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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

February 28, 1968

SUMMARY AND OUTLOOK

Outlook for economic activity

Over-all demands are expected to continue to expand at a very rapid pace in the second quarter. Assuming no Congressional action on the tax surcharge, and some further monetary restraint, growth in real GNP should be only a little below the 6 per cent annual rate anticipated for this quarter. With pressure on resources heightened and wages rising faster than productivity, industrial and consumer prices seem certain to remain under strong upward pressure.

In addition to substantially higher consumer demand, an increase in Federal defense expenditures larger than previously anticipated will be adding to rapid growth in GNP. Stepped-up requirements for manpower and military equipment have already pushed expenditures above those projected in the Budget, and further increases are anticipated, although the amounts are still unknow.

In the coming quarter, as in the first quarter, accelerating consumer expenditures are expected to be the major factor stimulating economic growth. The rise in retail sales indicated for January and February implies a first quarter gain in consumer outlays of about 2 per cent from the fourth quarter. Higher social security payments and rapidly rising hourly wages and employment can be expected to push up disposable income in the next quarter--sharply so without a tax increase. Thus, even with no reduction in the saving rate from recent high levels, consumers are likely to increase their spending sharply.

Although the economy entered the year with large inventories of most goods, continued accumulation of autos and hedge buying of steel suggest that additions to inventories will continue at a substantial rate in the second quarter. However, in view of the mortgage credit situation no further increase in residential construction activity is expected. Increases in fixed capital investment are likely to be of moderate dimensions.

Outlook for resource use and prices

Industrial production edged off a bit in January, and it is expected to change little in February, but is projected to resume its upswing thereafter.

Production has been limited in part in January and February by sporadic work stoppages in the auto industry, and by the continuing strikes in the copper and glass industries. On the other hand, strikes of bituminous coal miners and railroad workers have ended. The higher production levels in prospect would still suggest only a little further rise in manufacturing capacity utilization through the second quarter from the rate reached in December. Upward pressure on wages will continue in the second quarter. Contract negotiations in aluminum, apparel, and shipbuilding are likely to result in wage adjustments at the "going rate" of 6 per cent or more; and deferred increases in the 4 to 5 per cent range will be received by nearly 2 million workers. With no let-up in wage pressures, unit labor costs are likely to continue their upward course even if sizable gains in industrial production--and productivity--are achieved.

Through mid-February industrial prices continued sharply upward over a wide range of materials and products. Moreover, for 3 months now prices of foods and foodstuffs have been rising at wholesale. With food prices increasing and service costs tending to accelerate in recent months, the consumer price index is probably rising at least as fast as the 3.6 per cent annual rate of the last 3 months of 1967, and perhaps faster. There is little prospect for any significant slowing in the pace of advance over the next several months.

Demand for credit

Given the modest rise expected in expenditures for plant and equipment and inventories in the next few months, businesses may be able to meet their financing needs with only a relatively moderate recourse to external financing. Funds should be somewhat more available from internal sources in view of the build-up in liquid asset holdings during the latter half of 1967 and the better than expected profit performance of recent months. Moreover, corporate income tax payments, though still substantial, are not expected to be as large as in the spring of last year when there were sizable accelerated payments.

Such business credit demands as develop are likely to focus more on banks, particularly in light of the continued high rate of inventory accumulation. The near-term volume of new corporate issues in the bond market is expected to remain below early winter levels, unless fears of a credit squeeze begin to re-emerge. In this case further anticipatory borrowing in capital markets and also at banks could well develop. No let-up yet appears in sight for municipal bond offerings, however, though postponements of new issues could develop if the recent upward yield movements persists.

Federal Government credit demands over the balance of the fiscal year could be sizable enough to become a source of market pressure. Without a tax increase,assuming spending rises above Budget estimates (as we have projected), and depending on how low a mid-year Treasury cash balance is feasible, anywhere from $4-1/2 to $6-1/2 billion of new cash (including PC's) will have to be raised between now and mid-year, in addition to the $1.2 billion that would be raised by completion of the full cycle of weekly cash additions to the 3-month bill auction begun in the last week of February. Even the lower end of the range is above current market expectations.

These factors on the demand side suggest a mixed interest rate outlook, with the focus of upward interest rate pressures in the market for municipal and U.S. Government securities. Part of the Federal Government's cash need may be financed through participation certificates, and this would tend to affect intermediate- and longer-term yields, with some spill-over, perhaps, into the corporate market. Mortgage yields may not show much, if any, further upward push--at least until the late March--early April interest-crediting period for thrift institutions--since it appears that residential mortgage demands are being limited by current mortgage costs.

Supply of funds

Financial institutions are likely to continue to find net funds available for lending under some constraint over the next few months. While partial data for banks and nonbank intermediaries suggest that some improvement may be occurring in net inflows of time and savings accounts from the sharply reduced January pace, these inflows are likely to remain below the pace of summer and early fall, and could decline further if short-term rates rise from current levels.

With respect to commercial banks, the recent modest pick-up in time and savings deposits has mainly reflected growth in co sumer-type accounts, and continued moderate expansion in these deposits is expected. Major banks have thus far shown little inclination to push negotiable CD's onto the market, largely because they have not been able to see an immediate need for the funds, but also because Euro-dollars have remained generally available at relatively attractive rates.

Any significant strengthening of business loan demands during the spring would be accompanied by a greater effort on the part of major banks to obtain CD funds. Such activity could, for a time, raise the over-all rate of banks' time and savings deposit expansion somewhat further. But the upward pressures on short-term market interest rates likely to be generated would tend, in turn, to limit banks' ability to continue obtaining net new funds through the CD route and would probably lead to some further slackening in growth of other time deposits. It is expected that private demand deposits will not be a very substantial source of funds to banks over the coming months, with their growth remaining below last year's pace, since liquidity demands may moderate.

The rather moderate increases expected in deposits at bank and nonbank financial institutions will tend to contribute to maintenance of relatively taut lending terms. The survey of mortgage lender intentions taken early in February suggests no marked change through spring in the cautionary attitudes toward, or the level of, new commitments; recently, new commitments have been running slightly below normal for this period of the year. But any significant further market yield increases, especially for short-term rates, could further reduce the availability of funds to the mortgage, and also the municipal, markets.

The Federal Government may find that supply conditions make it somewhat more difficult to finance its cash requirements between now and mid-year, even with little further change in monetary policy. Limitations on the ability of banks to obtain additional new funds, given the relatively narrow spread prevailing between market interest rates and ceiling rates on bank deposits, could force the Government to finance more outside the banking system if business loan demands show a resurgence. Such a development usually adds to upward pressure on market interest rates. However, a tendency toward upward rate movements at the shorter end of the maturity structure could be moderated by sizable amounts of funds seeking re-investment as a result of the large maturities of tax bills over coming months (less than half of which, last year, were turned in for taxes).

Balance of payments

Recent news about the U.S. balance of payments continues to be bleak. Merchandise imports increased sharply further in January, to a rate 16 per cent higher than a year earlier. Imports of steel and copper, which reflect special factors, account for less than one-third of the 12-month increase. Although exports also rose sharply in January after dipping in December, the trade surplus was at an annual rate of only $1-1/4 billion, somewhat lower than in the fourth quarter and well below the rate of $4.3 billion for the first three quarters of 1967.

Thus, despite a more than seasonal reflow of bank credit in January and, presumably, some reduction in direct investment outflows as a result of the new mandatory restrictions, the over-all deficit on the liquidity basis has remained disappointingly large. After rough allowance for the large seasonal adjustment needed at this time of year, the liquidity deficit appears to have been at an annual rate in the $2-1/2 billion to $4 billion range in January-February.

The official settlements deficit has been much smaller than this, thanks to further borrowing by U.S. head office banks from their foreign branches operating in the Euro-dollar market, where supplies of funds have continued large. On an unadjusted basis, there has been an official settlements surplus, and the Federal Reserve has been able to make substantial repayments of outstanding swap drawings. But gold losses have continued as a result both of sales by the Pool in the London market and of foreign central bank purchases. The United States is purchasing European currencies drawn from the IMF by Canada, and will probably draw on its IMF gold tranche position early in March (confidential until announced), for the purpose of making further repayments of outstanding Federal Reserve swap drawings.

Economic activity in Europe has recently been expanding vigorously. A continuation of this expansion should provide the United States this year with an opportunity for its most rapid export expansion since 1963. But until the surge in imports can be considerably slowed down, the trade surplus will continue to run well below last year's level, and the over-all liquidity deficit will remain large in spite of cuts in outflows of U.S. capital.

 February 27, 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.)	Jan'68	77.9	78.5	76.9	1.3	3.5
Unemployment (mil.)	"	2.8	2.8	3.0	-2.9	-6.8
Unemployment (per cent)	"	3.5	3.7	3.7	--	--
Nonfarm employment, payroll (mil.)	"	67.1	67.1	65.6	2.4	7.4
Manufacturing	"	19.5	19.5	19.6	-0.1	4.8
Other industrial	"	8.1	8.2	8.2	-0.8	1.0
Nonindustrial	"	39.5	39.4	37.8	4.4	10.3
Industrial production (57-59=100)	"	161.2	161.8	158.2	1.9	7.0
Final products	"	161.1	161.7	158.1	1.9	7.4
Materials	"	161.0	162.0	157.9	2.0	6.8
Wholesale prices (57-59=100)1/	"	107.2	106.8	106.2	0.9	2.5
Industrial commodities (FR)	"	107.1	106.7	104.9	2.1	4.0
Sensitive materials (FR)	"	104.8	103.9	101.7	3.0	1.0
Farm products, foods & feeds	"	105.3	104.8	107.0	-1.6	-2.2
Consumer prices (57-59=100)1/	Dec'67	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. ($)	"	2.91	2.90	2.76	5.4	9.8
Weekly earnings, mfg. ($)	"	118.44	118.42	113.76	4.1	7.4
Personal income ($ bil.)2/	"	651.2	649.3	610.4	6.7	15.5
Corporate profits before tax ($ bil.)2/	QIV'67	84.0 3/	80.0	83.9	0.1	4.0
Retail sales, total ($ bil.)	Jan'68	27.2	26.4	25.7	5.8	8.4
Autos (million units)2/	"	8.0	7.4	7.4	7.3	-11.9
GAF ($ bil.)	"	6.4	6.4	6.2	2.1	8.9
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,445	1,243	1,111	30.1	0.8
Factory workweek (hours)	"	40.5	40.8	41.0	-1.2	-2.2
New orders, dur. goods ($ bil.)	"	25.1	26.4	22.1	13.9	6.6
New orders, nonel. mach. ($ bil.)	"	3.8	3.9	3.4	12.9	11.8
Common stock prices (1941-43=10)	"	95.04	95.30	84.45	12.5	1.8
Inventories, book val. ($ bil.)	Dec'67	140.6	139.3	135.2	4.0	n.a.
Gross national product ($ bil.)2/	QIV'67	807.3	791.2	762.1	5.9	14.0
Real GNP ($ bil., 1958 prices)2/	"	679.6	672.0	661.1	2.8	7.1

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates. 3/ FRB estimate based in part on published reports and is larger than rate implied by Commerce estimate for 1967.

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Feb. 23, 1968	4-week average	Last 6 months High	Last 6 months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.69	4.66	4.73	3.40
U.S. Treas. bills, 3-mo., yield (per cent)	4.97	4.95	5.06	4.15
U.S. Treas. bills, 1-yr., yield (per cent)	5.26	5.22	5.64	4.97
Net free reserves 2/ ($ millions)	-44	70	405	-70
Member bank borrowings 2/ ($ millions)	405	318	495	46
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds 1/	5.56	5.58	5.84	5.19
20-year U.S. Treas. bonds 1/	5.36	5.37	5.73	5.12
Corporate new bond issues, Aaa adj. 8/	6.29	6.26	6.55	5.82
Corporate seasoned bonds, Aaa 1/	6.09	6.11	6.24	5.64
Municipal seasoned bonds, Aaa 1/	4.06	3.98	4.15	3.82
FHA home mortgages, 30-year 3/	--	6.81	6.81	6.53
Common stocks, S&P composite series 4/				
Prices, closing (1941-43=10)	90.89	90.75	97.00	89.86
Dividend yield (per cent)	3.28	3.28	3.31	3.01

	Latest month	Amount	3-month average	Change from year earlier: Latest month	Change from year earlier: 3-month average
New Security Issues (N.S.A., $ millions)					
Corporate public offerings 5/	Feb. e/	1,600	1,895	202	335
State & local govt. public offerings	Feb. e/	1,200	1,137	6	68
Comm. & fin. co. paper (net change in outstandings) 6/	Jan.	+1,286	+ 531	-153	-27

	Latest month	Outstandings Latest month	Change: Latest month	Change: 3-month average	Annual rate of change from: Preceding month	Annual rate of change from: 3 months ago	Annual rate of change from: 12 months ago
		($ billions)			(per cent)		
Banking (S.A.)							
Total reserves 1/	Jan. 68	25.01	0.39	0.13	19.1	6.5	9.8
Credit proxy 1/	"	274.8	1.9	1.2	8.3	5.5	10.9
Bank credit, total 6/	"	348.4	4.0	1.9	13.9	6.8	10.8
Business loans	"	86.5	0.6	0.7	8.4	10.4	8.8
Other loans	"	140.7	2.6	1.1	22.6	9.3	7.5
U.S. Govt. sec.	"	59.1	-0.9	-1.1	-18.0	-20.5	9.0
Other securities	"	62.1	1.7	1.2	33.8	23.9	24.4
Total liquid assets 1/ 6/	Jan. 68	654.1	2.4	3.6	4.4	6.8	8.0
Demand dep. & currency 1/	"	182.6	1.1	0.8	7.3	5.1	7.2
Time & sav. dep., comm. banks 1/	"	183.7	-0.1	1.0	-0.7	6.4	14.2
Savings, other thrift instit. 6/	"	184.3	0.3	0.6	2.0	3.9	8.9
Other 6/ 7/	"	103.5	1.1	1.3	12.9	15.2	-1.6

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 Feb. 21. 3/ Latest figure is for Jan. 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)

	1967						1968
	Year	QI	QII	QIII	QIV	Dec.	Jan.
			Seasonally adjusted				
Goods and services, net 1/		1,352	1,319	1,364			
Trade balance 2/	3,614	1,009	1,154	1,084	367	-70	100
Exports 2/	30,500	7,671	7,712	7,639	7,478	2,460	2,720
Imports 2/	-26,886	-6,662	-6,558	-6,555	-7,111	-2,530	-2,620
Services balance		343	165	280			
Remittances and pensions		-264	-395	-364			
Govt. grants & capital 3/		-1,201	-1,013	-973			
U.S. private capital		-957	-1,137	-1,689			
Direct investments		-622	-648	-894			
Foreign securities	-1,251	-263	-170	-434	-384		
Banking claims	-467	66	-226	-391	84		
Other		-138	-93	30			
Foreign capital, nonliquid		823	1,227	872			
Official foreign accts.		392	736	277			
Long-term deposits		304	584	-29			
U.S. Govt. liab.		88	152	306			
Int'l. institutions 4/		70	97	117			
Other 5/		361	394	478			
Errors and omissions		-289	-557	+142			
		Balances, with and without seasonal adjustment (- deficit)					
Liquidity balance, S.A.	-3,572	-536	-556	-648	-1,832		
Seasonal component		298	334	-563	-69		
Balance, N.S.A.		-238	-222	-1,211	-1,901	-97	-12
Official settlements bal.,S.A.	-3,398	-1,822	-837	465	-1,204		
Seasonal component		540	147	-485	-202		
Balance, N.S.A. 6/		-1,282	-690	-20	-1,406	-492	
		Reserve changes, N.S.A. (decrease -)					
Total monetary reserves	-52	-1,027	419	375	181	-608	-210
Gold stock	-1,170	-51	-15	-92	-1,012	-900	-62
Convertible currencies	-1,024	-1,007	424	462	1,145	253	-169
IMF gold tranche	94	31	10	5	48	39	21

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

THE ECONOMIC PICTURE IN DETAIL

Gross national product. The economy appears to be continuing its rapid expansion. Assuming no action on the income tax surcharge and some increase in monetary restraint, gross national product should increase by about $18.5 billion, annual rate, in the second quarter, only slightly less than the projected increase for the first quarter. These increases in GNP are larger than in the second half of 1967 when GNP rose at an annual rate of $16 billion per quarter. But we expect a much stronger rise in final sales this half year--a rate of about $18 billion in each of the first two quarters compared to an average of less than $12 billion in the last two quarters of 1967--and much smaller increases in inventory investment than in the preceding half year.

Price increases in the first half of 1968 are expected to be similar to those in recent quarters. In the second half of 1967, the GNP deflator speeded-up to an annual rate of increase of 3.7 per cent, as compared to 2.3 per cent in the first half of the year. Heavy demand pressures are expected to push the rise in real output up to an annual rate of over 5.5 per cent in the first half of this year--more than 1 percentage point above the rate of increase of the second half of 1967.

The rapid economic expansion projected reflects the combined impact of sharply rising personal consumption, an increase in business fixed capital investment, and continued increases in defense spending at a faster rate than we had previously assumed. The slight slowing projected in the rate of expansion in real GNP from the first to the second quarter of this year--from nearly 6 per cent to 5-1/2 per cent--reflects in the main a slowing of the rise in business fixed capital spending and a leveling off in the rate of inventory investment.

The marked rise estimated for consumer expenditures in the first half of this year is in response to expected large gains in personal income, Increases in personal income were large in the latter part of 1967, but part of the rise was not reflected in consumption because of a further elevation of the saving rate--to 7.5 per cent in the fourth quarter. In the first half of this year, we expect income increases to be even larger than in last year's second half, but we also expect consumer spending to keep pace with incomes, with only a slight decline in the saving rate.

Incomplete information on retail sales for the first two months of 1968 lends support to this assumption. In the durable goods sector, unit sales of new domestic cars in January totaled 8.0 million, annual rate. Although the February rate appears to be running somewhat lower, increasing sales are projected for March reflecting higher incomes ready availability of desired models and intensified dealer competition. Sales of domestic cars are projected at a rate of 8.0 million in the first quarter, and 8.5 million in the second quarter. Other consumer durable goods purchases are also expected to rise in response to increases in income and a higher level of home competitions.

Sales of nondurable goods moved up about 3 per cent in January from December, and seem to be holding at an advanced level in February. In our projection, sales of nondurables for the first quarter as a whole have been held at about the January level, which implies a substantial increase from the fourth quarter. Services are expected to continue rising at least as rapidly as in other recent quarters.

Larger increases in consumer spending for nondurable goods and services are anticipated for the second quarter, as the full impact of increased social security benefits is reflected in outlays. The scheduled increase in social security benefits will amount to about $3.6 billion at an annual rate. In 1965, a large increase in social security benefits was promptly reflected in higher outlays for nondurables, and we are assuming a repetition of this pattern.

Recent changes in the international situation seem likely to lead to substantial additions to defense outlays over recent Budget estimates. Our projections--based solely on public information--assume defense outlays will rise at a rate of about $1 billion in each of the first two quarters, about double the rise shown in the Budget. This assumed rise appears minimal in view of the January call-up of reserves and widespread discussions of further increases in the size of the armed forces and in military equipment requirements.

In the Federal nondefense sector, expenditures are expected to rise at an annual rate of $0.8 billion in each of the first two quarters, in part reflecting higher CCC purchases of agricultural products.

Under these assumptions, the Federal deficit, NIA basis, may decline somewhat in the first quarter to an annual rate of $9.5 billion, but rise in the second quarter to a $12.5 billion rate--about the same rate as for calendar 1967 as a whole. Receipts will be increasing sharply as a result of rising personal income and an anticipated substantial increase in corporate profits. The increase in social security taxes will also help to reduce the first quarter deficit, but will be more than offset by the rise in social security benefits in the second quarter. State and local government purchases should continue to provide their customary stimuli to the economy.

Neither business investment nor residential construction appears likely to provide much additional stimulus after the first quarter. After leveling off in the first quarter of this year at 1.45 million units, housing starts are expected to dip slightly in the second quarter. However, with costs and prices rising, residential construction expenditures in the second quarter should equal the $27.7 billion rate projected for the first quarter.

The expansion shown in fixed business investment continues to be based primarily on the November Commerce-SEC survey. (The next survey of investment plans will be available about March 6.) However, more recent data for machinery shipments and unfilled orders and the greater-than-expected strength in corporate profits provide support to our projected rise in dollar fixed investment expenditures in the second quarter.

Nonfarm inventory accumulation, which was at an annual rate of $7.7 billion in the fourth quarter, is expected to accelerate to $10 billion or more in each of the first two quarters of the year. The rise in dealer's stocks of automobiles this quarter is expected to be more than seasonal as strike-induced shortages are made up. The stock of new cars in mid-February was running more than 5 per cent above the end-of-December level, but was still moderately below year-ago levels.

In addition, steel is expected to be stockpiled at a faster rate both this quarter and next in anticipation of a possible strike at the end of July. The accumulation for autos and steel--amounting to perhaps an annual rate of $3 billion--is expected to be on top of a further accumulation of stocks of other consumer goods (estimated at about $6 billion, annual rate), as consumer outlays rise, as well as a further rise in defense inventories (about $1 billion).

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February 28, 1968

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	1967 I	1967 II	1967 III	1967 IV	1968 Proj. I	1968 Proj. II
Gross National Product	743.3	785.0	766.3	775.1	791.2	807.3	826.2	844.7
Final sales	729.9	779.8	759.2	774.6	787.4	798.1	815.7	834.2
Private purchases	575.6	603.5	588.8	599.6	609.2	616.4	630.0	644.7
Personal consumption expenditures	465.9	491.7	480.2	489.7	495.3	501.8	512.3	525.3
Durable goods	70.3	72.1	69.4	72.5	72.7	73.8	76.5	79.3
Nondurable goods	207.5	217.5	214.2	217.2	218.5	220.3	224.4	230.4
Services	188.1	202.1	196.6	200.0	204.1	207.7	211.4	215.6
Gross private domestic investment	118.0	112.1	110.4	105.1	112.2	120.8	124.7	125.7
Residential construction	24.4	24.4	21.4	23.1	25.6	27.6	27.7	27.7
Business fixed investment	80.2	82.6	81.9	81.5	82.8	84.0	86.5	87.5
Change in business inventories	13.4	5.2	7.1	.5	3.8	9.2	10.5	10.5
Nonfarm	13.7	4.8	7.3	.6	3.4	7.7	10.0	10.5
Net Exports	5.1	4.8	5.3	5.3	5.4	3.0	3.5	4.2
Gov't purchases of goods & services	154.3	176.3	170.4	175.0	178.2	181.7	185.7	189.5
Federal	77.0	89.9	87.1	89.5	90.9	92.2	94.0	95.8
Defense	60.5	72.5	70.2	72.5	73.3	74.2	75.2	76.2
Other	16.5	17.4	16.8	17.0	17.6	18.0	18.8	19.6
State and local	77.2	86.4	83.3	85.4	87.4	89.5	91.7	93.7
Gross National Product in constant (1958) dollars	652.6	669.3	660.7	664.7	672.0	679.6	689.5	698.9
GNP Implicit deflator (1958=100)	113.9	117.3	116.0	116.6	117.7	118.8	119.8	120.9
Personal income	584.0	626.4	612.9	619.1	631.0	642.5	656.5	672.5
Wages and salaries	394.6	423.8	414.7	418.3	426.2	435.9	446.1	456.0
Disposable income	508.8	544.7	532.7	540.0	548.2	557.9	569.4	583.0
Personal saving	29.8	38.7	38.8	36.0	38.5	41.6	42.3	42.6
Saving rate (per cent)	5.9	7.1	7.3	6.7	7.0	7.5	7.4	7.3
Corporate profits before tax	83.8	80.5 1/	79.0	78.9	80.0	84.0 1/	86.0	89.0
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	143.2	151.7	149.1	148.1	152.7	157.0 2/	163.0	166.9
Expenditures	142.9	164.1	160.9	162.8	165.9	167.9	172.4	179.4
Surplus or deficit (-)	.3	-12.4	-11.9	-14.7	-13.2	-10.9 2/	-9.4	-12.5
Total labor force (millions)	78.9	80.8	80.3	80.3	81.1	81.6	82.0	82.4
Armed forces "	3.1	3.4	3.4	3.5	3.5	3.5	3.5	3.5
Civilian labor force "	75.8	77.3	76.8	76.8	77.6	78.2	78.5	78.9
Unemployment rate (per cent)	3.8	3.8	3.7	3.8	3.9	3.8	3.6	3.6
Nonfarm payroll employment (millions)	64.0	66.1	65.7	65.7	66.1	66.8	67.4	67.9
Manufacturing	19.2	19.3	19.5	19.3	19.2	19.4	19.6	19.7
Industrial production (1957-59=100)	156.3	157.8	157.1	155.9	157.2	159.4	162.5	165.5
Capacity utilization, manufacturing (per cent)	90.5	85.1	87.1	84.9	84.0	84.3	85.0	85.5
Housing starts, private (millions A. R.)	1.17	1.29	1.12	1.21	1.40	1.44	1.45	1.40
Sales new U.S.-made autos (millions, A. R.) 3/	8.38	7.57	7.16	8.11	7.57	7.44	8.00	8.50

1/ F.R.B. estimate based in part on published reports and is larger than rate implied by Commerce estimate for 1967.
2/ Reflects corporate profits estimate shown above.
3/ Quarterly figures incorporate revised seasonal factors.

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February 28, 1968

CHANGES IN GROSS NATIONAL PRODUCT AND RELATED ITEMS

	1966	1967	1967 I	1967 II	1967 III	1967 IV	1968 Proj. I	1968 Proj. II
	--- In Billions of Dollars ---							
Gross National Product	59.4	41.7	4.2	8.8	16.1	16.1	8.9	18.5
Final sales	55.4	49.9	15.6	15.4	12.8	10.7	17.6	18.5
Private purchases	37.5	27.9	6.9	10.8	9.6	7.2	13.6	14.7
GNP in constant (1958) dollars	35.9	16.7	-.4	4.0	7.3	7.6	9.9	9.4
Final sales	32.1	24.6	10.1	10.3	4.2	2.5	8.6	9.5
Private purchases	21.9	10.4	3.7	7.1	3.0	1.7	6.7	8.0
	--- In Per Cent; Quarterly Changes are at Annual Rates ---							
Gross National Product	8.7	5.6	2.2	4.6	8.3	8.1	9.4	9.0
Final sales	8.2	6.8	8.4	8.1	6.6	5.4	8.8	9.1
Private purchases	7.0	4.8	4.7	7.3	6.4	4.7	8.8	9.3
Personal consumption expenditures	7.6	5.5	5.4	7.9	4.6	5.2	8.4	10.1
Durable goods	6.5	2.6	-6.8	17.9	1.1	6.1	14.6	14.6
Nondurable goods	8.5	4.8	7.4	5.6	2.4	3.3	7.4	10.7
Services	6.9	7.4	7.7	6.9	8.2	7.1	7.1	7.9
Gross private domestic investment	9.9	-5.0	-38.6	-19.2	27.0	30.7	12.9	3.2
Residential construction	-9.6	0.0	9.6	31.8	43.3	31.2	1.4	0.0
Business fixed investment	12.8	3.0	-4.3	-2.0	6.4	5.8	11.9	4.6
Gov't purchases of goods & services	13.1	14.3	21.5	10.8	7.3	7.9	8.8	8.2
Federal	15.3	16.8	27.5	11.0	6.3	5.7	7.8	7.7
Defense	20.8	19.8	28.0	13.1	4.4	4.9	5.4	5.3
Other	-1.2	5.5	22.6	4.8	14.1	9.1	17.8	17.0
State & local	10.9	11.9	15.5	10.1	9.4	9.6	9.8	8.7
GNP in constant (1958) dollars	5.8	2.6	-.2	2.4	4.4	4.5	5.8	5.5
Final sales	5.3	3.8	6.3	6.3	2.5	1.5	5.1	5.6
Private purchases	4.4	2.0	2.9	5.5	2.3	1.3	5.1	6.0
GNP Implicit deflator	2.7	3.0	2.4	2.1	3.9	3.6	3.5	3.5
Personal income	8.6	7.3	7.5	4.0	7.7	7.3	8.7	9.7
Wages and salaries	9.9	7.4	7.2	3.5	7.6	9.1	9.4	8.9
Disposable income	7.8	7.1	8.2	5.5	6.1	7.1	8.2	9.6
Corporate profits before tax	9.5	-3.9	-23.4	-0.5	5.6	20.0 1/	9.5	14.0
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.7	5.9	1.3	-2.7	12.4	11.3 2/	15.3	9.6
Expenditures	15.8	14.8	23.7	4.7	7.6	4.8	10.7	16.2
Nonfarm payroll employment	5.3	3.3	4.3	0.0	2.4	4.2	3.6	3.0
Manufacturing	6.1	0.5	0.0	-4.1	-2.1	4.2	4.1	2.0
Industrial production	9.0	1.0	-5.5	-3.1	3.3	5.6	7.8	7.4
Housing starts, private	-20.4	10.3	87.0	32.1	62.8	11.4	2.8	-13.8
Sales new U.S.-made autos 3/	-4.4	-9.7	-50.3	53.1	-26.6	-6.9	30.1	25.0

1/ Based on F.R.B. estimate reflecting, in part, published reports and which is larger than the rate implied by Commerce estimate for 1967.
2/ Based on F.R.B. estimate of corporate profits.
3/ Quarterly figures reflect revised figures.

Industrial production. Industrial production is expected to show little, if any, increase in February following a decline from 161.8 in December to a preliminary figure of 161.2 in January. The January figure was 2 per cent above the reduced level reached a year earlier and was 3.5 per cent above the June 1967 low. Production changes in January reflected only in part special situations such as work stoppages at GM and the end of a strike in the machinery industry. Decreases were fairly general in production of consumer goods and industrial materials, where business inventories had reached high levels and final demands had not been quite as strong as anticipated.

In February, auto assemblies are indicated to be down 5 per cent or more to an annual rate of 7.8 million units from 8.3 in January and 9.0 in December. The February decline for some models reflects additional work stoppages, but dealer sales of new autos generally have been a little disappointing to producers and not up to the earlier advanced rates of output; thus, dealers' stocks have been rising towards the relatively high levels prevailing a year ago.

Weekly steel production resumed its advance in mid-January but output for the month was below December, on a seasonally adjusted basis. After the first week of February, steel production leveled off again so that only a small rise is indicated for February. Steel consumption in capital goods industries as well as in autos and appliances is reported by the industry to be below earlier expectations.

Output of crude oil and petroleum products is estimated to be up somewhat in February but additional weakness is indicated in some other nondurable goods industries. Also, more complete data for the textile industry for January suggest a larger decrease than the 1/2 per cent shown by the Board's preliminary index for textiles.

Capacity utilization. Utilization of capacity by manufacturers was estimated to be 84.5 per cent in January, down from 85.4 per cent in the previous month. At the January level the operating rate was only slightly above last summer. Manufacturing production in January was nearly 2 per cent higher than a year earlier, but over the same period capacity is estimated to have grown by more than 6 per cent.

Pressures on capacity vary somewhat from industry to industry. Utilization rates are high in the aircraft and electric power generating equipment industries, and only moderate amounts of unused capacity remain for production of most textile, petroleum and rubber products. Although steel production continued high in February as users hedged against a possible strike a sizable margin of unused steel capacity remains.

UTILIZATION RATES
(per cent)

Industry	1967						1968
	Q I	Q II	Q III	Q IV	Nov.	Dec.	Jan.
Manufacturing	87.1	84.9	84.1	84.3	84.3	85.4	84.5
Primary processing	86.0	83.1	82.5	84.4	84.1	85.7	84.4
Advanced processing	87.8	86.2	85.2	84.3	84.4	85.2	84.6

New orders and shipments of durable goods. New orders received in January by durable goods producers were originally reported down 4.7 per cent from the previous month, following an extraordinary 12 per cent increase in December. However, confidential information received after release of the advance report indicates a larger decline--perhaps 6.5 per cent. Some decline in January was not unexpected since the earlier increase appeared to be partly due to irregular factors and faulty seasonal adjustment.

Shipments of durable goods were originally reported to have increased 4.1 per cent in January. But in this case, also, information received after original release of this figure indicates an increase of only around 1 per cent. Either figure, however, results in a total volume of January shipments well above August--the month before the auto strike--and above the high of December 1966.

Business inventories. As in 1966, 1967 ended with inventory accumulation showing a pronounced spurt. In book value terms, inventory accumulation by manufacturers and distributors totaled nearly $1.3 billion in December (preliminary) and $1.1 billion in November and, for the entire fourth quarter, totaled $2.8 billion, or an annual rate of $11.2 billion. This compares with a $4 billion annual rate in the third quarter and $0.3 billion in the second.

A large part of the book value increase now reported for late 1967 apparently reflected sharply rising prices, and after allowance for price increases through an inventory valuation adjustment and also for changes in the rate of inventory investment outside of manufacturing and trade, total nonfarm inventory accumulation on a GNP basis showed a much smaller increase in the fourth quarter.

In contrast to late 1966, business sales--primarily at manufacturers--were rising sharply in November and December 1967, when the rate of inventory accumulation jumped; and the over-all ratio of business inventories to sales dropped substantially and in December for the first time in 1967 was somewhat below the high end-of-1966 level.

As shown in the table--which is based on book value figures--manufacturers, wholesalers, and retailers all participated in the sharp step-up in the rate of inventory accumulation over the last half of the year. The most pronounced shifts, however, were at wholesalers and retailers--from appreciable liquidation in the second quarter to moderate accumulation in the third and sizable accumulation in the fourth. At retail, this shift reflected to a major degree developments at auto dealers.

At manufacturers, the rate of accumulation in the fourth quarter was double the second and third quarter rates but only half as large as the extraordinary rate of late 1966. The step-up at manufacturers in late 1967 stemmed largely from a shift from liquidation to accumulation in consumer durable goods industries (including autos). The rate of accumulation in business and defense industries was maintained at a fairly sizable pace throughout the last half of the year.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES
($ billion, seasonally adjusted annual rates)

	IVQ 1966	IIQ 1967	IVQ 1967p
Manufacturing and trade, total	18.8	0.3	11.2
Durable, total	13.8	0.3	7.4
Nondurable, total	5.0	*	3.8
Manufacturing	12.0	2.8	5.7
Durable	9.9	2.4	4.7
Business and defense equipment	5.2	2.5	2.4
Consumer durables	1.2	-1.1	0.8
Other durables	3.4	1.0	1.5
Nondurable	2.1	0.4	1.0
Trade	6.8	-2.5	5.5
Durable	3.9	-2.1	2.7
Nondurable	2.9	-0.4	2.8
ADDENDUM:			
Total nonfarm, GNP basis	19.0	0.6	7.7

* Less than 0.05 per cent.

Retail sales. Retail sales, according to Census advance estimates, rose almost 3 per cent in January to a level nearly 6 per cent above a year earlier. In the last half of 1967, except for a spurt in September and a drop in October, total sales had held close to the rate at mid-year. Weekly sales figures for the first two full weeks of February suggest that a further small rise in sales--less than 1 per cent--is occurring this month.

Sales at durable goods stores in January were up more than total sales, led by a rise in new car sales and an advance in sales at lumber and other building materials outlets which more than offset a very sharp drop at furniture and appliance stores. Gains were registered at all types of nondurable goods stores except department stores.

CHANGES IN DOLLAR VOLUME OF RETAIL SALES
(Per cent)

	January 1968 from			Estimated Feb. 1968 from Jan. 1968
	Jan. 1967	Dec. 1967	4th Qtr. 1967 Avg.	
Total all stores	5.8	2.9	3.3	.8
Excluding automotive group	5.0	2.0	2.5	--
Durable goods stores	5.3	3.7	4.5	1.1
Furniture and appliance	-4.5	-7.8	-5.8	--
Nondurable goods stores	6.0	2.6	2.8	.7
Food, eating, and drinking	6.9	3.2	3.7	--
Apparel	1.5	4.1	2.9	--
General merchandise	4.9	0.1	0.2	--

Unit sales and stocks of autos. Dealer deliveries of new domestic autos in the first 20 days of February were 14 per cent above the relatively low level of a year earlier, when sales were at a seasonally adjusted annual rate of only 6.7 million units. For February as a whole, the annual rate of sales is expected to be about 7.5 million units, as compared with 8.0 million in January and 7.4 million in December. (Seasonal factors for both the sales and stock series have been revised to allow for an indicated shift of some of the spring sales to the winter months.)

The stock of new cars (seasonally adjusted) at the end of the second period of February was moderately higher than at the end of January, which in turn was 5 per cent above December. On February 20, the stock was 7 per cent below the high level of a year earlier and this gap is expected to be narrowed further by the end of the month. The increase in inventories has continued to be limited by work stoppages.

Sales of imported cars for the year 1967 increased 17 per cent from the previous year and the import share of the market rose from 7.3 to 9.3 per cent. January figures show a further rise in the import share to over 10.5 per cent.

Consumer credit. Early reports on instalment credit developments at commercial banks are generally consistent with indications of improvement in retail sales, as reported for January. Auto credit apparently expanded quite sharply at banks, as did holdings of nonauto goods paper. Personal loan volume, on the other hand, was about in line with other recent months, while home improvement credit continued sluggish. On balance, early reports suggest that January witnessed a continuation of the somewhat faster rate of expansion in consumer instalment credit that first became apparent last November, when the net increase in outstandings was a little over $400 million. In December, the increase was a little under $400 million.

Meanwhile, there are indications that the especially fast repayment rate of the second and third quarters of last year has begun to taper off. In each of those periods, repayments on instalment debt increased more than $500 million. In the final quarter of 1967, however, the increase in repayments was less than $100 million. As the table shows, much of the pick-up in the second and third quarters came in the other consumer goods category, while the fourth quarter slowdown resulted largely from a reduced rate of repayments on personal loans.

REPAYMENT ON CONSUMER INSTALMENT DEBT
($ billions, seasonally adjusted, quarterly totals)

	Total	Autos	Other Consumer Goods	Home Improve-ments	Personal Loans
1967					
Q1	18.8	6.6	5.7	.5	5.9
Q2	19.3	6.7	5.9	.5	6.1
Q3	19.8	6.7	6.3	.5	6.3
Q4	19.9	6.8	6.4	.5	6.2

Note: Figures may not add across due to rounding.

Further evidence of a slower repayments rate is provided by the ratio of repayments to disposable personal income. The ratio moved progressively up in 1967 and reached an all-time high of 14.5 per cent in the third quarter, but it then turned down to 14.3 per cent in the final quarter. This decline may have important implications for growth in consumer spending; a decrease in the repayment ratio is customarily viewed as an indication of the ability and willingness of consumers to incur more debt. Indeed, as suggested above, a turnaround in consumer attitudes may actually have begun last November.

Consumer buying expectations. The Census Quarterly Survey of Consumer Buying Expectations, taken in January, indicates some improvement over the October survey in expected purchases of new cars, household durables, and houses. At 103.9 (Jan. 1967-April 1967=100) the index for new cars, however, is still below the 104.7 of the July survey. The indexes for household durables and houses are also below the July 1967 levels. Expected expenditures on used cars at 103.4 are at a high for the 5 quarters of comparable data. Households in January were very optimistic about a substantial increase in family income, with 19.3 per cent of all households expecting an increase in the next 12 months and only 5.5 expecting a decrease. In July 1967, the previous high, 17.4 per cent had expected an increase.

Construction and real estate. Total new construction put in place edged higher in January, almost reaching the peak rate of March 1966. Private residential activity--already at a near-record high in December--continued upward for the thirteenth consecutive month. Private nonresidential construction outlays, which in recent months have fluctuated narrowly above last April, also increased a little in January; and public construction expenditures held at about the advanced December rate.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	January 1968 ($billions)1/	Per cent change from	
		December 1967	January 1967
Total	78.2	+1	+5
Private	52.8	+1	+9
Residential	27.3	+1	+37
Nonresidential	25.5	+1	-10
Public	25.4	--	-4

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

Seasonally adjusted housing starts, which had dropped sharply in December after an unusually sustained rise through November, veered upward again in January. While the January annual rate of 1,445 thousand was not far from Staff expectations, it barely exceeded the average for the fourth quarter of 1967 as a whole and was well below the rate of 1,590 thousand reached in November. As in the December decline, the January rise was broadly based both by type of structure and by region.

Some further advance in the rate of starts seems likely for February for technical as well as other reasons, even though there was an appreciable decline in the rate of building permits.

PRIVATE HOUSING STARTS AND PERMITS

	January 1968 (Thousands of units) 1/	Per cent change from	
		December 1967	January 1967
Starts	1,445	+ 16	+ 30
1 - family	898	+ 13	+ 11
2 - or-more-family	547	+ 21	+ 79
Northeast	235	+ 44	+ 12
North Central	412	+ 26	+ 29
South	522	+ 1	+ 14
West	276	+ 17	+124
Permits	1,111	- 16	+ 18
1 - family	635	- 10	+ 16
2 -or-more-family	476	- 23	+ 21

1/ Seasonally adjusted annual rates; preliminary.

New home sales by speculative builders in December were maintained at the relatively advanced November rate. Seasonally adjusted stocks of homes for sale by such builders remained very near the recent low reached last August, reflecting both high sales and continuing concern by builders about profit prospects under conditions of high and rising financing costs, particularly for Government-assisted mortgages.

Although lack of desirable used homes for sale has continued to be a feature of existing-home markets in a number of areas, sales of existing homes in December were running a fourth above the reduced year-earlier level, according to the National Association of Real Estate Boards. In December, as in other recent months, such homes were selling at prices 5 per cent above a year earlier. And with mortgage interest rates at or above earlier highs, indications were that increased reliance was being placed on instalment land contracts, all-cash transfers, and arrangements which permit assumption by the buyer of the seller's outstandings first mortgage and the use of a second mortgage in such cases to supplement the cash-downpayment.

Labor market. After ending the year with a considerable burst of strength, key labor market measures in January showed apparently conflicting movements; employment growth slowed significantly, but the unemployment rate dipped for the third month in a row and was a shade below the minimum rate attained during 1966.

Nonfarm employment rose only 36,000 in January, as compared with an average monthly gain of 200,000 during the preceding six months. However, the slower growth was largely a result of a much larger than usual seasonal decline in construction employment, which was down by 120,000--apparently the result of bad weather. Excluding this decline in construction and returns from strikes, the employment increase in January would have been about 140,000 (1.7 million at an annual rate). This would still be well below the gains af the past several months, but close to the average increase over the past year.

In manufacturing, employment rose some 45,000, with about 40 per cent of the increase representing the return of workers from strike, primarily in the machinery industry. Other than this, employment gains in durable industries were small, but widespread. Nondurable goods employment was off 15,000, as a result of a dip of this magnitude in the volatile apparel industry.

The workweek in manufacturing dropped by three-tenths of an hour in January, reflecting widespread declines which may also have been largely weather-induced. In nondurable goods industries, the workweek was down by half an hour, with cuts of over half an hour in the apparel, textiles and leather industries. There were reductions in hours in a number of durable goods industries as well. The largest were in the weather-sensitive lumber and stone, clay and glass industries--which were offset by a sharp rebound of the workweek in transportation equipment, as auto plants expanded their output to regain strike-lost production.

Among other sectors of the economy, apart from the drop in construction, there were continued strong employment gains in the State and local government, finance and service sectors (up by 90,000) and trade (up 30,000); Federal government employment continued to edge down slightly.

The unemployment rate declined by two-tenths of one per cent in January to 3.5 per cent, a drop of 0.8 from the 1967 peak of 4.3 per cent in October. The January unemployment dip occurred largely among the more "marginal" members of the labor force; there was a substantially greater than usual post-Christmas exodus of adult women from the labor market which reduced their unemployment rate, and a somewhat smaller than seasonal decline in the number of teenagers employed. The unemployment decline for both groups probably represented no more than the difficulties of precise seasonal adjustment of relatively volatile labor force groups at a time of year when large numbers typically change their labor force status. A more stable indicator of labor demand, the unemployment rate for adult males aged 25 and over, remained about unchanged at 1.9 per cent, a rate lower than during the 1966 boom, and about equal to the rate during the Korean War period.

Earnings. Hourly earnings in manufacturing rose again in January by 2 cents to $2.93, and were 5.4 per cent higher than a year earlier. The pattern of much faster than average increases continued in the low-wage manufacturing industries, and has spread to some high-wage industries as well. Reflecting the contract settlement between the U.A.W. and G.M. effective the end of December, hourly earnings in transportation equipment were up 23 cents, or 6.8 per cent, from a year earlier. In the low-wage lumber, apparel and leather industries, hourly earnings have increased 7 per cent or more since January 1967. Not far behind is the electrical equipment industry with a 6.7 per cent rise.

Average hourly earnings in January were more than 6 per cent above year-earlier levels in most major nonmanufacturing industries, both high- and low-wage.

INCREASES IN AVERAGE HOURLY EARNINGS
(Per cent)

Selected Industries	January 1966 to January 1967	January 1967 to January 1968
Contract construction	6.1	6.7
Finance, insurance and real estate	3.7	6.3
Retail trade	4.8	6.1
Manufacturing	4.1	5.4

The outlook is for further upward pressure on wages in low-wage industries in February, reflecting the increase in the Federal minimum wage on February 1. In the higher wage industries, particularly primary metals, contract negotiations in aluminum in May, and in steel in July will probably result in wage increases equal to the 6 per cent and more received by workers in the automobile, farm equipment and fabricated metal industry contracts.

<u>Compensation and unit labor costs.</u> Unit labor costs in manufacturing rose sharply between December and January, on top of a substantial upward adjustment of the December index. The rise of 1.5 percentage points in January reflected mainly a surge in hourly compensation. In addition to the sharp rise in hourly earnings, an increase in the Social Security wage base was added to the cost of supplements which are included in employee compensation. The rate of increase in hourly compensation had eased late in 1967, edging down from an over-the-year rate of increase of 6.5 per cent in the first three quarters of 1967 to 5.8 per cent in the fourth quarter, despite the fact that manufacturing hourly earnings were rising more rapidly than earlier. In conjunction with a pick-up in productivity, this had tended to temper the pressure on unit labor costs somewhat toward the end of 1967. In January, however, the over-the-year rate of increase in compensation rebounded to 6.7 per cent, output per manhour failed to show any gain, and unit labor costs shot forward again. With large wage adjustments still in the offing, further increases in unit labor costs seem likely in coming months, although larger productivity gains should keep the increases below the 5.5 per cent rate of most of 1967.

Personal income. Personal income rose $2 billion in January to a seasonally adjusted annual rate of $651 billion, up $41 billion or 6.7 per cent from a year ago. Although the increase in private wages and salaries, $1.9 billion was in line with the monthly average increase of 1967, the rise in total personal income was the smallest since October as it was limited by some special influences which, on balance, served to raise the, December level and to lower the January level.

Wholesale prices. The BLS industrial commodity average increased 0.4 per cent in January, to 107.8 per cent of the 1957-59 average, and continued to rise at about that rate in February. The January rise exceeded the original BLS estimate, and was the largest monthly increase in this index since the recent upturn began last summer. The increase over the 6 months from July to January was at an average annual rate of 3.4 per cent, with a faster rate since October.

Prices of foods and foodstuffs--and the total wholesale price index--also increased somewhat more in January than had been estimated a month ago, and in February farm and food prices continued on up. The January WPI was at a new high of 107.2, 0.4 per cent above December and 0.7 per cent above mid-1967, before the recent run-up in industrial commodity prices began. Average prices of foods and foodstuffs, though up considerably from November, remain below mid-1967.

Prices of fruits and vegetables were up further in January, with supplies limited by unfavorable weather, and prices of livestock and products also continued to advance--suggesting continuing increases in food prices at retail in January and also in February.

Increases in industrial prices were widespread in January. There were especially large further gains in metals and products, machinery and equipment, lumber and wood products, and furniture and household durables. Despite some decline in raw cotton prices following the earlier sharp run-up, prices of cotton goods rose further and the entire textile products and apparel group moved substantially higher. Footwear and rubber and paper products also continued upward, and prices of autos were increaeed somewhat further. Prices of chemicals and gasoline declined.

Price increases for raw and semi-fabricated copper materials continued to bulk large in the January industrial price rise, with the strike still underway and prices of available copper ingots (largely imports) moving higher and higher. Raw and semi-fabricated copper represent less than 2 per cent of the industrial average weight structure but in January increases in these copper items accounted for almost 15 per cent of the rise in the industrial index. For the entire period from July to January copper materials accounted directly for about 12 per cent of the rise in the BLS industrial average.

In the FR industrial commodity total, which includes cotton, as noted in the last Greenbook, the combined rise in copper and cotton materials--both temporarily in very short supply--accounted directly for nearly one-fourth of the index rise from July to January, although their combined weight is only about 3.5 per cent.

The table below shows the FR industrial commodity total, which from July to January increased about as much as the BLS industrial average despite some differences in classification, together with the special FR groupings of materials and products. Up to recent months, the fastest rate of advance in industrial prices during the post-1961 expansion period occurred in late 1965 and the first half of 1966--particularly the latter period. Price increases during the past 6 months generally have been at a faster pace than from mid-1965 to mid-1966.

From July to January, aside from the special cases of copper--which accounted for the bulk of the rise shown for nonferrous metals--and cotton--which bulked large in the textile material increase, especially large increases occurred for steel mill products, nonmetallic minerals and other building materials, trucks and passenger cars, and many other products for producers and consumers. In a few areas, price declines occurred recently, in contrast to increases from mid-1965 to mid-1966.

WHOLESALE PRICES OF INDUSTRIAL COMMODITIES
(Per cent changes)

	July 1965 to July 1966	July 1966 to July 1967	July 1967 to Jan. 1968 (annual rate)
Special FR groupings:			
Industrial commodities, total	2.4	0.6	3.5
Materials	2.9	-0.5	3.6
Sensitive	3.9	-5.9	9.6
Other	2.5	1.4	1.8
Products	2.0	2.1	3.2
Consumer nonfoods	1.7	1.7	2.4
Producers' equipment	2.6	3.0	5.0

Food consumption in 1967 and prospects for 1968. Final figures on per capita civilian food consumption in 1967 recently published by the Department of Agriculture (USDA) confirm earlier estimates that the civilian population ate more in 1967 than ever before. The USDA also suggests that food supplies likely to be available in 1968 will enable civilians to sustain this high level consumption, but probably at somewhat higher prices because of further expansion of demands. Retail food prices at grocery stores are expected to average about 2 per cent above 1967 and prices of food away from home are likely to advance at the 5 per cent annual rate of the past two years.

CIVILIAN PER CAPITAL FOOD CONSUMPTION
(1957-59 = 100)

	1965	1966	1967	Percentage increases 1966 to 1967
Total	101.4	102.6	104.4	1.8
Animal products	100.9	102.2	104.6	2.3
Crop products	102.0	103.1	104.2	1.1
Red meat	104.0	106.0	110.0	3.8
Beef	121.0	126.7	129.5	2.2
Pork	92.9	92.1	101.0	9.7
Poultry and eggs	104.6	109.0	113.4	4.0
Dairy products	98.0	98.0	97.0	-1.0
Fruits and vegetables	102.1	105.4	107.1	1.6
Cereal products.	98.0	96.0	97.0	1.0

Per capita consumption in 1967. Per capita civilian food consumption in 1967 averaged 2 per cent above 1966 and exceeded the 1946 record by 1 per cent. Both animal and crop product consumption rates were above a year earlier, as shown in the table.

Military food consumption on a per capita basis was roughly a half larger than average civilian consumption according to USDA estimates. It accounted for 2.2 per cent of total food use in 1966 and 1967.

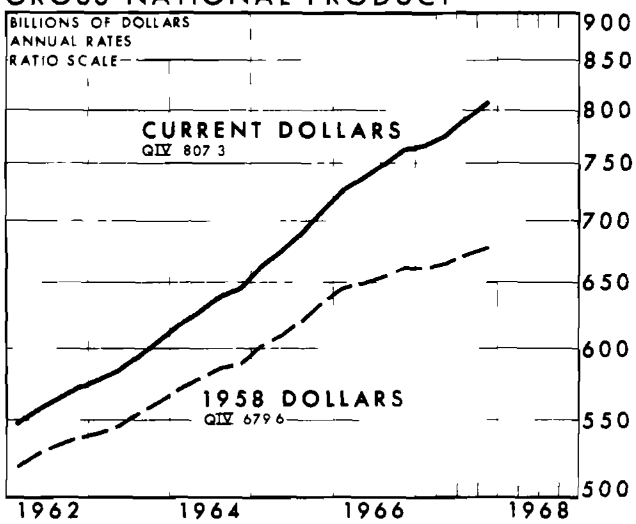
1968 prospects. Per capita consumption prospects in 1968 are firmer for the first half of the year than the second half when 1968 crop output becomes a more important variable influencing supply prospects. January 1 livestock inventory data and other reports suggest that pork and beef supplies will average above year-earlier levels at least through the first half of the year and stay close to 1967 in the second half. It seems likely that the downtrend in dairy consumption will continue and that consumption of poultry and eggs will remain close to 1967 levels.

Consumption of fresh and processed fruits during the first half of 1963 is expected to be less than a year earlier but consumption of processed vegetables will probably be larger. Production of winter vegetables for fresh market is down 10 per cent. Stocks of winter potatoes are in surplus supply.

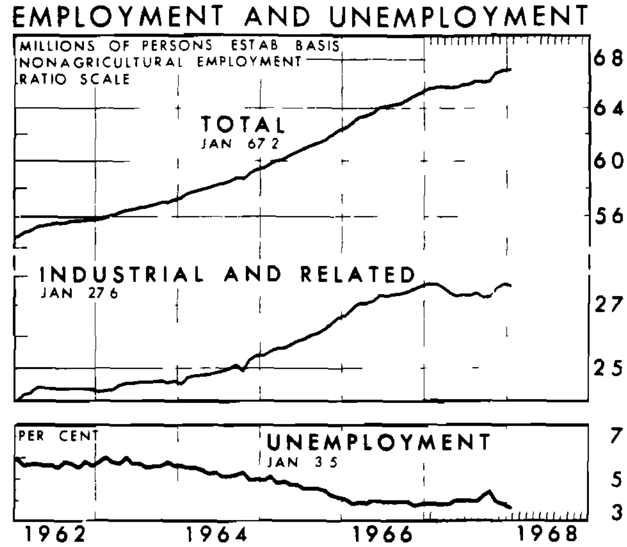
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

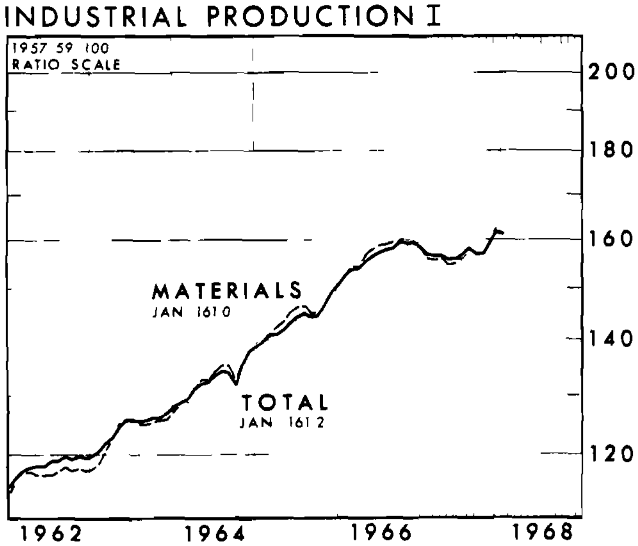
GROSS NATIONAL PRODUCT



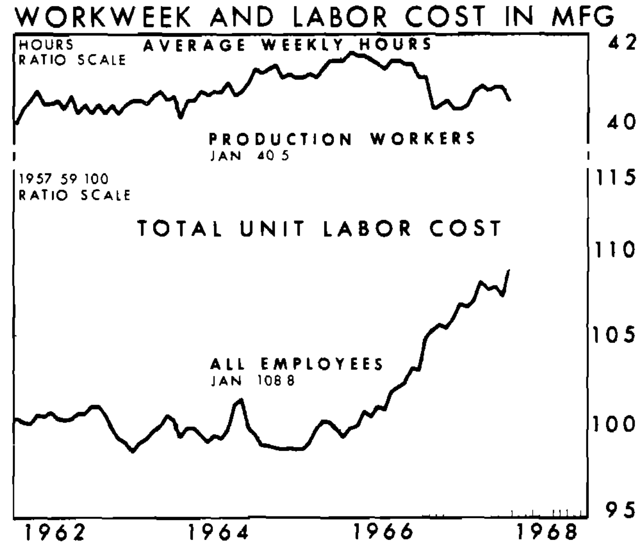
EMPLOYMENT AND UNEMPLOYMENT



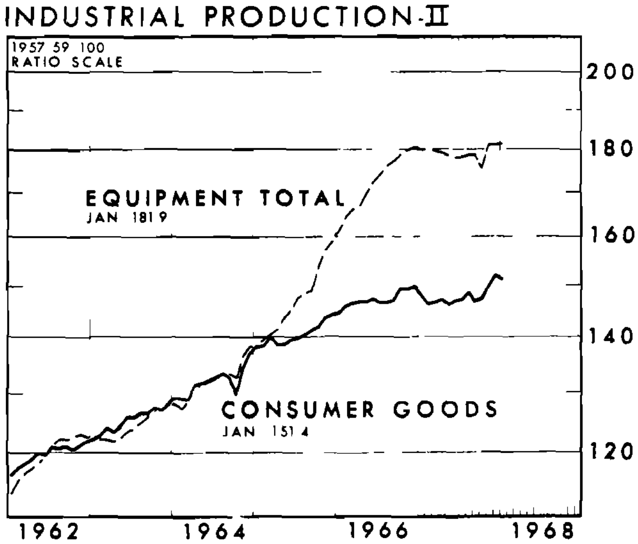
INDUSTRIAL PRODUCTION I



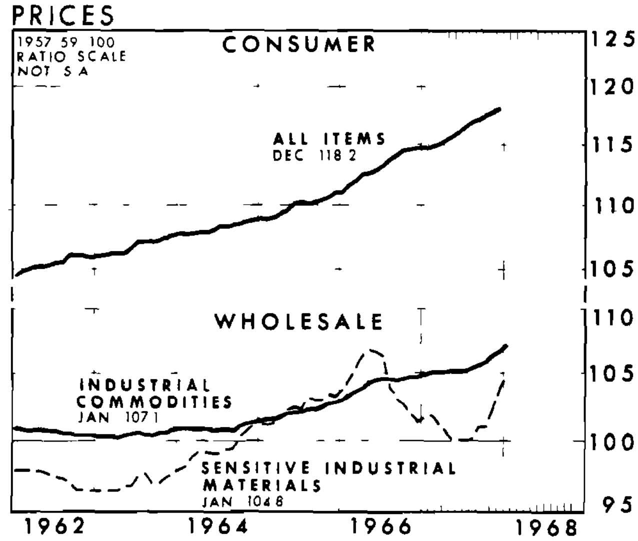
WORKWEEK AND LABOR COST IN MFG



INDUSTRIAL PRODUCTION II



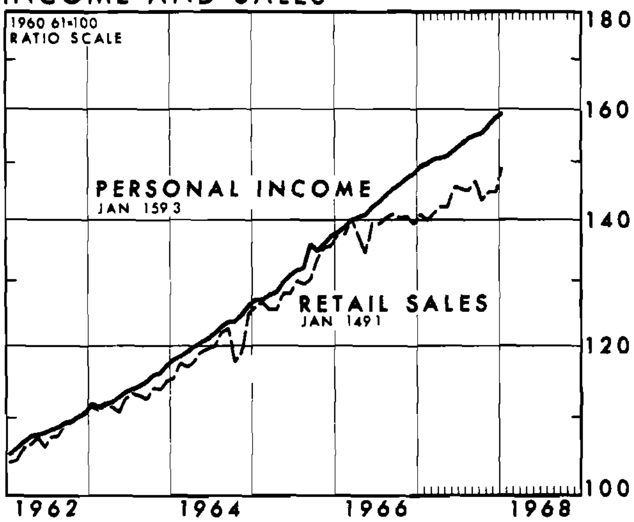
PRICES



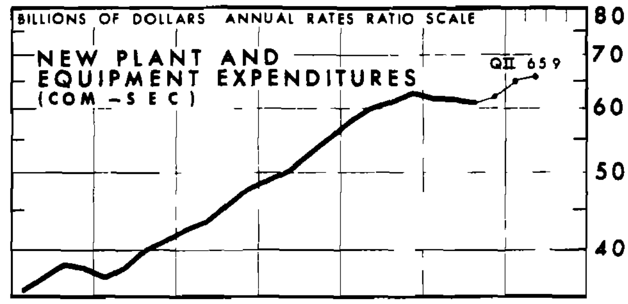
ECONOMIC DEVELOPMENTS - UNITED STATES

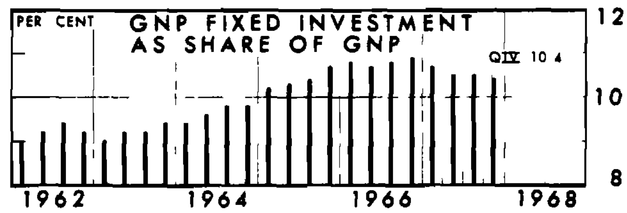
SEASONALLY ADJUSTED

INCOME AND SALES

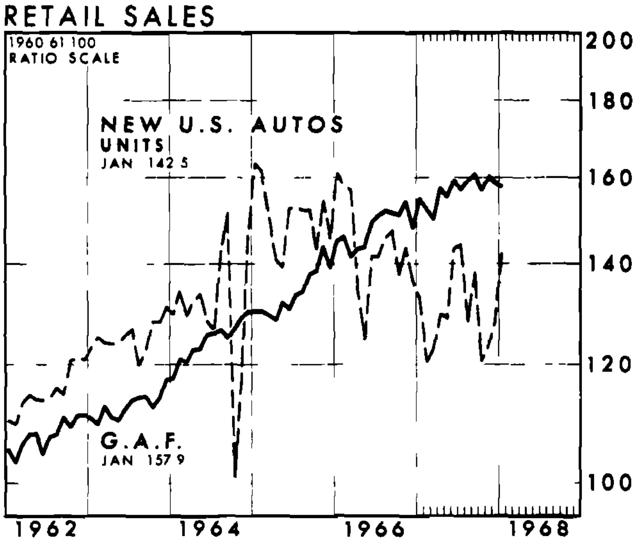


BUSINESS INVESTMENT

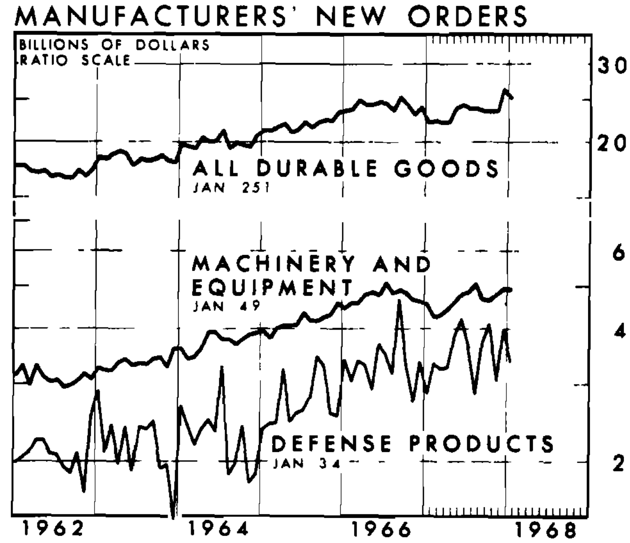




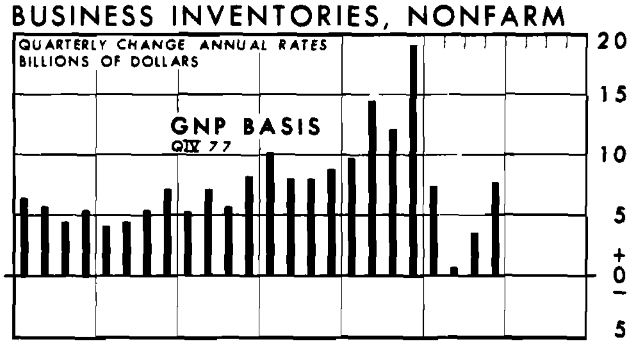
RETAIL SALES

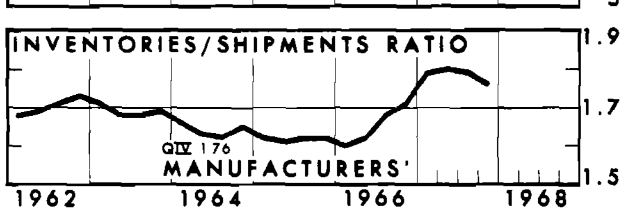


MANUFACTURERS' NEW ORDERS

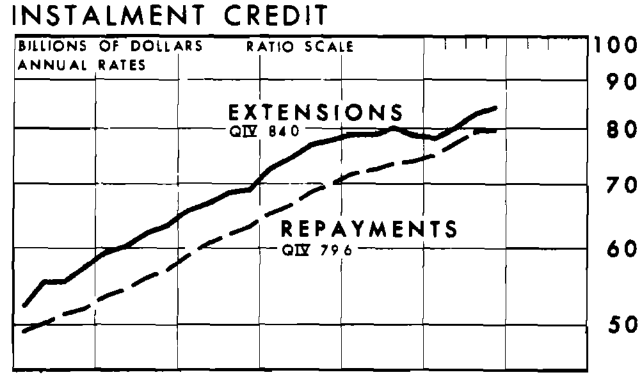


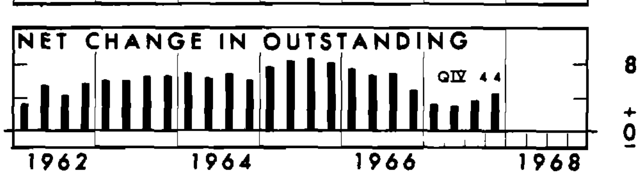
BUSINESS INVENTORIES, NONFARM





INSTALMENT CREDIT





DOMESTIC FINANCIAL SITUATION

Bank credit. Commercial bank credit, after expanding rapidly during January, declined in early February. However, in large part owing to heavy bank underwriting of the approximately $4 billion Treasury cash financing on February 21, credit is expected to show another relatively large rise for the month as a whole. The February bank credit proxy is projected to expand at around a 9 per cent annual rate, on a daily average basis, as compared to 8.3 per cent in January.

The more than seasonal decline in credit in early February reflected heavy liquidation both in loans and investments. During this period, city banks continued to reduce holdings of Treasury bills, reflecting mainly further secondary distribution of tax bills acquired by banks as they underwrote the $2.5 billion tax bill financing in mid-January. On February 21, however, city banks acquired a substantial volume of the new 15-month notes issued by the Treasury on that date. Following a sharp increase in January, weekly reporting banks also reduced their holdings of other securities in early February, although these security holdings rose somewhat in the week ending February 21.

The reduction in total loans outstanding in early February reflects in part a further decline in outstanding business loans, as these loans continued to retrace part of their rapid December-early January rise. During the comparable weeks of other recent years, these loans had increased. There has been little strength in evidence in nearly all major industry categories. The principal exception has been primary metals, where term loans recently have risen substantially--presumably reflecting borrowing by steel companies for plant and equipment expenditures.

Although corporations in other industry categories still are reported to be firming up bank credit lines and arranging commitments for term loans and revolving credits, these facilities have been used relatively little thus far. The low level of takedowns--given the apparently widespread inventory stockpiling--suggests that corporations are using up some of the liquidity obtained in their large capital market financings last year. In view of the President's balance of payments program, some corporations may have acquired additional cash as a result of withdrawals of funds from Canada and Europe or the retention of funds destined for foreign investment.

The loan decline in early February also reflected net repayments of outstanding indebtedness in certain other major loan categories. For example, security loans declined substantially following a sharp rise in late January when dealers built up bill positions more than normally and also, toward the end of the month, began to acquire "rights" for the mid-February refunding. However, securities loans at New York increased sharply for the week ending February 21, reflecting the Treasury financing on that date. "Other" loans also showed a large decline, offsetting the increase of the last week of January associated with a technical overdraft in a Government securities dealer account.

Bank deposits. Following a modest upward trend during most of January, gorwth in total time and savings deposits at commercial banks accelerated somewhat in late January and early February. The increase for the month of February, on average, currently is projected at an annual rate of 8.5 per cent, about the same as in December.

NET CHANGE IN TIME AND SAVINGS DEPOSITS
WEEKLY REPORTING BANKS
(Millions of dollars, not seasonally adjusted)

	1965 Feb. 3- Feb. 17	1966 Feb. 2- Feb. 16	1967 Feb. 1- Feb. 15	1968 Jan. 31- Feb. 14
Total time and savings deposits	715	349	673	203
Consumer-type deposits	n.a.	n.a.	368	291
Savings deposits	227	46	47	38
Time deposits, IPC (other than CD's)	n.a.	n.a.	321	353
CD's	158	94	363	-124
Total time and savings deposits Excluding CD's	557	255	310	327

n.a. - Not available.

The bulk of the recent increase has been in consumer-type time deposits. In early February, regular savings deposits at weekly reporting banks turned up again after declining in January. The January decline probably reflected in large part the movement of funds out of these deposits into savings certificates and new consumer-type open accounts after the interest crediting period. Consumer-type time deposits other than savings also continued to expand in early February at a moderate rate. Total time and savings deposits at country banks expanded moderately in February following a slowdown in January.

So far this year, outstanding negotiable CD's have shown only a little more than a normal seasonal rise. Although they declined over the first two weeks of February at all weekly reporting banks, this decline was partly offset by a moderate increase at banks in New York and Chicago in the week ending February 21. While there has been some firming in CD rates in recent weeks, there increases appear to have been mainly defensive in character, since issuing banks do not appear to be particularly inclined to add to outstandings, presumably because of continued slack loan demands and availability of Euro-dollars at relatively favorable rates.

Through early February, Euro-dollar rates continued to decline from the high levels reached in late December, and the cost of Euro-dollars declined relative to that of CD's. As a result, banks increased their borrowing from foreign branches. By mid-January, these borrowings had approximated their mid-December level, and by late February they had moved above it.

After rising sharply in late December and early January, the money stock has fluctuated considerably while generally expanding at a moderate pace. On a daily average basis, the money stock is projected to increase at a 2.0 per cent annual rate for the month of February as a whole.

<u>Nonbank depositary intermediaries.</u> Preliminary data indicate that savings and loan associations experienced a large net outflow of share capital in January. Mutual savings banks' inflows, on the other hand, rebounded sharply in January after outflows in December (all data unadjusted for seasonal factors). The divergent January trends at savings and loans and mutual savings banks reflect two main factors. The savings banks experienced unusually large withdrawals during the late December grace period, which greatly reduced December flows relative to January. The associations, on the other hand, did not have particularly large withdrawals during the reinvestment period, but subsequent inflows were considerably less than normal.

NET NEW MONEY INFLOWS 1/ TO NONBANK DEPOSITARY INSTITUTIONS
($ millions; not seasonally adjusted)

	Insured Savings and Loan Associations*			Mutual Savings Banks		
	1965	1966	1967	1965	1966	1967
Average monthly Feb. - Sept.	380e	-158	585	106	-31	212
October	780e	- 81	454	60	10	94
November	582e	584	552	241	216	273
December	200e	272	157	94	103	-17
	1966	1967	1968	1966	1967	1968
January	-65	290	-236p	144	331	200p
Memorandum:	1965-66	1966-67	1967-68	1965-66	1966-67	1967-68
Average monthly Dec. - Jan.	67e	281	-40p	119	217	92p

1/ Net new money is deposits less withdrawals less interest credited.
* Insured savings and loan associations represent 96 per cent of the resources of all operating savings and loan associations.
e/ Estimate.
p/ Preliminary.

At both institutions, the average December-January experience (shown in the last line of the table) was somewhat less favorable than in the similar 1965-66 period. This comparison should not be taken to imply that the nonbank institutions in early 1968 will necessarily face the kinds of pressures existing in the similar period of 1966. Fragmentary data suggest that some improvement in saving flows from the greatly reduced December-January pace is likely in February. During the first fifteen days of the month, the fifteen largest mutual savings banks in New York City reported net inflows nearly as large as in the same period of 1967, and double those of February 1966. Data are not available for S&L's, but the staffs of both the FHLBB and U.S. Savings and Loan League suggest that February inflows probably will show somewhat more than the normal rebound from January. This impression tends to be supported by the commercial bank experience discussed above. Thus, while indications appear to buttress industry views that end-of-year savings experience was not as bad as feared--and apparently was not sustained--it still remains evident that market interest rates have risen to a point where they are significantly diverting individual savings flows.

Despite the January savings outflows, not all of the S&L's experiences were negative. Some areas of the South and the Northwest recorded inflows. Moreover, in some other areas the January experience could be explained in part by special local situations and factors. Associations in Indiana, for example, were affected adversely by a change in state law, effective January 1, which permitted commercial banks to offer 3-month consumer certificates of deposit at 5 per cent, as opposed to the previous ceiling of 4 per cent. In California, the lower rate ceilings instituted last July by the FHLBB probably contributed to reinvestment period outflows in that area.

Savings and loan associations weathered the January experience with little difficulty because of their ample preparation for it. Share capital outflows were reflected in drawdowns in S&L holdings of cash and Treasury securities, but their net liquidity position remained relatively comfortable. Borrowings by the S&L's were not a net source of funds in January, as a modest increase in advances from the FHLBB system was more than counterbalanced by repayments of a large portion of their December borrowing from commercial banks.

Mortgage market developments. Over-all conditions in the residential mortgage market, which had been tightening for some time prior to year end, apparently have changed little further since then. In early February, some savings and loan associations in a few areas eased their lending terms slightly, as aggregate savings outflows during January proved to be less of a drain on resources than had been anticipated. Through February 22, weekly offerings to FNMA of Government underwritten loans in the secondary mortgage market edged down, partly reflecting the continued reduced volume of primary-market originations at this normally slack season for real estate activity in many localities.

During January, average rates on conventional new-home mortgages rose slightly further in the primary market, according to the FHA series. They attained a new postwar high which was 5 basis points above the previous peaks reached last December and in November of 1966. Within the more sensitive secondary market, on the other hand, yields on certain FHA home mortgages remained unchanged at the record level reattained a month earlier. Increases in home mortgage yields were limited by the deep discounts already being required on many loans. The 27-basis-point decline in yields on new issues of high-grade corporate bonds in January produced a further recovery in yield spreads favoring home mortgages over such bonds, as the table shows, although spreads were still well below earlier standards.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary Market: Conventional loans			Secondary Market: FHA-insured loans			
	Level (per cent)	Change (basis points)	Yield spread (basis points)	Level (per cent)	Change (basis points)	Yield spread (basis points)	Discount (points)
1967							
April	6.40	-5	101	6.29	-6	90	2.5
May	6.45	5	79	6.44	15	78	3.8
June	6.50	5	71	6.51	7	72	4.4
July	6.50	0	72	6.53	2	75	4.6
August	6.55	5	66	6.60	7	71	5.2
September	6.55	0	67	6.63	3	75	5.4
October	6.55	0	43	6.65	2	53	5.6
November	6.65	10	12	6.77	12	24	6.5
December	6.70	5	19	6.81	4	30	6.8
1968							
January	6.75	5	51	6.81	0	57	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. Gross yield spread is average mortgage return minus average yield on new issues of high grade corporate bonds.

Demand for home-mortgages during January was limited by the seasonally low number of real estate transactions and the large discounts (or points) often associated with high yielding mortgages carrying contract rates of 6 per cent--the statutory ceiling on all FHA and VA mortgages and on conventional loans in 9 states. Such discounts--averaging 6.8 points on FHA loans--have continued to deter some would-be sellers from placing houses on the market, inasmuch as home sellers nominally must ordinarily absorb all but 1.0 point of any mortgage discount, besides paying any real estate brokerage fees involved.

Reports from the just completed Federal Reserve Bank and Federal Home Loan Bank mortgage market survey--summarized in the document accompanying the Greenbook--indicate that total new commitments on residential mortgages have generally been running moderately below normal for this time of year. Over the next three months, the prospect appears to be for no marked change beyond the usual sharp seasonal rise. One reason often cited for the recent below-normal pace of new commitments--has been the already large backlog of older commitments yet to be taken down. For those mortgage-oriented thrift institutions which submit reports, aggregate outstanding residential mortgage commitments changed little between November and January, as the table shows, remaining slightly above their December 1965 level when outlays for new private residential construction were averaging close to the rate reached in recent months.

INDEX OF RESIDENTIAL MORTGAGE COMMITMENTS OUTSTANDING
(December 1965 = 100)

	Volume at end of		
	April 1967	November 1967	January 1968
Savings and loan associations	73	106	109p
Savings banks in New York State	79	97	91p
Reporting thrift institutions	75	103	103p
Reporting life insurance companies	74	76	78*
All three groups	75	97	97*

NOTE: Based on seasonally adjusted data which are confidential for life insurance companies. Data for savings and loan associations and savings banks include some nonresidential mortgages.

* December 1967 for life insurance companies.

Outstanding residential mortgage commitments of the more diversified life insurance companies have continued considerably below their end-of-1965 volume. This has reflected a sharp drop-off in new residential mortgage commitments--especially on homes--in favor of commercial mortgage loans, direct placements, and purchases of bonds in the open market. During the fourth quarter of 1967, new residential mortgage commitments of reporting life insurance companies were nearly a third below the fourth quarter of 1965. A more detailed discussion of life insurance company activity in the fourth quarter can be found in Appendix A.

Corporate and municipal bond markets. Yields on new corporate and municipal bonds have advanced since early in February, but at current levels yields in both markets remain below the 1967 highs reached in early December. In the corporate market, the upward yield adjustment appears to have been in reaction to overly aggressive bidding by underwriters on several utility issues earlier. Interest rate pressures were more marked in the municipal market however. Unlike the corporate market, where the calendar of new issues is abating, the volume of new municipal issues remains large. Moreover, there has also been an apparent slackening in bank purchases of municipals during recent weeks.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa		State and local Government	
	New	Seasoned		
	With call protection		S&P High Grade	Bond Buyer's (mixed qualities)
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
19	6.16	6.14	4.34	4.25
February 2	6.16	6.12	4.23	4.16
9	6.23	6.11	4.30	4.24
16	6.28*	6.10	4.36	4.32
23	6.27	6.09	4.43	4.38

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

A sizable part of corporate underwriter's optimism, reflected in their new issue bidding, arose out of the reduced February calendar of scheduled public bond offerings. As noted, however, such optimism was not fully shared by investors. The calendar failed to build up significantly as the month progressed and the ultimate volume of public bond issues is estimated at $760 million, somewhat below earlier estimates. This places February offerings below January as well as below the comparable month a year ago. With private placements estimated at $700 million, however, total bond and stock issues are expected to aggregate over $1.6 billion in February, slightly above a year earlier.

CORPORATE SECURITY OFFERINGS 1/
(Millions of dollars)

	Bonds				Total bonds and stocks	
	Public Offerings 2/		Private Placements			
	1966	1967	1966	1967	1966	1967
Annual total	8,018	14,991	7,543	6,965	18,075	24,801
	1967	1968	1967	1968	1967	1968
1st quarter	3,263	2,245e	1,811	2,300e	5,464	5,270e
January	745	885e	848	700e	1,684	1,810e
February	900	760e	362	700e	1,418	1,635e
March	1,618	675e	601	900e	2,362	1,900e

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

To date, the March calendar of scheduled public bond offerings remains very light at $485 million. This volume is expected to be supplemented by later additions to the calendar, but still the total volume may be only about $675 million. Thus, March is likely to represent the third consecutive month-to-month decline in these offerings. It should be noted that the March volume of issues could rise above current expectations, however, if corporate borrowers accelerate their debt financing plans in an attempt to catch an apparent void in the March calendar. Nevertheless, a likely rise in private placements and new stock issues (primarily due to two large utility offerings) will bring total bond and stock issues to about $1.9 billion, in line with recent months.

State and local government bond offerings during February are estimated to aggregate $1.2 billion, slightly above January and about equal to February 1967. This volume has not been fully absorbed by investors, however, as numerous issues remain in syndicate; dealers' advertised inventories have advanced about $100 million since mid-month. A drop-off in bank demand for these securities--relative to earlier in the year--apparently accounts for part of the weakness in the municipal market.

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

	1966	1967
Annual total	11,450	14,650
	1967	1968
Quarter I	4,173	3,450e
January	1,487	1,150e
February	1,231	1,200e
March	1,455	1,100e

1/ Data are for principal amounts of new issues.

But in addition to purely technical factors and somewhat reduced bank demand, the large prospective volume of municipal issues has acted to dampen the enthusiasm of market participants for new issues at current yields. The estimated volume of March municipal offerings is again in excess of $1 billion. This brings the first quarter volume to nearly $3.5 billion, second only to the unusually large volume in the first quarter of 1967.

Corporate profits. Corporate profits before taxes appear to have increased much more than had been expected from the third to the fourth quarter of last year and may have equaled the previous all-time record reached in the third and fourth quarters of 1966. The increase reflected entirely a sharp rise in profits for the manufacturing sector, as indicated by published earnings data for 570 large companies that account for 60 per cent of the profits of all manufacturing corporations.

Profits in the motor vehicle and nonferrous metals groups were well below year-earlier totals, because of strikes within these industries, but earnings in almost every other major manufacturing industry were as large or larger in the fourth quarter of 1967 than in the same quarter of 1966. For all manufacturing, profits are estimated to have increased about 2 per cent. This is only a small increase, but it contrasts with declines earlier in the year and implies a rise of 15 per cent in seasonally adjusted manufacturing profits before tax from the third to the fourth quarter. (Profits data for separate manufacturing industries are not available on a seasonally adjusted basis--hence the use of year-to-year rather than quarter-to-quarter comparisons.)

Total corporate profits, it should be noted, declined nearly 5 per cent between the fourth quarter of 1966 and the third quarter of 1967, and the decline centered in manufacturing industries. Thus, even though earnings of nonmanufacturing groups as a whole probably changed little in the fourth quarter of 1967, recovery of manufacturing profits sharply reversed the trend in total profits.

<u>Stock market</u>. Between mid-January and mid-February, common stock prices declined sharply. Although the market then turned up again, the subsequent "recovery" as of late February still appeared to be largely technical. A 5 per cent decline in New York Stock Exchange short interest between mid-January and mid-February, and corresponding 10 per cent decline in American Exchange short interest, suggests that

some short sellers believed the prices of their stocks were near bottom. Nonetheless, the mid-February short interest remained relatively high.

STOCK PRICES

	S&P 500	D-J Ind.	AMEX
Decline from mid-January to mid-February	-7.9%	-8.5%	-12.0%
Increase from mid-February to late February	+1.6%	+1.8%	+ 2.7%

Since the middle of January, trading volume on the American Exchange has declined significantly from the earlier peak levels, but New York Exchange volume has remained relatively high.

AVERAGE DAILY TRADING VOLUME

	New York Stock Exchange	American Exchange
Week ending:		
January 19	12.7	9.3
26	10.9	6.3
February 2	10.0	5.5
9	9.5	4.7
16	10.3	4.4
23	8.5	3.6

While the less seasoned stocks, as represented by the American Exchange index, are now farthest from their mid-January high's, the declines have not been concentrated in any specific industries. This across-the-board re-evaluation of stock values would imply that the factors affecting the market have been general ones--most probably uncertainty regarding public policy and international developments.

January data for margin debt (a series increasingly more reliable than customers' net debit balances) show that during the market decline, broker and dealer margin customers sold some of their holdings. Although bank purpose loans to others than brokers and dealers were unchanged at about $2.4 billion, margin debt in January declined by $160 million--offsetting 10 per cent of the increase over 1967 as a whole. This was the largest such decline since September 1965. At the same time, reflecting declining stock values and customer sales, collateral values associated with outstanding margin debt declined about $1.0 billion, or 5 per cent. The proportion of debt in accounts with equity status of 40 per cent or less, however, was virtually unchanged at 10 per cent, and thus the decline in stock prices did not increase the general vulnerability of margin accounts to calls.

<u>U.S. Government securities market</u>. Yields on short-term Treasury securities have risen on balance since early February, but yields on Treasury obligations maturing in 5 years or more have changed little, as the table shows.

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

	1967		1968	
	High	Dec. 29	Feb. 5	Feb. 27
Bills				
1-month	4.75 (1/4)	4.60	4.67	4.75
3-months	5.07 (12/15)	5.04	4.91	5.06
6-months	5.60 (12/1)	5.54	5.11	5.21
1-year	5.71 (12/29)	5.71	5.26	5.33
Coupons				
3-years	5.87 (11/13)	5.80	5.60	5.65
5-years	5.91 (11/13)	5.78	5.64	5.61
10-years	5.87 (11/13)	5.70	5.60	5.58
20-years	5.81 (11/20)	5.56	5.39	5.40

The recent advance in Treasury bill rates has occurred against a background of rising dealer financing costs and expectations of further tightening of money market rates following completion of the Treasury's February financings. The Treasury sale of over $4 billion new 15-month notes on February 13 added to supply pressures in short-term debt markets. Investment demand for short-term issues has remained generally good but dealers have recently become more willing sellers of bills, even at rising yields, following a substantial build-up in their inventories over the course of January. The Treasury announcement on February 20 of renewed $100 million cash additions to the weekly 3-month bill auction contributed to the cautious tone in the market.

The note and bond sector of the market, influenced by a variety of cross currents, held generally steady over the first 3 weeks of February. Among the factors affecting the market were continued uncertainties created by developments in the Far East, growing talk about a move toward tighter monetary policy, a diminished calendar of new corporate issues, and the feeling that a worsening of the situation in Vietnam would enhance prospects for a tax increase. Against this background, the Treasury successfully completed its February financing operations, as it sold to private investors some $3.8 billion of new 7-year notes and $4.1 billion of new 15-month notes. Both new issues performed well in the secondary market, though they have declined from their best price levels in recent trading sessions. Bank selling of the new 15-month notes, the bulk of which were alloted to banks permitted to pay for the issues through 100 per cent tax and loan account credit, appears to have been relatively light. Dealers were willing underwriters of the new issues and most recently held in position some $440 million of securities due in more than 1 year, presumably mostly the new notes. These positions represented a decline from peak holdings of $515 million on February 20.

Yields on short-term market instruments other than bills have generally edged up since early February as the following table indicates.

SELECTED SHORT-TERM RATES

	1966	1967		1968	
	High	High	Dec. 29	Feb. 5	Feb. 27
1-month					
CD's (prime NYC)					
Highest quoted new issue	5.50 (12/31)	5.50 (12/29)	5.50	4.88	4.90
Secondary market	5.75 (9/28)	5.45 (1/18)	5.40	5.00	5.05
3-months					
Bankers' acceptances	5.75 (10/25)	5.63 (12/29)	5.63	5.13	5.25
Federal agencies	5.76 (9/21)	5.30 (12/29)	5.30	5.05*	5.05**
Finance paper	5.88 (12/31)	5.88 (1/6)	5.50	5.13	5.25
CD's (prime NYC)					
Highest quoted new issue	5.50 (12/31)	5.50 (12/29)	5.50	5.38	5.38
Secondary market	5.90 (9/21)	5.70 (12/29)	5.70	5.30	5.40
6-months					
Bankers' acceptances	6.00 (9/23)	5.88 (12/29)	5.88	5.25	5.38
Commercial paper	6.00 (12/31)	6.00 (1/16)	5.63	5.50	5.50
Federal agencies	6.04 (9/21)	5.55 (12/29)	5.55	5.25*	5.30**
CD's (prime NYC)					
Highest quoted new issue	5.50 (12/31)	5.50 (12/29)	5.50	5.50	5.50
Secondary market	6.30 (9/28)	6.00 (12/29)	6.00	5.50	5.60
1-year					
Federal agencies	6.13 (9/23)	5.95 (12/29)	5.95	5.55	5.60
Prime municipals	4.25 (9/21)	4.00 (12/29)	4.00	3.25*	3.20**

N.B. - Latest dates on which high rates occurred are indicated in parentheses.
* - Rates on February 2.
** - Rates on February 23.

Federal Budget. New staff projections of Federal fiscal operations show a seasonally unadjusted cash deficit of $3.6 billion in the first half of calendar 1968. This measure of the deficit includes privately owned government-sponsored corporations in the Federal sector, and treats sales of participation certificates as financing.

The new estimate contrasts sharply with the large fiscal surpluses usually realized in the January-June period and also contrasts with the exact half-year balance between receipts and outlays implied by the January Budget Document when measured on the same basis.

FEDERAL DEFICIT OR SURPLUS AND CASH BORROWING FROM PUBLIC 1/
(In billions of dollars)

Half year periods	Not seasonally adjusted: Deficit (-) or surplus	Not seasonally adjusted: Change in Treasury Cash Balance	Borrowing 2/: Not seasonally adjusted	Borrowing 2/: Seasonally adjusted
1965 - I	7.6	5.1	- 2.5	2.6
II	-12.8	-6.6	6.1	.9
1966 - I	6.6	6.5	- .6	4.4
II	-12.9	-6.6	7.0	2.3
1967 - I	9.9	2.0	- 8.3	- 3.2
II	-21.4	- .8	20.4	16.0
1968 - I p	- 3.6	-1.6	1.7	6.7

p - Projected
1/ Equals old cash deficit or surplus plus allowance for participation certificates. Also equals new cash deficit plus allowance for privately-owned government sponsored corporations.
2/ Differs from old cash borrowing by inclusion of participation certificate borrowing, plus accrued interest on Treasury bills and savings bonds. Agrees with flow-of-funds concept of Federal obligations.

The increase in the expected deficit relative to the Budget Document results from three factors:

(1) Surtax revenues of $1.9 billion were assumed in the President's budget, but none are assumed in the current projection.

(2) Staff estimates of cash receipts other than from the surtax are $1 billion smaller than in the Budget, despite roughly similar income assumptions.

(3) Spending estimates for the January-June period are $0.7 billion higher than in the Budget, reflecting both higher estimates for defense outlays and larger borrowing demands on the Home Loan Bank System by savings and loan associations.

These staff estimates are consistent with the GNP projection presented earlier in the Greenbook. The corresponding deficit in the NIA Federal sector amounts to $9.4 and $12.5 billion in the first and second quarters of 1968, as measured on a seasonally adjusted annual rate basis.

The new staff estimate indicates a need for larger gross cash borrowing by the Federal sector over the remaining four months of the fiscal year than the market currently appears to expect. In addition to the already announced $1.2 billion still to be added to the cycle of 90-day Treasury bills and the $2.0 billion or so generally expected in further participation certificate offerings to the public, the new projection would require a minimum additional cash borrowing of roughly $2.5 billion as the table shows. This estimate assumes that the Treasury cash balance at the end of June would drop to $4 billion. A mid-year balance at this level would be unusually low, however, and would probably require overdrafts with the Federal Reserve System prior to the receipt of June tax payments. Moreover, since the Budget always experiences a large seasonal deficit in the early weeks of July, a Treasury balance as low as $4.0 billion at mid-year would necessitate sizable further cash borrowing early in fiscal 1969.

GROSS FEDERAL CASH FINANCING

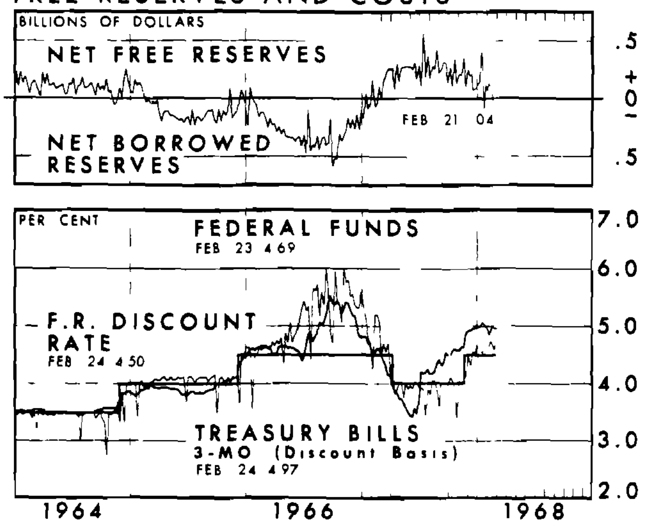
January-June 1968
(Billions of dollars)

	Already Completed Jan.-Feb.	Projected March-June
Gross Borrowing		
1. Weekly and Monthly Treasury bills	0.4	1.2 (announced)
2. Tax bills	2.5	2.6
3. Coupon issues	4.1	
4. PC's	0.8	2.2
Total	7.8	6.0
Gross Repayment		
1. Tax bills	--	(-)11.0
2. Other 1/	(-)0.5	(-) 0.6
Net Credit Demands of Federal Sector	(+)7.3	(-) 5.6
Memo: Treasury Cash Balance		
Change	(+)2.4	(-) 4.0
Level	8.0	4.0

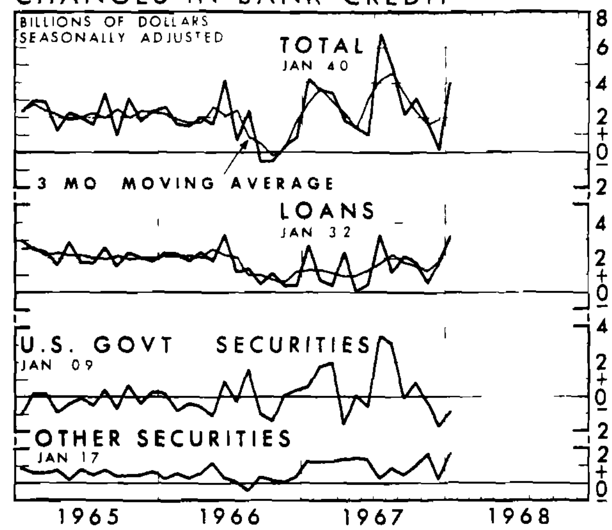
1/ Includes attrition in refundings and retirement of 1-1/2 per cent exchange notes. Also, allowance is made here for estimated net Federal agency debt operations, net changes in holdings of market securities by Treasury trust accounts, and changes in foreign series issues.

FINANCIAL DEVELOPMENTS - UNITED STATES

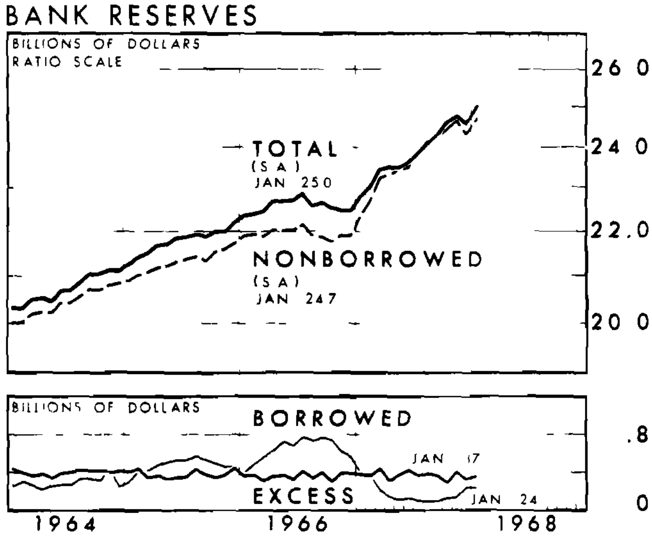
FREE RESERVES AND COSTS



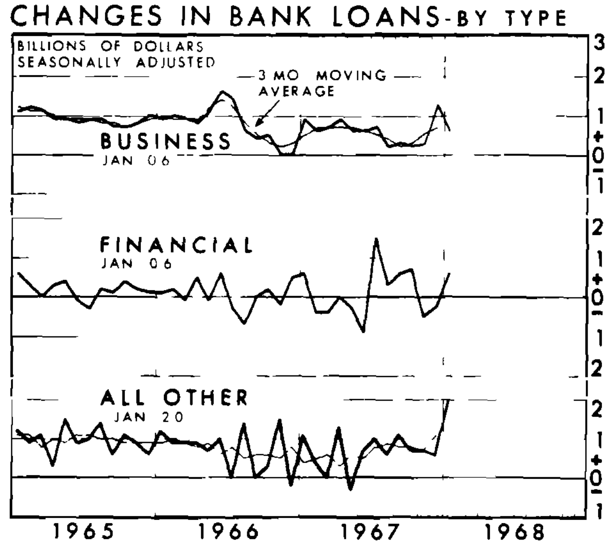
CHANGES IN BANK CREDIT



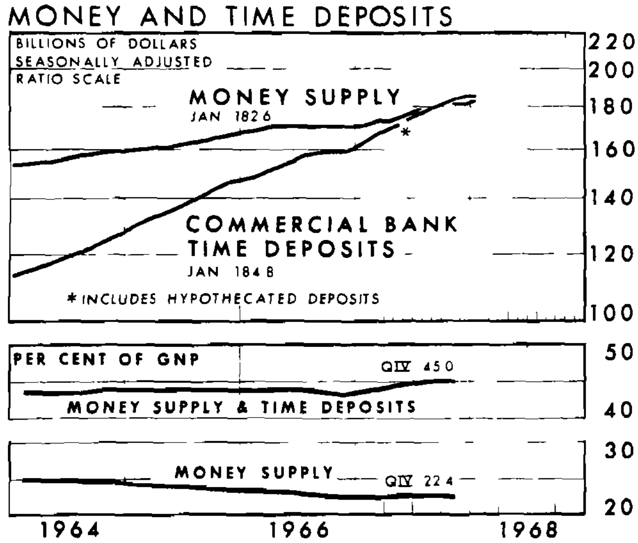
BANK RESERVES



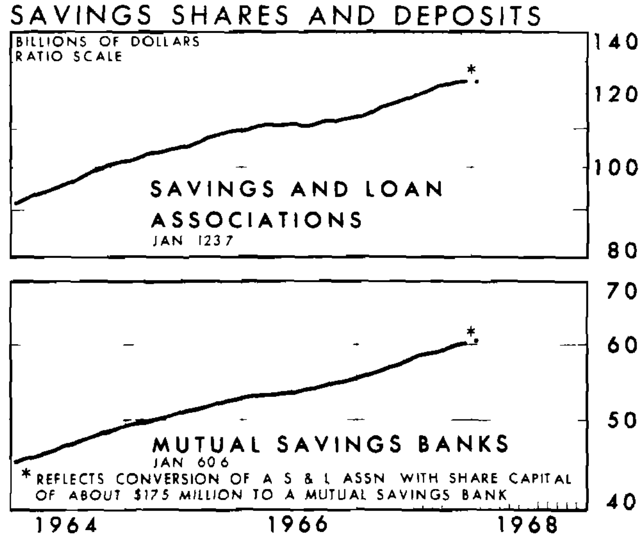
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

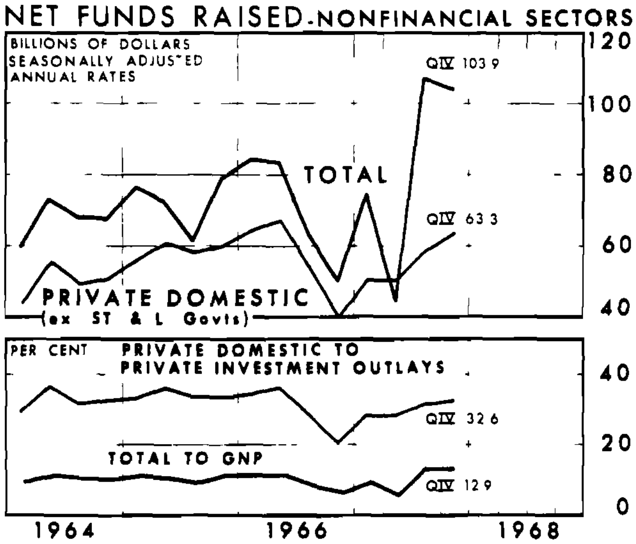


SAVINGS SHARES AND DEPOSITS

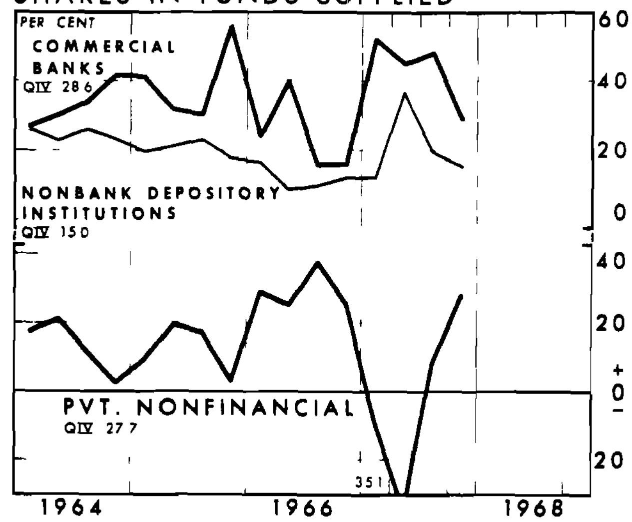


FINANCIAL DEVELOPMENTS - UNITED STATES

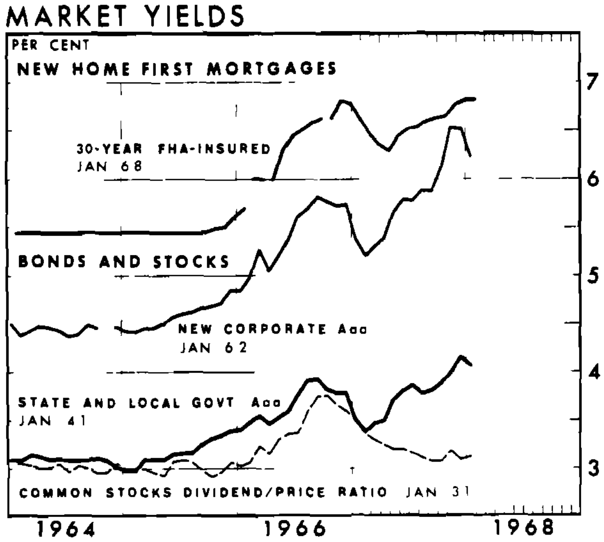
NET FUNDS RAISED-NONFINANCIAL SECTORS



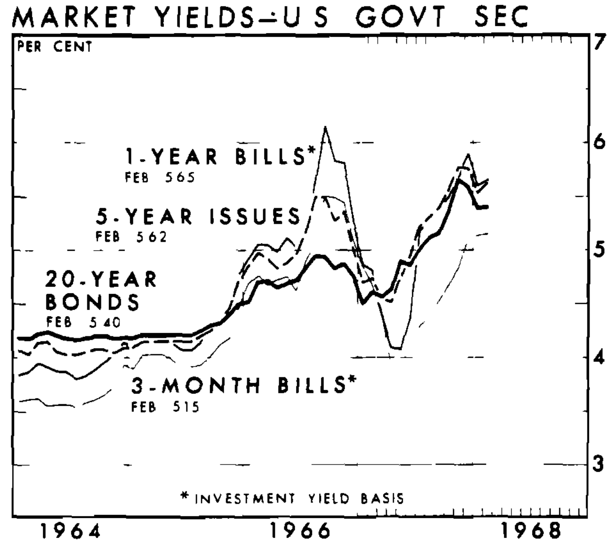
SHARES IN FUNDS SUPPLIED



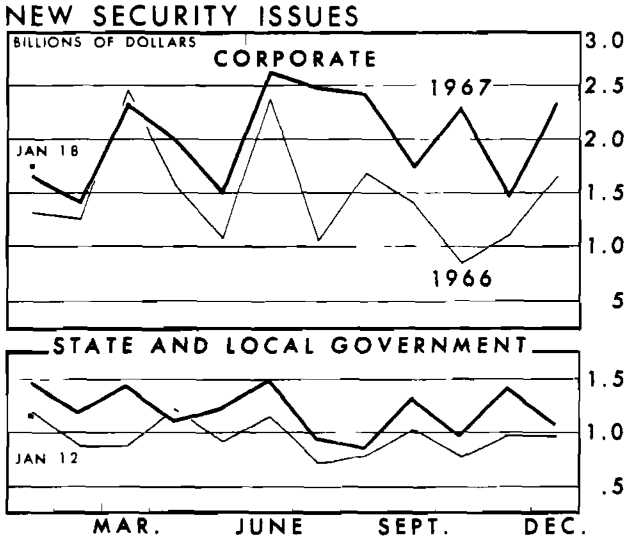
MARKET YIELDS



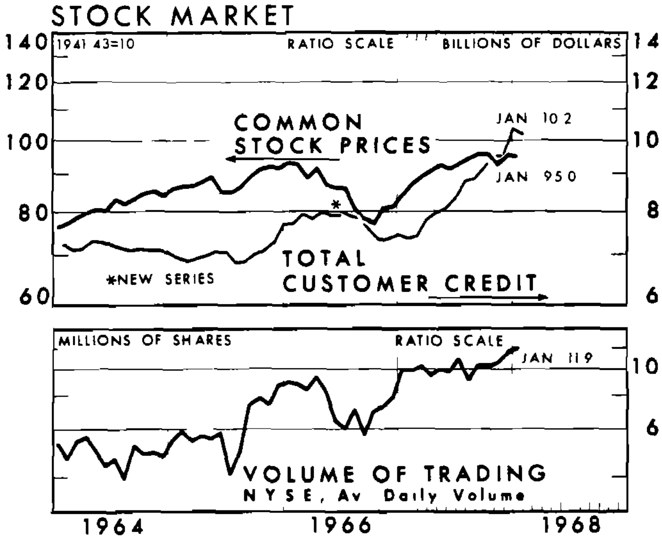
MARKET YIELDS—U S GOVT SEC



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Preliminary information indicates that the January deficit on the liquidity basis was about $125 million (not seasonally adjusted). Known transactions in near-liquid foreign official assets included the German acquisition of another $125 million of medium-term DM bonds under the 1967 agreement, a total of $60 million of various other smaller acquisitions of near-liquid assets, and the redemption of $200 million of U.S.-dollar Roosa bonds for Canada. Before these special transactions, which do not affect either the U.S. deficit on the official reserve transaction basis or the reserves of the foreign countries concerned, our January deficit on the liquidity basis was about $110 million.

In the first three weeks of February the unadjusted liquidity deficit was about $125 million. As the first quarter of the year is a seasonally favorable period, large upward adjustments are required in assessing the deficit. The first-quarter seasonal adjustments in the four years 1963-66 averaged nearly $600 million. (In 1967 a shift in timing of certain oil company tax payments from April to March occasioned a smaller adjustment.) While monthly variations are too erratic to permit an allocation of the adjustment to separate months of the quarter, it is evident that the rate of deficit thus far this year, before or after the special transactions mentioned above, should be thought of as corresponding to a seasonally adjusted annual rate in the $2-1/2 billion to $4 billion range rather than anything lower.

The trade surplus in January was at an annual rate of only \$1.3 billion, far below the \$4.3 billion average of the first three quarters of 1967. Since the over-all deficit on the liquidity basis before special transactions was running at a \$4 billion annual rate in the first three quarters of 1967, it is clear that the worsening on trade account since then has been offset by sharp reduction of net payments on some other accounts.

Reports under the Foreign Credit Restraint Program indicate that bank claims on foreigners were reduced in January by about \$200 million, a more than seasonal amount but somewhat less than in January 1967.

On the official reserve transactions basis the balance in January and the first three weeks of February appears to have been a surplus, without seasonal adjustment. The difference between the two measures of the deficit for this period reflects primarily the large inflow of foreign private liquid funds through the expansion of liabilities of U.S. banks to their foreign branches.

U.S. foreign trade. An export surplus in U.S. merchandise trade reappeared in January, following the drop to an import surplus in December 1967 as measured on the balance of payments basis (which excludes military exports). At a seasonally adjusted annual rate of \$1.3 billion, the January surplus was still below the very low fourth quarter rate of \$1.5 billion.

Exports in January increased by 11 per cent over the December value to an annual rate of \$32.6 billion (balance of payments basis). This compares with an annual rate of $29.9 billion in the fourth quarter of 1967 and $30.5 billion for the entire year of 1967.

Both agricultural and nonagricultural exports rose from December to January. The 15 per cent gain in agricultural shipments accounted for about one-fourth of the total export rise; the remainder of the increase was accounted for by a 10 per cent advance in non-agricultural exports.

Manufacturers' export orders for nonelectric machinery, which had slipped in the third quarter of 1967, rose sharply in the last two months of last year, giving promise of an advance in exports of these products in the coming months.

By areas, shipments to Asia-Africa increased sharply, accounting for about two-thirds of the total rise in exports in January. More moderate gains were recorded in exports to Canada and Japan. Shipments to Western Europe, which had declined sharply in the fourth quarter, showed little further change in January and have not yet responded to the economic upturn in Europe.

Imports in January climbed to a new high for the third successive month. In January, imports were at an annual rate of $31.4 billion, compared with $28.4 billion in the fourth quarter of 1967 and a $26.4 billion average for the preceding three quarters. About one-half of the increase from December to January is accounted for by exceptionally heavy arrivals of refined copper and a more modest rise in steel imports. As mentioned in the last Green Book, the increasingly large imports of these two commodities in recent months stem from domestic shortages caused by the long-continued copper strike and from anticipation of an interruption of domestic steel supplies this summer. A portion of the remaining increase in January imports may reflect a rise in dutiable imports resulting from the first phase of the Kennedy Round of tariff reductions which became effective on January 1.

Travel promotion. The Industry-Government Special Task Force on Travel has sent its report to the President, suggesting measures that could increase foreign travel in the U.S. and narrow the foreign travel gap. The Task Force has initiated actions which, with the support of Federal Agencies and private industry, should lead to a substantial reduction in cost of travel by foreign visitors to the U.S. Steps are already being taken to reduce domestic air fares, railroad fares, hotel and motel rates, car rental charges and package tour prices for foreign travelers. International air carriers and steamship lines serving the North Atlantic are seeking approval of low-cost directional fares to the U.S.

To encourage foreign travel to the U.S., the 1968 budgets of U.S. travel-related businesses and associations for promotion, advertising, and sales abroad have been increased.

<u>The balance of payments and Treasury debt management</u>. The following table, showing changes in various types of U.S. liquid and near-liquid liabilities to foreign official accounts, is designed to bring out certain Treasury debt management aspects of U.S. balance of payments financing last year. During 1967 the balance of payments deficit on the official reserve transactions basis was $3.4 billion. The U.S. gold stock decreased by $1.2 billion, while Federal Reserve and Treasury holdings of convertible foreign currencies increased by $1.0 billion and our IMF gold tranche position increased by $0.1 billion. Reserve liabilities rose by $3.3 billion, with the changes in composition shown by the table. It will be seen that foreign official holdings of U.S. Government securities increased by over £2.2 billion. This reduced the Treasury's needs for placing securities with domestic investors considerably.

About $500 million of the foreign official lending to the U.S. Government was via marketable securities (lines 3 and 4 of the table). Outstanding nonconvertible dollar Roosa bonds increased by somewhat over $150 million (line 7), and outstanding foreign currency issues by nearly $350 million (lines 9-11). The largest single item of change in 1967 was the $1.2 billion increase in short-term special (nonmarketable) dollar certificates of indebtedness (line 5), the great bulk of which occurred in the fourth quarter.

The table follows the present balance of payments accounting procedures in <u>not</u> counting nonguaranteed Agency securities as U.S. reserve liabilities. Since the British liquidation of their official security portfolio involved a considerable amount of running off of maturing Agency securities, the net assistance the Treasury obtained in its domestic debt management was actually somewhat less than indicated in the preceding paragraphs.

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

	Changes 1966 Year	Changes 1967 Year	Changes 1967 1st H.	Changes 1967 Q-3	Changes 1967 Q-4	Outstanding, end of 1967
U.S.-dollar liabilities						
Private liabilities						
1 Short-term dep. & misc.	-229	238	- 12	83	167	5,947
2 Time deposits over 1 year*	788	821	888	-230	163	1,733
U.S. Govt. securities						
3 Bills & certificates (mkt.)	-450	484	336	100	48	6,560
4 Bonds & notes (mkt.)	-245	48	57	- 6	- 3	908
Non.mkt. securities						
5 Certificates	-420	1,188	35	102	1,051	1,428
6 Convertible bonds & notes	-125	--	--	--	--	25
7 Nonconvertible b. & n.*	- 6	163	- 4	197	- 30	491
8 Other U.S. Govt. liabilities*	66	41	11	24	6	148
Foreign currency liabilities						
U.S. Govt. securities						
9 Short-term	517	-365	- 88	-125	-152	152
10 Convertible medium-term	-820	456	119	125	212	686
11 Nonconvertible medium-term*	- 46	250	--	125	125	361
I.M.F. gold deposit and gold investment	177	22	22	--	--	1,033
Total	-793	3,346	1,364	395	1,587	19,472
Of which: U.S. Govt. securities	1,595	2,224	455	518	1,251	11,411 1/
Memo item:						
U.S.-initiated swap drawings						
System	145	1,496	90	233	1,173	1,776
Treasury	--	126	--	--	126	126

*Classed as "non-liquid."

1/ Including $800 million of IMF gold investment in U.S. Govt. securities.

In the current quarter, with the balance of payments in surplus on the official reserve transactions basis (not seasonally adjusted), the implications for Treasury debt management are unfavorable.

Last year's favorable impact of balance of payments financing on Treasury debt management happened to work almost entirely through foreign acquisitions of U.S. Government securities, as U.S. gold sales were balanced by additions to U.S. official holdings of convertible currencies. But if there had been net losses of U.S. reserve assets, that would also have reduced Treasury needs for placing securities with private domestic investors, in so far as Federal Reserve open market purchases would have offset the effects on member bank reserves of the gold and convertible currency transactions. (Incidentally, it may be noted that foreign commercial banks and other private persons are ordinarily not large investors in U.S. Government securities.)

Reserve changes of major countries. Net official reserves of most of the G-10 countries fell in January. For nine countries other than Britain and the United States -- Switzerland being the eleventh of the Ten -- net official reserves declined by nearly $1.2 billion, as may be seen in the last column of the second table on page IV-9. Canadian and Japanese reserves accounted for a third of this decrease. The $0.8 billion decrease in net official reserves of EEC countries and Switzerland was in part a seasonal phenomenon; in any event it largely reflected outflows of commercial bank funds from these countries. German commercial banks' net foreign assets rose in January by $733 million. Swiss banks reportedly reinvested abroad all or most of the funds they had repatriated in December.

The two tables on the next page, based on partly unpublished and confidential data, show net reserve changes for the nine countries during 1966 and 1967 (in the lower table) and combined changes in their official reserves and commercial bank external net assets (in the upper table). These latter combined figures are the counterpart of surpluses (or deficits) on current, long-term capital, domestic nonbanks' short-term capital, and errors-and-omissions accounts in the balance of payments. On this basis, the EEC countries had a $1.5 billion balance of payments surplus in 1967, up from $1.2 billion in 1966. Japan had a deficit of $0.6 billion, and Canada a surplus of $0.4 billion.

In the EEC balance of payments there were small deficits in the fourth quarters of both 1966 and 1967, for seasonal and other reasons. One special factor in 1967 was the unusually large private purchases of gold by resident speculators and hoarders in November and December, mainly in the London gold market. To the extent that the purchasers were moving out of assets in their own currencies, they had to acquire dollars from their central banks.

Speculative movements from Britain or elsewhere into German mark deposits at German banks and into French franc deposits at French banks would not count as reducing the German and French deficits on the basis used here (upper table), since the resulting accruals to reserves would be balanced by increases in commercial bank liabilities. Such speculative flows may, however, have been a significant factor tending to enlarge the fourth-quarter official reserve gains (lower table). The total (gross) increase during the fourth quarter in German banks' DM liabilities to nonresidents, reflecting these and other flows, was $367 million; and the corresponding franc figure for French banks was $110 million.

RESERVE AND LIABILITY CHANGES: COMBINED OFFICIAL[1/] AND COMMERCIAL BANKS[2/]
(in millions of U.S. dollars)

	1966			1967			1968
	Jan.-Sept.	Q-4	Year	Jan.-Sept.	Q-4	Year	Jan.
Germany	519	- 71	448	1,124	-223	901	529P.
France	434	- 91	343	147	-105P.	42P.	n.a.
Italy	666	-108	558	383	- 10P.	373P.	-114P.
Netherlands	-128	91	- 37	- 52	114	62	n.a.
Belgium	-100	- 10	-110	40	116	156	n.a.
Total EEC	1,391	-189	1,202	1,642	-108P.	1,534P.	n.a.
Switzerland	n.a.	205	n.a.	220	n.a.	n.a.	n.a.
Sweden	76	19	95	98	-125	- 27	7P.
Japan	270	52	322	-473	- 97	-570	-280P.
Canada	89	58	147	24	341	365	n.a.

1/ Net gold and foreign assets and IMF position (including GAB).
2/ Net foreign short-term asset position.

Source: Confidential BIS data.
p. = Preliminary

OFFICIAL NET RESERVE CHANGES[1/]
(in millions of U.S. dollars)

	1966			1967			1968
	Jan.-Sept.	Q-4	Year	Jan.-Sept.	Q-4	Year	Jan.
Germany	- 44	395	351	14	83	97	-204
France	542	-156	386	101	240	341	- 38
Italy	253	- 83	170	554	8	562	-120
Netherlands	- 6	48	42	39	130	169	- 69
Belgium	- 18	54	36	110	138	248	- 74
Total EEC	727	258	985	818	599	1,417	-505
Switzerland	-393	378	- 15	-221	395	174	-313
Sweden	81	- 25	56	- 12	-182	-194	43
Japan	- 92	29	- 63	- 50	- 10	- 60	- 44
Canada	-287	7	-280	- 23	51	28	-357
Total, 9 countries	36	647	683	512	853	1,365	-1,176

1/ Net gold and foreign assets and IMF position (including GAB).
Source: Confidential BIS data.

The temporary fourth-quarter balance of payments deficit of the EEC countries as a group was apparently reversed in January. The combined changes in official reserves and banks' net assets (upper table) indicate a considerable deficit for Italy again in January, but a very large surplus for Germany. (Data for other countries are not yet available.) These developments were partly seasonal.

The German surplus in January of about $530 million counter-balanced the seasonal deficit of December, which was about $550 million. For the four months October-January, as the table shows, Germany had a balance of payments surplus of about $300 million. Thus, despite the sharp rise in German imports in recent months, export earnings have been large enough and outpayments for services, unilateral transfers, and capital flows have been small enough to produce a continuing large surplus. German industrial production rose sharply in December, and the November-December average was 9 per cent above the low level of the first half of 1967. Imports, which had begun to rise last spring and summer, increased sharply in November and December, averaging in those months 11 per cent above the first half of 1967.

The German surplus in the past year has not produced cumulative official reserve gains, only because monetary conditions in Germany have been so easy as to stimulate large short-term investments and loans abroad by the German commercial banks. Since the beginning of 1968 the Bundesbank has not been offering preferential rates on dollar-DM swaps to stimulate such outflows, but has rather been endeavoring to get the banks to enlarge their holdings of domestic money market paper and securities. Nevertheless, the banks' net external assets increased by $733 million in January -- partly in dollar assets, partly in DM net assets. The Bundesbank's swaps with the German banks increased by $223 million in the first two days of January, apparently reflecting contracts made at the end of December. Since then, the outstanding swaps have been gradually reduced: from a peak of $854 million they were down to about $700 million on February 20.

Italy's deficit in the four months October-January, as measured in the upper table on page IV-9, totaled about $120 million. This is a seasonally unfavorable period, with receipts from tourists low, and does not necessarily imply a change from annual surpluses (about $560 million in 1966 and about $370 million in 1967) to deficit in 1968. However, the trade balance appears to have been somewhat more unfavorable in recent months than a year earlier. In October and November this development was offset by a shift (dating from last summer) in leads and lags in trade payments, a shift which undoubtedly reflected precautions traders were taking against devaluations of sterling and other currencies of the sterling area. In December and January this temporarily favorable factor was no longer present.

The French balance of payments position appears to be close to balance. For the year 1967 as a whole the surplus as measured in the table was small. The fourth-quarter deficit of a little over $100 million is more than fully explained by two special factors: heavy gold buying on the London market by French residents, reportedly at least $80 million; and conversion by Algeria of $95 million of its franc holdings to buy gold. French imports and exports have both been rising, and apart from seasonal variations the trade deficit has not changed much over the past year and a half.

The $240 million increase in French official reserves in the fourth quarter of 1967, despite the payments deficit in that quarter, was the result of an even larger decline in the commercial banks' net external asset position. In addition to the $110 million increase mentioned earlier in their franc liabilities, the banks' foreign currency liabilities increased by $530 million while their foreign currency assets rose by only $300 million.

Sweden's underlying balance of payments position appears still to be one of surplus, despite the deficit ($125 million) and large loss of reserves ($180 million) registered in the fourth quarter (see tables on page IV-9). In the wake of the devaluation of sterling in mid-November there was a wave of speculation against the Swedish krona. After a severe drain of reserves, the Bank of Sweden raised discount rate from 5 to 6 per cent on December 15, and tightened some credit regulations. Speculation subsided thereafter, and the discount rate was reduced to 5-1/2 per cent, effective February 9.

The Japanese balance of payments moved into deficit last year, as imports continued to rise strongly while exports were leveling out. In the seasonally unfavorable month of January this year the deficit was $280 million, much larger than in other recent Januarys. However, seasonally adjusted exports rose sharply in January, no doubt reflecting the recent advances in import buying in the United States and Europe, and this will tend to arrest the deterioration in the balance.

The Japanese payments deficit in 1967 was covered in large part by a $510 million increase in the commercial banks' net foreign liabilities. While the banks' foreign assets, primarily in dollars, rose by $440 million, their liabilities increased by $950 million, also mainly in dollars -- partly in liabilities to U.S. banks and partly in Euro-dollar borrowings.

The recent easing in Euro-dollar rates has attracted Japanese banks to that market, particularly in view of Japan's present tight money policy. The government's informal ceilings on Euro-dollar borrowings by the banks were raised in January, to allow net borrowing of $45 million during the first quarter, in place of the $30 million originally announced.

In February, the Japanese Government arranged for a DM 100 million ($25 million) bond issue in Germany.

Canada's balance of payments surplus, on the basis defined by the upper table on page IV-9, increased toward the end of 1967 as the result mainly of a strong rise in exports. Official reserve changes were relatively small throughout 1967. The commercial banks, however, made a substantial addition to their external U.S.-dollar assets, placed partly in the United States and partly in the Euro-dollar market.

In January, the official reserves fell about $350 million in consequence of speculation against the Canadian dollar after the announcement of the U.S. balance of payments program. Canadian domestic political uncertainties have prolonged the pressures on the Canadian dollar. Data are not yet available on additions to commercial bank external assets in January.

Britain's gold and foreign exchange reserves, as publicly reported, fell from $2,794 million at the end of October (the last pre-devaluation date for which a reserve figure was given) to $2,748 million at the end of January. Deducting from the latter figure the $490 million the U.K. Treasury added to its reserves in November from the sale of its remaining holdings of U.S. securities, the decline was almost 20 per cent.

Another major transaction publicly acknowledged was the payment of $220 million in December on loans made to the U.K. by the U.S. and Canada in the early post-war period. Earlier, in November, Britain paid off the remaining $250 million of the IMF drawing of December 1964, but this repayment was effected with a $250 million loan arranged through the BIS and so left Britain's reserve position unchanged.

The implication of the above figures would seem to be that other payments from the reserves in the three months November-January totalled about $320 million. However, the actual outflow, apart from foreign central bank assistance, greatly exceeded this amount.

In November, the reserves, as officially reported, declined by $363 million before inclusion of the $490 million obtained from the securities portfolio. The loss would have been considerably greater but for foreign central bank assistance. Since there was a substantial reflux into sterling after November 18, the drain in the first part of the month was massive. This drain reflected, of course, not only speculative movements of funds but also the deficit on current transactions. The merchandise trade deficit alone amounted to about $850 million during the fourth quarter.

In December, the true reserve loss was again in excess of the officially reported $240 million decrease. Temporary weakening of confidence in the new par value of the pound necessitated considerable Bank of England support in the spot market in the early and middle part of the month.

In January, with confidence in the pound relatively firm, the reserves were officially reported to have increased by $53 million. Since there was a small decrease in the amount of central bank assistance outstanding during the month, the authorities placed themselves in the novel position of having understated a gain. During the month, the Bank of England took in a very large volume of spot dollars, but paid most of it out again to meet maturing forward contracts. The bulk of the dollar inflow apparently stemmed from purchases of sterling by the holders of the maturing forwards, to use in meeting their side of the contracts.

Thus far in February, payments by the Bank of England on forward contracts made in the weeks immediately before the devaluation are reported to have slightly exceeded the Bank's dollar intake.

The ease in the Euro-dollar market in January and February may have been partly associated with sterling developments. In particular, holders of maturing forward contracts may have placed their dollar profits in Euro-dollar deposits. The covered differential between 90-day Euro-dollar and local authority deposits has narrowed, but remained in favor of the former until this week.

Geographical breakdown of U.S. reserve liability changes. Of the $3.3 billion increase in U.S. liquid and near-liquid liabilities to foreign official accounts in 1967, $0.5 billion was to the United Kingdom and was the counterpart of the U.K. Government's liquidation of its security portfolio to build up U.K. monetary reserves.

The net increase in liabilities to EEC monetary authorities was over $1.3 billion. The total net increase to all continental European monetary authorities was about $2.1 billion, including about $350 million increase in U.S. Government securities denominated in foreign currencies. Much of the $1.75 billion increase in <u>dollar</u> liabilities to continental Europe was covered by use of swap drawings initiated by the Federal Reserve, the increase in which over the year was $1.5 billion (see memo item in the table on page IV-6). In the first quarter of last year total U.S. liabilities to continental European monetary authorities decreased somewhat, following the usual seasonal pattern. In each of the next three quarters there was a substantial increase. The fourth-quarter increase was somewhat smaller than those of the preceding quarters, perhaps partly for seasonal reasons.

Liabilities to Canadian official accounts classed as liquid showed little change over the year. Canada acquired $200 million of non-liquid U.S.-dollar-denominated Roosa bonds -- subsequently liquidated in January 1968.

Liquid liabilities to the monetary authorities of Japan, Latin America, and the rest of the world decreased by about $150 million, while their holdings of over-1-year time deposits increased by $900 million, mainly in the first half of the year. This group of countries has not acquired Roosa bonds.

Composition of EEC reserve gains. The following table summarizes confidential BIS data on the composition of the official net reserve gains of the EEC countries in 1967 and January 1968. The totals are the same as in the lower table of page IV-9.

COMPOSITION OF EEC OFFICIAL NET RESERVE GAINS
(in millions of dollars)

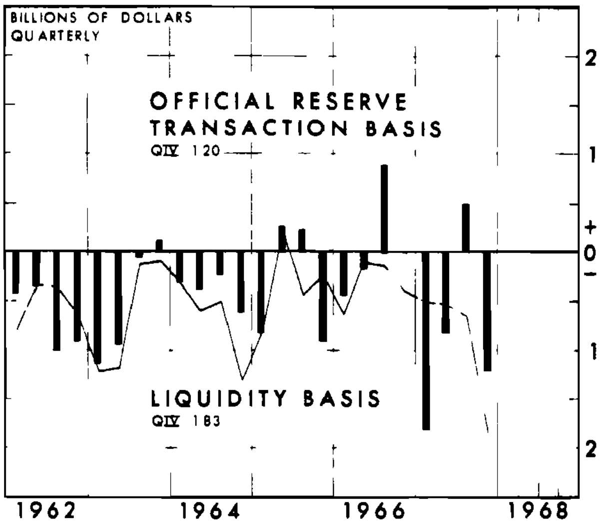
	1967 Jan.-Sept.	1967 Q-4	1968 Jan.
Total	818	599	-505
Gold	- 35	-112	-173
IMF gold tranche and GAB	- 312	-111	- 1
Liabilities (-)	111	- 89	31
Other assets (dollars, etc.)	1,054	911	-358
U.S. data: reserve liabilities to EEC	782	552	n.a.

Although the increase in these countries' net official reserves during the four months October-January was under $100 million, their holdings of foreign exchange and miscellaneous reserve assets increased by about $550 million, as may be seen in the fifth line of the table. Gold sales, repayments of their currencies to the IMF by other countries, and a net increase in their official liabilities made this possible. In the fourth quarter alone the rise in foreign exchange and miscellaneous reserve asset holdings was over $900 million. In the first three quarters of 1967 such holdings had increased by about $1,050 million. These figures of course include increases in claims on the United States. Our data show increases in U.S. reserve liabilities to the EEC countries of about $550 million in the fourth quarter and $780 million in the preceding three quarters, totalling over $1.3 billion as mentioned on page IV-16.

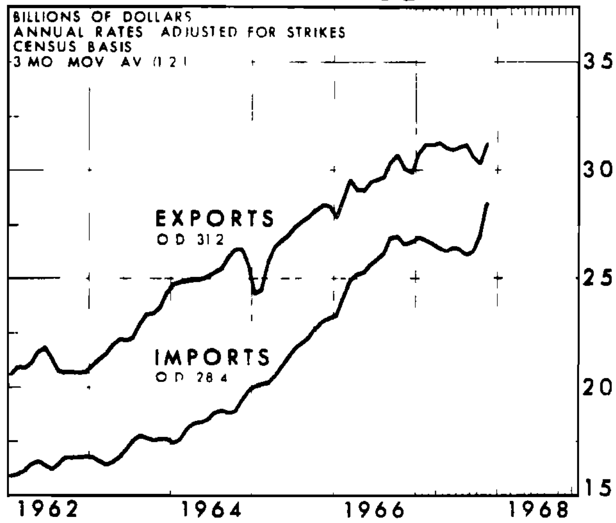
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

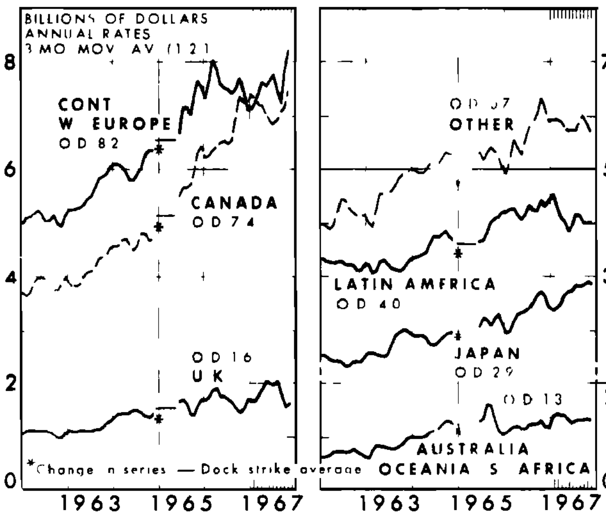
U S BALANCE OF PAYMENTS



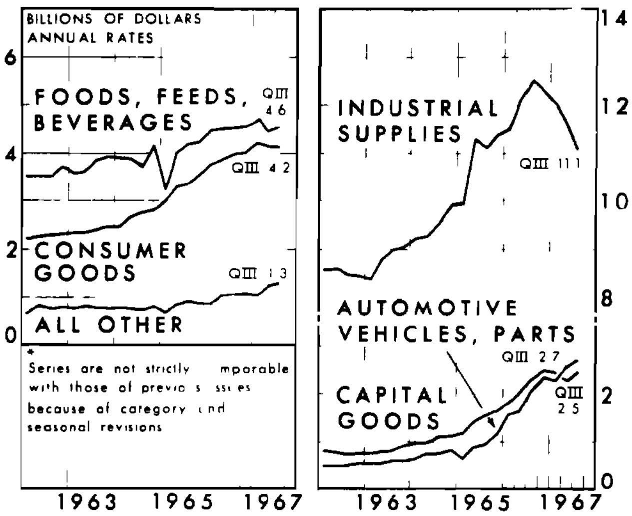
U S MERCHANDISE TRADE



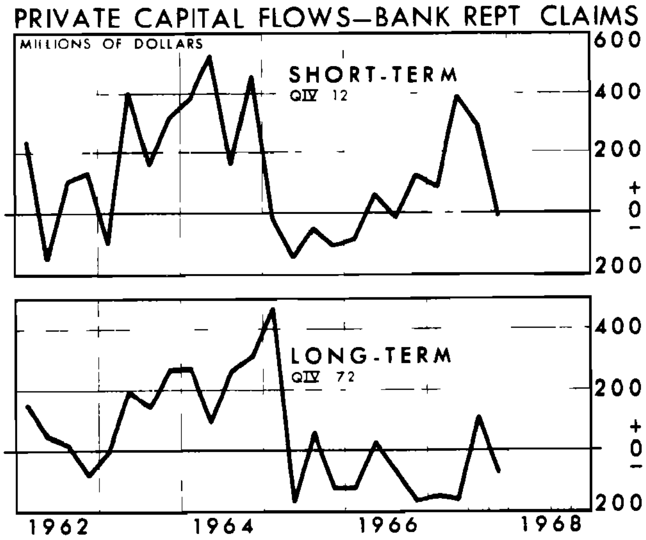
U S EXPORTS BY AREA



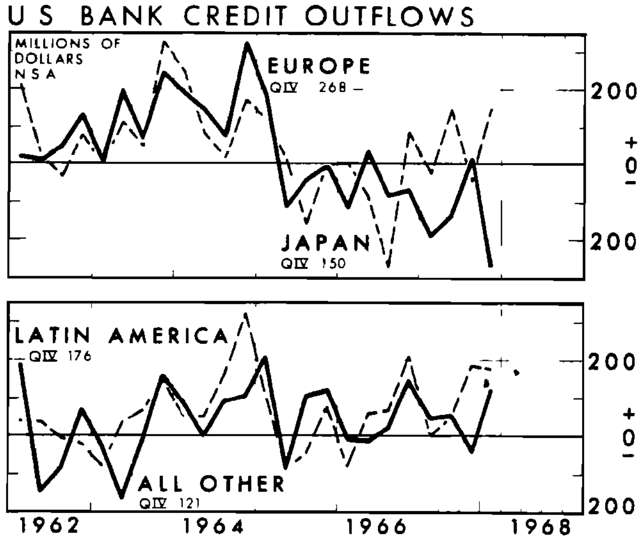
U S IMPORTS BY END USE



PRIVATE CAPITAL FLOWS—BANK REPT CLAIMS



U S BANK CREDIT OUTFLOWS



APPENDIX A

Life Insurance Company Activity In The Fourth Quarter of 1967*

The dollar volume of new forward investment commitments made in the fourth quarter of 1967 by a selected group of life insurance companies matched the extremely high fourth quarter of 1965. And even with a contra-seasonal decline in December, the year's total was second only to the 1965 record.

SELECTED LIFE INSURANCE COMPANIES NEW FORWARD INVESTMENT COMMITMENTS*
(Not seasonally adjusted)

	Total Amount ($ mil.)	Business & industrial bonds	Other Securities 1/	1-to 4-Family Mortgages	Income Property Mortgages and Real Estate 2/
		(Per cent of total)			
Quarter					
1965 - IV	3,810	36.5	7.2	11.4	44.9
1966 - IV	1,494	34.9	8.4	13.7	43.0
1967 - IV	3,753	37.0	9.0	5.2	49.9
Years					
1965	13,755	33.0	7.8	13.3	46.0
1966	10,887	33.3	8.4	12.5	45.8
1967	12,409	35.5	9.5	6.7	48.3

Source: Life Insurance Association of America. Sample survey of companies accounting for 70 per cent of industry assets in 1967 and 66 per cent of industry assets prior to 1967.

1/ "Other securities" includes public utility bonds, railroad bonds, state and local securities and other types of securities.

2/ Includes multifamily mortgages.

* THESE DATA ARE STRICTLY CONFIDENTIAL.

Over the year, commitments for home mortgage loans did not share in the recovery of new commitment activity from the 1966 pace. In the fourth quarter, new commitments on 1-to 4-family mortgages were even below the sharply reduced fourth quarter of 1966; and for the year

* Prepared by Mrs. Barbara Opper, Economist, Capital Markets Section.

they accounted for only one half their 1966 share of total commitments. In dollar amounts, the 1967 totals fell $0.5 billion below the 1966 level of $1.3 billion. This striking curtailment reflected mainly the narrowing yield spread between 1-to 4-family mortgages and other investments through most of the year. It also reflected the increased desire to avoid transactions in government-underwritten mortgages at the deep discounts that have once again become necessary to secure a competitive yield.

Under these circumstances both corporate securities and the dominant non-residential mortgage group appear to have shared in the additional funds thus made available. Moreover, the share of new commitments allocated to business and industrial bonds in the fourth quarter as a whole remained above that of recent years, although in December, contrary to trend, these commitments represented an unusually small share of total new commitments.

The December decline in new commitments for corporate securities may reflect both an abatement of corporate demands for funds and changing yield differentials. Although yield differentials between income property mortgages and corporate private placements were narrowed to the advantage of private placements in the fourth quarter, this in turn was accompanied by an unusual narrowing of the yield differential between privately-placed and publicly-offered corporate securities, with a consequent reduction in the historic appeal of private placements over public issues. (Although the confidential private placement yield series is only approximate, the yield differentials it helps to imply can generally be given some significance.) However, the decline in yields on publicly offered new issues since mid-December may have begun to reverse this development. Yield comparisons can be found in the table on the next page.

In 1967, there was an unusually large rate of acquisition of corporate securities by life insurance companies. Most of these acquisitions were made in the public market. But with forward commitments for privately placed issues rising sharply after their decline in 1966, the stock of commitments outstanding on corporate private placements reached record levels during the fourth quarter -- despite changing yield differentials. This suggests that, as these commitments mature, the volume of funds supplies by life insurance companies to corporations will continue to be relatively large -- but increasingly through the private placement market.

AA and A Rated Corporate Bonds

	New Publicly-Traded Offering Yields Compared With Yields on Life Insurance Company Private Placements		
	Composite: AA- and A-Rated Offered Publicly 1/	Composite: AA- and A-Rated Life Insurance Private Placements 2/	Yield Differential
	Offering Yield *	Yield *	
Dec. 1965	4.95%	5.46%	.51%
Dec. 1966	5.93	6.33	.40
Oct. 1967	6.40	6.64	.24
Nov. 1967	6.81	6.71	-.10 3/
Dec. 1967	6.68	6.77	.09

1/ Large new issues offered during the month.
2/ Life insurance data are from a LIAA sample accounting for two-thirds of industry assets. Data are commitments made during the month.
3/ The November publicly-offered consists entirely of public utility issues. Comparably-rated private placement commitments on public utility issues in November had an average yield of 6.85%, implying a differential of .04%.
* Yields are averages weighted by volume.
NOTE: Excludes issues with warrants, convertibles, etc. THE LIFE INSURANCE YIELD DATA ARE PROVIDED ON A STRICTLY CONFIDENTIAL BASIS.

APPENDIX B: POPULATION CHANGES*

Basic demographic trends which have characterized the period since 1957 continued in 1967. The birth rate continued to decline, the death rate remained stable at a low level, and the net civilian immigration rate was at the higher end of the relatively narrow range within which it has fluctuated in the postwar years. With relative stability in two of the components of population growth, the further reduction in the birth rate was reflected in a somewhat lower rate of growth in the total population in the year ending January 1, 1968 than in the year before. The net addition to the population last year was 30 per cent less than the peak of 3,058,000 in 1956.

TABLE 1

POPULATION, BIRTHS, AND MARRIAGES

Calendar Year's	Population: Net Increase 000's	Population: Net Increase Per Cent	Births 1/ Number 000's	Births 1/ Rate 2/	Marriages Number 000's	Marriages Rate 2/
			Annual Averages			
1942-1946	1,747	1.27	3,075	22.2	2,176	12.9
1947-1951	2,583	1.74	3,729	24.9	1,729	11.7
1952-1956	2,852	1.76	4,079	25.0	1,538	9.5
1957-1961	2,952	1.68	4,310	24.3	1,507	8.6
1962	2,827	1.53	4,213	22.6	1,577	8.5
1963	2,712	1.44	4,142	21.9	1,654	8.8
1964	2,612	1.37	4,070	21.2	1,725	9.0
1965	2,378	1.23	3,801	19.5	1,789	9.2
1966 3/	2,248	1.15	3,638	18.4	1,844	9.4
1967 3/	2,138	1.08	3,564	17.9	1,913	9.7

1/ Adjusted for underregistration.
2/ Per 1,000 total population for births, per 1,000 resident population for marriages.
3/ Data for 1966 and 1967 are preliminary.

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* Prepared by Jane Moore, National Income, Labor Force, and Trade Section, Division of Research and Statistics.

Marriage rates have been rising sharply however, and are expected to show further gains as the population of marriageable age increases. This, in turn, should be reflected in a rise in birth rates and a faster rate of growth in the population.

Births. The birth rate decreased again in 1967 marking the tenth year of decline. There were 3.6 million children born last year, 75,000 fewer than in 1966, and the rate of births per 1,000 population dropped to 17.9 from 18.4 the year before. The birth rate has fallen from more than 25 per 1,000 population to below the rate of the depression years of the 1930's since the downtrend began in 1958. In part, the decline reflects the smaller proportion of women in the childbearing ages in recent years. The fertility rate (which measures the number of births per 1,000 women 15 to 44 years) continued well above the low levels of the mid-1930's. In fact, the rate of decline in the fertility rate slowed somewhat between 1966 and 1967. Birth rates for first, second and higher order children are not yet available for 1967, but data for 1966 showed an increase in the number and the rate of first births. This rise reflects the increasing number of recently married young women, and suggests that some women decided to have children they postponed when first married.

Marriages. The marriage rate rose in 1967 to 9.7 per 1,000 population. The number of marriages totaled more than 1.9 million, close to half a million more than the postwar low in 1958. This was the fifth successive year of increase and the highest rate in the past 14 years. The 1967 rate, however, was still substantially below the high rates of the World War II years and the postwar peak of 16.4 reached in 1946.

TABLE 2

FEMALE POPULATION 18-24 YEARS
(In thousands of persons)

1962	8,762	1966	10,568
1963	9,044	1967	11,026
1964	9,298	1968 1/	11,301
1965	10,012	1969 1/	11,712

1/ Projected by Bureau of Census.

The current upswing in the marriage rate followed 5 years of stability (from 1958-1962) at the very low level of 8.5 per 1,000 population. A number of factors have contributed to the rise since 1963. Exemption of married men from the draft between the end of 1962 and late 1965 undoubtedly contributed to the rise in the number of marriages during this period. However, the main thrust has apparently come from the continued expansion in job opportunities for the 18 to 24 year group where most first marriages occur.

Outlook. For some years now, the burgeoning in the young adult population, abundant job opportunities and rising wages and salaries have led to the anticipation of an end to the downtrend in the birth rate. Expectations of a reversal in this trend were further heightened as the marriage rate continued its climb from the low plateau of the late 50's and early 60's. The further decline in the birth rate in 1967 emphasized again that an increase in the number of married couples is not necessarily a harbinger of a subsequent rise in births. The new methods of birth control and their greater availability through extensive family planning programs have undoubtedly played a part in this decline. Many young married couples apparently continued to postpone starting a family. Various reasons are offered for this postponement. The tight labor market of recent years has afforded exceptional job opportunities for women, and their continued employment after marriage has added significantly to family income. It has permitted the satisfaction of desires for home ownership, the purchase of household durables, additional education, and travel before settling down to raise a family. Recently, there has also been the unsettling effect of the war in Vietnam either by actual separation of couples or anticipation of such a possibility.

It would seem, however, that after four years of substantial increases in the number of young married couples, that the alternatives to raising a family would be satisfied by enough couples to result in a gradual upswing in the number of first births and be apparent in a rise in the birth rate. Even the most "pessimistic", or lowest, of the four Census Bureau projections of the future population, (which utilized for its projection the lowest rates of fertility of this century, excluding the depression years of the 30's), had assumed an end to the declining trend in the number of births by the year ending July 1, 1968, and a subsequent rise sufficient to increase the birth rate by the early 1970's. In the next to lowest projection of the future course of the fertility rate, the turn-around in the birth rate was expected in 1967. Demographic forecasts have not been outstandingly successful in the past in pinpointing turning points in fertility trends, but this one should not be too far in the future, particuarly in the light of recent marriage trends.

We are on considerably safer ground in anticipating a continuation of the rise in the marriage rate. To the other factors which have led to the rise in the marriage rate in recent years: the continually mounting number of young persons in the 18 to 24 year group and the expectation of rapid growth in the economy, will be added an increase in the number of college graduates this year. There will be close to 700,000 young persons graduating from college this June, about 17 per cent more than a year earlier. A larger than usual rise will also occur in June of 1969. This exodus of young persons from college into the tight labor market projected for this year should give added impetus to the upward trend in marriages, and result in an increase in new household formation with an attendant rise in purchases of household goods and services.

Confidential--FR

February 28, 1968

CURRENT AND PROSPECTIVE CONDITIONS IN THE RESIDENTIAL MORTGAGE MARKET

as Reported in Special Surveys by the Federal Reserve Banks and the Federal Home Loan Banks

February 1968

CURRENT AND PROSPECTIVE CONDITIONS IN THE RESIDENTIAL MORTGAGE MARKET AS REPORTED IN SPECIAL SURVEYS BY THE FEDERAL RESERVE BANKS AND THE FEDERAL HOME LOAN BANKS*

As mortgage lenders generally expect that their savings and cash flows will be slightly subnormal through May, they look for no basic improvement in their new mortgage commitments on residential properties above rates which were moderately below normal in early February. While market uncertainties have apparently lessened since the fall, structural problems have intensified in many areas to limit financing activity in February more than they did last September, when an earlier survey was made. Both the demand and supply sides of the market for new commitments on residential mortgages have been restrained by a large backlog of outstanding commitments, deep mortgage discounts, below-market usury ceilings, and attractive yields on alternative capital market instruments. On balance, current demands for residential mortgage credit reportedly may have about equaled, if not slightly exceeded, supplies of available funds at current rates and terms.

These over-all findings, based on 438 lender interviews held by the Federal Reserve Banks and the Federal Home Loan Banks in early February, varied somewhat among different areas, as might be expected from the localized nature of the primary residential mortgage market. The timing of the surveys--coming during a seasonally low month for real

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* Prepared by Robert M. Fisher, Senior Economist, Capital Markets Section, on the basis of reports from the Federal Reserve Banks to the Board's letter of January 17, 1968, and a summary prepared by the staff of the Federal Home Loan Bank Board based on an identical survey conducted by the Federal Home Loan Banks of savings and loan associations.

estate activity--undoubtedly complicated lender assessments of current and prospective conditions in relation to normal levels of activity. Nevertheless, a concensus seems clearly evident from the aggregate results. Generally, lenders felt that new commitments would continue to be made on home and apartment mortgages at a conservative pace through the spring, although an active volume of loan disbursements may well be maintained out of the large backlog of old commitments.

The survey results summarized below and tabulated at the end of this report are based on Federal Reserve Bank interviews with 126 commercial banks, 64 mortgage companies, 56 life insurance companies, and 28 mutual savings banks. Also included are Federal Home Loan Bank interviews with 164 savings and loan associations, as tabulated by the Federal Home Loan Bank Board. Identical questions were asked by the Federal Reserve Banks and the Federal Home Loan Banks. As in earlier surveys, the findings reflect only the viewpoints of lenders. No interviews were held with brokers, builders, or would-be buyers and sellers of residential real estate.

Current volume of new commitments

New commitments were generally being made on residential mortgages during February in a volume that was moderately below normal for the time of year. Moreover, all lender groups interviewed except savings and loan associations were apparently making new commitments at a somewhat less aggressive rate than they reported last September. Sharp declines in new commitment volume since last fall were implied for such typical long-distance lenders as savings banks and life insurance companies. This was also the case for mortgage companies, which service long-distance lenders by dealing chiefly in Government underwritten loans.

All Federal Reserve Districts reported a below-normal volume of new commitments in February for lenders other than savings and loan associations. By lender type, commercial banks were making new commitments more actively than life insurance companies, mortgage companies, or savings banks. Most market support was continuing to come from the traditional mortgage specialists--savings and loan associations. Greater strength in savings and loan lending activity was suggested by the fact that new commitments for these institutions were reported as above-normal in 5 of the 12 Federal Home Loan Bank Districts, normal in 2, and below-normal in 5.

Per cent of all respondents
with new commitments in February . . .

	Above Normal	Normal	Below Normal
Savings and loan associations	30	32	38
Savings banks	4	15	81
Both thrift institutions	27	29	44
Commercial banks	16	36	48
Life insurance companies	2	17	81
Mortgage companies	13	13	74
All five lenders	19	27	54

Note: Percentages in this and following tables are based on all reporting cases, which were especially small in number for savings banks. Each response was weighted equally, without adjustment for actual lending volume.

Restraints on normal new-commitment volume were widely reported on the supply side as well as the demand side of the market. Included among these was the already-advanced backlog of outstanding commitments. O. this subject, the Federal Reserve Bank of Philadelphia noted that "two of the life insurance companies /_interviewed_/ are fully committed for 1968 and part of 1969 /_in relation to their present cash flow projections_/. One other would be fully committed were it not for a policy of spreading the allocation for residential mortgage commitments over the calendar year."

Another widely-cited restraining factor was the deep discounts on FHA and VA mortgages bearing contract interest rates at the 6 per cent statutory limit. According to the Federal Reserve Bank of Minneapolis, "a contraction of FHA-VA volume as a result of below-market interest rate ceilings on such mortgages appears to have had an important effect on the volume of total commitments during this period. Commercial banks in the western part of the Ninth District were especially emphatic on this point. One Montana banker stated /_that_/ speculative construction by contractors is nil, because of relatively high FHA and VA discount rates rather than reluctance of home purchasers to pay high interest rates.' Life insurance companies, in general, report that they are completely out of the FHA-VA market. Since local mortgage bankers are heavily dependent on funds from life insurance companies, they also report a currently bearish picture in the residential mortgage loan commitment area."

Even within the Federal Reserve District of Boston, where mortgage conditions were easier than elsewhere, "the single most obvious result of the market tightening which has occurred /_since September_/ is that each type of financial institution has tended to retrench somewhat in its over-all lending activities so that it can better insure an uninterrupted flow of funds to its traditional sources of demand over the coming months.

A third restraining factor was sub-market usury ceilings in a number of States. The Philadelphia Federal Reserve Bank indicated that those /¯commercial_/ bankers doing less business than normal generally cited two factors: (1) temporary (seasonal) lack of demand and (2) 6 per cent usury ceiling and/or policy of not charging points on a loan. For the most part, the usury constraint is most felt at those banks offering ceiling rates on passbook and certificate savings.

Within the New York Federal Home Loan Bank District, "the present volume of new commitments being made /¯by savings and loan associations_/ on residential properties is sharply below normal for this time of year. The principal reason given is the 6 per cent limit on interest rates under the usury laws . . . most associations will entertain limited requests only from mortgage sources of long standing. Mortgage funds are being directed into the higher yielding bond and Government securities market. Others have turned to out-of-state /¯mortgage_/ purchases and have closed the mortgage window entirely to local mortgage applicants.

The Federal Reserve Bank of St. Louis indicated that new commitments were sharply below normal in Tennessee, which "has a usury law limiting the maximum interest rate to 6 per cent on loans under $50,000. This law effectively keeps out-of-state suppliers of funds from making home mortgages in the State." In the Richmond Federal Reserve District, new business was running below normal "due in part to a deliberate withholding of commitments pending the outcome of usury legislation in Virginia and Maryland."

Still another restraining factor was the relatively attractive yields available in other sectors of the capital market. The Federal Reserve Bank of New York reported that "the current gap between home mortgage interest rates [subject to usury laws] and bond yields has introduced some interesting distortions into the home mortgage lending market. For instance, among the savings banks interviewed, only the institution based in Connecticut, a state without a usury law, expected its new commitments on home mortgages to be about normal over the next three months. Each of the other savings institutions surveyed expect their new commitments to remain below normal over the same period."

Even so, new commitments on apartment houses were said to be running somewhat higher in many areas than those on small homes, as was the case last September. Some life insurance companies in several Federal Reserve Districts reported, in fact, that they still refused to make commitments on home mortgages altogether. The Minneapolis Federal Reserve Bank commented: "That multi-family loan commitments have performed somewhat better than homes appears to be related to the fact that current yields on non FHA-VA multi-family loans have been in the range of 7-1/4 to 8 per cent. Not only has this yield level proved competitive in relation to yields in the public (and perhaps private placement) corporate sector but also has had the effect of curtailing life insurance funds for the local single-family conventional mortgage market, currently at about a 6-3/4 per cent level."

Within the Atlanta Federal Reserve District, new commitments on home loans were sharply depressed because of "the virtual absence of a private market in FHA and VA loans" on which the region depends heavily. In contrast, a "high level of commitment volume in multi-family mortgages is being maintained substantially through joint ventures, willingness of sponsors to pay high interest rates, and in some cases to make other concessions to the lender. In all areas surveyed . . . demand for housing is being reflected in good apartment rental experience."

The New York Federal Reserve Bank, on the other hand, reported that a strong reluctance seems to have emerged among lenders to commit funds to permanent mortgages" for either home or apartment properties. Although "yields on multi-family mortgages are relatively attractive, the demand for multi-family mortgage financing has been dampened by a combination of high interest rates and the relatively high level of occupancy now required by permanent lenders [before picking up the mortgage]. Moreover, since these more stringent occupancy requirements have the effect of lengthening the period for which new construction loans to builders of multi-family properties must be carried, most banks which have ordinarily found this type of lending attractive now are reluctant to accept many new construction loan commitments."

Outlook for savings and cash flows

Savings flows to banks and savings and loan associations combined were expected to be slightly below normal over the next three months. Although commercial banks generally looked forward to a stronger net savings flow pattern through May than savings banks did, both types of lenders anticipated above-normal inflows in most Federal Reserve Districts. Least optimistic were the savings and loan associations, with only 18 per cent of all respondents foreseeing above-normal savings flows and 44 per cent expecting below-normal experience.

Per cent of all respondents expecting
net savings inflows through May to be . . .

	Above Normal	Normal	Below Normal
Savings and loan associations	18	38	44
Savings banks	37	22	41
Both thrift institutions	21	31	43
Commercial banks	36	50	14
All three lenders	27	42	31

Commenting on the savings outlook, the Boston Federal Reserve Bank underscored a comment made in several other Districts that "no undue fear of disintermediation is apparent among various types of institutions. . . ." In the Boston District, however, "among commercial banks and mutual savings banks, a new awareness of the importance of rate competitiveness in maintaining inflows was quite apparent . . . One manifestation of this is the large number of mutual savings banks which have recently begun paying daily interest. Many others are planning to start."

Although "the fear of disintermediation seems to have subsided" among savings banks interviewed in the Philadelphia Federal Reserve District, "these bankers expect inflows to be fairly below normal levels. Perhaps more important, almost all of the inflows are in the form of certificates rather than regular passbook savings. Certificates are regarded as too unstable for investment in residential mortgages."

A number of Federal Reserve Banks emphasized that end-of-year savings inflows to banks had actually been more favorable than anticipated. A commercial banker in the St. Louis Federal Reserve District nevertheless "expressed concern over the possible effect of Regulation Q on savings inflows if interest rates begin to rise. He felt the critical point would be reached under present regulations if the Treasury placed a 6 per cent coupon on a note issue."

Among the life insurance companies interviewed, the general outlook was for slightly below-normal cash flows through May. In only three Federal Reserve Districts were there no companies anticipating a less-than-normal cash flow experience.

Per cent of all respondents expecting adjusted cash flows through May to be . . .

	Above Normal	Normal	Below Normal
Life insurance companies	2	69	29

Outlook for new commitments

No marked change in new commitment activity appears likely over the next three months from recent below-normal levels, judging from the lenders questioned. This outlook nevertheless implies a fairly marked expansion in new commitment volume through the spring--a period when new commitments increase quite sharply under normal conditions. Savings and loan association lending prospects, which seem the brightest, suggest that these institutions will continue to provide a critical share of market support.

Per cent of all respondents expecting
new commitments through May to be . . .

	Above Normal	Normal	Below Normal
Savings and loan associations	32	33	35
Savings banks	18	26	56
Both thrift institutions	30	31	39
Commercial banks	22	37	41
Life insurance companies	4	10	86
Mortgage companies	12	16	72
All five lenders	22	28	50

The outlook for new residential commitments is reportedly constrained by many of the same factors also limiting normal current activity--large outstanding commitments, deep mortgage discounts, low usury ceilings, and attractive yields on other types of capital market investments. In the New York Federal Reserve District, two commercial banks indicated that they "do not find home mortgage yields any more attractive than do the savings banks. Yet, they feel that pressures from valued accounts--especially from corporate clients to pick-up the mortgages of newly-arriving employees--will force them to grant home mortgage loans they would rather not make."

In the Philadelphia Federal Reserve District, it was noted that "mortgage bankers are faced with a number of problems. One is lower allocations from correspondents. Another is lack of real estate listings for used housing because of reluctance by owners to sell. A third problem is lack of builder interest to guarantee minimum prices any more. Too, since FNMA essentially is the only bidder in the market [for FHA and VA loans], mortgage bankers fear further cuts in FNMA's price."

Current borrower demand

Most lenders evaluated credit demands of home builders and home buyers in February as being about in balance with available mortgage funds--if not somewhat in excess of supply--at current rates and terms. While the replies to this broad question were often difficult to evaluate, demand-supply conditions apparently varied a good deal among areas, as might be expected at this time of seasonal slack in real estate activity for many localities. Within 4 of the 12 Federal Reserve Districts, for example, mortgage demand was said to fall short of available funds.

Per cent of all respondents rating borrower demands in relation to mortgage funds available during February

	Demand exceeds funds	Demand in balance with funds	Demand falls short of funds
Savings and loan associations	39	35	26
Savings banks	52	22	26
Both thrift institutions	41	33	26
Commercial banks	29	40	31
Life insurance companies	35	46	19
Mortgage companies	41	35	24
All five lenders	37	37	26

Lessened borrower resistance to high mortgage rates was noted in several Federal Reserve Districts. The St. Louis Federal Reserve Bank added that "also inflationary expectations make the higher interest rates seem less burdensome."

The Federal Reserve Bank of New York cautioned that "since the usury laws [in its District] are holding rates at an artifically low level, it is not certain that the many applicants still in the market for mortgage money would be equally enthusiastic about obtaining a mortgage at higher rates." In this connection, the Federal Reserve Bank of Atlanta reported that "in virtually all cases the respondents volunteered the view that much additional demand would quickly emerge at lower levels of interest rates and relaxed terms."

The Federal Reserve Bank of San Francisco editorialized that "the basis for an expected increase in housing starts [in 1968] (again, barring a credit squeeze comparable to that of 1966, which most observers apparently discount) in large measure hinges upon a strengthening of basic housing demand. This strengthening in part stems from a recent reversal of the declining rate of in-migration into Southern California, and in part from a continued substantial reduction in the inventory of vacant and unsold housing in several mejor metropolitan areas. Furthermore, if the experience of the Seattle area is at all relevant (in Seattle, housing activity has shown sustained and substantial gains since 1964 in spite of a comparatively high level of interest rates and relatively less generous terms of lending), housing demand in other areas of the District (partly because of the sharp reduction in the housing surplus) may now be somewhat less sensitive to a modest firming in interest rates and terms from their present levels."

Related considerations

Considerable diversity among localities as well as among Districts was reported in mortgage market conditions, as in earlier surveys. The most optimistic summary was presented for the Boston Federal Reserve District, where "a general sense of satisfaction attaches to current market conditions." Even so, "conditions are tight, as evidenced by continuing high downpayment requirements, and recent point increases on FHA loans, but only midly so. As a result, lenders are generally pleased with their returns. They further report that borrower resistance to high rate structures is finally diminishing so that demand should hold up very well over the next few months while at the same time rates will be free to adjust to realistic levels to clear the market. The general feeling of worry and uncertainty evidenced in the September [1967] survey has diminished with greater confidence and even a cautious optimism toward the future taking its place."

A sharply contrasting picture was drawn for the Federal Reserve District of Philadelphia. There "the residential mortgage market picture will not brighten in the months ahead. Uncertainties and structural problems that have been around for some time continue to exist. Unsettled conditions in the residential mortgage market cast a shadow over some of the optimistic construction forecasts for 1968 now extant."

Although market uncertainities generally seemed less troublesome in February than they did last fall, they were still to be reckoned with in many areas. In this connection, the Atlanta Federal Reserve Bank noted that "the common concern of most respondents was the uncertainty attaching to the outlook for the FHA-VA sector, the proposed change to an auction basis by the Federal National Mortgage Association, and the expected reduction in support of the FHA-VA market by FNMA."

Tabulation of Replies

1. (For all respondents.) How would you best characterize your present volume of new commitments being made on residential (home and multifamily) mortgage loans?

	Commer- cial banks	Sav- ings banks	Insur- ance cos.	Mort- gage cos.	S&L's	Total
(a) substantially above normal for this time of year	3	--	--	2	13	18
(b) moderately above normal for this time of year	17	1	1	6	37	62
(c) about normal for this time of year	44	4	8	8	52	116
(d) moderately below normal for this time of year	36	13	12	16	39	116
(e) substantially below normal for this time of year	22	9	26	30	23	110
Total replies	122	27	47	62	164	422

2. (For banks and S&Ls.) What do you expect your net savings inflow (i.e., new savings minus withdrawals) to be over the next three months?

	Commercial banks	Savings banks	S&L's	Total
(a) substantially above normal for the period ahead	5	3	3	11
(b) moderately above normal for the period ahead	41	7	27	75
(c) about normal for the period ahead	63	6	63	132
(d) moderately below normal for the period ahead	16	10	57	83
(e) substantially below normal for the period ahead	1	1	14	16
Total replies	126	27	164	317

3. (For life insurance companies.) What do you expect your cash flow (adjusted for expected net changes in policy loans) will be over the next three months?

(a)	substantially above normal for the period ahead	--
(b)	moderately above normal for the period ahead	1
(c)	about normal for the period ahead	38
(d)	moderately below normal for the period ahead	11
(e)	substantially below normal for the period ahead	5
	Total replies	55

4. (For all respondents.) Taking into account your expectations about the availability of funds, how would you characterize the volume of new residential (home and multifamily) mortgage loan commitments that you expect to make over the next three months?

		Commercial banks	Savings banks	Insurance cos.	Mortgage cos.	S&L's	Total
(a)	substantially above normal for the period ahead	3	--	--	1	11	15
(b)	moderately above normal for the period ahead	23	5	2	7	42	79
(c)	about normal for the period ahead	45	7	5	10	53	120
(d)	moderately below normal for the period ahead	39	10	19	26	45	139
(e)	substantially below normal for the period ahead	11	5	23	20	13	72
	Total replies	121	27	49	64	164	425

5. (For all respondents.) How would you evaluate the present demand by prospective home buyers and home builders for mortgage loans at current interest rates and terms?

	Commercial banks	Savings banks	Insurance cos.	Mortgage cos.	S&L's	Total
(a) demand substantially exceeds mortgage funds available	9	2	6	10	16	43
(b) demand moderately exceeds mortgage funds available	28	12	12	17	45	114
(c) demand is just about in balance with mortgage funds available	50	6	24	23	55	158
(d) demand falls moderately short of mortgage funds available	32	5	9	11	30	87
(e) demand falls substantially short of mortgage funds available	7	2	1	5	8	23
Total replies	126	27	52	66	154	425