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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

January 31, 1968

SUMMARY AND OUTLOOK

Outlook for economic activity

We anticipate a sharp increase in final sales this quarter and some further increase in inventory investment. Total GNP is expected to rise at an accelerated rate in both current and constant dollars.

Despite recent indications of a less buoyant consumption picture, a substantial increase in consumer outlays continues to be a strong likelihood this quarter. Disposable income should continue to accelerate, and even if the savings rate remains high, consumer outlays for goods and services should increase by over $10 billion, almost double the rise in the fourth quarter.

GNP will also be buoyed by moderately rising Federal expenditures, including a rise in defense spending which earlier had been expected to level off. The rise in expenditures, in the absence of a tax increase, would leave the Federal deficit (NIA basis) very high although below recent levels, as accelerated growth in incomes boosts revenues at existing tax rates.

A further moderate increase in residential expenditures is likely this quarter, given the recent behavior of housing starts and construction prices. And if earlier survey results prove correct, spending for plant and equipment should show an abrupt increase. Some further rise in inventory investment is projected, but given the large increase in inventories last quarter--much larger than had been anticipated earlier--and the expected gains in consumer spending, the further inventory rise should be moderate.

Outlook for resource use and prices

Industrial production is projected as averaging 163 in the current quarter--for a rise of something less than a point a month as compared with 2-1/2 points a month in the immediate post-strike recovery in November and December. The rise during the quarter would be in line with the ongoing expansion in capacity and would leave the capacity utilization rate only slightly above the December level of 85.3 per cent.

The projection anticipates further expansion in steel output (as inventory accumulation increases as a hedge against a midyear strike), further recovery in business equipment (in line with the sharp step-up projected for outlays), some additional increase in defense output, and continuing gains in the nondurable sector where output has moved up steadily since last June to a new high in December almost 2-1/2 per cent above a year earlier. No further rise in auto output is expected, and, unless sales pick up soon, production schedules in February and March may be reduced.

The projected rise in industrial--and non-industrial--output is large enough to absorb continued rapid growth in the labor force and the unemployment rate should continue at about the low December rate of 3.7 per cent.

Additional upward pressure on wages in the current quarter will come in manufacturing from the contract settlement at G.M. with its 7-1/2 per cent first-year wage increase, and in nonmanufacturing (particularly service and trade industries) from the increase in the minimum wage. Unit labor costs in manufacturing showed an inexplicable drop in December, but even disregarding this deop, the rise over the last half of 1967 was slower than from mid-1966 to mid-1967. Despite the sustained upward movement in sight in wages, stepped-up productivity gains should continue to act to moderate the rise in unit labor costs.

Wholesale prices of industrial commodities have continued to rise at a rapid pace--in fact, since October the pace has accelerated, mainly as a result of the sharp spurt in prices of copper and cotton because of drastically limited domestic supplies. The effects of these and other price increases for materials continue to spread to fabricated products, providing sustained upward momentum to the industrial price average over the near-term. Moreover, since November prices of farm products have moved up and retail prices of foods began to rise again in December. As had been anticipated, however, the rise in retail prices of other commodities slowed at year-end, and continuing increases in the CPI at the recent 3-1/2 per cent rate appears likely.

Demand for credit

Credit demands are expected to continue to be relatively strong over the next few months, though remaining below the peak demands of the second half of last year. Continuation of credit demands at near the recent pace suggests that interest rates are not likely to decline much further. In fact, it is possible that some updrift in longer-term yields could develop, particularly those on U.S. Government securities and mortgages where interest rates appear low relative to competing instruments. Yields on corporate bonds, however, may show little change, or possibly edge off, from their current advanced levels.

The near-term volume of corporate bond offerings, including private placements, is not expected to be very different than in January, when these offerings were high by any standards other than the second half of 1967. But in contrast to last year, there are no present indications of a tendency for corporate bond issues to cumulate, and the volume of public bond offerings may be tapering. Businesses appear likely to show a relatively greater preference for financing through short-term borrowing than they did last year, since a larger proportion of financing needs will arise from greater inventory accumulation, and since concern about the availability and cost of funds in the future appears to have abated. Therefore, loan growth at banks is likely to remain above the relatively low $300 million a month pace of late summer and fall, although probably below the exceptionally rapid expansion in December-January.

The Federal Government will continue to be a sizable net borrower in credit markets in the near term, until tax receipts increase seasonally during the spring. About $ 4 billion or so in new cash may be raised in the weeks immediately ahead in connection with the mid-February refunding, which is likely to include an intermediate-term offering as one of its options, and through other means, such as addition to the weekly bill auctions. Moreover, not much relief appears in sight from the continuing heavy volume of new State and local government issues.

The blow of mortgage funds is likely to continue near its recent pace for the next few months, after allowance for seasonal influences, in view of the backlog of institutional commitments. However, institutions have reduced their rate of commitment growth most recently, and mortgage borrowing is likely to slow down as spring progresses, assuming there is no reversal in the recent more moderate net inflows of funds to savings institutions.

Supply of funds

Growth in time and savings deposits at banks and savings accounts at thrift institutions did not slow down as much in January as market participants had feared, and this has probably contributed to the improved tone of credit markets in the past few weeks. But supply factors are not likely to contribute to a significant further easing of credit conditions, given continued relatively strong credit demands.

There has recently been sizable bank demand for new municipal security offerings but it is not clear that this can persist for any considerable time in face of anticipated business loan and U.S. Government credit demands and little prospect of a significant pickup in savings flows. And while pressures on the liquidity positions of savings institutions and the Home Loan Bank System have been less than feared, continuing uncertainties with respect to savings flows to thrift institutions during the spring are likely to inhibit any significant liberalization of institutional mortgage commitment policies.

Banks this year have not yet made strenuous efforts to capture highly volatile short-term money, although they have been able to restore more than half the CD run-off experienced in December. Over the past few weeks, banks have reduced offering rates on CD's, especially those with relatively short maturities, by more than the decline in bill yields. Other funds have been readily available to banks through expansion in demand deposits, Treasury tax and loan accounts, and Euro-dollar borrowings. Some of the expansion in demand deposits appears to be temporary, though. In the months ahead, growth in such deposits will very likely diminish as deposit holders restructure their asset positions, given current relatively high interest rates and the abatement of uncertainties generated by such factors as the new balance of payments program. Banks will probably then have to become more active in seeking CD money if they are to accommodate loans without drawing on their liquidity.

<u>Balance of payments</u>

The worsening of the overall balance in the fourth quarter turns out to have been almost entirely explainable by changes in merchandise trade rather than by speculative capital flows. The annual rate of trade surplus dropped abruptly from $4.4 billion in the third quarter to $1.5 billion in the fourth. During this period, the liquidity deficit before special transactions increased by about the same amount. The increase was larger than this after special transactions since in the fourth quarter these included the liquidation by the British Government of its holdings of U.S. securities.

For the full year 1967, the deficits measured before and after all special transactions (including as special the German purchases of medium-term securities) were $4.6 billion and $3.6 billion, respectively on the liquidity basis, and $2.9 billion and $3.4 billion on the reserve transactions basis. By any of these measures, the deficit was the largest since 1960.

The sharp rise in imports in November and December came as a considerable surprise and disappointment. Even if exports began to expand more rapidly than imports in 1968, it is likely that the trade surplus for this year as a whole will be significantly smaller than the 1967 surplus, whereas the President recently stated that the aim should be to make it $1/2 billion larger. Hence, even with a net improvement of around $2 billion on flows of U.S. private capital this year over last, and improvement on some nontrade current items, the overall deficit is likely to remain substantial in 1968.

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.)	Dec'67	78.6	78.1	76.8	2.4	4.5
Unemployment (mil.)	"	2.9	3.0	2.9	1.0	- 3.5
Unemployment (per cent)	"	3.7	3.9	3.7	--	--
Nonfarm employment, payroll (mil.)	"	67.1	66.9	65.3	2.9	7.7
Manufacturing	"	19.5	19.4	19.5	- 0.3	4.9
Other industrial	"	8.2	8.2	8.1	1.3	2.2
Nonindustrial	"	39.4	39.3	37.6	4.9	10.4
Industrial production (57-59=100)	"	161.6	159.3	159.5	1.3	8.5
Final products	"	161.4	159.6	159.6	1.1	8.4
Materials	"	161.6	159.3	159.2	1.5	8.6
Wholesale prices (57-59=100)1/	"	106.8	106.2	105.9	0.8	2.6
Industrial commodities (FR)	"	106.7	106.3	104.7	1.9	3.8
Sensitive materials (FR)	"	103.9	102.3	101.4	2.5	0.7
Farm products, foods & feeds	"	104.8	103.4	106.7	- 1.8	- 1.6
Consumer prices (57-59=100)1/	"	118.2	117.8	114.7	3.1	6.5
Commodities except food	"	111.1	111.1	107.7	3.2	5.1
Food	"	116.2	115.6	114.8	1.2	5.1
Services	"	130.1	129.6	125.2	3.9	9.1
Hourly earnings, mfg. ($)	"	2.89	2.87	2.76	4.7	9.1
Weekly earnings, mfg. ($)	"	118.01	116.69	113.27	4.2	7.7
Personal income ($ bil.)2/	"	648.1	642.4	605.0	7.1	15.4
Corporate profits before tax ($ bil.)2/	QIV'67	82.5e	80.0	83.9	- 1.7	2.1
Retail sales, total ($ bil.)	Dec'67	26.3	26.5	25.4	3.8	6.6
Autos (million units)2/	"	7.5	7.2	8.0	- 5.7	-11.5
GAF ($ bil.)	"	6.4	6.5	6.0	6.5	13.2
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,256	1,587	931	34.9	-20.0
Factory workweek (hours)	"	40.8	40.7	41.0	- 0.5	- 1.5
New orders, dur. goods ($ bil.)	"	26.1	23.8	24.0	9.0	11.6
New orders, nonel. mach. ($ bil.)	"	3.9	3.9	3.6	8.7	10.2
Common stock prices (1941-43=10)	"	95.30	92.66	81.33	17.2	3.9
Inventories, book val. ($ bil.)	Nov'67	139.7	138.6	133.9	4.3	17.1
Gross national product ($ bil.)2/	QIV'67	807.6	791.2	762.1	6.0	14.0
Real GNP ($ bil., 1958 prices)2/	"	679.4	672.0	661.1	2.8	7.1

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Jan. 26, 1968	4-week average	Last 6 months High	Last 6 months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.65	4.62	4.73	3.40
U.S. Treas. bills, 3-mo., yield (per cent)	4.97	5.01	5.06	4.15
U.S. Treas. bills, 1-yr., yield (per cent)	5.26	5.32	5.64	4.97
Net free reserves 2/ ($ millions)	133	149	426	-70
Member bank borrowings 2/ ($ millions)	233	283	495	46
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds 1/	5.56	5.54	5.84	5.19
20-year U.S. Treas. bonds 1/	5.43	5.40	5.73	5.07
Corporate new bond issues, Aaa adj. 8/	6.34	6.26	6.59	5.82
Corporate seasoned bonds, Aaa 1/	6.12	6.18	6.24	5.58
Municipal seasoned bonds, Aaa 1/	3.98	4.06	4.15	3.75
FHA home mortgages, 30-year 3/	--	6.81	6.81	6.53
Common stocks, S&P composite series 4/				
Prices, closing (1941-43=10)	93.45	95.34	97.26	92.21
Dividend yield (per cent)	3.19	3.11	3.23	3.03

	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	Jan. '68e/	1,100	1,120	264	246
State & local govt. public offerings	Jan. '68e/	1,150	1,184	332	54
Comm. & fin. co. paper (net change in outstandings) 6/	Dec. '67	- 63	+288	+827	-212

	Latest month	Outstandings Latest month	Change Latest month	Change 3-month average	Annual rate of change from Preceding month	3 months ago	12 months ago
Banking (S.A.)		($ billions)			(per cent)		
Total reserves 1/	Dec.'67	24.62	-0.15	0.11	-7.2	5.3	10.0
Credit proxy 1/	"	272.9	-0.1	1.5	-0.4	6.7	11.6
Bank credit, total 6/	"	344.4	0.1	1.6	0.3	5.8	11.0
Business loans	"	85.9	1.3	0.6	18.4	8.6	9.3
Other loans	"	138.1	0.4	0.7	3.5	5.9	6.9
U.S. Govt. sec.	"	60.0	-1.8	-0.5	-35.0	-10.4	11.7
Other securities	"	60.4	0.2	0.9	4.0	18.7	24.0
Total liquid assets 1/ 6/	"	651.4	3.5	4.1	6.5	7.7	8.1
Demand dep. & currency 1/	"	181.5	0.3	0.8	2.0	5.1	6.5
Time & sav. dep., comm. banks 1/	"	183.8	1.3	1.6	8.5	11.0	15.9
Savings, other thrift instit. 6/	"	183.7	0.1	0.8	0.6	5.1	9.0
Other 6/ 7/	"	102.4	1.8	0.9	21.5	11.2	-2.3

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 Jan. 24. 3/ Latest figure is for Dec. 4/ End of week closing prices; yields are for Friday. 5/ Corporate security offerings include both bonds and stocks. 6/ Month-end data. 7/ U.S. savings bonds and U.S. Government securities maturing within 1 year. 8/ Adjusted to Aaa basis.

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

	1966	1967					
	QIV	QI	QII	QIII	QIV	Nov.	Dec.
				Seasonally adjusted			
Goods and services, net 1/	1,084	1,357	1,324	1,369			
Trade balance 2/	722	1,014	1,159	1,089	386	249	12
Exports 2/	7,402	7,676	7,717	7,644	7,503	2,630	2,542
Imports 2/	-6,680	-6,662	-6,558	-6,555	-7,117	-2,381	-2,530
Services balance	362	343	165	280			
Remittances and pensions	-246	-264	-395	-364			
Govt. grants & capital 3/	-724	-1,201	-1,013	-973			
U.S. private capital	-1,165	-957	-1,137	-1,695			
Direct investments	-1,003	-622	-648	-894			
Foreign securities	-83	-263	-170	-434			
Banking claims	44	66	-226	-397	104 e/		
Other	-123	-138	-93	30			
Foreign capital, nonliquid	780	823	1,227	873			
Official foreign accts.	425	392	736	277			
Long-term deposits	373	304	584	-29			
U.S. Govt. liab.	52	88	152	306			
Int'l. institutions 4/	17	70	97	117			
Other 5/	338	361	394	479			
Errors and omissions	-148	-287	-553	154			
	Balances, with and without seasonal adjustment (- deficit)						
Liquidity balance, S.A.	-419	-529	-547	-636	-1,853		
Seasonal component	-47	291	325	-572	-44		
Balance, N.S.A.	-466	-238	-222	-1,208	-1,897	-871	-93
Official settlements bal., S.A.	-18	-1,815	-828	470	-1,199		
Seasonal component	-180	533	138	-494	-177		
Balance, N.S.A. 6/	-198	-1,282	-690	-24	-1,376	-531	-468
		Reserve changes, N.S.A. (decrease -)					
Total monetary reserves	6	-1,027	419	375	181	511	-608
Gold stock	-121	-51	-15	-92	-1,012	-74	-900
Convertible currencies	173	-1,007	424	462	1,145	583	253
IMF gold tranche	-46	31	10	5	48	2	39

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. Growth in GNP is expected to accelerate this quarter, if consumer demand keeps pace with anticipated gains in consumer income. Although current dollar GNP rises at an annual rate of $19.5 billion in our projection, compared to $16.4 billion last quarter, the step-up in final demand is much greater--from $11.3 billion to $18.4 billion. Inventory growth is expected to rise somewhat further this quarter as stock-building continues in major industries, but the unexpectedly sharp rise in accumulation in the fourth quarter is unlikely to be repeated.

Most of the projected increase in GNP for this quarter derives from a sharp upturn--expected but not yet evident--in consumer spending. A pronounced rise in sales should occur in response to an accelerated increase in spendable income, without requiring any significant reduction in the rate of saving. Total government spending is scheduled to continue to expand at about the same rate as in the previous quarter. Investment in plant and equipment is expected to turn up sharply, the largest rise since mid-1966, according to the November plant and equipment survey. Residential outlays should edge up further, judging from previous starts and outstanding lending commitments.

The 9.7 per cent annual rate of increase in current dollar GNP in the first quarter represents a 6 per cent real growth as prices continue to rise rapidly; this is a sharp acceleration from the 4.5 per cent real growth rate in the fourth quarter.

Disposable income in the current quarter is expected to rise considerably faster than in the last three quarters of last year; even after adjustment for price increases, the rise should be the largest since the first quarter of 1967. Factors contributing to the acceleration have been detailed in previous Greenbooks--the continued large gains in employment and wage-rates, the $2.3 billion to be added to the annual income flow by the minimum wage increase, effective February 1, the initiation of higher old-age pensions in March, and finally, as compared to the fourth quarter, less loss of income from strikes. While most of the income rise is attributable to wages and salaries, other types of income should also expand. Interest payments are showing a strong upward trend as an increasing proportion of debt is financed at higher rates.

The rise in consumer expenditures projected for the first quarter is in line with the expected increase in spendable income and recent saving propensities; it implies a very small reduction from the 7.5 per cent saving rate attained in the fourth quarter to about 7.3 per cent. On the other hand, the projected increase of 8.5 per cent in consumption at an annual rate is much larger than has occurred for several quarters, as both the durable and nondurable categories expand more rapidly than earlier. However, the behavior of consumers over the past year was exceptionally cautious. Although disposable income rose by 4.3 per cent in 1967, the gain in real consumption, after adjustment for prices increases, was only 2.8 per cent. Not only were purchases of durable goods very low in relation to the increase in income, but nondurable goods outlays--which are usually more closely linked to population and income increases--also lagged.

Although the fourth quarter showed some improvement in durable goods purchases, despite the auto strike, expansion in nondurable goods sales appears to have continued to be unusually slow. Such pronounced and unusual weakness in consumer spending for nondurable goods probably will not persist much longer, in view of both income and population increases.

As a result, our projection of consumption in the first quarter, in addition to recognizing the factors which should result in considerably higher purchases of automobiles and household durable goods, would restore a more normal relation between income increases and nondurable goods purchases. Service expenditures are assumed to continue on a rising trend.

The outlook for automobile sales remains somewhat uncertain. Consumers do not seem to be exhibiting the enthusiasm for the new models which would justify us in continuing to anticipate a sales rate of 8.5 million domestic units this quarter, as shown in the last Greenbook. We have accordingly reduced our estimates to 8.0 million, compared to an actual sales rate of 7.25 million in the strike-affected fourth quarter. The rising rate of completions of new homes should stimulate sales of both durable and nondurable furnishings, although the number of new homes available for sale this quarter will still be low.

All in all, the projected increase in consumption seems conservative; normally, a sharper decline in saving would be anticipated with the increase in the flow of income to lower income groups, such as pensioners, and minimum wage reciepents. However, in view of wide-spread fears of inflation and other evidences of uncertainty disclosed in surveys of consumer attitudes, a substantial decline in the saving rate may be delayed for some time. This quarter, however, the income rise is likely to be so large that consumer outlays should almost double the fourth quarter rise merely by keeping pace with growth in spendable income.

An upsurge at an annual rate of $3 billion in plant and equipment outlays this quarter was predicted in the November official survey of business investment plans. Since the forecast for the second quarter indicated only a slight further rise, however, it is possible that the projected first quarter spurt will be phased out over a longer period. The rise is expected to center in private utilities, although outlays in manufacturing also are expected to increase at a faster rate. The indicated advance in industrial output should cause the utilization of capacity in manufacturing to rise to 85.4 per cent. This would be one percentage point above the fourth quarter average but only slightly above the December level.

Housing starts in the fourth quarter averaged 1.45 million at an annual rate--a little lower than shown in the last Greenbook--because of an unanticipated decline from a 1.6 million rate in November to 1.25 million in December. This drop can in part be attributed to the reduced number of working days and the severe weather. The rise in permit applications in December, however, indicates underlying strength in demand as well as possible fears of future tightness in mortgage money. However, funds will probably be sufficient to continue starts in the first quarter at the fourth quarter rate of 1.45 million. The dollar volume of construction should continue to rise somewhat.

Nonfarm inventory accumulation, after coming to a virtual halt in the second quarter, rose to a rate of $3.4 billion in the third quarter and to an estimated $7.5 billion in the final quarter of 1967, over $2 billion more than we had projected. Although dealers' auto stocks rose appreciably, about half the rise in inventories in the fourth quarter was in other types of nondefense goods.

Despite a drop in November, the inventory-sales ratio for durable goods exceeded that of November last year, and, in view of disappointing retail sales in December, it probably was higher by year-end and as high or higher than at the end of 1966, preceding the inventory readjustment. Despite this, most businessmen do not report dissatisfaction with their stocks. Rising sales and favorable anticipations are expected to lead to moderate further and across-the-board accumulation of inventories this quarter; moreover, stockpiling of steel at a rapid rate and a further buildup in auto inventories is expected. Work-in-process for defense is still rising, although at a slower rate than earlier this year. In total, nonfarm inventory accumulation is expected to increase from an annual rate of $7.5 billion to $9.5 billion. Inventory building on farms, however, is expected to increase much less than in the fourth quarter.

Net exports in the fourth quarter apparently plunged to a rate of about \$3.1 billion, from \$5.4 billion in the previous period, according to unpublished estimates, whereas the published estimates indicate that the fourth quarter rate was \$4 billion (this figure is still carried in the Greenbook in order to be consistent with the official GNP series for the fourth quarter). Exports were disappointing and imports much higher than had been hoped. It is now expected that net exports will increase at a rate of \$800 million in the current quarter from the very low fourth quarter level. This increase would be \$500 million larger than estimated in the previous Greenbook.

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	1966	1967				1968 Proj.
			IV	I	II	III	IVp	I
Gross National Product	743.3	785.1	762.1	766.3	775.1	791.2	807.6	827.1
Final sales	729.9	780.0	743.6	759.2	774.6	787.4	798.7	817.1
Private purchases	575.6	603.7	581.9	588.8	599.6	609.2	617.2	632.1
Personal consumption expenditures	465.9	491.6	473.8	480.2	489.7	495.3	501.4	512.1
Durable goods	70.3	72.1	70.6	69.4	72.5	72.7	73.7	76.7
Nondurable goods	207.5	217.5	210.3	214.2	217.2	218.5	220.2	224.2
Services	188.1	202.1	192.9	196.6	200.0	204.1	207.5	211.2
Gross private domestic investment	118.0	112.1	122.2	110.4	105.1	112.2	120.7	125.2
Residential construction	24.4	24.5	20.9	21.4	23.1	25.6	27.9	28.4
Business fixed investment	80.2	82.5	82.8	81.9	81.5	82.8	83.8	86.8
Change in business inventories	13.4	5.1	18.5	7.1	.5	3.8	9.0	10.0
Nonfarm	13.7	4.7	19.0	7.3	.6	3.4	7.5	9.5
Net Exports	5.1	5.0	4.3	5.3	5.3	5.4	4.0*	4.8*
Gov't purchases of goods & services	154.3	176.3	161.7	170.4	175.0	178.2	181.5	185.0
Federal	77.0	89.9	81.5	87.1	89.5	90.9	92.0	93.5
Defense	60.5	72.6	65.6	70.2	72.5	73.3	74.3	75.0
Other	16.5	17.3	15.9	16.8	17.0	17.6	17.7	18.5
State and local	77.2	86.4	80.2	83.3	85.4	87.4	89.5	91.5
Gross National Product in constant (1958) dollars	652.6	669.2	661.1	660.7	664.7	672.0	679.4	689.8
GNP Implicit deflator (1958=100)	113.9	117.3	115.3	116.0	116.6	117.7	118.9	119.9
Personal income	584.0	626.3	601.6	612.9	619.1	631.0	642.1	655.2
Wage and salaries	394.6	423.7	407.4	414.7	418.3	426.2	435.6	445.0
Disposable income	508.8	544.6	522.0	532.7	540.0	548.2	557.5	568.5
Personal saving	29.8	38.7	34.6	38.8	36.0	38.5	41.6	41.6
Saving rate (per cent)	5.9	7.1	6.6	7.3	6.7	7.0	7.5	7.3
Corporate profits before tax	83.8	80.1	83.9	79.0	78.9	80.0	82.5	85.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	143.2	151.5	148.6	149.1	148.1	152.7	156.2	161.1
Expenditures	142.9	164.1	151.9	160.9	162.8	165.9	167.5	171.7
Surplus or deficit (-)	.3	-12.6	-3.3	-11.9	-14.7	-13.2	-11.3	-10.6
Total labor force (millions)	78.9	80.8	79.8	80.3	80.2	81.1	81.7	82.2
Armed forces "	3.1	3.4	3.3	3.4	3.5	3.5	3.5	3.5
Civilian labor force "	75.8	77.3	76.5	76.9	76.7	77.7	78.2	78.7
Unemployment rate (per cent)	3.8	3.8	3.7	3.7	3.8	3.9	4.0	3.7
Nonfarm payroll employment (millions)	64.0	66.1	65.0	65.7	65.7	66.1	66.8	67.4
Manufacturing	19.2	19.3	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	159.2	163.0
Capacity utilization, manufacturing (per cent)	90.5	85.1	90.0	87.1	84.9	84.0	84.3	85.4
Housing starts, private (millions A. R.)	1.17	1.27	.92	1.12	1.21	1.40	1.45	1.45
Sales new U.S.-made autos (millions, A. R.)	8.38	7.57	8.13	7.33	7.83	8.00	7.25	8.00

*The Commerce preliminary estimate of net exports of goods and services for 67-IV, $4.0 billion as shown here, will be revised down when December trade balance data are incorporated in the estimate. The December data suggest the figure may be only $3.1 billion (with GNP reduced correspondingly). On this basis we estimate net exports in 68-I at $3.9 billion, up $.8 billion from 67-IV -- the rise shown above from the preliminary estimate.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1966	1967	1966 IV	1967 I	1967 II	1967 III	1967 IVp	1968 Proj. I
	------------------ In Billions of Dollars ---------------							
Gross National Product	59.4	41.8	13.3	4.2	8.8	16.1	16.4	19.5
Final sales	55.4	50.1	6.2	15.6	15.4	12.8	11.3	18.4
Private purchases	37.5	28.1	2.2	6.9	10.8	9.6	8.0	14.9
GNP in constant (1958) dollars	35.9	16.6	6.3	-.4	4.0	7.3	7.4	10.4
Final sales	32.1	24.6	-0.3	10.1	10.3	4.2	2.5	9.7
Private purchases	21.9	10.5	-2.8	3.7	7.1	3.0	2.0	7.9
	-- In Per Cent; Quarterly Changes are at Annual Rates ----							
Gross National Product	8.7	5.6	7.1	2.2	4.6	8.3	8.3	9.7
Final sales	8.2	6.9	3.4	8.4	8.1	6.6	5.7	9.2
Private purchases	7.0	4.9	1.5	4.7	7.3	6.4	5.3	9.7
Personal consumption expenditures	7.6	5.5	3.1	5.4	7.9	4.6	4.9	8.5
Durable goods	6.5	2.6	-1.7	-6.8	17.9	1.1	5.5	16.3
Nondurable goods	8.5	4.8	1.5	7.4	5.6	2.4	3.1	7.3
Services	6.9	7.4	6.5	7.7	6.9	8.2	6.7	7.1
Gross private domestic investment	9.9	-5.0	19.9	-38.6	-19.2	27.0	30.3	14.9
Residential construction	-9.6	0.4	-47.3	9.6	31.8	43.3	35.9	7.2
Business fixed investment	12.8	2.9	7.9	-4.3	-2.0	6.4	4.8	14.3
Gov't purchases of goods & services	13.1	14.3	10.1	21.5	10.8	7.3	7.4	7.7
Federal	15.3	16.8	10.1	27.5	11.0	6.3	4.8	6.5
Defense	20.8	20.0	16.5	28.0	13.1	4.4	5.5	3.8
Other	-1.2	4.8	-16.9	22.6	4.8	14.1	2.3	18.1
State & local	10.9	11.9	10.8	15.5	10.1	9.4	9.6	8.9
GNP in constant (1958) dollars	5.8	2.5	3.8	-.2	2.4	4.4	4.4	6.1
Final sales	5.3	3.8	-0.2	6.3	6.3	2.5	1.5	5.8
Private purchases	4.4	2.0	-2.2	2.9	5.5	2.3	1.5	6.0
GNP Implicit deflator	2.7	3.0	3.1	2.4	2.1	3.8	4.1	3.4
Personal income	8.6	7.2	8.3	7.5	4.0	7.7	7.0	8.2
Wage and salaries	9.9	7.4	7.8	7.2	3.5	7.6	8.8	8.6
Disposable income	7.8	7.0	7.5	8.2	5.5	6.1	6.8	7.9
Corporate profits before tax	9.5	-4.4	-.5	-23.4	-0.5	5.6	12.5	14.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.7	5.8	8.2	1.3	-2.7	12.4	9.2	12.5
Expenditures	15.8	14.8	15.3	23.7	4.7	7.6	3.9	10.0
Nonfarm payroll employment	5.3	3.3	4.4	4.3	0.0	2.4	4.2	3.6
Manufacturing	6.1	0.5	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	5.1	9.5
Housing starts, private	-20.4	8.5	-59.3	87.0	32.1	62.8	14.3	0.0
Sales new U.S.-made autos	-4.4	-9.7	-15.8	-39.6	27.3	8.7	-37.5	41.4

Industrial production. While there are only scattered and incomplete data on which to base an estimate, it seems likely that the upward movement in output of the past few months, aside from the gains because of major strike settlements, continued in January. Industrial production probably increased further by between a half and one point from the preliminary December level of 161.6 per cent, to another new high in January.

Output of crude oil increased further and production of some textile and chemical products probably rose. Output of refined petroleum products declined and production of raw steel, despite sharp increases in the last two weeks of January, failed to rise seasonally. Output of commercial aircraft and defense equipment is expected to have increased and the settlement of the Deere strike at the end of December added about .3 of one point to the total January index.

Auto assemblies in January had been scheduled at an annual rate of 8.9 million units, the same as in December, but actual output may not have reached that rate because of strikes (now settled) at some G.M. plants. Output schedules for February and March, which had been set at around the January rate, will probably be cut back to rates more in line with sales of domestic units, which have recently been at about a 7.8 million rate, unless sales pick up soon.

Output of other consumer durable goods, which by November had fully recovered from mid-year lows, declined in December. Production of TV sets and some appliances was cut back as factory stocks rose rapidly from June to November. In early January, retail sales of these goods were sluggish and TV output continued at the December rate.

Industrial production in the last half of 1967 rose at an annual rate of 8 per cent, but the underlying movement was obscured by numerous strikes in that period. The following table shows the published industrial production total index, the estimated strike losses as points in the total index (direct effects only), and an index adjusted for the strike losses.

INDUSTRIAL PRODUCTION
(Seasonally adjusted indexes)

	1967						
	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Published total index	155.6	156.6	158.1	156.8	156.6	159.3	161.6
Strike losses (index points):							
Electrical machinery	.1			.1	.2		
Nonelectrical machinery					.4	.1	
Farm machinery							.2
Autos, trucks, etc.				1.3	1.3	.6	
Copper			.2	.3	.3	.3	.3
Rubber	.4	.4					
Adjusted total index	156.1	157.0	158.3	158.5	158.8	160.3	162.1

Capacity utilization. Utilization of capacity by manufacturers was estimated to be 85.3 per cent in December, up one full point from the previous month. Little change is expected in January. A large part of the December increase can be attributed to the auto strike settlement. Increased auto production accounted directly for about one-half the increase in manufacturing output.

The operating rate for manufacturing is still well below the 91.0 per cent recorded in June 1966 and substantial amounts of unused capacity remain. Pressures on capacity, however, vary from industry to industry. Recent production increases in the textile, petroleum, and rubber industries have brought operating rates to levels which are high relative to historical experience. Production of aircraft and electric generating equipment has been at near capacity levels for at least a year. Steel capacity is difficult to estimate but despite recent production increases it would appear that margin of unused capacity remains.

UTILIZATION RATES

Industry	1967						
	QI	QII	QIII	QIV	Oct.	Nov.	Dec.
Manufacturing	87.1	84.9	84.1	84.3	83.2	84.3	85.3
Primary processing	86.0	83.1	82.5	84.4	83.2	84.4	85.6
Advanced processing	87.8	86.2	85.2	84.2	83.3	84.2	85.1

Orders and shipments. New orders received by manufacturers of durable goods jumped 9.5 per cent in December according to advance Census Bureau figures. While this rise is subject to revision and while a part of this extraordinary increase can be attributed to special situations and what may be imperfect seasonal adjustment, the rise nevertheless appears to be quite significant.

New orders--which had risen sharply from earlier lows in the spring--leveled off in midsummer and in October were slightly below their June levels. Part of this slowdown in the recovery was due to strikes and to the erratic behavior of the aircraft orders series. Beginning with November, new orders for durables picked up sharply and the December increases brought the series 3 per cent above its previous record high of September 1966. Moreover, every major industry shared in the latest increase and unfilled orders and shipments also registered strong advances.

Several special factors helped account for the December increase. Orders for motor vehicles rose 10 per cent from a November level still depressed by the Ford strike, and aircraft orders were up from an unusually low level the previous month. Iron and steel orders rose 13 per cent as buyers attempted to accumulate inventories in anticipation of a possible steel strike. At their December level, steel orders were about equal to the peak reached in the inventory buildup preceding the labor contract expiration in 1965. Even if both transportation equipment and iron and steel orders are excluded from the total, durable goods orders were still up 7.6 per cent in December.

New orders for machinery and equipment rose sharply in December to a new high. Increases in this area, however, were not uniform. Machine tool orders turned up in December, but after falling steadily all year to the lowest levels since 1964; moreover, machine tool shipments continued well above orders.

Unfilled orders for durable goods rose 1.2 per cent in December, continuing the increase which began last May. At the end of 1967, backlogs represented 3.2 months shipments, about the same relationship that prevailed a year earlier. Unfilled orders for aircraft rose throughout last year. Order backlogs for durable goods other than aircraft have now recovered most of the losses sustained early last year and have risen sharply in the last two months.

Shipments (sales) of durable goods by manufacturers increased 6 per cent in December and, with the latest increase, were a similar percentage above the record level of a year earlier. Strong gains were recorded in December in all major industries. Auto shipments were up sharply but this accounted for only a small part of the total gain.

Shipments of durable goods increased last summer and by August, the month before the auto strike, had recovered most of the losses sustained early in the year.

ORDERS AND SHIPMENTS: DURABLE GOODS
(Billions of dollars)

		New orders (monthly)	Shipments (monthly)	Unfilled orders (end of month)
1966	III	24.4	23.0	73.8
	IV	23.7	23.5	76.3
1967	I	22.2	22.9	74.9
	II	23.5	22.7	75.1
	III	23.6	23.3	76.9
	IV	24.4	23.7	78.8
	Oct.	23.4	22.3	78.3
	Nov.	23.8	23.6	78.5
	Dec.	26.1	25.2	79.5

Residential construction. Seasonally adjusted private housing starts, which had soared to a 1.59 million annual rate in November, dropped by a fifth in December to the lowest rate--1.26 million--since last June. The decline affected all types of structures and all regions. A more-than-seasonal decline was expected in December mainly because of the sharp rise and unsustainably high rate reported for November. In November some builders apparently had accelerated their schedules, as lender commitments were high but lender hesitancy about future prospects was increasing. In addition, unusually severe winter weather and statistical difficulties with the daily average adjustment for December also may have combined to deepen the reported decline.

On a quarterly basis, which suppresses some of the volatility, starts in the fourth quarter were still above the improved third quarter level, as shown in the table. The fourth quarter rise was concentrated in multifamily structures and in the South and North Central states. For the year 1967, starts totaled 1.29 million--a tenth above the 1966 total.

PRIVATE HOUSING STARTS AND PERMITS

	IV Q 1967 (Thousands of units)1/	Per cent change from	
		III Q 1967	IV Q 1966
Starts	1,446	+ 3	+ 58
1-family	884	--	+ 38
2-or-more family	562	+ 8	+102
Northeast	215	-18	+ 43
North Central	380	+10	+ 73
South	595	+10	+ 49
West	256	- 2	+ 72
Permits	1,244	+10	+ 70
1-family	667	+ 5	+ 48
2-or-more family	577	+18	+104

1/ Seasonally adjusted annual rates; preliminary.

Barring abnormal weather interruptions, a return to a more rapid rate of starts is indicated for January, and some further improvement is possible for the first quarter as a whole. Supporting this judgment, building permits declined much less than seasonally in December and were appreciably above the fourth quarter average and the highest since early 1964. Moreover, the December rise in permits was widespread both by type of structure and by region.

While seasonally adjusted sales of new homes by speculative builders declined in November, the rate was still one of the highest in 1967; and, partly reflecting the policy of many builders to limit construction to pre-sold units, seasonally adjusted stocks of new homes for sale remained very near earlier reduced levels.

In markets for existing homes, the limited availability of suitable properties and the higher discounts required in some areas have tended to moderate sales activity, which normally is around seasonal lows at this time. Even so, sales in both October and November were more than a third above a year earlier, according to the National Association of Real Estate Boards.

Retail sales. Sales in the first three weeks of January suggest little change, or a further small decline, from the December level.

In December the dollar value of retail sales was down slightly from November and up less than 4 per cent from a year earlier, according to the Census Bureau advance figures. Sales at durable goods stores were up only moderately both from the preceding month and from a year earlier. (See table.) At nondurable goods stores, sales were off a little following a sharp rise in November but were up moderately from a year earlier.

The December increase in sales at durable goods stores reflected increases in automotive, furniture and appliance, and farm equipment outlets. Declines were reported at all major nondurable goods outlets except drug stores.

For the fourth quarter as a whole, retail sales were nearly 1 per cent below the third quarter as durable goods sales, particularly strike-affected autos, dropped sharply while nondurable goods sales rose slightly.

PERCENTAGE CHANGES IN RETAIL SALES

	Month			Quarter		Dec. 1967 from
	Oct.	Nov.	Dec.	III	IV	Dec. 1966
Total	-2.4	1.4	- .5	1.6	- .9	3.8
Durable goods	-5.8	.3	.7	4.1	-4.0	2.0
Automotive	-9.9	.5	.8	6.4	-7.8	.5
Durables less autos	.3	- .1	.7	.8	1.6	4.0
Furniture and appliances	-3.5	3.2	1.7	.6	2.4	7.4
Nondurable goods	- .8	2.0	-1.0	.4	.6	4.7
Food and beverage	.1	1.0	- .3	.7	1.2	4.4
Apparel	-4.7	1.0	-6.9	1.3	-5.9	.8
General merchandise	-1.2	1.9	- .4	1.2	.6	8.5
Other	- .6	4.6	- .8	-1.1	2.0	3.7

Unit auto sales and stocks. New car sales in January rose less than most industry sources had anticipated. In the first 20 days, dealer deliveries of domestic autos were at a seasonally adjusted annual rate of 7.8 million units, about the same as a year earlier when auto sales were declining and stocks were rising to very high levels. Moreover, some producers already are beginning sales incentive contests, although such contests usually do not become common until spring.

Dealer stocks of new cars increased further in the first 20 days of January but in the last 10 days of the month work stoppages at some G.M. plants may have slowed the rise in inventories. On January 20, dealers had 1.3 million units on hand, a number which has been surpassed this early in the year only in 1966 and 1967.

Sales of used cars in the first 20 days of January were at the same rate as in December and also the same as a year earlier, when used car sales were relatively low. Seasonally adjusted used car prices (as reported in the CPI) eased slightly in December but were nearly one-tenth higher than a year earlier.

Consumer credit. Consumers have stepped up their borrowing in recent months, but net increases in instalment credit outstanding have been small compared with other recent years. December apparently will be the only month in 1967 in which the increase in outstandings was larger than a year earlier. For 1967 as a whole, the rise in instalment credit was about half that for 1966, as can be seen in the table.

INCREASES IN CONSUMER INSTALMENT CREDIT

	In billions of dollars	In percentage
1962	4.5	10.4
1963	6.1	12.7
1964	6.4	11.8
1965	8.0	13.2
1966	6.1	8.9
1967 (e)	3.2	4.3

As usual, much of the slack in total consumer credit and much of the unevenness in its growth pattern last year was traceable to auto credit. New extensions of auto credit, which had flattened out in 1966, dropped in early 1967 to their lowest level in more than two years. While there was some pick-up as the year progressed, loan volume generally continued below year-earlier levels.

Despite relatively sluggish credit extensions, there was a considerable further rise in repayments on old auto debt last year. The result was a marked narrowing of the gap between extensions and repayments of auto debt. In 1965, net increases in outstanding auto debt had averaged over $300 million per month. In 1966, the average dropped to $175 million, and in 1967 to less than $30 million per month.

Auto extensions may rise at a faster pace this year--even if unit sales do not increase as much as the industry expects--in view of the rise in average size of instalment contracts. The average new-car note has been running in the $2,800 - $2,900 range since the higher-priced 1968 models went on sale last fall, more than $100 above corresponding year-earlier levels, and it may have increased a little further in January.

Labor market. Resurgence in industrial employment and the continued rapid expansion in most nonmanufacturing sectors have combined to strengthen the tone of the labor market. Further strong demands for labor appear in prospect in coming months. High rates of production to build inventories in autos and steel, and to meet expanding equipment orders, as well as accelerated increases in personal income with their expansive implications for consumer spending, all suggest further large gains in employment.

Employment. Nonfarm employment increased by about 200,000 in December on top of a much larger November rise than was indicated by the preliminary data. The pick-up in nonfarm payroll employment from pre-auto strike August levels to December was 900,000--an annual rate of growth of 2.7 million jobs.

This resurgence of employment growth was reflected in the unemployment figures as well, with the rate dropping another two-tenths in December to 3.7 per cent. The unemployment rate declined appreciably among teenage workers in December and unemployment among adult men (25 and over) was below 2 per cent, as low as any time in the past two years.

The employment gains in November and December were broadly based. Manufacturing employment increased by 80,000 in December (after allowance for strikes), with new strength evident in the construction-related lumber, furniture and stone, clay and glass industries. Transportation equipment employment rose by 20,000 and was close to regaining its pre-strike level, although G.M. and Chrysler were still subject to intermittent strikes involving some 30,000 workers. Nondurable goods industries also showed renewed growth, having risen by more than 60,000 in two months.

The December and revised November data also painted a much stronger employment picture in construction. After months of no gains, employment increased by 100,000 from October to December which brought the level of construction employment back to its February 1967 high and to within about one per cent of its early 1966 peak.

The December data also indicate continued rapid growth in the trade-service-State and local government sector in the past few months. In fact, the only sector experiencing significant employment declines during the period was the Federal government, where the number of workers dipped somewhat further in December for a net reduction of 65,000 since July.

The average workweek in manufacturing also has been edging up since its mid-summer low of 40.3 hours, but at 40.8 hours in December, was still three quarters of an hour below the early 1966 peak levels, leaving room for further increases in hours to meet expanding manpower requirements.

Earnings. Average hourly earnings of production workers in manufacturing rose three cents in December following a two-cent rise in November and, at $2.90, were up 4.7 per cent over the year. This was the largest over-the-year increase for any month in 1967, and reflected in part the first impact of the large wage settlement in autos. A further rise in January is in prospect as a result of the G.M. settlement at the end of December. In addition, there were small but widespread increases throughout durable goods industries; nondurable goods earnings also showed a sizable gain.

Industrial relations. Substantial upward wage adjustments are in prospect in a wide range of industries in the next several months. Wage reopenings and contract expirations will raise the wages of about 1 million workers in the first quarter, largely in communications, construction, cans and glass containers.

Of particular interest are the current negotiations of the steelworkers and the major can companies--whose contract expires January 31--because of its implications for the upcoming aluminum negotiations (May) and steel (July). Preliminary reports suggest that the unions in the can and telephone industries are demanding wage and fringe packages costing about 7 per cent a year; the auto settlement of 6.0 - 6.5 per cent appears to have established a floor for upcoming negotiations. An additional 1-1/4 million workers will also receive deferred increases of 4 - 5 per cent in petroleum, trucking, retail trade, hotels, apparel and on airlines in the first quarter. Wages of a large number of low wage workers will also be raised early this year as a result of the increase in the minimum wage of 15 to 20 cents an hour, effective February 1.

Unit labor costs in manufacturing. Unit labor costs in manufacturing dipped in December following three months of relative stability and, at 106.7, the index was a tenth of a point below the June figure. However, in addition to a pick-up in productivity, the decline in unit labor costs in December was due to an unexplained lack of growth in average hourly compensation--despite a large gain over the month in hourly earnings--and may reflect in part seasonal adjustment or other statistical problems.

UNIT LABOR COSTS IN MANUFACTURING, 1967
ALL EMPLOYEES

	Index (1957-59=100)	Per cent change from a year earlier
Q I	105.2	5.5
Q II	106.1	5.4
Q III	107.2	5.5
Q IV	107.4	4.5
October	107.7	5.3
November	107.8	4.6
December	106.7	3.6

The slowdown in growth of unit labor costs late in the year was a result of the offsetting movements of productivity and compensation per manhour. Output per manhour showed virtually no increase in the first half of 1967, but picked-up late in the year with the rise in output; productivity in manufacturing rose at an annual rate of about 4 per cent from June to December. The increase in average hourly compensation, on the other hand, apparently dipped from about a 5-1/2 per cent annual rate in the second quarter of 1967 to a surprisingly low 3 per cent in the fourth quarter.

However, with sizable wage adjustments in prospect, as well as deferred wage increases and the rise in the minimum wage on February 1, average hourly compensation should resume a sharp upward course, at an annual rate of 6 per cent or more, in the coming months. While productivity is also expected to increase, the rise is not likely to be large enough to offset fully the effect of increasing compensation on unit labor costs.

Wholesale prices. The BLS wholesale price index for industrial commodities increased by 0.3 per cent from mid-November to mid-December, and, according to preliminary estimates, rose another 0.3 per cent in mid-January. At an estimated 107.7 per cent of the 1957-59 average, the BLS industrial average in mid-January was 1.6 per cent above mid-July, representing an annual rate of rise of 3.2 per cent. From mid-1966 to mid-1967, this index had increased less than 1 per cent. Since mid-January, price increases have been effected for a variety of industrial materials and products, including copper scrap, special tool steels, high-grade zinc, cotton cloth, appliances, color film, and mining machinery.

In December, the earlier sharp decline in prices of agricultural products was reversed abruptly, and the BLS index for farm products and processed foods and feeds rose about 1.5 per cent. This large increase combined with the continued sharp rise in the industrial price average in December led to the largest monthly increase (0.6 per cent) in the total wholesale price index since mid-1966. At 106.8, the WPI was back to the peak reached in September 1966, when the sharp 1965-66 run-up in prices of foods and foodstuffs culminated. Prices of farm products rose somewhat further in early January, and the total wholesale index increased to an estimated 107.1, a new high.

In November and December, industrial prices increased somewhat faster than they had from July to October. The speed-up was particularly noticeable in the special Federal Reserve industrial price average, which includes cotton as noted in the table below.

RECENT CHANGES IN WHOLESALE PRICES OF INDUSTRIAL COMMODITIES
(Special FR Groupings)

	Per cent of total Industrial Commodities Index	Per cent change at annual rate		
		July to October (3 mo.)	October to December (2 mo.)	July to December (5 mo.)
ndustrial commodity, total	100.0	2.7	4.2 1/	3.3 1/
A. Industrial materials	59.0	1.8	5.6	3.3
1. Sensitive materials	12.3	4.7	16.8	9.6
a) Raw and semi-fabr. copper	1.7	16.4	41.4	27.1
b) Cotton and Cotton cloth	2.3	4.0	40.2	18.7
c) Other sensitive materials	8.3	2.4	4.8	3.6
2. Sluggish materials	46.7	1.0	2.6	1.7
B. Industrial products	41.0	3.9	2.2	3.3
1. Motor Vehicles	7.0	11.4	0	7.0
2. Other products	34.0	2.5	2.6	2.5

/ The BLS Industrial Commodity index increased at a rate of only 3.6 per cent from October to December and 3.1 per cent from July to December. The lower rate for the BLS index appears to be due entirely to the classification by the BLS of cotton (and other natural fibers) as farm products and not as industrial commodities as in the FR groupings.

A sharp run-up in the price of cotton--which carried over into cotton cloth and house-furnishings--was a major factor in the November-December rise. Another major influence was the marked acceleration in the rise in prices of raw and semi-fabricated copper, a rise which had been going on since the beginning of the copper strike in mid-July. Of lesser significance was a step-up in price increases for man-made fiber textile products, and a moderate upturn in hides and leather following a decline of over a third from mid-1966 to October 1967. Altogether, prices of sensitive industrial materials increased nearly 3 per cent from October to December (an annual rate of 16.8 per cent), recovering, by December, three-fifths of the sharp decline from mid-1966 to mid-1967.

Price increases for sluggish materials--which in aggregate are nearly four times as important as sensitive materials in the industrial commodity average--also speeded up in November and December. During those two months steel mill products continued to rise at about the July-October pact (an annual rate of 2.8 per cent) and industrial chemicals showed no change following a sharp spurt in October. But these and other basic material price increases--including sharply higher copper prices--were being translated in November and December into higher prices for more highly fabricated "materials" (hardware, cans, brass fittings and various other parts and components for finished consumer and producer goods).

Average prices of finished industrial products increased at a slower pace in November and December than in the preceding three months, but the slower pace stemmed in the main from the behavior of motor vehicle prices. Between July and October (and mainly in October) motor vehicle prices increased sharply, with the introduction of 1968 models, and then they stabilized--at least temporarily. Relative stability in the rate of increase in average prices of all industrial products except motor vehicles obscures the fact that in recent months price increases have accelerated for machinery and equipment while they have moderated, on average, for consumer products.

Since December, prices of raw and semi-fabricated--and presumably also more highly fabricated--copper and products have continued to advance. The strike, now in its 29th week has resulted in the loss of nearly 1,000,000 tons of primary copper, and copper fabricators are reportedly paying 67 cents a pound or more for the limited supply of copper available on the open market (mostly sharply expanded imports as compared with the 38 cents price for domestically produced primary copper available before the strike. No end of the strike now appears in sight but pressures for settlement are mounting. Moreover, at present prices, efforts to substitute other materials for copper are accelerating. With the end of the strike, of course, the average price of primary copper will gradually subside--perhaps to 40 or 42 cents a pound for new domestic supplies.

The price of raw cotton, on the other hand, has receded somewhat in recent weeks. The earlier sharp run-up--while induced basically by the very short crop and limited supplies of long-staples--had a speculative element in it and the supply of long-staple cotton is proving to be somewhat larger than anticipated. Moreover, domestic mills are apparently shifting more to short-staple from long-staple cotton, where the price rise was most pronounced; and sharply higher prices--coupled with a continuing lag in foreign textile demands--is leading to a reduction in U.S. exports.

Tapering off of price increases for copper and cotton and their products would act to moderate the over-all increase in industrial prices, and the unusually sharp rate of increase in November and December was probably temporarily high.

Consumer prices. The BLS consumer price index increased another 0.3 per cent in December, to 118.2 per cent of the 1957-59 average--3.1 per cent above the level of a year earlier.

Reversing the moderate, seasonal decline of the preceding 3 months, grocery prices as well as the total food index increased 0.5 per cent (more than seasonally), largely as a result of increases for fresh vegetables, eggs, and processed fruits. Prices of restaurant meals--with their large wage component--continued their steady upward trend and were 4.8 per cent above a year earlier. Grocery prices in December were up only 0.3 per cent over the year.

Average prices of all commodities other than food were unchanged from November to December--following earlier sharp increases. Apparel prices were up somewhat further, although seasonally they are expected to edge down a bit. Gasoline prices declined as "price wars" were resumed in Los Angeles and Kansas City. New car prices decreased 0.1 per cent, substantially less than expected seasonally, but used cars declined more than seasonally as used car inventories reportedly increased.

Prices of consumer services, less rent, rose 0.4 per cent in December as medical care continued its sharp upward trend and home maintenance, mortgage interest, property taxes, and insurance also rose. Rents were up 0.3 per cent in December and 2.0 per cent for the year, the largest yearly increase since 1956. Over the course of 1967, the rise in service prices accelerated, reaching an annual rate of 4-1/2 per cent in the last 4 months. This was considerably above the rate in early 1967 but still below the rate prevailing during most of 1966.

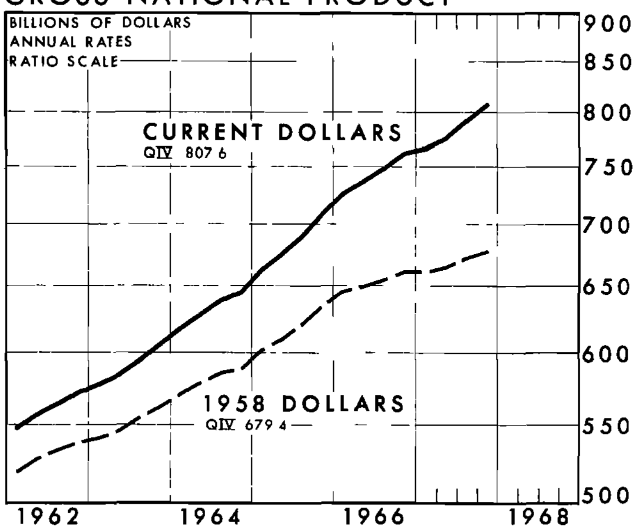
CHANGES IN CONSUMER PRICES, SELECTED PERIODS
(based on BLS indexes)

	Per cent change at annual rate			
	Dec. 1966 to Apr. 1967 (4 mo.)	April to Aug. 1967 (4 mo.)	August to Dec. 1967 (4 mo.)	Dec. 1966 to Dec. 1967 (12 mo.)
onsumer prices, total	1.5	4.2	3.3	3.1
Food	-3.0	7.8	-1.2	1.2
Other commodities	1.8	2.7	4.8	3.2
Services (including rent)	3.3	3.9	4.5	3.9

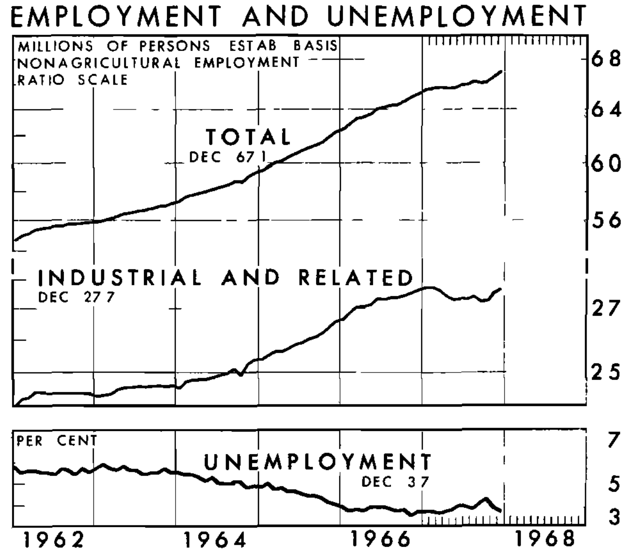
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

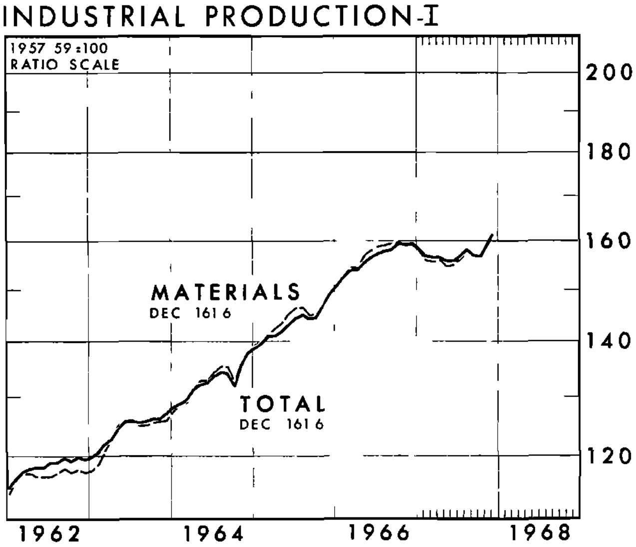
GROSS NATIONAL PRODUCT



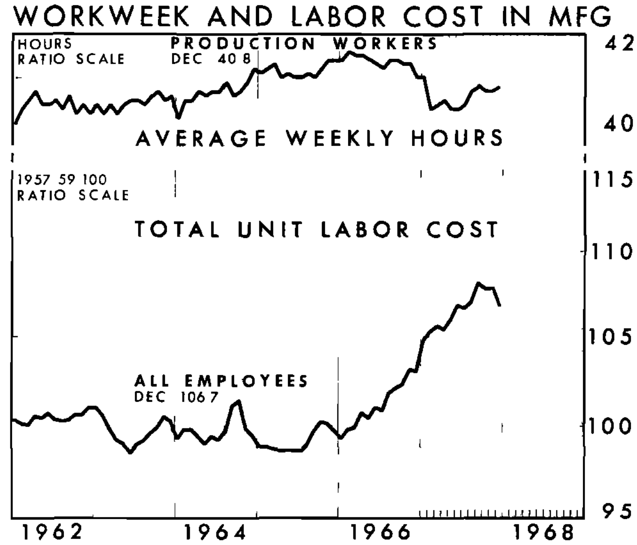
EMPLOYMENT AND UNEMPLOYMENT



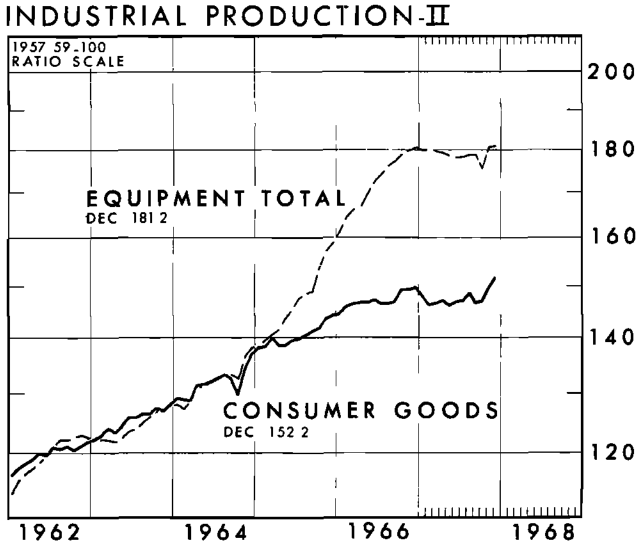
INDUSTRIAL PRODUCTION-I



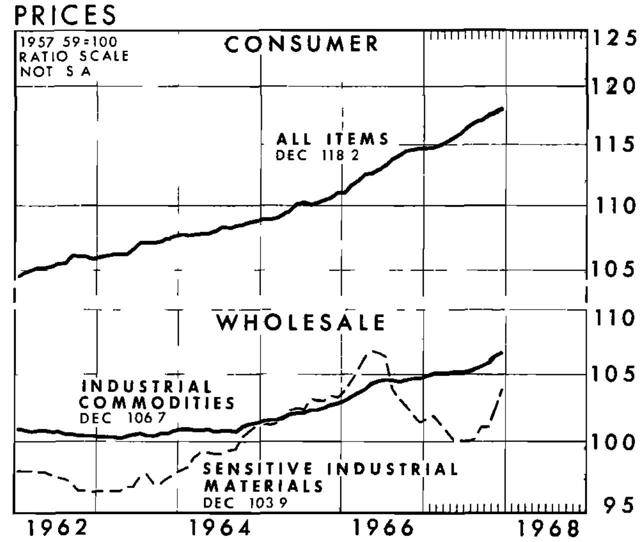
WORKWEEK AND LABOR COST IN MFG



INDUSTRIAL PRODUCTION-II



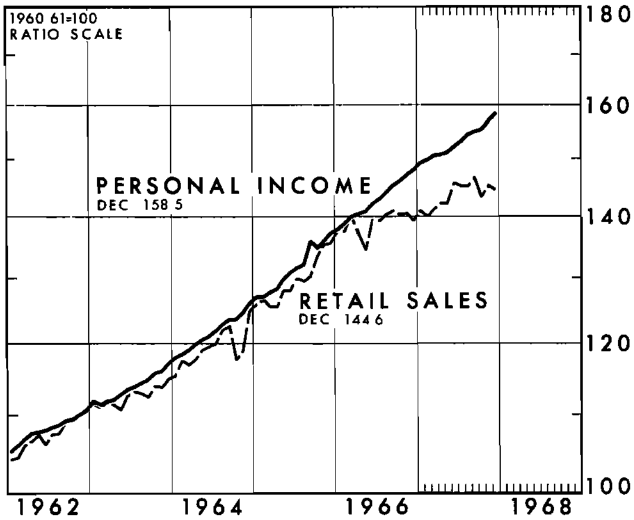
PRICES



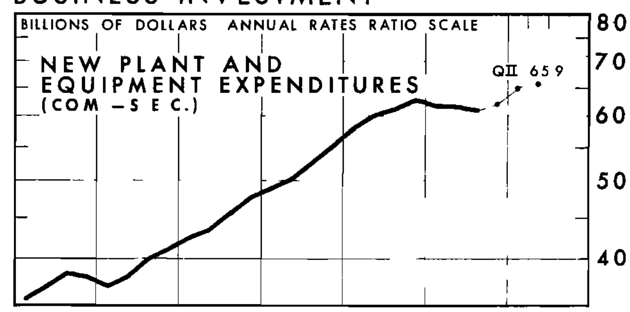
ECONOMIC DEVELOPMENTS - UNITED STATES

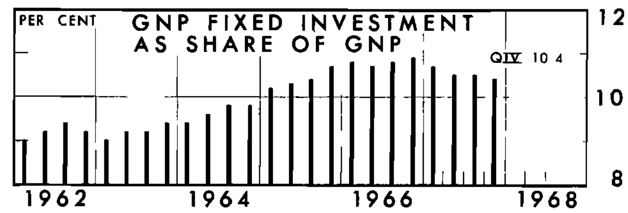
SEASONALLY ADJUSTFD

INCOME AND SALES

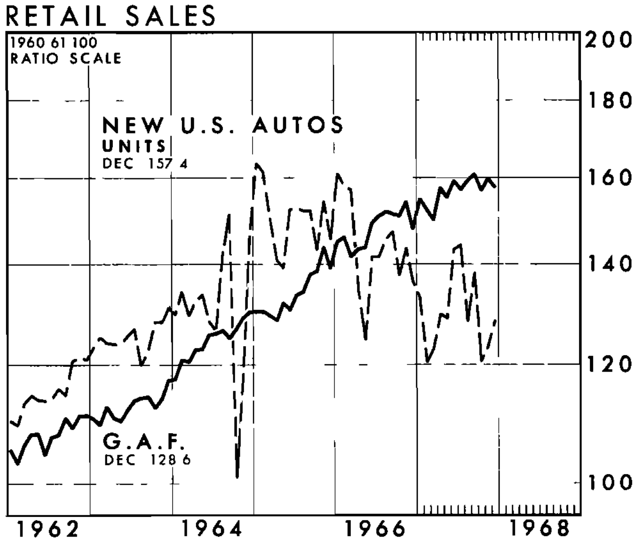


BUSINESS INVESTMENT

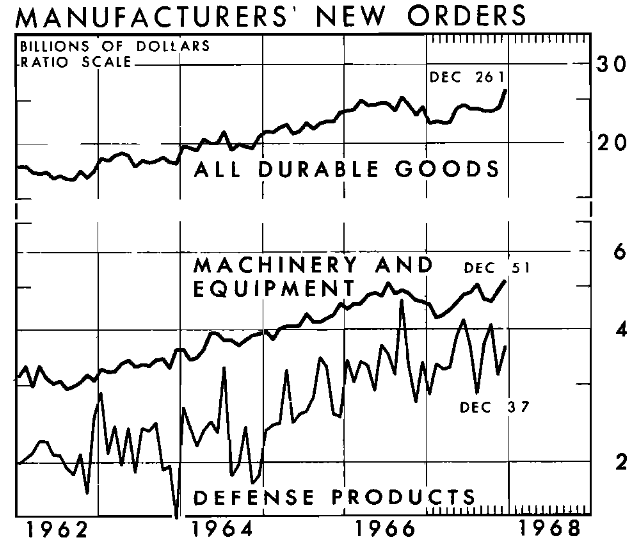




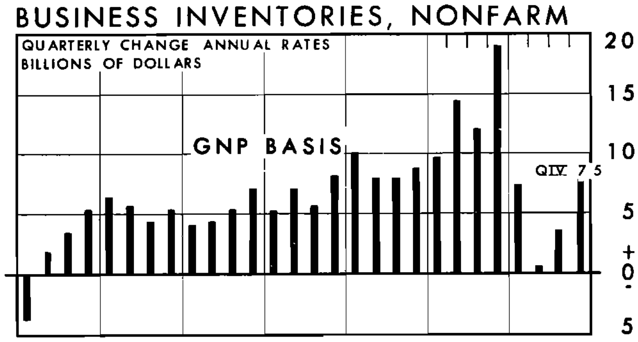
RETAIL SALES

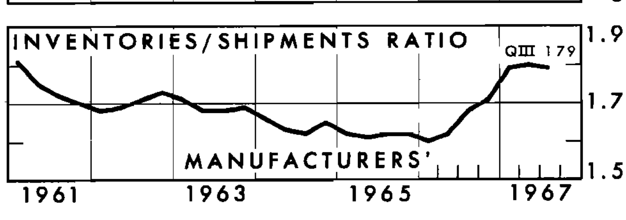


MANUFACTURERS' NEW ORDERS

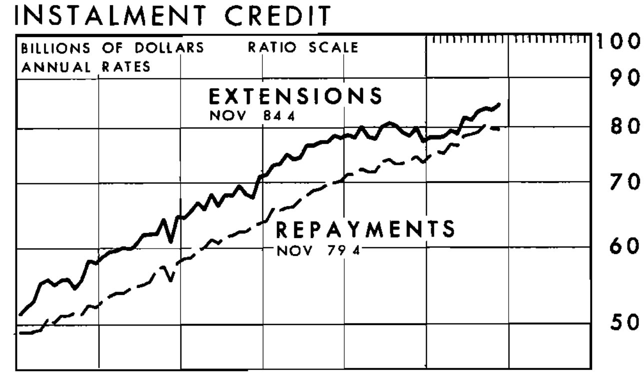


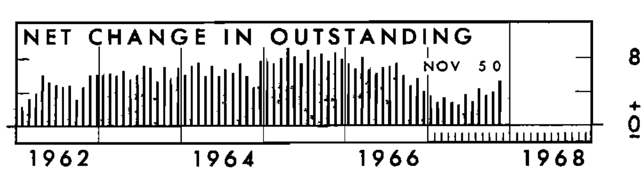
BUSINESS INVENTORIES, NONFARM





INSTALMENT CREDIT





DOMESTIC FINANCIAL SITUATION

Federal Budget. The President's new budget[1/] projects the following figures in terms of the new unified budget concepts:

NEW UNIFIED BUDGET
(In billions of dollars)

	Fiscal years		
	1967 actual	1968 estimated	1969 estimated
Receipts	149.6	155.8	178.1
Outlays (including net lending)	158.4	175.6	186.1
Budget surplus (+) or deficit (-)	-8.8	-19.8	-8.0

As indicated in the second table, receipts rise by $6.2 billion in fiscal year 1968 and by $22.3 billion in fiscal year 1969. These include the effect of 10 per cent tax surcharge recommended for individuals, beginning April 1, 1968, and for corporations retroactive to January 1, 1968. Also a further acceleration of corporate income tax payments is requested. These legislative changes account for $2.7 billion of the increase in receipts in fiscal year 1968 and $10.2 billion in fiscal year 1969. In addition to these higher rates of taxation, the President is requesting a continuation of the present excise tax rates on automobiles and telephone service.

1/ The new concepts are compared with the old budgets in Appendix A. More detailed data on the new budget are also given in that Appendix.

The economic assumptions underlying the new budget are a rise in GNP of $61 billion to a level of $846 billion in calendar year

INCREASES IN BUDGET RECEIPTS
(In billions of dollars)

	Fiscal Year	
	1968	1969
Receipts	6.2	22.3
Surcharge and acceleration of corporate taxes	2.7	7.5
Present income tax rates, but with same economic assumptions 1/	3.5	14.8

1/ Assumes the extension of present excise tax rates, now shceduled to drop April 1, 1968. Without this extension receipts would decline by $0.3 billion in FY 1968, and $2.7 billion in FY 1969. Figures allow for existing legislation and the increases in the employment tax yield in FY 1969. The ceiling on taxable earnings was raised in January 1968 and the tax rate is scheduled to increase in January 1969. These legislative changes increase fiscal 1968 revenues by $0.1 billion and fiscal 1969 revenues by about $3.2 billion.

1968 and an increase in corporate profits from $80.1 billion in calender 1967 to $87 billion in calendar 1968.

On the spending side, total Federal outlays are expected to rise by $17.2 billion in fiscal 1968 and $10.4 billion in fiscal 1969. Net lending--which is a component of total outlays--declines by $2.5 billion in fiscal 1969, mainly reflecting a $1.9 billion decline in mortgage acquisitions.

FNMA is expected to reduce its mortgage market support purchases quite sharply in line with proposed legislation to lift the ceiling on interest rates on Government-insured and guaranteed mortgages, and thus to attract a larger private supply of mortgage money. In addition, however, legislation is proposed which will accelerate the transfer of FNMA secondary market operations to private ownership. Such a transfer would, eventually allow complete exclusion of FNMA from the Federal budget in the same way in which the Federal home loan banks and Federal land banks are presently excluded from the new unified budget. Once excluded, FNMA would "not be subject to the constraints of the Federal budget and can raise money in the private capital market to meet mortgage purchase needs."[1/]

INCREASES IN TOTAL BUDGET OUTLAYS
(In billions of dollars)

	Fiscal Years	
	1968	1969
Total outlays	17.2	10.4
Net lending	.6	-2.5
Expenditures excluding net lending	16.6	12.9
Defense	6.4	3.3
Payments from social insurance trust funds	4.0	4.2
Civilian and military pay increase	a/	1.6
All other	6.2	3.8

a/ Pay increases in fiscal 1968 are allocated among various Government programs, but the pay increase in fiscal 1969 is shown as a separate lump sum entry and is not allocated among programs.

1/ The Budget of the United States Government, Fiscal Year 1969, p. 129.

Expenditures other than net lending increase by $16.6 billion in fiscal year 1968 and $12.9 billion in 1969. All major categories of expenditures show smaller increases in 1969 than in 1968, except the social insurance trust funds and expenditures (other than net lending) for housing and community development. Spending in the latter category increases from $0.7 billion to $1.4 billion mainly due to higher expenditures for model cities and urban renewal programs.

In summary, the new unified budget shows a deficit of $19.8 billion in fiscal year 1968 and $8.0 in fiscal year 1969. Allowing for some changes in cash balances and other such items, borrowing from the public is projected at $20.8 and $8.0 billion, respectively. These new borrowing figures include sales of participation certificates to the public, but they exclude the net borrowing by Federal home loan banks and Federal land banks. To allow for the projected net borrowing by these agencies, $1.6 billion needs to be added in the current fiscal year and $2.9 billion in fiscal 1969.

Considering that the Federal Government and government-sponsored agencies have borrowed a total of $20.4 billion in the period from July to December 1967, the remaining total net borrowing needs for January to June 1968 amount to $2.0 billion. Usually, the Government makes net repayments of funds in the first half of the calendar year and, thus, these borrowing requirements represent about $7-1/2 billion on a seasonally adjusted basis. Borrowing requirements would be greater by about $2.7 billion if the recommended tax legislation is delayed.

FEDERAL BORROWING FROM PUBLIC
(In billions of dollars)

	Borrowing (new concept) 1/	Privately-owned Government sponsored corporations	Grand total	Memo: Deficit in cash accounts 2/
Fiscal 1968	20.8	1.6	22.4	21.4
Fiscal 1969	8.0	2.9	10.9	10.9

Half year periods	Grand total: Not seasonally adjusted	Grand total: Seasonally adjusted	Not seasonally adjusted
1965 - I	-2.5	2.6	-7.6
II	6.1	.9	12.8
1966 - I	- .6	4.4	-6.6
II	7.0	2.3	12.9
1967 - I	-8.3	-3.8	-9.9
II	20.4	16.0	21.4
1968 - I p	2.0	7.4	0.0
II p 3/	13.2	7.8	14.3
1969 - I p 3/	-2.3	2.1	-3.4

p - Projected.
1/ Differs from old cash borrowing by including participation certificate borrowing, but excluding borrowing by privately-owned government corporations.
2/ Equals old cash deficit plus allowance for participation certificates. Also equals new cash deficit plus allowance for privately-owned government sponsored corporations.
3/ Allocation by half-years based on FRB projections.

A quarterly pattern for the current fiscal year budget is shown in terms of the NIA accounts by using available data through the fourth quarter of calendar year 1967, the Greenbook's estimates for the first quarter of 1968 and the fiscal year totals in the President's budget. Defense purchases are expected to rise only moderately over the remainder of the current fiscal year, but total Government spending increases by $10 billion from the fourth quarter of 1967 to the second quarter of 1968, partly due to the $3.6 billion rise in social security benefits beginning in March. Without the new

FEDERAL EXPENDITURES, REVENUES AND DEFICITS, NIA ACCOUNTS
(In billions of dollars, seasonally adjusted annual rates)

	Quarters				Fiscal years	
	1967		1968			
	III	IV	I	II	1968	1969
Purchases						
Defense	73.3	74.3	75.0	75.3	74.4	78.8
Nondefense	17.6	17.7	18.5	19.6	18.4	20.6
Other expenditures	75.0	75.5	78.2	83.4	78.3	85.6
Total expenditures	165.9	167.5	171.7	178.3	171.1	185.0
Total revenues 1/	152.8	156.2	161.1	174.7	161.1	182.5
Deficit 1/	13.2	11.3	10.6	3.6	10.0	2.5
Requested surcharge included in revenues: 1/						
Personal	--	--	--	6.2	1.6	7.0
Corporate	--	--	--	3.4	1.7	2.5

1/ Seasonally adjusted quarters do not add to fiscal year totals. If retroactive corporate surtax is enacted, corporate profit tax accruals for first quarter 1968 would be revised upward by $3.4 billion and deficit reduced correspondingly.

surcharge taxes, the NIA deficit would rise from an annual rate of $11.3 billion in the fourth quarter of 1967 to $13 billion in the second quarter of 1968. If the surcharges were enacted, however, the seasonally-adjusted deficit would amount to about $3-1/2 billion at an annual rate in the second quarter of 1968.

U.S. Government securities market. Yields on intermediate and long-term Treasury obligations declined sharply during the first two weeks of January, but subsequent increases have erased part of these declines. Currently, these yields remain well below their 1967 highs established around mid-November. Most Treasury bill rates have also fallen substantially in January, most notably on the longer maturities as the table shows.

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

	1967			1968	
	Low	High	Dec. 29	Jan. 12	Jan. 30
Bills					
1-month	3.25 (6/5)	4.75 (1/4)	4.60	4.75	4.77
3-months	3.33 (6/23)	5.07 (12/15)	5.04	5.08	4.87
6-months	3.71 (5/22)	5.60 (12/1)	5.54	5.24	4.99
1-year	3.80 (4/24)	5.71 (12/29)	5.71	5.23	5.24
Coupons					
3-years	4.27 (4/10)	5.87 (11/13)	5.80	5.44	5.50
5-years	4.38 (4/10)	5.91 (11/13)	5.78	5.42	5.55
10-years	4.45 (3/20)	5.87 (11/13)	5.71	5.43	5.54
20-years	4.44 (1/16)	5.81 (11/20)	5.56	5.29	5.38

The sizable rally in the Treasury bond prices during the first two weeks of January, which was triggered by announcement of the new balance of payments program and by rumors of possible peace negotiations in Vietnam, ran its course by mid-month. Even so, the market appeared to retain an underlying firmness, as it subsequently weathered--with relatively modest upward yield adjustments--a number of adverse developments, including deferral by Congress for later consideration of the President's tax increase proposal and increased tension in the Far East. Contributing to this market performance was a spreading conviction that monetary policy was not likely to tighten further in coming weeks during which the Treasury would be engaged in sizable financing operations. In addition, System purchases of coupon issues at mid-month, totaling $78 million, helped to reduce dealer inventories to relatively low levels, and subsequently a modest volume of net investor demand met with apparent dealer reluctance to reduce their positions further. In late January, dealers as a group had net short positions of about $40 million in bonds due after 5 years and net long positions of around $90 million in 1-5 year issues.

The decline in bill rates during January occurred against a background of reportedly good investor demand for all types of short-term market instruments and despite the auction by the Treasury of $2.5 billion of additional June tax bills on January 9. Dealers, continuing to find a ready availability of financing, tended to resist a decline in their inventories by bidding aggressively for new bills in the auctions and at times for outstanding bills in the market. As has been true in other recent years, the System was not a very important factor in the dealer market during January. The reserve requirement increase effective around mid-month led, however, to a reduced need to absorb reserves through open market operations.

Yields also declined substantially in January on short-term market instruments other than bills, as the following table indicates:

SELECTED SHORT-TERM RATES

	1966 High	1967 Low	1967 High	1967 Dec. 29	1968 Jan. 30
1-month					
CD's (prime NYC)					
Highest quoted new issue	5.50 (12/31)	4.25 (5/10)	5.50 (12/29)	5.50	4.88
Secondary market	5.75 (9/28)	4.30 (4/26)	5.45 (1/18)	5.40	4.90
3-months					
Bankers' acceptances	5.75 (10/25)	4.25 (6/6)	5.63 (12/29)	5.63	5.13
Federal agencies	5.76 (9/21)	3.82 (5/26)	5.30 (12/29)	5.30	5.15*
Finance paper	5.88 (12/31)	4.25 (5/24)	5.88 (1/6)	5.50	5.25
CD's (prime NYC)					
Highest quoted new issue	5.50 (12/31)	4.25 (4/19)	5.50 (12/29)	5.50	5.25
Secondary market	5.90 (9/21)	4.35 (4/28)	5.70 (12/29)	5.70	5.20
6-months					
Bankers' acceptances	6.00 (9/23)	4.38 (6/16)	5.88 (12/29)	5.88	5.25
Commercial paper	6.00 (12/31)	4.63 (6/26)	6.00 (1/16)	5.63	5.50
Federal agencies	6.04 (9/21)	4.11 (5/19)	5.55 (12/29)	5.55	5.40*
CD's (prime NYC)					
Highest quoted new issue	5.50 (12/31)	4.25 (4/21)	5.50 (12/29)	5.50	5.50
Secondary market	6.30 (9/28)	4.35 (4/14)	6.00 (12/29)	6.00	5.40
1-year					
Federal agencies	6.13 (9/23)	4.18 (4/7)	5.95 (12/29)	5.95	5.70*
Prime municipals	4.25 (9/21)	2.40 (4/14)	4.00 (12/29)	4.00	3.40*

N.B. - Latest dates on which high or low rates occuared are indicated in parentheses.
* - Rates on January 26.

Treasury finance. The Treasury will announce on January 31 the terms of its February refunding involving a relatively small $1.7 billion of publicly-held maturing securities. Within the next several weeks, the Treasury will also need to raise a sizable amount of new cash, possibly as much as $4 billion or so. Some market observers expect that a portion of this cash will be raised in conjunction with the February refunding and the balance in March.

Bank credit. Commercial bank credit expanded at a fairly rapid pace in January, following a marked slackening in late 1967. The bank credit proxy, on a daily average basis, is projected to increase at about a 9 per cent annual rate over the month, compared with a 4 per cent average in November and December. A substantial part of the advance was associated with loan expansion early in the month, but the Treasury cash financing at mid-month and increased availability of CD funds also were contributory factors.

NET CHANGE IN BANK CREDIT
(Annual rate, per cent)

	1967	1st Half	July-October	November-December	1968 January
Total loans and investments	11.0	9.9	15.7	3.2	11.1
U.S. Government securities	11.7	6.3	37.4	-22.2	-12.0
Other securities	24.0	31.2	12.3	18.4	17.9
Loans	7.8	5.9	11.1	6.0	15.5
Business loans	9.3	10.9	5.1	11.4	8.4

As measured by the end-of-month series, preliminary estimates indicate that total credit may have increased at an 11 per cent annual rate in January. Notwithstanding the $2.5 billion tax bill financing at mid-month with full Tax and Loan Account credit privilege, bank holdings of U.S. Government securities are expected to show a decline for the month. With investor demand for these securities unusually strong, city banks reduced their holdings of Governments more than seasonally prior to the financing, and in the week following, they made large further reductions--nearly as large as their net acquisitions in the financing week.

On the other hand, holdings of other securities are expected to decline much less than seasonally in January. Although city banks made sizable reductions in their holdings of short-term municipals, these were offset in part by increased acquisitions of longer-term municipals, agency issues, and participation certificates. There are reports that some banks have decided to make 1968 a loss year on securities transactions and have already engaged in a limited amount of portfolio lengthening, thus providing a base for realization of capital gains in future years.

A major part of the loan expansion in January was in business loans, which continued to rise at a rapid pace in early January following a marked pickup in mid-December associated mainly with tax and dividend payments and year-end adjustments. After mid-January, however, the uptrend tapered off, allowing for usual seasonal changes, and in the week ending January 24, business loans declined much more than in the comparable week of any recent year. For the month as a whole, it now appears that the seasonally adjusted increase might amount to about half the large December rise, or little more than the low average monthly rise over the last half of 1967.

Much of the January increase appears to have represented a continuation into early January of heavy year-end borrowing, which occasionally occurrs in certain industry groups, such as mining, petroleum and chemicals and public utilities. There is no clear indication as yet of stepped-up inventory borrowing by the metals-using industries.

Real estate and consumer loans appear to have expanded further in January at the somewhat faster pace that prevailed over the last quarter of 1967. Dealers in U.S. Government securities increased their borrowings sharply in early January as they expanded their trading positions to take advantage of the improving demand and rising prices of these issues, but they reduced positions and paid off a large part of these borrowings later in the month. Broker-dealer loans secured by other than Governments declined more than usual in January, presumably reflecting a reduction in inventories in response to strong investor demand.

Bank deposits. With large amounts of funds seeking investment and market yields declining from their December peaks, inflows of time and savings deposits at commercial banks resumed an upward trend in January after declining in the last half of December. On a monthly average basis, these deposits are expected to show little change from the December level, but from the end of December to the end of January, they are projected to increase at about a 5 per cent annual rate--quite moderate compared to earlier experience.

The major factor in the turnaround was the sizable recovery in negotiable CD's in January after a large decline in the last half of December. In the three weeks ending January 24, outstanding CD's rose $800 million, offsetting about four-fifths of the previous run-off. Nearly all the January inflow was in IPC deposits at banks outside New York City. In view of the January decline in short-term yields generally, some prime banks reduced their offering rates on the shortest maturities of CD's to around 4-3/4 per cent near the end of the month, and they were able to attract funds in the 5-6 month maturity range or longer at the 5-1/2 per cent ceiling.

Along with easing in our money markets, rates on Euro-dollar deposits declined substantially in early January from their relatively high levels in late December. As a result, banks moved promptly to recover their year-end losses of these deposits. By late January, liabilities of U.S. banks to foreign branches were above the December high.

NET CHANGE IN TIME AND SAVINGS DEPOSITS AT COMMERCIAL BANKS
(Millions of dollars, end-of-month basis)

	December		January	
	1966	1967	1967	1968
All commercial banks, seasonally adjusted				
Total	1,809	108	2,876	814
Total--excluding CD's (est.)	1,659	908	676	464
Weekly reporting banks, not seasonally adjusted 1/				
Total time & savings deps.	1,112	-160	2,906	1,046
Consumer-type deposits, Total	373	311	662	455
Savings deposits	175	114	-693	-246
Time deposits, IPC (other than CD's)	198	197	1,355	701
CD's	161	-801	2,214	565

1/ Weekly reporting bank data for January 1968 cover 4 weeks ending January 24. Data for January in both years include interest credited between last Wednesday of December and year end.

Meanwhile, inflows of time and savings deposits other than CD's appear to have declined further in January from their reduced December pace. While many commercial banks had expected substantial deposit attrition immediately following December interest crediting, outflows, by and large, did not materialize in the volume feared. Regular savings deposits, which had shown little growth in late 1967, declined in early January, but part of this decline apparently represented transfers into savings certificates and new consumer-type open account deposits. Increased bank advertising for consumer-type deposits in January no doubt contributed to the generally satisfactory behavior of these deposits over the month

The money stock, which had been drifting downward since early November, rose sharply in late December and early January, but in late January, it declined from its mid-month peak. Although the daily average for January is projected to rise at a 10-1/2 per cent annual rate, the level in late January is expected to show little change from that in late December. Most of the earlier increase appears to have been associated with the sharp rise in business and security loans in late December and early January. The public's sluggish readjustment of cash balances following the recent surge may have been due in part to increased uncertainty generated by the balance of payments program, peace talk, and a number of other unanticipated developments.

Nonbank depositary institutions. Preliminary data suggest that inflows to mutual savings banks and savings and loan associations moderated further in December and January from the already reduced pace earlier last fall. Although both institutions experienced this slowdown in net inflows, in December the deceleration at mutual savings banks was relatively larger than at savings and loans. The December experience at mutuals was apparently a reflection of large withdrawals during the 3-day grace period at the end of December at New York City savings banks, which are thought to have particularly interest-sensitive depositors. The difficulty that such institutions have in holding deposits during a period of relatively high market rates is compounded by the fact that mutuals, unlike savings and loans, are prevented from offering special accounts above the current passbook ceiling of 5 per cent.

NONBANK DEPOSITARY INSTITUTIONS: NET NEW MONEY 1/
(Millions of dollars, not seasonally adjusted)

	Mutual Savings Banks			Savings and Loan Associations 2/		
	1966	1967	1968	1966	1967	1968
October	10	94	--	-81	454	--
November	216	273	--	584	552	--
December	103	-10 to 10 3/	--	272	157 1/	--
January	144	331	150-250 3/	-65	290	0-100 3/

1/ Net new money is gross deposits net of both withdrawals and interest credited.
2/ Insured S&L's only; represents 96 per cent of all S&Ls.
3/ Estimate based upon incomplete data.

During the critical December-January reinvestment period, preliminary data suggest that at both institutions net withdrawals were not as large as during the similar 1965-66 period. Consequently, on the basis of this fragmentary evidence and impressions from industry sources, the staff is estimating that both institutions may have done somewhat better for the full month of January this year than in January 1966--the first month of sharply reduced inflows in 1966.

Undoubtedly, most of the reduced inflows since the fall have reflected the attraction of market instruments--especially Treasury securities. Moreover, underwriters have recently reported an increase in the number of relatively small orders for corporate bonds. But, despite the somewhat larger public purchases of market securities, several factors probably account for a reinvestment period experience better than many observers had expected in light of the level of market yields. Probably the most important factor accounting for the relative strength of net inflows was the existence of rate ceilings that limited the ability of commercial banks to attract funds from nonbank institutions. Staff studies suggest that nonbank institution claims are particularly sensitive to rates paid on consumer-type time certificates at commercial banks. With the latter rates now constrained by regulation, only limited incentive exists to make shifts from nonbank to bank claims. In addition, as suggested by a recent study of the FHLBB[1/],

1/ Federal Home Loan Bank Board "Dividend Rates and the Structure of Savings Accounts--member S&L Associations, July 1967". The principal results of this survey were that in July, average offering rates declined, primarily as a result of rate ceiling reductions in 10 States; that non-rate terms on special accounts became somewhat less liberal; and that growth in special accounts during the first half of 1967 accounted for three-fourths of total growth in savings capital at S&Ls.

minimum-term accounts--available at yields above the passbook rate--have become an increasingly important source of nonbank funds. Finally, although it cannot be demonstrated empirically, it is likely that some of the more sophisticated depositors removing balances in 1966 did not return to nonbank institutions in 1967, instead acquiring other financial assets such as equities and longer-term debt instruments.

With net inflows moderating in the fourth quarter, and with previously made mortgage commitments maturing, mutual savings banks sharply reduced their acquisitions of corporate bonds from the unprecedented high level of the first nine months of the year. At savings and loan associations, the slower growth in share capital in the fourth quarter was primarily reflected in the ending of loan repayments to the FHLBB and a quite large increase in "other borrowings"--mainly short-term bank loans. Most of this latter borrowing was made in December and probably reflects their preparation for potential withdrawals; currently, savings and loan associations are discouraged from borrowing from the FHLBB in anticipation of withdrawals. In addition to adjusting their liability structure, there was a slowdown in the growth of outstanding mortgage commitments by savings and loan associations in the fourth quarter.

Mortgage market developments. While flows to depositary institutions in the recent reinvestment period seem to have been stronger than lenders generally had expected, growth in mortgage commitments outstanding was moderated in December. Moreover, yields on home-mortgages were raised further, for both conventional and FHA-insured mortgages, as shown in the table.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary Markets Conventional loans		Secondary Market: FHA-insured loans		
	Level (per cent)	Change (Basis points)	Level (Per cent)	Change (Basis points)	Discount (Points)
1967					
April	6.40	- 5	6.29	- 6	2.5
May	6.45	5	6.44	15	3.8
June	6.50	5	6.51	7	4.4
July	6.50	0	6.53	2	4.6
August	6.55	5	6.60	7	5.2
September	6.55	0	6.63	3	5.4
October	6.55	0	6.65	2	5.6
November	6.65	10	6.77	12	6.5
December	6.70	5	6.81	4	6.8

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.

The further increases in December carried mortgage yields back to their peaks in November 1966 and were associated with a return of average discounts required by lenders to a record 6.8 points in the case of the FHA-yield series and with upward adjustment in discounts for conventional loans in states with low usury ceilings as well. Even so, the gross yield spread between FHA-insured mortgages and new corporate bonds remained unusually narrow, at about 30 basis points. And although further improvement in the yield-spread was indicated in January as bond yields receded, the possibility of some additional upward adjustment in mortgage yields and related discounts over the period ahead can not be ruled out.

The return to record yield requirements by lenders in December was apparently accompanied, however, by somewhat more liberal terms for qualified borrowers. In the case of conventional loans for new homes, average maturities were lengthened a half-year to 24.8 years with some increase also for comparable loans for existing homes, to 21.7 years, according to the Federal Home Loan Bank Board. Also, although loan-to-price ratios changed little, average prices of homes involved in transactions generally tended higher and loan amounts remained at or above already advanced levels.

Reflecting the substantial momentum regained by real estate markets in 1967, the volume of mortgage debt outstanding continued upward contraseasonally in the fourth quarter to a year-end level currently estimated at $369 billion, as shown in the table. The fourth-quarter increases for some of the lender groups with the broadest investment options--notably the mutual savings banks and life insurance companies--apparently fell far short of net acquisitions in comparable periods of most other recent years. However, the increase for the dominant savings and loan associations was one of the largest on record. And exceptionally large support from the Federal National Mortgage Association--only slightly less than in the first quarter of 1966--helped raise the net increase for all holders to about the levels prevailing in 1964 and 1965.

MORTGAGE DEBT OUTSTANDING BY TYPE OF HOLDER
(Billions of dollars, without seasonal adjustment)

	Amount	Increase in fourth quarter of			
	Dec. 1967p	1964	1965	1966	1967p
All holders	369.1	6.7	6.8	3.8	6.7
Financial institutions	298.3	6.2	5.9	2.6	5.3
Commercial banks	58.2	1.0	1.3	.8	1.2
Mutual savings banks	50.4	1.2	1.1	.7	.8
Savings and loan assns.	121.9	2.3	1.9	.1	2.4
Life insurance companies	67.6	1.6	1.6	1.0	1.0
Federal agencies	18.4	.1	.5	.6	1.0
FNMA	8.9	--	.4	.5	.8
Individuals and others	52.4	.4	.3	.6	.4

For 1967 as a whole, the net increase in total mortgage debt is estimated at $22.0 billion. This compares with $20.6 billion in 1966, and with a record $26.2 billion in 1965.

While the net increase in mortgage debt on 1- to 4-family properties averaged only about $12 billion, it accounted for more than half of the total increase. Moreover, once started, 1- to 4-family mortgage debt moved persistently upward through the year, as shown in the table on a seasonally adjusted basis. In fact, by the fourth quarter, the annual rate of net increase in such debt had apparently returned to the $15-$16 billion range which had prevailed in 1963-65. Debt increases for income properties were also back to relatively high rates by the fourth quarter.

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

	Total	1-4 family	Multifamily & Commercial 1/	Farm 1/
1965 IV	26.2	16.1	7.8	2.2
1966 IVp	20.6	10.0	8.5	2.1
1967 I p	17.2	7.6	8.1	1.4
II p	20.2	10.1	8.5	1.6
III p	23.5	13.9	7.8	1.9
IV p	26.5	15.8	8.6	2.1

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

Corporate and municipal bond markets. For the past several weeks, yields on corporate and municipal bonds have declined substantially from their highs reached early in December. In the last week of January, however, the yield decline moderated and, in some cases, yields edged up. In the corporate market, particularly, investor response accorded new issues at the reduced yield levels of early and mid-January lacked enthusiasm. This is partly reflected by the three utility issues that--in the latter part of the month--were released from underwriters' syndicate restrictions with subsequent upward yield adjustments ranging from 9 to 14 basis points.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa New	Corporate Aaa Seasoned	State and local Government S&P High Grade	State and local Government Bond Buyer's (mixed qualities)
	With call protection			
1966				
Late summer high	5.98*	5.44	4.26	4.24
1967				
Low - late Jan.- early Feb.	5.03	5.00	3.43	3.40
High - December	6.55*	6.24	4.51	4.45
1968				
Weeks ending:				
January 5	6.32	6.24	4.46	4.38
12	6.18*	6.20	4.35	4.27
19	6.16	6.14	4.34	4.25
26	6.27*	6.12	4.30	4.25

* - Some issues included carry 10-year call protection.

Several factors seem to have played a role in the sharp yield decline and subsequent upward tendencies evident in the new issue market. The yield decline coincided with the typical year-end abatement of new issue activity and the usual greater fund availability at major institutional investors during the turn-of-the-year period. These purely seasonal factors were probably augmented by the growing belief among market participants that the level of yields prevailing in early December were unlikely to be exceeded, as impressions strengthened that new issue demand in the public markets would be reduced from the record set in 1967. But aggressive bidding by underwriters on an increasing number of new utility issues subsequently met with significant investor resistance and resulted in a rising inventory of unsold bonds.

Despite the buildup in new issues as the month progressed, the volume of publicly-offered corporate bonds in January, which is expected to total about $900 million, is significantly below the nearly $1.3 billion monthly average for such issues during 1967. This volume is still unusually large, however, and in fact is a record for any January. With privately placed bonds estimated at $700 million for January, total bonds and stock offerings are estimated to aggregate about $1.8 billion, somewhat above that registered in January 1967. The recent pickup in privately placed issues reflects the increase throughout last year in life insurance company commitments for later takedown.

Looking ahead, the forward calendar of scheduled public bond offerings has not appreciably built up in recent weeks, and the February volume now scheduled totals only about $600 million. While further additions to the calendar are anticipated, the ultimate volume may not be more than $850 million. This would place February offerings below January as well as below the corresponding month a year earlier. This relative drop-off in expected volume is principally accounted for by the decline in announcements of new industrial offerings, noted in the last Greenbook. The February calendar to date consists largely of utility bond issues.

Total bond financing will most likely not show the decline in February, however, as private placements expand reflecting takedown from previously made commitments with institutional investors.

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

	Bonds					
	Public Offerings[2/]		Private Placements		Total bonds and stocks	
	1966	1967	1966	1967	1966	1967
Annual Total	8,018	14,954e	7,543	6.950e	18,075	24,743e
November	569	645	435	543	1,115	1,493
December	980	1,075e	555	1,000e	1,661	2.300e
	1967	1968	1967	1968	1967	1968
January	745	900e	848	700e	1,684	1,800e
February	900	850e	362	700e	1,418	1,775e

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

In the municipal market, the January volume of new bond offerings again exceeded the $1 billion mark and approximated the $1.2 billion monthly average for such issues over the past year. The strength of bank demand for municipals was apparently an important factor in the absorption of this volume of issues at declining yields. This is particularly the case for the two outsized issues which dominated the January calendar--the State of California ($100 million) and New York City ($114 million) bond offerings. In both cases, commercial banks associated with the underwriting of these issues reportedly took sizable amounts for their own portfolios.

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

	1966	1967
Annual Total	11,405	14,487
November	976	1,423
December	940	1,061
	1967	1968
January	1,487	1,150e
February	1,229	1,100e

1/ Data are for principal amounts of new issues.

The volume of new municipal bond issues estimated for February--at $1.1 billion--will be only slightly below January. It should be noted that this estimate does not allow for any substantial bulge in industrial revenue offerings, which in part accounted for the increased total volume of municipal issues late last year. Current prospects for passage of prohibitive legislation dealing with industrial bonds appear remote in this session of Congress but the Treasury's proposal to make such legislation retroactive to December 31, 1967 should tend to restrain more issues of such bonds. Any change in legislative proposals might again lead to a rush of issuers to market their bonds before such legislation becomes effective.

Stock market. After fluctuating around a relatively flat trend throughout the first half of December, equity prices--as indicated by the broadly based Standard & Poor's composite index--advanced 2.2 per cent between mid-December and mid-January. During the latter half of January, however, the composite index showed a rather sharp decline that more than erased this most recent advance. As indicated in the table, the decline began earliest and was sharpest among the higher quality issues--as reflected in the Dow-Jones Industrial average--but was subsequently reinforced by an abrupt retreat of lower quality issues.

SELECTED STOCK PRICE INDEXES

	S&P Composite	D-J Industrials	AMEX
1966 Low	73.20 (10/7)	744.32 (10/7)	12.07 (10/7)
1967 High	97.59 (9/25)	943.08 (9/25)	24.52 (12/29)
December 19	94.63 (12/19)	881.36 (12/19)	23.99 (12/19)
Recent High	96.72 (1/12)	908.92 (1/8)	25.73 (1/18)
Recent Low	92.89 (1/30)	859.57 (1/30)	24.77 (1/30)

The continued acceleration in the volume of stock market trading-- and its attendant back-office bottlenecks--led officials of the major exchanges to shorten trading hours by 90 minutes, effective January 22 and to continue for the indefinite future. While this action succeeded in reducing volume from the record highs reached earlier in January, with continued interest in equities, trading volume during the first week of the new regulation still remained larger than the exceptionally high volume of last fall--particularly on the American Exchange, where volume has increased relatively more rapidly than on the New York Exchange.

AVERAGE DAILY TRADING VOLUME

MONTH	NYSE	AMEX	AMEX as a Per cent of NYSE
August	9.0	4.4	49%
September	10.3	5.2	50
October	10.2	5.9	58
November	10.6	4.5	42
December	11.5	5.6	49
Week ending:			
January 5	12.3	7.0	57
12	13.2	7.6	58
19	12.8	9.3	73
26	10.9	6.3	58

At the same time that trading hours were shortened, officials of the American Exchange--where stock price growth has been about three times as great, since the October 1966 low, as that of NYSE stock prices--admonished member firms to discourage speculative trading by their customers. Along with the New York Stock Exchange, they also increased further to record levels the number of issues on which 100 per cent margin requirements were imposed. The publicity of all these actions might have contributed to recent declines in stock prices, but general uncertainties regarding public policies and international developments may also have been important factors.

NUMBER OF ISSUES ON WHICH 100 PER CENT
MARGIN REQUIREMENTS HAVE BEEN PLACED

	NYSE	AMEX
Date		
Mid-November	12	11
Mid-December	19	26
End of 1967	39	30
January 30	42	38

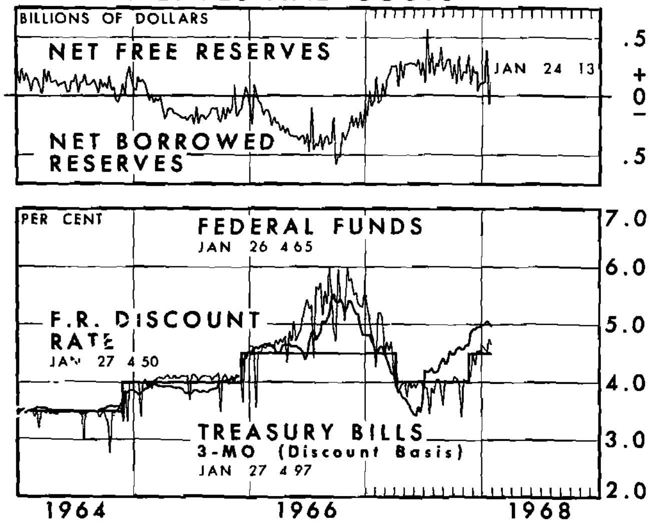
NB - Only one issue per company is counted.

Stock market credit increased \$242 million to a record high of \$8,774 million in December. While bank loans to non-brokers rose only \$22 million, the margin debt component increased \$220 million[1/]--the largest monthly increase since September. The distribution of accounts by equity status, however, was little changed during the month, with the proportion with equity under 40 per cent remaining about 10 per cent of the total. During the month, customers net free credit balances rose by \$263 million to \$2,763 million.

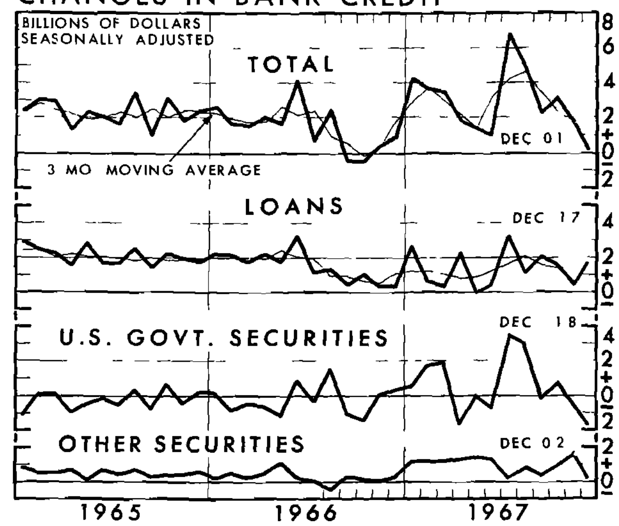
1/ Customers' net debit balances rose by considerably more, but only because of an increase in float resulting from significantly increased trading volume and the slow holiday mail deliveries.

FINANCIAL DEVELOPMENTS - UNITED STATES

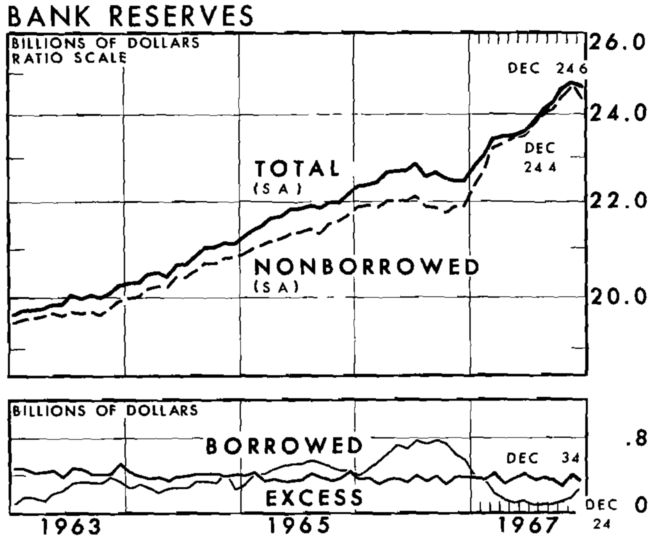
FREE RESERVES AND COSTS



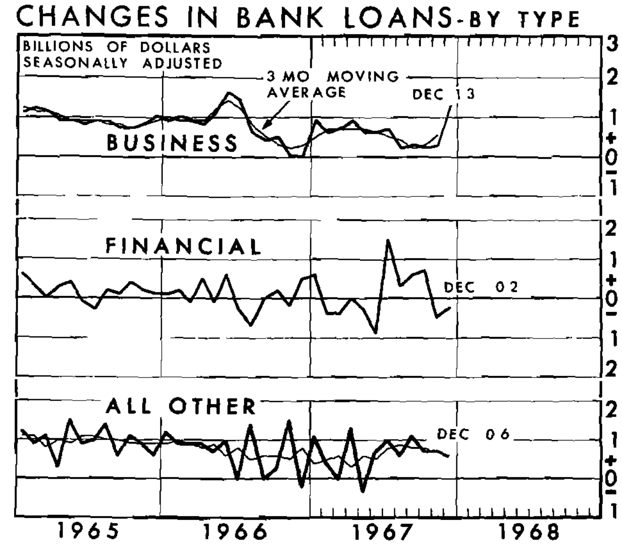
CHANGES IN BANK CREDIT



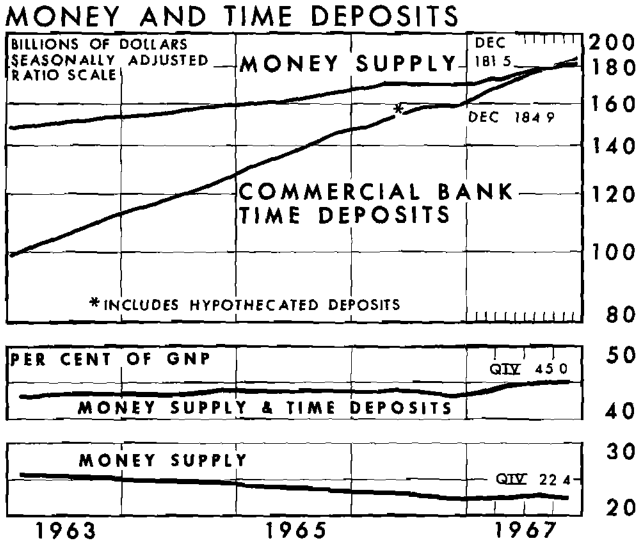
BANK RESERVES



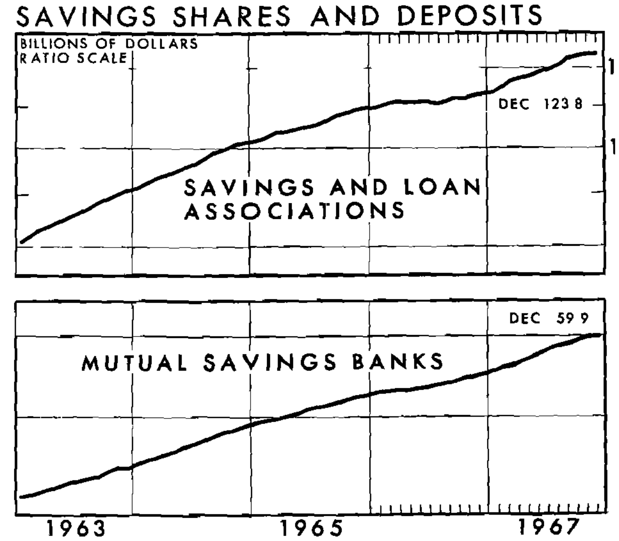
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

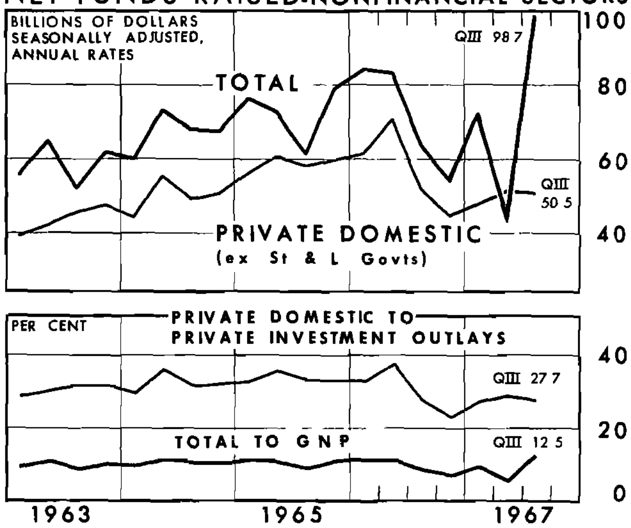


SAVINGS SHARES AND DEPOSITS

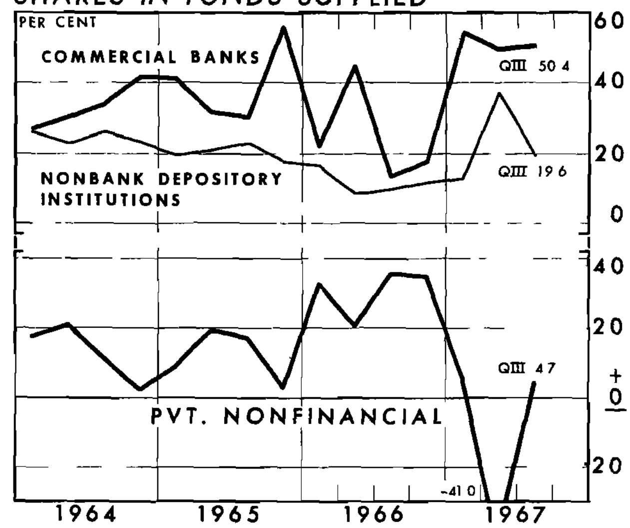


FINANCIAL DEVELOPMENTS - UNITED STATES

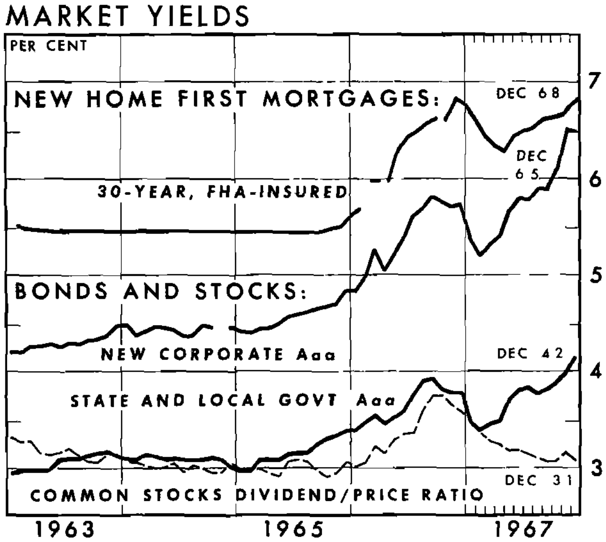
NET FUNDS RAISED-NONFINANCIAL SECTORS



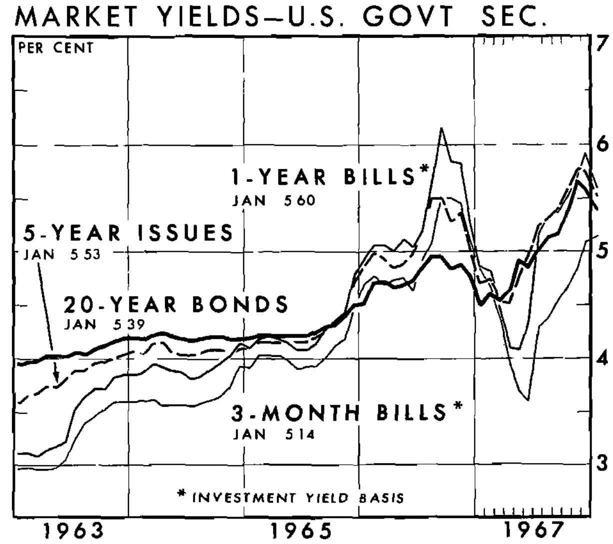
SHARES IN FUNDS SUPPLIED



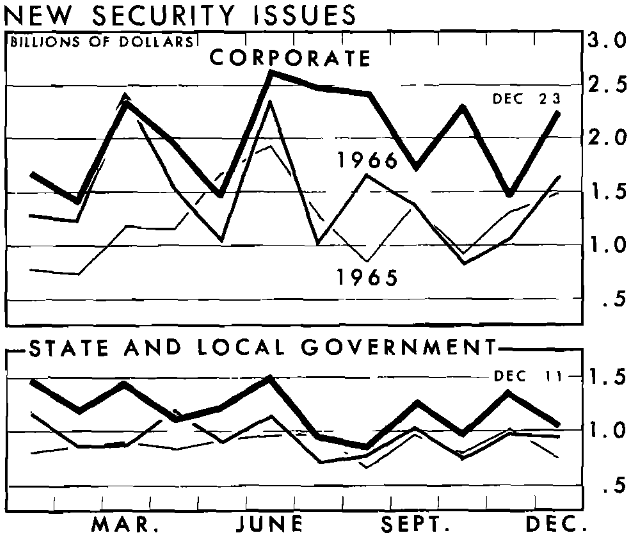
MARKET YIELDS



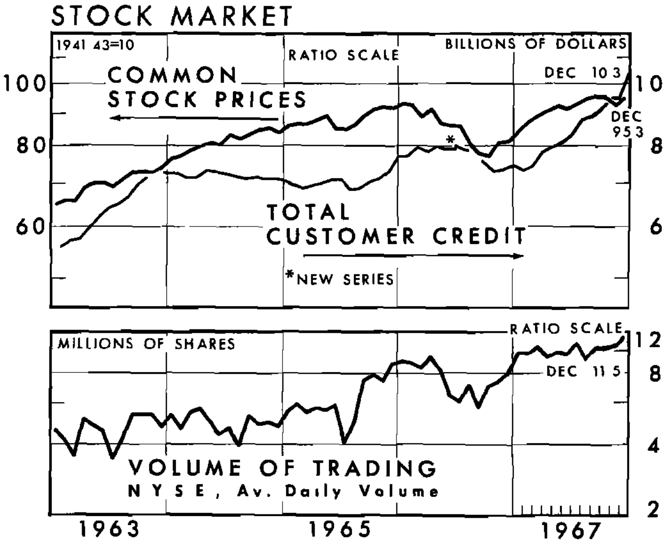
MARKET YIELDS—U.S. GOVT SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. The liquidity deficit in the fourth quarter of last year was about $1.9 billion, seasonally adjusted, slightly less than the earlier estimate. For the year the deficit was $3.6 billion. When adjusted to eliminate special receipts (or, in the fourth quarter, special payments because of the liquidation of the U.K. Government's investment portfolio) these figures become $1.5 billion for the quarter and $4.6 billion for the year. The latter compares with $2.9 billion in 1966.

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

			1967			
	1966	1967	Q-I	Q-II	Q-III	Q-IV
Liquidity deficit (-)						
Not seasonally adj.	-1,357	-3,565	-238	-222	-1,208	-1,897
Seasonally adjusted			-529	-547	-636	-1,853
Liquidity deficit before special transactions Seasonally adj. 1/	-2,942	-4,643	-903	-1,304	-845	-1,591
Official reserve trans. balance						
Not seasonally adj.	225	-3,372	-1,282	-690	-24	-1,376
Seasonally adjusted			-1,815	-828	470	-1,199
Official reserve trans. balance before special transactions Seasonally adj. 1/	-184	-2,934	-1,824	-910	466	-666

1/ See Appendix B for details of special transactions.

It is now clear that a large part of the deterioration in the liquidity deficit from the third to the fourth quarters -- about $750 million apart from special transactions -- was connected with a drop of about that amount in the merchandise trade surplus. This ominous weakening in the trade accounts is discussed below. Preliminary data on banking claims on foreigners show a sizable increase in December. However, after seasonal adjustments (which may now require some correction because of the distortions brought by the voluntary programs) there was an inflow of bank-reported claims of $100 million in the fourth quarter, whereas in the third quarter there was a seasonally adjusted outflow of $400 million.

There are major elements of the fourth quarter balance of payments that are still unknown -- in particular there will be no information for some time on direct-investment capital flows or income receipts. Nevertheless, given the data on trade and banking claims, it now seems less likely that speculative or other increased outflows of private capital were a large factor in the worsening of the fourth quarter balance. For the year as a whole, however, the total of net unrecorded payments -- changes in which may be a crude indicator of changes in speculative flows -- was probably over $1 billion, compared to an unusually low $300 million in 1966.

Weekly figures for January show a continuation of liquidity deficits, but they are too incomplete and imprecise to permit an evaluation of their significance at this time.

Measured on the official settlements basis, the deficit in the fourth quarter (S.A.) and for the year 1967 were $1.2 billion and $3.4 billion, respectively, about the same as estimated a month ago. Both figures were raised by the final sell-off of U.K. government assets, and would have been $.7 billion and $2.9 billion without such sales.

The large official settlements deficit last year was in striking contrast to the surplus of $225 million registered in 1966 or the $875 million average deficit of 1964-66. A major change from 1966 was in the rate of increase in short-term liabilities to foreign commercial banks. These liabilities -- which include amounts due to foreign branches of U.S. banks -- rose by a phenomenal $2.7 billion in 1966, but in 1967 the increase was much lower at an estimated $1.3 billion. However, the latter amount was still far above the average increase for years before 1966.

Holdings of liquid dollar claims against the U.S. by foreign official accounts increased markedly in 1967; such claims had been reduced by $1.6 billion in 1966 but expanded by $2.1 billion in 1967. During 1967 there was a notable $1.6 billion increase in liabilities under U.S.-initiated swaps, compared to a minor increase in 1966.

CHANGES IN U.S. LIABILITIES TO FOREIGN OFFICIAL ACCOUNTS
(In millions of dollars)

Type of liability	1967 Q-I	1967 Q-II	1967 Q-III	1967 Q-IV	1967 Year	1966
Foreign currency liabilities						
Short-term	--	31	--	60	91	-303
Over 1-year	--	--	125	125	250	-46
U.S.-dollar liabilities						
Deposits and misc.						
Short-term	-100	459	288	1,262	1,909	-1,099
Time deposits over 1-year	304	584	-229	143	802	788
U.S. Govt. bonds and notes						
Marketable	5	52	-6	-3	48	-245
Nonmarketable						
Convertible	--	--	--	--	--	-125
Nonconvertible	-1	-3	197	-30	163	-6
Other U.S. Govt. liabilities	30	-19	24	n.a.	35	66
I.M.F. gold deposit	17	5	--	--	22	177
Total	255	1,109	399	1,557	3,320	-793
Memo item:						
U.S.-initiated swap drawings						
System	-280	370	233	1,173	1,496	145
Treasury	--	--	--	126	126	--

In the early weeks of January the official settlements balance has shown surpluses largely as a counterpart to increases in liabilities to foreign branches of U.S. banks, and also because of sizable increases in accounts of the U.S. agencies of Canadian banks. See page IV-15 below regarding recent Canadian developments.

U.S. foreign trade: In December 1967, the U.S. foreign trade surplus virtually disappeared (balance of payments basis) with exports and imports about equal. Imports spurted to a new high, exceeding the record November total by about 6 per cent. Exports fell back from a relatively high November value to about the third quarter rate. For the entire fourth quarter the trade surplus was at an annual rate of $1.5 billion, approximately one-third of the second and third quarter rates, and was the lowest since the fourth quarter of 1959. The surplus in calendar 1967 was a disappointing $3.6 billion, slightly less than in 1966.

U.S. EXPORTS AND IMPORTS
(billions of dollars)

	1966			1967				
	Year	III	IV	Year e/	I	II	III	IV e/
Agricultural exports	6.9	7.4	7.0	6.4	6.5	6.6	6.5	6.2
Non-agricultural exports	22.5	22.4	23.0	24.6	24.6	24.5	24.6	24.6
Total exports								
Census	29.4	29.8	30.0	31.0	31.1	31.1	31.1	30.8
Balance of payments basis	29.2	29.5	29.6	30.5	30.7	30.9	30.6	30.0
Total imports								
Balance of payments basis	25.5	26.3	26.7	26.9	26.6	26.2	26.2	28.5
Trade balance	3.7	3.2	2.9	3.6	4.1	4.6	4.4	1.5

e/ Estimated.

The decline in the fourth quarter surplus stems principally from the sharp advance in imports. In the fourth quarter of 1967 imports were at an annual rate of $28.5 billion, 9 per cent higher than in the third quarter and about 7 per cent greater than the previous record highs in the fall and winter quarters of 1966-67. The ratio of imports to GNP which had declined somewhat in the preceding two quarters, was also up sharply in the fourth quarter, equaling the previous peak ratio in the third quarter of 1966.

About one-quarter of the increase in imports from the third to the fourth quarter was connected with actual or anticipated domestic strikes in copper and steel, together with larger imports of cars from Canada, probably related to the Ford strike. Also arrivals of petroleum which had been subnormal in the third quarter as the world pattern of petroleum distribution was disrupted by the Middle East war, returned to nearly normal rates in the fourth quarter, with December imports particularly heavy. Crude oil imports for the year 1967, however, fell about $100 million below quota allowances.

The copper strike is now adversely affecting our trade balance by $50 million a month. Imports of refined copper in the fourth quarter totaled nearly $600 million at an annual rate, compared with normal yearly requirements of less than $200 million. The strike has also resulted in reduced exports of refined copper, since domestic refineries have been closed.

Iron and steel were also imported in record amounts during the fourth quarter, partly in response to greater domestic use, but also in anticipation of a steel strike this summer.

Cars from Canada arrived in heavy volume in the fourth quarter as Ford plants here and in Canada attempted to recover some of the production lost during the recent strike. For the year 1967, imports of automotive vehicles from Canada were valued at $1.6 billion, compared with less than $1 billion in 1966 and $250 million in 1965 when the U.S.-Canadian automotive agreement was initiated. Shipments of cars to Canada also increased in 1967, but at a much slower pace. Consequently the export surplus in such trade shrank to about $100 million last year from about $500 and $300 million in 1965 and 1966, respectively.

Imports of cars from sources other than Canada were also greater in the fourth quarter. Sales of these cars accounted for about 11 per cent of total domestic sales in the last half of 1967, a sharp increase from the 8.5 per cent in the first half and the 7.5 per cent in calendar 1966. It appears that some of these imports in the closing months of 1967 were to replenish stocks heavily drawn down last spring and summer.

Other increases in fourth-quarter imports appear to be primarily related to the further strengthening in domestic economic activity. Building materials, textiles and metals other than steel and copper were imported in increased quantitites. In total, imports of industrial materials (including fuels) were about 12.5 per cent of final sales of goods (GNP less services and changes in inventories) in the fourth quarter, the greatest proportion since the third quarter of 1966.

Arrivals of consumer goods other than autos, which had slowed down in the middle quarters of 1967, again resumed their long-run upward trend, and increased slightly their share of total consumer expenditures on goods.

U.S. MERCHANDISE IMPORTS BY PRINCIPAL COMMODITY CATEGORIES
(millions of dollars, seasonally adjusted)

	1966			1967				
	Year	QIII	QIV	Year	QI	QII	QIII	QIV 1/
Total Imports 2/	25,542	6,592	6,661	5/ 26,816	6,688	6,593	6,542	7,102
Foods, bev.	4,499	1,132	1,142	4,610	1,181	1,116	1,141	1,172
Indust. supplies	12,092	3,142	3,061	11,832	3,011	2,898	2,767	3,156
Fuels	2,247	585	567	2,234	572	572	505	585
Building mtls.	789	194	184	757	184	181	188	204
Iron & steel	1,312	390	349	1,431	313	356	358	404
Other	7,744	1,973	1,961	7,410	1,942	1,789	1,716	1,963
Capital equip. 3/	2,151	576	621	2,402	609	571	615	607
Auto. vehicles and parts	1,896	516	586	2,622	571	640	679	732
Canada	915	244	322	1,603	325	410	426	442
Other	981	272	264	1,019	246	230	253	290
Consumer goods 4/	3,912	993	1,008	4,232	1,052	1,038	1,038	1,104
All other	992	233	243	1,227	264	330	302	331

1/ Preliminary. 2/ Census basis. 3/ Mainly machinery.
4/ Excluding food and automotive. 5/ Sum of unadjusted quarters.

Exports in the fourth quarter were at an annual rate of $30.0 billion (balance of payments basis) about 2 per cent below the third-quarter rate. Shipments of nonagricultural products were unchanged but those of agricultural commodities, already below 1966 levels in the first three quarters of 1967, fell further. By area, exports to Canada increased sharply but these were more than offset by declines in shipments to Latin America, Japan and other Asian countries. Exports to Western Europe held at the third quarter rate.

For the year as a whole, exports were about 5 per cent greater than in 1966. Exports of chemicals, machinery (mainly computers and telecommunication and other electrical apparatus), civilian aircraft and automotive vehicles to Canada were particularly strong in 1967.

The U.S. share of world trade in manufactured products showed a slight improvement in the first three quarters of 1967, when the United States accounted for about 20.5 per cent of total world exports of such goods, compared with 20.2 per cent in 1966. The share of the second ranking exporter, Germany, remained about the same, at 19.5 per cent. High levels of Canadian and Japanese imports, in which the United States has a large share, and low levels of imports in some European countries contributed to this result.

<u>Interest rates and monetary conditions abroad</u>. Money market conditions have been very easy during January in Germany and Switzerland. Although rates in the London money market have been steady at a high level ever since the British Bank rate increase at the time of devaluation, the forward exchange discount on sterling is wide and covered yields available to dollar holders moving into local authority deposits are much lower. Given these conditions in the European markets, and given also the general stability of U.S. money market rates during January, it is perhaps not surprising that Euro-dollar rates have fallen off sharply from their abnormally high December levels. Further discussion will be found at page IV-12. This week (January 29-31) the 3-month Euro-dollar rate has gone below 5-1/2 per cent for the first time since last September.

SHORT-TERM INTEREST RATES
(per cent per annum)

	Nov.3 1967	Nov.17	Dec.1	Dec. 15	Jan.19 1968	Jan.26
United States (3-mo. Treas.)	4.56	4.57	4.93	4.98	5.02	4.87
" " (C.D. new issues)	5.25	5.25	5.50	5.50	5.50	5.50
Euro-dollars (3-month)	5.68	5.75	6.62	6.31	5.81	5.63
United Kingdom (3-mo. Treas.)	5.73	6.26	7.33	7.27	7.34	7.34
Germany (3-mo. interbank)	4.19	3.88	3.88	4.13	3.00	3.56
France (Call money)	5.75	4.56	4.62	4.75	5.06	...
Switzerland (3-mo. deposit)	4.00	4.00	4.00	4.00	3.00	...
Canada (3-mo. Treas. bill)	4.82	4.85	5.33	5.69	5.66	6.08

In <u>Germany</u>, the December tightening of the money market was much less noticeable than in other years, and by mid-January interest rates on interbank loans were at their lowest levels since early 1963. Call money stood at 1.50

per cent on January 19 and 90-day loans at 3.00 per cent. Technical factors caused rates to be temporarily higher on January 26.

The Bundesbank has encouraged the easing of rates by curtailing the banks' short-term investment opportunities in two ways. Since early January it has withheld from sale domestic Treasury bills, which ordinarily it stands ready to sell to banks at posted rates. And it has not offered the banks preferential rates of forward cover on short-term Euro-dollar investments, as it did in late November and December.

Nevertheless, in the first half of January the German commercial banks' net assets abroad increased by $800 million, almost twice the December decline. Much of the outflow was in DM-denominated call loans. Directly and indirectly this addition to supplies in international money markets contributed to the easing in Euro-dollar rates. With the 3-month forward premium on the DM at more than 2-3/4 per cent in mid-January and still at about 2-1/4 per cent this week, the covered return to German banks for 3-month Euro-dollars has been quite closely in line with the domestic 3-month interbank rate.

The Bundesbank has been concerned by the fact that interest rates at the long-term end of the market have not declined appreciably further since the spring of 1967, but have remained in the 6-1/2 to 7 per cent range. A major part of the domestic bonds issued in Germany in 1967 was taken by the banks, and the Bundesbank is evidently encouraging bank purchases by keeping short-term money easy.

During the first half of January the government successfully placed DM 300 million of medium-term notes in the market, and another tranche of the same size has just been offered.

The cyclical upswing in German economic activity, which started about the middle of last year, appears to be picking up steam. New domestic orders to industry have risen uninterruptedly since the spring of 1967, and by November they were running 20 per cent above the January 1967 low. Industrial production in November was 6 per cent above the average for the first half of 1967. Import figures give further evidence of the rise in domestic demand; imports in October-November averaged 6-1/2 per cent higher than in the second quarter. Demand was particularly pronounced for raw materials and semi-finished goods. The growth in these categories of imports and the improvement in domestic new orders for intermediate goods suggests that German businesses were already beginning to rebuild depleted inventories.

In Britain, the increase in Bank Rate from 6-1/2 per cent to 8 per cent at the time of devaluation (November 18) was followed immediately by advances of 1 to 1-1/2 percentage points in short-term money market yields. Since then these rates have been fairly stable.

LONDON 90-DAY RATES
(per cent per annum)

	Nov. 17 1967	Nov. 24	Dec. 15	Jan. 19 1968	Jan. 26
Local authority deposits	6.81	7.69	7.81	7.75	7.75
Forward discount	1.64	.99	4.72	2.72	2.99
Covered yield	5.17	6.70	3.09	5.03	4.76
Euro-dollar deposits	5.75	6.75	6.31	5.81	5.63
Covered differential in favor local auth.	- .58	- .05	-3.22	- .78	- .87

There is little evidence, direct or indirect, of any substantial net movements of short-term funds either into or out of sterling balances and short-term investments since mid-December. Large forward discounts on sterling reflected lack of market confidence in the new parity of the pound -- and also the absence of official intervention in the forward market. For banks in London switches of covered investments into sterling were thus unattractive. Meanwhile exchange controls prevented any substantial covered switching in the other direction. Nor does there seem to have been any further flight from sterling. There appears to have been substantial liquidation of outstanding forward exchange contracts in the latter half of January.

The cutbacks in planned spending of the government announced on January 16 (see page IV-17 below and Appendix C) were viewed in the financial community as less deflationary than had been anticipated, and perhaps inadequate. At any rate, stock prices rose and bond prices declined. Long-term bond yields on January 19 and January 26 were close to mid-December high levels -- at 7.20 per cent in the case of 3-1/2 per cent War Loan. In the exchange market, however, spot sterling has held close to $2.41.

Euro-dollar interest rates this week have been lower than at any time since the end of September. The decline from mid-December has been much more than seasonal, and in that respect it has resembled the decline at the same time of year in 1966-67. However, a year ago the rate movement was part of a general reaction away from tight money conditions in all three of the principal centers -- in the United States, Britain, and Germany. This year, Euro-dollar rates in late November and December were abnormally high as a result of market uncertainties following the devaluation of sterling. The President's January 1 program may have caused increased willingness abroad to hold dollars and decreased desires to borrow dollars. The spillover of liquidity from the German money market into international markets was probably a major factor pushing rates down.

In December Euro-dollar rates were much above the general level maintained from June through October. They were also high in relation to U.S. rates on CD's. The liabilities of U.S. banks to their branches abroad declined from mid-December to the end of the year, and then increased about as much in the first three and a half weeks of March. (Recovery in January to mid-December levels has been the usual seasonal pattern in other recent years -- except in 1967, when U.S. banks' demand for Euro-dollars was diminishing.) Since January 10 there has been no appreciable further increase in liabilities of New York banks to their branches abroad, but a substantial increase outside New York. The further decline in Euro-dollar rates during this period has accompanied an easing of CD rates in this country.

EURO-DOLLAR AND U.S. SHORT-TERM RATES
(per cent per annum)

	Oct.4 1967	Dec.20	Jan.24 1968	Jan.31
Three-month rates:				
Euro-dollars	5.56	6.56	5.75	5.38
C.D.'s: new issues 1/	5.00	5.50	5.50	5.13
: secondary	5.12	5.64	5.40	n.a.
Call money: Euro-$	4.75	5.25	4.75	4.50
Federal funds 2/	3.96	4.48	4.68	n.a.

1/ Most often quoted rate. Fridays, except Jan. 31.
2/ Av. for week ending Wednesday.

In contrast to developments in Germany and Switzerland, the French money market has tightened this month. The call money rate, which stayed in a range of 4-1/4 to 4-3/4 per cent during the second half of 1967, averaged about 5 per cent in the first three weeks of January. The causes of the tightening are not entirely clear, but the fact that the Bank of France in the week ending January 17 sharply reduced its holdings of paper acquired through market operations supports the interpretation that the authorities tightened the market to limit outflows of short-term capital.

The $260 million net increase in French official reserves in November and December, when Algerian conversions of francs for dollars to buy gold from us amounted to $85 million, indicates a net inflow of short-term capital into franc assets of the order of magnitude of $350 million. (The balance on current and long-term capital transactions is thought to have been relatively small.) There was a very large inflow immediately after sterling devaluation. Subsequently there were outflows, including payments for gold bought on the London market by French hoarders, and some further outflow appears to have occurred early in January. With the change in official money market policy mentioned above, such outflows may have been slowed.

Though activity on the Paris gold market has greatly diminished, the price for Napoleon coins on January 18 still represented a premium of 61 per cent over their gold content.

French bond yields have risen further, and on January 12 the yield on public sector bonds (net of withholding tax) was 6.59 per cent, compared with 6.40 per cent in early November. In the fourth quarter of 1967 two French bond issues totaling the equivalent of $42 million were floated in the Euro-bond market, one for dollars by the postal administration and one for French francs by a pharmacological company.

While French monetary policy appears to be aimed at protecting French reserves from capital outflows, the Government announced on January 24 a program of fiscal measures to stimulate consumption and investment. Despite a continuing rise in French industrial production through November, earlier hopes of sharp expansion in domestic and foreign demand were not being borne out. Before the changes just announced, the government's over-all budget deficit (including that of the social security system) was to have been much smaller in 1968 than in 1967. The new program includes cancelation of part of the personal income tax instalment payable on February 1, acceleration of the increase in family allowances originally scheduled for October 1968, an increase in old age pensions and increased financial aid for industrial investment in depressed areas and for housing. With this program, the projected 1968 budget deficit is raised from Fr. 2 billion to Fr. 5 billion, which, however, will still be less than the 1967 deficit of over Fr. 7 billion.

According to press reports, the government will not float any long-term bond issues this year. The deficit is therefore likely to be financed partly through the banking system.

Recent monetary policy developments in Canada reflect a continuing concern about wage and price advances as well as market fears of adverse effects upon the Canadian balance of payments of the new U.S. direct investment controls and of the threatened U.S. import tax. Uneasiness about maintenance of the exchange parity of the Canadian dollar led to heavy forward buying of U.S. dollars by U.S. and Canadian companies in the week ending January 18. The Canadian banks bought U.S. dollars spot, to cover their forward sales, and thus caused a drain on official reserves. Effective January 22, the Bank of Canada raised its discount rate for the third time in five months -- bringing it to the crisis level of 7 per cent -- and at the same time announced that the chartered banks would discourage the use of bank credit by Canadian subsidiaries of foreign companies "to facilitate abnormal transfers of funds abroad" or "to meet requirements in Canada which have in the past normally been met by parent companies."

Sizable spreads have opened up between Canadian and U.S. interest rates, on an uncovered basis. The Canadian Treasury bill rate was 6.08 per cent on January 26, nearly 1-1/4 per cent above the rate on the U.S. three-month bill. (The covered arbitrage differential was very small.) Long-term bond yields, which leveled off in Canada as in the United States in November and December, rose further in Canada after the latest discount rate increase. On January 24 the spread as against U.S. long-term yields was 1-1/2 per cent.

The Bank of Japan's discount rate increase on January 6 -- the second in four months -- was followed by an increase in most commercial bank lending rates. The prime lending rate, for example, stayed equal to the discount rate, rising from 5.840 per cent to 6.205 per cent. Average bank lending rates have undoubtedly risen further; from a low of 7.28 per cent in August they had risen by November to 7.34 per cent.

Call loan rates rose to 8.395 per cent on January 6. This compares with a low last May of 6.570 per cent. Smaller banks have reportedly been shifting out of bonds into call loans. Bond prices and yields in Japan are controlled fairly closely by the Government. The Ministry of Finance is considering raising the yield on 7-year national bonds, which is now 6.795 per cent, in order to facilitate absorption of new issues.

U.K. Government expenditure plans. In its latest move to assure the viability of the new \$2.40 pound, the British government announced on January 16 that it would reduce public sector spending in the next fiscal year (starting April 1) by £300 million in real terms below earlier plans. The spending program for the following year was pared by £416 million. These cuts are in addition to the downward revisions in spending plans made when the pound was devalued on November 18.

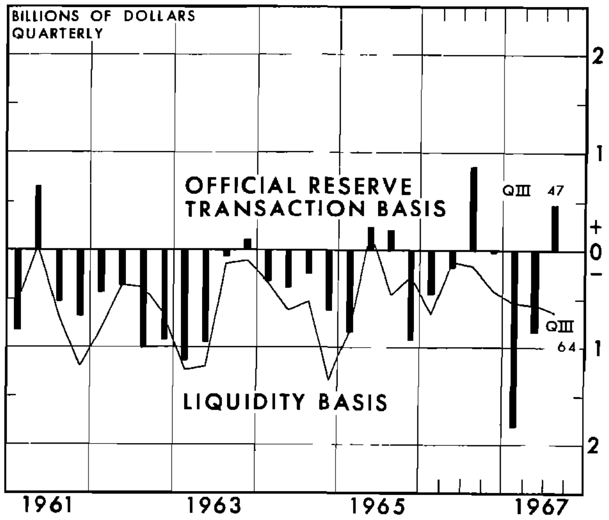
The changes in expenditure plans are reviewed in Appendix C. Any appraisal of effects must be tentative in the absence of information on revenue plans. To hold consumer demand in check, Chancellor of the Exchequer Jenkins has promised a "tough" budget -- which will be presented in March, a month earlier than usual. It is likely that a sizable increase in taxes will be included in that budget.

In promising restrictions for the future but imposing none now, the Chancellor has run the risk of adding fuel to the surge in consumer spending set in motion by the devaluation. Sales of consumer goods reportedly have boomed. People have evidently speeded up purchases they might otherwise have deferred, in order to avoid the price rises devaluation will inevitably produce. The possibilies of higher sales taxes and of more restraints on installment buying in the near future has doubtless increased the incentives to buy now.

U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

U.S. BALANCE OF PAYMENTS



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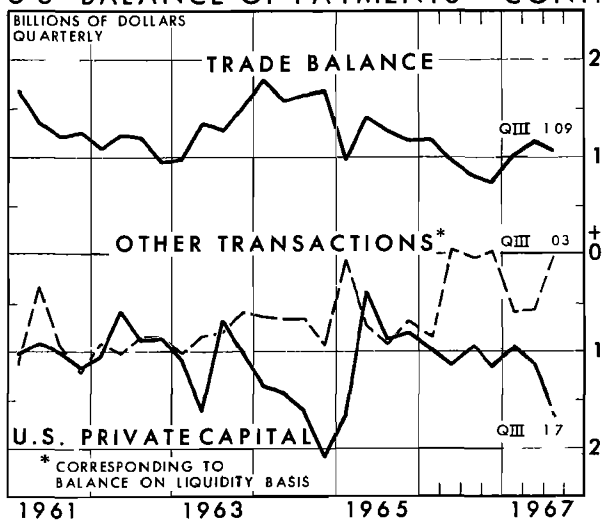
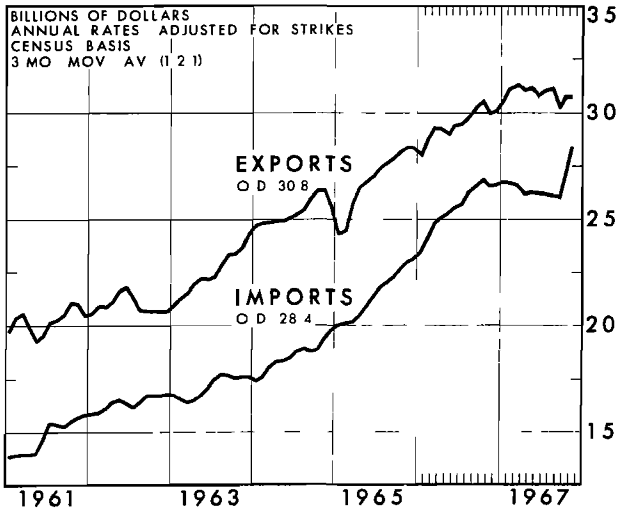
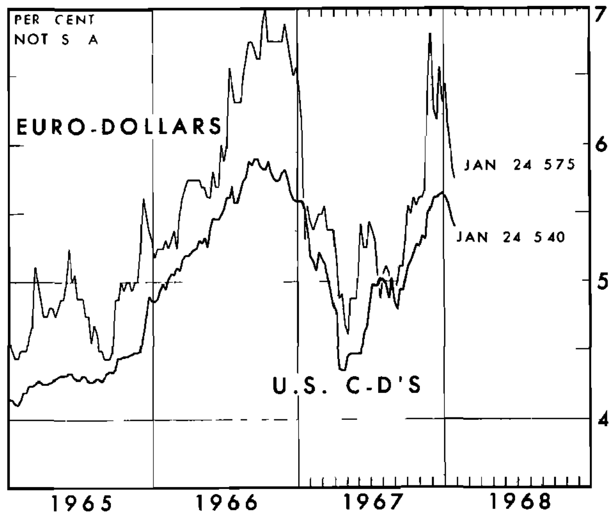


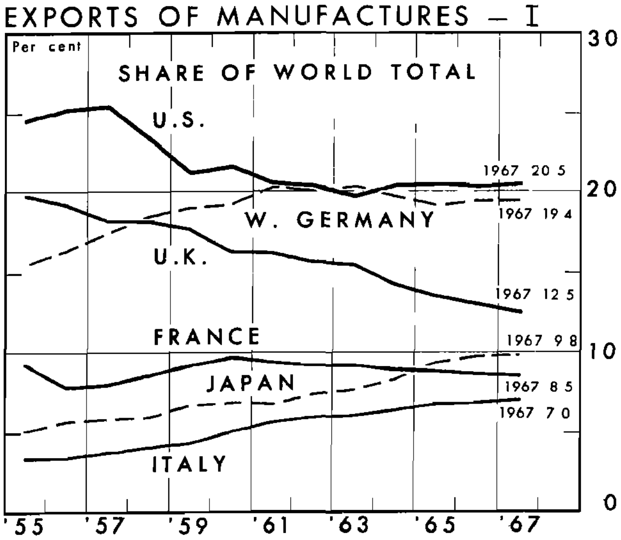
U.S. MERCHANDISE TRADE



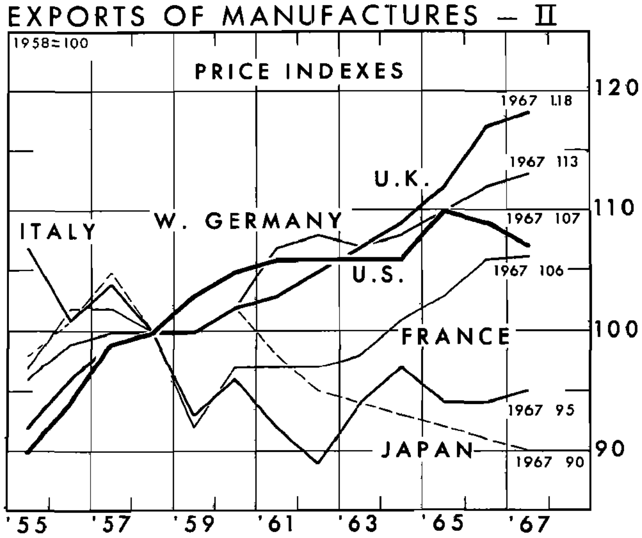
90-DAY RATES



EXPORTS OF MANUFACTURES — I



EXPORTS OF MANUFACTURES — II



APPENDIX A: THE NEW UNIFIED BUDGET CONCEPTS[1/]

The Federal Budget is undergoing a two stage conceptual revision in accordance with the recommendations of the President's Commission on Budget Concepts (PCBC).[2/] The first of these stages is being incorporated in the Budget just released, and it consists of a rearrangement of existing budgetary data. The second stage is planned for the January 1970 Budget Document. At that time receipts and expenditure data will be shifted to an accrual basis and the subsidy element in Federal loan programs will be separately identified.

The Structure of the New Budget. The new (fiscal 1969) budget aims to provide, in one unified presentation, the role of the Federal Government in the income and product flows of the economy and the Government's activities as a lender and as a borrower. Thus the new budget provides information which previously had to be pieced together from the national income and the cash budgets and from some supplementary tables in addition.

While the cash budget and the national income budget are replaced by a unified presentation in the new budget, the administrative budget is completely eliminated as an official Government budget. The Commission felt that because the administrative budget excludes trust fund receipts and expenditures it was misleading as a guide to the impact of Federal programs on the economy. Information on individual trust funds will, of course, be preserved.

In essence, then, the new budget presents a national income-type budget and a cash budget in one unified presentation. However, there are some coverage and accounting modifications which make the new budget somewhat different from both the national income accounts and the old cash budget. Leaving these modifications aside for the moment, the new budget summary, as shown in Table 1, will now be traced through. The new summary starts with a tabulation of requests for budget authority that authorize the Government to make outlays.

There follows the receipts and expenditure account which is a modified version of the Federal sector in the national income accounts. Receipts consist of all the tax income of the Federal Government and all compulsory fees. Receipts associated with activities which are

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1/ Prepared by Helmut Wendel, Economist, Government Finance Section, Division of Research and Statistics.

2/ See, Report of the President's Commission on Budget Concepts, U.S. Government Printing Office, Washington, D. C., October 1967.

operated as business-type enterprises or which are market oriented in character (such as receipts from the sale of goods or from interest payments) are not included as receipts, and instead are offset against the expenditures to which they relate.

Expenditures include all payments that generate current income for the recipients. A surplus or deficit is shown for the receipt-expenditure account; this shows to what extent the Federal Government provided net additions to or subtractions from other sectors' incomes, and is thus similar in spirit to the Federal surplus or deficit in the national income accounts.

Next the summary budget shows the Federal loan account. This is the section in which Federal loan programs are recorded; loan repayments are netted against loan disbursements.

Net lending is added to expenditures as previously defined to arrive at the concept of total budget outlays. The difference between receipts and total budget outlays is defined as the budget deficit. This budget surplus or deficit is roughly equivalent to the old cash surplus or deficit.

The budget summary continues by showing an account for the means of financing of the deficit. A deficit can be financed by borrowing from the public (including issuance of participation certificates) by drawing down cash balances, by increasing unpaid checks outstanding or by seignorage receipts. Finally, there is a table on outstanding Federal securities and loans. The change in outstanding Federal securities held by the public ties in with borrowing from the public, and the change in direct Federal loans outstanding ties in with new net lending. As a memorandum item, the amount of guaranteed and insured Federal loans is also shown.

In the future, the old Administrative budget and the cash budget will no longer be published, but the figures for fiscal year 1969 on these alternative bases will be shown this year. As for the Federal sector in the national income accounts, it is expected that revisions will be made to bring the NIA Federal sector into conformity with the new budget, but only after the second stage of revisions has been introduced in the budget document.

Table 1

BUDGET SUMMARY
(In billions of dollars)

Description	1966 actual	1967 actual	1968 estimate	1969 estimate
Budget authority:				
Requiring current action by Congress:				
Previously enacted		135.4	125.1	--
Proposed in this budget		--	3.3	141.5
Becoming available without current action by Congress		58.7	69.9	73.1
Deductions for interfund and intragovernmental transactions & applicable receipts		-11.5	-11.8	-12.9
Total, budget authority		182.6	186.5	201.7
Receipts, expenditures, and net lending:				
Expenditure account:				
Receipts		149.6	155.8	178.1
Expenditures (excludes net lending)		153.2	169.9	182.8
Expenditure deficit (-)		-3.6	-14.0	-4.7
Loan account:				
Loan disbursements		17.8	20.9	20.4
Loan repayments		12.6	15.1	17.1
Net lending		5.2	5.8	3.3
Total budget:				
Receipts		149.6	155.8	178.1
Expenditures and net lending		158.4	175.6	186.1
Budget deficit (-)		-8.8	-19.8	-8.0
Budget financing:				
Borrowing from the public		3.6	20.8	8.0
Reduction of cash balances, etc.		5.3	-1.0	*
Total, budget financing		8.8	19.8	8.0
Outstanding debt, end of year:				
Gross amount outstanding	329.5	341.3	370.0	387.2
Held by the public	265.6	269.2	290.0	298.0
MEMORANDUM--OUTSTANDING LOANS, END OF YEAR				
Direct loans (in loan account)		34.0	39.8	43.1
Guaranteed and insured loans		99.5	107.1	117.1

* Less than $50 million.

<u>Budget coverage and classification</u>. Table 2 presents a brief reconciliation between the new budget and the old budgets with data for fiscal years 1967 to 1969. The detailed entries that are involved in such a reconciliation are listed in Table 3 and further illustrated in Tables 4 to 6. The various budgets differ partly because the sector coverage is different and partly because certain transactions are differently classified as among receipts, spending, borrowing, and other means of financing.

In regard to sector coverage, the new budget excludes government-sponsored agencies that have become wholly privately owned. The Federal home loan banks and the Federal land banks fall in this category. In excluding these banks, the Commission considered not only their formal ownership status, but also the fact that they are not subject to budgetary review. In the new budget their net lending will not be included in Federal loans and their borrowing in the market will not be part of Federal borrowing from the public for either FY 1968 or FY 1969.

The 1969 Budget recommends accelerating the transfer of secondary market operations of FNMA to private ownership. Hence, at some time in the future the new budget is expected to exclude the secondary market operations fund of FNMA. By issuing additional stock to mortgage companies that agency would be able to retire its Federal capital subscription of $190 million.

The new budget discontinues treatment of the District of Columbia as a Federal agency, so that only direct Federal payments to the District will henceforth appear in the budget.

The classification of transactions as among receipts, expenditures, borrowing, and other means of financing is indicated in Table 3. Federal receipts in the new budget will shrink somewhat relative to the cash budget due to the exclusion of all receipts obtained from market oriented activities, such as the sale of surplus property, rents and royalties, etc. This decline is only partly offset by the inclusion in receipts of employee contributions to Federal retirement funds. The timing of receipts remains the same as in the cash budget until the second stage of revisions.

As already mentioned two measurements of Federal expenditures will be presented, expenditures excluding loans, and total outlays equal to expenditures plus loans. The loan category, however, will not include soft currency loans to foreigners and nonrecourse-type agricultural loans. These are classed as expenditures. The aim is to have only <u>bona fide</u> financial transactions in the loan category.[1/] In the

1/ The loan account in the budget includes only those domestic credit transactions where there are definite requirements for full repayment of the loans, plus all foreign loans made on commercial terms.

second stage of revisions, it is planned to estimate the subsidy element in loan programs and to enter the subsidy portion of the loans in expenditures excluding loans.

Net issues of participation certificates to the public will henceforth not be deducted from outlays, but will be included as a means of financing the deficit. The timing of expenditures will be changed only slightly in the first stage of revisions by going from the checks-paid basis of the cash budget to a checks-issued basis. The offsetting accounting entry will be made in means of financing other than borrowing, where the clearing account for outstanding but unpaid checks will be entered as an account payable item.

Borrowing from the public will be similar to the old concept of net cash borrowing, except that participation certificates and accrued interest on savings bonds and Treasury bills are added, and borrowing by the privately-owned Federally sponsored agencies (FHLB, FLB) is subtracted.

Table 2

SUMMARY COMPARISON OF NEW BUDGET WITH OLD BUDGETS,
FISCAL YEARS 1967 TO 1969
(In billions of dollars)

	1967	1968	1969
Receipts			
Administrative Budget receipts	115.8	118.6	135.6
Plus: Trust funds and other adjustments, net	37.8	40.2	45.5
Equals: Cash receipts from public	153.6	158.8	181.1
Less: Adjustments for netting	4.0	3.0	3.0
Equals: New unified budget receipts	149.6	155.8	178.1
Plus: Excess tax accruals over collections	- 4.8	2.2	1.1
Plus: Adjustments for grossing	2.8	3.1	3.2
Equals: NIA, Federal receipts	147.6	161.1	182.5
Expenditures			
Administrative Budget expenditures	125.7	137.2	147.4
Plus: Trust funds and other adjustments, net	29.4	38.8	41.3
Equals: Cash payments to public	155.1	176.0	188.7
Less: Adjustments for netting	4.0	3.0	3.0
Less: Privately-owned government-sponsored corporations 1/	- 3.9	1.6	2.8
Plus: Participation certificates, net	2.6	3.4	2.3
Plus: Miscellaneous	.8	.8	.9
Equals: Total outlays, new unified budget	158.4	175.6	186.1
Less: Net lending	5.2	5.8	3.3
Equals: Expenditures, new unified budget	153.2	169.9	182.8
Plus: Adjustments for grossing	2.8	3.1	3.2
Plus: Miscellaneous	- .9	- 1.9	- 1.0
Equals: NIA, Federal expenditures	155.1	171.1	185.0
Deficits			
Administrative Budget	9.9	18.6	11.8
Cash Budget	1.5	17.2	7.6
P.C.B.C. Budget	8.8	19.8	8.0
NIA Budget	7.5	10.0	2.5

1/ Includes Federal home loan banks and Federal land banks and, in the future, secondary market fund of FNMA.

NOTE: Data may not add due to rounding. For further details, see Tables 3 to 6.

Table 3

A COMPARISON OF BUDGET COVERAGE AND CLASSIFICATION

	Unified Budget 1/	Old Budgets: NIA Budget	Old Budgets: Cash Budget	Old Budgets: Administrative Budget
I. Coverage of Budget				
Trust funds	included	included	included	excluded
Federal home loan banks and land banks	excluded	excluded	included	excluded
District of Columbia	excluded	excluded	included	excluded
Deposit funds, net 2/	excluded	excluded	included	excluded
II. Classification of receipts and expenditures				
Receipts from market oriented activities 3/	excluded from receipts, netted against expenditures or outlays	excluded from receipts, netted against expenditures	includes some in receipts	includes some in receipts
Timing of receipts	cash	mixed accrual and cash	cash	cash
Timing of expenditures	checks issued except for interest which is accrued	mixed accrual and delivery	checks paid	checks issued except for interest which is accrued
Federal employees retirement funds	includes employee contribution as receipt and expenditure	includes employee and employer contribution as receipt and expenditure	excludes contributions	includes employee and employer contribution as expenditures
Seignorage	excluded from receipt, treated as means of financing	excluded	excluded from receipt, treated as means of financing	included as receipts

Table 3 - Continued

	Unified Budget 1/	Old Budgets NIA Budget	Cash Budget	Administrative Budget
Loans	excluded from receipt-expenditure account; included in total budget outlays	excluded	included	included
Net issues of participation certificates	treated as borrowing	excluded	treated as reduction of payments	treated as reductions of expenditures
III. Classification of borrowing				
Net issues of participation certificates	included	not applicable	excluded	excluded
Debt issued by Government agencies 4/	included	"	included	excluded
Investments by trust funds and agencies	netted	"	netted	not netted
Accrued interest on savings bonds and Treasury bills	included	"	excluded	included
Subscriptions to international organizations	excluded, treated as contingent liability	"	excluded	included
IV. Classification of means of financing other than borrowing				
Seignorage	included	not applicable	included	treated as receipt
Decrease in cash assets	included	"	included	included
Increase in liability to deposit funds 2/	included	"	consolidated with payments	not applicable

Table 3 - Continued

	Unified Budget 1/	Old Budgets		
		NIA Budget	Cash Budget	Administrative Budget
Increase in checks outstanding and interest accrued but not paid	included	not applicable	consolidated with payments	not applicable

1/ 1969 stage of revision.

2/ Since deposit of fund accounts are excluded from the new budget, the Government's liability to them becomes a means of financing. Deposit funds consist of independent accounts, such as the Exchange Stabilization Fund balance with the Treasury, military savings accounts, etc.

3/ Such as sale of surplus property, rents, royalties and loan repayments, and premiums on veterans life insurance.

4/ Refers to agencies which are wholly or partially owned. Privately-owned Government sponsored agencies are excluded on all respects from new budget.

Table 4

FEDERAL RECEIPTS RECONCILIATION
January 1968 Budget
(In billions of dollars)

			Fiscal Years	
			1968	1969
	Administrative Budget receipts		118.6	135.6
Plus:	Trust fund and other receipts, net		40.2	45.5
Equals:	Cash receipts from the public		158.8	181.1
Less:	Receipts to be netted against expenditures		4.1	4.2
		Detail 1969		
	Sales of Government property	1.7		
	Veterans Life insurance premiums	.5		
	Rents and royalties	.7		
	Interest receipts, repayments of loans, etc.	1.3		
Less:	District of Columbia local taxes		.4	.4
Plus:	Employee retirement contributions		1.3	1.4
Plus:	Miscellaneous interfund transactions 1/		.1	.2
Equals:	New unified budget receipts		155.8	178.1
Plus:	Excess of tax accruals over collections		2.2	1.1
Plus:	Grossing of receipts and expenditures 2/		3.1	3.2
Equals:	Federal receipts in national income accounts		161.1	182.5

1/ Consists of payments by social security beneficiaries for supplementary medicare, less government payments to social security trust funds as employer of military and covered civilian personnel.

2/ Mainly employer contributions to Federal retirement funds and premium receipts by Veterans' insurance funds, both of which are grossed in NIA accounts and netted in new budget.

Note: Data may not add due to rounding.

Table 5

FEDERAL EXPENDITURE RECONCILIATION
January 1968 Budget
(In billions of dollars)

		Fiscal Years 1968	Fiscal Years 1969
	Administrative Budget expenditures	137.2	147.4
Plus:	Trust fund and other expenditures, net	38.8	41.3
Equals:	Cash payments to the public	176.0	188.7
Less:	Receipts to be netted against expenditures	4.1	4.2
	Deposit funds, net	-.4	-.4
	Expenditures by District of Columbia	.3	.4
	Net expenditures of privately-owned Government-sponsored corporations 1/	1.6	2.8
Plus:	Employee retirement contribution	1.3	1.4
	Sales of participation certificates, net 2/	3.3	2.3
	Change in checks outstanding and accrued interest	.6	.6
	Miscellaneous interfund transactions	.1	.2
Equals:	Total outlays, new unified budget	175.6	186.1
Less:	Net lending	5.8	3.3
Equals:	Expenditures, new unified budget	169.9	182.8
Plus:	Excess of defense deliveries over defense expenditures	.3	.4
	Crossing of receipts and expenditures 3/	3.1	3.2
	Other, net	.2	1.1
Less:	Budget expenditures treated as financial outlays by NIA	2.4	2.6
Equals:	Federal expenditures in national income accounts	171.1	185.0

1/ Includes Federal home loan banks and Federal land banks and, in the future, secondary market funds of FNMA.
2/ Includes minor amounts for defense family housing mortgages. See table 6.
3/ Mainly employer contributions to retirement funds and premium receipts by Veterans' insurance funds, both of which are grossed in NIA accounts and netted in new budget.
Note: Data may not add due to rounding.

Table 6

FEDERAL BORROWING RECONCILIATION
January 1968 Budget
(In billions of dollars)

		Fiscal Years	
		1968	1969
	Increase in gross public debt (old concepts)	20.8	11.9
Plus:	Increase in obligations by Government agencies, net	4.7	4.5
Less:	Investment in Treasury securities by trust funds and agencies	6.7	8.4
Less:	Public debt held by IMF and international lending agencies	-.4	-.7
Less:	Accrued interest added to value of debt (savings bonds and Treasury bills)	.6	.6
Equals:	Net cash borrowing from public	18.6	8.1
Plus:	Participation certificates	3.4	2.3
Plus:	Defense family housing mortgages	-.1	-.1
Plus:	Accrued interest added to value of debt	.6	.6
Less:	Securities issued by privately-owned Government-sponsored corporations, less investments in Federal obligations by these corporations 1/	1.6	2.9
Equals:	Borrowing from the public, new unified budget	20.8	8.0

1/ Includes Federal home loan banks and Federal land banks and, in the future, secondary market funds of FNMA.

Note: Figures may not add, due to rounding.

APPENDIX B

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

	1966	1 9 6 7						
	Total	Q-1	Q-2	Q-3	Nov. p/	Dec. p/	Q-4 p/	Year p/
1. Liquidity deficit (-), not seasonally adj.	-1,357	-238	-222	-1,208	-871	-93	-1,897	-3,565
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.	-1,853	-3,565
Selected "special" transactions								
Investments in long-term deposits								
4. Foreign governments (excluding U.K.)	757	305	634	-228	25	137	163	87
5. International and regional institutions	196	70	24	54	30	14	20	168
6. Investments in U.S. Govt. Agency securities by international and regional institutions	244	-8	70	57	1/ 15	13	28	147
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 bond	23	--	--	--	6	--	12	12
12. Rescheduling of new Canadian issues	-150	--	--	--	--	--	--	--
13. Total, selected "special" transactions	1,585	374	757	209	-196	144	-262	1,078
14. Liquidity deficit (S.A.) before reduction by "special" transactions	-2,942	-903	-1,304	-845	-675 (NSA)	-237 (NSA)	-1,591	-4,643
15. Official settlements deficit (-), not seasonally adjusted	225	-1,282	-690	-24	-531	-468	-1,376	-3,372
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.	-1,199	-3,372
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.	-666	-2,934

APPENDIX C: REDUCTION OF U.K. PUBLIC SECTOR EXPENDITURE PLANS*

The British government announced on January 16 that it would reduce public sector spending in the next fiscal year (starting April 1) by £300 million in real terms below earlier plans. The spending program for the following year was pared by £416 million.

These cuts are in addition to the downward revisions in spending plans made when the pound was devalued on November 18, which amounted to £100 million for defense spending and £70 million for capital outlays in nationalized industries. At that time, the government also announced that refunds and premium payments under the Selective Employment Tax would be discontinued except in the development areas, and that export rebates would be abolished. Each of these two moves was expected to save the Treasury about £100 million. Consequently, the total by which the government has reduced its spending targets for the coming fiscal year amounts to almost £700 million.

The cutbacks will slow, but not eliminate, growth in public expenditures in the near term. Figures released by the government--covering all national and local public spending except, apparently, debt interest--show that outlays in the public sector in fiscal 1968-69 will be 4.4 per cent higher in real terms than the expected total in the year ending March 31. This is less than half the rate by which public sector outlays this year will exceed those for 1966-67. But public spending will apparently still be rising faster than national income, which the government now predicts will grow by 4 per cent next year. In the following fiscal year (1969-70), however, spending in the public sector is scheduled to level off entirely.

Composition of the cuts in planned spending

The January 16 reduction of £300 million for the fiscal year beginning April 1 will be limited exclusively to the civilian economy, and about 75 per cent of the new cutback for the following year relates to non-military categories. Both current and capital expenditures are affected, as are virtually all areas of government activity and responsibility.

Because of the implications for the world balance of power and Britain's status as a major power, the most highly publicized element of the latest retrenchment package was the forthcoming reduction in Britain's

*Prepared by Martin J. Kohn, Europe and British Commonwealth Section, Division of International Finance.

defense commitments. However, this does not affect the fiscal year 1968-69. The defense budget for fiscal 1969-70 will be trimmed £110 million below previous plans. In absolute terms, because of earlier cuts in plans defense spending will fall in each of the next two years. The decline will continue into the 1970's. The contract for the purchase of 50 F-111's from the U.S. has been canceled, a move which is expected to save Britain--after allowance for payment of cancellation costs--£400 million through 1977-78.

The largest item in the £300 million to be lopped off next year is an £80 million reduction in earlier plans for capital investment grants to private industry. The saving will be accomplished through reversal of a previously instituted speed-up in the disbursement of these payments.

In education, the principal savings are to come from a two-year postponement of the raising of the minimum school leaving age from 15 to 16. In addition, grants to "direct grant" schools are to be reduced, as are capital expenditures for higher educational institutions. Provision of free milk in schools will be discontinued.

In the medical field, prescription charges will be re-imposed on those deemed able to afford them. National health contributions from the public will be raised, allegedly to help meet the cost of prescriptions for the needy. Dental charges will be raised, and planned health and welfare capital expenditure outlays will be lowered.

Increases in family allowances will be paid as previously planned, but the full amount of the increase will be defrayed through upward adjustment of income taxes.

The number of housing starts in the public sector is to be lowered below pre-devaluation plans, and previously scheduled expenditures by the central government on road building will be reduced.

Civil defense and other Home Department expenditures will be lowered and civil service employment will be held at current levels.

Appraisal of effects

In the absence of information on revenue plans, any appraisal of the government's revamped spending program must necessarily be tentative. It seems clear, though, that if public sector spending increases as now planned, vigorous steps to curb demand elsewhere will still be required. The budget is to be presented in March, a month earlier than usual.

Four per cent growth in national income appears to be the maximum permissible if the unemployment rate is not to drop well below two per cent, into the zone where wages and prices are likely to increase rapidly. With growth in exports and private sector investment both expected and desired next year, the consumer sector emerges as the logical candidate to bear the brunt of further restrictive measures. In fact, likely growth in other areas implies that the volume of consumer expenditures must be kept at roughly current levels next year if the overall 4 per cent growth target is not to be exceeded.

The most serious doubts about the government's ability to keep a sufficiently tight rein on consumer spending center on the apparent inadequacies of current "incomes policies." The government's official line is still that wages should be increased only to reward proven productivity increases or to raise the pay of the lowest paid workers. However, the government's legal power over wages is now limited to delaying increases by seven months, and even this power is undercut by the provision which permits settlements to be made retroactive.

From the end of June--when the period of severe restraint ended--through December, weekly wage rates rose by 3.9 per cent. Even after July--when settlements deferred by the government's restraint program caused the rate to jump 1.6 per cent--the rate of increase was high. In the five months from July to December, wage rates rose by 2-1/4 per cent, or by almost 5-1/2 per cent at an annual rate. Therefore, even before the devaluation created new inflationary pressures, wages were rising at a considerably faster rate than the approximately 3 per cent at which productivity appears to be increasing.

TABLE 1. UNITED KINGDOM: PUBLIC SECTOR SPENDING, 1967-1970
(£ million, constant prices)

Spending Categories	Fiscal 1967-68 Estimated Expenditures	Fiscal 1968-69 Planned Expenditures 12/31/67	Fiscal 1968-69 Planned Reduction	Fiscal 1968-69 Revised Planned Expenditures	Fiscal 1969-70 Planned Expenditures 12/31/67	Fiscal 1969-70 Planned Reduction	Fiscal 1969-70 Revised Planned Expenditures
Defense	2,218	2,167	0	2,167	2,250	110	2,140
Social security, education, health	6,517	6,881	68	6,813	7,068	89	6,979
Housing	1,018	1,098	27	1,071	1,124	55	1,069
Roads and other transport	670	758	55	703	818	74	744
Home departments, civil defense	494	533	20	513	559	32	527
Ministry of technology	234	223	10	213	233	15	218
Investment grants	189	440	80	360	380	0	380
Environmental services	732	797	26	771	839	27	812
Overseas services	338	371	0	371	367	0	367
Agriculture	374	388	0	388	388	0	388
Selective employment tax, regional employment premia	170	156	0	156	131	0	131
Other	1,433	1,566	2	1,564	1,396	14	1,382
Contingency allowance	0	0	0	0	75	0	75
Capital spending by nationalized industries	1,676	1,695	0	1,695	1,564	0	1,564
Total	16,063	17,073	288	16,785	17,192	416	16,776
Adjusted total[a]	--	--	300	16,773	--	--	--

a/ The reductions for 1968-69 include a cut of £12 million in civil service manpower expenditures. Since this cut is not included in any of the listed spending categories, it has been added to the total for reductions and subtracted from the total for revised planned expenditures.