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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

January 4, 1968

SUMMARY AND OUTLOOK

Outlook for economic activity

The rebound in economic activity in November will probably be extended by further gains in industrial production and employment and a possible decline in the unemployment rate in December. A continued fast rate of economic growth in the first quarter now seems certain, despite a leveling off in Federal spending. Investment in inventories (already up substantially in the fourth quarter) and in plant and equipment is expected to be considerably higher this quarter, and consumer spending is also expected to rise somewhat faster. With demands strong and costs rising, the price advance is likely to continue at recent high rates, with an upturn in food prices adding to other pressures.

Judging from fragmentary data, inventory accumulation in the fourth quarter was higher than we anticipated earlier, and may increase further this quarter. Durable goods stocks may again be moving up to high levels; nevertheless, expanding output and sales of consumer goods and business equipment, as well as rising prices and strike fears will undoubtedly result in attempts to build stocks further. Substantial stockpiling of steel is expected in this quarter as a strike-hedge, and auto dealers' stocks will be rising as output is maintained at high levels.

Consumer spending is expected to rise in line with income, which for the quarter as a whole is likely to expand faster than in the strike-affected fourth quarter. Rising prices will continue to account for approximately half of the advance in the volume of consumer spending. The Federal pay raise will affect incomes for the whole quarter, an increase in the minimum wage in February will be followed in March by a rise in social security benefits, and employment and wages will be expanding with economic activity. However, the cautious attitude of consumers revealed by recent surveys of consumer sentiments and buying intentions supports a conservative estimate that the rate of saving will not drop below 7 per cent this quarter.

The first large advance in plant and equipment outlays in over a year is expected to take place this quarter, according to the November Commerce-SEC survey. And housing outlays should also increase somewhat further this quarter, in view of work already begun and the upward trend in costs.

Outlook for prices and resource use

Industrial production has recovered much more rapidly than had been anticipated four weeks ago, with the likelihood now that the index was 160.5 or more in December--almost 1 per cent above the previous high of a year earlier. Full recovery in the auto industry accounted for much of the indicated rise of 4 points or more from October to December, but there were also widespread gains for other final products and materials.

The production index is projected to rise further by about 1 point a month from December to March. By December, the rate of manufacturing capacity utilization was close to 85 per cent--back to the rate in the second quarter of 1967--as compared with the October low of 83 per cent. The production rise now projected through March would be about in line with the estimated capacity increase, with the rate of capacity utilization remaining at about 85 per cent.

No let-up is in sight in the rapid rise in wholesale prices of industrial commodities, which has been at an annual rate of around 3 per cent for 5 months. Moreover, in December, wholesale prices of farm products apparently increased, following four months of sharp decline. Further increase in wholesale farm prices from the low November level, coupled with persistent upward wage and other cost pressures, would no doubt lead to resumption of advance in consumer food prices. It still seems likely that the retail price increase for other commodities will slacken from the very rapid pace of last autumn, but with food prices rising at a moderate pace (1 to 2 per cent annual rate) and service costs moving up inexorably (at a 4 per cent rate or more), the prospect is for continuing increases in the CPI at a 3 to 3-1/2 per cent rate.

The collective bargaining schedule is quite light in early 1968, and the big push on wages--aside from the recent auto settlement--will come from the substantial increase in the minimum wage on February 1, which will affect largely workers in retail trade and services. In manufacturing, it will put some additional pressure on wages in lower paying industries. Reflecting widespread increases in wages, hours, and employment, the rise in average hourly compensation in manufacturing is expected to accelerate again. Unit labor costs in manufacturing have risen at an annual rate of about 3.5 per cent since midyear, as compared with almost 6 per cent from mid-1966 to mid-1967. The rise may moderate further in early 1968 as a higher rate of productivity increase accompanies the growth in output. The projected rise in output this quarter is expected to increase demands for labor and to reduce the unemployment rate somewhat.

Outlook for banking

Renewed U.S. Government credit demands in January will contribute to resumption of bank credit expansion following the December pause. The $2.5 billion Treasury tax bill financing will be accompanied by a rise in U.S. Government deposits. But without the effects of the financing, bank credit expansion would likely be relatively small since private demand deposits are expected to show little strength, and other sources of funds to banks to rise less than in recent months.

Banks' ability to obtain funds in the form of time and savings deposits in this country or through the Euro-dollar market abroad is expected to continue relatively limited in the weeks ahead. Recent short-term interest rate increases have further constrained banks' competitiveness in issuing large negotiable CD's, and have reduced the rate advantage of CD's to the extent that prospects for further net growth are quite uncertain. Growth in other time deposits and savings accounts is likely to continue at or below the recent reduced pace, since market interest rates are, at a minimum, not expected to decline and consumer spending is expected to be relatively strong.

With deposit growth constrained, anticipated relatively strong private loan demand would induce banks to undertake further portfolio adjustments. Business loans are likely to grow at a slower pace than in December, when a number of special circumstances temporarily enlarged demands, but inventory expansion and reduced capital market financing are factors likely to keep such loan growth above the very moderate August-November 1967 pace. In adjusting to such loan growth, as well as continued expansion in mortgage and consumer loans, banks are likely to reduce the rate at which they acquire municipal securities, will likely be quick to sell off bills acquired in the tax bill financing, and may have to make further reductions in the liquid assets that had been restocked last year.

Outlook for capital markets

In bond markets the seasonal lull in new financings is about to end. Publicly offered corporate bonds already listed for January, mainly utility issues, total about $800 million (less than the $1.2 billion average monthly volume in 1967) but this figure may increase somewhat before the month ends. The monthly volume of new municipal bond issues is expected to grow to exceed $1 billion, and the U.S. Government will be announcing a PC offering soon. Such credit demands add up to a fairly large total, but they also represent a moderation from the exceptionally heavy demands of last year. And the chances of an unexpected large build-up in the calendar may also be less this year, when, in contrast to last year, industrial corporations appear to be less inclined to undertake long-term debt financing.

The marketing of these various issues is likely to be facilitated by the improved bond market psychology of recent weeks. However, the recent tightening of monetary policy, in conjunction with anticipated business and consumer loan demands on banks, is likely to reduce banks' ability to add to their investment portfolio, as noted above. Also, a somewhat larger than usual share of the institutional flows that normally become available for investment in January has been pre-empted by delayed delivery commitments on bonds offered in 1967. Such supply conditions may be sufficient to keep interest rates from declining as the January offerings build up in the market, and may lead to some further updrift in yields.

Rates and other terms on home mortgages can be expected to tighten further. With spreads between yields on bonds and mortgages presently reduced to unprecedently narrow margins, funds from some lending institutions are being diverted increasingly to alternative forms of long-term investment, a factor that has moderated pressure on corporate bond markets. At the same time, the accumulating evidence of reduced savings growth at thrift institutions suggests that the availability of home financing through these specialized lenders is also becoming more limited. November data showing increases in gross withdrawals at S&L's and in passbook loans at saving banks, and fragmentary data for December suggest that a tendency toward reduced net inflows is continuing. However, none of the data available thus far or market reports suggest that thrift institutions are facing drains in January of very major proportions.

Balance of payments

One of the factors which precipitated the program of actions the President announced on January 1 was a marked deterioration in the U.S. payments position in the fourth quarter. This stemmed in part from shrinkage of the export surplus in October and November. The November rise in imports, in particular, was unexpectedly large. Earlier it had been thought that, with demand rising both here and abroad, the trade surplus in 1968 might be about as large as in 1967. The recent statistics, however, raise the question whether the projections may have understated the U.S. propensity to import and overstated U.S. ability to keep exports rising.

The President's message, which dealt in large part with capital movements, mentioned also a wide variety of measures to promote U.S. exports. Of the $3 billion total improvement sought in the balance of payments for 1968, a half billion was assigned to the trade surplus. However, those elements of the program that can be implemented promptly by administrative action do not deal with the underlying competitive position of the United States in world trade.

A second question relating to 1968 prospects concerns interest rate and credit market prospects in Germany and the rest of

Continental Europe. A foreseeable consequence of the new controls on direct investment outflows and the more stringent VFCR will be a rise in demands for credit and capital in the Euro-dollar and Euro-bond markets, with repercussions on European national markets. If Continental monetary policies failed to make allowance for the added demands, and if financial markets were permitted to tighten prematurely, the excessive damping of cyclical expansion would react unfavorably on U.S. exports. The European capital market has exhibited great adaptive ability in recent years, and especially so in 1967 when German monetary policy was easy. It is to be hoped that continuation of relatively easy money policies on the continent this year will facilitate absorption of additional demands caused by the U.S. program and maintain the momentum of European economic expansion.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per Cent Change: Year Ago*	Per Cent Change: 2 Yrs. Ago*
Civilian labor force (mil.)	Nov'67	78.1	78.0	76.6	2.0	4.5
Unemployment (mil.)	"	3.0	3.4	2.7	11.3	-0.5
Unemployment (per cent)	"	3.9	4.3	3.5	--	--
Nonfarm employment, payroll (mil.)	"	66.7	66.2	65.0	2.6	7.7
Manufacturing	"	19.4	19.2	19.5	-0.4	5.2
Other industrial	"	8.1	8.1	8.1	0.8	2.1
Nonindustrial	"	39.2	39.0	37.4	4.6	10.2
Industrial production (57-59=100)	"	159.0	156.4	159.1	-0.1	8.4
Final products	"	159.5	157.0	159.0	0.3	7.8
Materials	"	158.4	156.3	159.0	-0.4	8.4
Wholesale prices (57-59=100)1/	"	106.2	106.1	105.9	0.3	2.6
Industrial commodities (FR)	"	106.3	105.9	104.7	1.5	3.5
Sensitive materials (FR)	"	102.3	101.1	101.9	0.4	-1.1
Farm products, foods & feeds	"	103.4	104.1	107.1	-3.5	-0.9
Consumer prices (57-59=100)1/	"	117.8	117.5	114.6	2.8	6.5
Commodities except food	"	111.1	110.6	107.8	3.1	5.2
Food	"	115.6	115.7	114.8	0.7	5.4
Services	"	129.6	129.1	124.7	3.9	8.9
Hourly earnings, mfg. ($)	"	2.89	2.86	2.76	4.7	9.1
Weekly earnings, mfg. ($)	"	118.08	116.12	113.88	3.7	7.7
Personal income ($ bil.)2/	"	641.7	635.9	602.1	6.6	15.4
Corporate profits before tax ($ bil.)2/	QIII'67	80.1	78.9	84.0	-4.6	5.7
Retail sales, total ($ bil.)	Nov'67	26.5	26.1	25.6	3.6	7.6
Autos (million units)2/	"	7.1	7.0	8.4	-14.8	-20.7
GAF ($ bil.)	"	6.6	6.3	6.2	5.8	13.5
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,556	1,486	975	59.6	6.6
Factory workweek (hours)	"	40.9	40.6	41.3	-1.0	-1.2
New orders, dur. goods ($ bil.)	"	23.8	23.4	23.0	3.5	6.5
New orders, nonel. mach. ($ bil.)	"	3.9	3.6	3.7	5.3	13.9
Common stock prices (1941-43=10)	Dec'67	95.30	92.66	81.33	17.2	3.9
Manufacturers' Inventories, book val. ($ bil.)	Nov'67	82.1	81.5	76.9	6.7	22.2
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. 29, 1967	4-week average	Last 6 months High	Last 6 months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.66	4.49	4.55	3.40
U.S. Treas. bills, 3-mo., yield (per cent)	4.99	4.96	4.99	3.74
U.S. Treas. bills, 1-yr., yield (per cent)	5.56	5.58	5.64	4.63
Net free reserves 2/ ($ millions)	100	144	574	52
Member bank borrowings 2/ ($ millions)	345	185	353	46
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds 1/	5.74	5.75	5.84	4.73
20-year U.S. Treas. bonds 1/	5.55	5.59	5.73	4.95
Corporate new bond issues, Aaa 1/	8/	9/ 6.51	6.53	5.78
Corporate seasoned bonds, Aaa 1/	6.24	6.19	6.19	5.44
Municipal seasoned bonds, Aaa 1/	4.15	4.15	4.15	3.78
FHA home mortgages, 30-year 3/	--	6.77	6.77	6.51
Common stocks, S&P composite series 4/				
Prices, closing (1941-43=10)	95.88	95.37	95.81	93.01
Dividend yield (per cent)	3.08	3.09	3.18	3.07

	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	Dec. '67	2,125	1,965	490	782
State & local govt. public offerings	Dec. '67	975	1,033	35	145
Comm. & fin. co. paper (net change in outstandings) 6/	Nov. '67	+370	+110	-754	-335

	Latest month	Out-standings Latest month ($ billions)	Change Latest month ($ billions)	Change 3-month average ($ billions)	Annual rate of change from Preceding month (per cent)	Annual rate of change from 3 months ago (per cent)	Annual rate of change from 12 months ago (per cent)
Banking (S.A.)							
Total reserves 1/	Dec. '67	24.58	-0.18	0.09	-8.6	4.6	9.6
Credit proxy 1/	"	272.7	-0.3	1.4	-0.9	6.4	11.6
Bank credit, total 6/	Nov. '67	344.3	1.7	2.3	6.0	8.3	11.3
Business loans	"	84.6	0.3	0.3	4.3	3.8	7.6
Other loans	"	137.7	0.2	1.1	1.7	9.8	6.8
U.S. Govt. sec.	"	61.8	-0.5	--	-9.6	--	15.7
Other securities	"	60.2	1.6	1.0	32.8	20.2	24.4
Total liquid assets 1/ 6/	Nov. '67	647.8	4.6	4.2	8.6	8.0	7.7
Demand dep. & currency 1/	Dec. '67	181.3	--	0.7	--	4.7	6.4
Time & sav. dep., comm. banks 1/	"	183.8	1.3	1.6	8.5	11.0	15.9
Savings. other thrift instit. 6/	Nov. '67	183.7	1.2	1.3	7.9	8.9	9.5
Other 6/ 7/	"	100.3	0.6	0.4	7.2	4.8	-5.7

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 Dec. 27. 3/ Latest figure is for Nov. 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. 8/ No new issues during week. 9/ Two-week average--Dec. 8 and 15.

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

	1966		1 9 6 7				
	QIII	QIV	QI	QII	QIII	Oct.	Nov.
			Seasonally adjusted				
Goods and services, net 1/	1,151	1,084	1,357	1,324	1,369		
Trade balance 2/	802	722	1,014	1,159	1,089	130	240
Exports 2/	7,382	7,402	7,676	7,717	7,644	2,340	2,630
Imports 2/	-6,580	-6,680	-6,662	-6,558	-6,555	-2,210	-2,370
Services balance	349	362	343	165	280		
Remittances and pensions	-278	-246	-264	-395	-364		
Govt. grants & capital 3/	-759	-724	-1,201	-1,013	-973		
U.S. private capital	-932	-1,165	-957	-1,137	-1,695		
Direct investments	-900	-1,003	-622	-648	-894		
Foreign securities	-50	-83	-263	-170	-434		
Banking claims	89	44	66	-226	-397		
Other	-71	-123	-138	-93	30		
Foreign capital, nonliquid	376	780	823	1,227	873		
Official foreign accts.	172	425	392	736	277		
Long-term deposits	88	373	304	584	-29		
U.S. Govt. liab.	84	52	88	152	306		
Int'l. institutions 4/	39	17	70	97	117		
Other 5/	165	338	361	394	479		
Errors and omissions	277	-148	-287	-553	154		
Balances, with and without seasonal adjustment (- deficit)							
Liquidity balance, S.A.	-165	-419	-529	-547	-636		
Seasonal component	-530	-47	291	325	-572		
Balance, N.S.A.	-695	-466	-238	-222	-1,208	-939	- 895
Official settlements bal.	861	-18	-1,815	-828	470		
Seasonal component	-456	-180	533	138	-494		
Balance, N.S.A. 6/	405	-198	-1,282	-690	-24	-383	- 525
Reserve changes, N.S.A. (decrease -)							
Total monetary reserves	-82	6	-1,027	419	375	278	511
Gold stock	-173	-121	-51	-15	-92	-38	-74
Convertible currencies	426	173	-1,007	424	462	309	583
IMF gold tranche	-335	-46	31	10	5	7	2

1/ Equals "net exports" in the GNP.
2/ Balance of payments basis which differs a little from Census basis.
3/ Net of scheduled and non-scheduled repayments.
4/ Long-term deposits and Agency securities.
5/ Includes some foreign official transactions in securities.
6/ Differs from liquidity balance by counting as receipts (+) increases in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increases in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. The November rise in new orders for durable goods, increased tightness in the labor market, and the yearend advances in industrial output and in income all attest to underlying strength in the economy. We continue to anticipate an accelerated rate of growth in the first quarter of this year. GNP is projected to rise at the rate of about $20 billion, about the same as shown in the previous Greenbook; real growth is expected to attain an annual rate of close to 6.5 per cent, compared to about 5.5 per cent in the fourth quarter of 1967. The rate of increase in the over-all GNP deflator is expected to decline slightly from 3.7 per cent rate to 3.5 per cent. However, the Federal pay raise had accounted for .7 percentage point of the rise in the deflator in the fourth quarter. Thus, for the private economy alone the deflator would be moving up faster this quarter--at an annual rate of 3.5 per cent rather than the 3.0 per cent in the fourth quarter.

Although growth in activity projected for the fourth and first quarters is about the same as shown last month, we now expect a somewhat different composition of GNP in both quarters. Our current estimates indicate a more rapid build-up of inventories and somewhat larger gains in consumer outlays in both quarters than were projected earlier. On the other hand, Federal purchases and net exports are now indicated to be at lower levels.

The step-up in the rate of inventory accumulation in the fourth quarter reflects in part the relatively large increase shown in October and November in the book value of manufacturing inventories. Moreover, the avoidance of work stoppages in the auto industry in December also contributed to an inventory increase. Nevertheless, the rise in auto stocks so far has been relatively small, and the ratio of inventories to unit sales at yearend was lower than in late 1966. The earlier strikes and the unions' "no overtime" policy at General Motors were important factors limiting output and preventing dealer stocks from reaching more normal levels.

Auto production is scheduled at a 9 million annual rate, seasonally adjusted, in the first quarter, which implies a substantial increase of auto stocks even though sales are expected to increase substantially. While it still seems likely that there will be some scattered short strikes at G.M. plants in January, these should not significantly affect inventory building for the quarter as a whole. No signs have appeared of any possible early settlement of the steel dispute, and hedge buying of steel should add significantly to the rate of inventory building in this quarter. These special situations, sharply rising industrial activity, and manufacturers' expectations that sales will be much higher in 1968 than in 1967 suggest heightened accumulation of both material and work-in-process inventories this quarter. The upward trend in industrial prices is a further influence contributing to more rapid inventory accumulation.

Consumer expenditures are projected to accelerate somewhat this quarter. An upsurge in appliance and furniture sales has caused us to raise our estimates of durable goods spending in the fourth quarter, and this trend has been projected to continue into early 1968. Unit sales of new domestic autos are projected at a rate of 8.5 million in the first quarter. Although sales in November and December were considerably below this rate (and also below a year ago), they were apparently hampered by shortages of stocks at both General Motors and Ford, with the result that there should be some carry-over of demand into the first quarter. The dollar volume of auto sales also will be increased by the fact that prices have been raised and that the higher-priced 1968 models will constitute a much larger proportion of all cars sold than in the fourth quarter when 1967 models were still widely available.

The primary reason we have projected a relatively sharp rise in consumer outlays this quarter is the large rise anticipated in personal income. The increase this quarter promises to be about $14.5 billion or 9 per cent at an annual rate. Thus, in the absence of a tax surcharge, after-tax income should show a very sharp rise. On the other hand, consumers' attitudes toward their own economic prospects have remained cautious and recent anticipatory surveys do not suggest increased buying of major durables. These attitudes seem to reflect fear that prices will rise faster than income, the possibility of a tax increase, and concern over international developments. Although it is possible to exaggerate the significance of consumer surveys, it would be premature to forecast a reduction in the high propensity to save displayed in recent quarters. The increase in sales of consumer durables shown in the projection is accordingly consistent with the continuance of a 7 per cent saving rate.

Outlays for residential construction have been revised up slightly for both the fourth and first quarters, based on the strong October-November housing starts figures. Nonetheless, we anticipate a moderate decline in starts in the first quarter from 1.5 million rate attained last quarter because of the likelihood of a decline in commitments for residential mortgages. Business investment in new plant and equipment has been projected to show a sharp rise on the basis of investment plans shown by the November Commerce-SEC survey. About half of $3 billion rate of increase in the first quarter reflects a rise in outlays by utilities; durable goods manufacturing accounts for about a third of the rise.

Our estimates of both Federal defense and nondefense expenditures have been revised downward. We are now assuming that defense expenditures will hold at about $74.5 billion from the fourth quarter to mid-1968--the $1.2 billion rise shown for the fourth quarter was entirely accounted for by higher pay schedules. Estimated defense purchases are about in line with recent Administration statements that these purchases would not exceed the midyear Budget total of $74.2 billion for fiscal 1968. The rise projected for nondefense outlays in this quarter reflects some deferral of CCC purchases.

A leveling off in cash outlays for defense needs could occur as a result of delays in payments to producers, rather than delays in deliveries of products. Alternatively, the leveling off in spending could be effected by reductions in military inventories. Whether defense outlays will actually be constrained to the totals already announced, and if so, what the repercussions would be on production and financing needs, cannot be known until the new Budget is presented to Congress, probably at the end of this month.

The estimated Federal deficit, NIA basis, is reduced to about $11 billion in the fourth quarter and to $6 billion in the current quarter. These levels are well below the peak of $14.7 billion in the second quarter of 1967, mainly because of substantial growth in receipts--resulting from the sharp income gains--at a time when increases in expenditures are moderating.

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 IV	1968 Proj. I
Gross National Product	743.3	785.4	762.1	766.3	775.1	791.2	809.0	829.0
Final sales	729.9	781.0	743.6	759.2	774.6	787.4	802.8	820.0
Private purchases	575.6	604.6	581.9	588.8	599.6	609.2	620.7	635.5
Personal consumption expenditures	465.9	492.4	473.8	480.2	489.7	495.3	504.3	515.0
Durable goods	70.3	72.4	70.6	69.4	72.5	72.7	75.0	78.0
Nondurable goods	207.5	217.9	210.3	214.2	217.2	218.5	221.5	225.5
Services	188.1	202.1	192.9	196.6	200.0	204.1	207.8	211.5
Gross private domestic investment	118.0	111.5	122.2	110.4	105.1	112.2	118.1	124.7
Residential construction	24.4	24.5	20.9	21.4	23.1	25.6	28.0	28.8
Business fixed investment	80.2	82.5	82.8	81.9	81.5	82.8	83.9	86.9
Change in business inventories	13.4	4.4	18.5	7.1	.5	3.8	6.2	9.0
Nonfarm	13.7	4.1	19.0	7.3	.6	3.4	5.2	8.5
Net Exports	5.1	5.1	4.3	5.3	5.3	5.4	4.5	4.8
Gov't purchases of goods & services	154.3	176.4	161.7	170.4	175.0	178.2	182.1	184.5
Federal	77.0	90.0	81.5	87.1	89.5	90.9	92.5	93.1
Defense	60.5	72.6	65.6	70.2	72.5	73.3	74.5	74.5
Other	16.5	17.4	15.9	16.8	17.0	17.6	18.0	18.6
State and local	77.2	86.4	80.2	83.3	85.4	87.4	89.6	91.4
Gross National Product in constant (1958) dollars	652.6	669.6	661.1	660.7	664.7	672.0	681.0	691.7
GNP Implicit deflator (1958=100)	113.9	117.3	115.3	116.0	116.6	117.7	118.8	119.9
Personal income	584.0	626.6	601.6	612.9	619.1	631.0	643.5	658.0
Wage and salaries	394.6	424.0	407.4	414.7	418.3	426.2	436.9	448.3
Disposable income	508.8	544.9	522.0	532.7	540.0	548.2	558.6	570.5
Personal saving	29.8	38.3	34.6	38.8	36.0	38.5	39.8	40.7
Saving rate (per cent)	5.9	7.0	6.6	7.3	6.7	7.0	7.1	7.1
Corporate profits before tax	83.8	80.1	83.9	79.0	78.9	80.0	82.5	84.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	143.2	151.6	148.6	149.1	148.1	152.7	156.5	162.2
Expenditures	142.9	164.2	151.9	160.9	162.8	165.9	167.2	168.1
Surplus or deficit (-)	.3	-12.6	-3.3	-11.9	-14.7	-13.2	-10.7	-5.9
Total labor force (millions)	78.9	80.8	79.8	80.3	80.2	81.1	81.6	82.1
Armed forces "	3.1	3.5	3.3	3.4	3.5	3.5	3.5	3.5
Civilian labor force "	75.8	77.4	76.5	76.9	76.7	77.7	78.1	78.6
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	66.6	67.2
Manufacturing	19.2	19.4	19.5	19.5	19.3	19.2	19.4	19.6
Industrial production (1957-59=100)	156.3	157.3	159.3	157.1	155.9	157.2	158.8	162.5
Capacity utilization, manufacturing (per cent)	90.5	85.0	90.0	87.1	84.9	84.0	84.0	84.9
Housing starts, private (millions A. R.)	1.17	1.31	.92	1.12	1.21	1.40	1.51	1.44
Sales new U.S.-made autos (millions, A. R.)	8.38	7.65	8.13	7.33	7.83	8.00	7.44	8.50

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	42.1	13.3	4.2	8.8	16.1	17.8	20.0
Final sales	55.4	51.1	6.2	15.6	15.4	12.8	15.4	17.2
Private purchases	37.5	29.0	2.2	6.9	10.8	9.6	11.5	14.8
GNP in constant (1958) dollars	35.9	17.0	6.3	-.4	4.0	7.3	9.0	10.7
Final sales	32.1	25.6	-0.3	10.1	10.3	4.2	6.7	8.7
Private purchases	21.9	11.4	-2.8	3.7	7.1	3.0	5.7	7.3
	--- In Per Cent; Quarterly Changes are at Annual Rates ---							
Gross National Product	8.7	5.7	7.1	2.2	4.6	8.3	9.0	9.9
Final sales	8.2	7.0	3.4	8.4	8.1	6.6	7.8	8.6
Private purchases	7.0	5.0	1.5	4.7	7.3	6.4	7.5	9.5
Personal consumption expenditures	7.6	5.7	3.1	5.4	7.9	4.6	7.3	8.5
Durable goods	6.5	3.0	-1.7	-6.8	17.9	1.1	12.7	16.0
Nondurable goods	8.5	5.0	1.5	7.4	5.6	2.4	5.5	7.2
Services	6.9	7.4	6.5	7.7	6.9	8.2	7.2	7.1
Gross private domestic investment	9.9	-5.5	19.9	-38.6	-19.2	27.0	21.0	22.4
Residential construction	-9.6	0.4	-47.3	9.6	31.8	43.3	37.5	11.4
Business fixed investment	12.8	2.9	7.9	-4.3	-2.0	6.4	5.3	14.3
Gov't purchases of goods & services	13.1	14.3	10.1	21.5	10.8	7.3	8.8	5.3
Federal	15.3	16.9	10.1	27.5	11.0	6.3	7.0	2.6
Defense	20.8	20.0	16.5	28.0	13.1	4.4	6.5	0.0
Other	-1.2	5.5	-16.9	22.6	4.8	14.1	9.1	13.3
State & local	10.9	11.9	10.8	15.5	10.1	9.4	10.1	8.0
GNP in constant (1958) dollars	5.8	2.6	3.8	-.2	2.4	4.4	5.4	6.3
Final sales	5.3	4.0	-0.2	6.3	6.3	2.5	4.0	5.2
Private purchases	4.4	2.2	-2.2	2.9	5.5	2.3	4.3	5.5
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	7.9	9.0
Wage and salaries	9.9	7.5	7.8	7.2	3.5	7.6	10.0	10.4
Disposable income	7.8	7.1	7.5	8.2	5.5	6.1	7.6	8.5
Corporate profits before tax	9.5	-4.4	-.5	-23.4	-0.5	5.6	12.5	9.7
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.7	5.9	8.2	1.3	-2.7	12.4	10.0	14.6
Expenditures	15.8	14.9	15.3	23.7	4.7	7.6	3.1	2.2
Nonfarm payroll employment	5.3	3.1	4.4	4.3	0.0	2.4	3.0	3.6
Manufacturing	6.1	1.0	4.1	0.0	-4.1	-2.1	4.2	4.1
Industrial production	9.0	0.6	4.1	-5.5	-3.1	3.3	4.1	9.3
Housing starts, private	-20.4	12.0	-59.3	87.0	32.1	62.8	31.4	-18.5
Sales new U.S.-made autos	-4.4	-8.7	-15.8	-39.6	27.3	8.7	-28.0	57.0

Industrial production. Industrial production in December is tentatively indicated to have increased at least 1.5 points from the preliminary November figure of 159.0. At 160.5 or so, the total index will have exceeded the previous peak of 159.5 a year earlier. At this stage, our estimate of the December rise can be based only on the recovery in auto and truck production and a further increase in steel production. Gains in output of other final products and materials would, of course, raise the industrial production index even higher.

With Ford back in full production, auto assemblies rose to an annual rate of about 8.8 million units in December from 7.4 million in November. This, along with the increase in trucks and auto and truck parts amounted to over one full point in the total index. Production schedules for January are presently set at an annual rate of 8.9 million units, little changed from December. While sales of new domestic autos in December have partially recovered from their strike reduced low, they were still below last year's rate of 8.0 million units.

Output of the other cyclically-sensitive consumer goods--home goods and apparel--has increased from the mid-1967 low and in November was only 2 per cent below the 1966 highs. The only available current and reliable output data for these industries are for home radio and TV sets; in the first three weeks of December, their production was maintained at the advanced November level.

The rise in output of business equipment in November was associated mainly with strike settlements in the machinery and transportation industries. In November, new and unfilled orders for machinery and equipment were close to record levels, and, if maintained, could lead to increases in output of these goods. Output of defense equipment, which had increased rapidly in the first three quarters of 1967, changed little in October and November. While expansion in defense spending is reportedly leveling off and the rate of increase of unfilled defense orders slowed in the last half of the year, it is not yet possible to judge production developments for these goods for the months immediately ahead.

Output of steel increased further in December and was about 15 per cent above its 1967 low and only 3 per cent below the 1966 peak. With steel inventories at record levels at producing mills, and at their lowest levels since 1962 at consuming industries (end of November), further increases in steel production would clearly indicate another round of inventory accumulation by consuming industries.

Capacity utilization. Utilization of capacity by manufacturers is likely to have increased by about one-half point in December, if the manufacturing production index increases by 1.5 points or more as expected. The operating rate was estimated to be 84.2 per cent in November, up sharply from 83.1 per cent the previous month. About one-third of this increase can be attributed directly to rising motor vehicle production following settlement of the strike at Ford.

Despite widespread production increases, substantial margins of unused capacity still exist in most industries. Producers of aircraft, electric power generating equipment, and petroleum products, however, are operating at near capacity levels and only moderate amounts of unused capacity remain in the rubber and textile industries.

UTILIZATION RATES

Industry	Aug.	Sept.	QIII	Oct.	Nov.	Estimated	
						Dec.	QIV
Manufacturing	84.6	83.6	84.0	83.1	84.2	84.7	84.0
Primary processing	82.8	82.9	82.5	82.8	83.9	--	--
Advanced processing	85.8	84.1	85.2	83.3	84.4	--	--

Auto sales and stocks. Unit sales of new domestic autos in December are tentatively estimated at an annual rate in the 7.6 to 7.8 million range, up from 7.1 million in November. In 1966, sales were at an annual rate of 8.4 and 8.0 million units in November and December, respectively. It may be noted that sales of new cars other than Ford had been weakening for the three consecutive ten-day periods ending December 20. (Complete data for the last ten-day period of December are not yet available.) Despite the rather modest recent performance, optimism among auto producers remains high and industry estimates of new car sales (including imports) for the 1968 model year have remained at about 9.0 to 9.3 million units. These estimates may be on the high side in view of recent sales experience, but given the disrupting developments of late 1967 it is more difficult than usual to reach firm judgments.

DOMESTIC NEW CAR SALES (DELIVERIES)
Per cent change from year earlier
(Daily average rates)

	Nov. 1-10	Nov. 11-20	Nov. 21-30	Dec. 1-10	Dec. 11-20
Ford Motor Company	-71	-71	-54	-32	- 2
Other than Ford	+ 2	+ 6	- 4	- 4	- 6
Total	-17	-16	-17	-12	- 5

Rebuilding of new car inventories has continued with stocks climbing 7 per cent in the second period of December. Inventories still are one-fifth below a year earlier when stocks were high. If production schedules are maintained, and sales do not accelerate sharply, new car stocks some time in January will pass the level of a year earlier.

Sales of used cars in the middle period of December were slightly below a year earlier, and for the first two periods were 5 per cent below. Stocks on December 20 were 6 per cent below a year earlier.

Consumer credit. Consumers added more to their instalment debt in November than in any other month in 1967. The net increase in outstandings on a seasonally adjusted basis amounted to $418 million, or $5 billion at annual rates. The largest advances were in other consumer goods paper and personal loans. In general, new borrowing was up in November while the rate of repayments was off a little from its earlier high. Despite November's faster pace, the rise in consumer credit for the year as a whole is not likely to exceed $3.5 billion, sharply less than the $6.1 billion increase in 1966 and the smallest rise of any year since the recession low in 1961.

A major factor in the 1967 slowdown was the relatively fast rate at which consumers repaid their instalment debt. (Indeed, there was some evidence of pre-payment of debt.) Repayments were especially large in the second and third quarters, rising just about as much as new credit extensions during that period.

Much of the slowdown was centered in auto credit. Similarly it is this area that will largely determine the pace of expansion in the months ahead. Tending to increase use of credit is the fact that the average size of the new car note will be considerably higher in 1968 than in 1967, primarily because of higher base prices on the new models and the tendency of consumers to buy more and more optional equipment. On the other hand, there does not seem much prospect for a lengthening in average contract maturity or any significant increase in the proportion of new cars bought on credit beyond the 68 per cent of 1967.

Personal loans are likely to expand further in line with increased spending on education and rising costs of medical and other services. One questionmark will be the impact of the proposed restrictions on travel abroad by United States citizens. Demand for credit in the nonauto goods area rose steadily throughout 1967, and this is likely to continue this year. Indeed, demand for such credit could pick up markedly should sales of home furnishings show significant improvement. Repair and modernization loans have been in the doldrums for the past couple of years. Some lenders feel that consumers have been making personal cash loans for minor home repairs and improvements, instead of negotiating them under an FHA or some other special contractual arrangement.

A significant development has been the increased activity in bank credit cards. Volume outstanding under bank credit card and check-credit plans rose from $800 million in April 1967 to a little over $1 billion in October, and all indications point to sharply increased activity in this area, in oil company credit cards, and in credit cards generally in the period ahead.

Retail sales. The weekly figures for the three weeks of December from the 3rd through the 23rd suggest that on a seasonally adjusted basis retail sales rose further last month--perhaps as much as the 1-1/2 per cent increase in November. Sales at nondurable goods stores apparently were little changed or perhaps down slightly from the preceding month, with sales at apparel stores down substantially and at restaurants and grocery stores up moderately. However, durable goods sales appear to have increased sharply, reflecting a very strong rise at furniture and appliance stores and a moderate advance at auto dealers.

Consumer sentiment. Both the Census October Survey of Consumer Buying Expectations and the November survey conducted by the University of Michigan show that consumers were less optimistic in that strike-affected quarter. The University of Michigan's Index of Consumer Sentiment declined from the August level of 96.5 to 92.9. This drop was primarily attributable to the consumers' feeling that they would become financially worse off within the next twelve months. The dominating influence was the fear of inflation, with approximately 80 per cent of the units surveys stating that they expected their real purchasing power to decline.

Both surveys reveal that consumer intentions to purchase new cars are not bouyant. The Michigan survey showed that the expressed intentions to purchase new cars in the subsequent twelve months had fallen from the levels of the two previous surveys. Similarly, the Census survey showed that expected expenditures on new cars in the months following the October survey had declined somewhat from the July figures. Both surveys showed increases in intended expenditures on used cars but showed conflicting findings with respect to purchases of other household durables.

Residential construction and real estate. Seasonally adjusted housing starts, which had moved above our earlier projections in other recent months, continued upward in November. The annual rate of 1.56 million units for the month--which, incidentally, is significantly above even the most optimistic projections for the year 1968--

reflected mainly a dramatic spurt in just one region--the South. There starts showed a much less than seasonal decline and reached the highest seasonally adjusted rate for that region in more than three years. Seasonally adjusted rates in all the other regions--most of which had shown similarly isolated spurts recently--declined in November. Both single- and multi-family starts increased, but the increase continued greatest for multi-family units, which achieved a four-year high.

Unlike starts, seasonally adjusted building permits were down in November, though almost entirely for single family units. As in the case of starts, only the South showed an increase among the individual regions.

Even if starts turn downward in December from the advanced November rate, as seems likely, the average for the fourth quarter as a whole will exceed a 1.5 million unit rate. This would bring the annual total for 1967 to just above 1.3 million, as compared with the sharply reduced 1.16 million in 1966 and 1.47 million in 1965.

PRIVATE HOUSING STARTS AND PERMITS

	November 1967 (Thousands of units) 1/	Per cent change from	
		October 1967	November 1966
Starts	1,556	+ 5	+ 60
1-family	932	+ 3	+ 36
2- or more-family	624	+ 8	+116
Northeast	218	-15	+ 22
North Central	395	- 1	+ 89
South	686	+23	+ 58
West	257	- 6	+ 66
Permits	1,162	- 4	+ 62
1-family	627	- 7	+ 41
2- or more-family	535	- 1	+ 92

1/ Seasonally adjusted annual rates; preliminary.

A factor in the advanced rate of starts this autumn has apparently been acceleration of plans by some builders in response to increasing uncertainties about future mortgage market conditions. The further reduction in vacancy rates during the first half of the year, although anticipated, also has been a stimulative factor. While vacancy rates for both rental and home-owner properties are reported to have risen in the third quarter, the rise was extremely slight and well within the margin of sampling error; as shown in the table for the sensitive rental vacancy rate series, the averages have generally remained well below those in the same period of other recent years. Also, rent increases have apparently accelerated somewhat in recent months. And for single-family units, stocks of new homes in all stages of construction held by speculative builders have apparently continued near the sharply reduced level reached last summer.

RENTAL VACANCY RATES
(Per cent)

	Average for third quarter of				
	1961	1964	1965	1966	1967
All regions	7.9	7.7	7.2	6.8	6.4
Northeast	4.5	5.0	4.6	4.9	4.3
North Central	8.4	7.2	6.4	5.8	5.6
South	9.8	8.2	7.9	7.1	7.8
West	9.4	11.5	10.8	10.2	8.1

Orders. New orders received by manufacturers of durable goods rose 2 per cent in November. Gains were widespread, with only aircraft and electrical machinery registering decreases. New orders rose 19 per cent in the auto industry following settlement of the recent strike, although the November level was still well below the pre-strike level of August, and further recovery was to be expected in December. If both autos and aircraft are excluded from the total, orders increased 4 per cent--the first significant rise in several months. New orders rose for primary metals, fabricated metals, nonelectrical machinery, and other durable goods. The special machinery and equipment grouping increased 3 per cent, back close to the high for the year reached in August.

NEW ORDERS FOR DURABLE GOODS
(Seasonally adjusted, billions of dollars)

	1967			
	June	August	October	November
Total	24.3	23.7	23.4	23.8
Defense products	4.2	2.8	4.1	3.1
All other durables	20.1	20.9	19.3	20.7
Auto industry	3.9	3.8	2.8 1/	3.3
Other nondefense	16.2	17.1	16.5	17.4

1/ Strike low.

Between June and October new orders for durables had declined 4 per cent, with the decline entirely due to the drop in the auto industry. Shipments, meanwhile, were rising and growth in the order backlog had slowed. A large part of the increased order backlog was in the aircraft industry where there are long lags between orders and production. Increased orders in November, however, were concentrated in industries where the impact on production should occur more quickly.

Unfilled orders edged up 0.2 per cent in November, continuing the rise which began last May. Backlogs are now about 2 per cent above their record highs of last year. Unfilled orders represent about 3.3 month shipments at present, about the same as in May and also in November 1966.

Business inventories. The book value of business inventories (including revised figures for manufacturers) in October increased at a seasonally adjusted annual rate of $4.4 billion, moderately above the third quarter rate of $3.9 billion. The bulk of the October accumulation--and the moderate increase over the third quarter rate--was accounted for by durable manufacturing industries (notably defense, consumer durables, and construction materials); factory stocks of non-durable goods declined slightly in October and distributors' stocks showed only a slight increase.

In November, manufacturers' stocks (preliminary) jumped sharply--accumulation totaled $600 million (or an annual rate of $7.2 billion), the largest since last April. In November again accumulation was concentrated in durable goods industries, with particularly large spurts in defense and business equipment (apparently largely work-in-process). The book value of nondurable goods inventories continued to show little change.

A sharp (nearly 5 per cent) upturn in manufacturers' shipments accompanied the spurt (of 0.7 per cent) in inventories in November, and the stock-sales ratio declined to 1.75, the lowest of the year. This was only moderately above late 1966 but still well above the relatively low 1964-65 average. The rise in shipments--and the decline in the stock-sales ratio--was pronounced for both durable and nondurable goods. For durable goods, however, the rise in shipments--and the decline in stock-sales ratio--merely represented a return to about the pre-strike levels of August, and the November stock-sales ratio of 2.26 was still unusually high (comparing with 2.11 in December 1966 and 1.91 in 1964-65). For nondurable goods, however, the sharp rise in shipments (breaking out of the pattern of relative stability from May through October) and stability in inventories brought the stock-sales ratio down abruptly to a new postwar low of 1.23.

Labor market. The vigorous expansion in employment and improvement in unemployment that was apparent in the November data appears to have been sustained in subsequent weeks. While total employment and unemployment figures are not yet available for December, unemployment insurance claims through late December suggest a further decline in unemployment last month.

The ebb and flow in demand for labor in 1967 can be seen clearly in changes in the rate of insured unemployment. Labor demand in the industrial sectors of the economy--which were most affected by the dip in output early in 1967--tends to be sensitively reflected in the unemployment insurance claims, since an overwhelming proportion of the workers in these sectors are covered and apply for unemployment benefits when laid off. The total unemployment rate this year also was strongly affected by changes in supply of new workers and re-entrants to the labor market of women.

The insured unemployment rate shows a distinctly different unemployment pattern for the year than total unemployment, which increased until late in the year and reached its peak rate of 4.3 per cent in October, when the labor market was showing other signs of improvement. In contrast, the rate of insured unemployment rose sharply in the spring coincident with the decline in manufacturing employment, reached its 1967 peak in July, at 2.8 per cent, and declined steadily after that. The rate in November was 2.3 per cent, about the same as a year earlier; incomplete figures for the month suggest that the rate may show some further decline in December.

INSURED AND TOTAL UNEMPLOYMENT RATES
(Seasonally adjusted, quarterly averages)

1967	Total rate	Insured rate 1/
I Q	3.7	2.5
II Q	3.8	2.7
III Q	3.9	2.6
IV Q (December estimated)	4.0	2.3

1/ Monthly average of insured unemployment as a per cent of employment covered by State unemployment insurance programs.

The employment figures for November appear to suggest that a significant improvement in the labor market had been in the making, although obscured somewhat by the direct and indirect effects of the Ford and other strikes. Nonfarm employment advanced significantly more in the industrial sector than could be explained by the ending of the strike, and growth momentum was also stepped up in the non-industrial sectors, particularly trade and services.

Nonfarm payroll employment in November increased by 480,000, or almost 300,000 more than could be explained by strike returns, and was half a million above the prestrike (August) level. In manufacturing, employment rose by a quarter million in November. The recovery in employment in manufacturing was strongest in the nondurable goods sector, which reached a new high following 3 months of solid gains. In durable goods, the metal-using industries showed the largest gains, but smaller increases were widespread in other industries. Actually, the gain in transportation equipment was smaller than expected in view of the end of the auto strike. Protracted negotiations on local issues and brief stoppages at General Motors were in part responsible for the relatively poor showing. Further employment gains should be evident in December. The workweek in manufacturing averaged 40.9 hours, up two-tenths of an hour from the prestrike August level, but still four-tenths shorter than a year earlier.

Nonmanufacturing industries showed growing demand for manpower on a broad front. Growth was particularly strong in State and local government, services and trade; construction employment advanced somewhat, and has shown considerable firmness in recent months. The workweek has also lengthened appreciably. In fact, the only sector to show employment weakness was Federal Government, now down 50,000 from its midyear peak.

With continued growth in the nonindustrail activities, a firmer pattern for construction, and manufacturing employment growth sustained by further recovery in autos and high rates of production in steel and machinery, continued strong growth in nonfarm employment seems in prospect, in the first quarter, with a concomitant tightening of the labor market.

Productivity and unit labor costs. Both output and manhours rose sharply in manufacturing in November, following the end of the Ford strike. But the increase in output was greater than the rise in manhours, resulting in some rebound in productivity. Recovery of production from the auto strikes was still not complete in November, however, and the gain in productivity from a year earlier continued at less than one per cent, about the same slow pace maintained in the first three quarters.

Average hourly compensation in manufacturing also rose in November as the return of high-wage workers increased the average workweek and average hourly earnings, but the full impact on hourly compensation of the auto settlement with its large first-year increase is yet to be felt. Ratification by UAW and General Motors of the new contract did not come until the end of December. In addition, because of the continuation of some strike activity in November at auto plants and related industries, production schedules were disrupted and hours of work at premium pay in durable goods manufacturing still remained below the September level.

As a result, the November increase in average hourly compensation in manufacturing from a year earlier--5.7 per cent--was somewhat less than the 6.5 per cent average increase in the first three quarters of the year. However, with the recovery from the Ford strike completed in December, and the settlement at G.M. adding upward pressures on wage rates in January, compensation per manhour should begin to accelerate again. A substantial increase in industrial production--expected to run 9 per cent (annual rate) from the fourth to first quarters--should be associated with a temporary rise in productivity sharp enough to offset much of the impact of rising compensation on unit labor costs. However, increases in production (and productivity) of these magnitudes are unlikely to be sustained for long, and since earnings should continue up sharply throughout most of 1968, unit labor costs are likely to increase more rapidly again.

<u>Wholesale prices</u>. The BLS industrial price average increased another 0.3 per cent in November and, according to preliminary estimates, rose 0.2 per cent further in December. In view of the facts that in both October and November the preliminary estimates (of 0.2 per cent increases) understated the actual increases, and that the December estimate was closed out earlier than usual to permit a pre-Christmas release, the December estimate may be subject to upward revision also. At 107.3 per cent of the 1957-59 average, the present December estimate is 1.2 per cent above mid-July (for the 5-month period this represents a 3 per cent annual rate of increase). Since December 13, the BLS pricing date, increases have been effected for a variety of industrial materials and products including ferro alloys and other steel will products, several chemicals, fuel oil, some electrical equipment, and autos (to cover the new safety belts).

In both November and December, the major increases were in metals, machinery and textiles. In November these three groups accounted for roughly three-fourths of the rise in the industrial average. Prices of finished motor vehicles, which had contributed so much to the October increase, were unchanged although parts producers raised their prices 1.3 per cent. Industrial chemicals, which had increased significantly in October, also showed no change in November. Prices of lumber and plywood continued to decline, but much less than in October and less than expected seasonally.

Copper powder and scrap and copper and brass mill products have moved up sharply further, under the influence of the still-unsettled, 5-month strike. Steel scrap turned up in November as steel output increased, and prices of steel mill products rose further. Sizable increases in prices of cold rolled sheets and galvanized sheet and strip effective December 15 (noted in the last Greenbook) became industry-wide (while increases announced for hot-rolled sheets by a few small producers were rescinded when the major steel producers did not follow suit). More recently some steel producers have raised the prices of mill products used mainly by railroads. These increases will first appear in the January price index.

The machinery and equipment group in November showed the largest increase in 10 months. Substantial price increases were registered for metal working machinery after several months of little change, and prices continued to rise for agricultural, construction, and various other types of special-industry machinery.

The rise in prices of textile products in recent months has stemmed in the main from sharp increases in the price of raw cotton, under the influence of very short supplies particularly of long staple cotton, but also from a moderate upward movement in prices of man-made fibers.

The table below shows changes in the Federal Reserve special groupings of the BLS wholesale price indexes from July to November, as compared with changes over the preceding year. Salient features of the showing are: (1) the sharp upturn in average prices of sensitive industrial materials since July (this reflected primarily increases ranging from 10 to 30 per cent for the copper items included, and a 10 per cent increase in raw cotton together with sizable increases in cotton yarn and cotton and mixed cotton and man-made fiber fabrics); (2) the pronounced acceleration in the rise in prices of both consumer and producer industrial products and the unusually large contribution to the rise made by the sharp boost in prices of motor vehicles (primarily in October when 1968 models were first priced); and (3) the large further decline in prices of foods and food stuffs from July to November--which resulted in a moderate decline in the total wholesale index over the period.

FR GROUPINGS OF BLS WHOLESALE PRICE INDEXES

	Per cent change		
	July 1966 to July 1967	July to November 1967	
		Actual	At annual rate
All commodities (BLS)	0.1	-0.3	-0.9
Industrial commodities	0.6	1.1	3.1
Industrial materials	-0.5	1.0	2.9
Sensitive materials	-5.9	2.3	6.9
Other materials	1.4	0.5	1.4
Industrial products	2.1	1.1	3.4
Consumer nonfoods	1.7	1.0	2.9
Autos	0.3	2.9	8.7
All other	2.1	0.5	1.6
Producers' equipment	3.0	1.6	4.8
Autos, Trucks & Buses	0.6	3.0	9.0
All other	3.5	1.3	3.9
Foods and foodstuffs	-1.6	-4.1	-12.3
Livestock and products	-0.7	-5.9	
Crops and products	-2.7	-2.1	

In December, the BLS has estimated a sharp (2.4 per cent) rise in prices of farm products and an 0.5 per cent increase for processed foods and feeds. As a result of this turn-around in farm prices, the total wholesale price index rose 0.5 per cent, to 106.7 per cent of the 1957-59 average--slightly above the previous 1967 high of 106.5 in July. According to the BLS, increases occurred for grains, livestock, meats, eggs, and cotton. (Cotton, it should be noted, is classified as a sensitive industrial material--and thus as part of the industrial commodity total--in the special Federal Reserve groupings, used in the table above.) Apparently, however, the agricultural price rise caught by the BLS in December was exaggerated because of the pricing date--as the Assistant Commissioner commented at the press conference, the rise was "something of a statistical fluke." Corn prices in particular were temporarily high on that date, and December 13 was apparently unrepresentative for some other products. The Department of Agriculture's index of prices received by farmers increased only 1 per cent during the month ended December 15, as compared with the BLS finding of a 2.4 per cent increase for farm products. Nevertheless, rising prices of foods and foodstuffs--whatever the magnitude--contrast with developments from mid-year through November when these prices declined sharply.

Consumer prices. The consumer price index increased 0.3 per cent in November, the same as in October. At 117.8 per cent of the 1957-59 average, the November CPI was 2.8 per cent above a year earlier, with the bulk of the increase occurring since last April. The index increased at a 4.2 per cent annual rate from April to August when food prices rose sharply; since August, with food prices down somewhat, the index has increased at a 3.2 per cent rate.

Food prices declined slightly further in November, but the decline was less than seasonal. Prices of non-food commodities continued to rise at a rapid rate, owing mainly to another large increase in apparel prices, further gains in house furnishings, and a spurt in gasoline prices (principally because of the end of "price wars" in the Los Angeles area) despite a further decrease at wholesale. New car prices rose somewhat further--but less than seasonally--and used car prices edged off a bit.

Prices of consumer services increased 0.4 per cent in November--about the rate of other recent months. In addition to the continuing rapid increase in medical care, prices of public transportation and recreational services showed particularly large gains. Rents, mortgage interest rates, and property taxes were also higher.

Farm output. Total output of farm products in 1967 reached a record 17 per cent above the 1957-59 average and 3 per cent above that of 1966. By commodity, output performance was spotty, as shown in the table below, with output ranging from record highs for meat animals, poultry, feed grains, food grains, oil crops, and vegetables, down to relatively low levels for dairy products and fruits and nuts. Cotton output was the smallest since 1896.

FARM PRODUCTION
TOTAL FARM OUTPUT, GROSS PRODUCTION OF LIVESTOCK AND CROPS
(1957-59 = 100)

Item	1965	1966	1967 1/
Farm output	115	114	117
All livestock and livestock products	111	114	117
Meat Animals	111	116	118
Dairy products	103	100	100
Poultry and eggs	124	131	139
All crops	115	112	116
Feed grains	111	111	124
Food grains	117	118	134
Vegetables	110	110	112
Fruits and nuts	110	124	100
Cotton	121	78	62
Tobacco	107	109	116
Oil crops	153	164	171

1/ Preliminary

The varied pattern of 1967 farm output has important implications for consumers in 1968 through the volume of supplies of food and fibers that will be available to them and the prices that the commodities may command. For producers, the impact will be on their production plans for 1968. National production goals for 1968 call for cuts in acreages of feed grains and wheat and increases in acreages of cotton and rice.

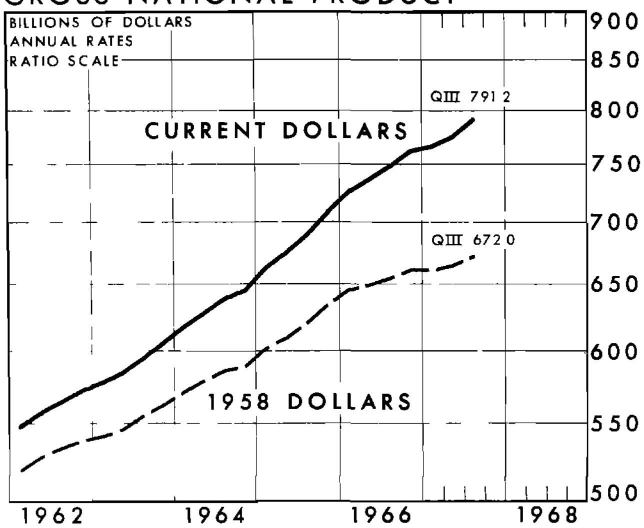
Record output of meat animals and poultry in 1967 permitted per capita consumption of 222 pounds, 4 per cent more than the reduced rate of 1966, and the largest of record. An equally high rate of meat consumption is indicated for 1968 on the basis of plans currently reported by producers. However, the biggest feed grain crops of record coupled with prospects for continued strong consumer demand may induce livestock producers to expand their plans. So real is the threat of overexpansion considered to be that Secretary Freeman called a conference of livestock and poultry producers and representatives of farm organizations in early December to urge restraint in livestock production plans and to call attention to measures available for stabilizing grain prices depressed by huge domestic and foreign output of feed grains. In the meantime the Department is promoting reductions in feed grain acreage in 1968 by reinstating attractive features of earlier acreage diversion programs which had been omitted in 1967.

The dairy enigma continues: price supports have been raised by successive steps a total of 27 per cent since 1965 but production continues to decline. Consumption is declining too, partly reflecting consumer resistance to higher prices. Short production of deciduous and citrus fruits and nuts in 1967 is apparently a one-year phenomenon caused by unfavorable growing weather in nearly all producing areas. Steps to increase 1968 cotton production have been announced. An attractive cotton acreage diversion program combined with adverse weather reduced the acreage for harvest in all areas. Nationally cotton yields were 67 per cent below 1966 and 87 per cent below the 1961-65 average.

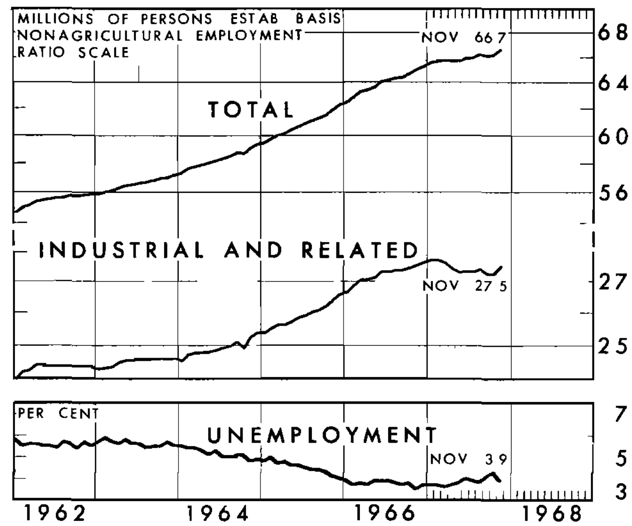
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

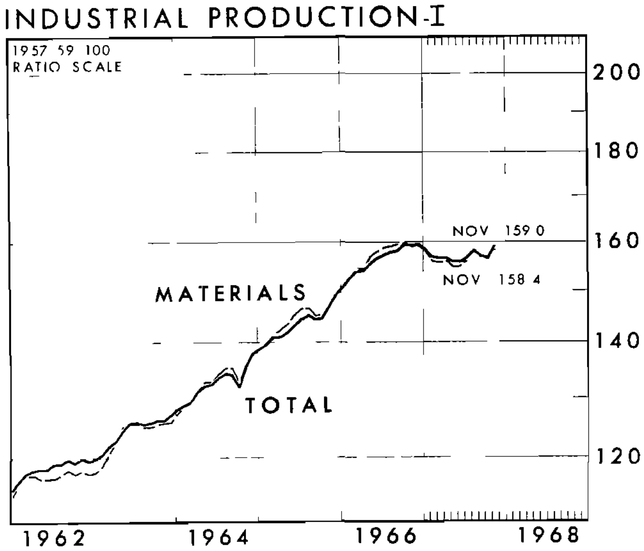
GROSS NATIONAL PRODUCT



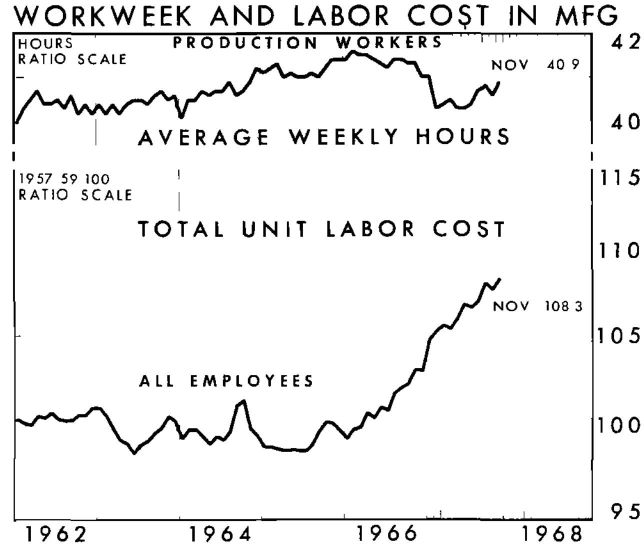
EMPLOYMENT AND UNEMPLOYMENT



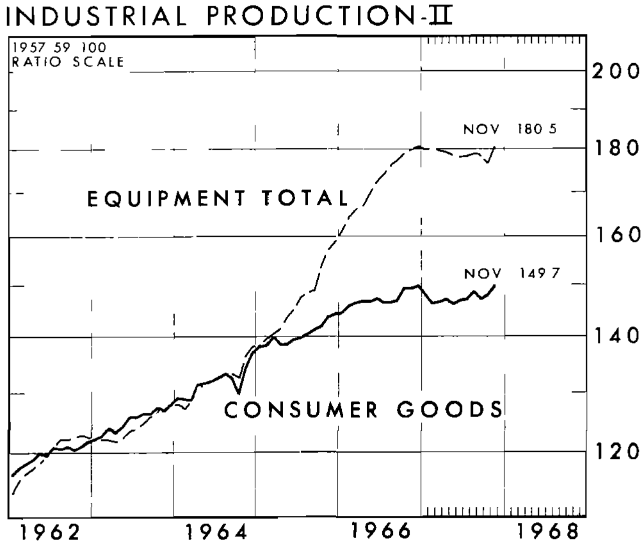
INDUSTRIAL PRODUCTION-I



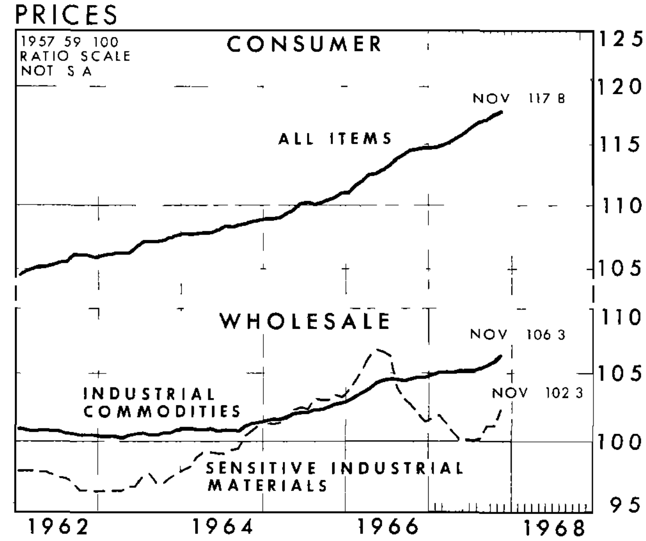
WORKWEEK AND LABOR COST IN MFG



INDUSTRIAL PRODUCTION-II



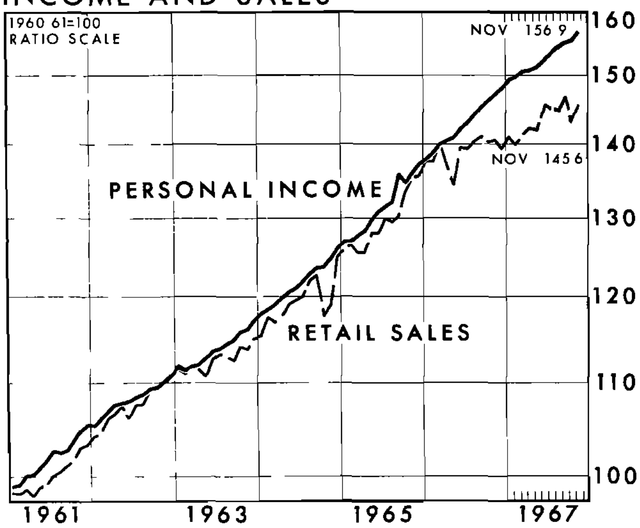
PRICES



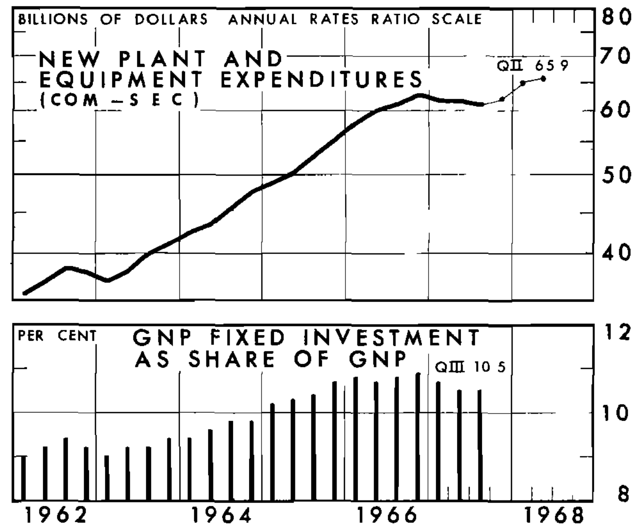
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

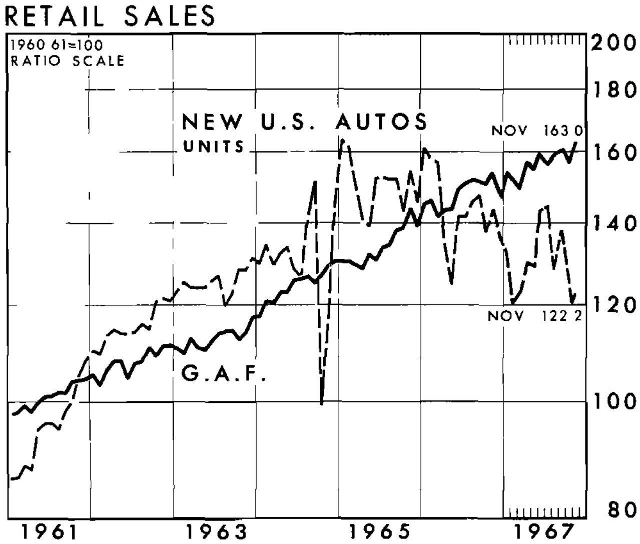
INCOME AND SALES



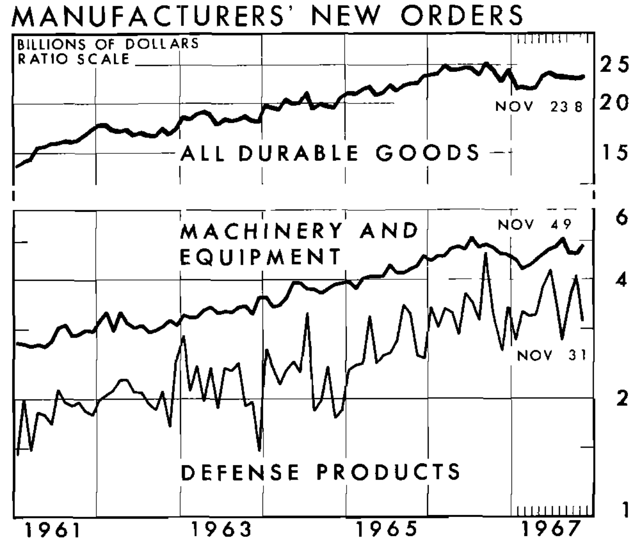
BUSINESS INVESTMENT



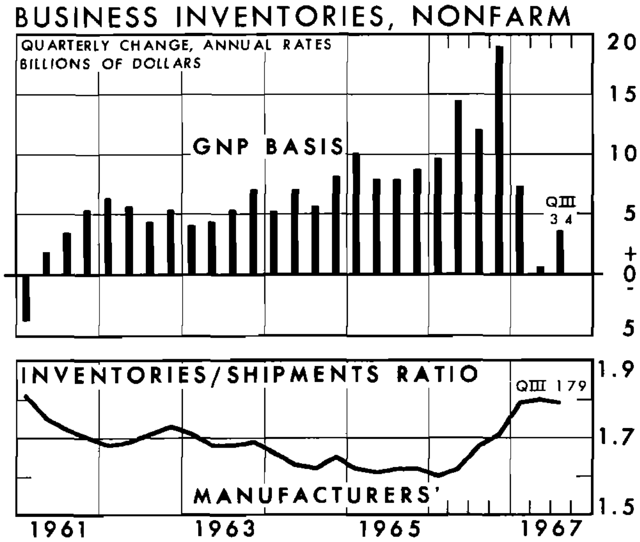
RETAIL SALES



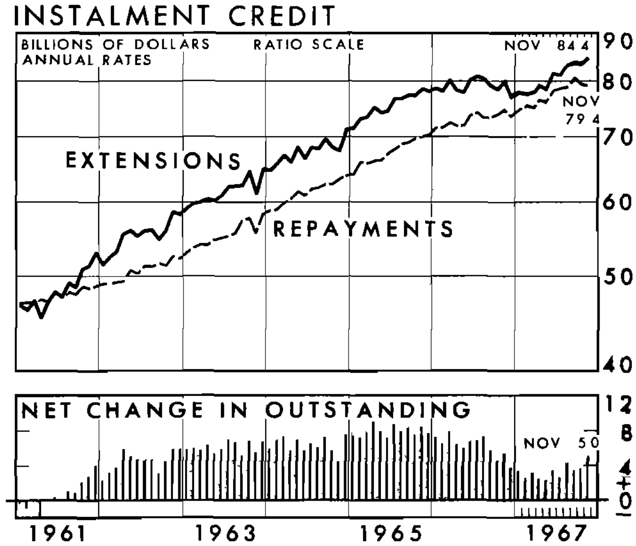
MANUFACTURERS' NEW ORDERS



BUSINESS INVENTORIES, NONFARM



INSTALMENT CREDIT



DOMESTIC FINANCIAL SITUATION

Bank deposits. The seasonally adjusted credit proxy declined slightly in December--the first decline since late 1966. Moreover, with the increased cost and reduced availability of Euro-dollars, borrowing from foreign branches remained essentially unchanged on an average basis.

Growth in seasonally adjusted time and savings deposits slowed further in the early weeks of December, and then declined in the final two weeks of the year. In large part, this weak performance reflected the $772 million attrition of negotiable CD's out of a record $5.9 billion of maturities. Rising market yields continued to reduce the relative attractiveness of these instruments and by the end of the month the Regulation Q ceiling rate of 5-1/2 per cent was being offered throughout the maturity range of CD's. While only incomplete preliminary information is available at this writing, the average maturity of CD sales apparently dropped further in December. For New York City banks, the average maturity of CD's sold in December was only 2.1 months, with the average maturity of outstandings for those banks declining to a record low of 2.4 months.

TIME AND SAVINGS DEPOSITS
ALL COMMERCIAL BANKS
Seasonally adjusted annual rate of increase

(per cent)

	Daily Average	End of the Month basis'
1967		
1st Half	17.3	16.7
3rd Q	14.7	14.7
October	12.7	14.4
November	11.9	10.7
December (preliminary)	8.5	3.4
Year (preliminary)	15.8	15.0

Not all of the slower growth of time deposits in December can be explained by CD attrition. The moderation in inflows of other time and savings deposits at weekly reporting banks, noticeable since early fall, became more pronounced in recent weeks, reflecting the pull of rising yields available on market securities. In addition, expansion in total time deposits at country member banks, most of which are not issuers of large denomination negotiable CD's, slowed noticeably in December.

The slowing in growth of time deposits occurred while the sum of private and Government demand balances was declining on a daily average basis. Since the early weeks of November, the money stock has been essentially unchanged, after almost uninterrupted expansion at about a 7 per cent annual rate in the first 10 months of the year. The failure of the money stock to rise in recent weeks--at a time when Government deposits were declining and the pace of economic activity apparently was expanding further--suggests that the unusually rapid rebuilding of money balances has now about run its course. As a result, the usual effects of higher interest rates on the demand for money have reasserted themselves, reducing the rate of expansion in the money stock.

Bank credit. With deposit growth constrained, banks in December reduced their liquidity to accomodate a sizable business loan expansion. Preliminary data indicate a large decline in U. S. Government security holdings over the month--concentrated in Treasury bills. For the same reason, the rate of accumulation of other securities--mainly municipals--was sharply reduced.

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

	1st Half	July-August	Sept.-Nov.	Dec. 1/	Year 1/
Total loans and investments	9.9	21.6	8.3	0.3	11.0
U. S. Gov't. securities	6.3	69.3	--	-38.8	11.4
Other securities	31.2	10.7	20.2	8.0	24.4
Loans	5.9	12.1	7.5	9.2	7.8

1/ All December rates are preliminary estimates based on incomplete data and are subject to revision.

NOTE: Data are on a last-Wednesday-of-the-month basis, except for June 30 and December 31.

Total loans increased somewhat faster than in the previous three months, and business loans are estimated to have expanded at the fastest rate since July, 1966. To some degree, special factors tended to accelerate business loan expansion in December. Loans to commodity dealers, for example, increased very rapidly as dealers, on behalf of the mills, made large cotton purchases from the CCC to cover 1968 production in view of the year's short crop. In addition, the normal year-end "carve-out" loans to the mining industry were very much larger than usual.

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

	1st Half	July-August	Sept.-Nov.	Dec. 1/	Year 1/
Total loans	5.9	12.1	7.5	9.2	7.8
Business	10.9	6.5	3.8	18.4	9.3
Real Estate	5.6	7.6	8.6	8.4	7.1
Consumer	4.1	6.1	9.0	8.8	6.2
Security	-17.7	158.3	4.4	39.0	12.7
Nonbank financial	-11.6	-5.3	24.8	10.0	--

1/ All December rates are preliminary estimates based on incomplete data and are subject to revision

NOTE: Data are on a last-Wednesday-of-the-month basis except for June 30 and December 31.

But, special factors aside, the strengthening of business loan demands reflects more basic underlying economic activity. For example, inventory stockpiling of steel, in anticipation of a strike later this year, has already begun to increase loan demands of the primary metals manufacturers--who apparently have been building up their own stocks. Similarly, the increasing level of dealer inventories of automobiles has produced some additional bank borrowing. More generally, the strengthening of business loan demands probably reflects both the expanded level of working capital needs by business firms--associated with the apparently increasing pace of economic activity--and the slower rate of capital market financing.

Among other loan categories, real estate and consumer loans maintained their somewhat higher rate of growth of recent months. On the other hand, loans to nonbank financial institutions--especially finance companies--moderated, probably associated with the increase in the prime rate in November, which again made direct bank financing considerably more costly than issuing commercial paper. The reduction in security loans, despite strength in the "other" category, reflected the reductions in inventories of U.S. Government security dealers over the month.

Bank liquidity. Despite the liquidation of securities and the higher pace of business loan demands in December, the banking system enters the new year with its liquidity position somewhat improved from that of a year earlier--although still low by standards of earlier years.

It is always extremely difficult to quantity the liquidity position of banks, but, as one measure, the loans-to-deposit ratio seems to suggest such an improvement--especially at the larger banks.

LOANS-TO-DEPOSITS RATIO

Last Wed. of November	All Commercial Banks	Member Banks			
		Reserve City Banks			
		New York City	Chicago	Other	Country
1960	55.4	66.0	60.3	59.7	50.4
1961	54.7	63.5	57.7	58.0	50.5
1962	56.3	66.6	57.3	60.7	51.5
1963	59.0	69.3	61.2	63.5	54.0
1964	60.7	69.4	62.1	66.1	55.9
1965	64.2	77.6	77.7	69.3	58.3
1966	66.4	82.7	77.7	71.5	59.8
1967	64.1	78.7	71.0	68.3	58.4

The absolute decline in this ratio from 1966 to 1967 was much larger at reserve city than at country banks. To a degree this development is associated with the substantial increase in loans at the larger banks in 1966 and their limited deposit growth in the second half of that year. In addition, the larger drop-off in the ratio for reserve city banks in 1967 is a reflection of the fairly normal pattern of more pronounced cyclical changes in loans at larger banks relative to the smaller ones. This tendency, however, was apparently accentuated in 1967 by the unusually large substitution of market financing for bank loans. This alternative source of funds is more available to larger firms which deal mainly with the larger banks.

When liquidity positions are indicated by the ratio of a bank's most liquid assets to deposits, however, the large weekly reporting banks do not show so marked an improvement--as indicated by measure I in the accompanying table. However, the addition of Treasury issues due in 1 to 5 years (measure II) improves the liquid asset ratio of these banks further--although, even this measure of liquidity at the end of 1967 remains below that of the period prior to 1964. Finally, the inclusion of acceptances and municipals due within 1 year would add 2.5 percentage points to the ratio in 1967, a year that is thought to be one of unusually large bank purchases of shorter-term municipals, but maturity breakdowns of municipal holdings are not available prior to mid-1966 so historical comparisons are limited.

LIQUID ASSETS-TO-DEPOSITS RATIO AT WEEKLY REPORTING BANKS

Last Wednesday of Dec.	Measure I 1/	Measure II 2/
1960	13.3	28.8
1961	16.7	30.8
1962	15.5	26.2
1963	12.4	22.0
1964	13.8	21.5
1965	12.6	18.2
1966	12.2	17.9
1967	12.4	19.2

1/ Ratio of: (1) U.S. Government securities maturing within 1 year; (2) loans to banks; (3) loans to brokers and dealers; and (4) balances with domestic banks to total deposits minus cash items.

2/ In addition to items in Measure I, U.S. Government securities maturing within 1 to 5 years included.

NOTE: Ratios prior to July 1965 adjusted for changes in bank coverage.

On balance, then, the impression remains that banks--especially the larger ones--have improved their portfolio liquidity in 1967 relative to 1966. But these liquidity ratios remain below those of 1964 and perhaps 1965, and do not suggest that banks are in an overly comfortable position to finance sharp increases in loans from portfolio adjustments if and as they find it difficult to obtain funds through expansion in their liabilities.

Corporate and municipal bond markets. After reaching their 1967 highs early in December, yields on municipal and new corporate bonds showed a slight tendency to decline thereafter as new issues volume slowed seasonally. Both markets appear to have taken the Board's recent announcements on reserve requirements and the new balance of payments actions in stride, although a continuing large prospective volume of new issues and uncertainties about the future strength of bank investment demands have contributed to a more cautious tone in the municipal than in the corporate market.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aa		State and local Government	
	New With call protection	Seasoned	Moody's Aaa	Bond Buyer's (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
November 17	6.53	6.10	3.98	4.33
December 8	6.55*	6.14	4.15	4.45
15	--	6.16	4.15	4.41
22	--	#6.22	4.15	4.41
29	--	6.24	4.15	4.44
1968				
January 5	p/6.36			

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

2/ Weeks preceding Federal Reserve discount rate increase.

3/ 1967 lows.

* Some issues included carry 10-year call protection.

\# Series break - Aaa railroad bonds no longer a component of the series.

The gross volume of new corporate bonds offered publicly in December totaled slightly over $1 billion, despite the seasonal slackness of new issues after mid-month. This exceeded the reduced November volume by more than $400 million and matched the unusually large volume offered in December 1966. Moreover, with private placements expected to show a seasonal increase substantially larger than last year, total corporate security offerings for December, including stock, are estimated at a relatively high $2.2 billion.

For all of 1967 the gross volume of corporate bond and stock issues amounted to an estimated $24.7 billion, three-fifths more than the previous $18.1 billion record for 1966. With the volume of private bond placements and stock slightly smaller than in 1966, the year-to-year increase in total corporate security offerings was more than accounted for by publicly offered bonds. Such issues expanded by nearly $7 billion to about $15 billion. Of this total $13.5 billion and nearly all of the increase was accounted for by industrial issues. At the same time, the relatively high level of interest rates and stock prices induced debt issuers to resort increasingly to convertible bonds. Thus, the volume of convertibles rose to over $4 billion for the year, more than double the previous record of $1.9 billion issues in 1966.

Corporate debt financing through public offerings is expected to remain high in January relative to normal experience, but nevertheless to fall below the $1 billion or more per month volume that prevailed during most of 1967. The calendar of issues already scheduled for January totals $790 million, about $50 million more than was ultimately offered in January 1967. Private placements for January are estimated at $700 million, $300 million below December's seasonally high volume, so total bond and stock volume is expected to amount to about $1.9 billion. The usual turn of the year investment demand from pension funds and trust accounts is not expected to be a significant factor this January since a substantial part of these excess funds were committed in 1967 for delayed delivery.

The bulk of corporate public bond offerings now scheduled for January are utility issues with only one significant industrial bond on the calendar (the $200 million Indiana Standard Oil debenture). Since the number of new industrial offerings announced has slowed recently, and corporate underwriters also report a slackening in the number of large industrial borrowers considering near-term debt financing, the monthly volume of public bond offerings may show a year to year decline in coming months. However, a continuing large volume of utility financing will still insure a substantial volume of new issues from non-financial corporations.

CORPORATE SECURITY OFFERINGS[1/]
(Millions of dollars)

	Bonds				Total bonds and stocks	
	Public Offerings[2/]		Private Placements			
	1966	1967	1966	1967	1966	1967
Annual Total	8,018	14,904e	7,543	7,050e	18,075	24,713e
4th Quarter	2,047	3,020e	1,247	2,222e	3,669	6,207e
November	569	620e	435	650e	1,115	1,615e
December	980	1,025e	555	1,000e	1,661	2,175e
	1967	1968	1967	1968	1967	1968
January	745	950e	848	700e	1,684	1,850e

1/ Data are gross proceeds.

2/ Includes refundings.

In the municipal bond market, the volume of new issues in December aggregated slightly below $1 billion, $300 million less than earlier estimates. All of this short-fall was accounted for by postponements--including several industrial revenue issues--which developed following a rise in municipal bond yields early in the month. Despite the drop in new issues volume, municipal dealers' advertised inventories advanced to more than $500 million early in the month and have shown little change since. The January volume of new issues is currently estimated at $1.2 billion, which is large considering the current level of inventories and a possible further slowing of bank demand.

During all of 1967, municipal security offerings rose to a record volume of nearly $14.4 billion, $3 billion more than in 1966. To some extent this growth reflected the continuing general expansion of capital needs among State and local government units. But volume was also accentuated on balance by the carry-over of borrowings postponed during the 1966 credit crunch--although, as has been indicated, as the year progressed, high interest costs again exerted restraints on some borrowers. At the same time, high interest rates, along with the threat of Congressional withdrawal of the tax exemption privilege, ballooned the volume of industrial reveuue offerings. Altogether, industrial issues aggregated $1.3 billion, an increase of 160 per cent from the previous record for such offerings in 1966.

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

	1966	1967
Annual Total	11,405	14,350e
4th Quarter	2,674	3,238e
November	976	1,313
December	940	975e
	1967	1968
January	1,487	1,200e

1/ Data are for principal amounts of new issues.

Corporate liquidity. The exceptionally large volume of corporate funds raised in capital markets during the third quarter, together with seasonally low income tax payments, were accompanied by a contraseasonal rise in corporations' holdings of liquid assets and a much smaller than usual expansion in their short-term debts. As a result, corporate liquidity--as measured by ratios of liquid assets to total current liabilities--remained practically unchanged from the second to the third quarter. In all other recent years, liquidity has declined by at least a full percentage point in the third quarter and in 1966 the decline was even larger.

Stability in the ratios in the third quarter this year is thus equivalent to a seasonally adjusted increase--the first such increase this year. In the first two quarters, when capital market financing was somewhat smaller and income tax payments were larger than in the third quarter, corporate liquidity ratios showed the usual quarter-to-quarter declines, and such improvement in liquidity positions as occurred was mainly in the lengthening of the average maturity of corporate debt. Nevertheless, even with improvement becoming apparent in liquidity ratios in the third quarter, corporate holdings of liquid assets remained below their levels of a year earlier and liquidity ratios remained at historical lows for this quarter.

CORPORATE LIQUIDITY

Year	Cash and U.S. Govt. Securities	Cash Govts. and "other" curr. assets 1/	Total Current Liabilities	Ratios to total curr. liab.: Cash & Govts.	Cash, govts, and "other" curr. assets
		Second to third quarter changes			
		(billions of dollars)		(percentage points)	
1964	-.4	.2	5.5	-1.2	-1.1
1965	-.4	-.2	6.1	-1.0	-1.2
1966	-1.5	-1.7	6.8	-1.4	-1.8
1967	.7	1.8	4.3	-.1	.1
		Level, end of third quarter			
		(billions of dollars)		(per cent)	
1964	63.9	84.1	196.6	32.5	42.8
1965	61.6	84.5	216.6	28.4	39.0
1966	61.6	86.0	241.5	25.5	35.6
1967	59.4	85.4	252.6	23.5	33.8

1/ Corporate holdings of marketable securities other than U.S. Governments--principally commercial and finance company paper--are included in these statistics in "other" current assets.

Source: Securities and Exchange Commission, Current Assets and Liabilities of U.S. Corporations. Excludes banks, insurance companies and savings and loan associations.

Mortgage market developments. The continued high level of bond yields during December kept interest rates in the mortgage market under upward pressure, with numerous savings banks and life insurance companies reportedly remaining out of the secondary market as the end of the year approached. Weekly offerings of Government underwritten home mortgages to FNMA for purchase under its secondary market operations accordingly remained fairly strong through December 29 (latest available data), although they continued below the near-record levels which prevailed before FNMA cut its buying prices late in November.

During November, the uptrend in mortgage rates on new homes accelerated within both primary and secondary markets, according to the official FHA series shown in the table. Returns on home mortgages, however, again rose less than average yields on new issues of high-grade corporate bonds. As a result, gross yield spreads favoring conventional or FHA-insured home mortgages over corporate bonds decreased sharply further to the narrowest margins in the history of the series (dating from 1953 for conventional loans and 1948 for FHA loans). In fact, implied net yield spreads--after allowance for servicing costs which run a good deal higher on mortgages than on bonds--may well have been negative on the average.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary Market: Conventional Loans			Secondary Market: FHA-insured loans			
	Level (Per cent)	Change (Basis points)	Yield Spread (Basis points)	Level (Per cent)	Change (Basis points)	Yield Spread (Basis points	Discount (points)
1966							
November	6.70	0	98	6.81	n.a.	109	6.8
December	6.65	-5	91	6.77	-4	103	6.5
1967							
January	6.60	-5	122	6.62	-15	124	5.3
February	6.50	-10	130	6.46	-16	126	4.0
March	6.45	-5	114	6.35	-11	104	3.0
April	6.40	-5	101	6.29	-6	90	2.5
May	6.45	5	79	6.44	15	78	3.8
June	6.50	5	71	6.51	7	72	4.4
July	6.50	0	72	6.53	2	75	4.6
August	6.55	5	66	6.60	7	71	5.2
September	6.55	0	67	6.63	3	75	5.4
October	6.55	0	43	6.65	2	53	5.6
November	6.65	10	12	6.77	12	24	6.5

NOTE: FHA series; interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points; secondary market yields and discounts are for certain 6 per cent, FHA-insured Sec. 203 loans. Gross yield spread is mortgage return minus average yield on new issues of high grade corporate bonds.

In view of these unfavorable yield-spread relationships as well as growing uncertainties about net savings inflows, reporting private lenders expanded their aggregate mortgage commitments at a slower pace during October-November, as the table shows. The reduced rate of commitment growth reflected partly the already-high level of outstanding commitments--particularly for savings and loan associations--and partly the resurgence of FNMA as a significant additional source of market support. S&L's, as might be expected, generally continued to increase their outstanding mortgage commitments on properties of all types more rapidly than the more diversified savings banks and life insurance companies.

AVERAGE MONTHLY RATE OF INCREASE IN MORTGAGE COMMITMENTS OUTSTANDING

Period	Thrift Institutions			Reporting life Insurance Companies	All Three Lenders
	Savings and loan Associations	Savings banks in New York State	Total		
1967 - I	6	2	4	--	2
II	12	6	9	1	5
III	4	2	3	2	3
Oct. - Nov.	2	--	1	1*	1*

NOTE: Based on seasonally adjusted data which are confidential for life insurance companies. * October only.

Growing selectivity of private lenders in making loans, higher mortgage discounts, and increases in interest rates may have dampened the turnover of some existing dwellings in recent months. Meanwhile, the rate of new home starts has continued upward, partly because buyers of such dwellings have greater ultimate recourse to a backlog of older mortgage commitments made earlier under more favorable terms.

Flows to depositary-type intermediaries. Net savings inflows showed a divergent experience for savings and loan associations and mutual savings banks in November. At the S&L's they were not only below previous Novembers through 1963 but also showed the first year-to-year decline experienced in 1967. This relative deterioration in November occurred despite a record volume of gross new savings, due to a balancing increase in gross withdrawals. In fact, the ratio of withdrawals to new savings rose to nearly 78 per cent, the highest November ratio ever registered and the first year-to-year increase in the ratio experienced for any month in 1967.

The November inflow of regular deposits to mutual savings banks, on the other hand, showed an increase relative to previous Novembers, and as shown in the table, inflows at both types of thrift institutions over the first eleven months of 1967 were also very large relative to earlier years.

DEPOSITARY-TYPE SAVINGS FLOWS, BY INSTITUTION
(Millions of dollars)

Date	Total	S&Ls	Mutual Savings Banks	Commercial Banks*
Nov. 1963	1,294**	814	239	241**
1964	1,356	866	318	172
1965	1,320	807	276	237
1966	726	614	254	-142
1967	836	575	321	- 60
Year to Nov.				
1963	24,575**	9,352	2,691	12,532**
1964	21,645	8,924	3,585	9,136
1965	23,478	6,741	2,982	13,755
1966	14,892	1,893	1,897	11,102
1967	29,913	8,947	4,457	16,509

* Excludes negotiable CDs at weekly reporting banks.

** Data for 1963 includes all time and savings deposits.

There is evidence, however, that the large net deposit gains at mutual savings banks in November were paralleled by increases in passbook loans. At the 15 largest savings banks in New York City, for example, the large first-half November and December net deposit gains were accompanied by extraordinarily large increases in passbook loans, as shown in the table. Past experience would suggest the likelihood of correspondingly large withdrawals after the December interest-crediting period. Data for these savings banks for the first three days of the reinvestment period at the end of December indicate that the December experience relative to 1966 and 1965 does show an increase in net loss after adjustment for passbook loans. The 1967 three-day loss of $64.6 million compares with $45.7 and $58.1 million for 1966 and 1965 respectively, or, as a percentage of deposits, .37 per cent, .29 per cent, and .38 per cent for 1967, 1966, and 1965.

PASSBOOK LOANS AND DEPOSIT GAINS

15 Largest Savings Banks in New York City
First 15 Calendar Days
(millions of dollars)

	Net Gain Deposits		Increase In Passbook Loans		Net Gain in Deposits After Adjustment for PBL	
	Nov. 1-15	Dec. 1-15	Nov. 1-15	Dec. 1-15	Nov. 1-15	Dec. 1-15
1964	39.0	63.9	2.5	24.0	36.5	39.9
1965	31.4	57.6	7.4	31.7	24.0	25.9
1966	46.3	74.5	10.7	28.3	35.6	46.2
1967	52.5	81.8	20.2	43.9	32.3	37.9

Source: Savings Bank Association of New York State. "Research Report"

Short-term market rates have become increasingly attractive to holders of shares and deposits in thrift insitutions. From end-October to December 1, rates on 3-month bills, 6-month bills and 4-6 month commercial paper increased by more than 35 basis points to 4.92, 5.49, and 5.50 per cent, respectively. The differential between the 6-month bill rate and the 5 per cent maximum rate paid on passbook savings claims increased correspondingly to 49 basis points, a spread exceeded in the recent past only by the 67-basis point differential in September, 1966.

As a result of the asset management policies conducted during 1967, both the S&L's and the mutual savings banks appear somewhat better equipped to withstand a shrinkage in savings flows than they were in 1966. The S&L's ratio of Government securities plus cash holdings (net of borrowings) to share capital, which decreased from 3.9 to 2.5 per cent for the two semiannual periods in 1966, increased to 5.3 in the first half of 1967 and further to 6.3 in the second half through November, a ratio not exceeded since the second half of 1963. Net advances from the FHLBB, which typically rise late in the year, increased by approximately $70 million in November and $100 million in the first three weeks of December, carrying outstanding advances back to their June, 1967 level; except for the unseasonal decline in advances in December 1966, the preliminary data for December 1967 indicate an unusually small increase in advances. The cash-to-deposit ratio of mutual savings banks has recovered from its slight 1966 decrease, although cash-plus-Governments to deposits has been maintained below its post-1963 levels; mutual savings banks have pursued an aggressive policy of purchasing a record amount of corporate securities in the public market, however, and have thereby improved the marketability of their asset composition.

Stock market developments. During much of December stock prices fluctuated around a relatively flat trend line, as seasonal tax-motivated transactions tended to depress the market. Trading activity was heavy, however, averaging over 11 million shares per day for the month. At month-end prices turned up again, on even more active trading, resuming the general advance that had developed during the latter half of November. To a considerable extent, this most recent stimulus to stock prices has apparently come from the covering of record short positions left open during the period of tax selling. In addition, however, there are several indications of renewed speculative activity.

Although the Dow-Jones industrial average and Standard and Poor's composite index of 500 stocks remain respectively 4.0 per cent and 1.3 per cent below the record highs reached near the end of September, the American Exchange index has advanced to a level 4.7 per cent above its previous high. Moreover, the number of stocks on which the American Exchange placed 100 per cent margin requirements rose from 11 on November 15 to a record of 30 in the last week of December. The New York Exchange, which places special margin requirements on convertible bonds and convertible preferred stocks as well as common stocks, increased the number of its issues covered by special requirements from 12 on November 5 to an unprecedented 53 at year end. Of the 53, 39 were common stocks. Few of the issues subjected to special margin requirements on either exchange were low-priced, but most were "glamour," or in a few cases gold mining, stocks. Even so, Standard and Poor's low-price common stock index is also at an all-time high, 4.9 per cent above the previous high reached in early October.

During November, margin customers moderated their borrowing activity somewhat relative to earlier months. Thus, margin debt rose only $70 million from a revised level of $6,020 million in October--the smallest monthly increase since May. Purpose loans at banks also experienced only a modest increase, rising $19 million to $2,442 million. At the same time, customers net free credit balances were drawn down $13 million, the first such net withdrawal since August, and some funds were apparently withdrawn from margin customers' special miscellaneous balances with brokers as well.

U.S. Government securities market. Yields on intermediate and long-term Treasury obligations have declined since early December, while Treasury bill rates have risen on balance as the table shows. In general, the U.S. Government securities market has been much steadier in recent weeks, following a period of sharp fluctuations in the wake of the devaluation of sterling and increases in U.K. and U.S. discount rates. There was only a minor reaction in bill and bond markets to the increase in reserve requirements announced in late December. And the Administration's program to alleviate the U.S. balance of payments deficit announced January 1 imparted firm tone to Treasury markets. Market professionals apparently viewed the steps as diminishing the likelihood of a further near-term tightening of monetary policy.

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

	1967				
	Low	High	Nov. 17	Dec. 11	Dec. 29
Bills					
3-months	3.33 (6/23)	5.04 (12/29)	4.67	4.90	5.04
6-months	3.71 (5/22)	5.60 (12/1)	5.13	5.46	5.54
1-year	3.80 (4/24)	5.71 (12/29)	5.27	5.62	5.71
Coupons					
3-years	4.27 (4/10)	5.87 (11/13)	5.66	5.71	5.80
5-years	4.38 (4/10)	5.91 (11/13)	5.72	5.81	5.78
10-years	4.45 (3/20)	5.87 (11/13)	5.75	5.74	5.70
20-years	4.44 (1/16)	5.81 (11/20)	5.70	5.63	5.56

The generally firm atmosphere in the Treasury bond market since the early part of December has reflected a variety of influences, including the seasonal hiatus in the schedule of new bond issues and generally light dealer inventories. A sizable volume of year-end tax swapping activity, featuring maturity lengthening transactions, has also contributed to the better market tone. There have been indications of a growing, but by no means universal, feeling that long-term bond yields could be at or near their peaks, even if short- and intermediate-term yields should advance further with less money market conditions.

With the development of slightly firmer money market conditions over the course of December, Treasury bill rates have edged higher on balance. This small advance in yields occurred despite strong investor demand during December which was supplemented by sizable net purchases by foreign official accounts. However, upward pressure on bill rates could be generated by the imminent Treasury cash financing in the bill area in conjunction with less easy money market conditions. Still, the technical position of the bill market is strong with dealer bill holdings relatively light.

The Treasury announced on January 3 that it would raise $2.5 billion of new money through the sale of June tax bills. The auction will be held on January 9, with payment on the 15th. Banks will be allowed 100 per cent tax and loan credit. An $800 million FNMA PC offering to the public was announced at the same time. It will include a $500 million 3-year issue and a $300 million 20-year portion, to be offered about January 16 and paid for on January 30.

Yields on a number of key short-term market instruments have risen further in recent weeks, as is indicated in the accompanying table.

SELECTED SHORT-TERM INTEREST RATES

	1966 High	1967 Low	1967 High	Nov. 17	Dec. 11	Dec. 29
3-months						
Bankers' acceptances	5.75 (10/25)	4.25 (6/6)	5.63 (12/29)	4.88	5.38	5.63
Federal agencies	5.76 (9/21)	3.82 (5/26)	5.30 (12/29)	5.05	5.25	5.30
Finance paper	5.88 (12/31)	4.25 (5/24)	5.88 (1/6)	5.13	5.38	5.50
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/31)	4.25 (4/21)	5.50 (12/29)	5.25	5.50	5.50
Secondary market	5.90 (9/21)	4.35 (4/28)	5.70 (12/29)	5.30	5.60	5.70
6-months						
Bankers' acceptances	6.00 (9/23)	4.38 (6/16)	5.88 (12/29)	5.13	5.63	5.88
Commercial paper	6.00 (12/31)	4.63 (6/26)	6.00 (1/16)	5.13	5.50	5.63
Federal agencies	6.04 (9/21)	4.11 (5/19)	5.55 (12/29)	5.40	5.55	5.55
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/31)	4.25 (4/21)	5.50 (12/29)	5.38	5.50	5.50
Secondary market	6.30 (9/28)	4.35 (4/14)	6.00 (12/29)	5.60	6.00	6.00
1-year						
Federal agencies	6.13 (9/23)	4.18 (4/7)	5.95 (12/29)	5.75	5.88	5.95
Prime municipals	4.25 (9/21)	2.40 (4/14)	4.00 (12/29)	3.40	3.75	4.00

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

Federal budget. Staff projections of the Federal budget through the first quarter of 1968 indicate a sharp decline in the Federal deficit on the basis of the seasonally adjusted national income accounts. This deficit had reached a peak of $15 billion at annual rates in the second quarter of 1967 and is projected to be down to a level of $6 billion by the first quarter of 1968. The decline is due to rising tax receipts and an apparent leveling off in Federal expenditures.

On a cash basis, the cumulative Federal deficit in the first three quarters of fiscal year 1968 is projected to amount to $25 billion. But with a seasonal surplus expected in the last quarter of the fiscal year, the total cash deficit for the fiscal year might be between $17 and $19 billion.

In the first quarter of calendar year 1968, a cash deficit of $5 billion is projected, requiring $4 billion of net cash borrowing during that quarter. About $1.5 billion of PC sales to the public are also assumed.

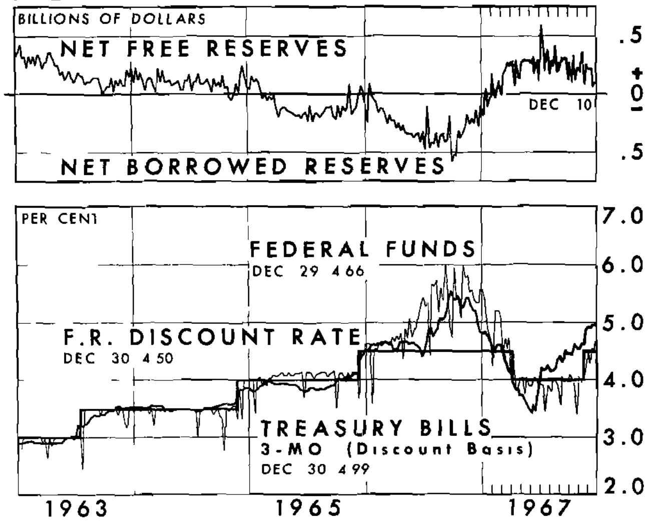
VARIOUS FEDERAL BUDGETS
(In billions of dollars)

	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	11.5	- 9.2	-11.0	- 4.9	- 1.5	- 4.3	-11.5
Cash receipts	34.6	31.1	38.0	49.9	35.9	32.2	37.8	153.6	168.1	164.0
Cash payments	41.3	38.8	36.7	38.4	45.1	43.2	42.7	155.1	172.4	175.5
Change in total cash balance	- 4.1	- 2.5	.7	1.4	.3	- 1.9	- .8	- 4.5	--	--
Net Cash borrowing (+)	2.4	5.1	- .9	-10.3	9.3	9.1	4.1	- 3.8	3.8	11.0
(Pool sales to public) 1/	- .5	--	1.1	1.8	--	.7	1.4	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	-10.7	- 5.9	- 7.7	- 2.1	- 6.4
Receipts	145.6	148.6	149.1	148.1	152.8	156.5	162.2	147.9	167.1	164.0
Expenditures	146.3	151.9	160.9	162.8	165.9	167.2	168.1	155.5	169.2	170.4
High employment surplus/deficit (-) 2/	- .4	- 3.3	-10.5	-13.0	-12.2	-10.2	- 5.5	- 6.8		

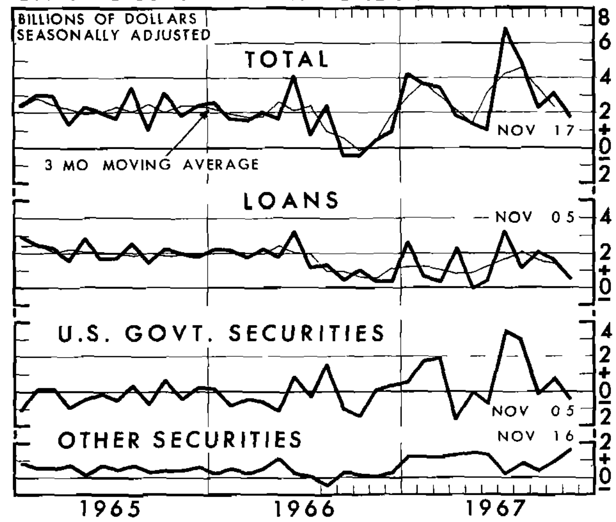
e - Staff projections. Based on existing tax rates.
1/ Not included in net cash borrowing.
2/ Uses 1966 IVQ as a high employment base.
3/ Includes tax legislation proposed in January 1967 estimated to raise $5.8 billion in fiscal 1968.
4/ The President's tax increase proposals were projected to produce $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

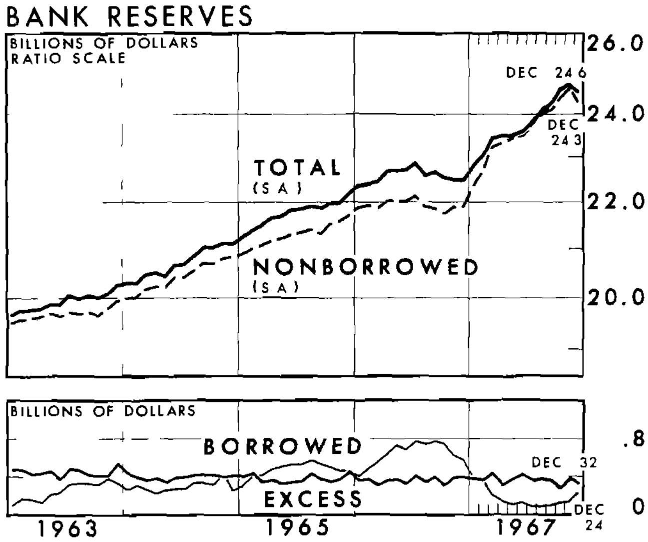
FREE RESERVES AND COSTS



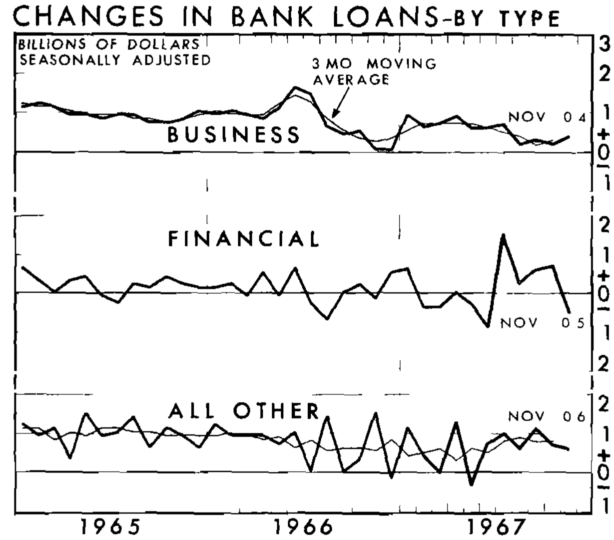
CHANGES IN BANK CREDIT



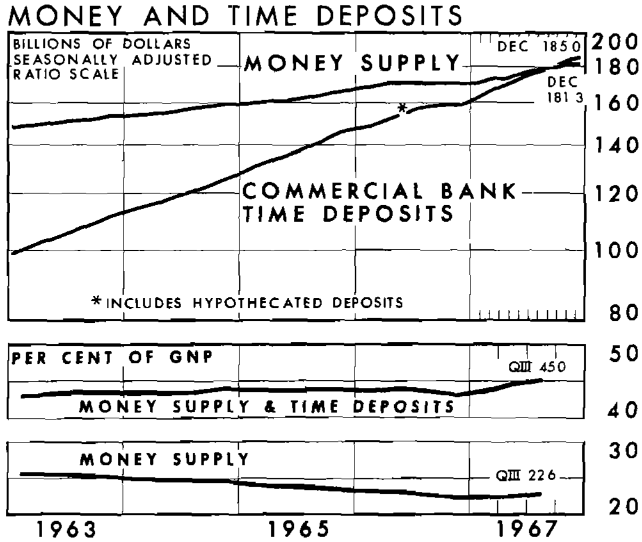
BANK RESERVES



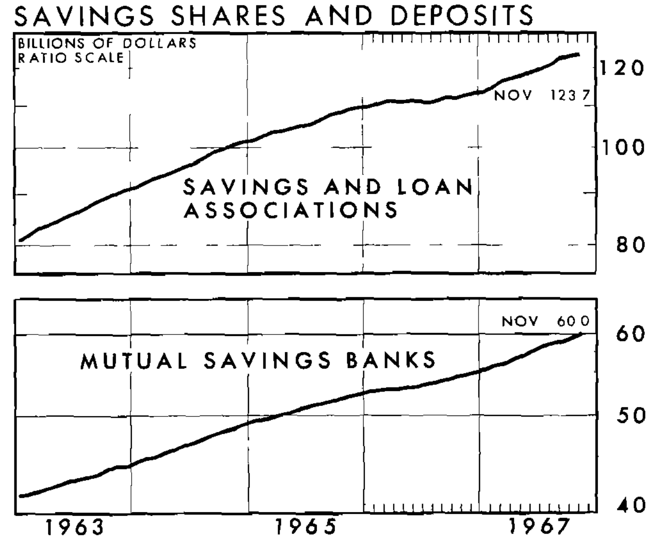
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

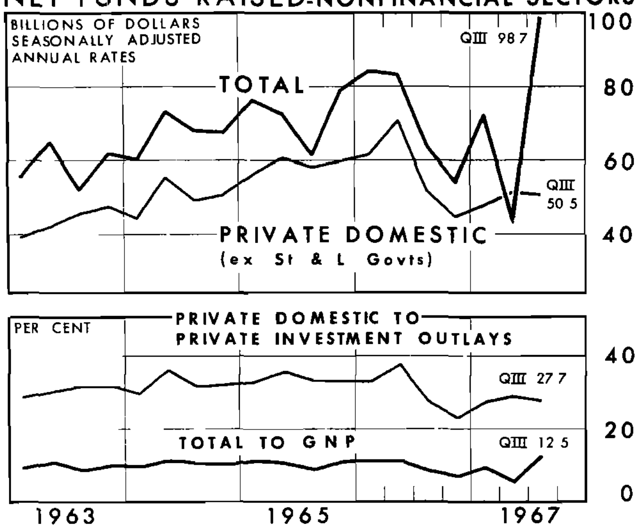


SAVINGS SHARES AND DEPOSITS

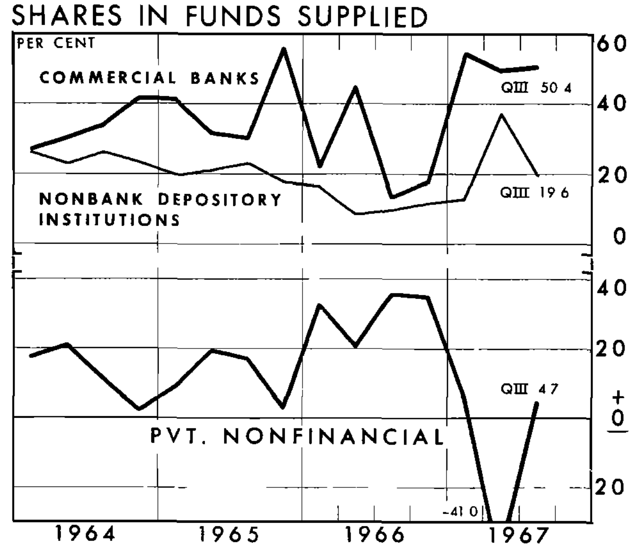


FINANCIAL DEVELOPMENTS - UNITED STATES

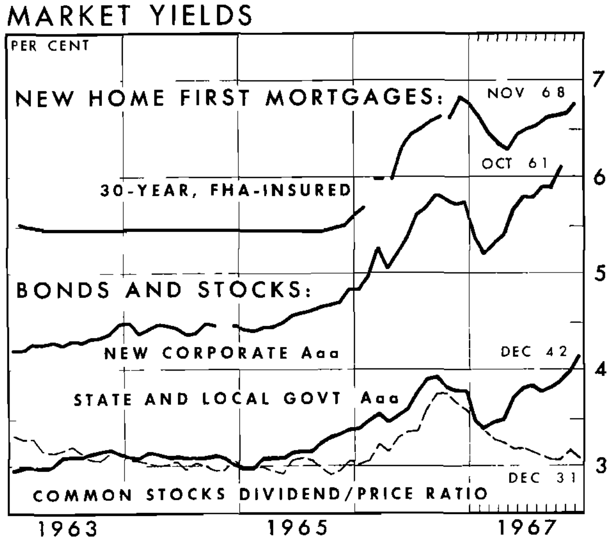
NET FUNDS RAISED-NONFINANCIAL SECTORS



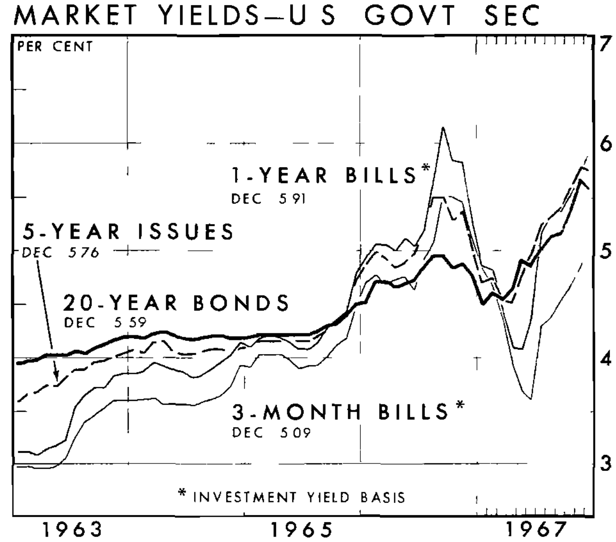
SHARES IN FUNDS SUPPLIED



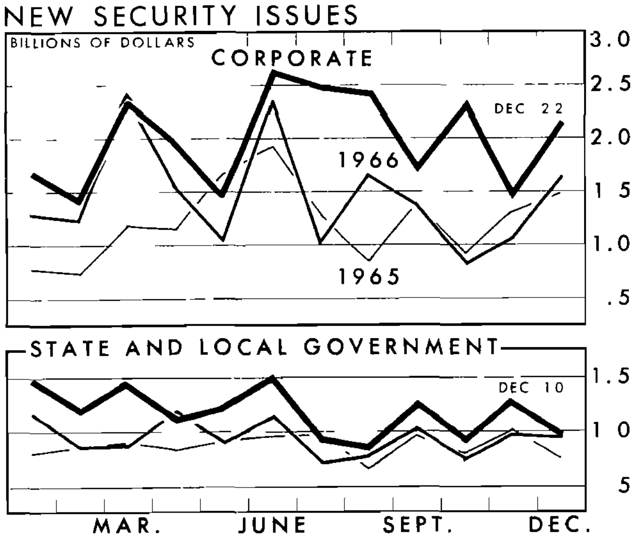
MARKET YIELDS



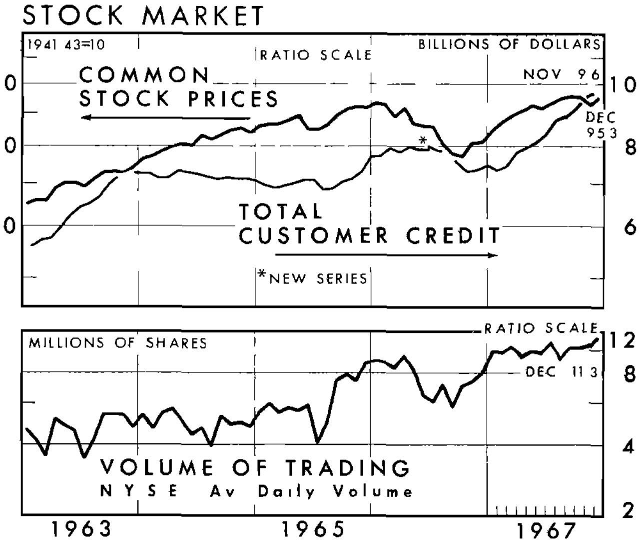
MARKET YIELDS—U S GOVT SEC



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

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New U.S. balance of payments program. On January 1, the President announced a program "designed to bring our balance of payments to -- or close to -- equilibrium in the year ahead." He said that the payments deficit for 1967 (on the published liquidity basis) would be "in the area of $3.5 to $4 billion -- the highest since 1960." An improvement of about $3 billion in 1968 would be sought from the following:

(1) Direct investment -- at least $1 billion;

(2) Lending by financial institutions -- at least $500 million;

(3) Travel -- $500 million;

(4) Government expenditures overseas -- $500 million; and

(5) Trade -- at least $500 million.

The President reiterated that the most urgent needs are for a tax increase and for responsible wage-price decisions to "help to stem the inflationary pressures which now threaten our economic prosperity and our trade surplus." He stated again that "the dollar will remain convertible into gold at $35 an ounce, and our full gold stock will back that commitment," but made no recommendation regarding the gold cover requirement for Federal Reserve notes. He asked that plans to create Special Drawing Rights in the IMF be speeded up.

The President's target figures for balance-of-payments improvement should be taken as indicating orders of magnitude. Some of the new measures have not been fully worked out and cannot be implemented at once. In any case, many of the figures are not closely calculable, since the net effect of the new measures will depend partly on foreign reactions and on other developments here and abroad.

The most important and fully articulated of the new measures are those relating to outflows of U.S. private capital. The Commerce Department program for direct investments is tightened severely and becomes mandatory, effective immediately. For each company, net capital flows (including reinvested earnings) in 1968 may not -- except as authorized in exceptional circumstances -- exceed the following percentages of the 1965-66 averages:

(1) To less developed countries -- 110 per cent;

(2) To developed countries heavily dependent on U.S. capital (including Canada, Japan, Australia, the United Kingdom, and Middle Eastern oil-producing countries) -- 65 per cent;

(3) To all other countries (developed countries in continental Western Europe and South Africa) -- investment only out of earnings, and only up to 35 per cent of the 1965-66 base.

Businesses are also required to repatriate foreign earnings at least in the proportions of 1964-66, and legislation to induce or encourage the repatriation of earnings may be proposed. Also, liquid funds abroad above the 1965-66 monthly average are to be returned by mid-1968. As earlier noted, the new program for direct investments is intended to cut net outflows -- mainly to continental Western Europe -- by at least $1 billion from 1967 to 1968.

The Federal Reserve programs for banks and other financial institutions remain technically voluntary, but may be made mandatory if necessary. The guidelines have been tightened in a way designed to induce a reflow of funds from abroad during 1968 of at least $500 million -- $400 million of bank credit and $100 million of covered assets of other financial institutions. This will represent an improvement, by comparison with 1967 outflows covered by the programs, of roughly $900 million, considerably more than the "at least $500 million" mentioned by the President.

For banks, the general ceiling on outstanding credits to foreigners has been cut to 103 per cent of the end-1964 base (or to the 1967 ceiling plus 1/3 of the difference between that amount and 2 per cent of total assets at end-1966, if that would produce a larger ceiling). But in addition, the banks are asked to reduce outstanding term loans to the developed countries of continental Western Europe as existing loans mature, and also to cut outstanding short-term credits to these countries by 40 per cent during the course of 1968. The over-all ceilings of the banks affected will be reduced correspondingly in order to prevent an offsetting increase in loans to other areas. It is roughly estimated that outstanding bank credit to continental Western Europe may be cut back by about \$700 million under this program during 1968, while other credits outstanding could increase by as much as \$300 million.

Nonbank financial institutions are to reduce outstanding covered foreign assets by at least 5 per cent, or about \$100 million, during 1968, and also to repatriate all liquid assets not essential to the conduct of their foreign business.

The travel deficit, estimated at \$1.6 billion in 1966 and over \$2 billion in 1967, had in any case been expected to decline during 1968 as a result of the ending of EXPO 67. The President now seeks a \$500 million improvement on travel. He asks "the American people to defer for the next two years all nonessential travel outside the Western Hemisphere." Legislation may be sought to help cut the travel deficit, and a travel Task Force is seeking new ways to promote travel by foreigners in the United States.

Measures mentioned in the message to cut net Government expenditures abroad include increased sales of military goods and services, foreign official investments in U.S. securities as offsets to U.S. military spending, reductions in the number of American civilians working overseas, and cuts in the personal foreign spending of U.S. forces and their dependents in Europe.

A wide variety of measures to promote U.S. foreign trade over the long run are mentioned in the Presidential message. These include intensified trade promotion programs; broader Export-Import Bank export insurance, guarantees, and financing; and an intensive effort to secure the removal of nontariff barriers to trade. In particular, efforts will be made to negotiate changes in the border taxes and rebates of foreign surplus countries, and in related rules under the GATT; legislative measures in this area may be proposed.

The President said he expected through these means to achieve an improvement of at least $500 million in the foreign trade surplus during 1968. Earlier projections had envisaged little change from 1967 to 1968, and even those projections probably required downward revision in the light of the poor trade results for October-November 1967, discussed below.

<u>Changes in U.S. reserve assets</u>. In December reserve assets declined by approximately $600 million, the result mainly of a reduction in the total gold stock of about $900 million and an increase in convertible currency holdings of around $250 million. There was also a rise in our IMF gold tranche. The record gold loss was primarily attributable to the November and December Gold Pool deficits, both of which were settled in December.

OFFICIAL RESERVE TRANSACTIONS
(millions of dollars; asset increase, +; liability increase, -)

	Years		Quarters of 1967			
	1966	1967	Q-1	Q-2	Q-3	Q-4
Total (not seasonally adjusted)	225	-3,400e.	-1,282	- 690	24	-1,400e.
Gold	- 571	-1,170	- 51	- 15	- 92	-1,012
IMF gold tranche	- 537	94	31	10	5	48
Convertible currencies	540	1,024	-1,007	424	462	1,145
Liquid and certain non-liquid liabilities to foreign official (-)	793	-3,350e.	- 225	-1,109	-399	-1,600e.

Note: This table does not show as financing items debt prepayments by foreign government, liquidation of securities by U.K, and certain minor special official transactions. However, increases in foreign official holdings of over-1-year time deposits are included in the last line.

For the year 1967 as a whole, as shown in the table the reduction in the total gold stock was about $1 billion, less than in 1965 but more than in any other year after 1960. There was a very large rise in U.S. holdings of convertible currencies, mainly sterling. Our IMF gold tranche rose by somewhat under $100 million. The official settlements deficit, which is presently estimated at about $3.4 billion had as its counterpart in addition to a small net decrease in the foregoing classes of reserve assets, an increase of close to $3.4 billion in liquid and certain nonliquid liabilities to foreign official accounts.

Sales of gold to foreign monetary authorities, either directly or through the Gold Pool, clearly kept the rise in U.S. liabilities to foreign official accounts from being even greater than it was. Probably sales of gold, through the Pool, to foreign private users, hoarders, and speculators had a similar effect in many cases. But insofar as private buyers of gold were previously holders of sterling, the drain of gold from U.S. reserves had as its counterpart some part of the U.S. official assistance to Britain through the rise in our convertible currency holdings.

U.S. balance of payments. The fourth quarter liquidity deficit, seasonally adjusted, was probably about $2.0 billion. This assumes a deficit (not adjusted) in December of about $200 million, and this could be off by perhaps by $100 million in either direction. For the year the published liquidity deficit would therefore be on the order of $3.7 billion, compared to $1.4 billion last year.

MEASURES OF THE U.S. BALANCE OF PAYMENTS
(in billions of dollars)

	Years		Quarters of 1967			
	1966	1967e	Q-1	Q-2	Q-3	Q-4e
Liquidity deficit (-)						
Not seasonally adj.	-1,357	-3,700	- 238	- 222	-1,208	-2,050
Seasonally adjusted			- 529	- 547	- 636	-2,000
Liquidity deficit before Special transactions Seasonally adj. 1/	-2,942	-4,650	- 903	-1,304	- 845	-1,600
Official reserve trans. balance: Not S.A.	+ 225	-3,400	-1,282	- 690	- 24	-1,400
S.A.			-1,815	- 828	+ 470	-1,250
Official reserve trans. balance before special transactions, S.A. 1/	- 184	-3,000	-1,824	- 910	+ 466	- 700

1/ See Appendix B for details of special transactions.

In the fourth quarter the liquidity deficit was worsened by special transactions, mainly because of the liquidation of $580 million of securities by the U.K. Government. Without these and other special transactions the fourth quarter deficit amounted to about $1.6 billion. For the year as a whole, however, special transactions reduced the liquidity deficit by nearly $1 billion, so that the liquidity deficit would have reached about $4.7 billion without them.

The official settlements deficit in the fourth quarter is more difficult to estimate because of the wide swings between private and official accounts that might have occurred at year end. However, for the quarter this deficit was probably on the order of $1.4 billion, before seasonal adjustment, and about $1.2 billion seasonally adjusted. If that estimate is not too far off, the official settlements deficit for the year would total about $3.4 billion. This balance also was worsened by the U.K. liquidations, and would have been perhaps $3 billion without these and certain other special transactions.

The deficit for the fourth quarter was much greater than anticipated, and a full explanation of what happened will require more information than is yet available. Clearly the trade balance was much below that of earlier quarters, as described below. If December trade was no better than the October-November average, the deterioration from the January-September quarterly average would amount to $1/2 billion, or a $2 billion annual rate, thus accounting for much of the worsening in the balance.

Information on private capital transactions in the fourth quarter is limited. In October and November the increase in bank-reported foreign assets was under $100 million; since the seasonal pattern of the past included a large fourth quarter outflow, it would take an extremely large outflow in December to raise the seasonally adjusted flow for the quarter to an amount close to the adjusted average of the earlier quarters of the year. Similarly, purchases of new foreign bonds in the fourth quarter, though substantial, were lower than the average of prior quarters. On the other hand, foreign purchases of U.S. corporate securities were probably considerably less than in the third quarter.

On current account, there may have been some reduction in travel outlays because of the closing of Expo-67, but this could have been offset by some reduction in investment income receipts, which were perhaps temporarily inflated in the third quarter by petroleum company earnings.

All these changes from the third quarter to the fourth do not seem to account for as much deterioration as occurred -- about $800 million before special transactions -- suggesting that some of the worsening may have been related to other elements, such as higher direct investment capital outflows or speculative outflows from the United States.

U.S. foreign trade: The foreign trade surplus in October-November combined fell sharply to an annual rate of $2.3 billion (balance of payments basis) compared with over $4 billion in each of the first three quarters of 1967. For the full year 1967 the surplus is likely to be only slightly above the very low value of $3.7 billion in calendar 1966, as both exports and imports rose. The trade surplus in 1963-65 averaged $5.5 billion.

U.S. MERCHANDISE TRADE, BALANCE OF PAYMENTS BASIS
(billion of dollars, seasonally adjusted annual rates)

	1966				1967			
	QI	QII	QIII	QIV	QI	QII	QIII	Oct.-Nov.
Exports	28.8	28.7	29.5	29.6	30.7	30.9	30.6	29.8
Imports	24.1	24.9	26.3	26.7	26.6	26.2	26.2	27.5
Balance	4.7	3.8	3.2	2.9	4.1	4.6	4.4	2.3

Exports in October-November dropped to an annual rate of $29.8 billion, about 3 per cent below the rate of the third quarter. Part of the decline reflected ending of emergency petroleum shipments.

Lower shipments of both agricultural and nonagricultural products contributed to the overall drop in exports. Among agricultural commodities, corn shipments were particularly strong in November as U.S. prices dipped below those of competing foreign suppliers when the heavy new U.S. crop was marketed.

By areas, the decline in October-November exports was principally in shipments to Western Europe, mainly because of the steep drop in October exports which reflected the termination of emergency oil shipments and other special events outlined in the last Green Book. November exports to Western Europe recovered nearly back to the third quarter rate, however, because of increased deliveries of aircraft.

Shipments to Canada in October-November were sustained at about the third quarter level by increased deliveries of automobiles and parts; exports of all other commodities, on balance, declined. Reversing the steady uptrend in exports to Japan in the first three quarters, shipments to that country in October-November declined, even though total Japanese imports increased.

Gains in exports to the less developed countries in Asia and Africa in October-November reflected mainly P.L. 480 rice shipments to Viet Nam and Indonesia. But shipments to the Latin American countries declined.

Imports in October-November were at an annual rate of $27.5 billion, about 3 per cent greater than the previous record rate of late 1966. November imports were especially large. About two-thirds of the sharp reduction in the trade surplus from the third quarter to October-November may be attributed to this rise in imports. Advances were greatest in imports of industrial materials and nonfood consumer goods, other than automobiles. Purchases of machinery dipped below the record amounts of the third quarter and the value of imported foodstuffs and automotive vehicles showed little change.

Almost all import categories of industrial materials increased in October-November from third quarter rates. The continued expansion in arrivals of iron and steel-mill products, with increases principally in purchases from Germany, is believed to be the first evidence of hedge buying against an anticipated domestic steel strike this summer. November steel imports were the highest on record. Even more pronounced was the sharp increase in imports of other metals, a reversal of the downtrend which had persisted since the beginning of 1967. While this turnabout may reflect, in part, the strenghening in domestic industrial output, a considerable portion of this import increase is in refined copper. With domestic supplies of copper getting tighter as a result of the copper strike (now in its sixth month) producers here are turning increasingly to foreign sources for copper. Imports of refined copper in the month of November alone were equal to the third quarter total and were nearly as high as the exceptionally large amount imported in the fourth quarter of 1966 when inventory buying of copper began. Extensive future contracts for foreign copper have been made. Even if the strike were to end immediately, heavy arrivals under such contracts would probably continue for some time.

Among other industrial materials imports of building supplies increased further as domestic residential construction remained strong, while the upturn in purchases of foreign textiles, first evident in the second quarter, continued through October-November. Imports of petroleum, which had dipped in the third quarter as a result of the Arab-Israeli war, also expanded but were still below the normal pre-crisis rates.

Arrivals of nonfood consumer goods other than cars, which had shown little change since the first quarter, resumed their long-term upward movement in October-November. Both nondurable and durable items shared in the latest advance. While the value of total imports of automotive vehicles was unchanged from third quarter rates, a decline in October-November arrivals from Canada was offset by a rise in imports from Europe and Japan. The pause in Canadian car imports in October-November was probably temporary and further expansion can be expected as integration of the U.S. and Canadian automotive industries proceeds. Sales of foreign cars (excluding Canadian cars) have accounted for about 11 per cent of total automotive sales in the last half of 1967 compared with about 8.5 per cent in the first half and 7 per cent in calendar 1966.

Bank-reported outflows. Total bank-reported claims on foreigners increased in November by approximately $60 million, making the 11-month net outflow $280 million. Outflows in December, expected on seasonal grounds, may swell the year's total considerably. Through November, short-term claims rose $500 million and long-term claims declined more than $200 million, net. Short-term claims rose largely through an increase in acceptance credits to Japan in the first half of the year. A large decline in long-term claims during the first half -- particularly to Continental Europe, Japan, and the U.K -- continued a trend initiated back in February 1965 when the Interest Equalization Tax was applied to non-export credits to foreigners in "developed" countries other than Canada. Since mid-year, term loans outstanding have risen by $120 million, with increases largely in loans to Latin America and Canada.

New security issues. Sales of new foreign securities to U.S. residents in the fourth quarter continued at a high rate, well over \$350 million. Nevertheless, sales were much reduced from the exceptionally high third-quarter sales of about a half billion. For the year as a whole, the record high \$1.6 billion of issues is about \$400 million above the plateau maintained in the years since inception of the Interest Equalization Tax in 1963.

Up to the third quarter there were increasingly large flotations by Israel, an IET-exempt country, and by international organizations, whose issues are also exempt from the tax. Takedowns on Canadian issues, also exempt, were relatively constant, being consistently above \$200 million each quarter. The decline in flotations in the fourth quarter resulted from much reduced borrowing by international organizations and virtual drying up of issues from countries other than Canada.

No further slackening in sales of new foreign issues is anticipated in the near term. New issues already scheduled for the first quarter of this year total close to \$300 million.

The international bond market outside the United States. New "foreign bond" issues (those placed in a national market foreign to the borrower and denominated in the currency of that market) and "Euro-bond" issues (those denominated in dollars or other currencies foreign to the market or markets where offered) reached a record two-month total of over $600 million last September and October. Toward the end of the year the flow of new issues diminished, partly for seasonal reasons. The year's total nevertheless reached a new record of $2.3 billion. In contrast to the two preceding years, when growth of U.S. companies' issues accounted for most of the growth in total issues, last year there was more than a doubling of issues by others. The new U.S. policy program will add greatly to demands for funds in the Euro-bond market in 1968.

INTERNATIONAL BOND ISSUES OUTSIDE THE UNITED STATES
(billions of dollars)

	1963	1964	1965	1966	1967p.
Foreign issues in national markets	350	234	256	339	371
Euro-bond issues	164	719	1,079	1,140	1,944
Total	514	953	1,335	1,479	2,315
U.S. companies	0	0	726	932	1,113
Other issuers	514	953	609	657	1,202

Yields on Euro-dollar bonds in the secondary market eased off in early 1967, but rose later, especially in May-June and again in October-November. These movements resembled those for corporate bond yields in the United States, but with less of an upward drfit. The spread between Euro-dollar bond and U.S. bond yields has narrowed markedly in the past two years, and especially since mid-1967. In early 1966, Moody's Aa bonds yielded under 5 per cent and U.S. companies' Euro-dollar bonds about

6-1/4 per cent. At mid-1967, the two yields were respectively 5.69 and 6.63 per cent, and at the end of November they were 6.32 and 6.66 per cent. The relative stability of domestic German mark bond yields in recent months -- at about 7 per cent for outstanding issues and slightly less on newly issued bonds -- has been an important factor restraining the rise in Euro-bond yields.

Euro-dollar market. Announcement of the U.S. balance of payments program pushed Euro-dollar rates up on Tuesday, January 2, by 1/8 to 1/4 per cent. On the next two days rates eased off somewhat.

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

	Call	30-day	90-day	180-day	Year
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
Fri. Dec. 8	5.00	6.38	6.25	6.25	6.44
Fri. Dec. 15	4.25	6.38	6.31	6.38	6.44
Fri. Dec. 22	6.75	6.56	6.38	6.44	6.50
Fri. Dec. 29	5.00	6.19	6.25	6.44	6.56
Tues. Jan. 2	5.25	6.25	6.50	6.63	6.75
Thurs. Jan. 4	5.13	6.06	6.25	6.50	6.69

Rates on 30-day and 90-day money, which today are in the 6 to 6-1/4 per cent range, are below their mid-December levels, in accordance with the usual seasonal pattern. Rates on longer-term deposits, after declining in early December from the November 28 highs, have moved higher on balance in the past three or four weeks. This is the case also for call money, now at 5-1/8 per cent bid.

Liabilities of U.S. banks to their foreign branches declined during the latter half of December, but did not fall off nearly as sharply

1/ London brokers' bid rates.

between the last Wednesday of the month and the last business day (Friday, the 29th) as they had done at the end of 1966. The net increase in the fourth quarter amounted to $0.2 billion. During the year 1967 there was an increase of $0.6 billion, but on the last-Wednesday-to-last-Wednesday basis the increase over the year was only about $0.1 billion.

The narrowing of forward discounts on the pound sterling since Christmas has not gone far enough yet to bring switching out of Euro-dollars into local authority or hire-purchase finance company paper.

With the decline in spot exchange rates for the DM in the past two weeks, forward premiums on the DM have widened again (to 3.0 per cent for the 3-month contract). An article recently published by the Bundesbank, summarized in Appendix A, contains much detailed information about German banks' foreign assets and liabilities. One interesting observation is that the Bundesbank's offering of special forward rates to the German banks near the end of November led to much less of an outflow of funds to the Euro-dollar market than might have been expected from the amount of swaps executed.

<u>Business conditions abroad</u>. For several months before the sterling devaluation in mid-November, British consumer expenditures and residential construction outlays were rising. However, with weakness in British exports and manufacturing investment, industrial production remained flat.

German data through October and November show that the upswing there was gaining momentum, and had begun to have an expansive influence on neighboring countries. But despite renewed rise in German imports, the export surplus has remained very large. An extraordinary degree of price and wage stability was achieved in Germany last year and the competitive position of German goods in many markets has improved.

Developments in other European countries (through September or October) were mixed, with the beginning of possible upturns in France and the Netherlands contrasting with less buoyant conditions in several other countries. In Canada output rose through last spring and summer -- at least to September. Japanese production was still increasing strongly through October, after two years of upswing.

In <u>Germany</u>, a sustained recovery from last spring's low point is now clearly under way, with industrial production up 5 per cent by October-November on average. New orders have been on the rise since the beginning of the year, and unfilled orders began to increase around midyear. Since then there have also been indications of restocking of inventories, despite tax disadvantages many producers felt might be involved in acquiring inventories before the institution of the value added tax at New Year. Increases in orders have come from both domestic and foreign buyers, and output has risen in both durable and nondurable goods sector.

INDUSTRIAL PRODUCTION
(seasonally adjusted; 1960 = 100)

	1966	1967			
	Q-II	Q-I	Q-II	Q-III	Sept-Oct.
United Kingdom	118	116	116	117	116
Germany	136	129	128	130	135a/
France	136	139	138	141	143
Italy	154	166	170	165	169b/
Netherlands	141	145	146	150	153b/
Belgium	135	137	136	133	140b/
Total EEC	139	139	139	140	141b/
Canada	153	155	156	158	158b/
Japan	190	218	228	236	243
United States	143	145	144	145	144

a/ October-November
b/ September only.

Because industry has ample unused capacity, fixed capital investment prospects have remained weak.

In the labor market, unemployment (which reached its peak last May) was further reduced in September and October, and job vacancies increased a little in October. From mid-1966 to mid-1967 the rise in hourly earnings had slowed greatly; in July, hourly earnings in manufacturing were less than 3 per cent above their year-earlier level.

German exports, which were falling in the earlier months of 1967, began to rise again in June, and in September-October were about 3 per cent greater than in the second quarter. Imports responded, with no apparent lag, to the revival of internal activity, their level in September-October being nearly 4 per cent above the second quarter.

French industrial production increased 2 per cent in September and fractionally further in October, these being the first changes in nearly a year that reflected other than accidental influences. Much of the rise was concentrated in automobiles, but output of other metal manufactures also advanced. A rise in exports of about 3 per cent from the second quarter to September-October was presumably a factor in the rise of production.

According to the surveys of business opinion, changes between July and November were generally favorable. Stocks of finished goods were reduced, in both the equipment and consumer goods industries. Order backlogs rose in the equipment industries and stopped declining in the consumer goods industries, though backlogs continued to shrink in industries producing intermediate goods. Manufacturers' expectations about the next 3-4 months also brightened, mainly because producers of consumer goods foresaw an end to the decline in their output.

French unemployment was still rising in October. The rise in hourly wage rates in the 12 months to October was 6 per cent, approximately the average annual rate of increase for the past three years.

Italian domestic demand appears to have been increasing more slowly in the summer and early autumn than before. This may have been a temporary pause due to repercussions of a dip in exports. At all events, exports in the third quarter were down 3 per cent from the second quarter, while industrial production was down by a similar proportion -- subject to substantial uncertainties regarding the appropriate seasonal adjustments. In September and October Italian exports were again rising, and in September industrial output was up. Meanwhile Italian imports continued to increase throughout the summer and early autumn.

Industrial output of investment goods was appreciably higher in September than at the beginning of 1967, and accounted for all of the gain in total industrial production over the first nine months of 1967.

Elsewhere on the Continent, exports of the Netherlands were sharply higher in August-October than earlier and Dutch industrial production in August-September was also at a new high. Dutch unemployment has exceeded job vacancies since early last year, but stopped rising after May. In several other countries, conditions were less buoyant during the autumn. There was no marked increase in any major category of demand in Sweden, no sign of recovery appeared in Belgium, and activity remained sluggish in Switzerland.

In Britain, the period since devaluation has been too brief to produce evidence of changes in trends. Through October total industrial production remained close to the level to which it had fallen by the end of 1966. Manufacturing output (75 per cent of the total) declined 2 per cent from its July peak to October. The unemployment rate reached a high of 2.4 per cent in August and September, and stood at 2.3 per cent in October, November, and December.

This over-all picture of slack demand for manufactures was the result of opposing tendencies: on the one hand, a strong rise in consumer buying after the relaxation of instalment credit regulations last summer; but on the other hand a further decline in exports and, in the third quarter, a running down of inventories.

Despite the new tightening of instalment credit at the time of the devaluation, early reports of Christmas trade suggest continued buoyancy of consumer demand. The rise in incomes has been an important factor. Weekly wage rates in November were up 3.4 per cent from June. About half of this increase occurred in July, immediately after the end of the period of "severe restraint."

British exports in the third quarter were 2 per cent lower in value, and 4 per cent lower in volume, than in the second quarter. Subsequently, they were sharply lower in October and November, running 20 per cent under the third quarter rate, partly in reflection of dock strikes in London and Liverpool. Expectations of a change in the sterling exchange rate, whch undoubtedly induced British exporters and foreign importers to put off payments for British exports, may also have contributed to postponing sales and shipments.

Some categories of construction activity were rising strongly through the third quarter, with increases in private residential construction and in fixed investment in the public sector. Private fixed investment, however, tended to decline. A further decline in manufacturing fixed investment in the fourth quarter seemed probably on the basis of a survey of intentions conducted in August and September. As for the 1968 outlook, a Financial Times survey in December indicated that the devaluation and accompanying measures had made business circles less, rather than more, optimistic about demand next year and that companies were consequently reducing their estimates of 1968 investment expenditures.

Canadian industrial production rose at an annual rate of about 5 per cent from the first to the third quarter of 1967. Output dropped in October, but would have registered a small gain in the absence of strikes. The unemployment rate, after rising in the first half of 1967, tended to stabilize in July-November and was 4.3 per cent in November.

New orders in manufacturing turned upward last summer. However, high manufacturers' inventories continued to exert a damping influence; through August (latest) the ratio of inventories to shipments was about 7 per cent above the 1965 normal. Housing starts, which were picking up sharply in the spring, fell back in the third quarter, apparently because of tighter financial markets.

Price advances have continued at a relatively rapid rate in Canada despite unutilized manpower and plant capacity. The consumer price index in the third quarter was 4 per cent above a year earlier. In response, the government has announced a personal income tax increase for 1968, and is reportedly making strenuous efforts to restrain expenditure increases in the budget for the next fiscal year beginning on April 1.

Japanese industrial production increased further in October, when it was 19.5 per cent above a year earlier. This rise compares with 18 per cent in the first year of the present upswing, from October 1965 to October 1966. Department store sales, especially of durable consumer goods and clothing, were very strong in September and October.

Some early signs of an eventual slowing of the cyclical upspwing have appeared. New orders for machinery have leveled off since midyear, but as they are still high and current output has not yet caught up, unfilled orders have continued to build up. Producers' inventories of manufactures, which began to increase last spring, rose somewhat more rapidly in September and October. The strong rise in imports has continued, and with exports dropping off after a temporary bulge in early autumn, the trade balance worsened moderately in October and November.

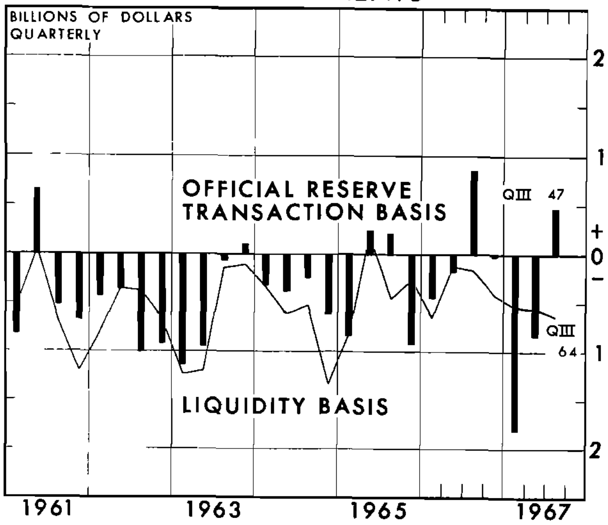
Both wholesale and consumer prices have been rising. In November, wholesale prices were about 3 per cent higher than a year earlier and consumer prices were up 6 per cent. In November, wholesale prices rose 0.5 per cent while consumer prices were unchanged.

Business demand for credit has been strong, but banks have pursued cautious lending policies. Bank credit has expanded at a steady annual rate of about 16 per cent in recent months. Late in December the Bank of Japan announced that it would tighten credit conditions further, and in the first quarter of 1968 it will restrain the credit expansion of the 13 large city banks to only 70 per cent of the increase in the same period a year earlier.

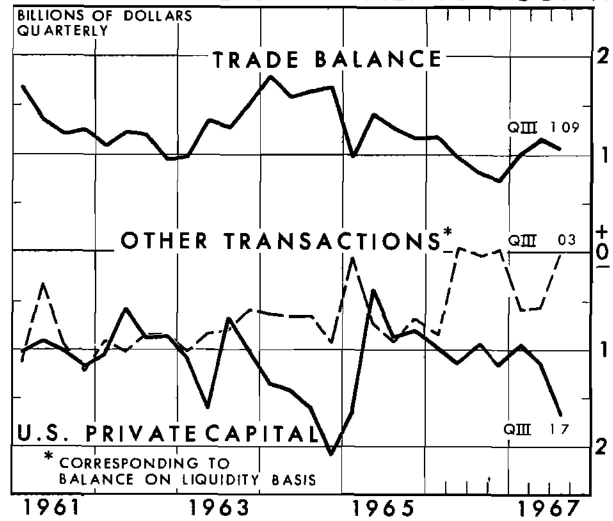
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

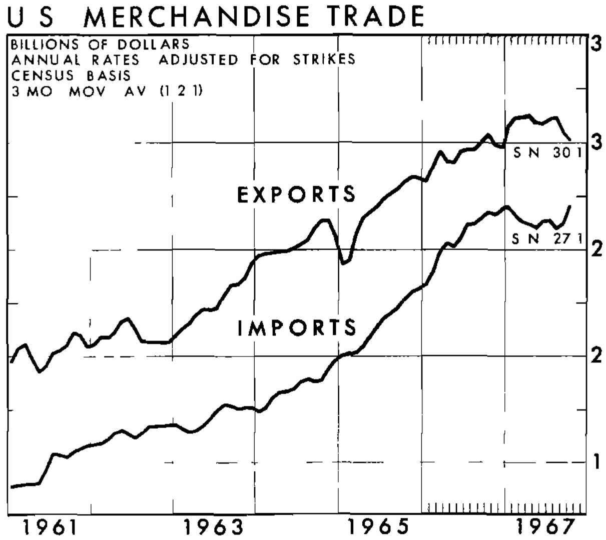
U.S. BALANCE OF PAYMENTS



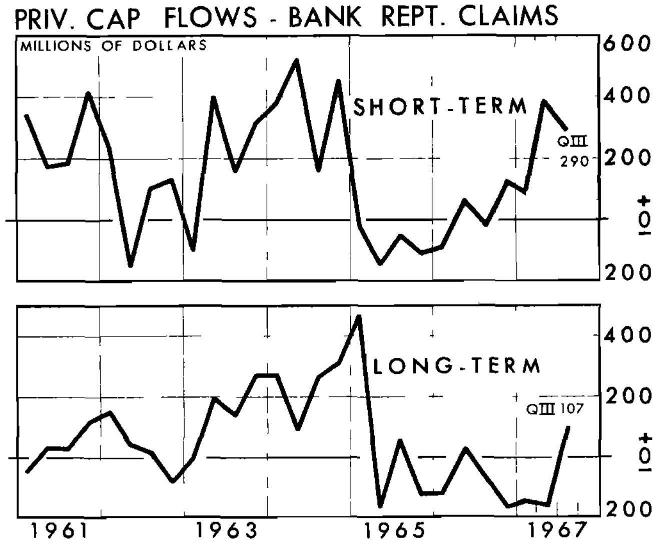
U.S. BALANCE OF PAYMENTS - CONT.



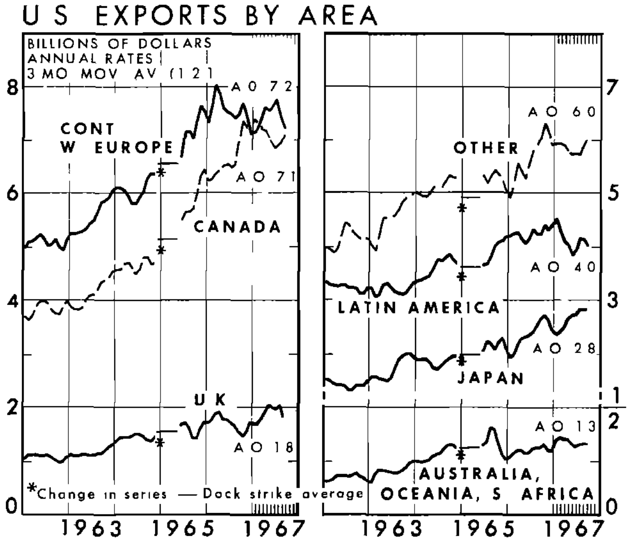
U S MERCHANDISE TRADE



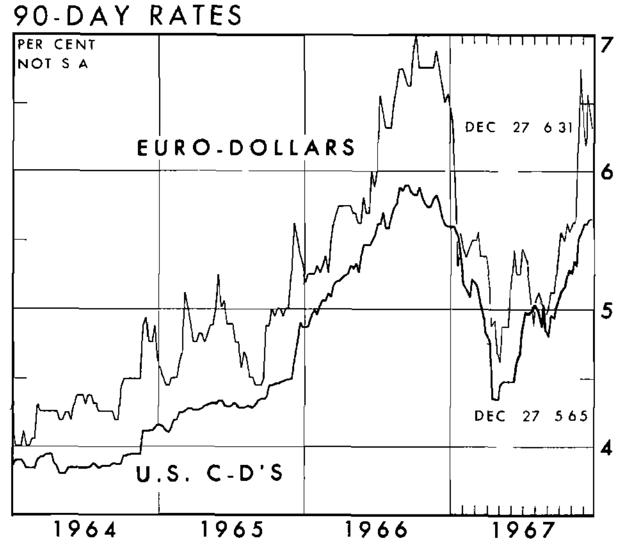
PRIV. CAP FLOWS - BANK REPT. CLAIMS



U S EXPORTS BY AREA



90-DAY RATES



APPENDIX A: THE NET FOREIGN ASSET POSITION OF GERMAN COMMERCIAL BANKS*

Over the past year and a half, the short-term foreign position of German commercial banks has shifted from a rather substantial net debtor position, customary ever since the war, to a very substantial net asset position. The banks' net foreign position changed by the equivalent of $860 million from June 1966 to September 1967; in the next two months there was a further increase in net assets of about $165 million, to an estimated over-all net asset position of $695 million at the end of November. The shift in the banks' position came mainly from a build-up in gross assets, which exceeded $2.3 billion at September 30; liabilities changed little.

The large export of German bank funds since mid-1966 was the consequence of two developments: the appearance of a growing current account surplus and, since the beginning of 1967, the emergence of increasingly liquid conditions in German financial markets as the result of an agressively expansionary German monetary policy. Throughout 1967 these two factors steadily increased the supply of loanable funds in the hands of German banks. Domestic demand for funds, however, was limited as the economy made its way out of the recession only slowly. Short-term interest rates in Germany fell markedly after the beginning of 1967. As a result, a substantial interest arbitrage incentive appeared favoring investments in major financial centers outside of Germany. Early in 1967 German banks were led by higher interest rates to invest in sterling money market paper and Euro-dollar deposits. Later, growing uneasiness as to the future of the pound produced a widening of the forward discount on sterling which eliminated the incentive of German banks to place funds in U.K. paper. German banks continued to place funds in the Euro-dollar market throughout the year.

The normal movement of funds was disturbed in November by the sterling crisis. In the first three weeks of November speculative inflows into Germany raised gross foreign liabilities of German commercial banks (mainly in DM) by approximately $100 million. However, the German banks' foreign assets also increased during that period, and increased still further toward the end of the month as a result of Bundesbank intervention in the forward exchange market.

The Bundesbank made DM/dollar swaps available to the commercial banks at favorable rates, as part of central bank cooperation to calm the November foreign exchange crisis; the purpose was to keep

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* Prepared by Rosemary A. Darlington, Europe and British Commonwealth Section, Division of International Finance.

the forward discount on the U.S. dollar from widening further and thus to encourage a return flow of funds into dollars. The Bundesbank sold the banks dollars spot, and DM forward. Three-month forward DM were initially offered at a cost of 1-3/4 per cent compared to the prevailing market rate of almost 3 per cent. The Bundesbank raised this rate in two steps, on November 29 and December 1, to 2-1/4 per cent.

In the last four days of November, the Bundesbank swapped out $375 million. According to a special article in the latest Monthly Report of the Bundesbank, approximately $100 million of the November swaps were used for new foreign money market investments by the German commercial banks. The forward side of the rest of these swaps was used as cover for export transactions or for outstanding investments which had originally been covered at higher cost; apparently the banks sold off the spot dollars they obtained. An additional $225 million of swaps were executed in the first five business days of December (the latest available information).

The currency composition of German banks' foreign assets and liabilities

Despite the strong pressures and movements which characterized foreign exchange markets during the past year, there was little change in the currency composition of German banks' foreign assets and liabilities during that period. As of September, 57 per cent of the banks' foreign assets and 80 per cent of the liabilities were denominated in marks. (See Table 1.) While by far the major part of the liabilities have for years been in DM, this is a more recent development on the asset side. The proportion of assets held in DM increased substantially during 1962, 1963, and 1964, primarily at the expense of dollar-denominated assets, and reached 50 per cent of the total only in 1964.

Assets in U.S. dollars compose the other major portion of the German banks' foreign position. At the end of September, approximately one-third, or $800 million, of total foreign assets were denominated in dollars. A large part of this total consisted of Euro-dollar deposits held primarily in London banks (including U.S. branches); the remainder represented working balances reported as sight deposits. On the liability side, dollars are a much less important part of the total. Of total liabilities to foreigners amounting to $1.8 billion at the end of September, only 14 per cent or $250 million were payable in dollars.

Foreign position according to country of deposit

The banks' creditor and debtor positions vis-à-vis various countries showed marked shifts last year. One of the most striking movements was the large-scale export of short-term funds to the Euro-dollar market in London. The banks' net short-term assets in the

TABLE 1. CURRENCY COMPOSITION OF GERMAN COMMERCIAL BANKS' SHORT-TERM FOREIGN ASSETS AND LIABILITIES[1/]
(DM billions and per cent)

	Net Foreign Position	Assets							Liabilities						
			DM		U.S. Dollars		Other			DM		U.S. Dollars		Other	
		Total	Total	%	Total	%	Total	%	Total	Total	%	Total	%	Total	%
December															
1963	-2.8	4.2	1.9	44.9	1.4	33.4	0.9	21.7	7.0	5.1	72.0	1.5	20.8	0.5	7.2
1964	-2.9	4.9	2.7	54.5	1.8	35.7	0.5	9.8	7.8	5.7	72.9	1.8	22.7	0.3	4.4
1965	-2.7	5.2	2.8	53.2	1.8	33.8	0.7	13.0	7.9	6.2	77.4	1.5	18.6	0.3	4.0
1966															
March	-1.3	5.5	3.2	59.1	1.8	31.7	0.5	9.2	6.9	5.5	79.8	1.1	16.6	0.3	3.6
June	-1.3	5.6	3.2	57.2	1.9	33.2	0.5	9.6	7.0	5.5	78.6	1.2	17.5	0.3	3.9
Sept.	-0.9	6.2	3.1	49.6	2.6	42.7	0.5	7.7	7.0	5.5	77.5	1.3	18.9	0.3	3.6
Dec.	-2.3	5.2	3.0	58.5	1.6	30.6	0.6	10.9	7.5	6.0	79.4	1.3	17.6	0.2	3.0
1967															
March	1.0	7.4	3.7	50.1	3.0	41.2	0.6	8.7	6.4	5.1	80.2	1.0	15.9	0.3	3.9
June	1.9	8.7	4.7	54.0	3.1	35.6	0.9	10.4	6.8	5.5	80.3	1.1	16.0	0.3	3.7
Sept.	2.1	9.3	5.3	57.2	3.2	34.5	0.8	8.3	7.2	5.9	81.4	1.0	14.2	0.3	4.4

1/ Totals may not add due to rounding.
Source: Bundesbank.

United Kingdom rose about $480 million between September 30, 1966 and September 30, 1967. (See Table 2.) This represented almost entirely an increase in gross short-term assets, particularly time deposits, of which the largest part were dollar deposits. Net Euro-dollar claims of German banks against the U.K. equaled $377 million at the end of September, as compared with only $66 million a year earlier. Most of the remaining increase of about $170 million in German banks' net claims against the U.K. represented a rise in DM-denominated assets. German banks maintained only a very small position in sterling.

TABLE 2. TOTAL NET FOREIGN POSITION OF GERMAN COMMERCIAL BANKS ACCORDING TO COUNTRY OF DEPOSIT[1/]
(DM millions)

	Europe					
	Total	EEC	U.K.	U.S.	Other	Total
December						
1964	-2,830	- 371	-1,056	400	-429	-2,859
1965	-2,001	- 511	- 320	184	-892	-2,709
1966						
March	- 609	- 118	320	59	-769	-1,319
June	- 545	51	329	23	-803	-1,325
September	- 182	618	265	189	-862	- 855
December	-1,232	- 208	- 66	-151	-938	-2,321
1967						
March	1,752	1,117	1,439	- 97	-699	956
June	2,841	1,512	1,994	-192	-712	1,937
September	3,196	1,823	2,178	-107	-969	2,120

1/ Overall position: all currencies.
Source: Bundesbank.

The German banks' export of dollars to London reflected the strong demand for funds on the Euro-dollar market, originating in good part from European branches of U.S. banks soliciting funds for their home offices, and also from European subsidiaries of American companies seeking financing outside U.S. markets. The combination of relatively high interest rates and availability of increasingly diversified debt instruments has apparently made the Euro-dollar market an increasingly attractive investment center to German banks in recent years. Conversely, German banks further reduced their short-term investments in the United States in 1967. As a result, their net position with the United States shifted from net assets of $47 million in September 1966 to net liabilities of $27 million in September 1967.

The EEC countries comprised the second area where German banks strongly expanded their net claims. The net position of the banks rose between mid-1966 and September 1967 by the equivalent of about $440 million. In this case, however, the improvement was principally the result of increased DM assets. Gross DM assets of German banks in other Common Market countries rose by the equivalent of $300 million; gross assets denominated in other currencies decreased $35 million. The remaining $175 million improvement in the banks' over-all position vis-à-vis EEC countries represented a decline in liabilities. Part of the strong demand of the Common Market countries for DM credit was undoubtedly the counterpart of their cumulative trade deficit with Germany, which totaled DM 3.3 billion in the January-September period.

APPENDIX B

MEASURES OF THE U.S. BALANCE OF PAYMENTS, AND SELECTED "SPECIAL" TRANSACTIONS
(Millions of dollars)

	1966	1967						
	Total	Q-1	Q-2	Q-3	Nov. p/	Dec. e/	Q-4 e/	Year e/
1. Liquidity deficit (-), not seasonally adj.	-1,357	-238	-222	-1,208	-895	-200	-2,034	-3,702
2. Seasonal adjustment	--	-291	-325	+572	n.a.	n.a.	44	--
3. Liquidity deficit, seasonally adjusted	-1,357	-529	-547	-636	n.a.	n.a.	-1,990	-3,702
Selected "special" transactions								
Investments in long-term deposits								
4. Foreign governments (excluding U.K.)	757	305	634	-228	13	57	71	782
5. International and regional institutions	196	70	24	54	41	--	17	165
6. Investments in U.S. Govt. Agency securities by international and regional institutions	244	-8	70	57	15 1/	--	15 1/	134
7. U.K. official trans. in U.S. nonliquid assets	--	8	2	3	-242	-20	-580	-567
8. Nonscheduled debt repayments to the U.S. Govt.	428	--	--	--	--	--	--	--
9. Transactions in nonmarketable, nonconvertible medium-term U.S. Govt. securities	-52	-1	-3	323	-30	--	95	414
Canadian Government transactions								
10. Advance purchases of Canadian bonds	139	--	30	--	--	--	--	30
11. Purchase of IBRD bonds	23	--	--	--	6	--	12	12
12. Rescheduling of new Canadian issues	-150	--	--	--	--	--	--	--
13. Total, selected "special" transactions	1,585	374	757	209	-197	37	-370	970
14. Liquidity deficit (S.A.) before reduction by "special" transactions	-2,942	-903	-1,304	-845	-698 (NSA)	-237 (NSA)	-1,620	-4,672
15. Official settlements deficit (-), not seasonally adjusted	225	-1,282	-690	-24	-525	-500	-1,408	-3,404
16. Seasonal adjustment	--	-533	-138	494	n.a.	n.a.	177	--
17. Official settlements deficit, seasonally adj.	225	-1,815	-828	470	n.a.	n.a.	-1,231	-3,404
18. "Special" transactions affecting official settlements balance	409	9	82	4	-221	--	-533	-438
19. Official settlements balance (S.A.) before reduction by "special" transactions	-184	-1,824	-910	466	n.a.	n.a.	-698	-2,966

1/ By foreign Governments. p/ Preliminary e/ Estimate