Prefatory Note

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

Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

---

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

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

Content last modified 6/05/2009.

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

December 6, 1967

CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

December 6, 1967

SUMMARY AND OUTLOOK

Outlook for economic activity

The firmer tone reflected in the newly available statistics on recent developments and the increased buoyancy reported for prospective plant and equipment expenditures point to more rapid expansion in GNP in the first quarter--assuming no tax increase effective in this period. New orders for durable goods were revised up for October and now show a very small decline from September; the production index turned up in November and unemployment is likely to show a decline; and housing starts recently have shown further strength.

In part, the recent quickening in activity reflects recovery in automobile production following the Ford and Chrysler settlements. It now seems likely that with more time allowed for bargaining at General Motors, plant shutdowns in January may be relatively minor. Business inventory investment is expected to accelerate in the first quarter, as auto inventories are rebuilt and an increased volume of steel is set aside in anticipation of a possible strike in the summer. With plans for business fixed investment now indicated to be substantially higher than reported in earlier private surveys, prospects are for all major private sectors of the economy to show strength in coming months.

Government purchases appear to be the only major category likely to be slowing in early 1968. According to recent Administration testimony, both Federal defense and nondefense expenditures should rise more slowly in the first half of next year than in recent months, and increases in State and local government outlays also may slow as grants-in-aid are reduced or deferred.

Overall, GNP is likely to increase about $20 billion in the first quarter and possibly an even larger amount in the second quarter, when higher social security benefits are expected to be added to the income stream. Prices are expected to remain under upward pressure.

Outlook for prices and resource use

Persistence of upward momentum in prices of industrial commodities has been affirmed by the official estimate of a further increase from mid-October to mid-November, and by resumption in recent weeks of more numerous announcements of price increases--including prices of steel sheets. Over the past 4 months, industrial commodities increased at an annual rate of 2.8 per cent and a continuing rise of about this order appears likely. At retail, prices of non-food commodities have been increasing at a considerably faster rate but some slowing to near a 3 per cent rate appears likely, in part because of the special nature of some of the recent advances in prices of apparel and autos. With food prices tending to stabilize, the CPI may be expected to continue to rise at about the 3 per cent rate of the early autumn.

Sizable increases in industrial prices in recent months have occurred in a context of rising costs but moderate consumer and business demands. In the period ahead, however, demand pull may become a more important contributor to further advances in prices. Because of the expected recovery in auto output, prospects for inventory building by steel consuming industries, and major additions to consumer income from existing and pending legislation, we appear to be moving into a period of strongly increased demands.

Manufacturing capacity is projected to remain relatively ample, over-all despite the expected spurt in output. Expansion in the labor force is expected to result in the unemployment rate remaining close to 4 per cent. Many types of skilled labor, however, are already in short supply. Mcre rapid increases in output per manhour and some lengthening of the work week are likely to add to effective manpower resources as over-all demands increase further, and to moderate the rise in unit labor costs.

Outlook for Banking

Given the current level and structure of interest rates, time and savings deposit inflows will probably decelerate over the winter months. Longer-term CD's are already non-competitive with other market instruments, and any further upward pressure on money market rates will tend to limit the sale of shorter-term CD's. And inflows of consumer-type time deposits will likely slow further, as consumer shifts to market instruments increase, particularly around the end-of-year interest crediting period.

Private demand deposit balances will probably continue to expand as transactions demands rise, but the pull of high interest rates may tend to moderate this expansion to a pace below the unusually rapid growth of 1967. Moreover, the Federal Government's cash and debt management policies will not be contributing to growth in private deposits and the money stock, since the Government's cash balance is not expected to decrease from the relatively low December average, and may rise.

With the supply of funds to banks constrained, and with inventory investment rising and accelerated economic growth contributing to a loan expansion more rapid than in late summer and early fall, banks are likely to reduce acquisitions of municipals and real estate loans. Treasury financings over the first quarter will contribute to some further expansion in Government security holdings and security loans of banks as they help in the underwriting of the new issues.

With their fund inflows diminished and loan demands strengthening, bank portfolio adjustments may exert upward pressure on market interest rates, particularly municipal yields. While banks have accumulated considerable portfolio liquidity over the past year, the combination of increased loan demands and slower deposit growth could result in reductions in their liquid asset holdings rather quickly. Moreover, Euro-dollar funds are likely to become less readily available than in recent months, in view of the rise in interest rates in the United Kingdom and as confidence in the pound is restored.

Outlook for capital markets and nonbank intermediaries

In corporate and municipal markets the heavy current volume of new offerings will taper off seasonally after mid-December, and thus far new offerings scheduled for January are quite moderate. However, substantial further additions to the January calendar could develop, since a number of recent postponements--notably the U.S. Steel offering--have not yet been rescheduled, and rumors of tentative plans by other sizable borrowers persist. Moreover, while institutional funds available for investment in long-term debt often show some seasonal expansion in January, a number of such institutions have reportedly already committed a part of their expected January flows for delayed take-down of bonds sold earlier in the fall. And, as noted above, banks are not likely to be a positive factor in capital markets. Thus the odds would seem to favor some upward drift in bond yields over the next few months. Even so the chances of a levelling off in interest rates over the weeks immediately ahead, cannot be ruled out, and a rally could develop particularly if prospects for tax action should turn more favorable.

Mortgage rates are likely to rise further. Because recent advances in bond yields have narrowed the spread with mortgage rates to one of the smallest margins since World War II, diversified institutional lenders have greatly reduced their loan commitments for home financing and are increasing the share of total funds being allocated to corporate bonds. With the home financing market thus relying for new money largely on the savings and loan industry and the FNMA, the likelihood of further shrinkage in S&L growth during January takes on added significance. Net flows to the savings and loan industry already showed signs of shrinking in October. Since short-term interest rates have recently advanced further, another substantial shrinkage in flows to S&L's can probably be expected during January, when shareholders at associations with semi-annual as well as quarterly interest accrual periods will be free to shift to higher yielding investment alternatives without loss of accrued interest.

International developments

Gold and foreign exchange markets have calmed down considerably following the hectic post-devaluation week. But there has been no further substantial reflow of funds into sterling, and this week demand for sterling weakened sharply as a result of renewed labor difficulties in Britain. The U.K. Government has obtained approval of the requested $1.4 billion standby arrangement from the IMF, after tentatively agreeing to reduce Government borrowing and money supply growth in 1968 and to consult periodically with the Fund about the possible need for additional measures of domestic restraint.

The U.S. balance of payments deficit has increased further during the current quarter. Part of the increase is attributable to a large shift of U. K. official holdings out of U.S. Government agency securities into more liquid U.S. assets. But even apart from that shift, there appears to have been renewed deterioration. It now seems likely that unless large special transactions can be arranged at year-end, the published liquidity deficit will exceed $3 billion for the year; the deficit apart from special transactions will probably exceed $4 billion. The balance of the official reserve transactions basis has reverted to deficit, partly because of the U.K. conversions; this deficit also seems likely to be on the order of $3 billion for the year. The prospect is for a continuation of large deficits in coming months.

The merchandise trade surplus diminished sharply in October because of an unexpected drop in exports, partly as a result of strikes and other special circumstances. For the July-October period, the trade surplus was at an annual rate of $3.8 billion, down from a $4.3 billion rate in the first half year and about equal to the low 1966 rate. The decline from the first half of 1967 was the result of a drop in exports while imports held steady. Both agricultural and nonagricultural exports in July-October were about 3 per cent lower than in the first half, the latter despite the beginning of renewed expansion in economic activity in Europe and Canada.

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.)	Oct'67	78.0	77.8	76.1	2.5	4.4
Unemployment (mil.)	"	3.4	3.2	2.9	16.8	5.3
Unemployment (per cent)	"	4.3	4.1	3.8	--	--
Nonfarm employment, payroll (mil.)	"	66.2	66.0	64.7	2.3	7.5
Manufacturing	"	19.2	19.2	19.4	- 1.3	4.7
Other industrial	"	8.1	8.1	8.1	0.3	2.1
Nonindustrial	"	38.9	38.8	37.2	4.6	10.2
Industrial production (57-59=100)	"	156.2	156.7	159.4	- 2.0	7.4
Final products	"	156.3	156.8	158.7	- 1.5	7.3
Materials	"	156.6	157.0	159.7	- 1.9	7.8
Wholesale prices (57-59=100) 1/	"	106.1	106.2	106.2	- 0.1	2.9
Industrial commodities (FR)	"	105.9	105.6	104.6	1.2	3.3
Sensitive materials (FR)	"	101.1	101.1	102.6	- 1.5	- 1.8
Farm products, foods & feeds	"	104.1	105.3	108.8	- 4.3	0.5
Consumer prices (57-59=100) 1/	"	117.5	117.1	114.5	2.6	6.4
Commodities except food	"	110.6	110.0	107.6	2.8	5.0
Food	"	115.7	115.9	115.6	0.1	5.5
Services	"	129.1	128.7	124.1	4.0	8.8
Hourly earnings, mfg. ($)	"	2.86	2.85	2.76	3.6	7.9
Weekly earnings, mfg. ($)	"	116.40	116.69	113.96	2.1	6.4
Personal income ($ bil.) 2/	"	636.0	634.4	597.5	6.4	15.5
Corporate profits before tax ($ bil.) 2/	QIII'67	80.1	78.9	84.0	- 4.6	5.7
Retail sales, total ($ bil.)	Oct'67	26.2	26.8	25.6	2.4	7.5
Autos (million units) 2/	"	7.0	8.1	8.0	-12.5	-15.8
GAF ($ bil.)	"	6.4	6.5	6.1	4.5	13.7
Selected leading indicators:						
Housing starts, pvt. (thous.) 2/	"	1,496	1,429	845	77.0	2.0
Factory workweek (hours)	"	40.7	40.8	41.3	- 1.5	- 1.2
New orders, dur. goods ($ bil.)	"	23.4	23.4	24.2	- 3.7	4.2
New orders, nonel. mach. ($ bil.)	"	3.6	3.7	3.6	- 2.1	6.6
Common stock prices (1941-43=10)	Nov'67	92.66	95.66	80.99	14.4	0.6
Manufacturers' Inventories, book val. ($ bil.)	Oct'67	81.5	81.2	75.8	7.6	22.4
Gross national product ($ bil.) 2/	QIII'67	791.2	775.1	748.8	5.7	14.7
Real GNP ($ bil., 1958 prices) 2/	"	672.0	664.7	654.8	2.6	8.3

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Dec. 1, 1967	4-week average	Last 6 months High	Last 6 months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.48	4.17	4.70	3.45
U.S. Treas. bills, 3-mo., yield (per cent)	4.92	4.76	4.92	3.41
U.S. Treas. bills, 1-yr., yield (per cent)	5.57	5.41	5.57	3.84
Net free reserves 2/ ($ millions)	204	215	574	90
Member bank borrowings 2/ ($ millions)	119	135	353	43
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds 1/	5.74	5.78	5.84	4.44
20-year U.S. Treas. bonds 1/	5.63	5.68	5.73	4.57
Corporate new bond issues, Aaa 1/	6.51	6.49	6.59	5.72
Corporate seasoned bonds, Aaa 1/	6.13	6.08	6.13	5.36
Municipal seasoned bonds, Aaa 1/	4.03	4.00	4.03	3.75
FHA home mortgages, 30-year 3/	--	6.65	6.65	6.29
Common stocks, S&P composite series 4/				
Prices, closing (1941-43=10)	94.50	93.36	97.26	88.43
Dividend yield (per cent)	3.12	3.16	3.25	3.01

	Latest month	Amount	3-month average	Change from year earlier Latest month	Change from year earlier 3-month average
New Security Issues (N.S.A., $ millions)					
Corporate public offerings 5/	Nov. '67	1 400	1,774	315	1,098
State & local govt. public offerings	Nov. '67	1,200	3,400	231	656
Comm. & fin. co. paper (net change in outstandings) 6/	Oct. '67	+557	-89	-710	-376

	Latest month	Out-standings Latest month	Change Latest month	Change 3-month average	Annual rate of change from Pre-ceding month	Annual rate of change from 3 months ago	Annual rate of change from 12 months ago
Banking (S.A.)		($ billions)			(per cent)		
Total reserves 1/	Nov. '67	24.74	0.13	0.21	6.3	10.6	10.3
Credit proxy 1/	Nov. '67	272.9	1.8	2.3	8.4	10.2	11.8
Bank credit, total 6/	Oct. '67	342.6	3.1	3.4	11.0	12.3	10.9
Business loans	"	84.3	0.2	0.2	2.9	3.3	7.3
Other loans	"	137.5	1.4	1.3	12.3	12.0	7.0
U.S. Govt. sec.	"	62.3	0.7	1.2	13.6	23.8	16.7
Other securities	"	58.6	0.9	0.7	18.7	14.9	21.1
Total liquid assets 1/ 6/	Oct. '67	643.9	4.9	5.0	9.2	9.6	7.1
Demand dep. & currency 1/	Nov. '67	181.3	1.1	0.7	7.3	4.9	6.6
Time & sav. dep., comm. banks 1/	Nov. '67	182.5	1.7	1.8	11.2	12.0	15.9
Savings, other thrift instit. 6/	Oct. '67	182.5	1.2	1.4	7.9	9.4	9.4
Other 6/ 7/	"	100.4	0.8	0.8	9.6	9.8	-5.8

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 Nov. 29 3/ Latest figure is for Oct. 4/ End of week closing prices; yields are for Friday. 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)

	1966		1 9 6 7				
	QIII	QIV	QI	QII	QIII	Sept.	Oct.
			Seasonally adjusted				
Goods and services, net 1/	1,151	1,084	1,364	1,315	n.a.		
Trade balance 2/	802	722	1,014	1,151	1,126	337	137
Exports 2/	7,382	7,402	7,676	7,708	7,670	2,545*	2,346
Imports 2/	-6,580	-6,680	-6,662	-6,557	-6,544	-2,208	-2,209
Services balance	349	362	350	164	n.a.		
Remittances and pensions	-278	-246	-264	-390			
Govt. grants & capital 3/	-759	-724	-1,205	-931			
U.S. private capital	-932	-1,165	-958	-1,130			
Direct investments	-900	-1,003	-622	-684			
Foreign securities	-50	-83	-263	-171	-433		
Banking claims	89	44	62	-176	-398		
Other	-71	-123	-135	-99			
Foreign capital, nonliquid	376	780	824	1,215			
Official foreign accts.	172	425	397	759			
Long-term deposits	88	373	309	605	-229		
U.S. Govt. liab.	84	52	88	154			
Int'l. institutions 4/	38	15	64	95			
Other 5/	166	340	363	361			
Errors and omissions	277	-148	-234	-576			
Balances, with and without seasonal adjustment (- deficit)							
Liquidity balance, S.A.	-165	-419	-530	-550	-670		
Seasonal component	-530	-47	289	326	-538		
Balance, N.S.A.	-695	-466	-241	-224	-1,208	-338	-1,021
Official settlements bal.	861	-18	-1,813	-830	462		
Seasonal component	-456	-180	531	139	-460		
Balance, N.S.A. 6/	405	-198	-1,282	-691	2		
Reserve changes, N.S.A. (decrease -)							
Total monetary reserves	-82	6	-1,027	419	375	44	278
Gold stock	-173	-121	-51	-15	-92	2	-38
Convertible currencies	426	173	-1,007	424	462	38	309
IMF gold tranche	-335	-46	31	10	5	4	7

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.
*/ Data have been adjusted by $50 million, raising August and lowering September.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. The GNP outlook continues to be affected to an important extent by questions concerning fiscal restraint. In addition, there are uncertainties concerning the effective date of the Federal pay raise, the duration and severity of a possible strike at GM, and the initial date and amount of increase in Social Security benefits. We have assumed that the proposed surtax will not become effective in the first quarter but that restraint on Federal spending is moderating substantially the rise in Federal outlays, We have also assumed that the Federal pay raise will be enacted shortly and be retroactive to October 1. The increase in Social Security benefits, on the other hand, is assumed not to take place until April. We have also assumed that there will be no strike on national issues at GM but that a number of plant stoppages will occur in January; the loss in the first quarter because of strikes, however, is likely to be much smaller than in the third and fourth quarters of this year.

Under these assumptions, economic expansion should continue to strengthen in the present quarter and be followed by an even larger increase in the first quarter of next year. GNP in current dollars is estimated to rise at an annual rate of nearly $20 billion in the first quarter to a level of close to $828 billion. This compares with an anticipated increase of almost $17 billion in the current quarter. The annual rate of growth in real GNP in the January-March period would be 6 per cent, up from just under 5 per cent in the fourth quarter. The rise in the GNP deflator of about 3.7 per cent, annual rate, in the fourth quarter would be somewhat lower in the first quarter because the Federal pay raise would not contribute to an increase in the deflator; but the private GNP deflator is projected to rise somewhat more rapidly.

Our fourth quarter GNP projection is not substantially different from that included in the last full Greenbook--dated November 8--but the composition of the rise is different in several respects. It now seems that there will be more inventory accumulation in the current quarter than we anticipated earlier, partly because a strike deadline at GM has been postponed until after the first of the year. In addition, a somewhat larger increase in expenditures on new plant and equipment now seems likely while consumer expenditures, net exports, and Government purchases are expected to be lower than estimated earlier.

Projected defense outlays for fiscal 1968 are now being cut back by substantial amounts. Until very recently it had been assumed that defense outlays would top the Budget estimated by from $2 to $4 billion, but the expectation now is that NIA expenditures, which reflect actual deliveries of goods, will be close to the January Budget. Thus, we have reduced our fourth quarter estimate of defense outlays below our previous projections by almost $1 billion, annual rate, to $75.0 billion, and the first quarter rise is now estimated at only $500 million.

However, as with many Budget adjustments, the effect on GNP may be less than indicated since in many instances deliveries of goods may be merely deferred. Some part of defense expenditure cuts may therefore be reflected in private inventories in the first half of 1968.

Production of autos is rising following the settlements at Ford and other producers continue at close to full production. The possibility of an early settlement in the steel industry has lessened and steel inventory building is under way and reflected in higher orders and output. The upward revision in durable goods orders in October suggests more strength in business demand than had been evident earlier. Further, the failure to enact the proposed surtax is reinforcing inflationary expectations which may be inducing more widespread inventory accumulation.

The rise in consumer expenditures at an annual rate of $8 billion in the fourth quarter is commensurate with the projected rise in spendable income, which was slowed in October and November by strikes. The Federal workers' pay raise, even if received in December, will be reflected in December retail sales, but should have a greater impact in early 1968.

An important development now indicated for the first quarter is an expected $3 billion (nearly 20 per cent annual rate) increase in outlays for new plant and equipment, after virtually no increase for the year 1967. An additional increase of about $1 billion is indicated for the second quarter, according to the November Commerce-SEC survey of business plans for new plant and equipment outlays (confidential until released) continuation of even moderate gains in the second half of next year would result in an increase for the full year 1968 well in excess of indications from recent private surveys.

Residential construction outlays are expected to be somewhat larger in the first than in the fourth quarter, according to present indications. Starts rose to an annual rate of 1.5 million in October and permit applications also increased. Inventories of unsold new homes are very low and demand for homes is still rising, despite a higher rate of completions recently and rising costs of financing. Uncertainties concerning the supply and price of mortgage funds is expected to limit housing starts to a level of between 1.4 and 1.5 million in the next few months, but given the usual lags between starts and expenditures--as well as higher costs--the dollar value of residential construction is expected to continue to rise in early 1968.

Nonfarm inventory accumulation is projected to rise to a rate of about $7 billion in the first quarter from an estimated rate of $3.5 billion in the current quarter. In addition to steel and autos, the anticipated rise in business plant and equipment outlays should also give rise to some accumulation of materials and work-in-process. The trend in distributor inventories depends somewhat on the strength of retail sales, but with capacity utilization rates low in most industries, inventories and sales could rise simultaneously.

Consumer income in the first quarter will benefit from several special influences. In February, minimum wage increases of 15 per cent should add at least $2 billion to workers' income, with additional increases likely later as other workers endeavor to restore traditional differentials. In the private economy, pay increases continue large and employment and hours are expected to rise.

Our projected growth of $10 billion in consumer expenditures in the first quarter includes domestic sales of new cars at an annual rate of 8.5 million units--not especially high in view of the probable deferral of fourth quarter sales.

Growth in consumer outlays is assumed to be in line with the increased income flow and the savings rate is projected to remain at about 7 per cent of disposable income. We know of no satisfactory explanation of why the savings rate has remained so high throughout 1967, and the large, lumpy additions to income expected in coming months may not be spent immediately. Therefore, since we are not postulating an increase in income taxes effective in the first quarter, there is no basis for assuming any significant shift in the savings rate in a downward direction.

Corporate profits before taxes, which were at an annual rate of about $80 billion before taxes in the third quarter, should rise to about $82.5 billion in the current quarter and approach $85 billion in the first quarter, if our GNP estimates prove correct. Somewhat higher rate of capacity utilization and a higher rate of productivity gain are expected to contribute to the rise, along with growth in aggregate expenditures and income.

Total Federal expenditures for fiscal 1968, NIA basis, are assumed to be somewhat below the $170.4 billion projected in the midyear

Budget review. As indicated above, the rise in defense spending is expected to slow further in the first quarter and to level off or possibly decline in the second quarter. Part of the proposed budget cuts are expected to be in grants to States and localities, so that the rise in State and local outlays also may be somewhat less than previously anticipated.

The deficit, NIA basis, reached a peak in the second quarter of 1967 at an annual rate of $14.7 billion, and fell to $13.1 billion in the third quarter. A reduction is expected in the current quarter and a further decline to a rate of about $6.5 billion in the first quarter of next year is possible, reflecting a further increase in receipts arising from both the projected increase in incomes and the rise in payroll taxes incorporated in the legislation increasing social security benefits. (This will not result in an immediate rise in cash receipts, since the increase in taxes has been accomplished by raising the taxable wage base, which would not affect cash flows appreciably until the final quarter of calendar 1968; in the NIA accounts, however, the higher taxable base for earnings will be reflected in a higher and fairly stable level of receipts throughout the calendar year.)

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 IV	1967 I	1967 II	1967 III	1967 Proj. IV	1968 Proj. I
Gross National Product	743.3	785.2	762.1	766.3	775.1	791.2	808.0	827.5
Final sales	729.9	781.3	743.6	759.2	774.6	787.4	804.0	820.2
Private purchases	575.6	604.6	581.9	588.8	599.6	609.2	620.6	634.2
Personal consumption expenditures	465.9	492.2	473.8	480.2	489.7	495.3	503.5	513.5
Durable goods	70.3	72.0	70.6	69.4	72.5	72.7	73.5	76.3
Nondurable goods	207.5	218.0	210.3	214.2	217.2	218.5	222.2	225.7
Services	188.1	202.1	192.9	196.6	200.0	204.1	207.8	211.5
Gross private domestic investment	118.0	110.8	122.2	110.4	105.1	112.2	115.6	122.5
Residential construction	24.4	24.5	20.9	21.4	23.1	25.6	27.8	28.4
Business fixed investment	80.2	82.5	82.8	81.9	81.5	82.8	83.8	86.8
Change in business inventories	13.4	3.9	18.5	7.1	.5	3.8	4.0	7.3
Nonfarm	13.7	3.7	19.0	7.3	.6	3.4	3.5	6.8
Net Exports	5.1	5.4	4.3	5.3	5.3	5.4	5.5	5.5
Gov't purchases of goods & services	154.3	176.8	161.7	170.4	175.0	178.2	183.4	186.0
Federal	77.0	90.4	81.5	87.1	89.5	90.9	93.9	94.7
Defense	60.5	72.8	65.6	70.2	72.5	73.3	75.0	75.5
Other	16.5	17.6	15.9	16.8	17.0	17.6	18.9	19.2
State and local	77.2	86.4	80.2	83.3	85.4	87.4	89.5	91.3
Gross National Product in constant (1958) dollars	652.6	669.4	661.1	660.7	664.7	672.0	680.0	690.7
GNP Implicit deflator (1958-100)	113.9	117.3	115.3	116.0	116.6	117.7	118.8	119.8
Personal income	584.0	626.5	601.6	612.9	619.1	631.0	643.0	656.0
Wage and salaries	394.6	423.7	407.4	414.7	418.3	426.2	435.5	446.2
Disposable income	508.8	544.6	522.0	532.7	540.0	548.2	557.5	568.1
Personal saving	29.8	38.2	34.6	38.8	36.0	38.5	39.5	39.9
Saving rate (per cent)	5.9	7.0	6.6	7.3	6.7	7.0	7.1	7.0
Corporate profits before tax	83.8	80.1	83.9	79.0	78.9	80.1p	82.5	84.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	143.2	151.7	148.6	149.1	148.1	152.8p	156.6	162.2
Expenditures	142.9	164.5	151.9	160.9	162.8	165.9	168.3	168.8
Surplus or deficit (-)	.3	-12.9	-3.3	-11.9	-14.7	-13.1p	-11.7	-6.6
Total labor force (millions)	78.9	80.8	79.8	80.3	80.2	81.1	81.6	82.0
Armed forces "	3.1	3.5	3.3	3.4	3.5	3.5	3.5	3.5
Civilian labor force "	75.8	77.3	76.5	76.9	76.7	77.7	78.1	78.5
Unemployment rate (per cent)	3.8	3.9	3.7	3.7	3.8	3.9	4.0	3.8
Nonfarm payroll employment (millions)	64.0	66.0	65.0	65.7	65.7	66.1	66.5	67.1
Manufacturing	19.2	19.3	19.5	19.5	19.3	19.2	19.3	19.5
Industrial production (1957-59=100)	156.3	156.9	159.3	157.1	155.9	157.2	157.3	160.5
Capacity utilization, manufacturing (per cent)	90.5	84.7	89.8	87.0	84.8	83.8	83.1	83.7
Housing starts, private (millions A. R.)	1.17	1.30	.92	1.12	1.21	1.40	1.46	1.47
Sales new U.S.-made autos (millions, A. R.)	8.38	7.69	8.13	7.33	7.83	8.00	7.6	8.5

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1966	1967 Proj.	1966 IV	1967 I	1967 II	1967 III	1967 Proj. IV	1968 Proj. I
	------------------ In Billions of Dollars ------------------							
Gross National Product	59.4	41.9	13.3	4.2	8.8	16.1	16.8	19.5
Final sales	55.4	51.4	6.2	15.6	15.4	12.8	16.6	16.2
Private purchases	37.5	29.0	2.2	6.9	10.8	9.6	11.4	3.6
GNP in constant (1958) dollars	35.9	16.8	6.3	-.4	4.0	7.3	8.1	10.6
Final sales	32.1	26.0	-0.3	10.1	10.3	4.2	8.4	8.3
Private purchases	21.9	11.4	-2.8	3.7	7.1	3.0	5.8	7.9
	----- In Per Cent; Quarterly Changes are at Annual Rates -----							
Gross National Product	8.7	5.6	7.1	2.2	4.6	8.3	8.5	9.7
Final sales	8.2	7.0	3.4	8.4	8.1	6.6	8.4	8.1
Private purchases	7.0	5.0	1.5	4.7	7.3	6.4	7.5	8.8
Personal consumption expenditures	7.6	5.6	3.1	5.4	7.9	4.6	6.6	7.9
Durable goods	6.5	2.4	-1.7	-6.8	17.9	1.1	4.4	15.2
Nondurable goods	8.5	5.1	1.5	7.4	5.6	2.4	6.8	6.3
Services	6.9	7.4	6.5	7.7	6.9	8.2	7.2	7.1
Gross private domestic investment	9.9	-6.1	19.9	-38.6	-19.2	27.0	12.1	23.9
Residential construction	-9.6	0.4	-47.3	9.6	31.8	43.3	34.4	8.6
Business fixed investment	12.8	2.9	7.9	-4.3	-2.0	6.4	4.8	14.3
Gov't purchases of goods & services	13.1	14.6	10.1	21.5	10.8	7.3	11.7	5.7
Federal	15.3	17.4	10.1	27.5	11.0	6.3	13.2	3.4
Defense	20.8	20.3	16.5	28.0	13.1	4.4	9.3	2.7
Other	-1.2	6.7	-16.9	22.6	4.8	14.1	29.5	6.3
State & local	10.9	11.9	10.8	15.5	10.1	9.4	9.6	8.0
GNP in constant (1958) dollars	5.8	2.6	3.8	-.2	2.4	4.4	4.8	6.2
Final sales	5.3	4.1	-0.2	6.3	6.3	2.5	5.0	4.9
Private purchases	4.4	2.2	-2.2	2.9	5.5	2.3	4.4	5.9
GNP Implicit deflator	2.7	3.0	3.1	2.4	2.1	3.8	3.7	3.5
Personal income	8.6	7.3	8.3	7.5	4.0	7.7	7.6	8.1
Wage and salaries	9.9	7.4	7.8	7.2	3.5	7.6	8.7	9.8
Disposable income	7.8	7.0	7.5	8.2	5.5	6.1	6.8	7.6
Corporate profits before tax	9.5	-4.4	-.5	-23.4	-0.5	6.1p	12.0	9.7
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.7	5.9	8.2	1.3	-2.7	12.7p	9.9	14.3
Expenditures	15.8	15.1	15.3	23.7	4.7	7.6	5.8	1.2
Nonfarm payroll employment	5.3	3.1	4.4	4.3	0.0	2.4	2.4	3.6
Manufacturing	6.1	0.5	4.1	0.0	-4.1	-2.1	2.1	4.1
Industrial production	9.0	.4	4.1	-5.5	-3.1	3.3	.3	8.1
Housing starts, private	-20.4	11.1	-59.3	87.0	32.1	62.8	17.1	2.7
Sales new U.S.-made autos	-4.4	-8.2	-15.8	-39.6	27.3	8.7	-20.0	47.4

Industrial production. Industrial production in November is estimated to have increased somewhat more than one full point iron the preliminary October figure of 156.2 per cent, mainly because of settlement of the Ford and Caterpillar strikes and an increase in output of iron and steel. At about the 157.5 per cent level the November index would be about 2 points below the peak in December 1966.

The partial recovery in production of autos, trucks, and automotive parts[1/] amounts to about .6 of one point in the total index, a recovery of almost one-half the loss due to the Ford strike. If, with the settlement of the strike at Caterpillar, output of nonelectrical machinery recovers to the September level, this would add another .3 of one point to the November index. Steel ingot production through the week ending November 25 had increased 4.5 per cent from the October level, partly in response to improved auto production. In addition, steel mills have been adding to stocks in anticipation that steel consuming industries, whose stocks of steel mill shapes and forms are extremely low, will start another round of accumulation in preparation for a possible strike next summer. Output of crude oil, which had declined sharply from August to October, increased somewhat in early November. Paperboard production in November was above year earlier levels for the first time since last February.

In the first half of 1967, under the impact of cutbacks in output in most of the cyclical industries which account for about 70 per cent of the total index, industrial production declined 4 points.

1/ In the first eleven days of November, Ford produced only 17,000 cars; in each of the following two weeks, Ford produced 40,000 as compared with 50,000 units at its highest weekly rate in 1967.

Meanwhile, output of noncyclical goods, mainly consumer staples and defense equipment, continued to expand at about the same rate as in 1966. Upward production trends in some of the cyclical goods output since mid-year, however, have been obscured because of direct and indirect effects of strikes and the total index has shown a sawtooth pattern.

The cyclical industries shown below have experienced varying degrees of recovery from their 1967 lows; the major exception is business equipment which continued to decline through October. The following table indicates, the highs, lows, and most recent levels of selected cyclical goods.

OUTPUT OF SELECTED CYCLICAL GOODS
1957-59 = 100, Seasonally Adjusted

	1966-67 highs		1967 lows*		Latest Data Available	
Total index	12/66	159.5	6/67	155.6	11/67	e157.5
Autos	10/66	178	3/67	136	11/67	145
Appliances	10/66	172	5/67	147	9/67	153
T.V.	12/66	184	7/67	118	10/67	159
Business equip.	12/66	189	10/67	177	10/67	177
Iron & steel	7/66	143	6/67	121	10/67	127
Textiles	6/66	144	7/67	137	9/67	141
Construction materials	4/66	144	6/67	137	10/67	139

e - estimated

* - excludes strike induced lows.

Capacity utilization. Utilization of capacity by manufacturers is likely to have increased by one or two tenths of a point in November if the manufacturing production index rose by a point or so, as expected. The operating rate was estimated to be 83.0 per cent in October, down from 83.6 per cent the previous month. About two-thirds of the decline was a result of the continuing increase in capacity. The remaining decrease was a result of lower manufacturing output caused in large part by a strike at Caterpillar. The Ford strike apparently did not contribute much to the October decline since motor vehicle production showed little change from the already reduced September level.

Unused capacity exists in most industries. Only producers of aircract and electric power generating equipment are now operating at higher than usual rates.

UTILIZATION RATES

Industry	July	August	September	October
Manufacturing	84.0	84.6	83.6	83.0
Primary processing Industries	81.7	83.0	82.8	82.5
Advanced processing Industries	85.7	85.8	84.1	83.3

Orders. New orders received by manufacturing of durable goods were down only 0.3 per cent in October according to the latest Census figures; an earlier Census release had shown a much larger decline. The latest decline was the third in the past four months and the series is now about 4 per cent below its recovery high in June. New orders for durable goods had risen strongly from April through June.

The decreases in the latest two months were much less than the amounts which could be attributed to the Ford strike. Motor vehicle orders were down about 15 per cent in October after falling a similar amount the previous month. However, this must be balanced against the fact that the highly volatile aircraft orders series was up 25 per cent in October and an even greater amount the previous month. If autos are excluded from the total, durable goods orders were up 4.0 per cent between August and October, but if both autos and aircraft are excluded orders declined 3.5 per cent in that period.

New orders tended slightly lower in October in other industries. Primary metals, all other durable goods, and the special machinery and equipment grouping each showed a small decrease. Fabricated metal products was the only industry other than aircraft to register an increase.

Unfilled orders moved up 1.3 per cent in October, continuing the rise which began in May. Most of the increase in the latest month came in the aircraft industry. Since the low point of last spring, backlogs have increased about 6 per cent and aircraft backlogs accounted for over half of this increase.

NEW ORDERS

(Billions of dollars, seasonally adjusted)

Industry	1966 IIIQ	1967 IQ	1967	
	Monthly	Average	June	October
Total durable goods	24.39	22.16	24.26	23.36
Primary metals	3.98	3.25	3.59	3.47
Autos	3.51	3.49	3.89	2.74
Aircraft	2.61	2.11	3.07	2.95
Machinery & equip.	4.94	4.37	4.79	4.64

Business inventories. Business inventories have been behaving a little more erratically than usual in recent months. The large adjustment during the first half of the year which culminated in sizable liquidation in June was followed by a shift back to substantial accumulation in July and August (the revised August estimate shows accumulation of nearly $800 million, double the original estimate). Then, in an abrupt turnabout, in September there was a small amount of liquidation again. Despite the September decline, the book value of business inventories increased at a seasonally adjusted annual rate of $3.9 billion for the entire third quarter--up considerably from the nominal rise in the second quarter. Preliminary indications for October are available only for manufacturers and these show an increase in book value of factory stocks at a seasonally adjusted annual rate of $4.4 billion.

The recent large fluctuations in the rate of change in total business inventories have reflected a variety of influences, but the auto manufacturing industry and wholesalers as a group have been major contributors. Thus auto producers shifted from liquidation of $96 million in June to accumulation averaging $240 million a month in July and August (reflecting partly inadequate seasonal allowance for the effects of the earlier model changeover) and then, with the Ford strike underway, back to liquidation of $253 million in September and slight accumulation in October. At wholesalers, a shift from sizable liquidation in July to large accumulation in August and then back to no change in September contributed significantly to the total business inventory change in those months.

MONTHLY CHANGES IN BOOK VALUE OF BUSINESS INVENTORIES
(In millions of dollars, seasonally adjusted)

	June	July	August	September	October
Manufacturing & trade, total	-274	257	794	- 79	
Manufacturing	-188	507	473	-194	367
Auto industry	- 96	266	213	-253	37
Other manufacturing	- 92	241	260	59	330
Trade	- 86	-250	321	115	
Auto dealers	-161	-188	- 99	174	
Other retail stores	- 15	98	130	- 59	
Wholesalers	90	-160	290	0	

Book value of auto dealer stocks, which had declined steadily during the first 8 months of the year, increased substantially in September despite little change in unit stocks of new cars. This book value increase and the large September decline reported by auto manufacturers, apparently reflected in part a bookkeeping transfer of ownership from manufacturers to dealers when the new models were introduced.

The stock-sales ratio for manufacturers in October, at 1.84, was well above the already high rate at the end of last year, owing in large part to sharply depressed sales of the auto industry in October when the book value of stocks was about unchanged from last December. In addition, stock-sales ratios for defense industries and also for all other manufacturing industries combined were moderately higher than last December. In the trade sector, the stock-sales ratio for auto dealers was unusually low in September and for all other lines together was down from late 1966 and close to the more normal end-of-1965 level.

Auto sales and stocks. Dealer deliveries of new domestic autos in November were 17 per cent below a year ago. The seasonally adjusted annual rate of sales for November was 7.2 million units, only 3 per cent higher than the reduced October level.

Excluding Ford, sales in November were up slightly from a year earlier but in the final ten-day period were down 4 per cent from last year. Ford sales, while still sharply below a year earlier, increased dramatically in the latest ten-day period. Ford production in November totaled 140,000 units and for December is expected to reach about 230,000 units which is near capacity and 13 per cent higher than in December 1966. Stocks of all makes of domestic new cars on November 20 remained about one-fourth below a year earlier.

Sales of used cars in the first twenty days of November were slightly below a year earlier while stocks were 4 per cent below. Seasonally adjusted used car prices, as reported in the CPI, eased slightly in October but remained 4 per cent above a year earlier.

<u>Consumer instalment credit.</u> The October increase of $311 million in consumer instalment credit was somewhat larger than in the preceding month but below the 1967 high reached in August. The rate of growth diminished in both automobile and other durable goods paper, while in personal loans, where the increase was marked, the spurt was due to a larger volume of new loans as well as a slower rate of repayment.

INCREASES IN CONSUMER INSTALMENT CREDIT
(Billions of dollars, seasonally adjusted)

	1966	1967
1st Quarter, monthly average	595	253
2nd Quarter, " "	524	233
3rd Quarter, " "	547	284
July	564	225
August	602	344
September	475	284
October	380	311

Repayments on most types of instalment debt in October were lower than in September. This decline may have reflected, in part, the practice followed by many lenders in strike-affected areas of granting a moratorium on payments on outstanding loans during a strike period. Until a strike settlement is announced, the volume of new loans also tends to be limited both by lenders and by potential borrowers. But in periods immediately following settlement, there is a tendency toward increased borrowing--particularly personal cash loans--as well as a greater-than-usual leniency among lenders in granting new loans.

Extensions of auto credit in October were little changed from September despite some improvement in sales and a small rise in the average amount of the note. The net increase in auto credit--i.e., extensions minus repayments--amounted to only $20 million, the smallest rise in the past five months.

Construction and real estate. Total construction expenditure, which had reached a new peak seasonally adjusted annual rate of $78.9 billion (revised) in September, changed little in October and November. Residential construction outlays continued upward however, and in November, were the highest since March 1966. Outlays for private nonresidential construction, which have fluctuated within a narrow range since spring, held at the moderately reduced October rate. Although plans call for some curtailment in Federal construction expenditures over the period ahead, state and local expenditures are continuing to rise and, in November, total public construction outlays were at another new high.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	November 1967 ($billions) 1/	Per cent Change from	
		October 1967	November 1966
Total	79.0	--	+ 10
Private	51.5	--	+ 9
Residential	26.2	+ 1	+ 29
Nonresidential	25.4	--	- 5
Public	27.5	+ 1	+ 10

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

Because of growing uncertainties about the course of the economy and, in particular, the course of domestic capital markets, the pace and duration of recovery in housing activity beyond the intermediate period ahead remains open to question. However, total housing starts have been running somewhat above earlier projections in recent months. By October, starts had regained the 1.5 million rate average of the fourth quarter of 1965, just before the 1966 downturn in housing starts began. The major impetus to the current recovery has come from multifamily structures, the most volatile sector of residential construction activity and the one in which basic demographic and other demand factors are particularly strong.

PRIVATE HOUSING STARTS AND PERMITS

	October 1967 (Thousands of units) 1/	Per cent change from 4th Q 1965	Per cent change from 4th Q 1966
Starts	1,496	--	+ 63
1 - family	914	- 7	+ 43
2 - or more family	582	+ 14	+ 109
Northeast	265	- 3	+ 77
North Central	399	+ 1	+ 81
South	552	- 4	+ 39
West	280	+ 10	+ 88
Permits	1,202	- 5	+ 64
1 - family	655	- 10	+ 46
2 - or more family	547	- 1	+ 93

1/ Seasonally adjusted annual rates; preliminary.

The upturn in single family starts from the unusually reduced rate in the fourth quarter of 1966 has been less pronounced than for multifamily starts, but since last spring it has persisted in the face of growing concern about the impact on potential home-owner demands of the shift toward rising mortgage interest rates and the deepening discounts required for loans on both existing and new properties. At the same time, speculative builders have continued to show little disposition or ability to build ahead of the market. In September (the latest month available) seasonally adjusted sales of new homes by speculative builders again turned up appreciably after three months of relatively little change. The number of new homes available for sale (including those under construction) remained among the lowest in the history of the series, which began in late 1962.

Defense expenditures. Military contract awards have been stable since June 1967. Thus, even recognizing the long lags between such awards and actual spending, expenditures for military goods may level off shortly, unless a new spurt in military orders occurs. Personnel compensation will still rise, though, due to the expected pay increase

MILITARY PRIME CONTRACT AWARDS
(In millions of dollars, seasonally adjusted)
Monthly

1967 - January	3,338
February	3,849
March	2,984
April	2,920
May	4,121
June	3,626
July	3,610
August	3,686
September	3,665
October	3,665

Other evidence of a leveling off of military expenditures can be found in the recent relationship between purchases and contracts. Contract awards are a leading indicator of military outlays, with purchases tending to lag behind when awards rise rapidly; at such times, the ratio of purchases to contracts falls. In periods of stability in contract awards, military purchases other than for personnel compensation tend to be fairly constant at a level about 5-10 per cent above contracts. The following table shows that purchases were lagging behind contract awards during the rapid build-up of 1965 and 1966, but they have reestablished their typical relationship during 1967. Thus spending appears to have caught up with the prevailing level of contract awards.

NATIONAL DEFENSE

(In billions of dollars, seasonally adjusted ,annual rates)

	Purchases of goods and services	Personnel Compensation	Other Purchases	Contract Awards	Ratio: Other Purchases to contract Awards
1964-Q1	50.5	20.0	30.5	29.2	1.05
2	50.7	20.1	30.6	28.2	1.08
3	49.8	20.6	29.2	26.8	1.09
4	48.9	20.7	28.2	24.2	1.17
1965-Q1	48.4	20.5	27.9	25.6	1.09
2	49.2	20.5	28.7	29.5	.97
3	-50.2	21.3	29.0	30.0	.97
4	52.4	22.5	29.9	35.1	.85
1966-Q1	55.1	23.5	31.6	34.8	.91
2	58.4	24.1	34.3	40.6	.85
3	63.0	25.5	37.5	42.9	.88
4	65.6	26.3	39.3	40.6	.97
1967-Q1	70.2	26.8	43.4	40.7	1.07
2	72.5	27.1	45.4	42.7	1.06
3	73.3	27.5	45.8	43.8	1.05

Plant and equipment expenditures. The November Commerce-SEC survey of business plans to spend on plant and equipment (confidential until released) has two major findings. First, spending for this year has been further written down. Thus, the March survey indicated a rise of 3.9 per cent for the year 1967; the latest survey, after two intervening scaling-downs, shows an increase of only 1.4 per cent, and, after allowance for price and cost increase, suggests a decline in the physical volume of investment. Anticipated spending for the fourth quarter is now $500 million (annual rate) smaller than shown in the August survey.

The second major finding is the sharp increase now planned from the current quarter, which shows a moderate advance, to the second quarter of 1968, as may be seen in the table. The increase over these 2 quarters amounts to 6 per cent or an annual rate of 12 per cent. For the spring of 1968, anticipated expenditures are 7 per cent above the further reduced average for the year 1967, suggesting that even moderate increases in the second half of the year would result in an advance for the year as a whole significantly above those indicated by recent private surveys.

An unusual feature of this prospective rise, however--and one for which we now have no adequate explanation--is its concentration in the first quarter. Thus, $3 billion of the total rise of $3.8 billion, annual rates, is planned for early 1968. Moreover, public utilities account for $1.5 billion of this first quarter increase and manufacturing for $1.2 billion, for a combined total of $2.7 billion. In the second quarter, utilities are unchanged from the preceding quarter and the rise in manufacturing is much smaller.

EXPENDITURES FOR NEW PLANT AND EQUIPMENT

	1966 Actual	1967 November Plans	1967 Actual I	1967 Actual II	1967 Actual III	1967 IV	1968 Planned I	1968 Planned II
(Billions of dollars; quarterly figures, seasonally adjusted annual rates)								
All industries	60.6	61.5	61.7	61.5	60.9	62.1	65.1	65.9
Manufacturing	27.0	26.8	27.9	27.0	26.2	26.5	27.7	28.4
Durable Goods	14.0	13.8	14.2	13.8	13.5	13.8	14.6	15.0
Nondurable Goods	13.0	13.1	13.7	13.2	12.7	12.8	13.1	13.4
Nonmanufacturing	33.6	34.6	33.8	34.5	34.7	35.5	37.3	37.5
Mining	1.5	1.4	1.4	1.3	1.5	1.5	1.6	1.5
Railroad	2.0	1.6	1.8	1.6	1.4	1.5	1.5	1.5
Non-rail Transportation	3.4	3.9	3.1	3.9	4.1	4.5	4.8	4.8
Public Utilities	8.4	9.6	9.2	9.7	9.8	9.6	11.1	11.1
Communications, Commercial and Others	18.4	18.2	18.3	18.1	18.0	18.5	18.3	18.7

<u>Labor market</u>. With settlement of several major strikes, indications of firmness are again becoming apparent in the labor market. The end of the Ford, Caterpillar tractor and steel haulers strikes returned over 200,000 workers to payrolls between October and November and should result in a rebound of manufacturing employment. High rates of activity to recover strike-lost auto production and to build inventories against possible industrial strife in the steel industry, are strong expansionary factors for the next several months. If in addition,

increases in private demands for plant and equipment, now anticipated, materialize and there is no extended strike at GM the next several months should show strong gains in durable goods manufacturing output, employment and hours. Under these circumstances, a significant recovery of overall employment growth, and some decline in overall unemployment seems likely in the next few months. Unemployment insurance claims already have shown substantial improvement from their late spring summer highs, and by late November were only slightly above year-earlier levels--when the total unemployment rate was at its lowest level of 1966.

The combined impact of a recovery in employment and the work week--with more hours worked at premium pay--and the direct and indirect effects of substantial increases in wages and fringes, will undoubtedly be reflected in sharp gains in wage and salary income during the next several quarters.

Wages and industrial relations. Although increases in wage rates and fringes negotiated during 1967 were substantially larger than during the same period a year earlier, their effect on average hourly earnings so far in 1967 has been tempered by a decline in overtime hours of work at premium pay and some reduction of employment in high wage manufacturing industries. These declines moderated the rise in earnings in total manufaccuring and offset somewhat the generally larger increases in earnings in nonmanufacturing sectors.

As a result, earnings of production workers in all private nonfarm industries rose little more between the third quarters of 1966 and 1967 (4.7 per cent) than in the preceding year (4.5 per cent).

AVERAGE HOURLY EARNINGS OF PRODUCTION WORKERS
(Per cent increases)

	IIIQ 1965 to III Q 1966	III Q 1966 to III Q 1967
Private nonfarm	4.5	4.7
Manufacturing	4.2	4.0
Mining	5.5	4.5
Construction	5.6	5.6
Communication	2.9	4.3
Trade	4.8	5.6
Finance, insurance, etc.	3.6	5.8
Laundries, cleaning and dyeing	5.3	9.0
Hotels, motels, and tourist courts	6.4	7.7

In the coming months, however, increased upward pressure on wage rates may be anticipated in manufacturing industries as the impact of substantial wage rate increases in recent contract settlements pervade the economy. The settlements at Ford and Chrysler--an average increase in wages and fringes of about 6 per cent over the life of the contract (and 7-1/2 per cent in wages rates alone in the first year)--is expected to set a pattern for contracts yet to be negotiated in the automobile and machinery industries, and affect next year's negotiations in can, steel, aerospace and shipbuilding industries. Recovery of employment and hours of work should also act to accelerate the growth of average earnings in manufacturing in the next several months.

At the same time, continued rapid gains in earnings may be anticipated in other, lower-wage industries, at least through the first half of 1968. This will reflect the expected further tightening of the labor market, as well as the increase in the Federal minimum wage on February 1, 1968, which is likely as in 1967 to have substantial impact on wages in retail trade, the service sectors and in lower-wage manufacturing industries. Increases in wage rates to maintain traditional wage differentials may also be anticipated.

Compensation, Productivity and Unit Labor Costs. Rapid rates of increase in compensation per manhour will undoubtedly be reflected in pressure on unit labor costs. Some offset to their impact on labor costs should come with a further recovery of productivity. The over-the-year rate of growth of unit labor costs for the total private economy had eased somewhat to under 4 per cent in the past two quarters, the result both of the dampening effect on employee earnings of the dip in manufacturing, and a modest recovery in productivity from its first quarter of 1967 low. But the annual rate of productivity growth for the private economy in the second and third quarters of about 2 per cent is still well below the postwar average of about 3.2 per cent. A somewhat higher rate of productivity growth should be apparent in the next few quarters, however, accompanying a pick-up in growth in real GNP.

OUTPUT PER MANHOUR AND UNIT LABOR COSTS
FOR THE TOTAL PRIVATE ECONOMY

Per Cent Change From Year Earlier

	Output per manhour	Unit Labor Costs
1966 - 1Q	3.9	1.9
2Q	3.8	3.1
3Q	2.5	4.1
4Q	2.0	5.2
1967 - 1Q	0.5	6.5
2Q	1.9	3.9
3Q	2.2	3.6

Wholesale prices. The BLS index of wholesale prices of industrial commodities increased 0.3 per cent in October, instead of 0.2 per cent as estimated originally. The preliminary estimate for November shows a further increase of 0.2 per cent--to 107 per cent of the 1957-59 average--bringing the rise for the 4 months from mid-July to mid-November to an annual rate of 2.8 per cent, compared with less than 1 per cent over the preceding year.

Prices of farm products and processed foods and feeds, which had declined 1 per cent in October, were down an estimated 0.6 per cent further in November and the total wholesale price index remained at the mid-October level of 106.1. This is down moderately from this year's high (to date) of 106.5 in July and from the August-September 1966 high of 106.8--with sharp decreases for both major farm categories--livestock and products, and crops and products--accounting for the decreases.

The larger-than-estimated increase in the industrial commodity average from mid-September to mid-October reflected in part higher prices for motor vehicles than had been anticipated. Manufacturers' prices for both autos and trucks increased about 2.4 per cent from September to October as 1967 models, at moderate end-of-year discounts, were replaced by 1968 models priced about 2 per cent higher than 1967 models in October 1966. For autos, according to the BLS, the actual increase in manufacturers' prices for 1968 models (relative to introductory prices for 1967 models) average 3-3/4 per cent, but nearly half of this increase was credited as quality improvement (primarily safety improvements and anti-air-pollutant devices). This year's 2 per cent rise in prices of new model autos is the largest since the late 1950's; from 1959 to 1966 new car prices after adjustment by the BLS for quality improvements tended to drift down, from 102.1 per cent of the 1957-59 average in October 1959 to 98.0 in October 196.6 (part of the decline--in 1965--reflected reductions in Federal excise taxes).

The rise in prices of motor vehicles was the major influence on the September-to-October change in the industrial commodity average; with a weight of only 8 percent in this total, motor vehicles accounted for over two-fifths of the total rise for those commodity sectors showing increases. However, there were also major increases in October for copper products and inorganic chemicals, and in addition there were widespread, though generally small, gains for other producers' equipment and consumer products. Gasoline, lumber, plywood, and steel scrap showed rather pronounced declines.

CHANGES IN PRICES OF INDUSTRIAL COMMODITIES
MID-SEPTEMBER TO MID-OCTOBER
(BLS, WPI)

	Per cent of total index	Per cent Change
All industrial commodities	100.0	0.3
Major decreases, total	5.4	-3.6
Gasoline	2.7	-5.3
Lumber and plywood	2.3	-2.0
Steel scrap	0.3	-3.4
Other (mostly increases), total	94.6	0.5
Major increases	13.2	2.1
Motor vehicles	7.7	2.5
Nonferrous metals	4.4	1.1
Inorganic chemicals	1.1	2.7
All other commodities	81.4	0.2

The slackening in public announcements of price increases in late October and early November apparently did not noticeably affect the upward movement of industrial prices. The present BLS estimate suggests some slowing of the rise between mid-October and mid-November, but this would seem to follow mainly from a leveling off in motor vehicle prices after the sharp October increase. In view of this development and reported further declines in prices of gasoline, lumber and plywood, the estimated 0.2 per cent increase in the industrial average from mid-October and mid-November is significant. And in recent weeks, business has resumed its earlier "open-mouth" policy on price increases.

According to the BLS price report, "metals and textiles led the [November] advance." Among metals, prices of steel scrap have risen from the October low and price increases for copper scrap and various copper products have accelerated further with no end of the copper strike in sight. Metal price increases have continued apace since mid-November, with silver up sharply furhter, molybdenum boosted 4 per cent, and further increases in steel mill products--the most recent being announcements by several major producers of a 3.4 per cent increase effective December 15 on cold rolled steel sheets and the move of a single producer to raise prices on hot-rolled sheets and galvanized sheet and strip. If these steel increases should become industry-wide, prices will have been raised this year on roughly 85 per cent of all steel mill products--with the bulk of the increased since mid-August.

Higher metals--as well as labor--costs are prompting further price increases in producers' equipment, as, for example, the recently announced 4.7 per cent price increase by G. E. for transit-car equipment and the 10 per cent increase by Boeing on several major commercial aircraft models ordered after January 1. (Aircraft is not directly represented in the BLS wholesale price index.)

Upward price pressures persist for cotton and some cotton products as freezing weather during November reportedly lowered further cotton crop prospects, possibly to the lowest level since 1895. With prices of manmade textile products also increasing, wholesale prices of apparel have been rising this fall, although not nearly so rapidly as at retail. Over the past year, retail prices of apparel have shown more than twice the increase reported at wholesale.

Consumer prices. The consumer price index increased 0.3 per cent in October to 117.5 per cent of the 1957-59 average, with food prices down slightly further and other commodities and services continuing upward. For the first 10 months of the year the CPI increased at an average annual rate of nearly 3 per cent, with the rate much lower (1.5 per cent) in the first four months of the year when food prices were declining, much faster (4.2 per cent) from April to August when food prices rose sharply, and 3 per cent from August to October when food prices declined seasonally. In the recent period, lower food prices were accompanied by a step-up in already rapid price increases for other commodities and some acceleration in the upward trend of service prices.

Average retail prices of nonfood commodities have increased sharply this year, with gains widespread among durable and nondurable goods. Through October, the nonfood commodity average had increased at an annual rate of over 3.5 per cent--double last year's increase; moreover, a third of this year's rise occurred in September and October.

Throughout the year, apparel has been a prime mover in the over-all increase, and sharp increases in used car prices played a major role up to midsummer. In September and October, when fall and winter lines are introduced, retail prices of apparel increased more than 2 per cent--double the usual seasonal rise--to a level almost

4.5 per cent above a year earlier. Used car prices--up 11 per cent (7 per cent, seasonally adjusted) from January to August--showed a further increase in September but then stabilized in October.

In October, new car prices--which had declined somewhat less than seasonally earlier in the year and had contributed relatively little to the over-all change in nonfood commodity prices--jumped 5.2 per cent. Roughly half of this rise is estimated by the BLS to have reflected the usual seasonal increase occurring between the last month of the old models and the first month of sales of (predominantly) new models. The remainder of the rise represents higher retail prices for 1968 models relative to introductory prices for 1967 models, after allowance for quality improvements, it should be noted that 1968 models were first priced and included in the October index, even though, because of this year's earlier introduction date, a number of 1968 models were sold in September. Also, 1967 models accounted for roughly one-fifth of October new car sales, and some further rise in the CPI average of new car prices is to be expected in November as the 1968 model component of total new car sales expands.

Altogether, the sharp increases in apparel and new car prices (without adjustment for seasonal variations) accounted for nearly two-thirds of the rise in average prices of nonfood commodities in September and October. As noted above, sizable seasonal price changes occur in the autumn, particularly for food, apparel, and new cars--

although they tend to be offsetting in the total index with food prices tending lower and prices of other commodities tending higher.

In coming months, the rise in average retail prices of nonfood commodities will undoubtedly be slower than in September and October--and it is likely to be less than the average increase for the year to date. The earlier sharp run-up in used car prices appears to have ended. Apparel prices are not likely to continue to increase so rapidly unless demands pick up very sharply; over the past year, price increases appear to have absorbed the bulk of the rise in the dollar value of retail apparel sales. Future changes in new car prices will depend partly on the strength of consumer demands--which will determine the timing and extent of dealer discounts--and partly on the effects of continuing materials cost increases and any price effects of the new safety equipment required as of January 1. Prices of other goods--including appliances and furniture--are likely to continue to rise.

Even though food prices may start creeping up again--largely because of the steady and rapid growth in prices of restaurant meals, with their very large labor component--the rise in the CPI in coming months seems likely to hold nearer to the recent 3 per cent rate than to the 4.2 per cent annual rate of late spring and summer.

Current situation and outlook for agriculture. After a brief respite in 1966, farm operators are again caught in a cost-price squeeze in 1967. This squeeze is essentially a reflection of increasing supplies and not one of weakening domestic demands as foreign takings, although exports are running 8 per cent below the abnormally large volume of 1966. Farm prices generally have followed a downward course this year under the impact of record production while prices paid by farmers for the inputs of production have moved upward, but at a slower pace than in 1966. As a result, net realized farm income this year is expected to decline to $14.8 billion, 10 per cent below the near-record of 1966. Gross incomes have lagged behind year-earlier levels by a relatively narrow margin. Cash receipts from the 4 per cent larger marketings and the 5 per cent lower prices of both livestock and crops are only slightly under last year, but Government payments are substantially less.

Domestic consumers have benefitted from the record farm output of livestock and crops this year because of its moderating effect on retail food prices, especially meats. The estimated rise in food expenditures of between 3 and 4 per cent is less than the rise in consumer incomes. Consequently, the percentage of income spent on food has declined to 17.7 per cent from 18.3 in 1966. Most of the rise in food expenditures has been due to increased consumption: consumption is up 2.6 per cent, and retail prices of food are averaging 1 per cent above last year because of rising prices of food eaten away from home. Through October prices of food eaten at home have averaged about the same as in the first 10 months of 1966.

Prospects for 1978 were characterized as "more of the same" by Department of Agriculture analysts at the mid-November Outlook Conference. A rec'rd gross farm income just above $50 billion and about $1 billion higher than in 1967 is foreseen, but the gain will probably again be offset by rising production expenses, leaving realized net income at about the same level as in 1967--about $14.75 billion. Supplies of farm products are expected to continue large in 1968, but prices received are likely to strengthen from the reduced levels of late 1967. With consumer incomes continuing to expand, prices of meat animals may be stronger than the relatively low levels of the first half of 1967. Large supplies of feed, lower prices of feed, and prospects for improved prices may stimulate production of livestock products after mid-1968. Although no big gains are likely, output of livestock products for 1968 as a whole may at least match the 1967 record.

In order to adjust output more closely to prospective demand, program changes for 1968 have been announced to encourage cuts in wheat, corn, and sorghum grain production and to encourage an increase in cotton. However, the USDA suggests that there is little basis for expecting overall crop output to change very much in 1968 from the 1967 performance, assuming average growing weather.

Farm debt rose faster than the value of farm assets during 1967 according to preliminary Balance Sheet of Agriculture data presented at the Outlook Conference. Debts rose 9 per cent, approaching the rapid rate of the year before. Farm real estate debts increased at a slower pace than non-real-estate debts, partly because of restraints on new mortgages made particularly during the second half of 1966. Expansion of farm real estate debt continued to lag in 1967, apparently reflecting weakened demand for farm mortgage loans in part and competition of nonfarm borrowers for funds. Dollar volume of farm mortgages recorded in the first half of 1967 was 20 per cent below a year earlier. Farm finance analysts of the USDA suggest that a greater part than usual of operating and short and intermediate term investment expenditures may have been financed with nonreal-estate credit instead of farm real estate credit. Apparently borrowers did not refinance their old mortgage loans or make advance payments on them as frequently as they do in a period when interest rates are not rising and credit is more readily available.

Value of farm assets advanced about 4 per cent in 1967 compared with a gain of 5 per cent in 1966. Most of the rise was in farm real estate values which were estimated at $191.5 billion, 5 per cent above a year earlier. In the four previous years, values had advanced about 6 per cent annually. Other physical assets--

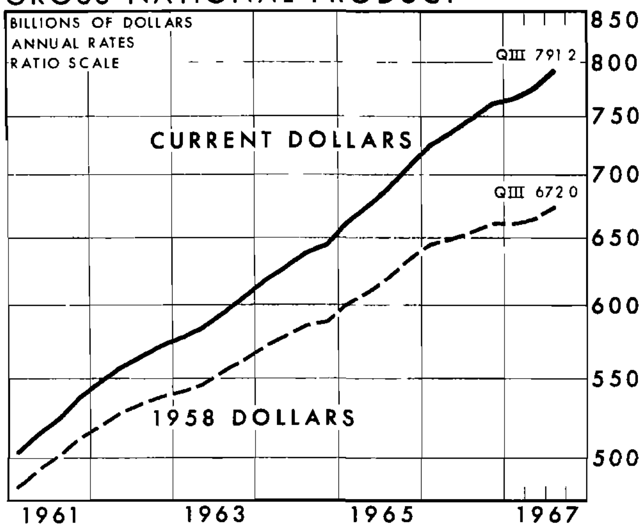
inventories of livestock, crops, and machinery--increased 2 per cent compared with an increase of 5 per cent last year.

Real estate dealers, farmers, and lenders polled by the Department of Agriculture in preparation for the outlook conference reported that although national credit needs have been strong much of the year, farmers' access to credit has been fairly well maintained. On interest rates, reporters indicated that rates on new mortgage loans have been higher by one-half to one percentage point than in early 1966 and rates on nonreal-estate loans are probably up by one-fourth percentage point. Although farmers were reported as becoming accustomed to the higher rates, they were reported to be appraising their investment needs more carefully and some of them are postponing longer-term investments in expectations of lower rates later.

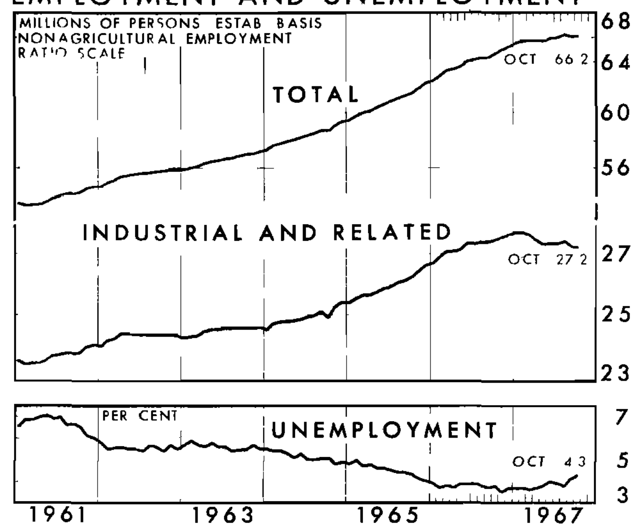
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

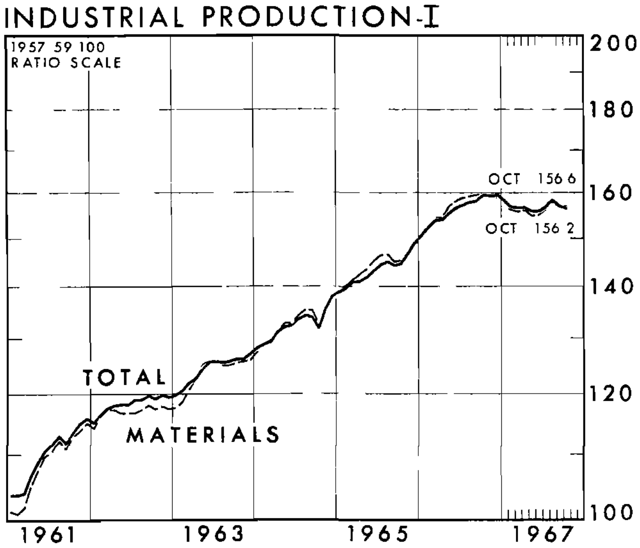
GROSS NATIONAL PRODUCT



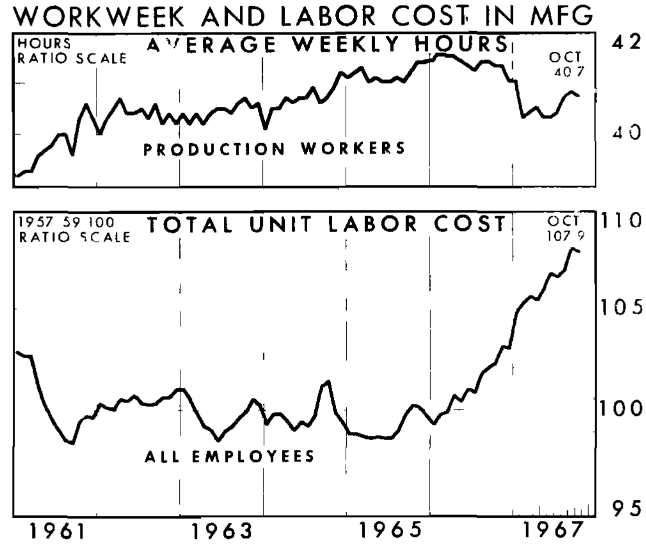
EMPLOYMENT AND UNEMPLOYMENT



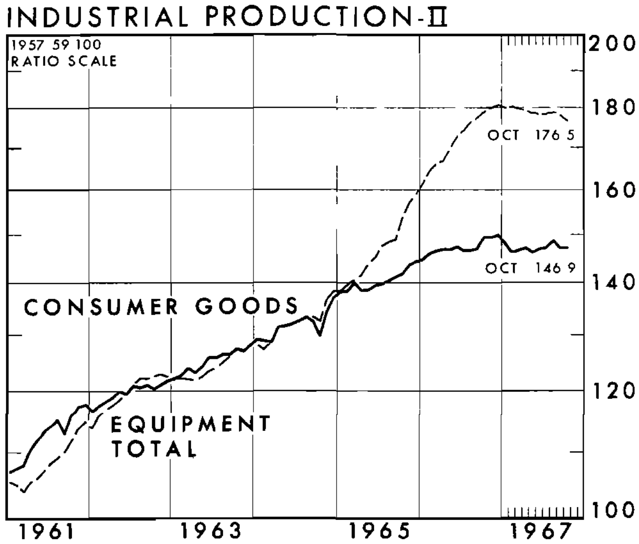
INDUSTRIAL PRODUCTION-I



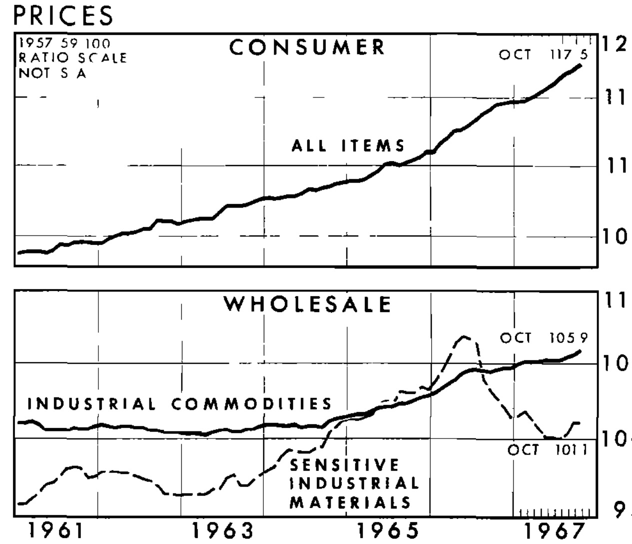
WORKWEEK AND LABOR COST IN MFG



INDUSTRIAL PRODUCTION-II



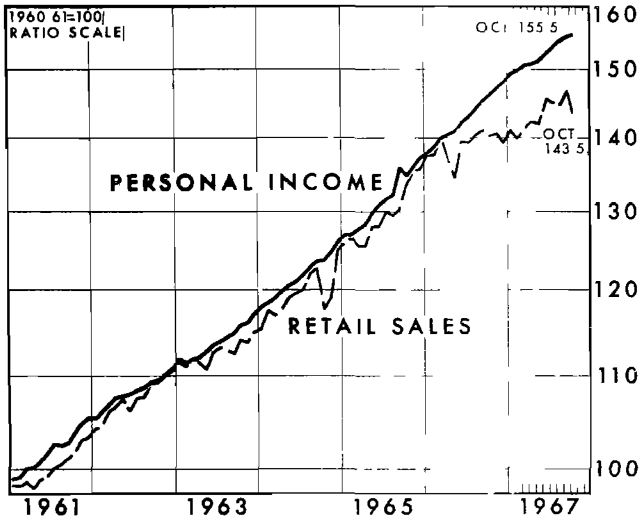
PRICES



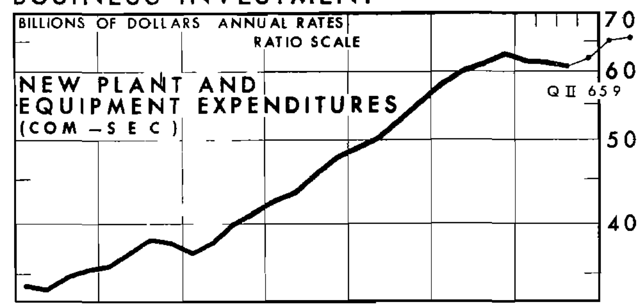
ECONOMIC DEVELOPMENTS - UNITED STATES

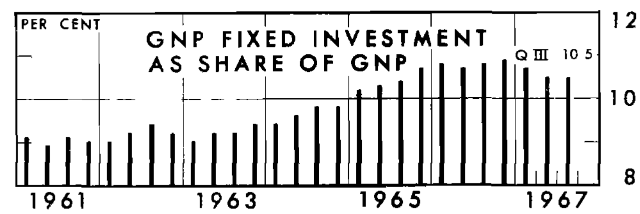
SEASONALLY ADJUSTED

INCOME AND SALES

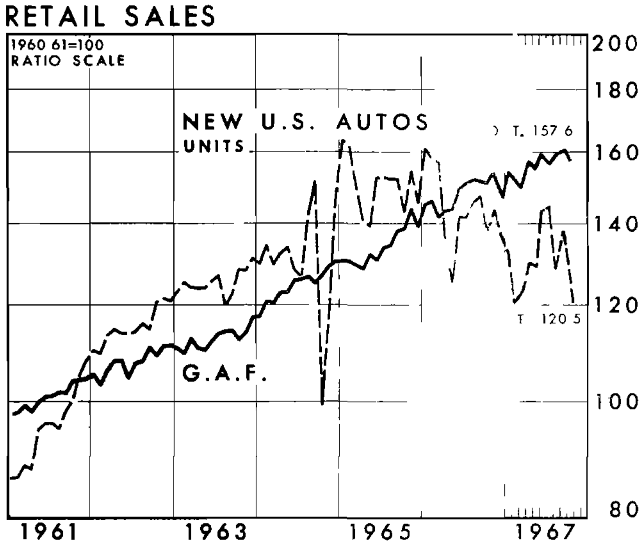


BUSINESS INVESTMENT

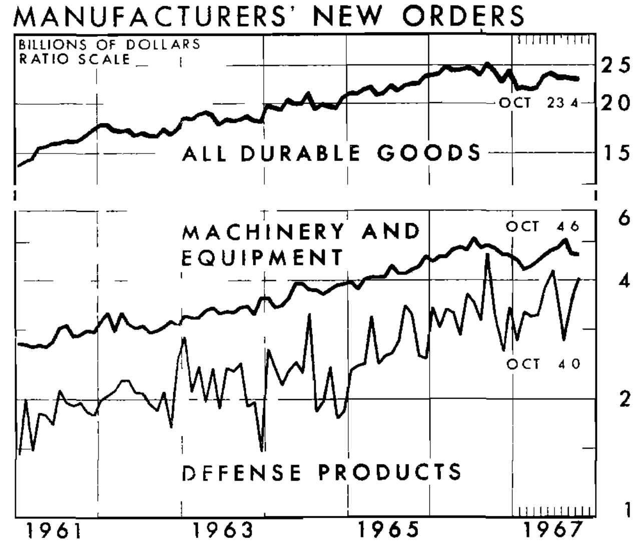




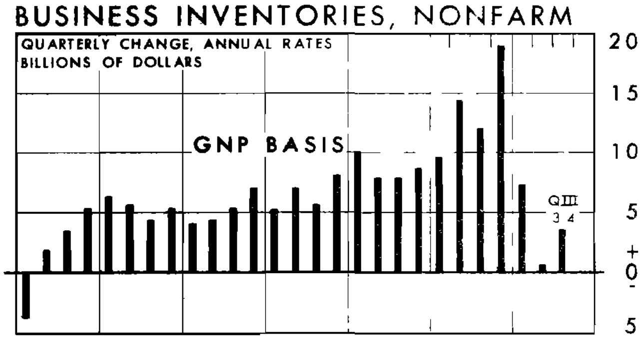
RETAIL SALES

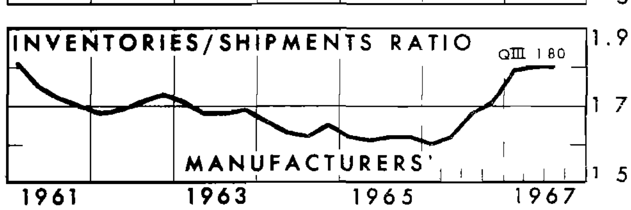


MANUFACTURERS' NEW ORDERS

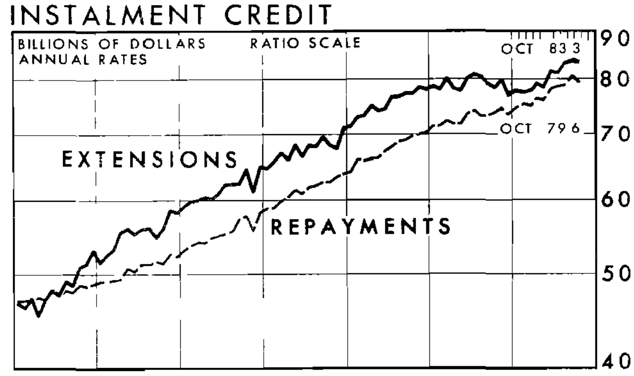


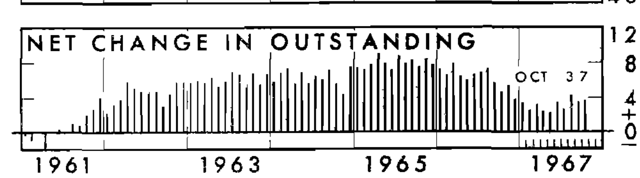
BUSINESS INVENTORIES, NONFARM





INSTALMENT CREDIT





DOMESTIC FINANCIAL SITUATION

Bank credit. Based on incomplete information, estimated total outstanding loans and investments at all commercial banks (last Wednesday of the month series) increased at a 7.0 per cent annual rate in November, the third consecutive month of relatively moderate credit growth, following the rapid July-August pace associated with large Treasury cash financings. Bank acquisitions of municipal and agency securities accounted for a large portion of the November increase, as total bank loans expanded at a reduced rate and holdings of Governments declined. On a daily average basis, the bank credit proxy, adjusted to include Euro-dollar borrowing, is expected to increase at about a 9.0 per cent annual rate (excluding Euro-dollar borrowing, the credit proxy is expected to increase at about a 8.5 per cent annual rate). The larger growth in bank credit indicated by this series reflects, in part, the reduction in Government security holdings of banks as November progressed, which affected the daily average bank credit series less than the end-of-month series.

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

	1st Half	July-August	September-October	November 1/	1st 11 months 1/
Total loans & investments	9.9	21.6	9.4	7.0	12.1
U.S. Gov't. securities	6.3	69.3	4.9	-9.6	16.5
Other securities	31.2	10.7	13.6	26.6	25.1
Loans	5.9	12.1	9.9	6.5	8.0

1/ All November rates are preliminary estimates based on incomplete data and are subject to revision.
NOTE: Data are on a last-Wednesday-of-the-month basis.

Although the 6.5 per cent November expansion rate in total loans was less than the average for the preceding four months, business loans grew at an 8.5 per cent seasonally adjusted annual rate--their highest rate since July. At weekly reporting banks, most of the November expansion in business loans occurred at banks outside New York City.

The increased pace of business loan expansion may reflect in part the indicated more rapid inventory accumulation this fall, but it also is associated with some special factors. Loans to food processors, commodity dealer and retail trade all showed more than seasonal expansion, apparently reflecting some shifting of October demands into November. And, the fact that November was a five-week month imparted some upward bias to the monthly estimate. On the other hand, net acquisitions of bankers' acceptances, which had been important to the increase in business loans in September and October, contributed a relatively small proportion to the November expansion.

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

	1st Half	July-August	September-October	November 1/	1st 11 months 1/
Total loans	5.9	12.1	9.9	6.5	8.0
Business	10.9	6.5	3.6	8.5	8.7
Real Estate	5.6	7.6	7.5	10.6	6.9
Consumer	4.1	6.1	9.0	8.9	5.9
Security	-17.7	158.3	39.6	-37.1	20.7
Nonbank Financial	-11.6	-5.3	37.2	20.0	0.9

1/ All November rates are preliminary estimates based on incomplete data and are subject to revision.
NOTE: Data are on a last-Wednesday-of-the-month basis.

Among other loan components, consumer loans continued to expand at the higher rate which began about midyear. The acceleration in these loans has occurred mainly in the nonautomobile consume durables area and in personal loans--perhaps associated with expanded use of bank credit cards. Loans to nonbank financial institutions also continued to rise, although apparently not as rapidly as in other recent months, and security loans declined for the first time since midyear. The indicated acceleration in growth of real estate loans is probably largely statistical, resulting from the five statement weeks in November.

With total loan demand moderate, bank holdings of other securities expanded sharply--at an annual rate of more than 26 per cent, or almost twice the September-October pace. These purchases reflected acquisitions of attractively priced municipals and also, as in October, participation certificates. In both October and November, an increasing proportion of the municipals acquired by banks have had maturities greater than one year.

During November, banks reduced somewhat their holdings of Government securities. Although, on balance, banks acquired a portion of the new note in November, the financing this month was of less than seasonal size. In addition, there were large bank liquidations of Treasury bills over the month, probably reflecting in part sales of tax anticipation bills underwritten in October.

Bank deposits. The pace of total time and savings deposit inflows in November, on a daily average basis, fell slightly further to about an 11.0 per cent annual rate, down from the 12 per cent rate of September-October and the 17 per cent rate of the first half. Negotiable CD's sales accounted for a substantial part of the November growth, increasing an estimated $1 billion, on an end-of-month basis. The unusually large increase in outstanding CD's probably reflects an effort to prepare for large December maturities as well as the higher cost of Euro-dollars following the devaluation of the British pound. Euro-dollar borrowings increased approximately $450 million through the week ending November 22, when they reached a new high of $4.8 billion. However, preliminary data indicate a more than seasonal decline in such borrowing the last week in November, reflecting in part at least the increase in Euro-dollar rates associated with the devaluation and the rise in the British Bank rate.

Probably most of the domestic CD sales by banks were in the shorter maturity ranges, as the 5.50 per cent ceiling made longer maturities noncompetitive. Some indication of this noncompetitiveness can be read from the fact that CD's were available in the secondary market, at the end of November, at a 6 per cent yield for 6-month maturities. To attract CD funds, banks raised rates on shorter-term CD's along with the general upward adjustment in short-term rates, including the discount rate and the prime lending rate at the time of the devaluation. By month-end, offering rates of 5.50 per cent were available on 60- to 90-day maturities. Early in December, it was reported that two large New York City banks were offering 5.00 per cent on 30-day maturities.

Inflows of time and savings deposits other than CD's moderated further in November, after rough seasonal adjustments. It is quite likely that the recent Treasury note offering at 5-3/4 per cent diverted some individual savings to this issue that otherwise would have gone to banks.

The money stock is estimated to have increased at about a 7.0 per cent annual rate in November, roughly the same as in October and the first half of the year. A large part of the recent expansion reflects runoffs in Treasury balances over the last three weeks of November, despite the midmonth cash refunding.

Thus, as yet, there has been little evidence that high interest rates on available money substitutes have begun to produce significant efforts to economize on money holdings, as has occurred in earlier postwar periods of rising interest rates. Reports continue to circulate in financial markets that corporations are adding large amounts to their demand balances in an effort to cement bank relationships in order to assure continued access to bank credit. At some point, the desire to obtain higher yields may tend to offset this building of compensatory balances and at that point expansion in the money stock would tend to recede.

<u>Corporate and municipal bond markets</u>. Yields on corporate and municipal bonds showed signs of stabilizing in the immediate post-devaluation period when prospects for a quick tax increase seemed to have improved. Thereafter, as hopes for a tax increase faded again,

yields in both markets edged upward to new highs. At these highs, investor demands have improved and new issues most recently have moved out quite well, particularly in the corporate bond market.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa New	Corporate Aaa Seasoned	State and local Government Moody's	State and local Government Bond Buyer's
	With call protection		Aaa	(mixed qualities)
1965				
End of July 1/	4.58	4.48	3.16	3.25
Early December 2/	4.79	4.60	3.37	3.50
1966				
Late summer high	5.98*	5.44	4.04	4.24
1967				
Weeks ending:				
February 3 3/	--	5.02	3.25	3.50
September 22	5.82	5.64	3.82	4.14
November 3	6.12*	5.93	3.92	4.27
November 17	6.53	6.10	3.98	4.33
December 1	6.49	6.13	4.03	4.42
December 8 4/	6.55*			

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.
4/ Preliminary estimate based on the terms of three of the four relevant issues that will ultimately be included in the weekly average.
* Some issues included carry 10-year call protection.

An unmanageably large volume of offerings scheduled for mid-November, in conjunction with unsettled market conditions following the devaluation, forced substantial adjustments in the corporate and municipal bond calendars. In the corporate market, a total of more than $550 million of scheduled bond offerings were postponed or cut back in size. Included in this total was the indefinite postponement of U.S. Steel's $225 million debenture issue. Some scheduled municipal offerings were also postponed during the post-devaluation week and several issuers rejected the bids they received.

Flotations of publicly-offered corporate bonds in November aggregated an estimated $750 million--little more than half the volume expected earlier. Total bond and stock offerings estimated at $1.7 billion, remained relatively high, however, as increases in stock offerings and in the projected volume of private placement partially offset the decline in public offerings.

Public bond offerings already scheduled for December aggregate over $900 million, and further additions to the calendar may raise the ultimate volume to $1.0 billion. Fragmentary evidence also suggests that private placement takedowns in December are likely to show the usual seasonal bulge. Thus, the total volume of bond offerings is expected to exceed the reduced November total by one fourth or more. With one large exception, amounting to $150 million; nearly all of the December calendar of public offerings is concentrated in the first half of the month.

CORPORATE SECURITY OFFERINGS1/
(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	4,604	1,627	1,552	4,197	6,834
4th Quarter	2,047	3,100e	1,247	2,200e	3,669	6,100e
October	499	1,350e	256	550e	892	2,250e
November	569	750e	435	650e	1,115	1,700e
December	980	1,000e	555	1,000e	1,661	2,150e
Year	8,018	14,984e	7,543	7,028e	18,075	24,606e

1/ Data are gross proceeds.
2/ Includes refundings.

State and local government bond offerings in November totaled $1.2 billion, and December flotations are expected to be about $1.3 billion. As noted in earlier Greenbooks, this large continuing flow of offerings reflects an unprecedently large supply of industrial revenue issues. In November such issues totaled almost $300 million and some analysts predict more than $500 million will enter the market in December.

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

	1966	1967
1st Quarter	2,964	4,171
2nd Quarter	3,256	3,872
3rd Quarter	2,510	3,050e
4th Quarter	2,674	3,450e
October	759	950e
November	976	1,200e
December	940	1,300e
Year	14,404	14,543e

1/ Data are for principal amounts of new issues.

Mortgage markets. As bond yields have edged higher in recent weeks, upward pressures on home mortgage rates have continued. During October and November, these pressures were reflected in a sharply increased volume of offerings of Government underwritten mortgages to FNMA. In consequence, FNMA cut its secondary market purchase prices by one per cent effective November 25, increasing the yield to FNMA on such loans by about 12 basis points. This was the second price reduction made by FNMA since spring in an effort to bring its prices into closer alignment with the general advance of home mortgage yields. According to FNMA field reports made at the end of last month, the combination of the FNMA price cut and the increase in the Federal Reserve discount rate produced fairly widespread price reductions on FHA and VA mortgages by institutional investors still active in the secondary market. The field reports also indicate somewhat less willingness on the part of investors to commit ahead on these loans, particularly in view of uncertainties about prospective savings behavior after the end-of-year dividend crediting period.

Reflecting the considerably improved availability of mortgage funds which developed earlier this year, total mortgage debt outstanding rose more than seasonally during the third quarter to reach a level exceeding $362 billion. The quarterly increase was again sparked by the dominant savings and loan associations. Net acquisitions of S&L's along with expanded support from FNMA considerably more than offset a leveling-off or decline by more diversified lender groups. Altogether, the S&L share of aggregate expansion in residential mortgages--the major component of total outstanding debt--was the largest for any third quarter since 1963, the record year for association net lending. Data available for October suggest that these trends were continuing into the current quarter.

PERCENTAGE DISTRIBUTION OF INCREASES IN
OUTSTANDING RESIDENTIAL MORTGAGE DEBT

	1965				1966 p.				1967 p.		
	I	II	III	IV	I	II	III	IV	I	II	III
Total	100	100	100	100	100	100	100	100	100	100	100
S & L Assns.	45	49	44	38	39	35	9	1	16	53	53
All others	55	51	56	62	61	65	91	99	84	47	47
MEMO: Total increase in debt, N.S.A. ($ billions)	3.9	5.3	5.4	5.2	3.7	4.1	2.7	2.1	2.2	3.7	4.5

The additional upsurge during the third quarter in the rate of net lending on home mortgages, which still remained considerably below its late 1965 peak, more than offset some indicated decline in growth of mortgage debt secured by multifamily as well as by commercial properties. The reduced growth rate in mortgage debt on income-producing properties reflected the exceptionally rapid spurt in the second quarter and the sharply reduced takedowns by life insurance companies during the third quarter that seem likely to be reversed in the current quarter. Farm mortgage debt again picked up its rate of growth.

INCREASES IN MORTGAGE DEBT OUTSTANDING
(Seasonally adjusted annual rates in billions of dollars)

		Total	Residential			Commer-cial 1/	Farm 1/
			Total	1-4 family	Multi-family 1/		
1965	III	26.8	20.3	16.4	3.9	4.2	2.2
	IV	26.5	20.6	16.9	3.7	3.8	2.6
1966	I p.	27.3	17.7	14.1	3.7	7.4	2.3
	II p.	23.4	14.9	12.0	2.9	6.6	2.1
	III p.	18.1	10.0	7.9	2.1	5.8	2.2
	IV p.	14.9	8.5	6.9	1.6	4.5	1.9
1967	I p.	17.0	10.7	7.6	3.0	5.0	1.4
	II p.	19.9	13.4	10.1	3.3	5.2	1.6
	III p.	23.6	16.8	13.7	3.1	4.6	1.9

1/ Includes estimates for holdings of individual and others which are excluded in the flow of funds series.

The quality of outstanding mortgage debt improved further during the third quarter, judging from such after-the-fact measures as long-term delinquency rates and foreclosure rates relating chiefly to loans closed in earlier periods. Although the composite delinquency rate on home mortgages (MBA series) rose more than seasonally, the increase reflected a rise in short-term delinquencies, partly triggered by strikes and related layoffs. The 60-day-or-more delinquency rate, on the other hand, showed further year-over-year improvement. The over-all foreclosure rate on nonfarm mortgages (FHLBB series) again dipped further, registering the lowest level for the period in four years.

Stock market. Since November 8--when they reached their recent low--stock prices have advanced nearly 5 per cent. As a result, the broad stock price averages on both the New York and American exchanges have recovered nearly two-thirds of the preceding decline from their 1967 highs. Trading activity since November 8 has been heavy, averaging about 11 million shares per day on the New York exchange.

RECENT CHANGES IN STOCK PRICE INDEXES

	S&P 500	Dow-Jones Industrial	AMEX
Per cent decline from high 1/ to November 8	-6.6	-9.9	-7.0
Per cent increase from November 8 to present	+4.5	+4.5	+4.8
Per cent of decline presently erased	63.4	41.2	63.6

1/ October 8 for AMEX index, September 25 for others.

The November increase in stock prices began as only a technical rally of the sort which had occurred several times during the preceding decline. And it was broken temporarily by sharp one-day declines after the British devaluation and again after the recent indication that no tax increase is likely in 1967. Despite these temporary setbacks, however, the rising price tendency has persisted.

In October, despite the drop in stock prices then, margin debt increased by $180 million to $6,090 million, and bank loans to other than brokers and dealers rose by $86 million. Total customer credit, including both margin debt and bank loans, rose to $8,513 million at the end of October, up $1,608 million since the low in January. Customers net free credit balances also rose in October--by $112 million-- to $2,513 million.

U. S. Government securities market. Yields on Treasury obligations have fluctuated over a wide range since mid-November. On balance, Treasury bill rates have risen some 30 to 40 basis points from their levels just prior to the sterling devaluation and the concomitant increases in U.K. and U.S. discount rates, while yields on intermediate- and long-term issues have changed only slightly, as is shown in the table. Currently, yields on Treasury coupon issues are somewhat below their highs of the year reached just before mid-November and again approximated immediately following the devaluation.

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

	1966	1967			
	High	Low	High	Nov. 17	Dec. 5
Bills					
3-months	5.59 (9/21)	3.33 (6/23)	5.01 (12/1)	4.67	4.96
6-months	5.98 (9/19)	3.71 (5/22)	5.60 (12/1)	5.13	5.55
1-year	5.94 (9/21)	3.80 (4/24)	5.67 (12/1)	5.27	5.66
Coupons					
3-years	6.22 (8/29)	4.27 (4/10)	5.87 (11/13)	5.66	5.69
5-years	5.89 (8/29)	4.38 (4/10)	5.91 (11/13)	5.72	5.77
10-years	5.51 (8/29)	4.45 (3/20)	5.87 (11/13)	5.75	5.73
20-years	5.12 (8/29)	4.44 (1/16)	5.81 (11/20)	5.70	5.64

Market reaction to news of devaluation and advances in U.K. and U.S. discount rates was softened by sizable Desk purchases of Treasury bills and coupon issues. In the two weeks following the devaluation, the Desk was a net buyer of over $800 million of bills from dealers, with purchases about evenly divided between those for System account and for official foreign accounts. Immediately after the devaluation, the Desk also bbought $186 million of coupon issues, thereby relieving dealers of the bulk of their inventories in over 1-year Treasury obligations. Since then, dealers have further reduced their holdings of notes and bonds and as of December 4 they had small net short positions in securities due after 1-year.

Following their initial adjustments in the wake of the sterling devaluation, yields in both the bill and bond markets remained highly volatile, as market participants were swayed by apparently changing prospects for some restrictive fiscal measures. Developments in the gold market also affected market psychology. Most recently, fading market hopes for enactment this year of the Administration's tax surcharge proposals have given rise to speculation about a further move in the near future to a less easy monetary policy, including a possible further increase in the discount rate, and a generally weak atmosphere has prevailed in all maturity sectors of the market.

Yields on key short-term market instruments other than bills generally have adjusted up from 1/8 to 1/2 of a percentage point since mid-November as the table shows.

SELECTED SHORT-TERM INTEREST RATES

	1966 High	1967 Low	1967 Nov. 17	1967 Dec. 5
3-months				
Bankers' acceptances	5.75 (10/25)	4.25 (6/6)	4.88	5.38
Federal agencies	5.76 (9/21)	3.82 (5/26)	5.05	5.20*
Finance paper	5.88 (12/31)	4.25 (5/24)	5.13	5.38
CD's (prime NYC)				
Highest quoted new issue	5.50 (12/31)	4.25 (4/21)	5.25	5.50
Secondary market	5.90 (9/21)	4.35 (4/28)	5.30	5.55
6-months				
Bankers' acceptances	6.00 (9/23)	4.38 (6/16)	5.13	5.63
Commercial paper	6.00 (12/31)	4.63 (6/26)	5.13	5.50
Federal agencies	6.04 (9/21)	4.11 (5/19)	5.40	5.45*
CD's (Prime NYC)				
Highest quoted new issue	5.50 (12/31)	4.25 (4/21)	5.38	5.50
Secondary market	6.30 (9/28)	4.35 (4/14)	5.60	6.00
1-year				
Federal agencies	6.13 (9/23)	4.18 (4/7)	5.75	5.95*
Prime municipals	4.25 (9/21)	2.40 (4/14)	3.40	3.75*

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

* Yields on December 1.

Federal Agency offering. An excellent reception was accorded the $1.0 billion sale of new FNMA participation certificates which came to market on November 28. Of the $1.0 billion total, $650 million were sold to private investors, including $450 million due in 26 months at a 6.35 per cent yield and $200 million maturing in 20-years at a 6.40 per cent yield. These yields were about one percentage point higher than those set on the previous PC issues marketed in mid-June 1967.

Federal Budget. Budgetary prospects, as projected by the staff, assuming the passage of a higher wage base for social security contributors, are shown in the table with data through the first quarter of 1968. The seasonally adjusted Federal deficit, in the national income accounts, is projected to decline from its third quarter level of $13 billion to about $6-1/2 billion in the first quarter of next year. If the Administration's surtax proposals were to be enacted early next year, the seasonally adjusted national income budget would be in balance toward the end of fiscal year 1968.

The corresponding cash deficit in the first quarter in 1968 is projected in the amount of $5 billion, giving rise to an equal amount of net cash borrowing through direct Treasury debt. In addition, $2 billion of P.C. sales are assumed for the first quarter. The Treasury may begin cash financing in January, possibly by selling additional June tax bills.

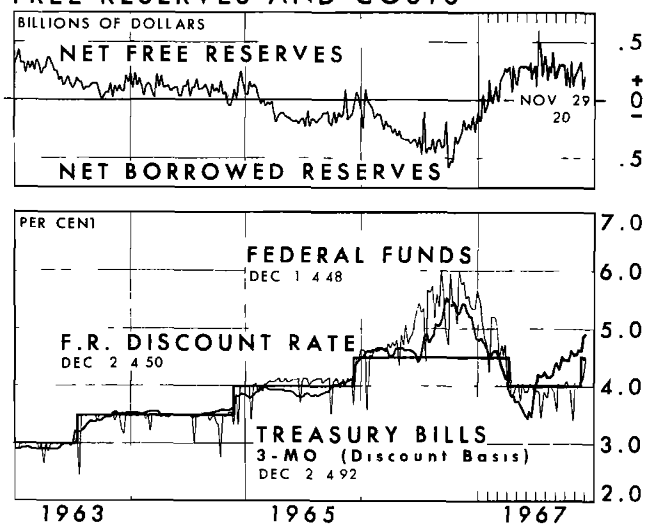
VARIOUS FEDERAL BUDGETS
(In billions of dollars)

	1966		1967				1968	FY 1967	Fiscal Year 1968	
	III	IV	I	II	III	IVe	Ie	Actual	January Budget 3/	Summer Review 4/
Quarterly data, unadjusted										
Cash surplus/deficit (-)	- 6.7	- 7.7	1.4	11.3	- 9.2	-11.1	- 5.0	- 1.8	- 4.3	-11.5
Cash receipts	34.6	31.1	38.0	49.8	35.9	32.0	37.6	153.5	168.1	164.0
Cash payments	41.3	38.8	36.7	38.6	45.1	43.1	42.6	155.3	172.4	175.5
Change in total cash balance	- 4.1	- 2.5	.7	1.2	.3	- 2.5	1.2	- 4.7	--	--
Net Cash borrowing (+)	2.4	5.1	- .9	-10.3	9.3	8.4	5.0	- 3.8	3.8	11.0
(Pool sales to public) 1/	- .5	--	1.1	1.8	--	.7	2.0	2.9	5.0	5.0
Seasonally adjusted annual rate										
Federal surplus/deficit (-) in national income accounts	- .7	- 3.3	-11.9	-14.7	-13.1	-11.6	- 6.6	- 7.7	- 2.1	- 6.4
Receipts	145.6	148.6	149.1	148.1	152.8	156.6	162.2	147.9	167.1	164.0
Expenditures	146.3	151.9	160.9	162.8	165.9	168.3	168.8	155.5	169.2	170.4
High employment surplus/deficit (-) 2/	- .4	- 3.3	-10.5	-13.0	-12.2	-11.0	- 5.9	- 6.8		

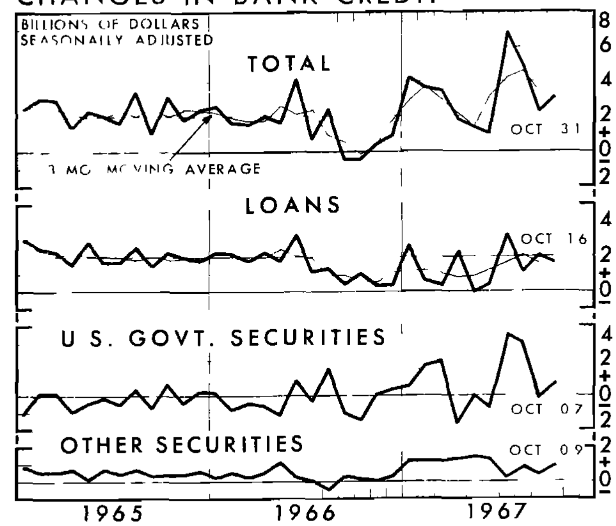
e - Staff projections. Based on existing tax rates.
1/ Not included in net cash borrowing.
2/ Uses 1966 IVQ as a high employment base.
3/ Includes tax legislation proposed in January 1967 estimated to raise $5.8 billion in fiscal 1968.
4/ The President's tax increase proposals were projected to produce $7.4 billion of additional revenues in fiscal 1968, assuming a 10 per cent surcharge effective July 1, 1967, for corporations, and October 1, 1967, for individuals. Figures also assume lowest expenditure totals considered possible by the Administration.

FINANCIAL DEVELOPMENTS - UNITED STATES

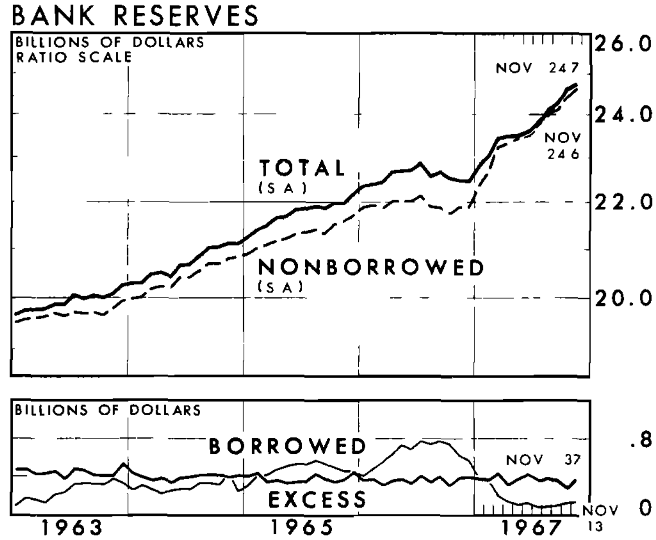
FREE RESERVES AND COSTS



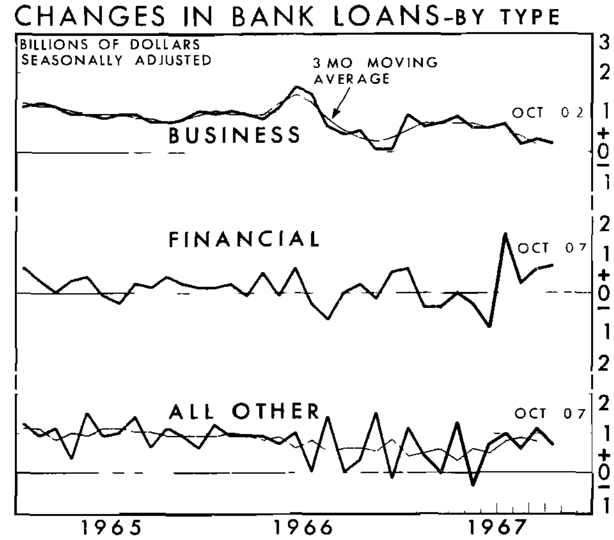
CHANGES IN BANK CREDIT



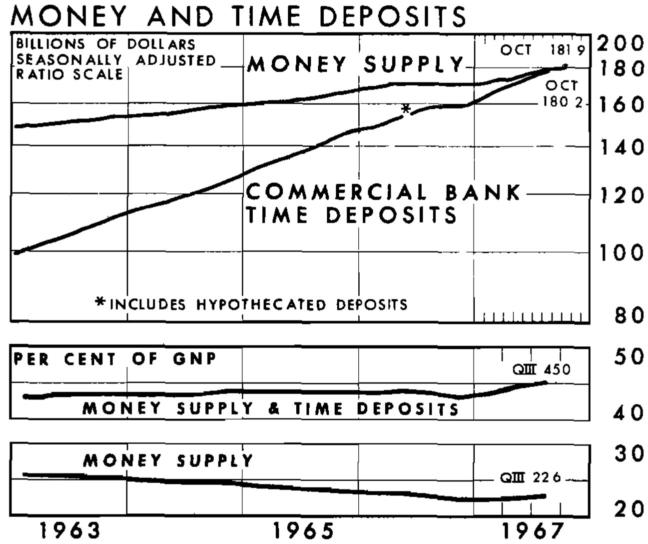
BANK RESERVES



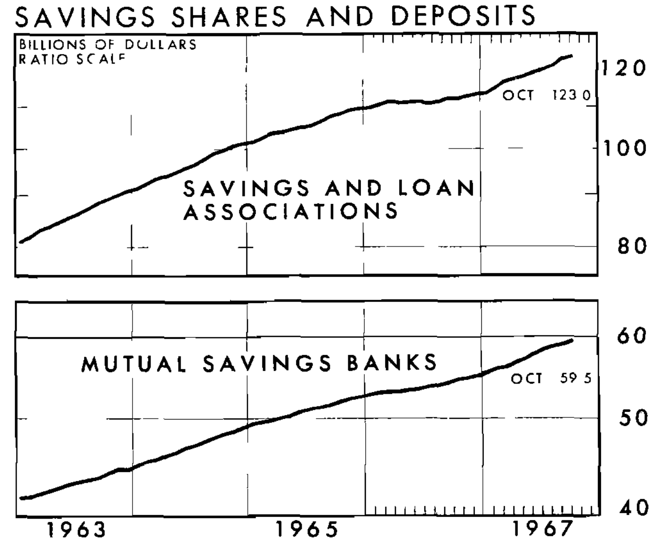
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

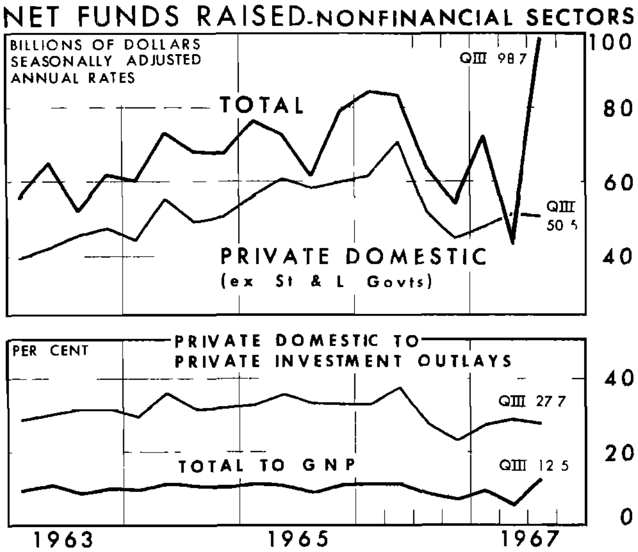


SAVINGS SHARES AND DEPOSITS

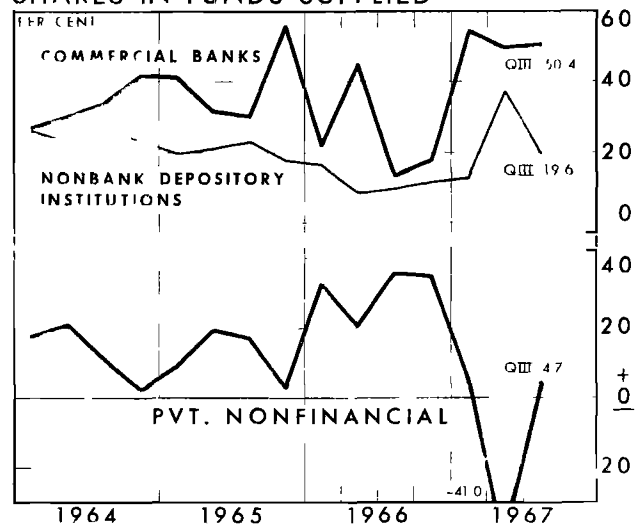


FINANCIAL DEVELOPMENTS - UNITED STATES

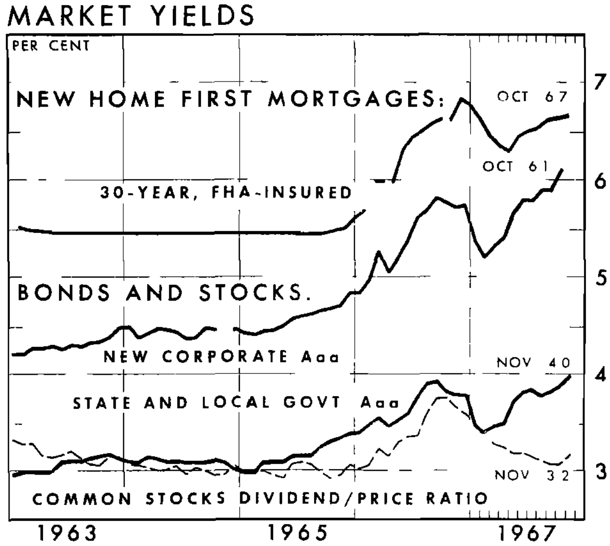
NET FUNDS RAISED-NONFINANCIAL SECTORS



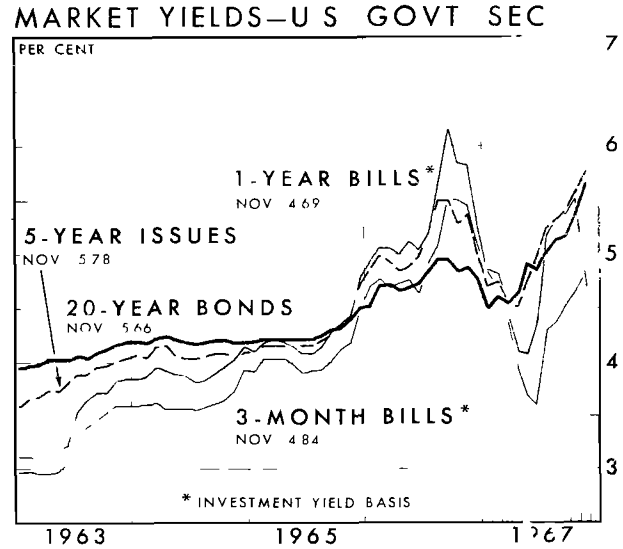
SHARES IN FUNDS SUPPLIED



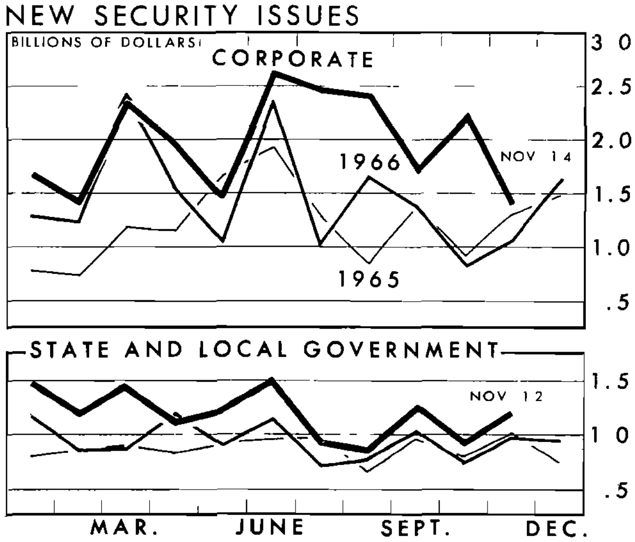
MARKET YIELDS



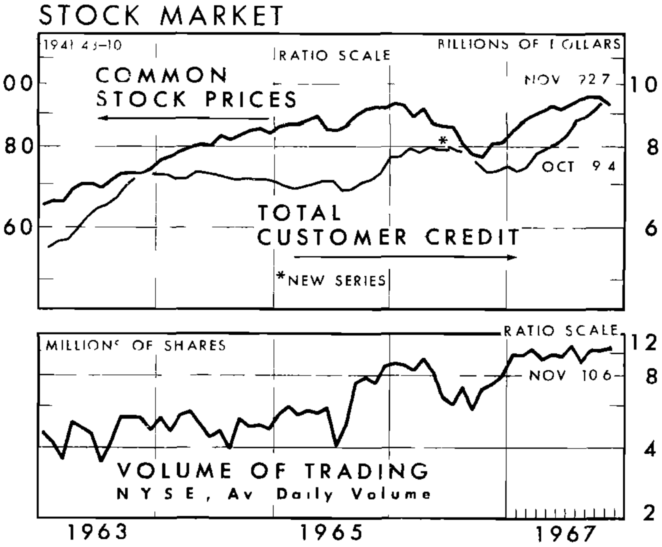
MARKET YIELDS—U S GOVT SEC



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

Contents | Page

U.S. balance of payments. Since September the balance of payments has registered further large deficits and a major attrition of gold reserves has occurred. While heavy gold losses and some of the overall deterioration that has taken place can be traced to the sterling crisis and its aftermath, there was also some weakening of the trade account in October.

The October liquidity deficit (not seasonally adjusted) was near $1.0 billion; excluding "special" transactions, primarily the negative effect of conversions of about $300 million of long-term U.K. Government assets and an offsetting investment of $125 million by Germany in a non-liquid U.S. Treasury issue, the deficit amounted to about $850 million. This would be about $1/4 billion above the average of October deficits for the past several years. Several possible explanations for the larger than usual deficit were offered in the last Green Book, but it now appears that lower exports (discussed below) may have been an important factor, while bank lending was quite small according to early reports.

In November, using weekly data through the 29th, the unadjusted liquidity deficit was on the order of $700 million. About $240 million of the increase in liquid liabilities represented the conversion of the remainder of the U.K. Government investments, but no other large negative factors are known at this time. However, there were probably speculative capital outflows from the United States that will not be recorded in the statistics and, if not reversed in December, may have a sizable impact for the fourth quarter as a whole. In the eleven months through November the liquidity deficit (not seasonally adjusted) amounted to an estimated $3.4 billion, and to about $4.4 billion before reduction by "special" transactions.

Measured on the official reserve transactions basis the deficit in October (NSA) is estimated at about $300 million, and the amount would have been negligible if it had not been for the conversion of the U.K. official portfolio. The contrast with the large liquidity deficit reflected in part increases of about $150 million in liabilities to foreign branches of U.S. banks and about $100 million in U.S. assets of Canadian banks. During November the official reserve transactions balance has gyrated widely, and will probably show a sizable deficit for the month. Liabilities to foreign branches built up considerably in the early part of November, but then fell off again as deposits shifted into sterling, gold and continental currencies.

In the week ending December 6, the Treasury gold stock showed a loss of $475 million, reflecting a transfer to the Stabilization Fund in anticipation of settlement for the U.S. share of the November losses of the gold pool.

Reserve gains by the Common Market countries, including net foreign assets of the commercial banks of these countries, were about $2 billion for the year through October, and a very large further gain accrued to them in November.

In Appendix A some comments are provided about the U.S. balance of payments outlook for 1968, as modified by the possible effects of the U.K. devaluation.

U.S. foreign trade: The U.S. merchandise trade surplus fell sharply in October from the September rate, as exports declined by about 8 per cent while imports held firm. This was a surprising drop, since foreign demand was not expected to weaken. About three-quarters of the total drop of $200 million (seasonally adjusted) in exports from September to October appears to be related to the following special events.

1. Emergency crude oil shipments, particularly to the United Kingdom, necessitated by the Arab-Israeli war, came to an end.

2. Exports of aircraft, which fluctuate greatly from month to month, fell sharply in October following a steep rise in September.

3. Automobile exports, which ordinarily increase seasonally from September to October, failed to rise this October because of the Ford strike. It is likely that some shipments were only temporarily postponed and that exports of automobiles around the end of the year may be greater than usual.

4. Shipments of tobacco to the United Kingdom and wheat to Pakistan fell substantially in October because of delays in shipments under government programs. Deliveries of these products are expected to return to a more normal rate sometime later in the marketing year.

The decline in exports to the U.K. in October was particularly pronounced. In addition to the reductions in tobacco and crude oil shipments mentioned above, there were reduced exports of chemicals and machinery which may stem, in part, from dock strikes in London and Liverpool.

U.S. FOREIGN TRADE
(billions of dollars; balance of payments basis)
Seasonally adjusted annual rates

	1966		1967	
	1st half	2nd half	1st half	July-Oct.
Exports	28.8	29.6	30.8	30.0
Imports	24.5	26.5	26.4	26.3
Trade balance	4.3	3.0	4.3	3.8

Note: Figures may not add due to rounding.

For the four months of July-October combined, the U.S. trade surplus on the balance of payments basis was at an annual rate of $3.8 billion, compared with $4.3 billion in the first half of the year. The entire drop can be attributed to exports (mainly because of the low October figure) as imports in the July-October period were close to those in the first half. Both agricultural and nonagricultural exports in July-October were about 3 per cent lower than in the first half of the year.

By area, shipments to Japan and Western Europe in July-October were running at a higher rate than in the first half of the year. Excluding emergency oil shipments, however, exports to Western Europe would have been about the same in both periods. Deliveries of goods to Canada, Latin America and other Asia and Africa countries in July-October were below the average rate of the first six months, seasonally adjusted.

Sterling devaluation aftermath. The financial repercussions of the British devaluation and accompanying measures of domestic restraint have thus far been fairly limited -- at least apart from the rush to buy gold in the London market in the first week after the devaluation. No important devaluations subsequent to those mentioned[1/] in the Interim Green Book have occurred. There have been moderate increases in short-term interest rates in some countries, and sharp advances in sterling money market and Euro-dollar rates -- the latter partly reversed since November 28. There were movements of private funds from Euro-dollars into German marks; these were subsequently more than offset by outflows of German bank funds, stimulated by Bundesbank provision of forward cover at attractive rates.

Despite high short-term rates in sterling money markets, the persistence of a sizable discount on forward sterling has inhibited inflows of covered-interest-sensitive funds into sterling.

Short-term capital flows. Exchange rates and reserve data indicate that movements of funds into Continental European currencies, which had developed in the week following sterling devaluation on November 18, tapered off after Friday, November 24.

Disappointingly, there has been no further massive reflow into sterling since the first few days after the devaluation. For the month of November Britain's published reserves showed a $127 million gain including $490 million of proceeds of liquidation of the dollar securities

1/ On page 15 of the November 25 Interim Report the footnote to the table should have included Ceylon and Iceland. Various small British dependencies and former dependencies also devalued; Nepal did not.

portfolio, or a \$363 million loss without that. The total drain (unpublished) arising from underlying deficit plus net short-term capital flows was much larger, as the British received official assistance, including a \$250 million net increase in their swap drawings with the Federal Reserve.

Massive buying of gold in the London market in the week after sterling devaluation gave place last week and this week to diminishing dealings. Sales by the Gold Pool fell off sharply after the Frankfurt meeting of central bank governors on Sunday, November 26, and this week there have been some net purchases by the Pool.

Capital flows into Continental European currencies after the sterling devaluation apparently included sizable movements into German marks and French francs, reaching peak intensity on Friday, November 24. In the following week, as a result of Bundesbank actions described below, German commercial banks made large placements of funds in dollar assets (or other foreign exchange). The Bank of France's official reserves (including IMF position) rose by about \$290 million during the month of November as a whole.

Probably the movements out of dollars into gold and Continental currencies were in large part movements of Euro-dollar funds, no doubt including funds that had moved out of sterling before the devaluation. It is therefore not surprising that the liabilities of U.S. banks to their branches abroad have declined somewhat since devaluation. On November 29 they were about \$400 million lower than on November 15. (The high figure on Wednesday, November 22, was a pre-Thanksgiving abnormality.)

Interest rates. In the London Euro-dollar market, rates jumped sharply after the devaluation weekend. They rose further until Tuesday, November 28, but have fallen back somewhat since then. On Wednesday, December 6, the 3-month rate stands at 6-1/4 per cent, compared with 5-3/4 per cent before the devaluation and a peak of 6-7/8 per cent in between.

EURO-DOLLAR DEPOSIT RATES 1/
(per cent per annum)

	Call	1-month	3-month	6-month	Year
Fri. Nov. 17	4.56	4.94	5.75	5.94	6.19
Tues. Nov. 21	4.88	5.25	6.44	6.50	6.63
Fri. Nov. 24	5.13	5.75	6.75	6.81	6.88
Tues. Nov. 28	5.88	6.50	6.88	6.88	7.13
Fri. Dec. 1	5.38	6.63	6.63	6.63	6.75
Tues. Dec. 5	5.25	6.19	6.19	6.25	6.44
Wed. Dec. 6	5.26	6.06	6.25	6.19	6.44

1/ London brokers' bid rates.

The sharp rise of around 1 per cent in Euro-dollar rates between November 17 and November 28 accompanied a comparable rise in sterling interest rates, both on Treasury bills and on local authority deposit obligations, following the 1-1/2 per cent increase in Bank Rate announced November 18. It is likely that withdrawals of dollar supplies by buyers of gold and Continental currencies were a factor in the Euro-dollar rate rise. The subsequent easing reflected the calmer state of exchange markets in recent days, and was undoubtedly pushed along by the additional supplies of funds put into the market by German commercial banks.

For U.S. banks, the current level of the 3-month Euro-dollar rate, 6-1/4 per cent, is high relative to the new issue rate on CD's which is now at the 5-1/2 per cent Regulation Q ceiling.

Continental European interest rates have in general risen comparatively little since November 17. The Canadian Treasury bill rate, abnormally high in mid-November in relation to the Bank of Canada's discount rate, rose further by 1/2 per cent in the two weeks after sterling devaluation, following the 1 per cent rise in the Canadian discount rate. In all major industrial countries, long-term rates have changed little since mid-November.

Forward exchange rates and covered interest rate differentials. The discount on forward sterling, which had widened in the first half of November to 1.6 per cent per annum on the three-month contract, settled down during the second week after the devaluation at around 1-1/4 per cent, with the spot rate at the $2.42 ceiling and the forward rate about $2.413. (This week both spot and forward rates have weakened, and the forward discount has widened.) With a 1-1/4 per cent discount, the covered rate differential favoring Euro-dollars over local authority deposits at the end of last week was about 1/4 per cent. Since October 20, just after the October 19 advance in the U.K. Bank Rate, the local authority rate has risen a little more than the Euro-dollar rate, but the forward discount is larger now than at that time. Thus, because of high Euro-dollar rates and the persistence of sizable forward discounts on sterling, covered switching from Euro-dollars into sterling has not developed.

For the German mark, the market rate of forward premium against dollars widened to 3 per cent or more on November 24. However, since Monday, November 27, following the Sunday decision of the Bundesbank to offer the German commercial banks swaps at an attractive rate, the market

INTEREST RATES
(per cent per annum)

	Nov. 10 Fri.	Nov. 17 Fri.	Nov. 24 Fri.	Nov. 28 Tues	Dec. 1 Fri.
Short-term:					
Euro-dollar:					
Call	4.56	4.56	5.12	5.88	5.38
1-month	5.06	4.94	5.75	6.50	6.63
3-month	5.75	5.75	6.75	6.88	6.63
6-month	5.88	5.94	6.81	6.88	6.63
United Kingdom (£):					
90-day Treasury bills	6.20	6.26	7.40	n.a.	7.33
90-day local authorities dep.	6.75	6.81	7.69	n.a.	7.69
Germany:					
Call interbank a/	2.0	1.38	3.00	n.a.	1.75
90-day interbank a/	4.0	3.88	3.88	3.88	3.88
France:					
Call	4.62	4.38	4.58	4.75	4.69
1-month b/	4.58	4.75	5.00	n.a.	5.00
3-month b/	5.12	5.12	5.31	n.a.	5.38
Canada:					
91-day Treasury bills a/	4.96	4.97	5.39	n.a.	5.46
Long-term:					
U.K. 3-1/2% War Loan a/	7.06	7.07	7.12	n.a.	7.12
Germany 6% public authorities a/	6.64	6.64	6.64	6.62	6.64 c/
Canada 5-3/4% Govt. 1992 b/	6.27	6.47	6.47	n.a.	6.38

a/ Thursday rates in the Friday columns.
b/ Wednesday rates in the Friday columns.
c/ Wednesday, Nov. 29.

premium has remained at or a little below 2 per cent per annum. With three-month German interbank loans stable at 3-7/8 per cent and with three-month Euro-dollar deposits moving down from 6-7/8 on the 28th to 6-1/4 now, the covered rate spread in favor of flows into dollars has narrowed but remains positive, at about 1/2 per cent.

For two days last week (November 27 and 28) the Bundesbank offered the banks swaps into dollars with a special forward premium rate of only 1-3/4 per cent per annum as the cost of DM cover. This gave the banks very favorable covered interest spreads (1-1/4 per cent on three-month investments) and produced a very large outflow of funds -- contributing to the easing of Euro-dollar rates, as noted above. To damp this outflow, which was threatening to tighten the German money market, the Bundesbank raised its special swap rates. Effective November 29 the rate for swaps maturing in January was raised to the relatively unattractive level of 2-1/4 per cent, and a further increase to 2-1/2 per cent was made on December 1. For longer swaps the Bundesbank changed its rate to 2 per cent at first and then to 2-1/4 per cent.

It is possible that some of the $600 million of preferential rate swaps entered into by German banks in the four days November 27-30 replaced maturing market cover, and did not put fresh money into the Euro-dollar market. However, if the market rate for forward DM had remained at 3 per cent or more (as might have happened in the absence of the Bundesbank's intervention) outstanding covered investments in dollars might not have been renewed at maturity.

Other European financial markets. Conditions in Swiss financial markets appear to have been little affected by the sterling devaluation. The Swiss money market began to tighten in mid-November in anticipation of the usual end-of-year liquidity pressures and windowdressing. The Zurich 3-month deposit rate has held at 4 per cent since the end of October, when it rose from a low of 2.75 per cent in mid-September. In the Swiss capital market, new issues are being well subscribed. Swiss National Bank reserves declined during the first half of November, when transfers of the Swiss banks' loan to the U.K. occurred; changed little in the statement period straddling the devaluation weekend; and rose by $64 million in the period November 24-30 inclusive.

The U.K. devaluation had no major effects on financial conditions in Italy. Bank of Italy reserve gains in the first half of November reflected primarily the favorable underlying balance of payments, which this autumn has been benefiting from German supplies of commercial credit.

Repercussions in Japan. On November 25, Japanese banks increased by 1/4 per cent the interest rate on dollar import acceptance credits. (The rate for 90-day bills with letter of credit, for example, was increased from 7-1/2 to 7-3/4 per cent.) This followed the increase in American bankers' acceptance rates after the U.S. discount rate increase. The usual seasonal outflow of short-term capital has been intensified.

The Japanese stock market in the week of November 20-25 had one of its worst drops in years, as investors considered the possible effects of sterling devaluation on Japanese trade. On November 20 the stock average fell even more than the historic decline on July 19, 1963, when President Kennedy proposed the Interest Equalization Tax.

Call loan money rates are expected to rise in December by about one-third of a percentage point as a result of a tightening of Bank of Japan credit to commercial banks. This would increase the over-month-end call loan rate to 8.03 per cent, the highest level in two and a half years.

On the fiscal side, the Government reportedly plans to make the budget for the fiscal year beginning next April more restrictive, particularly by restraining the growth of public works expenditures. This move, prompted by the British devaluation and subsequent actions, is designed mainly as a defensive measure to reduce adverse pressures on the balance of payments.

Stand-by credits for U.K. The British Government announced on November 23 that new credit arrangements totalling $1.5 billion had been worked out with foreign governments and central banks. Also, the $1.4 billion IMF stand-by arrangement was formally approved on November 29, after participants in the Fund's General Arrangements to Borrow (GAB) accepted the proposed financing arrangements.

The British Government's letter of intent to the IMF stated as one of its goals a balance of payments surplus on current and long-term capital account at an annual rate of $480 million in the second half of 1968, and "a further substantial rise" beyond that. (In 1967 there will have been a deficit on this basis. Swollen by extra imports after the late-1966 removal of the surcharge, by effects of the Suez Canal closing, and by dock strike repercussions, this deficit may exceed $800 million.) In outlining the measures taken and to be taken to back up the devaluation, the letter referred to the measures to restrain domestic public and private demand and to hold back wage and price increases that were announced on November 18 (see Interim Green Book, November 25). In addition, a tentative judgment was expressed that it would be desirable to hold the Exchequer's borrowing requirement in the fiscal year beginning next April to not more than £1 billion. This goal, and the measures necessary to reach it, will be reviewed with the Fund staff next February, and again in July and November 1968. Finally, the Government stated that the course of bank credit expansion "will be taken into account in determining appropriate policy actions"; its expectation at present, taking account of past and future measures, is that the expansion "will be sufficiently limited to ensure that the growth of money supply will be less in 1968 than the present estimate for 1967 ... despite the expected substantial recovery of reserves."

Domestic economic conditions in Britain. The pace of economic activity did not accelerate significantly in the months preceding devaluation, so far as the available data go. Industrial production, which had risen markedly in June and July, fell off again in August and September. Output for the third quarter as a whole was a scant 1/4 of one per cent higher than in the second quarter.

Unemployment fell slightly in October and November -- the first declines in 1967 -- suggesting a resumption of last spring's recovery in activity. However, at 2.3 per cent, the unemployment rate is only a little below the 2.4 per cent peak reached during July and August, and is far above the rate of 1.8 per cent in November 1966 and the rate of 1.2 per cent which prevailed in the first half of 1966.

Price rises have been moderate since the period of severe restraint ended at midyear. Retail prices fell from June through September and then rose sharply in October, but not quite up to June's level. The index was only 2 per cent higher than in October 1966. Wholesale prices of manufactured goods (home market sales) rose slightly less than one per cent in the June-October period.

Wages shot up in July by 1.6 per cent in a single month, but advanced less than 1 per cent over the next three months.

Concern over the depressing effect on business of the government's already announced restrictive measures, coupled with fears that the government will impose further restraints in the months ahead, has produced a slide in stock prices. The Financial Times index of 30 industrials was over 6 per cent lower yesterday (Tuesday, December 5) than it had been the day before devaluation.

Current conditions in Germany. The beginning of recovery in industrial orders and production which became apparent with the July data has continued. Though the production index in August and September was below its sharply raised July level, a new advance in October brought the average for the third quarter to 2 per cent above that of the preceding quarter.

German business opinion looks for a strong first quarter of 1968 -- with inventory investment stronger after the shift to the value added tax system is made, and with construction activity picking up after the winter season. For the final months of this year there is little bullishness. Part of the strength in orders and output in October was related to end-of-month deadlines for orders under the special investment budget and also under the special depreciation allowance plan. However, a considerable advance in nondurable goods output also occurred in October.

The Canadian economy: fiscal policy. Canada this year has been faced with the unpleasant combination of slow industrial demand and accelerating inflation. Pressures on prices have grown out of a combination of rapid increases in wages and heavy federal budget deficits. Manufacturing hourly earnings rose by 8 per cent in the twelve months to July of this year, while most studies suggest that productivity is rising less rapidly in Canada than in the United States. The current federal budget requires financing of $1.5 billion, approximately double the requirements of last year.

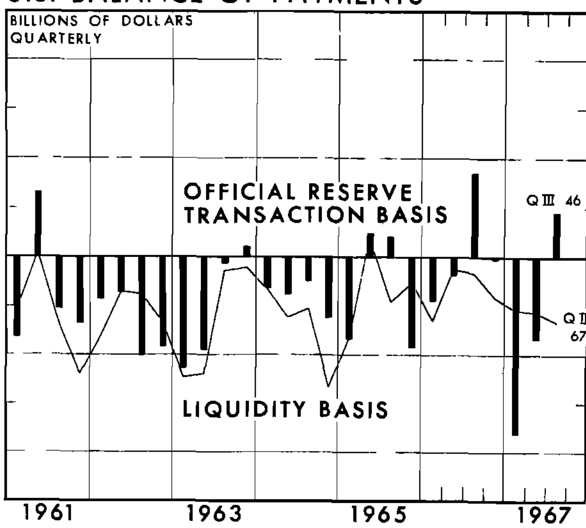
The Canadian Government has now responded to these difficulties with a restrictive fiscal policy. On November 30 Finance Minister Sharp announced a tax program which, in combination with restraints on expenditures, will reduce next year's federal borrowing requirements to $750 million. A 10 per cent increase in liquor and tobacco taxes takes effect immediately, and a 5 per cent surtax on personal income taxes is scheduled for January 1. Corporate profits tax payments are to be speeded up, but the effect of this will be offset by the beginning of refunds of the special refundable tax on corporate profits. The repayments begin in June 1968.

In addition to providing a restraint on aggregate demand and an easing of pressures on financial markets, the tax program seems to be aimed particularly at consumers; the absence of any increase in the tax burden on corporations suggests that the government may be trying to shift resources out of consumption and into investment.

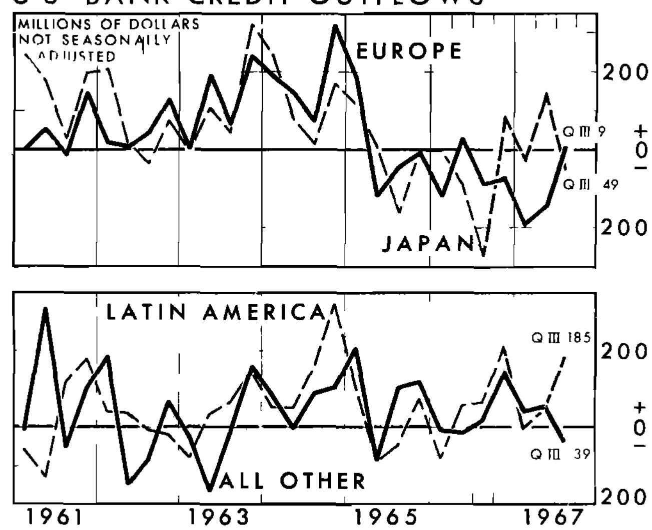
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

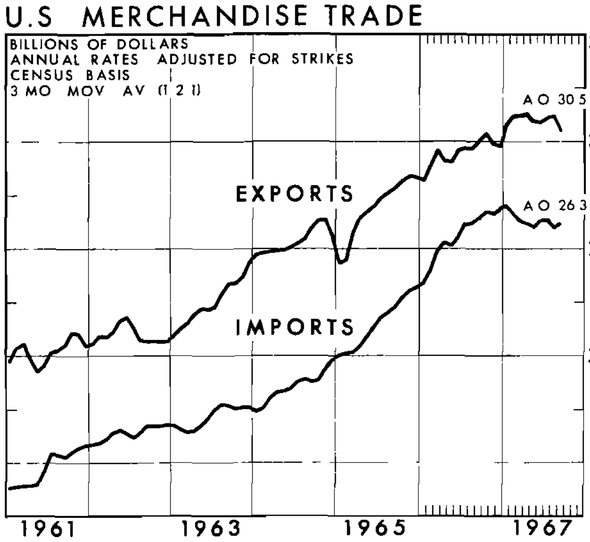
U.S. BALANCE OF PAYMENTS



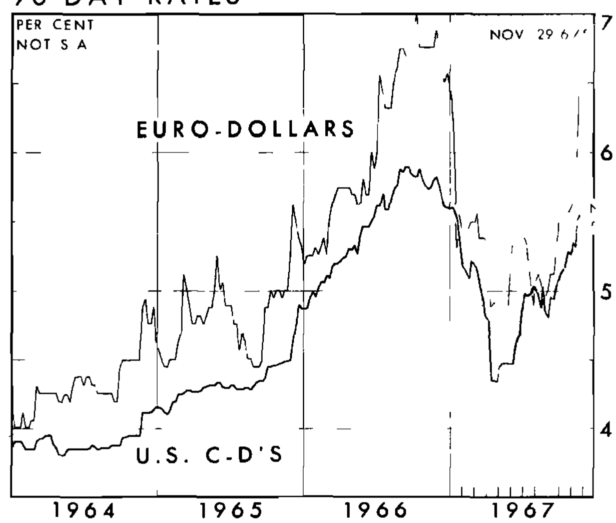
U S BANK CREDIT OUTFLOWS



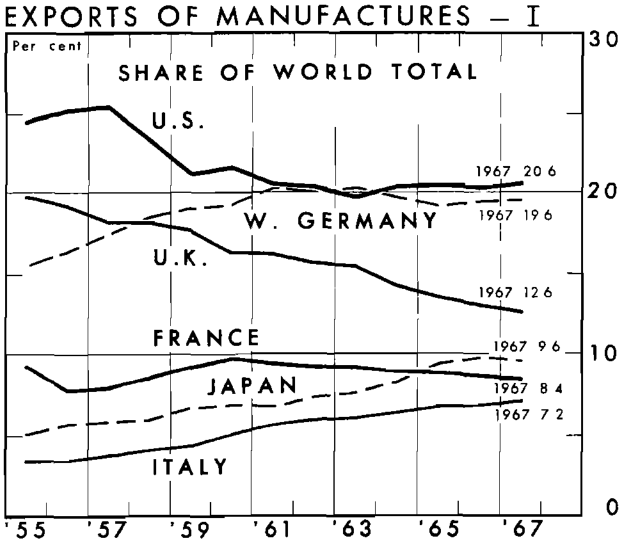
U.S MERCHANDISE TRADE



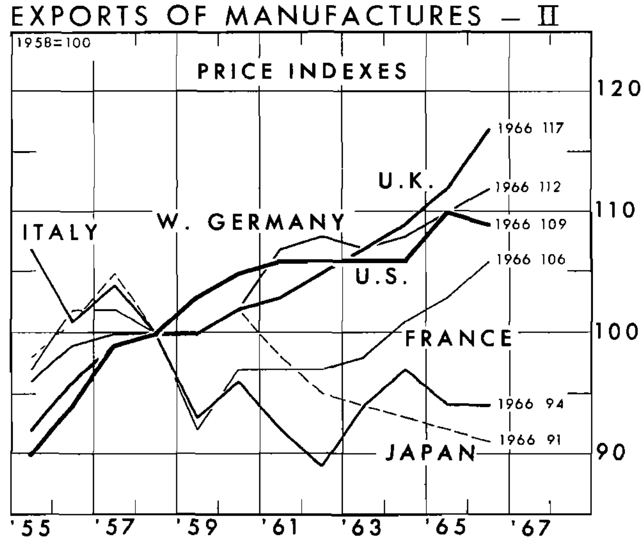
90-DAY RATES



EXPORTS OF MANUFACTURES — I



EXPORTS OF MANUFACTURES — II



APPENDIX A: IMPACT OF U.K. DEVALUATION ON THE U.S. BALANCE OF PAYMENTS

The most recent inter-agency projections of the U.S. balance of payments for 1968 were made in early November, before the devaluation of sterling and before data for U.S. merchandise trade in October were available. That projection was based on a number of assumptions that might now be modified, including those made for GNP here and industrial production abroad, both of which may be too high, but for present purposes the reassessment in this note is confined mainly to the effects of the U.K. devaluation.

On the liquidity basis, the projected deficit for next year was estimated to be well over $3 billion; no allowance was made (except for the German agreement) for possible reductions in the published result through special financing operations by foreign governments, partly because of their unpredictability, but also because it was anticipated they might not be forthcoming. It now appears that this year's liquidity deficit, as published, will also be well over $3 billion, even after deducting very large amounts of "special" receipts.

The main elements of the 1968 projection were: (1) a merchandise trade surplus of about $4-1/2 billion, about the same as was then projected for 1967; (2) an improvement in other current account items and private remittances of $1/2 million, stemming largely from gains in investment income receipts and from elimination of the extraordinary remittances to Israel and travel payments to Canada of 1967, partly offset by an increase in military expenditures, (3) reduced outflows of U.S. private capital of most types, though an allowance was made for larger direct investments in less-developed countries, and (4) some increase in the rate of U.S. Government net credits to foreigners.

In these projections no specific assumptions were made about the situation of the U.K. other than to include an estimate of the rate of growth of industrial production in the U.K. Implicitly some share of the overall increase in exports would be expected to go to the U.K., and some share for the U.K. of the rise in U.S. imports would be similarly implied. A summary of U.S. current transactions with the U.K. is given in Table 1. The U.K. accounts for 5.7% of U.S. exports and 7% of U.S. imports. Assuming roughly pro rata shares of 1967-68 projected changes in merchandise trade, U.S. exports to the U.K. would have risen about $125 million, and imports from the U.K. would have risen by about $150 million. Receipts of income and fees would also have been expected to rise about $50 million. On balance, therefore, these earlier estimates did not imply any significant change in the U.S.-U.K. bilateral current balance between 1967 and 1968. On the other hand, the projections did not allow for a major change in the U.K. balance of current and long-term capital transactions, which showed only a minor deficit in the first half of 1967 and could have shifted into a modest surplus in 1968 without a major modification of world trade patterns. As it turned out, the basic deficit of the U.K. worsened sharply in the second half of 1967, and a substantial shift will now be necessary to meet U.K. goals as communicated to the International Monetary Fund.

Effects of Devaluation on U.K. Trade Balance

Although it is not the purpose of this note to evaluate the chances of the U.K. achieving a large surplus, or to enumerate the obstacles to be overcome, some rough judgments have to be made of the extent of the change in the U.K. current account that might occur because of devaluation and associated measures, in order to come to some conclusions about the consequences for the United States.

It now appears that the deficit in the U.K. current account in the second half of 1967 may be on the order of £200 million, and for the full year about £300 million. In terms of the old exchange rate, this is a deficit for the year of about $850 million. On merchandise trade alone (balance of payments basis) this would represent a deficit of about $1.1 billion, including exports of about $14.5 billion and imports of $15.6 billion. Before devaluation, the OECD had projected some improvement in the U.K. trade balance for 1968. The OECD assumed a 5.5% increase in exports (though from a 1967 export estimate that was probably too large) and a 3% increase in imports. In this note (see following table) the export increase to be expected is raised slightly to 6%, but a larger increase of 5% is used for imports on the grounds that the OECD projection assumed a slower growth rate for the U.K. economy than was assumed in the inter-agency projection. This results in only a minor gain in the trade balance in 1968 over 1967.

There is considerable debate about whether, with devaluation, domestic demand in the U.K. can be damped down enough to make room for greatly enlarged exports, and whether U.K. exporters will aggressively seek larger foreign sales through price cuts and more energetic promotion. It seems to be the judgment of the IMF, and also of the OECD staff, that the U.K. is likely to achieve a modest current account surplus for 1968, which might be taken to mean on the order of £150 million, or $360 million. The full potential of the devaluation would be delayed into 1969, when a current account surplus at a rate of £400-500 million is suggested, on the assumption of adequate domestic policy measures. However, the gain from a large deficit in 1967 to even a modest surplus in 1968 amounts to a net shift of over $1 billion (it would be even larger from the rate of the last half of 1967). A further large gain for 1969 over 1968, as noted above, would therefore be a considerable achievement.

These target levels of current account surplus for the U.K. could be reached through various combinations of export and import changes. The choice made here is to assume that about one third of the gain will come from increases in exports above the levels they might have attained without devaluation, and two thirds from reduced imports. In the following table, the U.K. export gain from year to year in dollar terms is put at 9%, which amounts to an incremental increase resulting from devaluation of about 3%, added to the 6% increase that might otherwise have occurred. The total export gain for the year would then amount to $1.3 billion, of which about $450 million represents the added effect of devaluation. These rates of exports are up sharply over the last half of 1967, when dock strikes held down exports. Of course, the 1968 estimates make no allowance for similar work stoppages. On the import side, it is assumed that higher sterling prices, and measures taken to dampen internal demand, will hold the dollar cost of imports down to the 1967 amount, rather than the 5% gain that might have occurred. As a rough approximation, the U.K. trade balance overall in 1968 might improve by $1.3 billion compared to the 1967 balance, and by $1.2 billion over the balance that might have resulted without devaluation. The following section attempts to evaluate the direct and indirect trade effects for the U.S. of such an improvement in the U.K. trade balance.

ESTIMATE OF U.K. CURRENT ACCOUNT, 1967 AND 1968
(in billions of dollars)

		1967			1968	
	1966	I half	II half (est.)	Year	Without devaluation 1/	With devaluation 2/
Merchandise trade 3/						
Exports	14.3	7.5	7.0	14.5	15.4	15.8
Imports (f.o.b.)	14.6	8.0	7.6	15.6	16.4	15.6
Net	-.3	-.5	-.6	-1.1	-1.0	+.2
Other current account, net	+.2	+.2	--	+.2	+.2	+.2
Total current account, balance	-.2	-.3	-.6	-.9	-.8	+.4

1/ Assumes exports +6% and imports +5%, 1968 over 1967. An earlier OECD projection assumed exports +5.5% and imports +3%, 1968 over 1967, but using a different 1967 estimate.

2/ Assumes exports +9% over 1967; imports are held at the 1967 estimated dollar amount.

3/ As included in the balance of payments accounts.

Effect on Trade Balance

In 1966, U.S. exports to, and imports from, the United Kingdom were roughly in balance, at about $1.7 billion each. About 17 per cent of total exports to the U.K. were foodstuffs, 38 per cent were industrial materials (including tobacco) and 32 per cent were capital goods, principally machinery. Automobiles and other consumer goods were 7 per cent of the total. In contrast about one third of our imports from the U.K. in 1966 were automobiles and other consumer goods. Imports of industrial supplies and equipment together were 50 per cent of the total and another 15 per cent were foodstuffs, mainly alcoholic beverages (see Table 2).

Most of our exports to the U.K. are not generally sensitive to price changes since they are essential and demand for them would be relatively inelastic. Food shipments are primarily determined by supplies both in the U.K. and in other exporting countries, such as Argentina and Canada, rather than by U.K. price movements. Sales to the U.K. of industrial supplies and equipment are primarily affected by the rates of economic activity there, and on the capacity-utilization ratio. It can be presumed that the U.K. needs these materials to support industrial expansion. Alternative foreign suppliers would offer no price advantage, unless there were widespread price cutting because of continued economic slack in Europe, and only a small portion of these goods is likely to be produced domestically by utilizing unused capacity.

Our exports to the U.K. (excluding emergency shipments of crude oil resulting from the Arab-Israeli war) in 1967 increased by about 8 per cent from 1966, despite the sluggishness of the British economy. With an economic upturn there anticipated in 1968 even before the devaluation, further increases in exports to that country of about $125 million in the coming year were expected. With devaluation, this increase is less likely to occur, although it seems unlikely that shipments would fall below the 1967 rate.

Exports of consumer goods (about $100 million in 1966 and holding at that rate in 1967), which are more responsive to price changes, can be expected to drop somewhat. Shipments of industrial materials (including tobacco) and equipment might also be held down temporarily if the U.K. were to reduce inventories. (There is some indication that there was some increase in stocks of manufactures, particularly machinery, by the U.K. in the first half of 1967, possibly reflecting the abolition of U.K. import surcharges at the beginning of the year.) Machinery and aircraft, however, are long-lead items and no immediate change in deliveries of such equipment is to be expected. In summary, a rough guess would suggest a decline of about $100 million below previously projected exports to the U.K.

in 1968 as the initial effect of the devaluation. If the U.K. succeeds in increasing output and export sales there is a strong possibility that the U.K.'s requirements for imported industrial materials and equipment may increase, and the U.S., which accounts for about 12 per cent of the U.K.'s total imports, can be expected to provide part of these additional imports beginning in the later part of 1968. To the extent the anticipated increase in U.K. exports is at the expense of internal demand, with only a very small change in total output, such a "feedback" effect would be negligible.

Imports from the United Kingdom, with about one third consisting of consumer goods, may be effected to a greater degree than exports by the devaluation. Demand for consumer goods is highly elastic and imports of such items may rise appreciably above the $600 million total purchased from the U.K. in 1966. A major question, however, is the extent to which the potential lowering of dollar prices made possible by the devaluation will be passed on to the U.S. importers or retained by British exporters to increase their profit margin. In the latter case, the dollar value of U.K. exports might be unaffected in the short run, but promotional efforts and investment aimed at future export business might yield longer-run gains. First reports indicate that the dollar price for scotch whiskey has held, with the sterling price being increased by the full 14.3 per cent of the devaluation. This may be equally true for other commodities such as gem diamonds, where the supply is limited and demand relatively inelastic. For still other commodities, such as metals, current delivery contracts are in terms of U.S. dollars. Dollar prices of such commodities would not quickly be changed by the devaluation.

A basic difficulty limiting possible reductions in U.K. prices is the high dependence of the U.K. on imported raw materials. For example, in the case of woolens, the sterling price of raw wool from Australia, which has not devalued, can be expected to increase, and this increase, compounded by markups through the channel of production, is likely to be carried through to the finished woolen product. The import content of total consumption in the U.K. is about 20 per cent, and it may be higher for exports. In any case, with more aggressive marketing by the British there are likely to be shifts among suppliers, e.g., British woolens may now compete more effectively against Italian woolens, British cars with German cars, etc. Such substitution would not add to total imports but would replace one foreign source by another.

Under the recent inter-agency projection, imports from the U.K. could have been expected to increase by about $150 million in 1968, assuming the U.K. holds its 7 per cent share of total U.S. imports. After devaluation, a further increase of $100 million might be reasonable, largely in consumer goods. About $50 million of this additional rise in imports from the U.K. might represent a shift from other foreign suppliers.

On balance the direct effects of the devaluation may result in a reduction of about $200 million in our trade balance with the U.K. in 1968, but this includes about $50 million of imports diverted from other countries, so the net direct trade effect might be adverse by $150 million.

The effect of the U.K. devaluation on U.S. exports to other countries might be of the same order of magnitude. As noted above, some gain in U.K. exports in 1968 was anticipated before devaluation, and the incremental export gain from devaluation (including not only price effects but also increased sales effort) might be on the order of $450 million.

The U.S. share of world exports of manufactured products (excluding those to the U.S. and the U.K.) was about 21 per cent in 1966. On a pro rata basis, an incremental British gain of $450 million in exports of manufactured products (of which $100 million might be to the U.S.) could mean a loss of about $100 million in U.S. shipments to these markets. The amount of this loss could vary, depending on a number of factors. In terms of the area distribution of trade, a strong gain in U.K. export sales to Canada and Latin America, where the U.S. predominates as a supplier, would have greater adverse effects on our exports than an expansion by the U.K. in European and Asian countries where the U.S. is a less significant supplier (see Table 5).

The reduction in income from reduced exports to the U.K. by those countries which are traditionally large suppliers to the U.K. may also affect our trade balance. Sterling area countries, such as Australia, India, and Pakistan, which have not devalued, may be particularly hard hit. U.S. exports to those countries may drop while those countries try to adjust to their loss of sales in the U.K. market.

Perhaps the greatest uncertainty is the reaction of exporters and governments in countries that compete in world markets with U.K. manufactured goods. There is already some evidence of concern that local firms will be at a competitive disadvantage, and governments may well try to effect an offset to devaluation by adjusting border taxes or through other means. Manufacturing firms in some of the countries where domestic demand has not been strong and where there is unused capacity would certainly try to match any British price reductions. As a consequence, U.S. exports could be faced not merely with a U.K. export drive, but also with a tendency for prices of competitive manufactured goods to fall relative to U.S. prices on a broad front.

It does not seem possible to quantify the effects of such a competitive development (which would affect U.S. imports as well as exports) but this potentiality needs to be considered in relation to cost and price developments here.

Summing up the net effects of the sterling devaluation on the U.S. trade balance in 1968, it is suggested here that these might be a $250 million incremental reduction.

Income and Fees from Investments

In recent years the U.S. has received about $400 million per year as remittance of income, fees and royalties from direct investment in the U.K. (Table 1). In the first half of 1967 income receipts were reduced, perhaps because of lower earnings, but remittances may have accelerated after mid-year as a hedge against devaluation. As shown in Table 4, there was a sharp drop in earnings of the manufacturing affiliates in 1966, but this was reflected primarily in lower reinvested earnings.

The effect of devaluation, and associated U.K. measures, at least at the outset, may be to hold down sterling profits to their recent levels, though more may be earned on exports. Manufacturing sales of U.S. subsidiaries are primarily (2/3) within the U.K., but the proportion exported may rise. Nevertheless, devaluation will probably have an effect in 1968 primarily by lowering the dollar equivalent of sterling earnings and remittances. It has been assumed that there would be a rise of some 10 per cent in U.S. direct-investment income and royalty receipts in 1968, which would imply a rise of about $40 million from the U.K. With the lower exchange rate, it now appears that these receipts might be some $50 million under expectations.

Other private income from investments in the U.K. is not very large and is partly on dollar obligations. Income from equity securities, or other sterling assets, might be reduced by $5 million or so. However, this might be more than offset by higher yields on short-term capital. Similarly, income payments from the U.S. might be reduced because of some U.K. liquidations, but any rise in yields over the 1967 average would tend to offset such reductions.

Other Current Account

Receipts from U.K. tourists are quite small ($50-75 million) and presumably would now be somewhat smaller. U.S. tourists' expenditures in the U.K. are larger ($150-175 million) and probably will rise somewhat, on the theory that, while each visitor might be expected to spend a certain amount of dollars in any case, a larger number might be attracted. However, if it can be assumed that most of any increase would be at the expense of other countries (London as a substitute for Paris), the net negative effect on tourism might be on the order of $20 million. Savings on military expenditures, which are over $150 million annually in the U.K., are expected to be only minimal because no reduction is likely in the large proportion of the total that represents troop pay.

The remaining current account items are relatively minor, but on balance devaluation might reduce the dollar equivalent of receipts from such things as film rentals and other royalties and fees by $10 million. The foregoing estimates are summarized in Table 4.

Effect on Capital Account

The only major long-term capital flow from the United States to the U.K. in recent years has been for direct investments. That flow averaged about $200 million annually in 1963-65, these rose to $384 million in 1966, though part of the latter amount was probably financed by the issuance of Euro-bonds by U.S. financing affiliates of the companies. In the first half of 1967 the rate of outflow was comparable to the 1966 rate, and the latest survey of investment plans for the U.K. by U.S. companies indicated a sustained rate of plant and equipment expenditures in 1967 and only a small decline in 1968. Of course, the survey was conducted much before devaluation.

How this flow will go in 1968 and thereafter depends very largely on whether U.S. managements become convinced that their U.K. plant capacity can now be advantageously built up to compete effectively in world trade. If the outcome for the U.K. current account is at least as good as that assumed above, there may not be any decline from the relatively high recent level of outflow. In fact, if the U.K. affiliates have been reducing their working capital in the U.K. to a bare minimum, as seems likely, there might be a temporary increase in the rate of outflow. Of course, if prospects for the viability of the U.K. economy were to weaken further, the capital flow would be expected to decline considerably.

In a larger context, however, it may be that U.S. companies will not alter their overall foreign investment plans as a consequence of events in the U.K., but will instead vary the location of their investments. For instance, any doubts about the future of U.K. industry, taken together with some advantages that may be offered by tax changes in Germany, might leave total capital flows unchanged but with a shift toward Germany. Another consideration is in the operation of the Commerce voluntary program, which also would tend to set upper limits on the aggregate capital outflow.

Other private capital flows between the U.S. and the U.K. have not been important recently, apart from the use of U.K. branches of U.S. banks as intermediaries in the Euro-dollar market.

On balance, it does not seem possible at this time to quantify the direct effect of devaluation on U.S. capital flows, except to suggest that the overall total is less likely to be affected than the flow to the U.K. alone.

TABLE 1. U.S. CURRENT ACCOUNT TRANSACTIONS WITH THE U.K.
(millions of dollars

	1965	1966			1967
	Total	Total	I half	II half	I half
Exports of goods and services	2,650	2,907	1,425	1,482	1,601
Merchandise	1,628	1,754	885	869	920
Military sales	56	78	20	58	193
Transportation	245	258	124	134	134
Travel	71	68	32	36	21
Royalties from direct investments	139	151	69	82	73
Income from direct investments	270	250	168	82	110
Other private income	63	92	44	48	52
U.S. Govt. income	32	105	8	97	21
Other	146	151	74	77	77
Imports of goods and services	2,508	3,020	1,378	1,642	1,489
Merchandise	1,410	1,776	800	976	843
Military expenditures	154	145	78	67	86
Transportation	394	441	219	222	226
Travel	142	167	67	100	72
Income on private investments	241	304	116	188	155
Other	167	187	98	89	107
Balance on goods and services	142	-113	46	-159	112

TABLE 2. U.S. TRADE WITH THE UNITED KINGDOM,
BY PRINCIPAL COMMODITY GROUPS
(millions of dollars)

	U. S. Exports			
	1966 Year	Per cent distribution	Jan.-Sept. 1966	Jan.-Sept. 1967
Total	1,737	100.0	1,287	1,457
Foods, feeds, beverages	304	17.5	225	192
Industrial supplies	664	38.2	486	540
Capital goods	548	31.5	406	497
Machinery	504	29.0	375	447
Aircraft	44	2.5	31	50
Automotive vehicles	25	1.4	19	16
Consumer goods	97	5.6	75	76
Other	45	2.6	35	35
Special category	54	3.1	40	100

	U.S. Imports			
	1966 Year	Per cent distribution	Jan.-Sept. 1966	Jan.-Sept. 1967
Total	1,786	100.0	1,267	1,244
Foods, feeds, beverages	268	15.0	182	183
Industrial supplies	421	23.6	294	297
Capital goods	450	25.2	327	293
Machinery	311	17.4	222	258
Aircraft	139	7.8	105	35
Automotive vehicles	133	7.4	102	97
Consumer goods	447	25.0	316	316
Other	66	3.7	46	57
Special category	--	--	--	--

TABLE 3. RECEIPTS FROM U.S. DIRECT INVESTMENTS IN THE U.K.
(millions of dollars)

	1965			1966		
	Total	Mfg.	Other	Total	Mfg.	Other
U.S. share in earnings of U.K. affiliates	498	419	79	427	359	68
Reinvested earnings	242	220	22	190	160	30
U.S. receipts of dividends, interest and profits	263	204	59	251	208	43
U.S. receipts of fees and royalties	139	n.a.	n.a.	151	n.a.	n.a.

Note: The sum of reinvested earnings and U.S. receipts of dividends, interest and profits does not equal the U.S. share in earnings because of (1) effects of tax payments, (2) the exclusion of interest from earnings, and (3) differing country allocations of earnings and remittances. These data differ slightly from more recent balance of payments data.

TABLE 4. SUMMARY OF ESTIMATED EFFECTS OF U.K. DEVALUATION ON THE U.S. BALANCE OF PAYMENTS CURRENT ACCOUNT
(in millions of dollars)

	Change from earlier projected 1968
U.S. exports to U.K.	-100
U.S. exports to other countries	-100
U.S. imports (U.K. and other countries)	- 50
U.S. receipts of income and fees	- 50
U.S. military expenditures	+ 10
Tourism and other current account	- 30
Total	-320

TABLE 5. UNITED STATES AND UNITED KINGDOM SHARES OF TOTAL IMPORTS OF MAJOR WORLD AREAS, 1965 AND 1966
(per cent)

	1965		1966	
	U.S.	U.K.	U.S.	U.K.
Canada	70.0	7.2	72.4	6.5
Western Europe	11.0	7.8	10.7	7.8
Common Market	11.6	5.3	11.2	5.2
Australia, New Zealand, South Africa	20.1	28.5	20.5	27.6
Latin America	43.0	4.8	43.7	4.4
Middle East	17.5	12.5	18.0	12.8
Other Africa	9.7	14.8	10.3	13.4
Other Asia	23.8	10.3	24.8	8.6
Japan	28.9	2.0	27.9	2.3

Note: Other Africa excludes U.A.R.
Other Asia excludes Middle East countries.