	-13
Processing	181 cwt.	n.a.	11	n.a.
Potatoes, fall	229 cwt.	1.90	1	- 8
Apples	124 bu.	3.16	- 2	12
Oranges, winter 67-68	106 boxes	1.74	-30	-48
Livestock production <u>2/</u>				
Pork, dressed wt.	8,984 lb.	.35 <u>4/</u>	14	-16
Beef, dressed wt.	15,055 lb.	.52 <u>4/</u>	4	5
Poultry, ready-to-cook	6,951 lb.	.17 <u>4/</u>	13	-14
Meat and poultry	32,035 lb.	n.a.	8	n.a.
Milk	922 cwt.	5.17 <u>5/</u>	- .2	- 2
Eggs	4,391 doz.	.32	7	-25

1/ Crop production estimates based on October 1, 1967 survey.

2/ Livestock production, January - September.

3/ Cotton price is based on 488 pound bale.

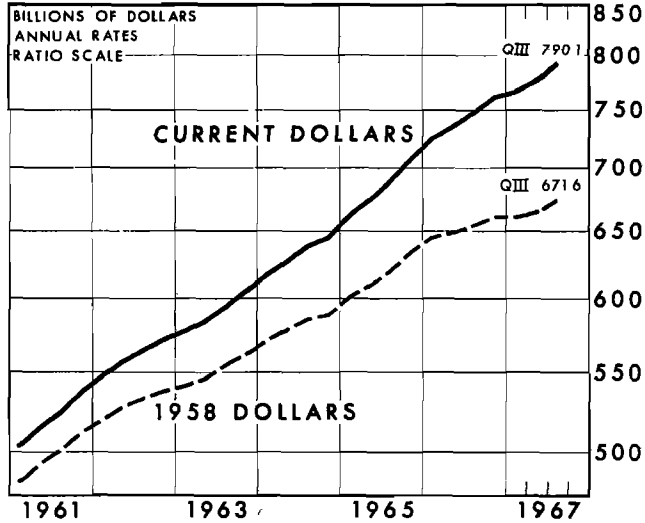
4/ Net farm value of quantity of live animal equivalent to 1 pound of retail cuts. Poultry price is for frying-chickens.

5/ Wholesale.

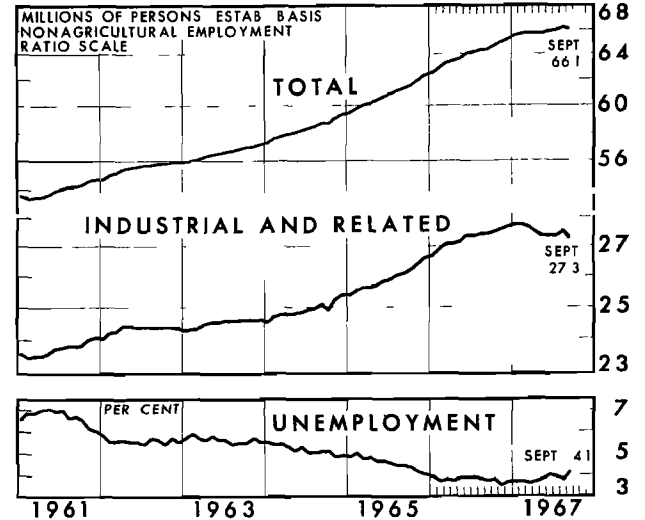
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

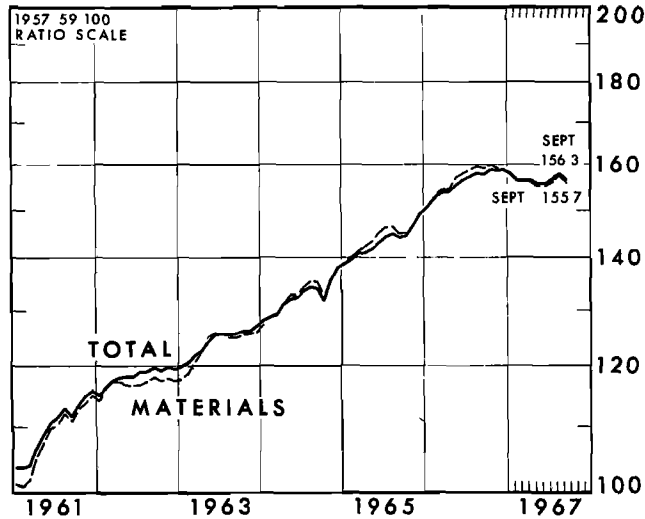
GROSS NATIONAL PRODUCT



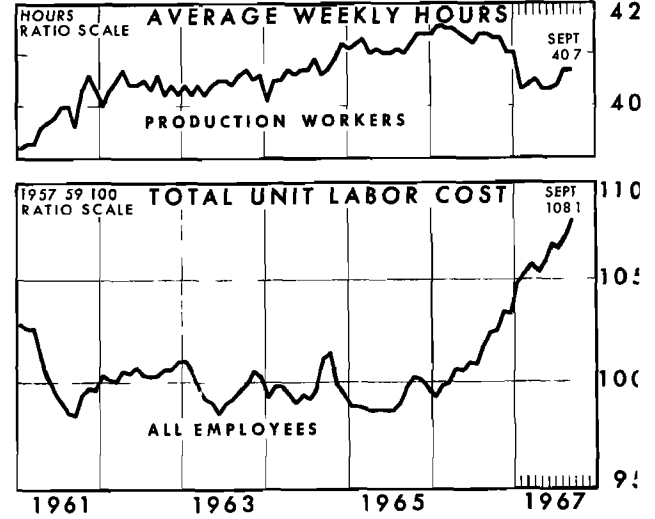
EMPLOYMENT AND UNEMPLOYMENT



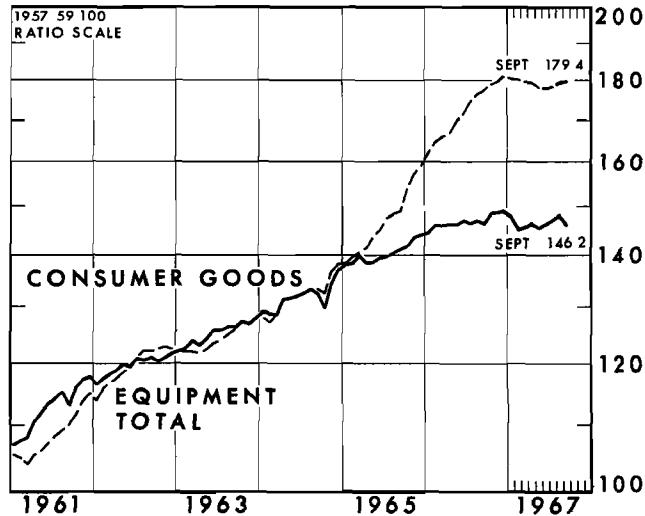
INDUSTRIAL PRODUCTION-I



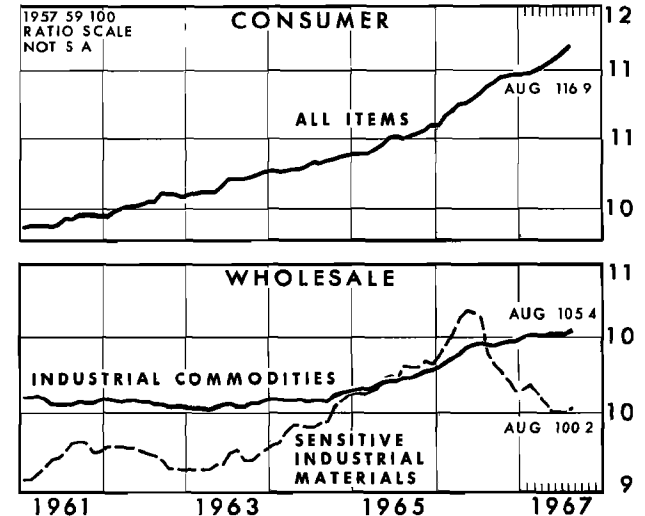
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



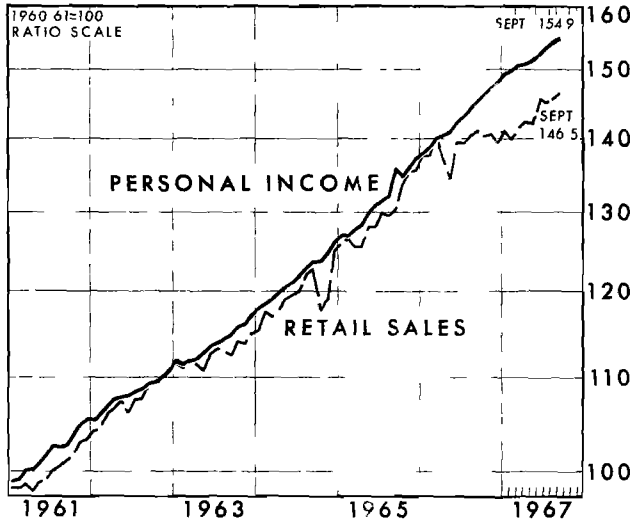
PRICES



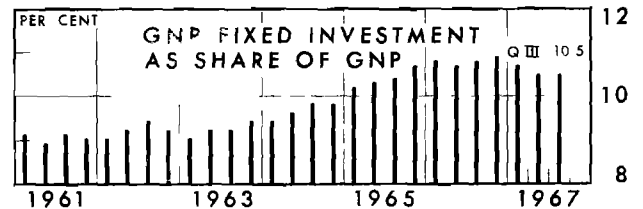
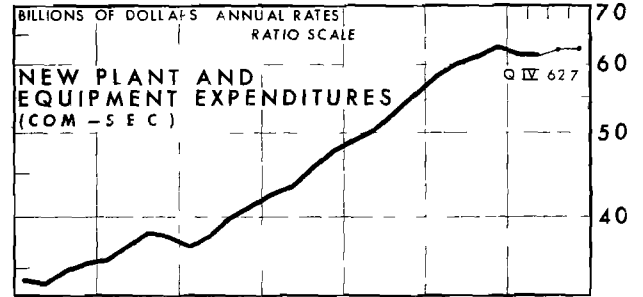
ECONOMIC DEVELOPMENTS - UNITED STATES

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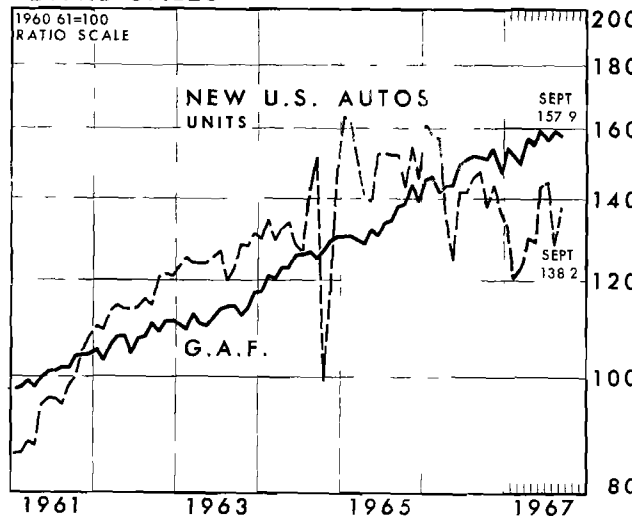
INCOME AND SALES



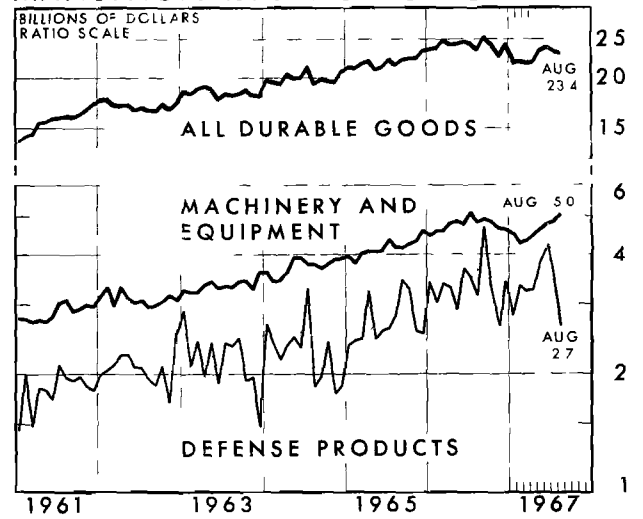
BUSINESS INVESTMENT



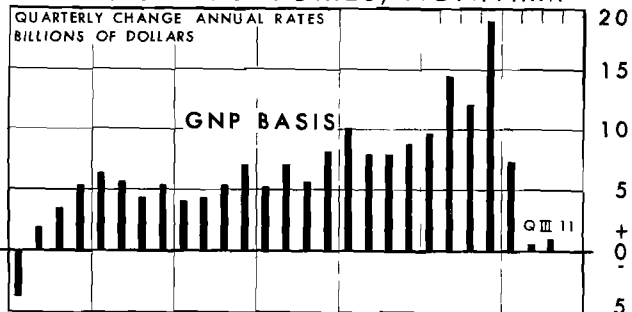
RETAIL SALES



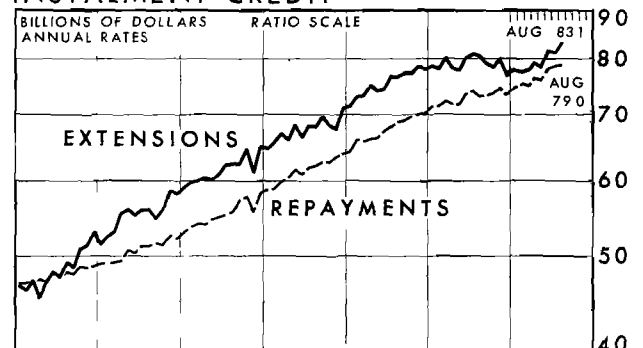
MANUFACTURERS' NEW ORDERS



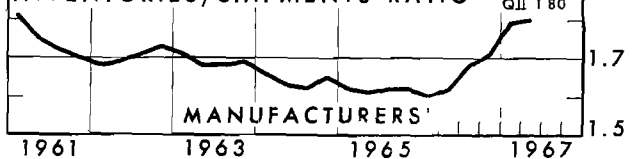
BUSINESS INVENTORIES, NONFARM



INSTALMENT CREDIT



INVENTORIES/SHIPMENTS RATIO



 DOMESTIC FINANCIAL SITUATION

Bank credit. Lacking the stimulus of a Treasury financing or an acceleration of tax payments, bank credit at all commercial banks in September increased at an annual rate of less than 8 per cent, or about one-third the July-August pace. Late in the month and in early October, however, bank credit expansion at the weekly reporting banks accelerated somewhat. During the second week in October earning assets of these banks will probably show a substantial rise associated with bank underwriting of the recently issued tax anticipation bills.

CHANGES IN BANK CREDIT IN 1967
ALL COMMERCIAL BANKS
(Seasonally adjusted annual rate, per cent)

	1st Q	2nd Q	July-August	September	1st 9 mos.
Total Loans and Investments	<u>14.4</u>	<u>4.4</u>	<u>22.5</u>	<u>7.8</u>	<u>12.5</u>
U.S. Govt. Securities	30.5	-13.2	64.4	-3.9	19.9
Other securities	29.6	26.8	18.3	8.3	25.2
Loans	6.7	3.6	12.7	11.0	7.6

Liquidation of U.S. Government securities was quite modest in September following bank acquisitions of the notes issued for cash by the Treasury at the end of August with 100 per cent tax and loan credit. The slower pace of business loan demands in September and the

attractive yields on the notes led to smaller than normal sales by banks of their securities. There were also sizable bank purchases of other Treasury issues--particularly bills by the larger institutions. In late September and early October, New York City banks did liquidate over \$500 million of Treasury securities, mainly bills, but these apparently represented reduction of trading position by dealer banks. In the second week of October, New York banks acquired almost \$1.2 billion of bills in the recent financing--with 75 per cent tax and loan credit.

Acquisition of other securities in September moderated further to about an 8.5 per cent annual rate. The further slowdown of tax-exempts put on by banks in September probably reflected earlier portfolio positioning in expectation of heavy loan demands. As indications developed of relatively modest business loan demands, banks increased their purchases of municipals, with deliveries reflected in a higher pace of tax-exempt acquisitions at weekly reporters in late September and early October. At New York banks, purchases continued to be essentially all in the short-term maturities. (More detailed information on the maturity of municipal bond holdings of member banks as of mic-1967 can be found in Appendix A.)

As in August, business loan growth continued moderate in September, expanding at about a 3 per cent annual rate,^{1/} less than

^{1/} Based on revised seasonal adjustment factors. See Appendix B, for a discussion of revised seasonally adjusted loan components for all commercial banks.

one-third of the first half pace, when tax-related loan demands were sizable. A large part of the September growth was associated with a sizable contraseasonal increase in bank holdings of acceptances-- apparently reflecting acceptance financing by the Japanese. Borrowing over the tax and dividend dates at weekly reporters outside of New York was relatively large--perhaps indicating that the financial position of businesses with limited access to capital markets has not improved as much as that of the major corporations.

Though business loan expansion in September as a whole was moderate, these loans increased sharply at weekly reporting banks in late September and early October. The early October expansion probably reflected in large part borrowing to meet accelerated payments of withheld taxes--as in 1966. Following this expansion, business loans declined more than usual at New York City banks. On balance, business loan developments since the September tax date have not yet formed a pattern which permits any clear generalization, but it does not appear that any unusual strengthening of business loan demands has developed in recent weeks.

Despite the slower growth of business loans, total bank loans in September, as in July-August, expanded over twice as rapidly as in the first half of 1967. The earlier growth was largely accounted for by the behavior of security loans in July and August, associated in large part with Treasury financings. In September security loans continued to expand relatively rapidly, but the more recent growth reflected an increased volume of loans on securities other than Treasury

issues. In early October these trends continued. A substantial volume of these "other" security loans in recent weeks is reported by some banks to reflect greater financing of commercial paper inventory and miscellaneous transactions. Although margin and security underwriting loans of banks probably also increased, bankers suggest that these did not account for a large share of the expansion in total security loans.

COMPOSITION OF LOAN GROWTH IN 1967
ALL COMMERCIAL BANKS
(Seasonally adjusted annual rate, per cent)

	1st H.	July-August	September	1st 9 months
Total loans	<u>5.2</u>	<u>12.7</u>	<u>11.0</u>	<u>7.6</u>
Business	9.2	5.8	2.9	7.8
Real estate	5.9	7.6	6.4	6.4
Consumer	4.1	6.1	6.0	4.8
Security	-22.8	171.4	53.3	25.3
Nonbank financial	- 6.6	- 15.3	31.6	- 4.4

Loans to nonbank financial institutions--which have declined on balance since mid-1966 as finance companies have relied more on market financing--increased relatively sharply in September. A large part of this increase was associated with the earlier automobile model introduction, which affected the timing of needs of finance companies to finance dealer floor plan loans. Additionally, a large but temporary

unsecured loan to a life insurance company also is reported to have increased total nonbank financial loans sharply in September. Real estate and consumer loans in recent weeks have continued to expand somewhat more rapidly than in the first half of 1967.

Bank deposits. After a \$850 million attrition in negotiable CD's in September, weekly reporters increased their outstandings by \$120 million in early October. However, in the second week of October--with increased competition from the new tax bill--outstandings in New York declined somewhat, although Chicago bankers were able to increase their CD's by almost \$50 million. CD rates continued to edge up slightly the first weeks of October. Offering rates of 5.50 per cent on long maturity CD's became more common, but a few banks have shaded downward their rates on shorter maturities since the tax date. This rate pattern is in keeping with the shift in bankers' expectations toward relatively modest near-term loan demands. In early October, outstanding CD's totaled \$20.0 billion, \$750 million below their late August peak, but a \$4.4 billion increase for the year to date.

Slower CD growth has tended to keep the expansion in total time and savings deposits in early October to only somewhat above the September 11.4 per cent rate of growth. In addition, a moderately slower growth in consumer-type interest-bearing deposits has apparently continued into early October.

In the first two weeks of October the 90-day Euro-dollar rate has risen about 50 basis points above the September average. This increase, associated mainly with seasonal factors, has brought

the rate relationship between CD's and Euro-dollars back to a more normal level; since late July rate relationships had made Euro-dollars a relatively attractive source of funds to U.S. banks, and from May through August borrowing from branches had increased about \$900 million. Despite CD run-offs and the attractive Euro-dollar rate, however, the level of such borrowing remained essentially unchanged over the month of September, but then expanded by over \$200 million in early October-- to the highest level since December of 1966.

The money stock in late September and early October rose somewhat faster than the 1.3 per cent annual rate for September as a whole. This rise partly reflects fluctuation in Treasury cash balances in recent weeks, although the growth may also have been sustained by recent expansion of total bank credit demands.

U.S. Government securities market. Yields on Treasury notes and bonds rose further in the first half of October, with yields on 20-year bonds advancing to new 45-year highs and those on 5 to 10 year bonds approaching their highs of 1966. Treasury bill rates also moved up in this period, as the table shows.

YIELDS ON U. S. GOVERNMENT SECURITIES
(Per cent)

	1966 Highs	September 11	October 2	October 17
Bills				
3-months	5.59 (9/21)	4.34	4.40	4.67
6-months	5.98 (9/19)	4.93	5.05	5.17
1-year	5.94 (9/21)	5.09	5.17	5.24
Coupon issues				
3-years	6.22 (8/29)	5.38	5.44	5.55
5-years	5.89 (8/29)	5.38	5.43	5.60
10-years	5.51 (8/29)	5.28	5.35	5.49
20-years	5.12 (8/29)	5.13	5.21	5.39

N.B. Latest dates on which high rates occurred are indicated in parentheses.

The recent gradual, but substantial, rise in Treasury bond yields has occurred against a background of large Treasury deficit financing, increasing pessimism concerning passage of the President's tax recommendations, uncertainties created by weakness in sterling, and recent and prospective major additions to the corporate bond calendar. While some investor selling of Treasury coupon issues has been reported, partly on switches into new corporate and agency issues, dealers have been reluctant buyers and on balance their holdings of over 1-year issues changed little between late September and mid-October. In this period the Treasury investment accounts made some purchases and at mid-month dealers held only about \$50 million of issues maturing in more than 1 year.

The rise in Treasury bill rates this month has occurred while the market was digesting \$4.5 billion of new April and June tax bills auctioned on October 3. Banks, which underwrote virtually all of the new issues because of the 75 per cent tax and loan credit allowed by the Treasury, appeared to be somewhat larger sellers of the new bills than had been anticipated by the dealers. Thus, dealers built up their inventories of bills in this period despite some fairly good offsetting nonbank demand at times and sizable System purchases earlier in the month. It should be added that shorter-term bills maturing before the end of this year have been in good demand recently and rates on such issues have not moved up with the rest of the market. Relatively low dealer financing costs from day-to-day have also encouraged some dealers to position bills, thereby moderating the recent advance in yields.

In the first half of October, selected yield increases continued to occur on short-term market instruments other than bills, and currently yields on virtually all of these instruments are higher than a month ago, as the table shows.

SELECTED SHORT TERM INTEREST RATES

	1967		
	Sept. 11	Oct. 2	Oct. 17
Commercial paper 4-6 months	5.00	5.00	5.00
Finance company paper 30-89 days	4.75	4.75	5.00
Bankers' Acceptances 1-90 days	4.62	4.88	4.88
Certificates of deposit (prime NYC)			
Most often quoted new issue:			
3-months	4.88	5.00	5.12
6-months	5.12	5.25	5.38
1-year	5.38	5.38	5.50
Secondary market:			
3-months	4.95	5.10	5.20
6-months	5.30	5.45	5.50
Federal Agencies (Secondary Market)			
3-months	4.45	4.45	4.80*
6-months	5.25	5.40	5.35*
1-year	5.40	5.45	5.55*
Prime Municipals 1-year	3.20	3.25	3.50*

* Yields on October 13.

Federal agency securities. Yields on new agency issues (not shown in the preceding table) have followed other interest rates up in recent financings. The 6-month to 5-year paper coming to market recently has carried yields ranging from 5.50 per cent on the shorter maturities to 5.88 per cent on 5-year Federal Land Bank bonds. The latter issue met with a relatively poor market reception and recently traded at a discount to yield about 5.95 per cent. On balance, recent agency offerings have not involved the raising of any net new money from the public, but some seasonal demands for new cash could occur in December, perhaps supplemented by an offering of participation certificates.

Treasury finance. The Treasury is expected to announce the terms of its November refunding on October 25. The financing will involve a relatively moderate \$2.6 billion of publicly-held maturing debt, but the Treasury is also expected by the market to raise some net new cash in this refunding. And even if a fair amount of new money is raised in conjunction with the November refunding, the Treasury will probably need to return to the market for additional cash later in November, possibly with a payment date in the first half of December. On our projections, the Treasury will need to raise \$3.5 to \$4.0 billion of new money before mid-December, not counting continued \$100 million additions to the weekly and monthly bill auctions.

Corporate and municipal bond markets. Yields on new and seasoned corporate bonds have advanced significantly from late September to levels not reached since the early 1920's. And sensitive municipal yield indices have risen to the highest levels since the early thirties, when the value of the Federal income tax exemption was considerably less than presently.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa		State and local Government	
	New	Seasoned	Moody's	Bond Buyer's
	With call		Aaa	(mixed qualities)
	protection			
<u>1965</u>				
End of July ^{1/}	4.58	4.48	3.16	3.25
Early December ^{2/}	4.79	4.60	3.37	3.50
<u>1966</u>				
Late summer high	5.98*	5.44	4.04	4.24
<u>1967</u>				
Weeks ending:				
February 3 ^{3/}	--	5.02	3.25	3.40
September 22	5.82	5.64	3.82	4.14
October 6	6.00	5.72	3.83	4.25
13	6.01	5.76	3.83	4.33

^{1/} Week prior to President's announcement of increased U.S. involvement in Vietnam.

^{2/} Week preceding Federal Reserve Discount rate increase.

^{3/} 1967 lows.

* Some issues included carry 10-year call protection.

Intensification of the general upward pressure on bond yields has developed as events in Washington have led market participants to conclude that no tax increase will be enacted this year. In light of these changed expectations, a number of corporations with future needs for funds have taken steps to accelerate the timing of their borrowing. At the same time, investors have shown a reluctance to commit funds for new corporate offerings, until they have a better fix on how far the present uptrend in rates can be expected to go.

Ten corporate bonds with sizeable unsold balances have been released from underwriters price restrictions since late September with subsequent yield advances in the secondary market ranging from 6 to 17 basis points. Five recent issues still remain in syndicate. While one of these, last week's \$75 million Aaa-rated Philadelphia Electric Company offering with 5-year call protection, provides investors a record-breaking yield of 6.10 per cent, the issue remains less than one-third sold. And most recently, a Aa-rated utility with 5-year call protection was reoffered at 6.375 per cent but failed to attract significant investor interest, despite the fact its yield is 18 basis points above a similar offering only two weeks ago.

Reflecting the stepped-up supply of new offerings, the estimated October volume of publicly-offered corporate bonds has been revised upward to \$1.3 billion, \$400 million above the reduced September level. Total stock and bond offerings, including private placements, are also expected to be larger than in September and nearly 2-1/2 times greater than in October 1966. Recently announced issues of three large corporations, which are known to have given up hopes of catching a better market, account for most of the upward revision in October volume.

The November calendar of corporate public bond issues has also been growing rapidly and may ultimately approximate or exceed the increased October volume. Issues definitely scheduled for November already aggregate more than \$750 million, and sizable further additions are generally anticipated by underwriters.

CORPORATE SECURITY OFFERINGS^{1/}
(millions of dollars)

	Bonds				Total Bonds and Stocks	
	Public Offerings ^{2/}		Private Placements			
	1966	1967	1966	1967	1966	1967
1st Quarter	1,774	3,263	2,586	1,811	5,094	5,464
2nd Quarter	1,941	4,017	2,083	1,465	5,115	6,208
3rd Quarter	2,256	4,575e	1,627	1,650e	4,197	6,825e
September	676	875e	657	650e	1,400	1,725e
October	499	1,300e	256	600e	892	2,200e
November	569	1,300e	435	600e	1,115	2,100e

^{1/} Data are gross proceeds.

^{2/} Includes refundings.

The changed outlook on taxes, with its implications for monetary policy and bank investment demands, has created particular weakness in the municipal bond market. While recent weekly calendars of new issues have been relatively light due partly to a number of postponements, current and prospective offerings are much larger, and dealers have added to market pressures by attempting to liquidate holdings of older inventories.

Because postponements or reductions in the size of new offerings amounted to more than \$180 million during the first two weeks of October, municipal offerings for the month as a whole are now expected to drop below \$1 billion. Among the issues indefinitely postponed is the \$120 million Kentucky Turnpike Authority bond, which

has now been deferred on three occasions starting in the late summer of 1966. Several other recent postponements were forced by statutory interest rate limits.

With a sizable volume of municipal issues already tentatively scheduled for November, volume in that month may again expand to or above the \$1 billion mark. But any estimate in the present circumstances is highly tentative both because of the sensitivity of marginal borrowers to levels and changes in bond yields, and because of the uncertain timing of the large volume of industrial revenue issues now planned. Some underwriters are estimating that \$1.2 to \$1.5 billion of new industrial revenue bonds will be brought to market over the balance of this year and early next year, as corporations and municipalities seek to take advantage of tax exemption before the Treasury Department can force a change in this feature of industrial revenue issues.

STATE AND LOCAL GOVERNMENT BOND OFFERINGS
(Millions of dollars) 1/

	1966	1967
1st Quarter	2,964	4,115
2nd Quarter	3,256	3,807
3rd Quarter	2,510	2,975e
September	1,032	1,250e
October	759	925e
November	976	1,000e

1/ Data are for principal amounts of new issues.

Mortgage markets. Mortgage lenders in September generally looked for no more than a usual seasonal decline in loan-commitment volume over the near term, but indications were that lenders have become increasingly selective in recent months. This change has reflected the continued upward yield pressures from other sectors of the capital market since last spring, along with the growing concern about additional pressures that might be expected in 1968. As a result, although net inflows of loanable funds have remained quite large, mortgage interest rates and yields required by lenders have continued to move upward.

In September, while contract rates for conventional first mortgages on new homes remained at about their advanced August average (FHA series), those for existing homes rose about 5 basis points further, to 6.60 per cent. Also, the FHA secondary market yield series--the most sensitive of the mortgage yield indicators--advanced for the fifth consecutive month, to within 18 basis points of the peak reached last November. To meet this advance in yield requirements, discounts on such mortgages, which had already moved beyond the restrictive 4 per cent range in June, continued to move higher in September, as shown in the table.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary Markets: Conventional loans		Secondary Market: FHA-insured loans		
	Level (Per cent)	Change (Basis points)	Level (Per cent)	Change (Basis points)	Discount (Points)
<u>1966</u>					
November	6.70	0	6.81	n.a.	6.8
December	6.65	- 5	6.77	- 4	6.5
<u>1967</u>					
January	6.60	- 5	6.62	-15	5.3
February	6.50	-10	6.46	-16	4.0
March	6.45	- 5	6.35	-11	3.0
April	6.40	- 5	6.29	- 6	2.5
May	6.45	5	6.44	15	3.8
June	6.50	5	6.51	7	4.4
July	6.50	0	6.53	2	4.6
August	6.55	5	6.60	7	5.2
September	6.55	0	6.63	3	5.4

NOTE: FHA series; interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points; secondary market yields and discounts are for certain 6 per cent, FHA-insured Sec. 203 loans.

Although the upward adjustment in mortgage yields has been sustained, it has not been so sharp as the advance in yields offered by other types of competing instruments in most recent months. Consequently, the yield advantage offered by mortgages has remained exceptionally low. In September, it was only 75 basis points higher than that on new Aaa-rated corporate bonds. This compares with an average differential of at least 100 basis points in 1964 and appreciably more in most other recent years. Moreover, with bond yields moving higher again in October, even this differential may have been narrowed

still further. In these circumstances, offerings by private holders of mortgages for purchase by the FNMA in the secondary market have turned up again after a short-lived drop following the 1-1/2 point downward adjustment in purchase-price by FNMA in late August.

Flows to depositary-type intermediaries. Incomplete data suggest that savings and loan associations probably experienced no serious further slowing in the growth of their share capital during the September-October reinvestment period (in which shareholders of many associations are free to withdraw funds without loss of interest). Even when dividends credited are excluded, the associations in the Federal Home Loan Bank Board sample show only a slight net withdrawal through the fifth business day of October. Unfortunately, although this represents a substantial improvement over the like period of last year when savings and loan associations were still under considerable pressure, no comparable data are available to show how recent experience relates to earlier years in the 1960's. For the whole month of October last year, all savings and loan associations experienced a net withdrawal of \$56 million, which compares with net inflows in Octobers of the four preceding years ranging from \$580 to \$815 million.

No universe estimates of reinvestment period experience are available for mutual savings banks. Data for the 15 largest mutuals in New York City do show a less favorable year-to-year comparison in the reinvestment period than for the S&L's. But by October 1966 net inflows to savings banks had already recovered significantly to a level not far below most earlier years.

FLows TO S&L'S AND SELECTED SAVINGS BANKS
DURING THE SEPTEMBER-OCTOBER REINVESTMENT PERIOD^{1/}

(Millions of dollars)

	S & L's		Savings Banks ^{2/}	
	1966	1967	1966	1967
Last 3 days of September	-352 ^{3/}	-162 ^{3/}	-73	-57
1st 5 business days of October	-266	139	6	- 2
Total	-618	- 23	-69	-59

^{1/} Based on surveys of 480 associations conducted by the Federal Home Loan Bank Board.

^{2/} Largest 15 savings banks in New York City.

^{3/} Excludes dividends credited which are estimated to have been \$607 and \$627 million respectively for the full month of September in 1966 and 1967.

While the preceding data suggest that savings experience at depository-type institutions has remained quite favorable recently, there was some general tendency for growth in seasonally adjusted savings flows to slow down during August and September. As the table shows, this tendency seems significant chiefly when compared with the record expansion of the second quarter. Thus, even if final data should ultimately indicate that the August-September tendency toward a somewhat slower savings growth has continued in October, this would probably still not represent any real change from what participants in the thrift industry characterized as "normal" in their responses to last month's Federal Reserve survey.

SEASONALLY ADJUSTED GROWTH RATES OF
SAVINGS AT DEPOSITARY-TYPE INTERMEDIARIES
(Annual rates)

		S&L's	Savings Banks	Commercial Banks 1/
1965	I	7.8	7.7	13.9
	II	8.0	7.3	9.8
	III	8.0	6.8	14.6
	IV	7.6	6.6	16.6
1966	I	5.5	5.2	5.8
	II	2.0	2.4	12.4
	III	.9	5.5	13.3
	IV	4.5	5.8	8.9
1967	I	9.7	10.4	10.4
	II	11.4	11.4	16.6
	III	9.7	8.3	14.2

1/ Excludes negotiable CD's at weekly reporting banks.

Stock market. Stock prices, as measured by Standard and Poor's composite 500 stock index, have declined about 2,5 per cent from the near-record level reached on October 9. Trading volume was initially heavy, but slackened somewhat as the decline continued.

Further widening to a new record of the spread favoring bond over stock yields seems to have been the major contributor to the recent uncertainty about stocks. But fears of another credit crunch in the months ahead have apparently also refocused market attention on the weaknesses imparted to stocks by tight money last year. In addition, some third quarter reports of corporate earnings appear to have been a disappointment to market participants.

Prior to the recent price weakness a number of stock price indices had moved to new highs--particularly those which measure developments in stocks with special speculative appeal. As the table shows, both the American Stock Exchange index and Standard and Poor's low-priced index showed larger advances than either the broad New York Stock Exchange index or the narrower "blue-chip" Dow-Jones industrial average. This is true whether one makes comparisons over relatively long periods as from the 1966 highs and lows or for shorter periods such as from the end of January, when stock market credit first began to expand.

RELATIVE MOVEMENT OF STOCK PRICE INDICES

	S&P Low Priced	AMEX	NYSE	D-J Industrials
Peak level of 1967 ^{1/}	181.82	23.16	54.16	943.08
Percentage change:				
1966 low to 1967 high	87	89	38	20
1966 high to 1967 high	33	35	6	-7
1966 low to Feb. 1, 1967	31	30	20	8
Feb. 1, 1967, to 1967 peak	43	47	15	11

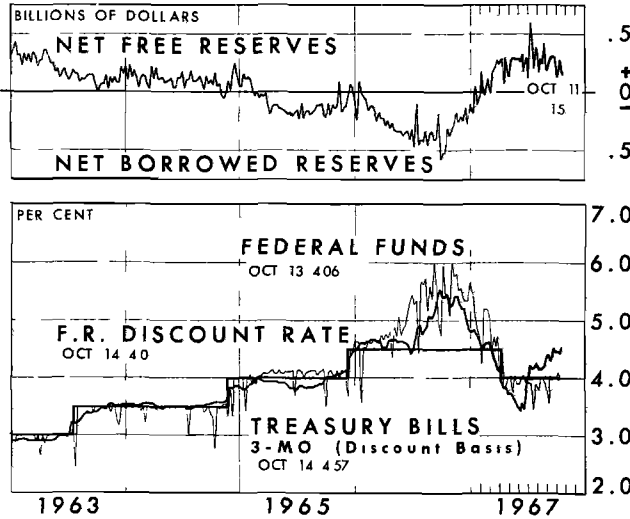
^{1/} All October 9, 1967 except Dow-Jones Industrials which was September 25, 1967.

During September, margin debt extended by New York Stock Exchange member firms to their customers expanded another \$180 million, the second largest monthly increase this year. Over the same period, purpose loans at banks also rose, by about \$70 million, the largest

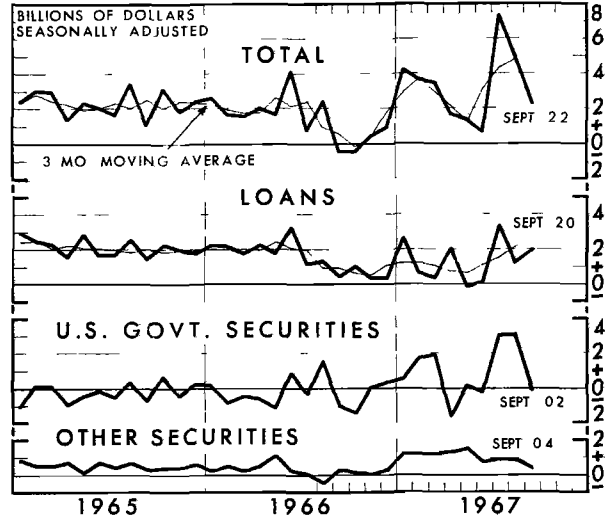
increase for any month this year. Since the end of January, when stock market credit stopped declining following the 1966 market break, margin debt has expanded \$940 million at member firms, and over the same period purpose loans at banks have risen \$272 million. This combined increase of \$1.2 billion has raised outstanding stock market credit to a new record total of \$8.1 billion.

FINANCIAL DEVELOPMENTS - UNITED STATES

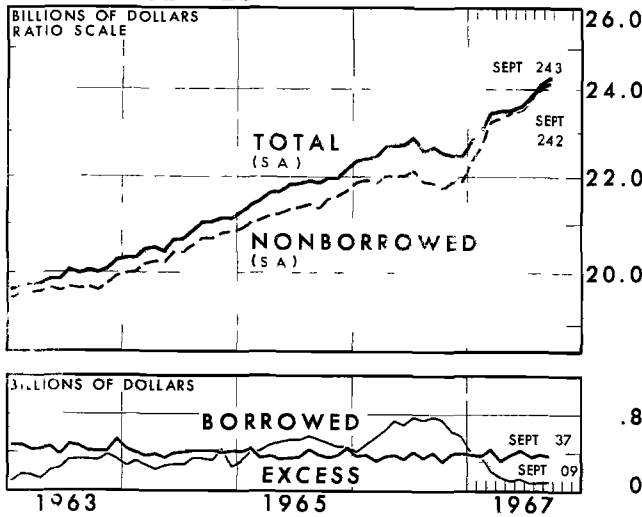
FREE RESERVES AND COSTS



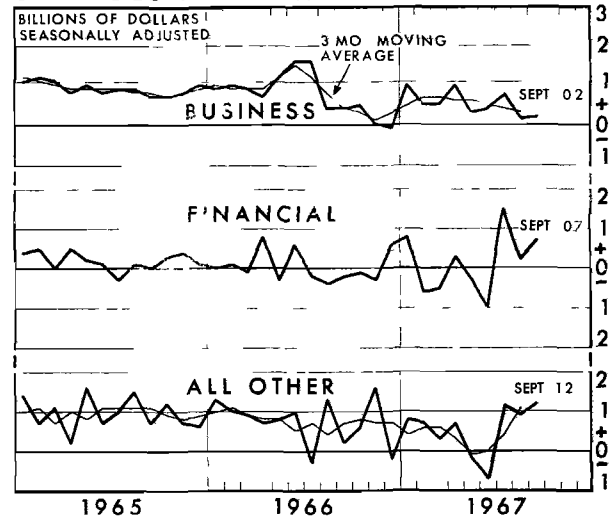
CHANGES IN BANK CREDIT



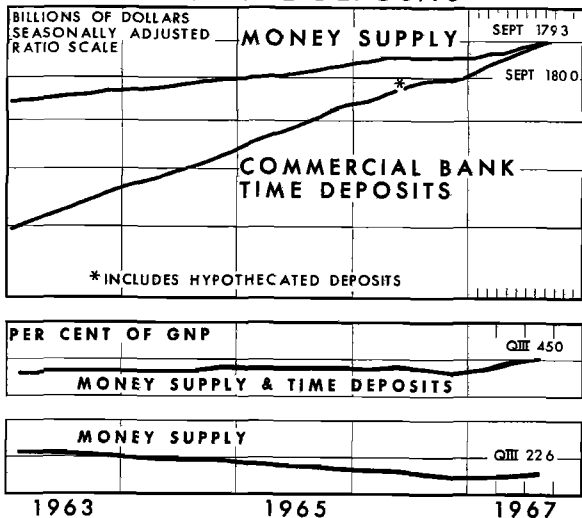
BANK RESERVES



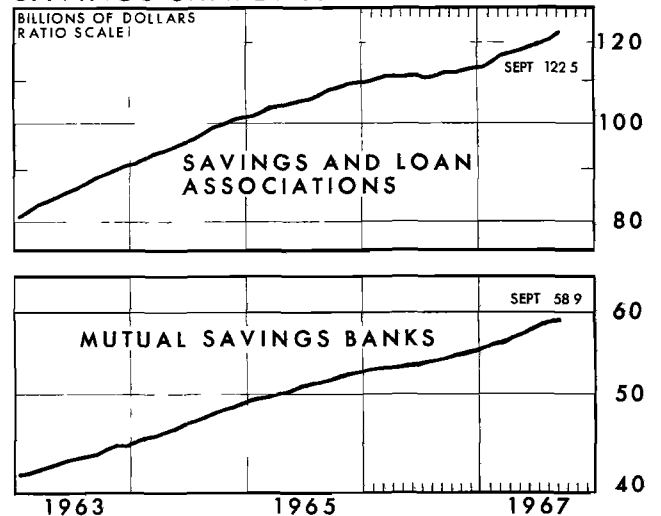
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

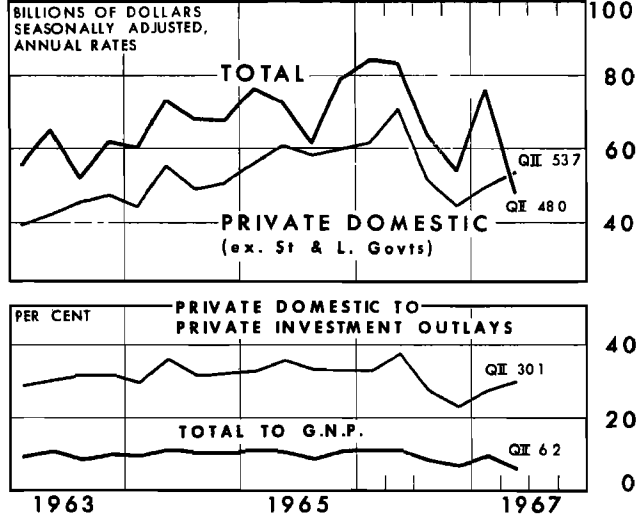


SAVINGS SHARES AND DEPOSITS

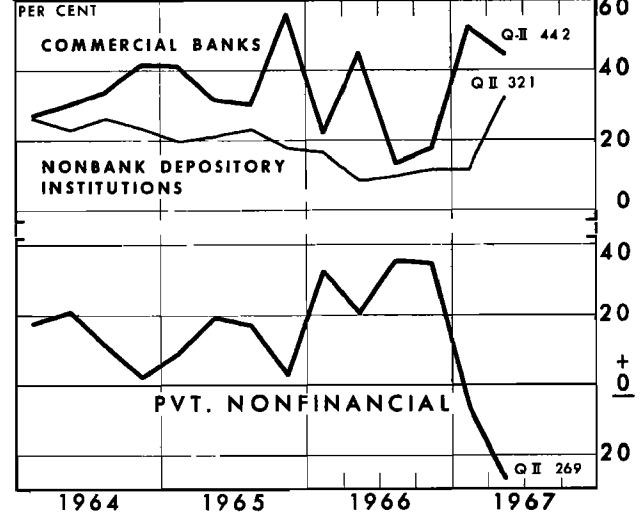


FINANCIAL DEVELOPMENTS - UNITED STATES

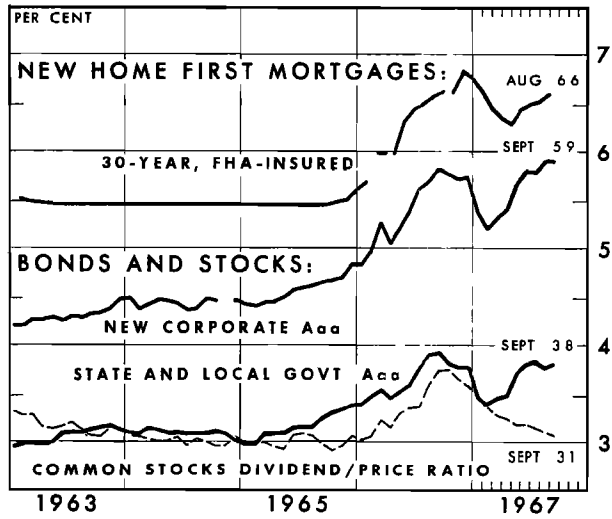
NET FUNDS RAISED-NONFINANCIAL SECTORS



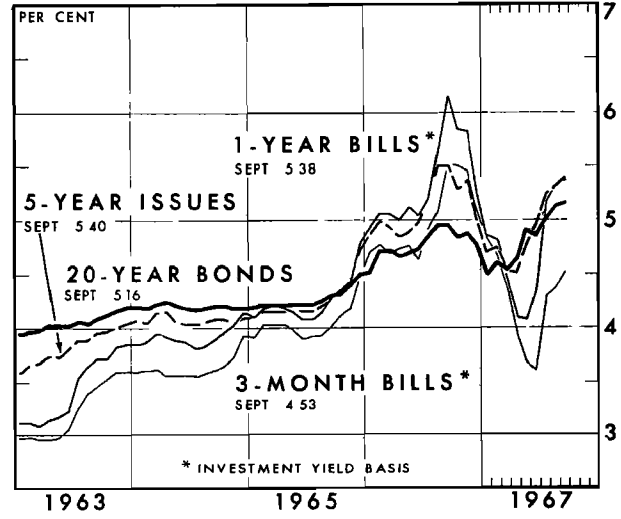
SHARES IN FUNDS SUPPLIED



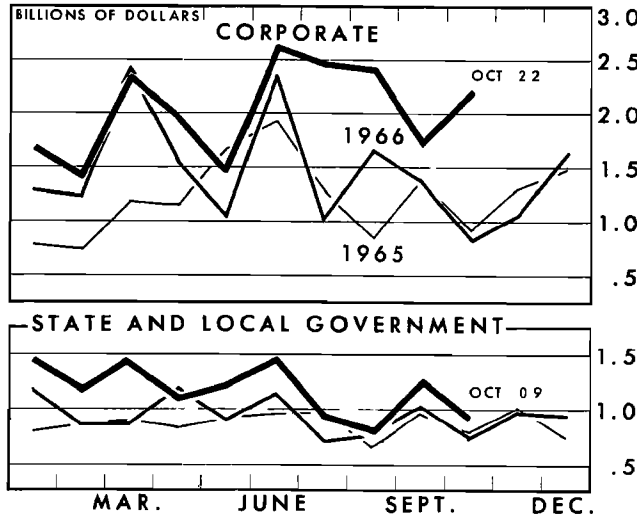
MARKET YIELDS



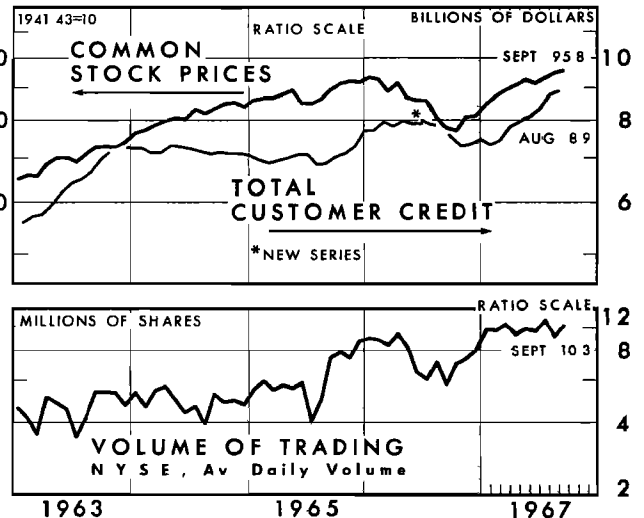
MARKET YIELDS-U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. The deficit on the liquidity basis continued to be large through the third quarter, and weekly indicators for the early part of October suggest that the heavy deficit typical of that month in other years will probably be repeated. With a preliminary September figure of \$307 million, the deficit for the quarter, without seasonal adjustment, amounted to \$1,178 million. After seasonal adjustment this deficit was about \$630 million. Thus, on this measure of the deficit which is commonly featured in published reports, there will be a slight deterioration from an annual rate of \$2.1 billion in the first half to an annual rate of \$2-1/2 billion in the third quarter.

To obtain a more meaningful indicator of the recent trend in the liquidity deficit requires an adjustment for temporary factors, and for investments of foreign official liquid dollar funds in over-one-year deposits. The latter amounted to \$914 million in the first half, so that without this assistance the deficit rate would have been \$3.9 billion. In the third quarter net transfers into official "long-term" deposits were probably negligible, although there was some benefit from the purchase by Germany of a \$125 million nonliquid Treasury note. On the other hand, the first half results were adversely affected by extraordinarily large net unrecorded payments in the second quarter (\$576 million), while in the third quarter such unrecorded flows may have reversed, as a typical reflection of strong pressure on sterling. Beginning in the second quarter there were large payments connected with Expo 67 in Canada, and with the Arab-Israeli conflict. At this

stage, when information for crucial sectors of the accounts for the third quarter is still lacking, the overall deficit figures do not suggest that any basic change one way or the other has yet occurred.

The official settlements balance in the third quarter, seasonally adjusted, was probably in surplus by about \$1/2 billion, as U.S. banks added about \$1.0 billion to their liabilities to foreign branches. Inflows via the branches were especially large in August, and, after a cessation in the earlier weeks of September, were resumed on a substantial scale. These developments are discussed below.

U.S. foreign trade. The trade balance is expected to show some improvement in the remainder of the year over the \$4.3 billion rate of the first half. In July and August a \$4.7 billion rate was reached, even though agricultural exports were still relatively low. The effect of the Arab-Israeli war on third quarter trade was probably a temporary increase in net exports of about \$50 million. A strike in the copper industry, which began in mid-July, has also caused some distortions in trade patterns, but with only a minor net effect on third-quarter trade. Imports of refined copper had been raised early in the year in anticipation of the strike and continued high through August. On the other hand, imports of unrefined copper were very low after June.

U.S. liabilities to commercial banks abroad. From the end of May to the end of August total U.S. short-term liabilities to commercial banks abroad increased by \$1.6 billion, after decreasing by \$0.9 billion in the first five months of the year (and by several hundred million in the latter half of December).

CHANGES IN U.S. SHORT-TERM LIABILITIES TO COMMERCIAL BANKS ABROAD
(in millions of dollars)

1967	Total	Canada	U.K.	Switzerland	Other Europe	Japan	Other
Jan.	-515	- 91	-158	-107	-116	-60	17
Feb.	- 30	-101	- 12	41	12	- 2	32
Mar.	-207	12	- 89	- 35	- 63	21	- 53
Apr.	-111	65	-258	33	- 6	22	33
May	<u>- 65</u>	<u>- 5</u>	<u>- 69</u>	<u>- 94</u>	<u>10</u>	<u>3</u>	<u>90</u>
5 months	-928	-120	-586	-162	-163	-16	119
June	338	- 4	276	52	- 11	82	- 57
July	354	205	159	- 52	64	-29	7
Aug.	<u>870</u>	<u>- 18</u>	<u>820</u>	<u>- 63</u>	<u>46</u>	<u>44</u>	<u>41</u>
3 months	1,562	183	1,255	- 63	99	97	- 9

Apart from the very large increase in the liabilities of U.S. banks to their own branches abroad, to be discussed later, a \$200 million rise in liabilities to banks in Canada was the biggest single element in this summer's increase. This reflected chiefly changes in the liabilities of Canadian bank agencies in this country to their head offices. According to Canadian data, the head offices' U.S.-dollar cash and balances with banks in the United States (mainly the Canadian agencies) increased by \$276 million in June and July. The over-all net flow of funds from Canadian banks to the United States, including withdrawals by U.S. depositors and loans and investments made directly by the head offices, was \$378 million.

The pull of funds to the United States from Canada is explainable by the sharp rise in U.S. money market rates in June and the widening forward discount on the Canadian dollar in July as the spot rate rose strongly. The Canadian banks financed the flow mainly by (a) increasing their net U.S.-dollar liabilities to countries other than the U.S. and U.K. by more than \$100 million; and (b) obtaining nearly \$300 million of U.S.-dollar denominated deposits from Canadian residents (presumably covered) at the expense of the Canadian official reserves.

Liabilities of U.S. banks to their branches abroad rose very sharply in the summer, leveled off in September, and rose again in the first half of October by about \$300 million. Some of the funds U.S. banks obtained this month are likely to have come into the Euro-dollar market from Continental European holders moving out of sterling. Euro-dollar market developments associated with last summer's large inflow are discussed in a later section. In September, Euro-dollar interest rates rose sharply. In the first half of October no further important changes in these rates occurred, and advances in sterling money market rates reduced somewhat the interest incentive for movements from sterling into Euro-dollars.

The September advances in Euro-dollar interest rates carried call money from a low of 4 per cent up $3/4$ to $4-3/4$, and 1-year money from $5-3/4$ up $1/4$ to 6. Other maturities moved up within these ranges. As usually happens at the end of September, the 3-month rate rose markedly, influenced by the seasonal jump at that time in the German 3-month inter-bank loan rate. The 3-month Euro-dollar rate reached $5-3/4$ per cent at the end of September; since then it has eased off slightly.

Whereas during August the spreads between Euro-dollar rates and U.S. CD rates had been unusually small (with three-month Euro-dollars at about 5 per cent and CD new issues at about 4-3/4 per cent), such spreads widened during September. This may have been a factor in the slowing of U.S. banks' intake of Euro-dollar funds for head office use; the U.S. banks' liabilities to branches increased very little in September after rising by about \$1 billion during July and August.

A number of factors may have been responsible for this rise in Euro-dollar interest rates during September. (1) Though German money market rates remained low (until the month-end jump in the 3-month rate), German commercial banks reduced their net external assets (all currencies) by more than \$100 million, thereby tending to draw their own or others' funds out of the Euro-dollar market. (Up to July the German banks had been increasing their net external assets greatly.) (2) The temporary subsiding of the flight from sterling after mid-September deprived the market of what had certainly been an important source of funds in July and August. (3) The generally rising trend in U.S. Treasury bill rates since the end of July may have influenced U.S. banks to pay more for Eur-dollar money, if necessary, to maintain their liabilities to branches at the high level already reached by the end of August.

One consequence of the September rise in Euro-dollar interest rates may have been to attract funds out of (covered) sterling short-term investments, after flight movements had slackened. Statistical confirmation of this hypothesis is not yet available, but it is consistent with the September widening of rate spreads in favor of Euro-dollars over sterling

assets such as deposits with local authorities and hire-purchase finance companies. It is consistent also with the relative firmness of the sterling spot exchange market in the latter part of September; the movements in question would have involved closing out of forward exchange contracts rather than spot purchases of dollars.

Euro-dollar interest rates and movements of funds in May, June, July and August. Confidential summary data are now available on changes in the external assets and liabilities of commercial banks in most of the G-10 countries during these earlier months. Beginning in May, U.S. banks were increasing their liabilities to branches abroad, slowly at first (with an interruption at the end of May) and then at an accelerating pace, with a very large increase in August. This growth in U.S. liabilities was mainly to branches in London. London banks, including the U.S. branches, were in turn increasing very greatly their U.S.-dollar and other foreign currency liabilities to continental European countries and others -- all told, by \$1.5 billion in four months. By also switching back into dollars or other currencies out of (covered) sterling investments a sum of \$0.2 billion (mainly in August), London banks were able to increase their foreign currency assets by \$1.7 billion, approximately two-thirds of which went into net additions to the balances due to U.S. branches at their head offices. The other one-third of this asset increase may have included Euro-dollar lending to banks in Japan and Italy; in both these countries banks were increasing their external dollar liabilities during these months.

The \$1.5 billion increase in the London banks' external foreign currency liabilities was facilitated by easy money conditions in Germany.

German banks increased their net external assets by nearly \$300 million in the four months May-August; directly or indirectly this outflow, which was especially large in May and in July, contributed to the availability of funds in the London Euro-currency market.

During the second quarter, banks in Switzerland accepted an increase in foreigners' Swiss franc deposits of more than \$250 million and in turn added about \$200 million to their foreign-currency external assets. The ultimate source of this addition to the international pool of funds available to London and U.S. banks appears to have been movements out of sterling at the time of the Mid-East crisis.

In fact, net sterling external liabilities reported by banks in the United Kingdom -- not including U.K. official sterling liabilities -- declined by \$0.8 billion in these four months. In addition, nonresidents' holdings of local authority and hire-purchase finance company paper declined by \$0.2 billion. In various ways, some no doubt quite roundabout, these withdrawals from sterling holdings must have made a very large contribution to the availability of funds to the London Euro-currency market.

Euro-dollar interest rate changes during the months May-August included: (1) during May, a rise in Euro-dollar rates, before U.S. short-term rates started up; (2) during June, when rates in the United States rose sharply, a leveling of Euro-dollar rates; and (3) during July, when rates in the United States leveled off, a decline in Euro-dollar rates. (4) Changes in August were small.

It seems likely that the resumption of the U.S. banks' bidding for Euro-dollars was an important factor in the May rise in rates. After

that, however, the stability of Euro-dollar rates in June, July and August reflected the pressure of supply of funds coming to the Euro-dollar market, and in turn encouraged U.S. banks to absorb a large part of the supply. On the supply side, the easy credit conditions in Germany were an important factor at least up to July; in August, movements out of sterling became the dominant factor.

Short-term rates in the sterling money market, which had fallen by about 1-1/2 percentage points in the first four months of 1967, remained quite level in the next four months. When Euro-dollar rates rose in May there resulted an interest differential, uncovered, in favor of movements from sterling paper to Euro-dollars. However, because the forward discount on sterling first narrowed (when Euro-dollar rates rose) and then widened again after midyear, the covered rate differentials remained fairly small -- until the September rise in Euro-dollar rates. While movements out of sterling this year were clearly encouraged by interest rate relationships, it is also clear that much of the movement was dominated by the confidence factor.

Interest rates in national markets abroad. Despite advances in U.S. short-term interest rates since June, and despite increases in Euro-dollar rates in May and June and again (after intervening declines) in September, short-term interest rates in major European national markets have been relatively stable. During most of July, August and September they were near their lows for the year. There has been no significant tightening of money in Germany, where the recent interest rate rise for 3-month interbank money is purely seasonal. The Swiss 3-month deposit rate

SHORT-TERM INTEREST RATES
 (per cent per annum)
 (at dates near month-ends except October 1967)

	1966	1967					More
	Sept.	Apr.	June	Aug.	Sept.	recent	
U.S.: 3-mo. Treas. bill	5.30	3.68	3.82	4.34	4.37	4.58 (Oct. 13)	
: Federal funds	5.40	4.05	3.98	3.89	4.00	4.06 " "	
: 3-mo. CD (secondary)	5.84	4.35	4.84	5.03	5.03	5.17 (Oct. 11)	
: 3-mo. CD (new issue)	5.50	4.13	4.75	4.88	5.00	5.00 " "	
Euro-dollar: Call	6.00	4.32	4.94	4.13	4.75	4.50 (Oct. 13)	
: 3-mo.	6.88	4.62	5.31	5.00	5.75	5.56 " "	
U.K.: 3-mo. Treas. bill	6.60	5.30	5.12	5.16	5.33	5.33 (Oct. 13)	
: 3-mo. Local authority	7.44	5.84	5.56	5.53	5.69	5.94 (Oct. 6)	
: Forward sterling discount	-.94	-.99	-.43	-.75	-.68	-.68 " "	
: 3-mo. Local auth. covered	6.50	4.85	5.13	4.78	5.01	5.26 " "	
Canada: 91-day Treas. bill	5.01	4.00	4.28	4.32	4.76	4.91 (Oct. 13)	
Germany: 3-mo. interbank loan	6.75	4.00	3.99	3.50	3.45	4.19 (Oct. 13)	
Switzerland: 3-mo. Treas. bill	4.25	4.25	4.25	2.75	2.75 ^{2/}	-- " "	
France ^{1/} : Call money	4.60	5.07	4.50	4.48	4.20	4.50 " "	
: 30-day comml. paper	4.95	4.97	4.63	4.37	4.45	4.50 (Oct. 12)	
Netherlands: 3-mo. Treas. bill	4.75	4.50	4.56	4.44	4.44	4.50 (Oct. 12)	
Belgium: 4-mo. Treas. cert.	5.80	5.60	5.75	5.60	5.40	5.30 (Oct. 10)	

^{1/} Monthly averages.

^{2/} September 15.

in late August and mid-September was at its lowest in 5 years. In Britain, however, the Bank of England has responded to Euro-dollar rate increases by acting to push sterling money market rates up somewhat since mid-September. The British authorities have made no change in Bank rate since the last reduction, in May.

Movements of long-term yields have been mixed since the marked de-escalation of rates ended last spring. In May and June waning confidence in the pound caused a sharp upturn in yields in the U.K., but rates have not changed much since midyear. In Germany, on the other hand, bond rates have edged down further.

In Canada, both short- and long-term rates have been rising since April. The Bank of Canada raised its discount rate to 5 per cent on September 27.

In Britain, short-term market rates have moved up appreciably in recent weeks. On most days since September 21 the Bank of England has forced the discount houses to borrow from it at Bank rate. Previously, since April the Bank had invoked penalty rate assistance to the market on only one occasion. In consequence of this pressure on the market, the Treasury bill rate moved up somewhat less than 1/4 per cent by the end of the month. The local authority rate moved similarly in September, and has risen further this month; on October 6 it stood 40 basis points above its mid-August-to-mid-September level.

It is generally assumed in the financial community that any further narrowing of the margin between the Treasury bill rate and Bank rate -- the former is now only 1/8 per cent below the latter -- would call for a rise in Bank rate, to which the clearing banks' loan and deposit rates are tied.

Economic recovery appears to have been under way in Britain since June. Manufacturing output rose about 2 per cent from May-June to July-August. Underlying this pick-up has been a rise in consumer buying.

Retail sales (excluding autos) in August were about 3 per cent greater, in volume terms, than in May. Installment credit outstanding, after falling for ten months, rose in both July and August.

Continuing weakness in the current account of the U.K. balance of payments reflects primarily a decline in merchandise exports, which was continuing in September. Hopes for an export-powered recovery, making the resumption of domestic growth clearly compatible with an improvement in the balance of payments, have not been realized; but world market conditions have been particularly unfavorable this year.

Yields on long-term British government bonds moved up about 1/2 a percentage point from April through early July, thus returning to about the levels of November 1966. The authorities intervened to support bond prices on several occasions in the May-July period. Changes since then have been small.

Evaporation of confidence in the balance-of-payments outlook brought the upswing in bond prices to a halt last spring. Profit taking in early May helped depress prices, and at the same time institutions were switching out of government bonds into steel shares on a large scale after announcement of the vesting date for steel securities, because of tax advantages. The steel industry was nationalized on July 28.

In Germany, the expansionary monetary policy introduced at the beginning of the year produced a substantial decline in interest rates, which continued to July for short-term rates and is perhaps not yet over for long-term rates. However, long-term rates remain high compared with those in the United States, Canada, and Switzerland.

GOVERNMENT BOND YIELDS
(per cent per annum)
(at dates near month-ends except October 1967)

	1966	1967				More	
	Sept.	Apr.	June	Aug.	Sept.	Recent	
U.S. (3-1/2% 1990)	4.77	4.68	4.97	4.94	5.03	5.11	(Oct. 11)
Euro-dollar bonds (H-13 series)	6.81	6.13	6.33	6.40	6.39	6.39	(Oct. 13)
U K (War Loan)	7.13	6.44	6.84	6.85	6.94	6.90	(Oct. 12)
Canada (5-1/4% 1990)	5.80	5.56	5.83	5.93	6.17	6.18	(Oct. 4)
Germany (6% publ Author bonds)	8.12	6.87	6.84	6.76	6.62	6.63	(Oct. 12)
Switzerland (Swiss Confederation)	4.57	4.77	4.70	4.55	4.55	...	
France <u>1/</u> (Publ sector bonds) <u>2/</u>	6.29	6.42	6.39	6.36	6.40	6.37	(Oct. 6)
Italy <u>1/</u> (Non-govt bonds)	6.38	6.43	6.45	6.44	
Netherlands (4-1/4 and 4-1/2%)	6.47	5.95	6.17	6.04	6.10	6.17	(Oct. 6)
Belgium (20-yr bonds)	6.76	6.77	6.77	6.64	6.66	...	

1/ Monthly average.

2/ French bond yields are net of withholding tax (12% on most issues, 10% on the rest).

Earlier indications of an incipient upswing in the German economy are supported by recent data, showing in particular a rise in manufacturers' new orders from May-June to July-August, including a rise in consumer goods orders; an advance in industrial production over the same interval; and a decline in unemployment since the end of May.

New orders for capital goods were pushed up last spring by government orders under the first investment budget and are being supported again this autumn by state and local authorities' orders under the second investment budget; the Government recently reported that the October 15 target date for the placing of these orders was being successfully met. The

Ministry of Economic Affairs has stated that expenditures under these investment budgets will be carried through rapidly whatever the economic reactions. If signs of overheating reappear in the next twelve months, other stabilization measures will be adopted, including slowing of 1968 budget outlays.

The six German economic research institutes are in agreement that a cyclical upswing has begun. They expect that inventory rebuilding after the turn of the year -- when the new value-added tax comes into operation -- will give further support to the upswing.

The decline in German short-term interest rates has resulted from a series of reserve requirement reductions by the Bundesbank which have added greatly to bank liquidity. Domestic demand for bank credit has been slow, and the banks have added greatly to their net external assets. At the end of August these amounted to about \$650 million; a year earlier external liabilities had exceeded assets by about \$300 million. As noted above, some repatriation occurred in September to meet tax-date liquidity pressures.

Since July the Bundesbank has been acting to make outflows of bank funds less profitable, without raising domestic interest rates. It has done this by intervening in the spot exchange market, pushing the dollar rate for the DM down to parity from the premium level that had prevailed throughout the first half of the year. The forward rate has remained at a premium. The cost of covering dollar investments, which had been negligible at the beginning of the year, has thus averaged about 1-1/2 per cent per annum during the third quarter.

While the decline in long-term rates has been more persistent this year in Germany than elsewhere, 6 per cent public authority bonds are still yielding over 6-1/2 per cent. Demand for long-term funds on the part of public authorities has been heavy, though their access to the market is still strictly regulated. In a notable change of policy, the Bundesbank began purchasing long-term Federal government and agency bonds for its own account in September.

In France, a moderate decline in short-term rates continued until mid-September, reflecting action by the authorities to keep the banking system liquid -- primarily through a gradual and complicated reduction in liquid asset reserve requirements -- and reflecting also weak private loan demand in the third quarter. Industrial production in July and August was unchanged from June, at about the same level as at the beginning of the year.

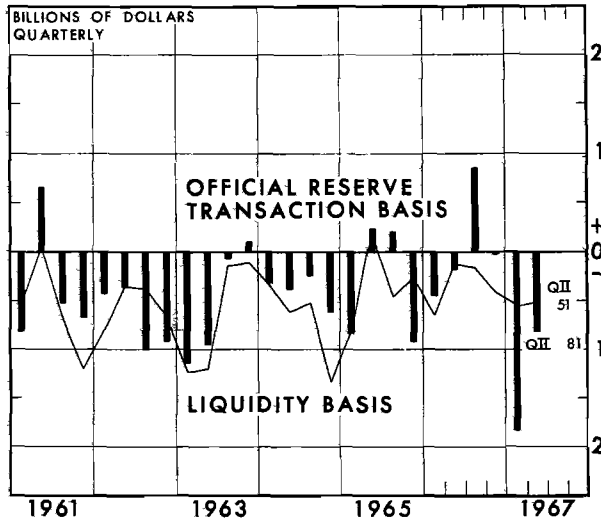
The Treasury has been a heavy borrower of short-term funds as a result of the Government's widened budget deficit. New procedures require the Treasury to enter the money market on a larger scale than formerly; previously the banks had to buy considerable amounts of Treasury paper to meet their reserve requirements.

Rates in the 30-day money market are influenced by Bank of France intervention. It has become clear that an important consideration in this intervention is to keep French rates in line with Euro-dollar rates, to minimize both outflows and inflows of liquid funds.

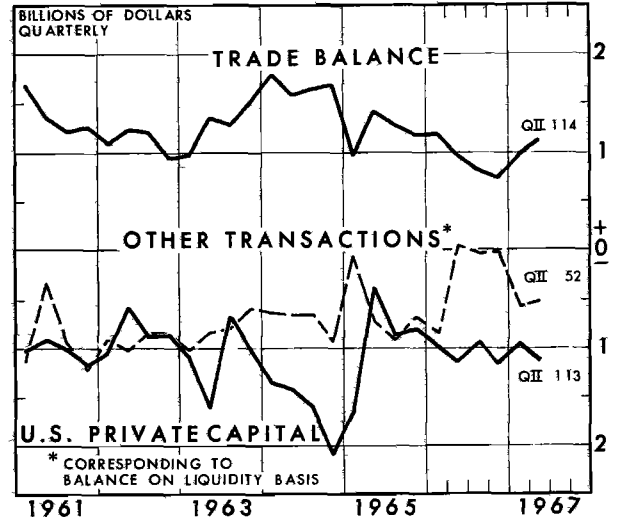
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

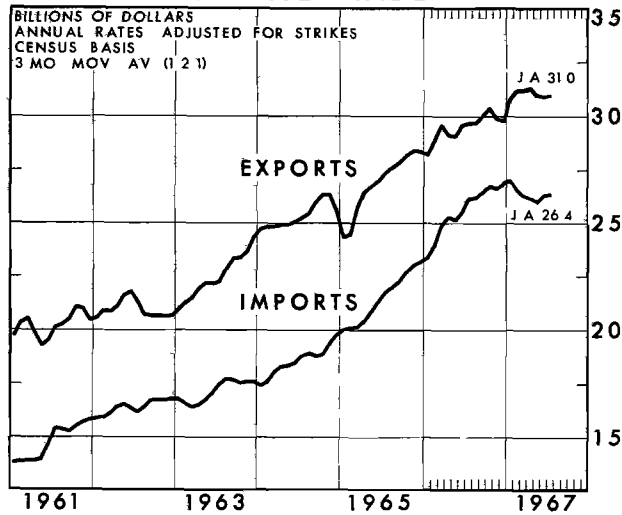
U.S. BALANCE OF PAYMENTS



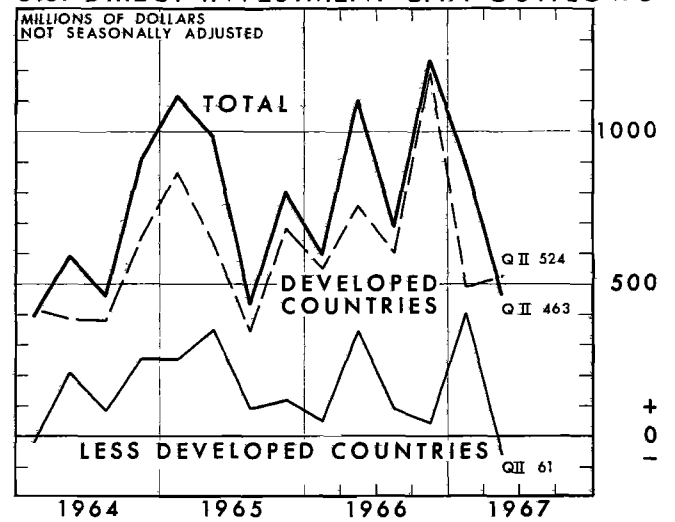
U.S. BALANCE OF PAYMENTS - CONT.



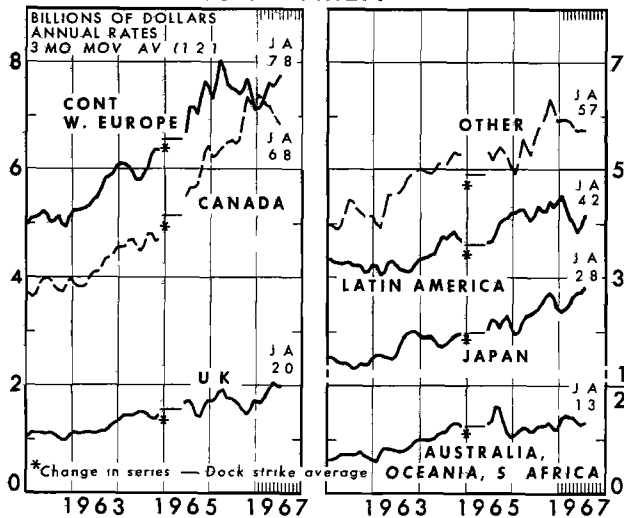
U.S. MERCHANDISE TRADE



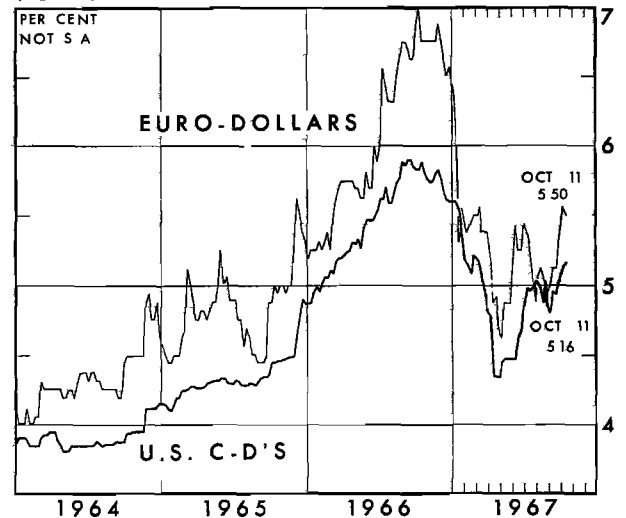
U.S. DIRECT INVESTMENT CAP. OUTFLOWS



U.S. EXPORTS BY AREA



90-DAY RATES



APPENDIX A: MATURITY STRUCTURE OF MUNICIPAL BOND PORTFOLIOS OF MEMBER BANKS*

On the June 30, 1967 Call Report of Condition, a special schedule was added to obtain more detailed information regarding the maturity structure of municipal security holdings of member banks, the first such survey since June 30, 1956. For the first time information was also obtained on positions in such securities held by member banks as dealers or underwriters, rather than as part of the banks' investment portfolio. The results of this survey are shown in tables A-1 and A-2.

Among the State and local securities held by member banks almost one-third mature in over 10 years. Among classes of member banks, New York City banks have the longest maturities with almost one-half of their holdings maturing in over 10 years and almost one-third in over 20 years. Country banks have only about one-fourth of their portfolio maturing in over 10 years, with most of their holdings in the intermediate maturity range. The proportion of State and local securities held by member banks maturing in less than 1 year--about one-fifth--did not differ greatly across classes of banks, although the reserve city group had larger holdings of tax warrants, short-term notes, and bills than country banks, perhaps reflecting the greater reliance of States and political subdivisions on larger banks for short-term financing.

As can be seen in line 2 of tables A-1 and A-2, a little over \$1.4 billion or 3.6 per cent of total member bank portfolios of municipal securities were held as dealer and underwriter positions at mid-1967, with over 90 per cent of these held by reserve city banks.

Banks with dealer and underwriter positions in municipal securities are few in number--95 reserve city banks and 35 country banks--and are generally banks with deposits in excess of \$500 million (table A-3). About 40 per cent of the member banks acting as dealers and underwriters in municipals are located in the New York, Chicago, and San Francisco districts (table A-4). These three districts accounted for 60 per cent of total bank dealer positions in State and local obligations.

Trading positions accounted for 7.4 per cent of total municipals held by the 95 reserve city banks acting as dealers and underwriters, and 6.3 per cent of the total portfolios of municipals of the 35 country banks taking such positions. It appears probable that at times variations in trading positions--particularly at the larger banks--can account for a considerable proportion of the short-run variations in reported bank acquisitions of State and local banks.

* Prepared by A. Angela Lancaster, Research Assistant, Banking Section, Division of Research and Statistics.

Table A-1
 Obligations of States and Political Subdivisions
 Held by All Member Banks as of June 30, 1967
 (Billions of dollars)

	All member banks	Reserve City Banks			Country Banks
		New York	Chicago	Other	
TOTAL	39.1	5.5	1.4	15.2	16.9
Held as dealer or underwriter	1.4	0.4	0.1	0.8	0.1
Held for own investment account	37.7	5.1	1.4	14.4	16.8
Tax warrants, short-term notes, and bills with original maturities of 1 year or less	3.9	0.8	0.2	1.7	1.2
Other within 1 year	<u>3.2</u>	<u>0.3</u>	<u>0.1</u>	<u>1.3</u>	<u>1.5</u>
Total maturities within 1 year	7.1	1.1	0.3	3.0	2.7
All other (by maturity from date of call):					
After 1 but within 5 years	9.5	0.7	0.3	3.3	5.1
After 5 but within 10 years	9.2	0.6	0.3	3.3	5.0
After 10 but within 20 years	8.7	1.1	0.4	3.8	3.5
After 20 years	3.3	1.6	0.1	1.1	0.5
MEMO: Number of banks	6,108	12	11	166	5,919

Table A-2
Obligations of States and Political Subdivisions
Held by All Member Banks as of June 30, 1967.
(Percentage distribution)

	All member banks	Reserve City Banks			Country Banks
		New York	Chicago	Other	
Total	100.0	100.0	100.0	100.0	100.0
Held as dealer or underwriter	3.6	7.1	4.9	5.5	0.6
Held for own investment account	96.4	92.9	95.1	94.5	99.4
Tax warrants, short-term notes, and bills with original maturities of 1 year or less	10.0	14.2	15.6	10.9	7.2
Other within 1 year	<u>8.2</u>	<u>5.4</u>	<u>5.9</u>	<u>8.4</u>	<u>9.0</u>
Total maturities within 1 year	18.2	19.6	21.5	19.3	16.2
All other (by maturity from date of call):					
After 1 but within 5 years	24.2	12.7	21.7	21.7	30.4
After 5 but within 10 years	23.5	11.6	23.8	21.4	29.3
After 10 but within 20 years	22.2	19.5	24.4	24.9	20.5
After 20 years	8.4	29.4	3.7	7.2	3.0

Table A-3
Obligations of States and Political Subdivisions
Held as Dealers and Underwriters
By Member Banks as of June 30, 1967
By Bank Size

Size (total deposits)	Reserve			Reserve		
	City Banks	Country Banks	Total	City Banks	Country Banks	Total
	(Number of Banks)			(Millions of Dollars)		
Less than \$50 million	--	4	4	--	0.5	0.5
\$50 million to \$100 million	3	3	6	0.3	1.5	1.8
\$100 million to \$500 million	37	18	55	119.4	52.6	172.0
Over \$500 million	<u>55</u>	<u>10</u>	<u>65</u>	<u>1,184.5</u>	<u>52.4</u>	<u>1,236.9</u>
Total	95	35	130	1,304.2	107.1	1,411.3
	(Percentage distribution of member banks)			(Percentage distribution of dollar amount)		
Less than \$50 million	--	11.4	3.1	--	0.5	*
\$50 million to \$100 million	3.2	8.6	4.6	*	1.4	0.1
\$100 million to \$500 million	38.9	51.4	42.3	9.2	49.1	12.2
Over \$500 million	<u>57.9</u>	<u>28.6</u>	<u>50.0</u>	<u>90.8</u>	<u>48.9</u>	<u>87.6</u>
Total	100.0	100.0	100.0	100.0	100.0	100.0

* - less than 0.1 per cent.

Table A-4
 Obligations of State and Political Subdivisions
 Held as Dealers and Underwriters
 By Member Banks as of June 30, 1967
 By District

District	Banks		Holdings	
	Number	Percentage Distribution	Millions of Dollars	Percentage Distribution
Boston	7	5.4	162.1	11.5
New York	18	13.8	439.6	31.1
Philadelphia	3	2.3	18.8	1.3
Cleveland	7	5.4	120.9	8.6
Richmond	8	6.2	32.9	2.3
Atlanta	13	10.0	32.7	2.3
Chicago	17	13.1	114.0	8.1
St. Louis	9	6.9	51.2	3.6
Minneapolis	6	4.6	50.8	3.6
Kansas City	11	8.5	29.5	2.1
Dallas	13	10.0	62.4	4.4
San Francisco	<u>18</u>	<u>13.8</u>	<u>296.5</u>	<u>21.0</u>
TOTAL	130	100.0	1,411.3	100.0

APPENDIX B: REVISION IN SEASONALLY ADJUSTED LOAN COMPONENTS*

Supplementing the revised seasonally adjusted series for money supply, bank deposits, the credit proxy, and the major bank credit components for all commercial banks--reported in recent Greenbooks--revisions of seasonal factors have now been completed for the components of total loans for all commercial banks.

This revision reflects changes in seasonal factors for recent years, including special adjustments in some series to take account of fluctuations in loans associated with variations in the last-Wednesday reporting date from year to year. An attempt has been made also to reconcile the seasonally adjusted movements in the sum of the individual loan components with changes in total loans adjusted.

As indicated by the comparisons of the monthly changes in the old and revised seasonally adjusted loan components provided for 1966-67 in charts B-1 and B-4, the most important revisions were in the series for business loans, security loans, and nonbank financial loans. Revisions in these three series, are most closely related to the changing pattern of tax payments, as explained below. In addition, these three series are affected more than other loan components by the date on which the last-Wednesday reporting date falls. Consequently, last-Wednesday adjustments have been made in business, security, and nonbank financial loans based on analysis of fluctuations in weekly reporting bank data for these categories. In most cases, last-Wednesday adjustments reduce the seasonally adjusted level of bank loans most when the reporting date falls on the last day of the month, although there is considerable variation in these adjustments for different series and different months. Last-Wednesday adjustments for security loans appear to be due largely to the one-year and nine-month Treasury bill auctions, which normally occur on the last day of the month. Consequently, Wednesday adjustments for security loans are applicable for most months only when the Wednesday date falls on the last day of the month. Similarly, the largest Wednesday adjustments for nonbank financial loans and for business loans are applied when Wednesday falls on the last day of the month but variable adjustments are applied for Wednesday dates in some months reflecting intramonthly movements at the end of the month.

* Prepared by Edward R. Fry, Angela Lancaster, and Mary F. Weaver, Banking Section, Division of Research and Statistics.

Federal Finance and Banking Data

The Revenue Act of 1964 and the Tax Adjustment Act of 1966 considerably changed the pattern of Federal tax receipts by accelerating the payments of withheld and income taxes by corporations. The resultant shift in payment dates has had a pervasive effect on banking data, influencing the pattern of business loan demands, the timing of Treasury financings, and the pattern of Government, private demand, and time deposits. Indeed, the seasonal pattern of most components of bank portfolios has been influenced to one degree or another.

The most important shifts in tax payment schedules were completed in June 1967, although withholding tax remittances by corporations will continue shifting through next February and pending tax legislation provides for further modest acceleration of corporation income tax payments in the future. The effects of tax shifts on banking data have been most noticeable over the past two years. While tax payment patterns were in transition during the entire period, fluctuations in many banking series around the tax dates have shown enough regularity since 1965 to indicate that large shifts in seasonal factors are occurring. The separation of seasonal from other influences in this period, however, is a complicated matter owing to the fact that such factors as abnormalities in corporate liquidity, changes in availability of tax bills, and the relative attractiveness of CD's and other liquid assets all affect the reliance of businesses on bank loans for meeting tax payments. These complexities, as well as the limited number of observations, make it impossible to eliminate all of the new seasonal "noise" that began to appear in banking data in 1966.

This can best be illustrated in the business loan component of bank credit. The solid line of the upper panel of chart B-1 shows the estimated amount by which total corporate tax payments in 1966-67 differed from the payments that would have occurred without acceleration. The dashed line shows the old seasonally adjusted month-to-month change in business loans. It is clear, that the new tax payment pattern has been a dominant influence in the movement of business loans on that basis. The lower panel of this chart repeats the old seasonally adjusted business loan pattern and adds the revised seasonally adjusted series. As can be seen from this panel, the revised series has smoothed the fluctuation in the old seasonal pattern, but the influence of the new tax schedule still remains.

Charts B-2, B-3, and B-4 display the old and new seasonally adjusted series for other components of bank credit, and suggest that the revised seasonal factors have also removed only a part of the effect of the new payments schedule from the banking data. Other securities and consumer and real estate loans have evidently been affected least by the new tax payment schedule since their new profile differs little from the old one. Aside from business loans, security and nonbank finance company loans, and acquisitions of Treasury securities have been affected most.

As more experience is gained with the effects of the new seasonal influences, further revisions of seasonal adjustment factors will be made. However, it goes without saying that continued care will be required in interpreting banking data whenever the underlying seasonal factors are changing as rapidly as at present.

Revised seasonally adjusted data are shown for six loan components in the accompanying table, covering the period from 1965- to date. Revised data from 1959-64 will be made available in the October "L.4.3--Banking and Monetary Developments."

LOANS AT COMMERCIAL BANKS
Revised seasonally adjusted in billions of dollars

Period	Business	Real Estate	Security	Agricultural	Consumer	Nonbank
1965--Jan. 27	59.5	43.9	7.5	7.7	31.4	10.2
Feb. 24	60.7	44.4	7.7	7.8	31.7	10.3
Mar. 31	61.8	44.9	7.8	7.8	32.1	10.2
Apr. 28	62.7	45.3	7.8	7.9	32.6	10.5
May 26	63.6	45.7	7.9	7.9	33.0	10.8
June 30	64.4	46.2	7.8	8.0	33.4	10.8
July 28	65.3	46.6	7.2	8.1	33.8	11.1
Aug. 25	66.2	47.2	7.3	8.1	34.2	11.2
Sept. 29	66.9	47.7	7.2	8.1	34.6	11.4
Oct. 27	67.6	48.2	7.4	8.2	35.1	11.6
Nov. 24	68.4	48.7	7.4	8.2	35.4	11.8
Dec. 31	69.4	49.2	7.4	8.3	35.7	11.9
1966--Jan. 26	70.3	49.8	7.3	8.4	36.1	12.1
Feb. 23	71.3	50.3	7.3	8.5	36.4	12.3
Mar. 30	72.2	50.7	7.0	8.6	36.8	12.5
Apr. 27	73.0	51.1	7.4	8.5	37.1	12.6
May 25	74.1	51.4	7.4	8.6	37.3	12.5
June 30	75.7	51.9	7.5	*8.4	37.5	13.0
July 27	77.1	52.2	7.5	8.5	37.7	12.7
Aug. 31	77.7	52.6	7.4	8.7	38.0	12.1
Sept. 28	78.1	52.9	7.4	8.7	38.2	12.1
Oct. 26	78.6	53.3	7.4	8.7	38.4	12.3
Nov. 30	78.6	53.5	7.3	8.7	38.7	12.2
Dec. 31	78.6	53.8	7.9	8.7	38.8	12.1
1967--Jan. 25	79.5	54.2	8.4	8.7	39.0	12.2
Feb. 22	80.1	54.4	8.3	8.7	39.1	11.9
Mar. 29	80.6	54.6	8.3	8.9	39.2	11.5
Apr. 26	81.4	54.8	8.1	9.0	39.4	11.8
May 31	81.8	55.1	7.9	9.1	39.4	11.8
June 30	82.2	55.4	7.0	9.3	39.6	11.7
July 26	82.9	55.7	8.7	9.4	39.8	11.5
Aug. 30	83.0	56.1	9.0	9.5	40.0	11.4
Sept. 27	83.2	56.4	9.4	9.5	40.2	11.7

* - Beginning June 30, about \$0.2 million participation certificates previously included in agricultural loans are reclassified as "other securities."

NOTE: Revised seasonally adjusted data beginning 1959 will be made available in the next L.4.3 "Banking and Monetary Developments."

B--C-1

Chart B-1

Estimated Month-to-Month Changes in Total Corporate Tax Payments
Due to Acceleration and Seasonally Adjusted Changes in Business Loans
1966-1967

Billions of dollars

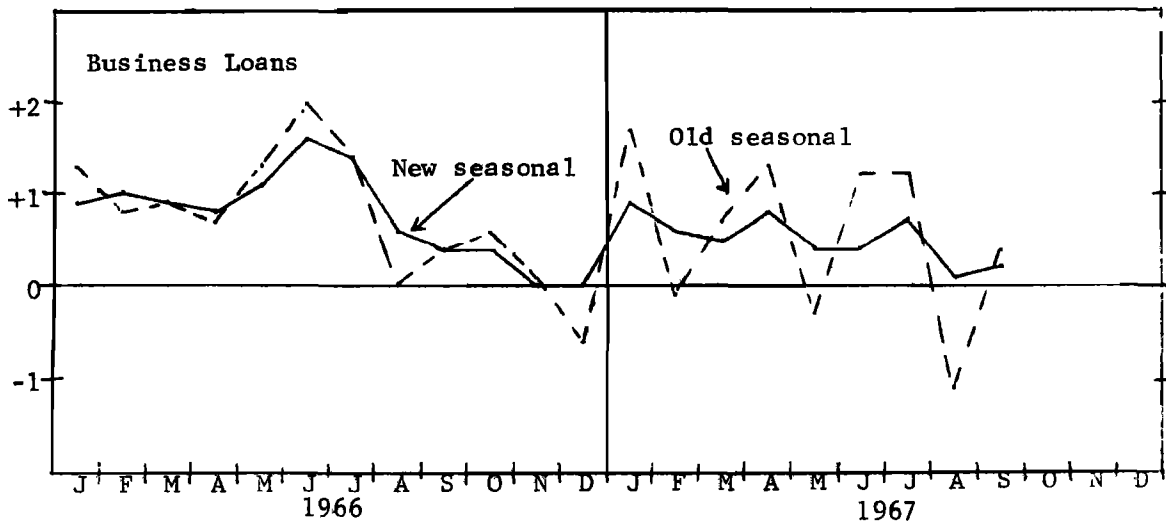
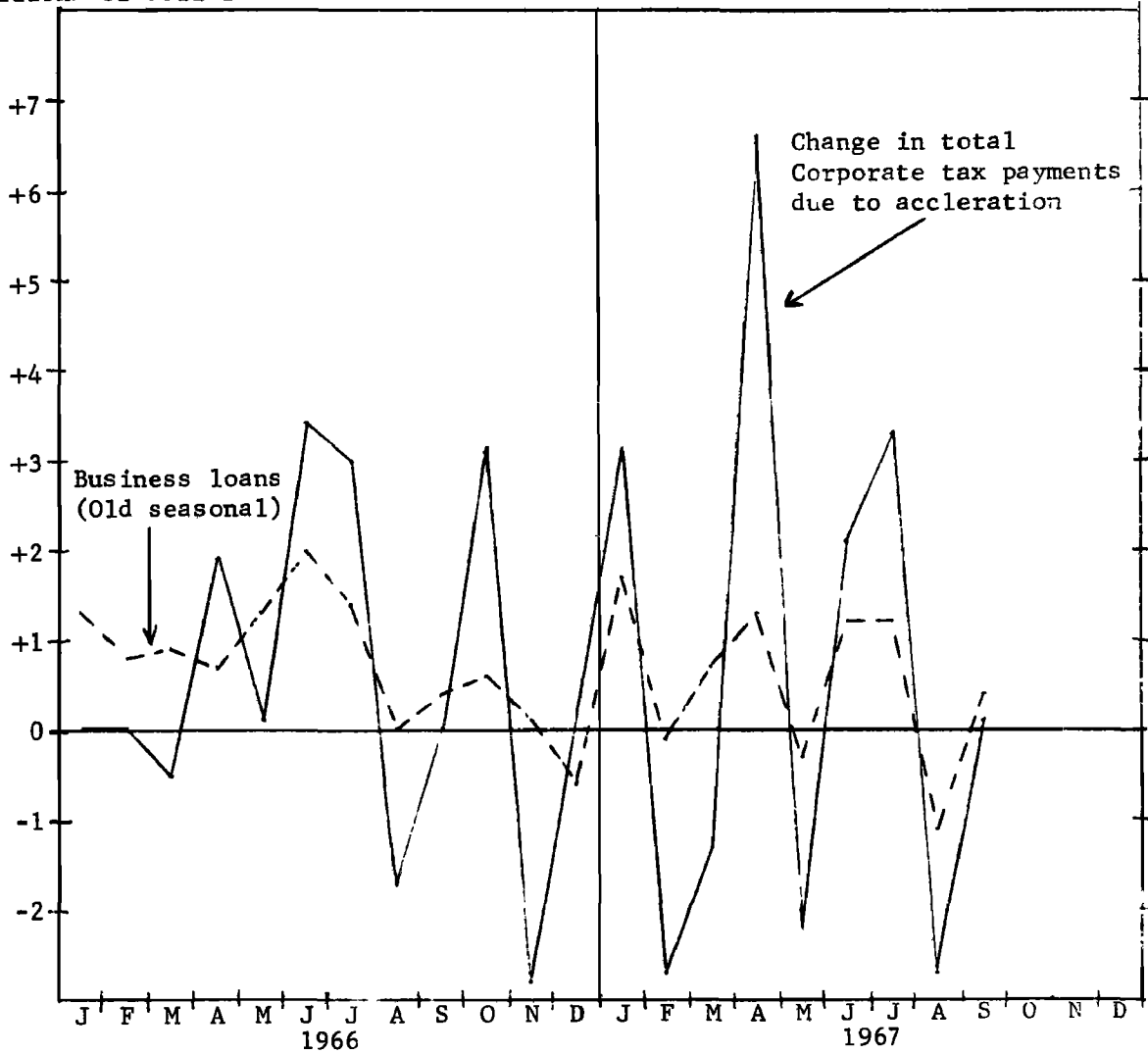


Chart B-2
Month-to-Month Changes in Total
Loans and Investments

1966-67

Billions of dollars

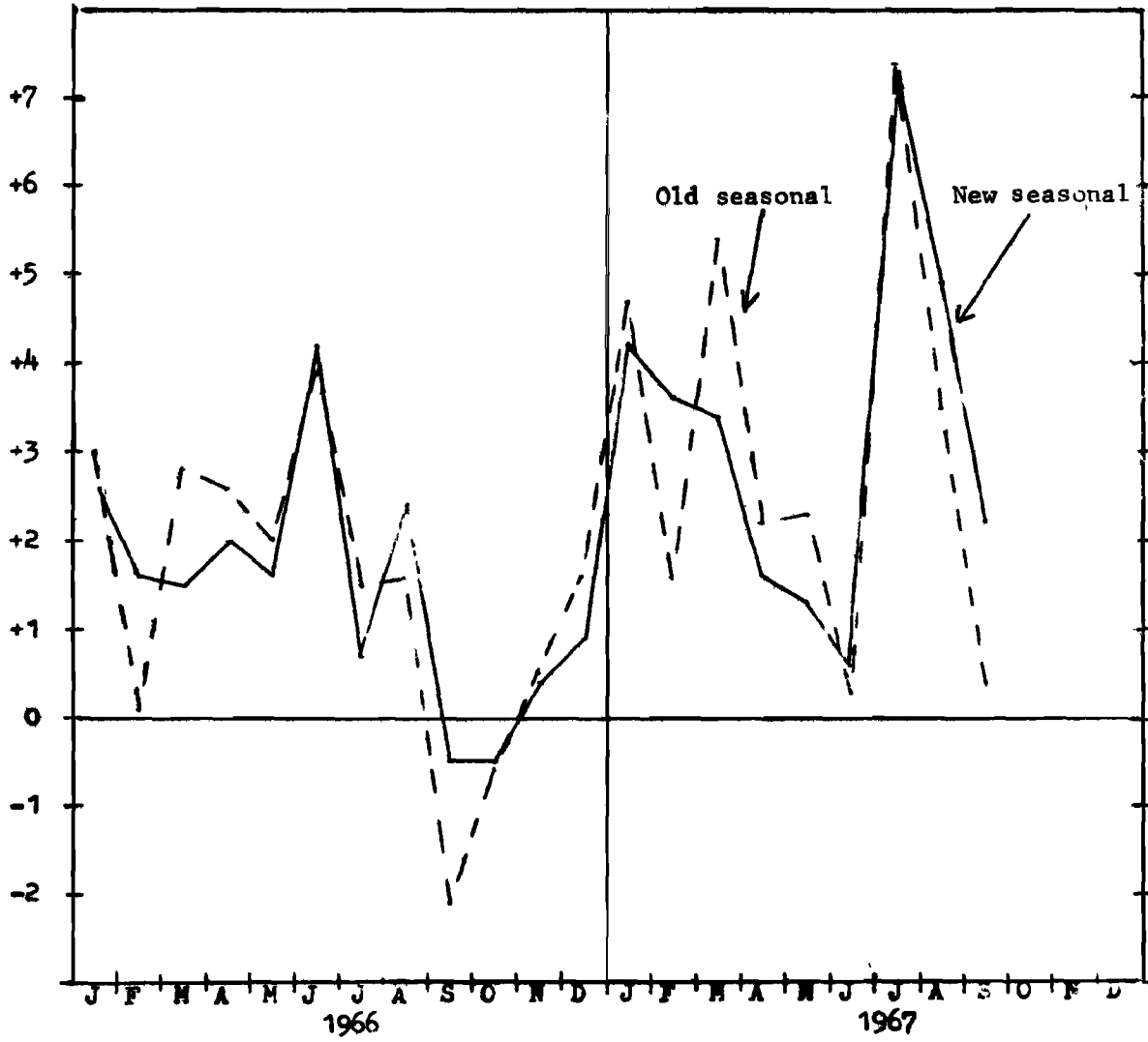
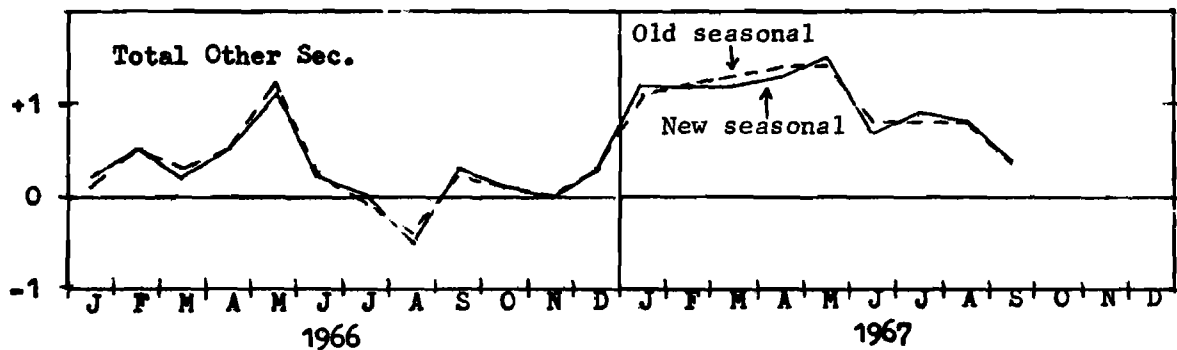
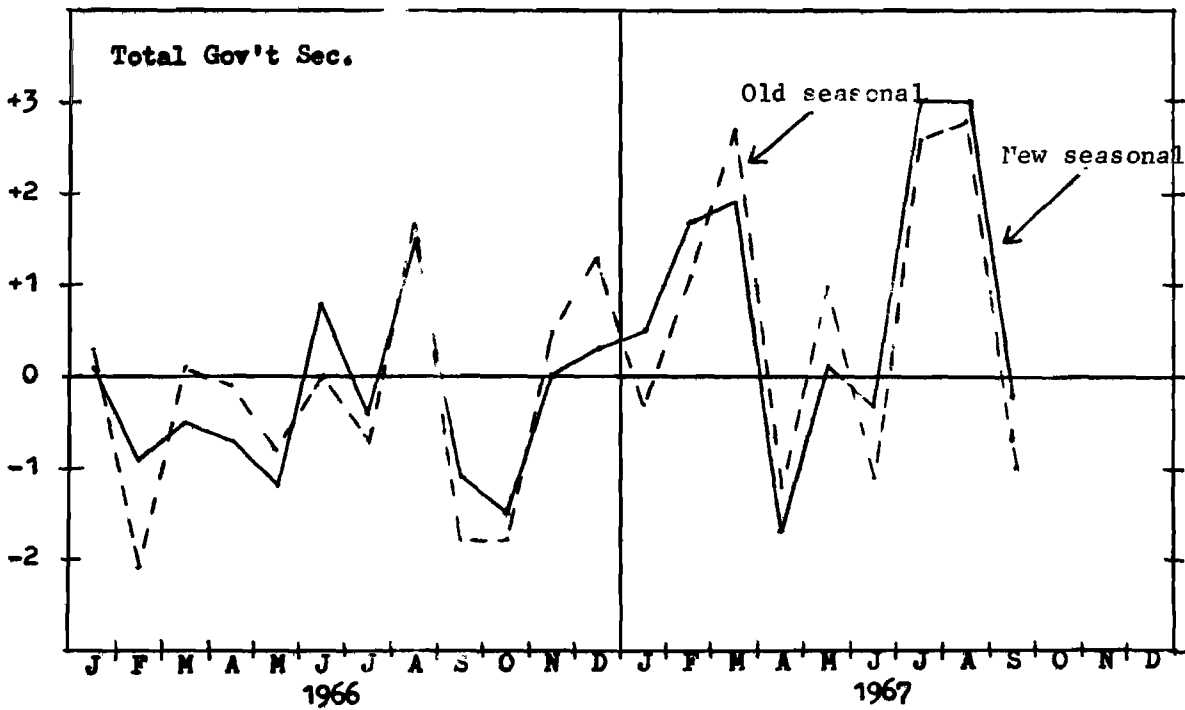
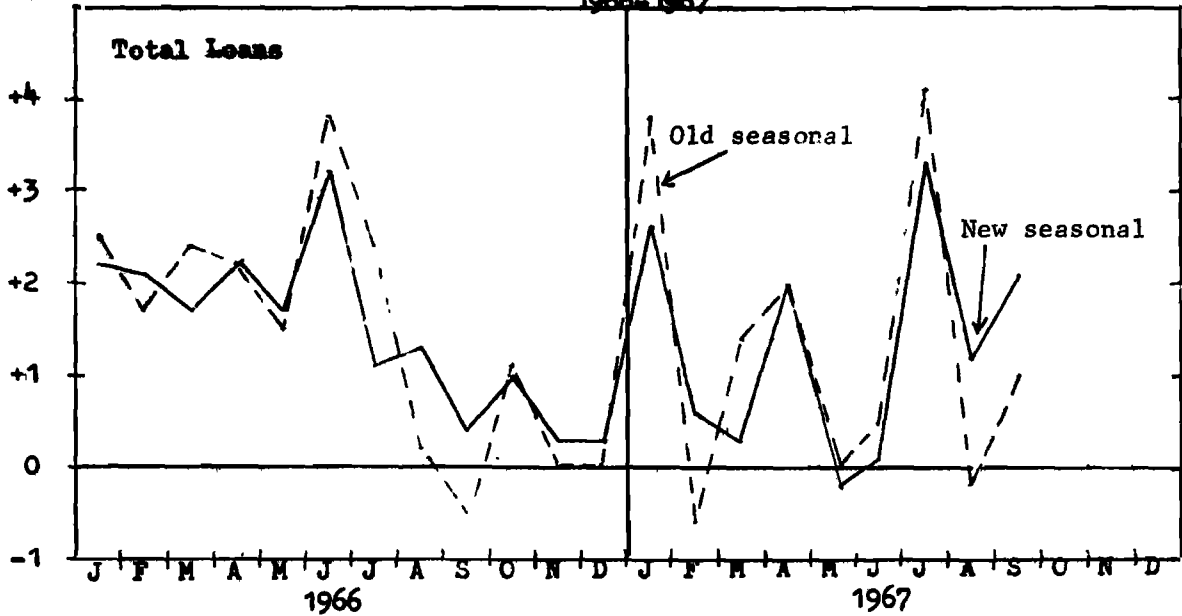


Chart B-3
Month-to-Month Changes in
Major Bank Credit Components
1966-1967

Billions of dollars



B--C-4
 Chart B-4
 Month-to-Month Changes in
 Selected Loan Components
 1966-1967

Billions of dollars

