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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

May 22, 1968

SUMMARY AND OUTLOOK

Outlook for economic activity

The excessive pace of economic expansion appears to be continuing in the second quarter. The increase in the gross national product is likely to total close to $24 billion, exceeding that of last quarter by an appreciable margin. The rate of growth in real output is now estimated at 7 per cent annually, above the 6 per cent attained last quarter. This heightened rate of output indicates additional pressure on already tight manpower, and further rapid increases in wage rates and prices.

A number of factors appear to be combining to generate this substantial growth in over-all output: defense expenditures are likely to continue upward at the accelerated rate of the first quarter, investment in inventories is likely to be rising, and net exports are expected to recover substantially from their weak first quarter performance. Residential construction expenditures are also increasing faster than expected, reflecting housing starts at an estimated annual rate of about 1.5 million for the quarter.

On the other hand, expansion in personal consumption expenditures will probably be smaller than the exceptional advance in the first quarter. The increase will still be substantial, however, in comparison to those in the preceding year and a half. A dip in retail sales in early April appeared to be attributable mainly to civil disturbances, and was followed by renewed strength in auto buying and increased demand for other consumer goods in late April and early May. Disposable income is rising more rapidly than in the first quarter, reflecting expanding employment, rising wages, large Federal tax refunds, and full reflection of the increase in social security benefits. The rise in income should outpace the projected increase in consumer spending, resulting in an increase in the saving rate to about 7 per cent from the 6.6 per cent in the January-March period.

Outlook for prices and resource use

The rise in the industrial price average--which has slowed this spring--is likely to step up again this summer. The recent slowing has been associated in large part with the post-strike downward adjustment in copper prices. The total number of industrial commodities with reported price increases--including materials and both consumer and producer products--remains large, indicating sustained and widespread upward cost and demand pressures.

Prices of foods and foodstuffs at wholesale have been marking time since February, following a sharp run-up last winter. Resumption of a moderate rate of advance is expected, in large part because of continuing strong demands pressing on moderately lower supplies of livestock and products. Rising food prices, further upward cost pressures in the trade and service sectors, and the lagged effects of earlier wholesale price increases are likely to keep the CPI moving up at a fast pace in the near future.

Upward pressure on wages and unit labor costs will continue throughout this quarter. High first-year wage increases (in the telephone industry, the settlement was about 9 per cent) are likely to spread to the aluminum, shipbuilding and apparel industries, and substantial wage and fringe packages (7 to 10 per cent annually) have already been negotiated or are imminent for a major portion of the construction industry.

Employment growth, barring prolonged strikes in aluminum and shipbuilding and any significant expansion of current strike activity in the construction industry, should be large enough to keep the labor market tight and the unemployment rate at the April level of 3.5 per cent. The projected rise in industrial output, in pace with real GNP growth, should increase slightly the rate of manufacturing capacity use.

Demands for credit

The recent sharp rise of interest rates, and accompanying state of near disarray in some long-term markets, reflect the continuation of dilatory behavior on fiscal legislation, as well as the cumulative effects from the tightening of monetary policy since last fall. Unless expectations of an even firmer monetary policy, or fears of a drying up in bank funds, are moderated, still higher interest rates remain a distinct possibility.

The calendar of new corporate bond issues appears to be holding near its advanced May size, while municipal bond offerings seem to be building up somewhat further. But some postponements have already occurred, and it is possible that additional issues--either now on the calendar or in the planning stage--may also be postponed as a result of the very high level of interest rates and congestion in marketing that recently developed in capital markets. On the other hand, tendencies for borrowers, especially corporations, to shift borrowing to banks and away from capital markets may be discouraged by the further tightening of lending standards that is reported to be in process at banks.

The present lull in business loan growth at banks is likely to be followed by a surge in June, in connection with tax payments, even though banks' attitudes toward lending are becoming more restrictive. While corporations did improve their liquidity positions earlier this year, uncertainties as to future availabilities of credit may influence businesses to rely fairly heavily on currently available bank funds, rather than on sales of liquid assets in meeting June tax payments. Demands for bank loans in the weeks ahead may also be influenced by more rapid inventory accumulation.

The Federal Government will not need to raise much new cash over the next few weeks, but its cash needs will become sizable very early in the new fiscal year. Assuming only payment for the $500 million Export-Import Bank PC after mid-June, the Treasury's cash balance is likely to necessitate very large cash borrowing to cover the July-August deficit, perhaps as high as $9 billion (and about $1.5 billion less if--*mirabile dictu*--a tax bill is passed before midyear). The market is likely to begin to anticipate such large needs as June progresses--for instance, dealers are likely to want to continue reducing their positions--with consequent further upward pressures on interest rates. The Treasury may also find it desirable to anticipate its July-August needs by raising, or announcing, some new cash in one form or another before the current fiscal year ends.

Supply of funds

Given the current level of market interest rates and existing Regulation Q ceilings, there appears to be little likelihood that time and savings deposits over the next couple of months or so will show any more strength than during the past two months, when they have grown at only about a 2 per cent annual rate. In fact, time and savings deposits could well be even weaker since banks will probably not be able to avoid a fairly sizable attrition in outstanding CD's in June. And banks will find it quite difficult, and probably impossible, to regain lost CD funds in early summer, when securities, including Treasury bills, issued to meet Treasury cash financing requirements begin to compete more actively with CD's and tend to drive short-term market rates further upwards.

Consumer-type time deposits--both savings and other time--probably may rise slowly over the next few weeks. In July, however, another substantial outflow of funds from consumer time and savings deposits at large commercial banks seems likely. This outflow probably will be considerably larger than that in April, not only because the general level of market rates will be considerably higher but also because interest crediting at midyear is more widespread than at the end of March.

Demand deposits are not expected to provide a substantial offset to the reduced time deposit inflows. With deposit sources of funds constrained, further growth in Euro-dollar borrowings appears likely, although any substantial further demands in that market may push interest rates on Euro-dollars up rather sharply.

The current level of market yields and projected volume of Treasury financing likewise suggest continued reduced inflows at the nonbank depositary institutions. Looking further ahead to the late June-early July reinvestment period--when all institutions credit interest--outflows of funds from those institutions can be expected to be very large unless there is a tax increase.

Given this reduced access to funds by institutions, and with outstanding mortgage commitments already high, new mortgage commitments are expected to continue to slow further while mortgage yields continue to rise. Recent advances in mortgage yields have matched the most recent increase in bond yields, and the diversified lenders continue to have no incentive to shift funds to the mortgage market--despite recent regulatory revisions in FHA and VA ceilings.

Other markets, too, will probably continue to feel the effects of the tightening of supply conditions, at least for a while further. The extent to which there will be additional adjustments in mortgage and other debt markets will depend in part on the experience of institutions and the market generally during the June tax and midyear interest-crediting periods.

International developments

Release of the preliminary balance of payments results for the first quarter of 1968 had little effect on exchange markets, since the main magnitudes--notably the poor showing on merchandise trade and the liquidity deficit at an annual rate of $2-1/2 billion--had been known earlier. Preliminary indicators for April indicate a somewhat higher rate of deficit in that month, with some renewed outflow of U.S. bank credit. No early improvement in the over-all liquidity balance is in sight. In April and May substantial inflows of foreign liquid funds through branches of U.S. banks have continued.

Gold and foreign exchange markets have become increasingly tense in recent weeks, with sterling very weak, gold at new highs, and the German mark, Dutch guilder, and Swiss franc approaching their ceilings against the dollar. The root sources of tension include a spreading realization that the U.S. payments deficit is likely to be substantial again this year, disappointment that the U.K. foreign trade figures have not yet shown much improvement, continuing substantial payments surpluses for Germany and some other European countries, and increased discussion of possible exchange rate changes. Uncertainties have been intensified recently by further postponement of fiscal action in the United States, and by political difficulties in Britain and in France.

Events that could calm the markets might include sales of South African gold in the free market, action by the U.S. Congress to raise taxes, and some sign of improvement in the U.S. and U.K. trade figures. But these events may not happen soon. In particular, while the U.K. trade balance may well improve in the months ahead as the effects of the November devaluation and the March budget make themselves increasingly felt, near-term pressures on sterling resulting from shifts of both private and official funds seem likely to remain severe.

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.)	Apr'68	78.3	78.7	76.8	2.0	4.0
Unemployment (mil.)	"	2.7	2.9	2.9	-5.8	-3.5
Unemployment (per cent)	"	3.5	3.6	3.7	--	--
Nonfarm employment, payroll (mil.)	"	67.9	67.8	65.7	3.5	7.1
Manufacturing	"	19.6	19.5	19.3	1.3	2.9
Other industrial	"	8.4	8.4	8.1	3.1	3.8
Nonindustrial	"	40.0	39.9	38.2	4.6	10.0
Industrial production (57-59=100)	"	162.7	162.7	156.5	4.0	5.7
Final products	"	162.4	162.8	157.3	3.2	6.0
Materials	"	163.4	162.5	156.0	4.7	5.8
Wholesale prices (57-59=100)1/	"	108.3	108.2	105.3	2.8	2.7
Industrial commodities (FR)	"	108.0	107.8	105.1	2.8	3.9
Sensitive materials (FR)	"	107.7	108.2	100.7	7.0	1.2
Farm products, foods & feeds	"	112.8	112.9	110.0	2.5	2.0
Consumer prices (57-59=100)1/	Mar'68	119.5	119.0	115.0	3.9	6.7
Commodities except food	"	111.9	111.5	107.8	3.8	6.0
Food	"	117.9	117.4	114.2	3.2	3.5
Services	"	132.1	131.3	126.3	4.6	10.0
Hourly earnings, mfg. ($)	Apr'68	2.95	2.96	2.79	5.7	9.7
Weekly earnings, mfg. ($)	"	119.18	120.06	113.01	5.5	6.7
Personal income ($ bil.)2/	"	670.1	666.5	616.5	8.7	16.6
Corporate profits before tax ($ bil.)2/	Q I'68	88.8	85.1	79.0	12.4	6.1
Retail sales, total ($ bil.)	Apr'68	27.6	28.1	25.9	6.6	10.8
Autos (million units)2/	"	7.9	8.7	7.9	-1.0	-4.1
GAF ($ bil.)	"	6.8	7.0	6.4	7.1	17.5
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,620	1,500	1,116	45.2	17.6
Factory workweek (hours)	"	40.4	40.7	40.5	-0.2	-2.7
New orders, dur. goods ($ bil.)	"	25.4	26.1	22.2	14.3	5.0
New orders, nonel. mach. ($ bil.)	"	3.8	3.6	3.4	10.7	7.3
Common stock prices (1941-43=10)	"	95.67	89.09	90.96	5.2	4.4
Inventories, book val. ($ bil.)	Mar'68	141.8	141.6	136.8	3.7	15.0
Gross national product ($ bil.)2/	Q I'68	826.7	807.3	766.3	7.9	13.9
Real GNP ($ bil., 1958 prices)2/	"	689.7	679.6	660.7	4.4	6.9

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended May 17, 1968	4-week average	Last 6 months High	Last 6 months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	6.42	6.10	6.42	4.30
U.S. Treas. bills, 3-mo., yield (per cent)	5.68	5.51	5.68	4.85
U.S. Treas. bills, 1-yr., yield (per cent)	5.82	5.72	5.82	5.17
Net free reserves 2/ ($ millions)	-308	-415	384	-535
Member bank borrowings 2/ ($ millions)	712	715	823	87
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds 1/	6.04	5.96	6.04	5.47
20-year U.S. Treas. bonds 1/	5.54	5.51	5.73	5.32
Corporate new bond issues, Aaa adj. 8/	6.62	6.64	6.65	6.18
Corporate seasoned bonds, Aaa 1/	6.27	6.25	6.27	6.07
Municipal seasoned bonds, Aaa 1/	4.25	4.20	4.28	3.90
FHA home mortgages, 30-year 3/	--	6.94	6.94	6.77
Common stocks, S&P composite series 4/				
Prices, closing (1941-43=10)	96.90	97.82	98.66	89.03
Dividend yield (per cent)	3.12	3.07	3.36	3.04

	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/	May '68e/	2,050	1,853	531	-113
State & local govt. public offerings	"	1,300	1,252	78	- 6
Comm. & fin. co. paper (net change in outstandings) 6/	March'68	+1,394	+ 708	+559	-210

	Latest month	Out-standings 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
Banking (S.A.)		($ billions)			(per cent)		
Total reserves 1/	Apr. '68	25.10	-0.18	0.39	-8.4	1.9	7.1
Credit proxy 1/	"	276.9	-1.1	0.7	-4.8	3.2	8.2
Bank credit, total 6/	"	354.8	3.0	1.9	10.2	6.6	9.8
Business loans		89.2	1.4	0.9	19.1	12.5	9.2
Other loans	"	142.9	2.2	0.6	18.8	5.4	8.4
U.S. Govt. sec.	"	59.2	-0.7	--	-14.0	0.7	5.5
Other securities	"	63.4	-0.1	0.3	- 1.9	6.4	18.3
Total liquid assets 1/ 6/	Apr. '68	677.3	1.3	3.8	2.3	6.9	8.2
Demand dep. & currency 1/	"	184.7	1.3	0.7	8.5	4.8	6.9
Time & sav. dep., comm. banks 1/	"	186.9	0.3	1.1	1.9	7.0	11.2
Savings, other thrift instit. 6/	"	187.6	0.3	1.1	1.9	7.2	7.9
Other 6/ 7/	"	108.1	-0.6	0.9	-6.6	9.9	6.0

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 May 15. 3/ Latest figure is for April 4/ End of week closing prices; yields are for F iday. 5/ Corporate security offerings include both bonds and stocks. 6/ Month-end data. 7/ U.S. savings bands 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		
	I	II	III	IV	I	Mar.	Apr.
				Seasonally adjusted			
Goods and services, net 1/	1,318r	1,264r	1,417r	802r	425p		
Trade balance 2/	974r	1,098r	1,086r	326r	103r	-170	
Exports 2/	7,660r	7,703r	7,627r	7,478r	7,933r	2,440	
Imports 2/	-6,686r	-6,605r	-6,541r	-7,152r	-7,830r	-2,610	
Services balance	344	166	331	476	320p		
Remittances and pensions	-264	-395	-356	-269			
Govt. grants & capital 3/	-1,201	-1,013	-966	-947			
U.S. private capital	-973r	-1,112r	-1,812r	-1,561r			
Direct investments	-622	-648	-939	-818			
Foreign securities	-262r	-199r	-476r	-315r	-396		
Banking claims	79r	-198r	-433r	85r	359		
Other	-168	-67	36	-513			
Foreign capital, nonliquid	925r	1,214r	863r	259r			
Official foreign accts.	459r	756r	80r	161r			
Long-term deposits	371r	604r	-160r	189r	52		
U.S. Govt. liab.	88	152	240	-28			
Int'l. institutions 4/	70	97	117	15			
Other 5/	396	361	666	83			
Errors and omissions	-338	-511	216	-129			
			Balances, with and without seasonal adjustment (- deficit)				
Liquidity balance, S.A.	-533	-553	-638	-1,845r	-600		
Seasonal component	295	330	-573	-52	367		
Balance, N.S.A.	-238	-223	-1,211	-1,897r	-233	-36	-534
Official settlements bal.,S.A.	-1,817	-832	456	-1,220r	-520		
Seasonal component	537	143	-495	-185	612		
Balance, N.S.A. 6/	-1,280	-689	-39	-1,405r	92	-205	
			Reserve changes, N.S.A. (decrease -)				
Total monetary reserves	-1,027	419	375	181	-904	-864	-86
Gold stock	-51	-15	-92	-1,012	-1,362	-1,197	-156
Convertible currencies	-1,007	424	462	1,145	401	511	58
IMF gold tranche	31	10	5	48	57	-178	12

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 (+) increase in liquid liabilities to commercial banks, private nonbanks, and international insitutions (except IMF) and by not counting as receipts (+) increases in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. The upward swing in total economic activity remains exceptionally strong. The gain in the gross national product this quarter is expected to amount to $24 billion--about $4 billion more than the very large first quarter increase. Real GNP should rise at an annual rate of over 7 per cent, up from the already advanced 6 per cent rate of last quarter.

These rapid rates of expansion follow a year in which a first quarter pause was followed by successively higher quarterly growth rates. Thus, economic momentum has been rising for a year and a half. Unemployment has fallen to minimal levels, while price and wage increases have become larger. This quarter, the GNP deflator is expected to rise at an annual rate of 4 per cent as compared with 3.7 per cent in the first quarter.

Although the increase in gross national product is anticipated to be appreciably larger this quarter, the rise in final sales will be smaller--about $21 billion as compared with an extraordinary $26 billion in the first quarter. A smaller gain in consumer expenditures accounts for much of the slowing in the rise of final sales. However, a projected increase in inventory accumulation in contrast to the sharp decline in the first quarter more than compensates for this.

Consumer spending is expected to increase by $12.4 billion this quarter. This is well below the $17 billion in the first quarter, but it is still almost twice the quarterly rate of expansion in 1967. Although retail sales dipped by nearly 2 per cent in April, for the first month-to-month drop since last fall, the easing was at least partly a result of civil disorders. Moreover, the April decline followed several months of remarkably sharp increases in sales. Late April and early May sales appear to have rebounded to or above the advanced March rate. For the quarter, an 8.5 million rate of domestic new auto sales is projected. Although this is a very high level of sales, the increase is only about half that in the first quarter and thus accounts for much of the slower increase in consumption expenditures. Nondurable goods outlays also appear to be rising more moderately than in the first quarter.

Disposable income of consumers is expected to increase somewhat faster this quarter than last. The saving rate, which dropped almost a full percentage point to 6.6 per cent last quarter, should rise to about 7 per cent, partly because of the smaller increase in auto sales and partly because the exceptional first quarter advance in nondurable goods sales is unlikely to be repeated. Even if a tax increase should be enacted early next month, it is unlikely to have an appreciable effect on consumer income or demand for the quarter as a whole.

The modest level of nonfarm inventory accumulation last quarter, which has been revised down to an annual rate of less than

$2 billion, reflected in part the sharp acceleration in consumer spending. Accumulation in defense industries also slowed, and stocks held by machinery and equipment producers declined for the first time since 1961. Since last October, in manufacturing and trade combined, the inventory-sales ratio for durable goods has fallen from 2.11 to 1.96, and that for nondurables from 1.15 to 1.13--lower than for any March in recent years. The retail stocks-sales ratio, excluding autos, declined from 1.36 in December--a figure which was about average for last year--to 1.30.

In this situation, and in the face of continued prospects for further rapid advances in prices and wages, businessmen are expected to expand output at a faster rate this quarter. Auto-makers intend to produce at a rate which should add further to dealers' stocks, possibly as a steel-strike hedge, and steel inventory accumulation likely will continue. Under these circumstances, our projected $5.0 billion rate of accumulation for this quarter appears conservative, but the continued rapid increase anticipated for final demand seems likely to prevent a sharper rise.

The near-term housing outlook is somewhat stronger than foreseen last month. The April rate of private starts reached a surprising 1.6 million units. Although a sharp drop is expected by June, for technical reasons as well, because of tight credit markets, the second quarter average likely will approach an annual rate of 1.5 million units, only slightly below the upward revised rate of the first quarter. Outlays for housing construction are estimated to rise by about $1 billion.

Business investment in new plant and equipment is also expected to continue to rise this quarter in line with expectations of an 8 per cent increase in outlays this year as reported by business in the McGraw-Hill survey last month and consistent with the strength in new orders for machinery and equipment in recent months.

A further rise of about $2.5 billion in defense spending is anticipated this quarter. The acceleration in outlays in the first half of this year in part appears to reflect greater activity in Vietnam and a rise in armed service strength, and in part a catch-up from the last half of 1967, when deliveries of defense goods were held down. Although the trend of military prime contracts has been down since November, the backlog of orders for aerospace and other defense products indicates that deliveries could continue rising for some time.

The Federal deficit, NIA basis, is expected to continue very high this quarter, probably at an annual rate close to $10 billion. However, if the surtax is not passed the deficit will be almost $3.5 billion higher, since our receipts estimates include an allowance for the surtax for corporations (which are treated on a liability basis in the NIA accounts). Under any circumstances, however, a sharp rise in profits will add significantly to the rise in revenues. This quarter, profits are expected to attain a rate of $96 billion, $7.5 billion above the first quarter and $11 billion above the final period of 1967. Social security and individual income taxes are also climbing. However, refunds to individuals have been far above last year (and above expectations), particularly in the first quarter.

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 Ip	1968 Proj. II
Gross National Product	743.3	785.0	766.3	775.1	791.2	807.3	826.7	850.3
Final sales	729.9	779.8	759.2	774.6	787.4	798.1	824.0	844.8
Private purchases	575.6	603.5	588.8	599.6	609.2	616.4	635.7	651.7
Personal consumption expenditures	465.9	491.7	480.2	489.7	495.3	501.8	518.7	531.1
Durable goods	70.3	72.1	69.4	72.5	72.7	73.8	78.4	80.4
Nondurable goods	207.5	217.5	214.2	217.2	218.5	220.3	228.1	234.3
Services	188.1	202.1	196.6	200.0	204.1	207.7	212.1	216.4
Gross private domestic investment	118.0	112.1	110.4	105.1	112.2	120.8	118.0	122.6
Residential construction	24.4	24.4	21.4	23.1	25.6	27.6	28.2	29.1
Business fixed investment	80.2	82.6	81.9	81.5	82.8	84.0	87.2	88.0
Change in business inventories	13.4	5.2	7.1	.5	3.8	9.2	2.7	5.5
Nonfarm	13.7	4.8	7.3	.6	3.4	7.7	1.8	5.0
Net Exports	5.1	4.8	5.3	5.3	5.4	3.0	1.7	3.5
Gov't purchases of goods & services	154.3	176.3	170.4	175.0	178.2	181.7	188.3	193.1
Federal	77.0	89.9	87.1	89.5	90.9	92.2	96.2	98.9
Defense	60.5	72.5	70.2	72.5	73.3	74.2	76.7	79.1
Other	16.5	17.4	16.8	17.0	17.6	18.0	19.5	19.8
State and local	77.2	86.4	83.3	85.4	87.4	89.5	92.1	94.2
Gross National Product in constant (1958) dollars	652.6	669.3	660.7	664.7	672.0	679.6	689.7	702.1
GNP Implicit deflator (1958=100)	113.9	117.3	116.0	116.6	117.7	118.8	119.9	121.1
Personal income	584.0	626.4	612.9	619.1	631.0	642.5	659.0	676.6
Wages and salaries	394.6	423.8	414.7	418.3	426.2	435.9	447.6	459.1
Disposable income	508.8	544.7	532.7	540.0	548.2	557.9	571.5	588.8
Personal saving	29.8	38.7	38.8	36.0	38.5	41.6	38.0	41.8
Saving rate (per cent)	5.9	7.1	7.3	6.7	7.0	7.5	6.6	7.1
Corporate profits before tax	83.8	80.8	79.0	78.9	80.0	85.1	88.8	96.3
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	143.2	151.8	149.1	148.1	152.7	157.3	164.9	172.7
Expenditures	142.9	164.3	160.9	162.8	165.9	167.9	175.6	182.5
Surplus or deficit (-)	.3	-12.5	-11.9	-14.7	-13.2	-10.7	-10.7	- 9.8
Total labor force (millions)	78.9	80.8	80.3	80.3	81.1	81.6	81.9	82.3
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	78.4	78.8
Unemployment rate (per cent)	3.8	3.8	3.7	3.8	3.9	3.9	3.6	3.5
Nonfarm payroll employment (millions)	64.0	66.1	65.7	65.7	66.1	66.8	67.6	68.2
Manufacturing	19.2	19.3	19.5	19.3	19.2	19.4	19.5	19.7
Industrial production (1957-59=100)	156.3	157.8	157.1	155.9	157.2	159.5	161.9	164.8
Capacity utilization, manufacturing (per cent)	90.5	85.1	87.1	84.9	84.1	84.4	84.4	84.6
Housing starts, private (millions A. R.)	1.17	1.29	1.12	1.21	1.41	1.44	1.50	1.47
Sales new U.S.-made autos (millions, A. R.)	8.38	7.57	7.16	8.11	7.57	7.44	8.19	8.50

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1966	1967	1967 I	1967 II	1967 III	1967 IV	1968 Ip	1968 Proj. II
	-----------------	In Billions	of Dollars	-----------------				
Gross National Product	59.4	41.7	4.2	8.8	16.1	16.1	19.4	23.6
Final sales	55.4	49.9	15.6	15.4	12.8	10.7	25.9	20.8
Private purchases	37.5	27.9	6.9	10.8	9.6	7.2	19.3	15.3
GNP in constant (1958) dollars	35.9	16.7	- .4	4.0	7.3	7.6	10.1	12.4
Final sales	32.1	24.6	10.1	10.3	4.2	2.5	16.2	9.9
Private purchases	21.9	10.4	3.7	7.1	3.0	1.7	11.9	7.5
	---In Per Cent; Quarterly Changes are at Annual Rates----							
Gross National Product	8.7	5.6	2.2	4.6	8.3	8.1	9.6	14.1
Final sales	8.2	6.8	8.4	8.1	6.6	5.4	13.0	10.1
Private purchases	7.0	4.8	4.7	7.3	6.4	4.7	12.5	9.6
Personal consumption expenditures	7.6	5.5	5.4	7.9	4.6	5.2	13.5	9.6
Durable goods	6.5	2.6	-6.8	17.9	1.1	6.1	24.9	10.2
Nondurable goods	8.5	4.8	7.4	5.6	2.4	3.3	14.2	10.9
Services	6.9	7.4	7.7	6.9	8.2	7.1	8.5	8.1
Gross private domestic investment	9.9	-5.0	-38.6	-19.2	27.0	30.7	-9.3	15.6
Residential construction	-9.6	0.0	9.6	31.8	43.3	31.2	8.7	12.8
Business fixed investment	12.8	3.0	-4.3	-2.0	6.4	5.8	15.2	3.7
Gov't purchases of goods & services	13.1	14.3	21.5	10.8	7.3	7.9	14.5	10.2
Federal	15.3	16.8	27.5	11.0	6.3	5.7	17.4	11.2
Defense	20.8	19.8	28.0	13.1	4.4	4.9	13.5	12.5
Other	-1.2	5.5	22.6	4.8	14.1	9.1	33.3	6.2
State & local	10.9	11.9	15.5	10.1	9.4	9.6	11.6	9.1
GNP in constant (1958) dollars	5.8	2.6	-.2	2.4	4.4	4.5	5.9	7.2
Final sales	5.3	3.8	6.3	6.3	2.5	1.5	9.7	5.8
Private purchases	4.4	2.0	2.9	5.5	2.3	1.3	9.0	5.5
GNP Implicit deflator	2.7	3.0	2.4	2.1	3.9	3.6	3.7	4.0
Personal income	8.6	7.3	7.5	4.0	7.7	7.3	10.3	10.7
Wages and salaries	9.9	7.4	7.2	3.5	7.6	9.1	10.7	10.3
Disposable income	7.8	7.1	8.2	5.5	6.1	7.1	9.7	12.1
Corporate profits before tax	9.5	-3.6	-23.4	-0.5	5.6	25.5	17.4	33.8
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.7	6.0	1.3	-2.7	12.4	12.0	19.3	18.9
Expenditures	15.8	15.0	23.7	4.7	7.6	4.8	18.3	15.7
Nonfarm payroll employment	5.3	3.3	4.3	0.0	2.4	4.2	4.8	3.5
Manufacturing	6.1	0.5	0.0	-4.1	-2.1	4.2	2.1	4.1
Industrial production	9.0	1.0	-5.5	-3.1	3.3	5.9	6.0	7.2
Housing starts, private	-20.4	10.3	87.0	32.1	66.1	8.5	16.7	-8.0
Sales new U.S.-made autos	-4.4	-9.7	-50.3	53.1	-26.6	-6.9	39.2	15.1

Industrial production. Industrial production was revised upward in February and March and the first quarter level is now 161.9 (up .3 of one point from the earlier figure), as compared with 159.5 in the fourth quarter--an annual rate of increase of 6 per cent, the same as real GNP.

In April, industrial production was unchanged from the March level of 162.7 as increased production of materials was offset by declines in output of final products. Production of autos, television sets, and some appliances was reduced and output of tobacco products was curtailed by a work stoppage. Production of commercial and freight and passenger equipment also declined. Among materials, output of iron and steel and some other durable and nondurable materials rose further, reflecting in part accumulation of steel inventories by consuming industries and the return to work following settlements in the copper and glass industries.

Although industrial production was at a new high in March and April, that high is only 2 per cent above the December 1966 level, as shown in the table. Output has increased significantly since 1966 only in defense equipment, nondurable materials, consumer staples, and commercial equipment. With the additions to productive capacity since that time, output in many industries could be increased significantly if the demand and manpower were there.

INDUSTRIAL PRODUCTION
Per cent change to April 1968

	From 1966 high	From 1967 low*
Total index	2.0	4.6
Consumer goods	2.7	5.4
Autos	-7.6	38.4
Home goods	.3	8.9
Apparel	- .9	5.8
Staples	3.8	--
Business equipment	-3.4	1.5
Industrial	-7.0	- .1
Commercial	3.1	--
Defense equipment	14.5	--
Materials	2.3	5.7
Durable	-1.1	5.8
Steel	1.2	19.6
Nondurable	4.9	6.2

* - Excludes strike months.
Note: The above table compares the April 1968 levels with highs and lows for each sector, regardless of the month, in order to show the expansion or decline from that sector's 1966 high and the amount of recovery from each sector's 1967 low.

In May, industrial production is likely to rise above the March-April level. Auto production schedules are set at an annual rate of 9.0 million units, about 7 per cent above the reduced April level, and through May 17 output has exceeded the scheduled rate. Output of raw steel increased somewhat in early May and a further recovery in production is anticipated in the copper industry. Also, insofar as the April decline in average weekly hours in manufacturing was attributable in part to civil disorders and the Friday-Saturday holidays before Easter Sunday is allowed for in the industrial production seasonal factors, any rise in hours will have a smaller effect on the production index than on production worker manhours.

Capacity utilization. The April rate of manufacturing capacity utilization was estimated to be 83.9 per cent, down from an upward revised 84.3 per cent the previous month. The April decline was the third in the last four months as seasonally adjusted manufacturing output again failed to rise significantly above its December level.

Steel output increased sharply in April and operating rates are far above normal. Pressures on steel capacity do not appear to be as great as in the 1965 inventory build-up, however, and some margin apparently remains for increased output of most steel products.

The aircraft industry continues to operate at near capacity levels and only moderate amounts of unused capacity are available for the production of textile, petroleum and rubber products. Operating rates are relatively low in other manufacturing industries.

UTILIZATION RATES
(Per cent)

Industry	1967		1968			
	QIII	QIV	QI	February	March	April
Manufacturing	84.1	84.4	84.4	84.4	84.3	83.9
Primary processing Industries	82.5	84.6	84.4	84.4	84.3	84.5
Advanced processing Industries	85.2	84.3	84.4	84.3	84.4	83.5

Retail sales. Retail sales in April, seasonally adjusted, declined 1.7 per cent from March for the first month-to-month decline since October. However, early May data suggest a substantial rebound from the slackened April pace.

Civil disorders in April undoubtedly affected sales; some retail outlets were closed and spending was reduced generally. Moreover, the April decline came after several months of very large increases, with a particularly sharp rise of 2.7 per cent in March. The April drop was concentrated mainly in durable goods (off 3.5 per cent), with the automotive group showing the largest decline. The nondurables category was off less than 1 per cent, although the apparel group was down nearly 6 per cent.

CHANGES IN RETAIL SALES FROM PRECEDING MONTH
(Seasonally adjusted, in per cent)

	1968			
	January	February	March	April
Total, all stores	2.2	1.2	2.7	-1.7
Excluding automotive	1.7	0.7	2.3	-1.1
Durable goods stores	2.4	2.8	3.4	-3.5
Automotive group	4.6	3.6	4.1	-4.5
Lumber	-0.4	7.7	3.7	-4.2
Furniture and appliances	0.1	2.8	2.6	-2.1
Nondurable good stores	2.2	0.5	2.3	-0.9
Food, eating and drinking	1.6	-0.7	1.7	-0.1
Apparel	4.9	2.5	3.7	-5.8
General merchandise	0.9	3.5	4.1	-1.2

Unit auto sales and stocks. Dealer deliveries of new domestic autos in the first period of May were unchanged from a year earlier, when sales were unusually high. Sales for the month of May are likely to be at an annual rate in the vicinity of 8.5 million units, as compared with 7.9 million in April.

Production has continued to run above sales, and stocks of new cars increased 5 per cent further in early May. On May 10 stocks totaled 1.6 million units, one-tenth above a year ago.

Sales of used cars in April were down somewhat from March but about the same as a year earlier. Stocks changed little from the previous month but were 6 per cent above a year ago.

Sales of new imported cars in April continued to account for over one-tenth of the total new car market and were one-third higher than a year earlier.

Consumer credit. The pace of the instalment credit expansion has picked up sharply this year. The annual rate of increase reached $6.2 billion in the first quarter, up from $4.4 billion in the fourth quarter and almost double the rate in 1967 as a whole. Rising credit demands associated with the pickup in consumer spending have been largely responsible for the rebound, although a slower rate of repayments on old debt--as compared with much of 1967--has also been a factor.

CONSUMER INSTALMENT CREDIT
(Billions of dollars, seasonally adjusted annual rates)

		Extensions	Repayments	Net change
1967	Q1	78.0	75.0	3.0
	Q2	79.9	77.1	2.8
	Q3	82.6	79.3	3.3
	Q4	83.9	79.5	4.4
1968	Q1	86.9	80.7	6.2

Most areas of consumer credit shared in the first-quarter pickup, but increases in auto credit were particularly important. However, the first quarter surge in auto credit merely served to return that category to its normal position vis a vis total instalment credit, i.e., about 40 per cent of the total. The extent of this recovery may be judged by last year's data which show auto credit outstanding accounting for only 10 per cent of the rise in total instalment credit.

The instalment credit expansion probably slowed a little in April. Reports for that month are only fragmentary, but the drop in new car sales from the advanced March level apparently had a negative effect. A turnaround appears under way in May, however, in view of the higher rate of auto sales indicated by the first 10-day report.

Even with demands for instalment credit picking up, there is still little evidence of a tightening in supply conditions in response to the shift in monetary policy. In 1966, the impact of tighter monetary policy on the consumer credit markets was quite clear. As lenders saw their own funds become more limited and more costly, they adopted more restrictive policies. In the case of new car loans, for example, the typical maximum maturity remained at 36 months, but fewer customers were able to obtain those terms. Consumer finance charges also rose and by spring 1966 interest rates on auto loans were up a quarter- or half-point in many areas. Other consumer rates also went up, although in some cases they were already bumping against ceilings imposed by usury laws.

This year consumer lending standards have grown somewhat more restrictive, but in general the response of credit grantors to monetary policy changes has been both slower and less marked than two years ago. Consumer interest rates, for example, have reacted even more sluggishly than in 1966, with advances confined largely to new car loans. And non-price auto terms are still relatively liberal. At major sales finance companies, the proportion of new-car contracts with 36-month maturities has remained near the 82 per cent level prevailing during most of 1967. Perhaps the only significant note of tightening in auto terms has been in down payment requirements for used-car loans.

Nevertheless, as time goes on, lending standards will almost surely become more stringent. As lenders see the differential between cost and return on funds narrowing, they can be expected to screen their loans more carefully and take other precautions to minimize bad loans and losses.

<u>Manufacturers' orders and shipments</u>. Advance figures on new orders received by durable goods manufacturers in April were 2.7 per cent below March and 4 per cent below the record high last December. The decline from March to April reflected a substantial drop in new orders for aircraft and more moderate declines in orders for nonferrous metals, fabricated metals, and for transportation equipment other than motor vehicles and aircraft.

New bookings for aircraft--mainly commercial--had increased by 60 per cent in March, lifting new orders for all durable goods by 5.2 per cent. In April new orders for durable goods excluding aircraft were 1 per cent above March but about unchanged from the average of the first two months of the year. New orders for machinery and equipment rose 4.6 per cent further, returning to about the December-January level. April new orders for iron and steel were up 10 per cent from the sharply reduced March level but were still 7 per cent below the average in the three preceding months.

Unfilled orders rose in April only in the aerospace, motor vehicle, and iron and steel industries. The order backlog was either unchanged or down slightly in the other major industry groupings. The rise in the aerospace backlog occurred despite the large drop in new orders; shipments were also off sharply from the record March level and were below the level of new orders. Shipments by all major industries except primary metals were off from the near-record March rate.

Business inventories. The book value of inventories held by manufacturing and trade concerns increased about $200 million in March, according to preliminary figures. This increase was appreciably smaller than the rise in either January and February; and for the entire first quarter the rate of increase in book values was at an annual rate of approximately $4 billion, down sharply from the fourth quarter rate of $11.8 billion. Moreover, price increases accelerated further and accounted for virtually the entire book value increase during the first quarter. The inventory valuation adjustment nearly doubled in the first quarter and inventory accumulation on a GNP basis (after IVA) in all nonfarm industries--i.e., including construction and other lines as well as manufacturing and trade--was at an annual rate of only $1.8 billion, down from $7.7 billion in the fourth quarter.

The sharp fall-off in the rate of inventory increase in the first quarter was concentrated in durable manufacturing industries, where first quarter accumulation was only a fourth as large as in late 1967, and at wholesalers, where sizable accumulation in the fourth quarter was succeeded by some liquidation in the first. Accumulation by retailers also declined considerably, despite further large accumulation by auto dealers. Stocks of nondurable goods manufactures showed a much larger increase in the first than in the fourth quarter.

CHANGE IN BOOK VALUE OF NONFARM BUSINESS INVENTORIES
(Billions of dollars, seasonally adjusted annual rates)

	1967 IV	1968 I(p)
Manufacturing and trade, total	11.8	4.3
Manufacturing	6.3	3.3
Durable	5.4	1.3
Nondurable	0.9	2.0
Trade	5.5	1.0
Wholesale	3.3	-0.3
Retail	2.2	1.3

A marked slowing of the rise in book value of inventories in "defense products" industries (from a $2.3 billion rate in the fourth quarter to $0.8 billion in the first) and a shift from a $0.7 billion rate of accumulation to liquidation at a $1.0 billion rate in machinery and equipment industries featured developments in durable goods manufacturing industries.

A large step-up in business sales--chiefly at retail stores--accompanied the step-down in the rate of inventory accumulation, in March and for the first quarter as a whole. As a result, the over-all business inventory-sales ratio declined to 1.50 in March from 1.52 in December and an average of 1.55 in the fourth quarter. The March ratio was the lowest since September 1966. The March inventory-sales ratio for manufacturers, where sales increased only moderately, was below the ratios observed in 1967, but it was still above the low levels prevailing from 1964 until the last quarter of 1966. The ratio of retail inventories to sales was at an historically low level.

Construction and real estate. New construction put in place in April continued little changed from the peak rate reached in February. Residential construction (which is probably understated in the present Census projection) held at the advanced rate reached in March after a 15-month expansion. Nonresidential outlays, which had dipped somewhat in March, also changed little. Public construction--in a steady recovery from its recent low last summer--edged higher, but remained below its peak in February of last year.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	April 1968 ($ billions) 1/	Per cent change from	
		March 1968	April 1967
Total	81.2	--	+13
Private	54.5	--	+18
Residential	27.4	--	+30
Nonresidential	27.1	--	+ 9
Public	26.7	+1	+ 3

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

Seasonally adjusted private housing starts, which had turned downward in March, rose sharply in April to an annual rate of 1,620 thousand, the highest since early 1964. The rise probably reflected in part a further acceleration of builder schedules at a time when additional tightening in money markets seemed imminent and mortgage commitments outstanding and building permits were still quite high. The rise--which was out of line with initial projections and which may be subject to downward revision--was apparently exaggerated by technical measurement factors. For seasonal adjustment purposes, Census makes no explicit allowance for working days. This year, the number of working days in April (22) actually exceeded those in March (21) for the first time since 1963 when starts also rose--by 9 per cent--from March to April.

Multifamily starts, the most volatile component of the total, accounted for the major share of the April rise, but single-family starts also increased. Regionally, a surge occurred in the Northeast states as was expected because of an unusually low March rate. The West also showed a marked rise.

Unlike starts, seasonally adjusted permits dropped in April and were the lowest since January. The decline affected both single-family and multifamily structures and all regions except the West. On the basis of this and other considerations, a decline over the remaining months in the current quarter is to be expected. For technical and other reasons, the decline may be particularly marked in June. Even with the exceptionally high April rate, the average for the second quarter as a whole is still expected to be a little below the advanced first quarter rate now estimated by the Census Bureau at 1.5 million.

PRIVATE HOUSING STARTS AND PERMITS

	April 1968 (thousands of units) 1/	Per cent change from	
		March 1968	April 1967
Starts	1,620	+ 8	+45
1-family	952	+ 4	+25
2-or-more-family	668	+14	+87
Northeast	230	+33	+28
North Central	385	- 9	+42
South	666	+ 7	+36
West	339	+21	+92
Permits	1,297	- 6	+26
1-family	647	- 7	+12
2-or-more-family	650	- 4	+44

1/ Seasonally adjusted annual rates; preliminary.

Sales of new homes by speculative builders rose less than seasonally in March, the latest month for which data are available. But stocks of homes for sale by such builders--particularly homes already completed--continued unusually small and equalled only 4.3 months' supply at the March rate of sales--even lower than a year earlier when the supply amounted to 4.5 months' sales. Moreover, while the median intended price of builders' stocks of homes was unchanged, at $23,600, prices of the homes sold advanced sharply to a new high of $24,400, nearly a tenth above a year earlier.

In the market for existing homes, with potential buyers apparently willing to accept both higher interest rates and higher prices, sales in March averaged almost a tenth above the level in March of 1967 when such sales had already begun to revive. Average prices of such houses, as in February, continued 4 per cent above a year earlier, according to the National Association of Real Estate Boards.

Personal income. Personal income in April rose nearly $4.0 billion to a seasonally adjusted annual rate of $670 billion, 8.7 per cent more than a year earlier. April income was $11.0 billion, or 1.7 per cent, above the first quarter average.

April was the only month of the last six in which special factors affecting personal income were about offsetting. Exclusive of such influences, the April increase was only three-fourths as large as the average rise in the November to March period.

CHANGES IN PERSONAL INCOME
(Billions of dollars, seasonally adjusted annual rates)

		Total	Total, excluding effects of special factors 1/
1967	November	6.5	4.5
	December	6.9	6.4
1968	January	1.6	3.7
	February	8.5	6.4
	March	7.1	4.0
	April	3.6	3.7
November to March average		6.0	4.8

1/ Strikes, retroactive payment of Federal Government pay raises, increases in social insurance taxes because of base increase, higher level of social security benefits, increases in minimum wage rates, and smaller-than-usual year-end extra dividends in December.

Labor market. The labor market continued to show substantial strength in April, although the data were somewhat distorted by unusual factors in the survey week. While the unemployment rate declined for the second straight month, employment gains were only moderate and hours of work fell off because of religious observances and civil disorders. Unemployment claims through early May reflect a pattern of continued tightness in the labor market.

Nonfarm payroll employment rose 100,000 in April, but when the net return of workers from strike is taken into account, the increase is reduced to 45,000--less than half of the March increase. However, the increase in nonfarm employment so far this year has been at a brisk rate, and the rise from April a year ago of 2.3 million was the largest over-the-year gain since early in 1967. Employment in nonmanufacturing industries showed less than its usual buoyancy--up by only 35,000 in April--largely as a result of an increase in strike activity in construction and a decline of 35,000 in retail trade. The dip in retail trade probably reflected both the difficulties of seasonal adjustment around Easter time and civil disturbances; trade employment should rebound substantially in May.

In manufacturing, employment rose by about 75,000 in April, of which almost 50,000 represented the net effects of returns, to work after strikes, primarily in glass and copper, and new strikes in fabricated metals.

Due to the combination of religious holidays and civil disturbances during the survey week, hours of work fell in virtually every major industry with the exception of construction. The workweek in private nonfarm establishments was down two-tenths of an hour, and in manufacturing three-tenths of an hour. As a result of the reduced workweek, with less overtime at premium pay, manufacturing earnings showed no change from the March level of $2.96 an hour.

The unemployment rate dipped again by one-tenth of a point, and in April was back to the low January rate of 3.5 per cent. This was nominally equal to the lowest rate attained since the Korean War, but certain changes in the series at the beginning of 1967 had the effect of lowering the unemployment rate slightly so that the data are not entirely comparable; even so, the April rate reflects an extremely tight labor market. The decline in April occurred largely among teenagers whose unemployment rate fell over a point to 11.9 per cent. The unemployment rate for adult men (age 25 and over) remained extremely low--below 2 per cent.

Labor force. The 1.6 million increase in the total labor force in the year ending in the first quarter of 1968 was about "normal" but substantially smaller than the increase of more than 2 million the previous year when the armed forces expanded by half a million. The civilian labor force increase, however, was not much less than the rise a year earlier. The age composition of the increase has shifted significantly with the teenage civilian labor force showing little change this past year and with all of the rise occurring among adult men and women.

LABOR FORCE CHANGES
(Thousands of persons)

	1Q 1966 to 1Q 1967	1Q 1967 to 1Q 1968
Total labor force	2,141	1,634
Armed forces	483	59
Civilian labor force	1,658	1,575
Adult men	376	684
Adult women	1,038	940
Teenagers	245	-50

As in other recent years, women accounted for the major portion of the civilian labor force increase. The continued rapid growth in the trade-service-State and local government complex has provided ample job opportunities for women and their labor force participation rate continued to rise. Rates of labor force participation for married women under 35 years with young children have shown a significant rise in recent years. Increases in earlier years had been more marked among women past 35 years.

The substantially larger increase in the number of adult men entering the civilian labor force in the past year reflected both the sharper rise in the number of young adults in the population and the relative stability in military manpower. With more young persons reaching the early twenties--the heritage of the post-World War II bulge in births--the number of young men entering the civilian labor force increased sharply over the past year. With the economy continuing to grow rapidly, the increased supply of adult men becomes an important addition to available resources. In other recent years, the small growth in the adult male population had tended to aggravate scarcities of skilled labor.

Industrial relations. A pattern of first-year wage increases substantially larger than for later years of the contract--a so called "front load"--has been evident in a number of wage settlements in recent months. A high first-year wage increase (7 per cent) was an important feature of the automobile workers' contracts negotiated last fall; this has not only set a pattern for manufacturing contracts in other metal working industries but is appearing in contracts negotiated in nonmanufacturing activities. According to recent BLS data on major collective bargaining settlements negotiated in the first quarter of this year, the median first-year increase in nonmanufacturing was 7.7 per cent, as compared with 7.4 per cent in manufacturing. The recent settlements in the telephone industry have given added impetus to this trend. More than half of the 3-year wage increase falls in the first year--9 per cent compared with 4 per cent in the second and in the third years. Several settlements in trade also appear to be following the pattern.

Collective bargaining agreements covering close to 2 million workers are yet to be negotiated this year in such major industries as aluminum, steel, shipbuilding, aerospace, apparel and construction, as well as for additional communications workers. The spreading emphasis on substantially higher first-year wage increases suggests continued strong upward pressure on wages and unit labor costs in the current year. This emphasis presumably reflects worker concern with the rising cost of living and as long as these costs persist on this sharp upward course, it is likely that the pattern of larger first-year wage increases will continue.

Wholesale prices. The BLS wholesale price index increased by only 0.1 per cent in April, rather than the 0.2 per cent estimated earlier, to 108.3 per cent of the 1957-59 average. (CONFIDENTIAL UNTIL RELEASE MAY 28.) The smaller-than-estimated increase resulted from a decline of 0.1 per cent for farm products and processed foods and feeds rather than a 0.1 per cent increase.

The April price rise for industrial commodities was 0.2 per cent, as estimated a month ago, but down from 0.3 per cent in March and 0.5 per cent in February. As suggested by the table, the slower rise in the industrial commodity total in April than in March stemmed from a decline in sensitive industrial materials prices, which had shown an exceptionally large rise from last August to March. The April decline reflected primarily the beginning of a run-down in average prices of copper--following the strike settlement--and a further drop in steel scrap prices as mills curbed their scrap purchases in anticipation of a possible steel strike. Lumber and plywood prices continued to rise at a rapid rate.

Average prices of other (sluggish) materials, in contrast, resumed an upward movement in April after showing no change in March, when two, exceptionally large declines in container board and liquified petroleum gas offset the steady and relatively widespread price upcreep for many other materials (such as steel products and glass and other construction materials).

Moreover, prices of both finished consumer and producer's products stepped up a bit in April and increased at about the average rates of the preceding 5 months.

WHOLESALE PRICES OF INDUSTRIAL COMMODITIES
(Special FR groupings, 1957-59=100)

				Per cent change	
	Feb.	Mar.	April	Average Oct. to Mar.	March to April
Industrial Commodities	107.5	107.8	108.0	0.4	0.2
Materials	106.2	106.6	106.7	0.5	0.1
Sensitive	106.4	108.2	107.7	1.4	-0.5
Other	106.2	106.2	106.5	0.2	0.3
Products	109.1	109.2	109.5	0.2	0.3
Consumer nonfoods	106.7	106.8	107.0	0.2	0.2
Producers' equipment	114.2	114.4	114.7	0.3	0.3

Consumer prices. As reported in the Supplement to the preceding Green Book, the BLS consumer price increased 0.4 per cent in March, with sizable gains reported for foods, other commodities, and services. The large March rise confirmed a move toward accelerating increases in the CPI beginning in late 1967--with services and foods accounting for the bulk of the step-up.

The April CPI will not be released until May 28, but preliminary estimates indicate a further increase in retail food prices. Another rise of 0.4 per cent in the total index seems quite likely.

Non-real-estate debt of farmers. Farmers owed approximately $23.5 billion in non-real-estate debt at the end of 1967. The increase of 10 per cent from a year earlier was about the same as the average annual increase over the past 10 years. Among institutional lenders, indebtedness to member banks showed the smallest increase last year (7 per cent) and indebtedness to PCA's, the largest (17 per cent). Farmers Home Administration lending for operating expenses and other short-term purposes was determined by annual appropriation, as usual. Although farmers indebtedness to banks increased more slowly than to other institutions during 1967, member banks still held their position as the major supplier of institutional credit to farmers, as can be seen in the table.

NON-REAL-ESTATE DEBT OF FARMERS
Amount Outstanding December 30, 1967

	Amount outstanding December 1967 (millions)	Per cent change from December 1966	Average annual per cent change since 1957
Principal instit. lenders			
Commercial banks	$9,272	8.4	9.9
Member	5,702	7.2	9.9
Nonmember	3,570	10.2	10.0
Farm Credit Admin.	3,694	16.4	14.5
Prod. Credit Ass'n.	3,518	16.6	14.8
Other Financial Inst.	176	12.1	10.0
Farmers Home Adm.	798	8.3	6.2
Total	13,764	10.4	10.6
Nonreporting creditors	9,764 est.	10.4	9.9
Grand total	23,528	10.4	10.3

Debt owed by farmers to nonreporting creditors probably amounted to an additional $9.8 billion, assuming that the relationship to institutionally-held farm non-real-estate debt now is the same as in the 1960 benchmark year. Farmers interest expense on non-real-estate debt in 1967 is estimated by the USDA at $1.4 billion, representing about 4 per cent of farm production expenses.

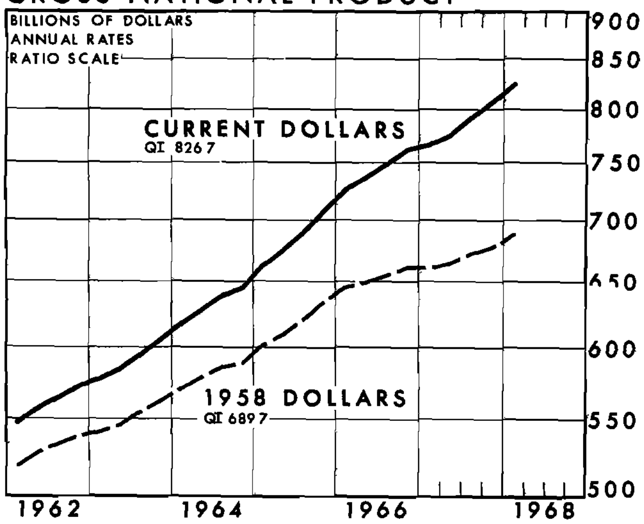
Farmers are using more borrowed funds in their businesses now than 10 years ago. Farm non-real-estate debt outstanding at the end of 1967 was equal to 48 per cent of 1967 gross income and 68 per cent of production expenses; 10 years earlier, the comparable ratios were 25 and 38.

First quarter developments. Analysts are dependent almost entirely on data reported by the production credit associations of the Farm Credit Administration for indications of what has happened in farm non-real-estate credit since the end of 1967. Nationally, loan balances of the PCA's increased 6 per cent during the first quarter reflecting, in part, the beginning of expanded seasonal demands for production credit, particularly in the South. With the seasonal influence removed, the upward trend in PCA balances during the quarter was 3 per cent, indicating that the long-term upward trend in PCA lending is continuing.

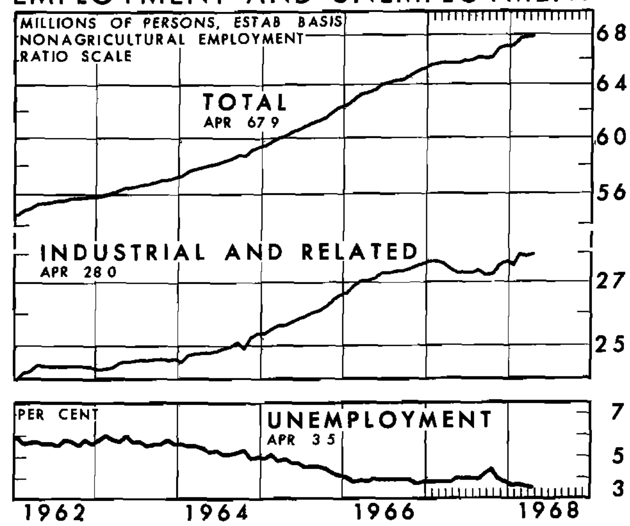
ECONOMIC DEVELOPMENTS UNITED STATES

SEASONALLY ADJUSTED

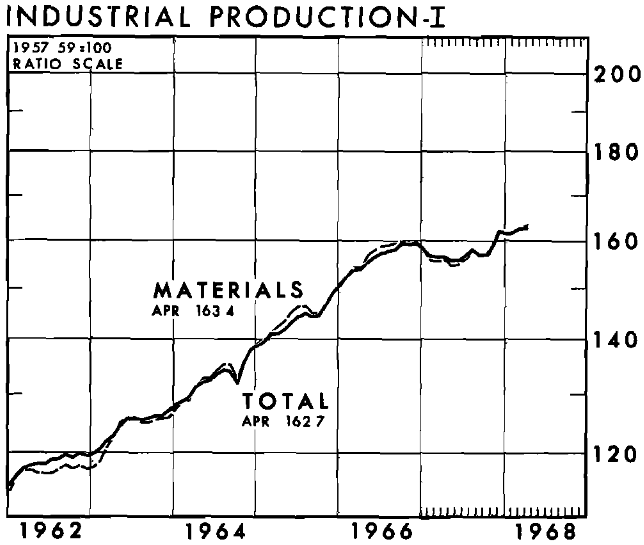
GROSS NATIONAL PRODUCT



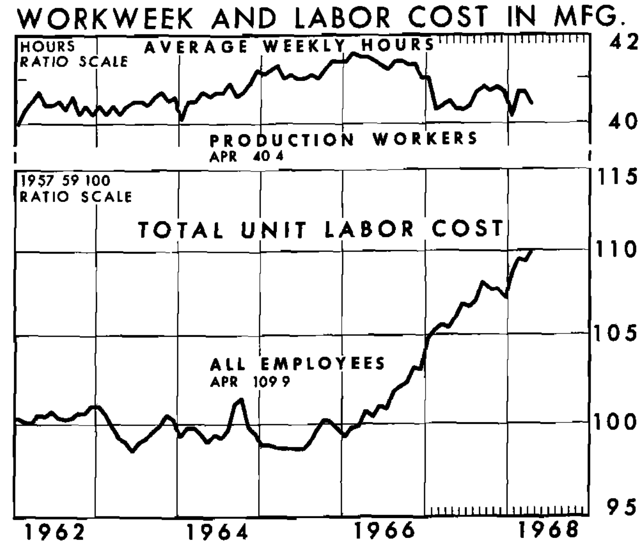
EMPLOYMENT AND UNEMPLOYMENT



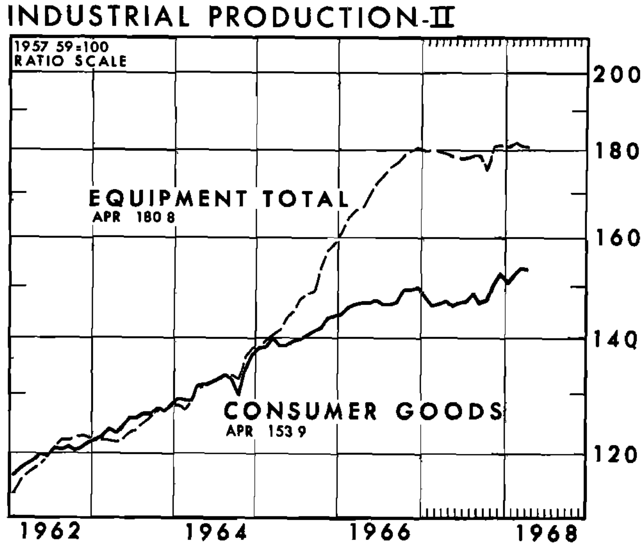
INDUSTRIAL PRODUCTION-I



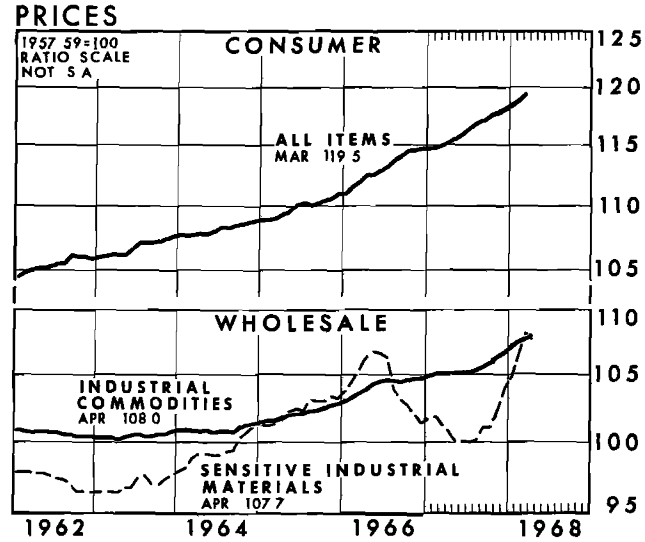
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



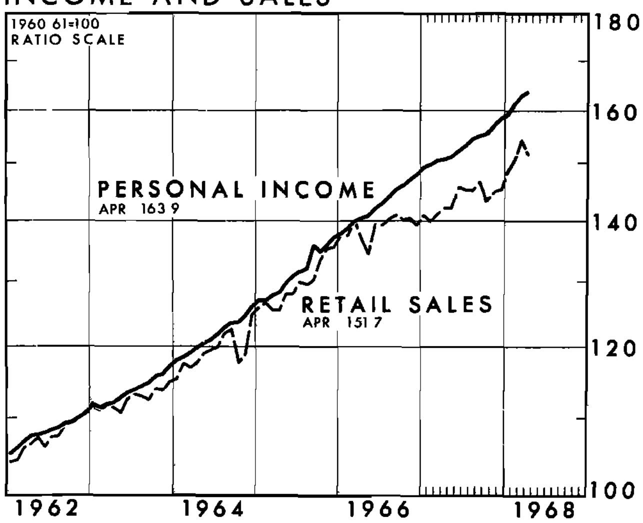
PRICES



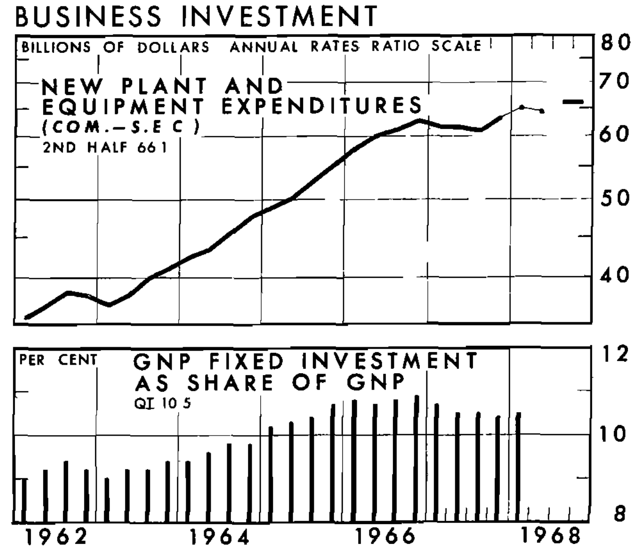
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

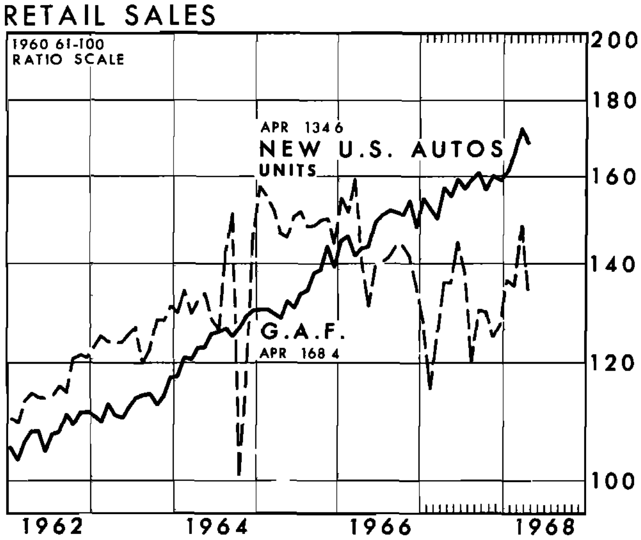
INCOME AND SALES



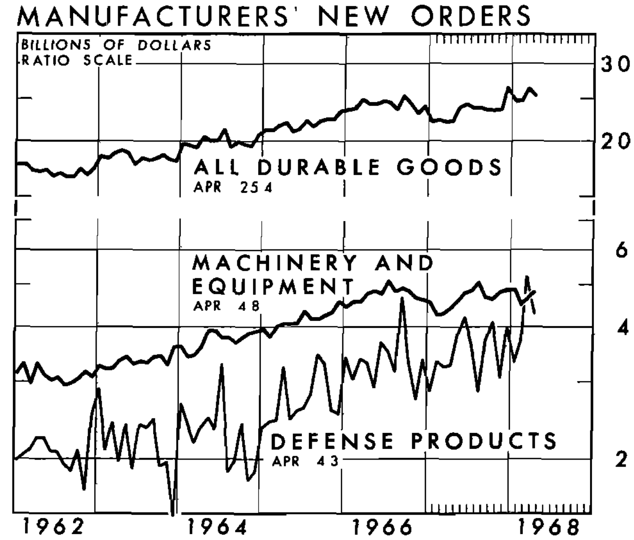
BUSINESS INVESTMENT



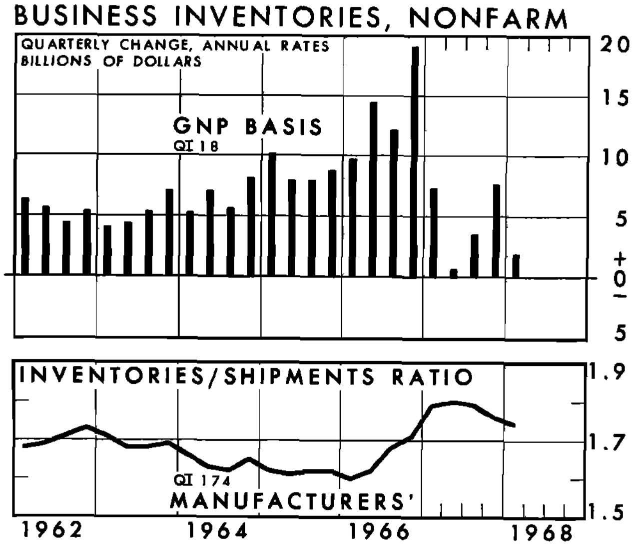
RETAIL SALES



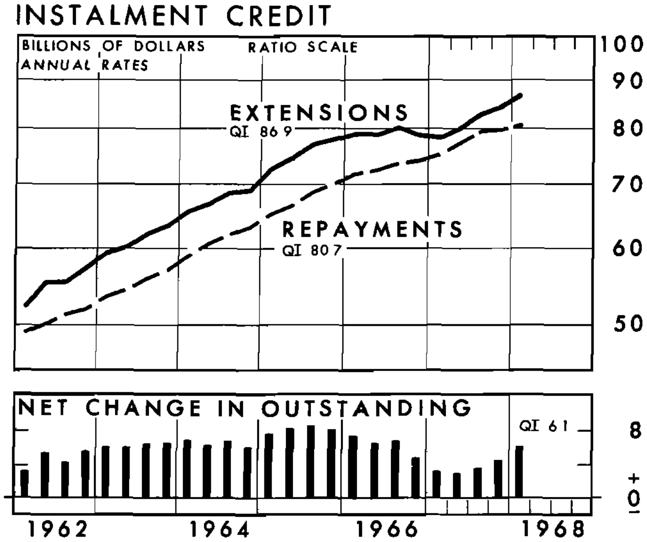
MANUFACTURERS' NEW ORDERS



BUSINESS INVENTORIES, NONFARM



INSTALMENT CREDIT



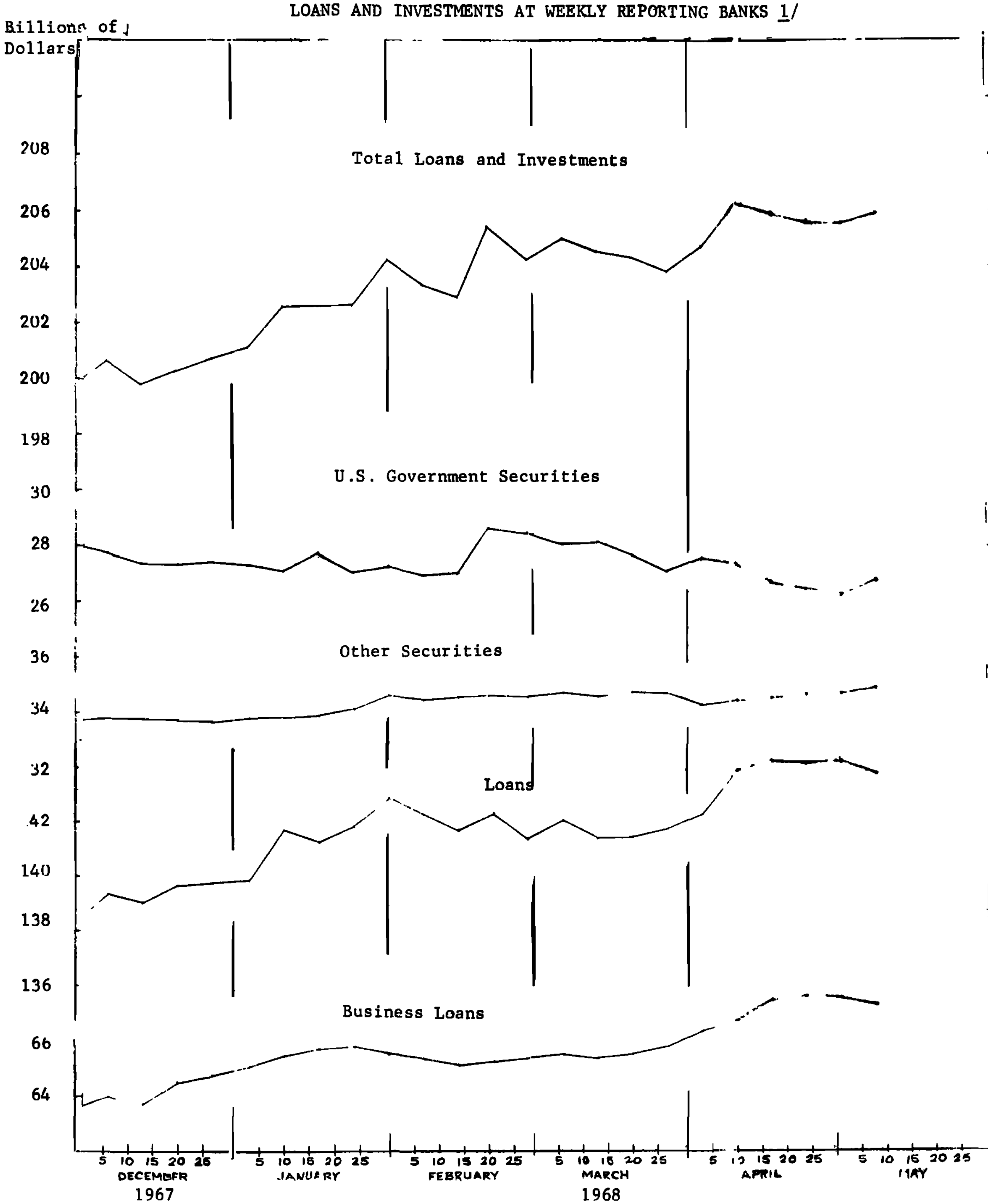
DOMESTIC FINANCIAL SITUATION

Bank credit. Commercial bank credit, measured on a daily average basis by the credit proxy, is currently projected to decline at a 0.5 per cent annual rate in May. Adjusted to include changes in non-deposit sources of funds (capital, bank liabilities to foreign branches, and borrowing from Federal Reserve banks), the May credit proxy would show a 1.7 per cent annual rate of increase, compared with a 6.3 per cent annual rate for the first four months of the year, similarly adjusted. Total loans and investments at all commercial banks as measured by the end-of-month series, increased at a 7.7 per cent annual rate over the first four months, but sufficient data are not yet available to present an adequate estimate for May.

Following a $2-1/2 billion increase in late March and early April, associated primarily with business loan expansion, total loans and investments at large banks have declined from their April peak--as indicated by the chart on the following page. The approximate $400 million decline since early April reflects both continued bank liquidation of Government security holdings and the apparent leveling off of growth in bank loans since that date.

With only a modest expansion in total time and savings deposit inflows following the recent increase in Regulation Q ceilings, and somewhat tighter reserve positions, weekly reporting banks made large reductions in their holdings of Treasury bills and moderate reductions in Treasury notes and bonds through the first week in

LOANS AND INVESTMENTS AT WEEKLY REPORTING BANKS 1/



1/ Seasonally adjusted levels; experimental series based on preliminary seasonal factors.

May. Since the first of the year, large banks have liquidated almost $3 billion in Treasury bills while generally maintaining or adding to holdings of longer-term Government securities, resulting not only in a $2 billion decline in their total holdings of Government securities, but also a significant lengthening of the maturity structure of their portfolios.

In general, weekly reporting banks also reduced their holdings of other securities--particularly short-term municipals by New York City banks--in late April and early May. However, as a result of recent heavy acquisitions of longer-term municipals by California banks, total holdings of other securities showed an increase, on balance, for this period.

The continued liquidation of bank short-term security holdings has contributed to a further erosion of the liquidity banks had accumulated in 1967. By May 1, the liquid asset/deposit ratio at weekly reporting banks had receded by more than 60 per cent of the increase from November 1966 to November 1967 (these two months represent approximately the recent periods of lowest and highest levels of bank liquidity, respectively). The loan/deposit ratio also suggests that liquidity has declined appreciably at weekly reporting banks since November 1967, although this ratio is not yet as high as in November 1966. At large banks in New York, however, the loan/deposit ratio is higher than in November 1966, reflecting in part the recent concentration of CD attrition at these banks.

LIQUIDITY MEASURES
Weekly Reporting Banks
(Per cent)

Ratios	Total			New York		
	Nov. 1966	Nov. 1967	May 8, 1968	Nov. 1966	Nov. 1967	May 8, 1968
Liquid asset/deposit 1/	11.7	13.5	12.4	13.8	20.7	17.4
Loan/deposit	76.1	72.4	75.1	87.7	84.3	91.6

1/ Liquid assets include bank holdings of U.S. Government securities maturity within one year, loans to brokers and dealers, loans to domestic banks, balances with domestic banks, bankers' acceptances, tax warrants and other short-term municipals. Deposits exclude cash items in the process of collection.

Although business loans have increased about $4.0 billion, on a seasonally adjusted basis, since the first of the year, there has been no further net expansion since mid-April. However, this apparent cessation of growth probably reflects in large part a lag in the adjustment of seasonal factors to the increased volume of corporate tax borrowing in April and the repayment of those borrowings in late April and May. In addition, since mid-April, banks have made substantial reductions in holdings of acceptances (included in their business loan total).

Demands for business loans were probably also dampened to some extent by the recent increase in the prime rate to 6-1/2 per cent. Prior to the increase in the prime rate, commercial paper rates, on an effective yield basis, had risen enough so that banks compared favorably with the commercial paper market as a source of funds. However, even with recent increases in commercial paper rates--which for 4-6 month maturities, are now within 10 basis points of the prime rate, on an investment yield basis--the commercial paper market presents a less costly means of financings and has probably diverted some loan demand from banks. Finally, with reduced deposit inflows and tighter reserve positions, some banks are reported to be firming lending policies.

While business loans within most industry categories generally have been close to their usual volume, there have been some exceptions. For example, borrowing by primary metals, retail trade, and textiles groups has tapered off following rapid expansion in recent months. Borrowing by the mining category also dropped off sharply after the early April increase associated with the acquisitions of a subsidiary of Kennecott Copper Co. Loans to wholesale trade (other than commodity dealers), services and "all other" categories have shown more than seasonal strength since mid-April.

Real estate loans at all commercial banks continued to expand in April and early May at close to the accelerated pace that has prevailed since August. However, growth in consumer loans slackened in April, reflecting in large part the falling off in automobile sales last month. Finally, security loans fluctuated around a downward trend in April, probably associated with the generally higher level of rates on dealer loans.

Bank deposits. In spite of the recent increase in Regulation Q ceilings, time and savings deposits at all commercial banks are projected to increase at only a 2 per cent annual rate in May, on a daily average basis, just marginally above the 1.3 per cent rate of April and about one-third the pace of the first quarter. As market rates advanced in recent weeks, CD rates moved quickly to the new ceilings on shorter maturities, resulting in a relatively moderate increase in CD's outstanding of $249 million at weekly reporting banks in the three-week period ending May 8. Nevertheless, CD's accounted for almost one-half of the expansion of total time and savings deposits at large banks for this period, as inflows of consumer-type time deposits remained weak in light of rising market yields.

NET CHANGES IN TIME AND SAVINGS DEPOSITS
Weekly Reporting Banks
(Millions of dollars, not seasonally adjusted)

	1965 Apr. 21- May 12	1966 Apr. 20- May 11	1967 Apr. 19- May 10	1968 Apr. 17- May 8
Total time and savings deposits	698	746	641	548
Consumer-type deposits	n.a.	n.a.	337	125
Savings Deposits	143	-259	221	-61
Time deposits, IPC (other than CD's, IPC)	n.a.	n.a.	116	186
CD's	449	185	-15	249
Memo:				
Total time and savings deposits excluding CD's	249	561	656	299

n. a. --not available.

After a decline of about $1-1/2 billion between the end of February and mid-April, the subsequent rise in CD's outstanding at large banks took place entirely in the last week of April, following the increase in Regulation Q ceilings. During the first two weeks in May, outstandings declined by $40 million on balance. Initially banks appeared not very interested in longer-term CD's (6-month maturities or more), since most banks kept their offering rates on these maturities appreciably below the ceilings. In recent weeks, however, with market yields rising above CD ceilings on all maturities, banks have been unable to roll over their maturing CD's even with offering rates pushed to the ceiling on all maturities. For the week ending May 15, outstanding negotiable CD's declined $113 million at large banks in New York and Chicago.

COMPARISON OF SELECTED MARKET RATES TO
REGULATION Q CEILINGS ON LARGE NEGOTIABLE CD'S
(As of May 21)

	Maturity			
	1 month	2 month	3 month	6 month
CD ceiling	5.50	5.75	6.00	6.25
Treasury bills	5.76 1/	5.87	6.05	6.31
Commercial paper 2/	--	--	--	6.40
Finance company paper 3/	6.11	6.14	6.18	6.27

1/ All market rates are on an investment yield basis.
2/ Dealer offering rates at prime New York banks.
3/ Published offering rates on directly placed paper.

The weakness in consumer-type time deposits at large banks reflects primarily the large outflow of regular passbook savings deposits which began following the quarterly interest crediting period at the end of March. The outflow was particularly large during the first three reporting weeks in April, but in late April it tapered off, and in the week of May 8 these deposits showed a small rise. Over the entire six-week period, savings deposits fell $700 million. Growth in time certificates and open accounts remained at the reduced pace prevailing since the end of February, and failed to offset the savings deposit outflow during most of April. Over the most recent three weeks, however, total consumer-type time deposits showed a small net increase. Data for New York and Chicago for the week ending May 15 do not indicate any sizable outflow of these funds in response to the issuance of the Treaury's new 6 per cent notes.

With reduced deposit inflows, banks have made heavy use of the Euro-dollar market in late April and early May. From mid-April to mid-May, bank liabilities to foreign branches rose more than $600 million.

The money stock in May, on a daily average basis, is currently projected to expand at a 6.0 per cent annual rate, down from the rapid April pace, but still above the 4.5 per cent annual rate of growth in the first quarter. With continued reductions in U.S. Government deposits, the reduced rates of growth in bank credit and currency outstanding resulted in a rate of expansion in the money stock only somewhat below the 8.5 per cent pace of April.

<u>Nonbank depositary intermediaries</u>. In May, as in April, rising market yields and attractive Treasury and Agency issues--particularly the recent 6 per cent Treasury financing--probably continued to contribute to a reduced rate of savings inflows at nonbank financial intermediaries. Information available so far for May indicates a relatively substantial deposit inflow to the largest mutual savings banks in New York City during the first half of the month. But this was accompanied by an unusually large increase in passbook loans which reduced "adjusted" deposit inflow to one-half the year-earlier amount as the table shows.

GROWTH IN SAVINGS/SHARE ACCOUNTS AT NONBANK
DEPOSITARY INTERMEDIARIES
(Seasonally adjusted annual rate)

	Mutual Savings Banks	Savings and Loan Associations	Combined
		(Per cent)	
1967 I	9.8	9.4	9.5
II	11.0	11.4	11.3
III	8.6	9.8	9.4
IV	6.7	5.8	6.1
1968 I	7.5	5.6	6.2
Feb.	8.8	6.0	6.9
Mar.	8.5	8.3	8.4
Apr. p/	4.7	3.8	4.1

INFLOWS TO 15 LARGEST MUTUAL SAVINGS BANKS IN NEW YORK CITY
(Millions of dollars; not seasonally adjusted)

First 15 days of May	Net change in deposits	Increase in passbook loans	Change in deposits less increase in passbook loans
1965	23	6	17
1966	11	11	0
1967	69	14	55
1968	48	25	23

During April, net savings flows were particularly weak at both S and L's in California and savings banks in New York State--two of the most market-sensitive areas. Outflows (not seasonally adjusted) at California associations were also increased by large State income tax payments as well as sizable withdrawals of out-of-state funds.

NET NEW MONEY FLOWS 1/
(Millions of dollars; not seasonally adjusted)

	Insured Savings & Loan Associations		Mutual Savings Banks	
	California 2/	All other	New York State	All other
1966, April	-529	-267	-302	-155
1967, April	106	346	91	- 23
1968, April p/	-257	- 42	- 92	27

1/ Net new money is the net change in deposits excluding interest and dividends credited.
2/ Data shown are for the San Francisco FHLB district, in which California is predominant. Insured savings and loans represent 96 per cent of industry resources.

With their outstanding mortgage commitments at a record level and deposit outflows large, S and L's in April borrowed $290 million from the Federal Home Loan Banks, the largest amount since July of 1966, though considerably less than the average for that year. California associations accounted for most of the recent borrowing, raising their total indebtedness above their holdings of cash and Government securities for the first time in a year. S and L's outside of California, however, generally continued in relatively strong liquidity position. In April, liquidity at mutual savings banks--as measured by their holdings of cash and Governments relative to deposits--probably continued the downtrend of the last two years. However, this decline in the traditional liquidity measure, is no doubt a reflection of the additional marketability gained in portfolios of these banks by their continued large acquisitions of corporate bonds.

Mortgage market developments. As net savings flows to thrift institutions slackened further through mid-May and bond yields rose, the mortgage market apparently continued to tighten, and home mortgage yields increased appreciably further.

Early in May, as soon as enabling legislation permitted, contract interest rates on FHA and VA home mortgages were raised by administrative action to 6-3/4 per cent from 6 per cent--a step that somewhat reduced the record discounts inhibiting buyers, lenders, and builders alike. While some investors had been holding back in anticipation of a rate increase, fragmentary reports suggest that the home mortgage market as a whole remained under considerable restraint even after FHA and VA contract rates had been raised, and that the rate increase put some upward pressure on mortgage yields generally. Restraint also reflected further uncertainty about tax legislation and international developments, the perseverance of fairly substantial discounts on the new 6-3/4 per cent FHA and VA loans, and the low usury ceilings in some States.

Early in May, FNMA instituted its new weekly bidding procedure for auctioning advance commitments to purchase FHA and VA home mortgages under its secondary market operations.1/ Bids in FNMA's auctions of May 13 and May 20 were the first to be based on the new 6-3/4 per cent contract interest rate. In the May 13 auction, the average accepted bid price on 6-month commitments was equivalent to an implied gross yield before servicing of as much as 7.35 per cent in the private market, after allowing for FNMA commitment fees and stock purchase required of all sellers; in the May 20 auction, the implied average yield was even higher--7.45 per cent. Discounts on the 6-3/4 per cent loans averaged 5 or more points in each auction.

For a number of reasons, including the special and still novel nature of the "auctions," themselves, FNMA auction prices may not have been entirely representative of private market conditions with respect to both level and movement. However, they do imply

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1/ See Appendix A for further details, along with additional discussion about the change in FHA and VA ceiling rates.

that secondary market yields on FHA and VA home mortgages continued upward during the first three weeks of May. If further increases should occur in the period ahead, investment in home mortgages will come under increasing restraint in 8 States with 7 per cent usury ceilings, in addition to 6 States where usury limits are still 6 per cent. These restrictive limits invariably apply to all conventional loans and in some cases to FHA and VA mortgages as well. As in indication of the share of the total market affected, the 14 States with either 6 or 7 per cent usury ceilings accounted last year for a third of all housing units for which building permits were issued.

During April, yields required by lenders on home mortgages accelerated to new postwar highs in both the primary and secondary market, according to the FHA series shown in the table. Because returns on new issues of high-grade corporate bonds declined temporarily in April, the gross yield spread between home mortgages and such bonds widened somewhat. But the spread gave no net incentive for mortgage investment after allowance is made for servicing costs, which are much higher on mortgages than on securities.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary Market: Conventional loans		Secondary Market: FHA-insured loans		
	Level (per cent)	Yield spread (basis points)	Level (per cent)	Yield spread (basis points)	Discount (points)
1967					
April	6.40	101	6.29	90	2.5
May	6.45	79	6.44	78	3.8
June	6.50	71	6.51	72	4.4
July	6.50	72	6.53	75	4.6
August	6.55	66	6.60	71	5.2
September	6.55	67	6.63	75	5.4
October	6.55	43	6.65	53	5.6
November	6.65	12	6.77	24	6.5
December	6.70	19	6.81	30	6.8
1968					
January	6.75	51	6.81	57	6.8
February	6.75	46	6.78	49	6.6
March	6.80	24	6.83	27	7.0
April	6.90	41	6.94	45	7.9

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.

By the end of April, the seasonally adjusted backlog of outstanding residential mortgage commitments of reporting lenders--which reattained its end-of-1965 level in March--edged still higher to a record postwar level, as shown in the table. However, in view of the additional pressures on the home mortgage market during May the backlog of commitments is likely to reverse direction and turn downward in coming months.

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

	Volume at end of:		
	April 1967	November 1967	April 1968
Savings and loan associations	72	107	114p
Savings banks in New York State	80	98	91
Reporting thrift institutions	(75)	(104)	(106p)
Reporting life insurance companies	76	77	86*
All three groups	75	97	101p*

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.

* March 1968 for life insurance companies.

Corporate and municipal bond markets. Yields in both corporate and municipal markets advanced sharply following the May 15 announcement of a further delay in Congressional consideration of the tax-expenditure package. Although this news came too late to affect the corporate new issue yield series for that week, subsequent bidding has driven yields on corporates to new peaks, as indicated by staff estimates shown in the last line of the table. These estimates suggest that corporate new issue yields are nearly 20 basis points above their previous peak of less than a month ago. In the municipal market, the recent yield rise is estimated to amount to about 25 basis points, and yields in that market now match the peaks reached during the gold crisis.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa New With call protection	Corporate Aaa Seasoned	State and local Government S&P High Grade	State and local Government Bond Buyer's (Mixed qualities
1966				
Late summer high	5.98*	5.44	4.26	4.24
1967				
Low				
Late January-early February	5.03	5.00	3.43	3.40
High - December	6.55*	6.24	4.51	4.45
1968				
Low	6.12(2/2)	6.07(3/8)	4.23(2/2)	4.16(2/2)
High	6.66(4/26)	6.26(5/17)	4.61(3/13)	4.62(3/14)
Weeks ending:				
April 26	6.66	6.22	4.47	4.43
May 3	6.44*	6.25	4.50	4.44
10	6.63	6.25	4.43	4.37
17	6.62	6.26	4.55	4.52
Memo: Estimate for early days of the week of May 24	6.85.	n.a.	n.a.	4.62

* Some issues included carry 10-year call protection.

Contributing to these upward yield pressures has been the large volume of unsold bonds. Recently, corporate underwriters terminated price restrictions on five bond issues, which had been priced far from market levels. In the municipal market, even after price reductions, advertised inventories remain around $650 million, and underwriters report that is an understatement of the actual amount of unsold bonds. Although buyer hesitancy is prevalent in both markets, the municipal market appears particularly influenced by the notable lack of interest of the two major types of institutional investors in municipals--commercial banks and fire and casualty insurance companies. A further depressant in both markets is the very heavy near-term volume of scheduled corporate and municipal bond offerings.

Public flotations of corporate bonds in May are estimated at $1.2 billion, the largest volume this year and about half again as large as the monthly average pace during the first four months. The large volume partly reflects a number of issues expected late in April that were offered in the first week of May, as well as the recent addition of two large industrial issues scheduled to be offered late in May--one of which might be pushed into June. Partially offsetting this increased volume, two utility issues amounting to $115 million were cancelled because of the level of rates; commercial paper financing was used as a substitute for one of the issues.

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

	Bonds					
	Public Offerings[2/]		Private Placements		Total bonds and stocks	
	1966	1967	1966	1967	1966	1967
Monthly average	668	1,249	629	580	1,506	2,067
	1967	1968	1967	1968	1967	1968
QI monthly avg.	1,088	822	604	575	1,821	1,726
QII monthly avg.	1,339	970e	489	683e	2,069	1,904e
April	1,368	710e	410	650e	2,016	1,710e
May	965	1,200e	396	650e	1,519	2,050e
June	1,684	1,000e	659	750e	2,673	1,950e

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

Total bond and stock offerings of nearly $2.1 billion expected in May have been held down by a revision in the estimated amount of private placements, reflecting a slower growth than had been anticipated earlier. Final private placement data just received for the first quarter indicate the volume of takedowns was below a year earlier--with March exhibiting a substantially less than seasonal advance. Fragmentary evidence, however, still points to a further expansion in takedowns of private placements as the year progresses.[1/]

1/ See Appendix B for a discussion of private placement activity at life insurance companies in the first quarter.

Corporate bond offerings already scheduled for June amount to nearly $700 million and may ultimately exceed $1.0 billion, but in the current market environment this estimate cannot be very firm. It is possible that the timing of a number of rumored industrial financings may be accelerated if borrowers come to feel that interest rates will move even higher. However, some other issues may be postponed at this advanced level of yields--replaced by bank or money market financing. The staff now estimates that total corporate bond and stock offerings, including private placements, are likely to aggregate nearly $2.0 billion in June, only slightly below both the outsized May volume and the monthly average for 1967.

In the municipal market, estimated volume of new offerings in May remains large, advancing above earlier estimates due to a late build-up in the calendar. The May estimate of new issue volume stands at $1.3 billion, slightly above April and equivalent to the monthly average in the second quarter of last year. June volume is currently estimated at $1.2 billion--but this again is unusually uncertain in view of the upward rate pressures in this market and the possibility that a significant volume of issues may be postponed. During the first four months this year, announced postponements averaged about $110 million a month.[1/]

1/ A discussion of the effect of credit conditions on municipal bond offerings and contract awards can be found in Appendix C.

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

	1966	1967
Monthly average	950	1,221
	1967	1968
QI Monthly average	1,391	1,238
QII Monthly average	1,291	1,250e
April	1,130	1,250e
May	1,247	1,300e
June	1,497	1,200e

1/ Data are for principal amounts of new issues.

Recent municipal bond volume has not been enlarged by industrial aid issues and, if the current bill concerning the tax status of such bonds is approved, their future volume should be extremely small. Only issues of less than $1 million would be exempt from Federal income taxes under the most recent proposal. Larger issues would be taxable if issued after May 1, 1968, unless commitments had been made by that date. In 1967, issues of less than $1 million comprised only 2.5 per cent of the total volume of industrial aid financing.

Stock market. The general stock market exuberance, which had been in evidence throughout April and early May, appears to have abated. The net depressants seem to be the consensus that Vietnam negotiations will not result in a quick settlement, and the uncertainty surrounding Congressional action on any package of fiscal restraint.

Prices of New York Stock Exchange common stocks reached new all-time highs in early May, but thereafter drifted lower. Trading volume on the New York Exchange, while still heavy, also lost its upward momentum. The enthusiasm for American Exchange issues has not yet been dampened, however, as indicated in the tables below. This market in the past has often been the last to reflect changes in investor sentiments.

STOCK PRICES

	Dow Jones Industrial Average	NYSE	AMEX
Mid-January high	908.92	54.17	25.73
March low	825.13	48.70	21.58
March 29	840.67	50.05	22.42
May 8	918.86	55.29	26.75
May 21	896.38	54.42	27.22

AVERAGE DAILY TRADING VOLUME
(Millions of shares)

	NYSE	AMEX
Jan.	11.9	7.3
Feb.	9.2	4.1
Mar.	9.2	3.6
Apr.	14.8	6.6
Week ending:		
May 3	14.6	8.2
10	12.8	7.4
17	12.6	8.5

During April, when stock prices advanced steadily, margin debt of broker and dealer customers rose $190 million (preliminary) to a new high of $6,380 million. Analysis of stock market credit data would suggest that, in part at least, these new margin purchases were achieved through the use of existing or pre-existing collateral values built up by rising stock values; only a part of the new purchases involved the payment of the 70 per cent margin requirement in cash. In contrast to the rise in stock prices and margin debt of broker and dealer customers, bank purpose loans to non-brokers at weekly reporting banks declined $20 million to $2,350 million in April; presumably the decline reflects the further loss of convertible bond margin business to brokers and dealers, as well as the more rigorous purpose statement now required from customers.

The application of margin requirements between mid-March and mid-May to the financing of dealers' new positions in certain convertible bonds does not appear to have adversely affected the price of such bonds in the secondary market. An analysis of convertible bonds shows that, after the elimination of the effects of rising stock values, prices of outstanding convertible bonds remained unchanged to slightly higher over the period.

Corporate profits. Corporate profits before taxes showed another sharp increase in the first quarter to a seasonally adjusted annual rate of $88.8 billion, according to preliminary Department of Commerce estimates--about the level the staff has been projecting. Most of the $3.7 billion rise over the fourth quarter rate represented increased inventory profits. As a result, profits after inventory valuation adjustment (that is, profits calculated so as to eliminate the effect of price changes on corporate valuation of inventories) rose only $1.6 billion in the first quarter. And staff estimates show most of this increase as having occurred outside of manufacturing and trade.

CORPORATE PROFITS

(Billions of dollars; seasonally-adjusted annual rates)

	1967				1968
	I	II	III	IV	Ip
Profits before taxes	79.0	78.9	80.0	85.1	88.8
Inventory valuation adjustment	- .8	- .7	- .8	-2.3	-4.5
Profits and i.v.a.	78.1	78.3	79.2	82.7	84.3
Manufacturing, trade and misc. nonfinancial	53.7	53.7	53.6	56.4	56.6
Transportation, communication and public utility	11.7	11.9	12.1	12.3	12.5
Financial institutions	9.6	9.5	9.6	10.0	11.0
Rest of the world	3.2	3.2	3.9	4.0	4.2

NOTE: Department of Commerce except industry details for QI 1968 which are Federal Reserve estimates.

For manufacturing corporations, the ratio of profits before taxes to sales appears to have risen about as much in the first quarter of this year as it did in the preceding quarter. But, at a seasonally adjusted rate of 8.7 per cent, the profit ratio--though inflated by inventory profits--was still well below the levels of 1965 and early 1966.

PROFIT MARGINS FOR MANUFACTURING CORPORATIONS
(Profits before taxes as a per cent of sales)

	Per cent		Per Cent
1965 - year	9.4	1967 - III	8.1
		IV	8.4
1966 - I	9.8		
		1968 - I	8.7
1967 - I	8.5		
II	8.2		

NOTE: Based on FTC-SEC series. Quarterly figures are seasonally adjusted by Census Bureau. First quarter 1968 preliminary and confidential

Despite the continued increase in labor costs, profit margins of manufacturers--and therefore profits before tax for manufacturers and in turn for all corporations--seem likely to rise further in the second quarter. Economic activity is projected to expand at least as rapidly as in the first quarter and inventory profits are likely to be even larger. Moreover, profits in the current quarter will not be dampened as in the first quarter by the increases, effective during that quarter, in the social insurance tax rate and the minimum wage.

U.S. Government securities market. Yields on U.S. Government securities have risen substantially further since the last meeting of the Open Market Committee, and in most maturity areas are at or close to new post-World War II highs. Advances on short and intermediate-term maturities other than very short bills have ranged from 25-40 basis points and those on long-term bonds have averaged about 16 basis points. Recent increases in yields on Treasury bills have carried their levels for the first time above the highs reached at the height of the credit crunch in 1966. Similarly, yields on coupon issues, with the exception of long-term bonds, have exceeded their previous highs, touched briefly at the height of the gold crisis in mid-March of this year.

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

	1966 Highs	1967 Nov. 17 1/	1968 Mar. 14 2/	Apr. 23	Apr. 29	May 21
Bills						
1-month	5.60 (9/19)	3.85	5.10	5.45	5.55	5.70
3-month	5.59 (9/21)	4.67	5.45	5.49	5.55	5.92
6-month	5.98 (9/19)	5.13	5.63	5.60	5.64	6.08
1-year	5.94 (8/21)	5.27	6.65	5.57	5.64	6.03
Coupons						
3-years	6.22 (8/29)	5.66	6.03	5.93	5.98	6.36
5-years	5.89 (8/29)	5.72	6.00	5.84	5.96	6.22
10-years	5.51 (8/29)	5.75	5.95	5.73	5.73	6.01
20-years	5.12 (8/29)	5.70	5.77	5.52	5.50	5.66

1/ Yield levels before devaluation of the pound sterling.
2/ Peaks reached during gold crisis.

Most of the further yield advance has occurred recently, in response to the sudden worsening of prospects for effective fiscal action. Coming at a time when professional inventories in domestic securities markets were generally large, when the ability of the banking system to attract new funds with large CD's was already becoming quite limited, and when international markets for sterling and gold were under deepening pressure, the changed outlook on taxes reawakened fears among market participants of an impending domestic credit crunch and international financial crisis.

Yield advances have been particularly sharp on issues with maturities adjacent to the two new 6 per cent notes offered in the Treasury's May refinancing. The yield on the new 15-month maturity has risen to 6.37 per cent and that on the 7-year maturity to 6.16 per cent. Reception of these issues had been unexpectedly favorable during the financing when for a time Congressional progress on the fiscal package seemed on balance to be favorable. But with the recent shift in market psychology, dealers and others who had established temporary positions in these issues have pressed to liquidate them; while investors generally have held back in committing available funds. Just prior to settlement on the financing, dealer holdings of all Treasury coupon issues due after 5 years amounted to about $600 million and their holdings of 1-5 year maturities to $490 million. These positions have since been reduced to $345 and $340 million, respectively, the former largely through market purchases for Treasury trust accounts.

While yields on longer-term bill maturities began to edge somewhat higher early in May in reflection of the end of April monthly bill auction and the new 15-month issue offered for cash in the May financing, the yield on three-month bills remained close to the 5.50-5.55 per cent range--prevailing at the time of the last Open Market Committee meeting--until nearly mid-May. Demand for shorter-bill maturities had been strong in the latter part of April. And the choice of a "rights" financing for the new 7-year note in the May financing created some continuing demand for such issues. Even before the deterioration in prospects for fiscal action, however, the cumulative impact of a persistently tight money market on dealer financing costs had already begun to exert upward pressures on shorter-term Treasury bill yields. When the change in fiscal outlook developed, therefore, the reaction of bill rates was particularly sharp.

Other short-term rates. In line with the general rise in interest rates, yields on short-term obligations other than bills have also increased substantially since the last meeting of the Committee. Secondary market yields on Federal Agency securities in the 3 to 6-month area, for example, have climbed more than 1/2 a percentage point over the period. And a new 9-month issue of Federal Intermediate Credit Bank debentures was just offered to yield 6.45 per cent--25 basis points higher than expected when the issue was first announced.

Yields on commercial paper, finance company paper and bankers' acceptances have gained about 1/4 of a percentage point, raising the rate of 6-month acceptances to 6.25 per cent on a bank discount basis the highest return on this kind of an instrument since 1920.

With yields on market securities pushing up to these high levels, rates on new CD issues at New York banks have been forced to their ceilings, and in the secondary market, yields on CD's have moved to levels well above the ceilings.

SELECTED SHORT-TERM RATES

	1966 High	1967 Nov. 17 1/	1968 March 14 2/	1968 April 23	1968 April 29	1968 May 17
1-month						
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/31)	4.75	5.25	5.50	5.50	5.50
Secondary market	5.75 (9/28)	4.85	5.25	5.70	5.55	6.00
3-month						
Bankers' acceptances	5.75 (10/25)	4.88	5.63	5.88	5.88	6.13
Federal agencies	5.76 (9/21)	5.05	5.47	5.66	5.54	6.11
Finance paper	5.88 (12/31)	5.13	5.38	5.75	5.75	6.00
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/31)	5.25	5.50	5.88	5.88	6.00
Secondary market	5.90 (9/21)	5.30	5.60	5.90	5.95	6.15
6-month						
Bankers' acceptances	6.00 (9/23)	5.00	5.75	6.00	6.00	6.25
Commercial paper	6.00 (12/31)	5.13	5.63	5.88	5.88	6.13
Federal agencies	6.04 (9/21)	5.40	5.88	5.81	5.73	6.26
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/31)	5.38	5.50	6.00	6.00	6.25
Secondary market	6.30 (9/28)	5.60	5.88	6.10	6.15	6.30
1-year						
Federal agencies	6.13 (9/23)	5.75	5.79	5.53	5.80	5.97
Prime municipals	4.25 (9/21)	3.40	3.60	3.70	3.65	3.80

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

1/ Pre-devaluation yield levels.

2/ Peaks reached during gold crisis.

<u>Federal finance</u>. Treasury cash borrowing requirements in the weeks immediately ahead will be significantly affected by the manner in which Congress and the President finally dispose of the package of fiscal proposals recently endorsed by the Senate-House conference. Because of the inevitable delays involved in changing expenditure programs, no significant cut backs in Federal outlays can be expected during the next two to three months, regardless of how Congress finally resolves the spending-cut issue. And the excise tax rates now scheduled to be reduced on May 31 are likely to be maintained without change, even if Congress fails to go along with the rest of the package of tax increases. But the volume of near-term receipts from income taxes will be substantially affected by what Congress decides on the surtax and the further acceleration of corporate income tax payments.

For any receipts from these latter provisions to be collected in fiscal 1968, favorable action on the fiscal package must be taken by June 1. Enactment of the proposal by that date would raise an estimated $1.3 billion of additional receipts in June.

If the conference proposal is approved after June 1 but before July 1, while no payments on the surtax of the speed-up of corporate income taxes would be collected in June, payments from these items would become due by July 15. If the due date were not until July 15, however, corporations would be required under the proposed law to pay on only one-third of their second quarter surtax liability, rather than on the full liability as would be the case if the due date were June 15 (and hence in the same quarter as the liability).

The table shows more explicitly how prospective increments in the estimated flow of both corporate and personal income tax receipts would vary depending on the timing of final approval of the fiscal package.

VARIATIONS IN FLOW OF ESTIMATED RECEIPTS
WITH TIMING OF ENACTMENT OF PROPOSED TAX PACKAGE
(In millions of dollars)

	June	July	August
Enactment by June 1			
Corporate surtax	.6	--	--
Corporate acceleration	.5	--	--
Personal surtax	.2	.4	.6
Enactment Between June 1 and July 1			
Corporate surtax	--	.3	--
Corporate acceleration	--	.2	--
Personal surtax	--	.3	.6

Many observers are now predicting that the hassle on spending cuts will result in a failure to enact either the surtax or the further acceleration of advance payments on corporate taxes. If this should prove to be the case, the only special addition to Treasury cash flows in the immediate offing would be the new $500 million offering of Export-Import Bank participation certificates, scheduled for payment on June 19. Under this--hopefully extreme--assumption, the Treasury would end the fiscal year with an estimated cash balance of about $5 billion. A cash balance this low would require the Treasury to borrow nearly $5 billion in July, and at least an additional $4 billion in August, as the table shows.

TREASURY CASH OUTLOOK ASSUMING NO SURTAX
AND NO CORPORATE SPEED-UP
(In billions of dollars)

	May	June	July	August
Net cash drains	-3.9	-3.5	-4.8	-4.2
Net borrow from public	3.0	-4.3	4.8	4.2
Change in cash balance	- .9	- .8	--	--
Level of cash balance	5.6	4.8	4.8	4.8

Since funds from the July cash borrowing would be needed by mid-month, the Treasury might decide to go to the market as early as late June, when a sizeable volume of funds would be released to investors that held maturing June tax bills but did not use them to pay taxes. However, near-term Treasury borrowing could, of course, be somewhat smaller and deferred until well into July, if favorable action on the tax package should swell receipts in June. Moreover, a part of the large July-August need could be met by continuing to raise new money in weekly bill auctions after the cycle of weekly increments already in process stops. The present schedule of additions to 3-month bills terminated with the auction of May 20, and that for 6-month bills ends with the auction of June 24.

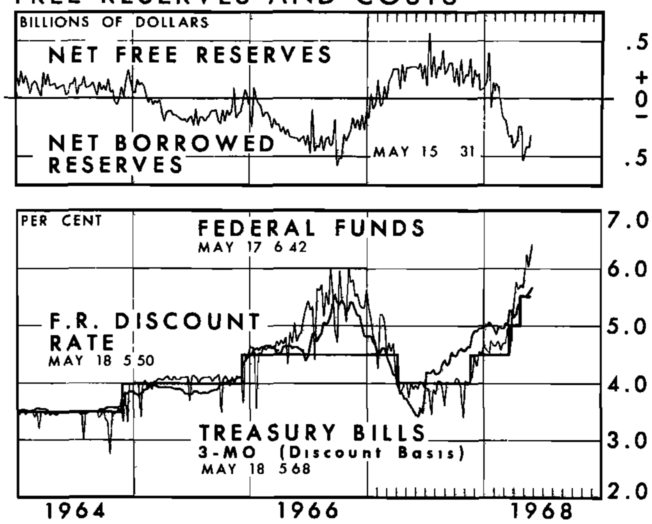
NEW BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS
(In billions of dollars)

	Fiscal years				Calendar quarters				
	Actual		1968e		1967		1968		
	1966	1967	No tax	Surtax	III	IV	I	IIe No tax	IIe Surtax
Quarterly data, unadjusted									
New Budget:									
Surplus/deficit	-3.7	-8.8	-23.9	-22.6	-8.5	-11.0	-8.6	4.2	5.5
Receipts	130.9	149.6	152.8	154.1	35.4	31.9	36.3	49.3	50.6
Total expenditures and net lending	134.6	158.4	176.7	176.7	43.9	42.9	44.8	45.1	45.1
Means of financing:									
Total borrowing from the public	6.0	3.6	22.6	22.6	9.0	10.1	6.7	-3.2	-3.2
Decrease in cash operating balance	.6	5.2	.9	-.4	-1.0	1.1	.1	.6	-.7
Other 1/	-2.9	--	.5	.5	.5	-.2	1.8	-1.6	-1.6
Cash operating balance, end of period	10.9	5.7	4.8	6.1	6.7	5.6	5.4	4.8	6.1
Seasonally adjusted annual rate									
Federal surplus/deficit in national income accounts	.9	-7.5	-12.9	-11.1	-13.2	-10.7	-10.7p	-13.3	-9.8
Receipts 2/	132.9	147.6	160.1	161.9	152.7	157.3	164.9p	169.2	172.7
Expenditures	131.9	155.1	173.0	173.0	165.9	167.9	175.6	182.5	182.5

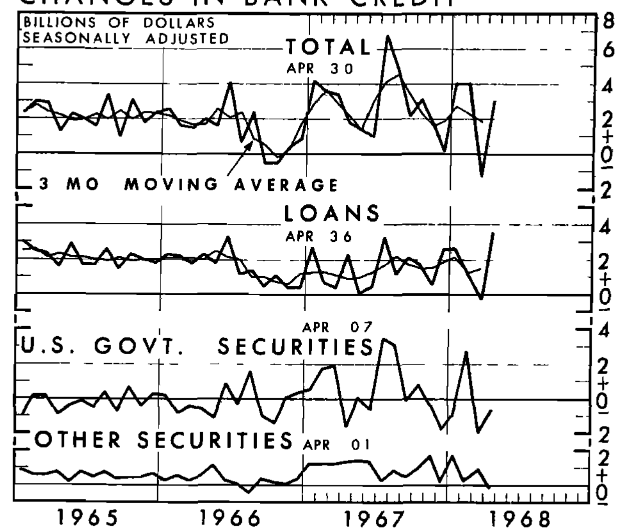
e - No tax projections based on existing tax rates, including extension of telephone and auto taxes. Surtax projections show effect through June 30 of enactment of Conference Committee bill by June 1.
p - Preliminary. Corporate tax accruals subject to revision if retroactive surtax is passed.
1/ Includes various accrual items, such as deposit fund accounts and clearing accounts.
2/ Quarterly receipts do not add to fiscal year totals.

FINANCIAL DEVELOPMENTS - UNITED STATES

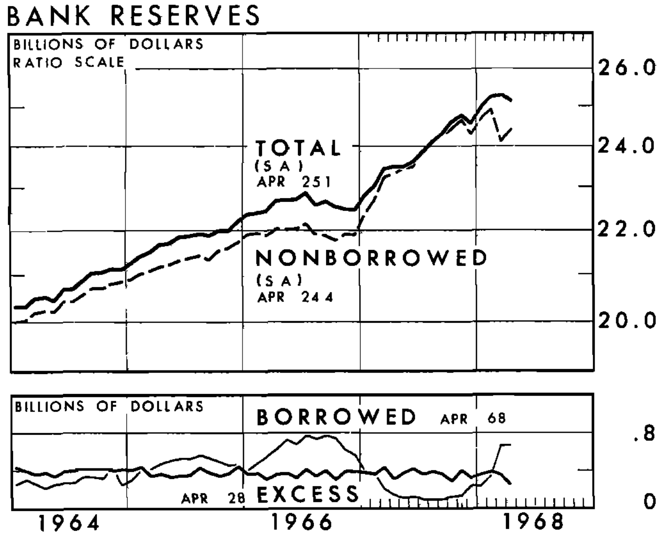
FREE RESERVES AND COSTS



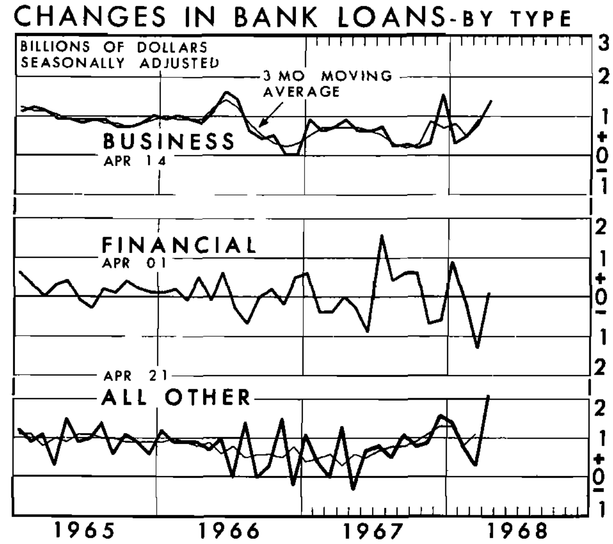
CHANGES IN BANK CREDIT



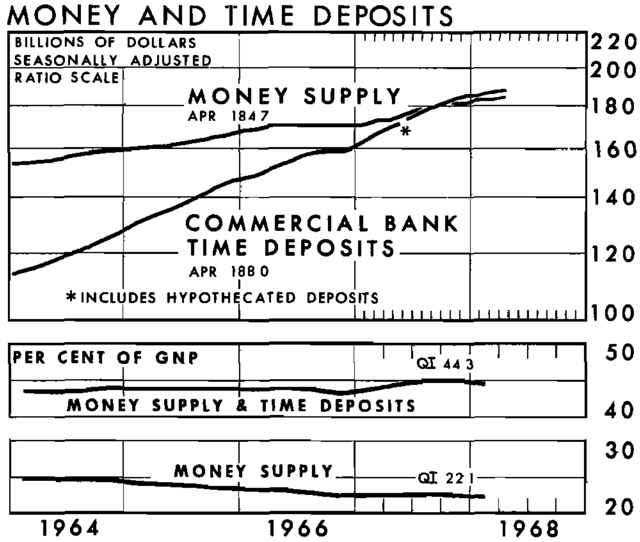
BANK RESERVES



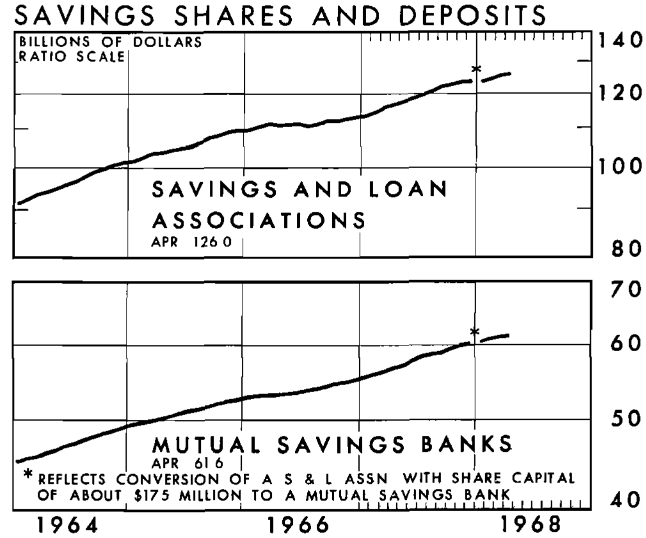
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

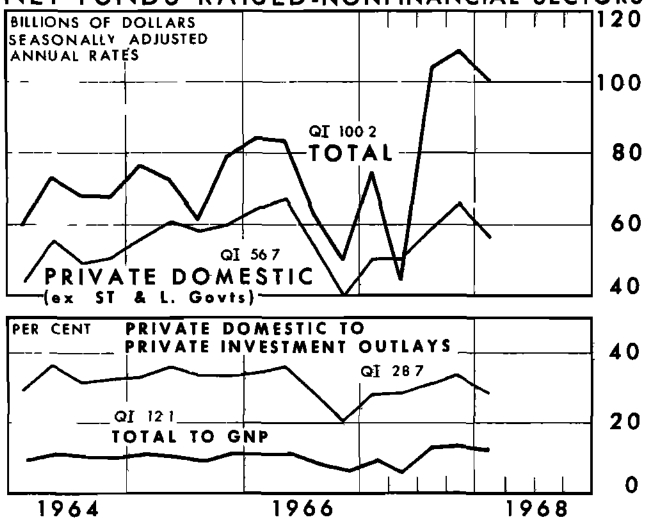


SAVINGS SHARES AND DEPOSITS

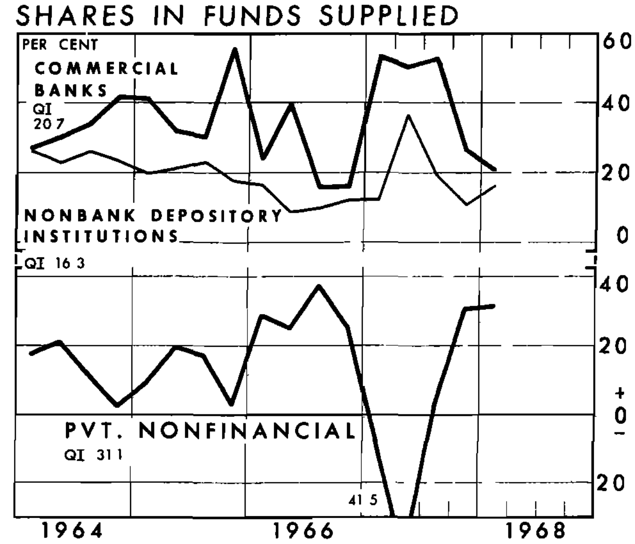


FINANCIAL DEVELOPMENTS - UNITED STATES

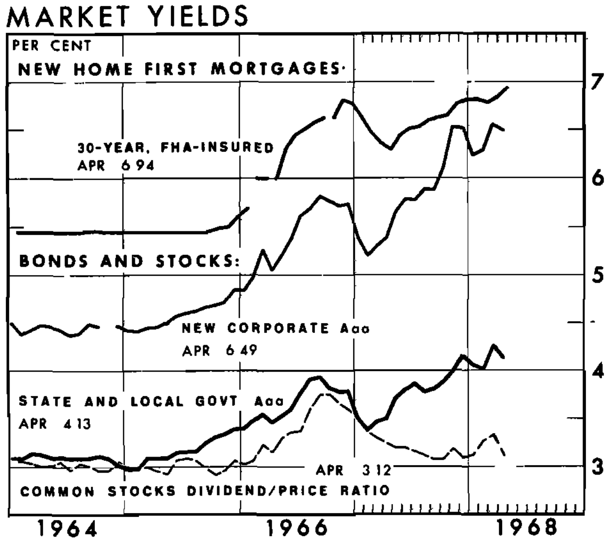
NET FUNDS RAISED-NONFINANCIAL SECTORS



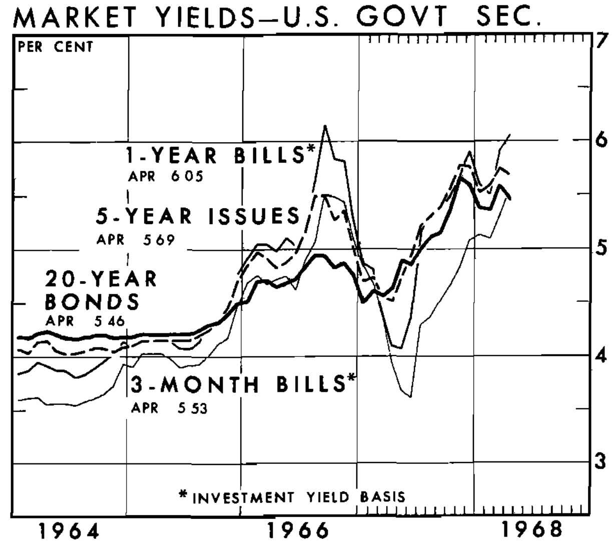
SHARES IN FUNDS SUPPLIED



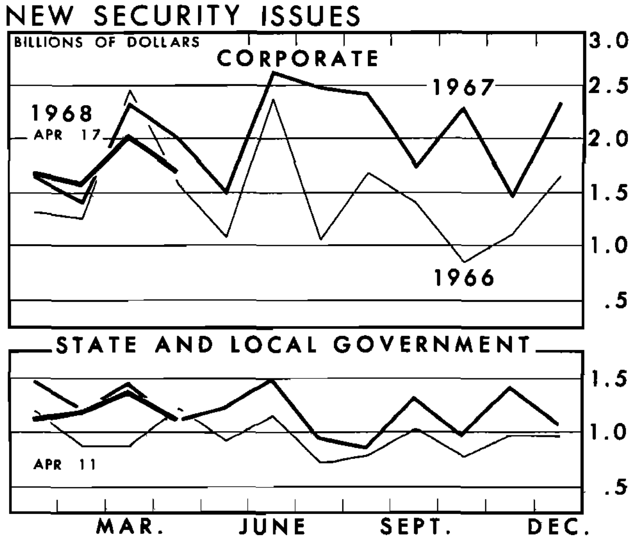
MARKET YIELDS



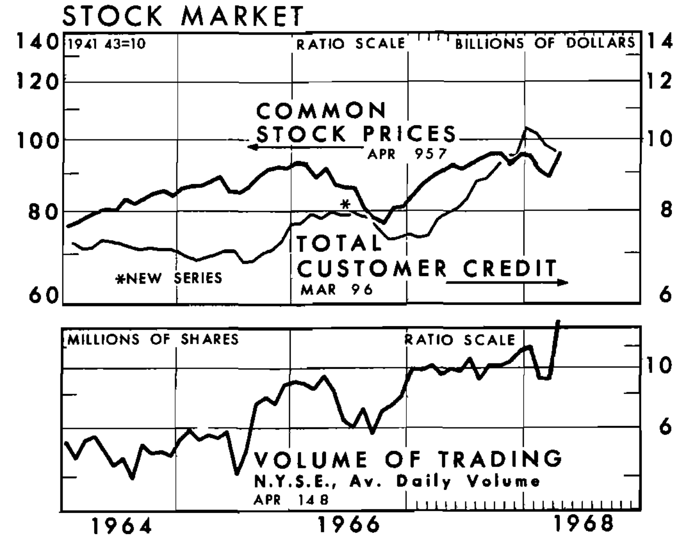
MARKET YIELDS—U.S. GOVT SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

Gold and foreign exchange markets. Developments in recent weeks have reflected increasing uncertainties about relative currency parities and a more bullish atmosphere in gold markets. The markets have been sensitive to news about fiscal action or inaction by Congress.

Gold prices fluctuated in the neighborhood of $39.50 from the first of May until the middle of last week, the rising trend during April having apparently been checked by profit-taking sales by speculators.

Rumors of continental currency revaluations began to circulate in the second week of May. Until then, most major continental central banks were either staying out of the exchange markets or selling dollars in support of their own currencies. After about May 9, exchange markets became quite unsettled; the German mark and Swiss franc were strongly bid and sterling turned down, requiring substantial support by the Bank of England.

In the middle of last week South Africa's statement that it would continue to withhold its newly mined gold from the private market and the news that the Congress would delay action on the fiscal package started (1) a flurry of gold buying that brought the price to about $41.50 by the end of last week and to about $42.50 by the beginning of this week; (2) speculative (or precautionary) buying of marks and Swiss francs; and (3) large scale selling of sterling that brought the spot rate to new lows and necessitated substantial support by the Bank of England.

Euro-dollar borrowing by U.S. banks. During April and May the rise in liabilities of U.S. banks to their branches abroad has accelerated. In the six weeks from Wednesday April 3 to Wednesday May 15 these liabilities increased by about $700 million. The greater part of this rise, about $500 million, occurred at banks outside New York. But at New York banks there was a further $300 million increase from last Wednesday to Monday May 20. There can be little doubt that movements out of sterling have been contributing significantly to the availability of funds in the Euro-dollar market.

Interest rates on Euro-dollar deposits of all maturities rose sharply in March to nearly equal their 1966 peaks, and then fell off somewhat after the gold rush ended. Since early April, with U.S. interest rates rising and U.S. banks adding further to their already large borrowings in the Euro-dollar market, a new rise in Euro-dollar rates has occurred. The spreads between Euro-dollar rates and the Federal funds rate have been more or less normal in size during the past four months, except during the gold rush in March. On May 22 the call deposit rate stood at 6.50 per cent, a record high except for a brief moment at the end of December 1967, and the 3-month rate was 7 per cent.

MEASURES OF THE U.S. BALANCE OF PAYMENTS
(millions of dollars)1/

	1967			1968		
	I-Q	Apr.	Jan.-Apr.	I-Q	Apr.	Jan.-Apr.
Liquidity balance (deficit -)						
Seasonally unadjusted	-238	-338	-576	-233	-534	-767
Seasonally adjusted	-533			-600		
"Special" transactions 2/	+377	+196	+573	+237	+168	+405
Liquidity balance before special transactions						
Seasonally unadjusted	-615	-534	-1,149	-470	-702	-1,172
Seasonally adjusted	-910			-837		
Official settlements balance (deficit -)						
Seasonally unadjusted	-1,280	-616	-1,896	+92	-400e	-308
Seasonally adjusted	-1,817			-520		
"Special" transactions affecting official balance	+9	+4	+13	+25	+3	+28
Official settlements balance before special transactions						
Seasonally unadjusted	-1,289	-620	-1,909	+67	-403	-336
Seasonally adjusted	-1,826			-545		

1/ Figures may not add due to rounding.
2/ Changes in nonliquid liabilities to foreign monetary authorities (including those issued under the German military offset agreement) and to international institutions, and in some periods certain other official transactions.
e/ Estimated.

U.S. balance of payments. Preliminary information indicates that the April deficit on the liquidity basis was about $550 million (not seasonally adjusted). Special transactions during the month were $170 million, principally the purchase of the fourth and final $125 million nonconvertible medium-term DM bond by Germany under the agreement of last year. The April deficit before special transactions was about $700 million, about $175 million greater than in April 1967.

On the official reserve transactions basis, the April deficit is roughly estimated at about $400 million, not seasonally adjusted. U.S. liabilities to foreign monetary authorities increased in April following a large decline in the first quarter associated with foreign private and official gold buying in March. The U.S. gold stock declined further in April by $156 million and U.S. official holdings of foreign currencies increased by about $60 million.

Bank claims on foreigners reported under the foreign credit restraint program increased in April by about $70 million, a greater than seasonal outflow. In the first quarter there was a large inflow.

The first quarter balance of payments data recently released by the Department of Commerce differ a little from those shown in the supplement to the last Green Book. On the liquidity basis the deficit for the first quarter was published as $600 million, seasonally adjusted. On the official reserve transactions basis, the balance was given as a deficit of $520 million, seasonally adjusted.

The principal developments in the first quarter were the sharp drop in the balance on goods and services, particularly merchandise trade, and a more than offsetting improvement in capital transactions. Net sales of U.S. securities to foreign markets in the first quarter were very high and included $560 million of newly-issued bonds sold by U.S. corporations to finance their direct investments abroad (see below). Foreigners' net purchases of outstanding U.S. stocks during the first quarter as a whole were $275 million; however, in March, the month of the gold rush, such purchases dropped sharply.

Net U.S. purchases of foreign securities amounted to about $400 million, after seasonal adjustment, in the first quarter, compared with $365 million in the previous quarter.

U.S. foreign trade. The trade surplus in the first quarter fell to $0.4 billion at an annual rate (balance of payments basis), less than one-third of the very low rate of $1.3 billion (revised) in the fourth quarter. The surplus in the first quarter of 1967 was nearly $4.0 billion at an annual rate.

U.S. EXPORTS AND IMPORTS
(billions of dollars, seasonally adjusted annual rates)

	1966	1967					1968p
	Year	Year	I	II	III	IV	I
Agricultural exports 1/	7.0	6.5	6.6	6.6	6.4	6.2	6.7
Nonagricultural exports 1/	22.4	24.5	24.5	24.5	24.7	24.5	25.4
Total exports:							
Census basis	29.4	30.9	31.2	31.1	31.1	30.7	32.0
Balance of payments basis	29.2	30.5	30.6	30.8	30.5	29.9	31.7
Total imports:							
Balance of payments basis	25.5	27.0	26.7	26.4	26.2	28.6	31.3
Trade balance	3.6	3.5	3.9	4.4	4.3	1.3	0.4

1/ Census basis.

A major element in the reduction of the trade surplus in the first quarter of the year was the sharp drop in exports in March. The 11-day longshoremen's strike in New York at the end of March is estimated to have accounted for about one-half the drop in March exports, although a more complete evaluation may be possible when April trade data are available. The remaining half of the export decline may be attributed to a particularly sharp drop in shipments to Canada, particularly cars; reduced deliveries of commercial aircraft; and a decline in exports of agricultural commodities. Little, if any, of these commodity categories, move through the port of New York.

The low March rate of aircraft exports appears to be temporary. Reported deliveries in April are at the high January-February rate. Automotive exports to Canada in March may have slowed because of the strike in GM plants there during February and March. With automotive production in Canada at record rates in April and May, a sharp increase in deliveries of automotive equipment above the low March level may be expected.

Export orders for machinery, seasonally adjusted, have expanded sharply in the last two quarters; these new orders may result in increased shipments of such equipment toward the end of this year.

Imports in March are also believed to have been affected by the New York port strike, although to a lesser degree than exports. A rough approximation indicates that March imports would have been \$50-75 million higher if it were not for the strike.

Despite the strike, all commodity categories of imports in the first quarter advanced sharply over the exceptionally high values of the fourth quarter. Arrivals of metals were especially large. In addition to copper and steel, increased quantities of aluminum were imported, reflecting mainly greater domestic requirements but also possibly some hedge buying pending the outcome of the labor contract negotiations in the aluminum industry.

Imports of other industrial materials -- wool and other textile materials, building materials, and paper -- also expanded sharply. The unusually severe winter required heavy purchases of fuel oil in the first quarter. Arrivals of crude petroleum, however, were still below normal as tanker schedules have not yet returned to the pre-Middle-East war pattern.

Purchases of foreign machinery, both electrical and non-electrical types, which had been on a high plateau in the last half of 1967, expanded by 10 per cent in the first quarter to a new high.

Automobiles and other nonfood consumer goods also shared in the strong growth in imports in the first three months of the year. Arrivals of U.S. type cars from Canada were up by nearly 30 per cent over those in the fourth quarter. Purchases of European and Japanese cars were also exceptionally heavy, with sales in the U.S. in the first four months 40 per cent higher than in the corresponding period of 1967. The increased popularity of the Volkswagen in the U.S. this year has been attributed to the availability of semi-automatic transmissions in these cars. Approximately 20 per cent of all Volkswagens sold in the U.S. in the first four months were reported to be so equipped.

The largest expansion in other consumer goods has been in the nondurable sector, mainly apparel but also footwear. The expansion in purchases of foreign durable consumer goods other than cars was much less marked.

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

	1966	1967					1968
	Year	Year	I	II	III	IV	I
Total Imports 1/	25,550	26,825	6,684	6,571	6,564	7,127	7,830
Foods, beverages	4,499	4,586	1,181	1,116	1,141	1,191	1,238
Industrial supplies	12,092	11,791	3,011	2,898	2,767	3,146	3,566
Fuels	2,247	2,235	572	572	505	590	611
Building materials	789	757	184	181	188	203	244
Iron and steel	1,312	1,422	313	356	358	395	419
Other metals	2,910	2,868	769	697	623	799	1,040
Other	4,834	4,509	1,173	1,092	1,093	1,159	1,252
Capital equipment	2,151	2,395	609	571	615	611	676
Machinery	1,939	2,265	573	544	583	576	627
Auto vehicles & parts	1,896	2,611	571	640	679	745	908
Canada	915	1,590	325	410	426	436	560
Other	981	1,021	246	230	253	309	348
Consumer goods 2/	3,912	4,222	1,052	1,038	1,038	1,099	1,216
Durable	2,108	2,189	557	528	536	571	592
Nondurable	1,349	1,565	387	393	379	410	506
All other	1,000	1,220	260	308	324	335	315

1/ Census basis.
2/ Excluding food and automotive.

Euro-bond issues by U.S. corporations. The mandatory foreign direct investment control program has produced a sharp expansion of U.S. corporate security issues in Europe to finance capital outlays abroad.

In the first four months of this year U.S. companies have offered for sales on the Euro-bond market over $700 million of long-term obligations, about $600 million of which have been convertible debentures. The total compares to similar issues of only $130 million in the first four months of last year and $527 million for 1967 as a whole. (These figures cover issues, most of which are denominated in dollars, offered for placement in more than one foreign capital market; in January-April 1968 U.S. companies have offered over $50 million in long-term obligations on single foreign capital markets.) The table below outlines recent trends in Euro-bond financing by U.S. companies and others.

NEW ISSUES ON THE EURO-BOND MARKET
(millions of dollars)

				Jan.-Apr.	
	1965	1966	1967	1967	1968
Total:	1,080	1,140	1,940	660	1,050
U.S. company issues	360	450	530	130	700
Other 1/	720	690	1,410	530	350
U.S. company share of total issues	33%	40%	27%	20%	67%

1/ Includes offerings by foreign public agencies, state enterprises, and national and local governments as well as private companies.

<u>Financial market conditions abroad</u>. In the past four months few important changes have occurred in financial conditions abroad, except in Canada where interest rates are now sharply higher than they were in January. In continental Europe, despite rising Euro-dollar interest rates and a large volume of bond issues by U.S. companies, and despite the continuing expansion of European business activity, interest rates are in many instances relatively low and have generally not risen much in recent months; in Germany and Switzerland long-term yields have even declined a little. In Britain, on the other hand, stringent credit restrictions remain in force and interest rates are high. However, because of large forward discounts on sterling in the exchange market, covered interest differentials are very unfavorable for movements into sterling. In Japan, credit conditions remain tight, and interest rates have been rising.

In the <u>United Kingdom</u> long-term rates have remained high and sticky because of fears of inflation, uncertainties about the pound, and expectations that the government will continue its tight money policy. Long-term government bond yields rose last year from May until near year-end, and since then have been close to the 1966 highs.

Short-term rates such as local authority deposit rates which are not tied to the Bank of England's Bank Rate have risen significantly since January, influenced by increased yields on dollar assets and the persistence of large discounts on forward sterling. In consequence of the high cost of deposit funds, local authorities have increased their borrowing from the clearing banks.

SHORT-TERM INTEREST RATES
(per cent per annum)

	Level Jan. 10	Change from previous date Jan. 31	Feb. 28	Mar. 15	Mar. 27	Apr. 30	May 8	Level May 8
Euro dollar:								
Call	4.63	- .13	+ .50	+1.25	- .37	+ .25	+ .12	6.25[a/]
3-month	6.13	- .75	+ .12	+1.50	- .62	+ .25	- .19	6.44[b/]
United Kingdom:								
Tr. bill[1/]	7.31	+ .16	- .13	- .06	- .25	0	- .03	7.00[c/]
Local auth.[1/]	7.88	0	+ .43	+ .07	- .25	+ .12	+ .13	8.38[c/]
Germany:								
Call money	1.88	+1.37	+ .13	- .25	- .45	- .80	+ .90	2.78[d/]
3-mo. inter-bank	3.25	+ .31	- .06	+ .13	- .13	+ .13	0	3.63[c/]
Switzerland:								
3-mo. bank dep.	3.00	- .25	0	0	0	n.a.	n.a.	n.a.
France:								
Call money	4.88	0	- .07	+ .25	- .06	+ .38	+ .25	5.63[e/]
12-mo. Tr. bill	5.09	- .05	- .02	+ .23	- .13	- .03[4/]	+ .16	5.25
Belgium:								
3-mo. Tr. bill	4.40	- .05	- .25	- .10	- .05	- .15	0	3.80[5/]
Netherlands:								
3-mo. local auth.[4/]	5.44	- .69	+ .06	- .06	- .19	+ .19	n.a.	n.a.
Sweden:								
Tr. bill	6.92	0	- .52	0	0	- .25	n.a.	n.a.
Canada:								
91-day Tr. bill[3/]	5.83	+ .46	+ .51	+ .10	+ .08	+ .02	- .06	6.94[c/]
Japan:								
Call, over mo.-end	8.40	0	+ .36	0	0	0	0	8.76

1/ Friday rates.
2/ Monday rates.
3/ Thursday rates.
4/ April 23 auction.
5/ May 3.

a/ In following two weeks rose to 6.50.
b/ In following two weeks rose to 7.00.
c/ In following week unchanged.
d/ In following week rose to 3.06.
e/ In following week rose to 5.75.

LONG TERM INTEREST RATES
(per cent per annum)

	Level	Change from previous date 1/						Level
	Jan. 10	Jan. 31	Feb. 28	Mar. 13	Mar. 27	Apr. 30	May 8	May 8
Euro bonds:								
Foreign govts. 2/	7.57	-.01	-.16	+.02	+. 22	-.12	+.05	7.57
U.S. corps. 3/	6.92	+.36	-.07	n.a.	+.14	-.10	n.a.	n.a.
United Kingdom:								
War Loan 4/	7.12	+.07	+.03	+.05	-.06	+.04	-.03	7.22 a/
Germany:								
6% Publ.Auth.	6.61	+.01	+.05	+.01	0	-.19	-.09	6.40 b/
France:								
Publ. sector 5/	6.59	-.03	-.02	+.01	+.03	.12	0	6.46
Priv. sector 5/	6.75	-.01	-.01	+.04	+.01	-.11	-.01	6.66
Italy:								
Composite 6/	6.48	...	0	...	+.02	n.a.	n.a.	n.a.
Belgium:								
Govt. 3/	6.58	+.02	-.09	n.a.	0	-.04	n.a.	n.a.
Netherlands:								
Govt. 2/	6.45	0	-.06	+.17	-.03	-.08	n.a.	n.a.
Canada (Govt):								
4-1/2% 1972	6.65	+.15	+.16	+.23	+.08	-.22	0	7.05 c/
4 1/2% 1983	6.49	+.22	+.19	+.15	.04	-.37	0	6.64 d/

1/ In cases of missing figures, change is from last date for which a figure is given.
2/ Friday rates.
3/ End of month.
4/ Thursday rates.
5/ Net of withholding tax (generally 12%).
6/ Monthly average.

a/ In following week rose to 7.27.
b/ In following week declined to 6.37.
c/ In following week rose to 7.15.
d/ In following week rose to 6.82.

The March 21 lowering of Bank Rate from 8 per cent to 7-1/2 per cent followed by two days the presentation of the 1968-69 budget, announcing a severe fiscal policy. Though generally it was hoped that interest rates could be allowed to come down from crisis levels, the Bank rate reduction involved no easing of the credit restrictions imposed last November. These restrictions limit bank credit to the private sector to not more than the amount outstanding at the time of devaluation, with exceptions only where loans contribute in some way to improvement of the balance of payments.

Persistence of uncertainties about the pound reflects in part the absence as yet of a clear turn for the better in Britain's trade accounts. Recent trade developments are analyzed in an Appendix which will be circulated with the Supplement to this Greenbook. In summary, the principal cause of concern is the unexpectedly high import volume in recent months, evidently associated with restocking of materials as well as with the pre-Budget bulge in consumption.

In <u>Germany</u>, continued monthly balance of payments surpluses and the Bundesbank's easy monetary policy have led to further increases in the liquidity of the banking system. As a result, interest rates in Germany have not risen significantly despite a substantial increase in credit demand.

Rates for 3-month inter-bank loans have recently leveled off at around 3-5/8 per cent after rising seasonally in February and the first half of March from low January levels. The March gold crisis upset financial markets temporarily; speculative inflows and the temporary cessation of money exports by German commercial banks caused call money rates in Germany to fall from around 3 per cent in the second week to an average of

2.60 per cent in the third week of March despite the incidence of a major tax date at that time. Call money rates again rose above 3 per cent in the early part of April, but dropped below 2 per cent toward the end of that month.

An interest-arbitrage equilibrium has been maintained between Euro-dollar rates and German money rates through a widening of the forward premium on the German mark against the dollar. In the first week of May, for example, the 3-month forward premium of 2.9 per cent just matched the difference between the 3-month Euro-dollar rate of 6.5 per cent and the 3-month German interbank loan rate of 3.6 per cent. (During February the forward premium on the DM against the dollar had been about 2 per cent, and in mid-March it rose briefly to 4 per cent.)

Since last November the Bundesbank has from time to time provided the German banks with dollar swaps at forward rates more attractive than those available in the market. During the intervals, sometimes quite brief, when such swaps are made their impact is of course either to keep the market premium on the forward DM (or discount on the forward dollar) smaller than it would otherwise be or to stiffen German money market rates relative to Euro-dollar rates. The Bundesbank has attempted to minimize the latter effect, by operating mainly at times when speculative inflows of funds were occurring or feared.

During the five months November through March outstanding swaps increased by $858 million, white net external dollar assets of the banks increased by only $170 million as may be seen in the table. Speculative inflows may have affected the banks' dollar holdings in two ways: they may have repatriated uncovered dollar assets, or they may have reduced their spot holdings in consequence of customers' forward sales of dollars to them. Moreover, after entering into swaps with the Bundesbank, banks may have sold dollars in the market -- i.e., in effect, back to the Bundesbank -- while retaining the forward contract side of the swap.

CHANGES IN EXTERNAL SHORT-TERM POSITON OF GERMAN BANKS
(millions of dollars equivalent)

	1967		1968		
	Nov.	Dec.	Jan.	Feb.	Mar.
Swaps with Bundesbank	+371	+261	+191	-406	+441
U.S.-$ net assets	+141	- 88	+343	-161	- 65
All currencies (incl.DM)					
Assets	+139	-204	+560	- 11	-114
Liabilities	+ 53	+259	-202	+ 90	+ 85
Net assets	+ 86	-463	+762	-101	-199

The changes in German banks' external liabilities have affected primarily their DM deposit liabilities to banks and others outside Germany; there is some evidence of windowdressing operations at the year-end. While the banks' DM liabilities to nonresidents have been expanding over the whole period covered by the table, the net increase during the month of March (when speculative inflows occurred) was not particularly large.

Long-term bond yields (public authority bonds) have declined by about 20 basis points since January. After rising slightly during February and March, yields declined noticeably during April and early May.

Since last October yields on German domestic bonds have been lower than on foreign DM bonds, and since November or December lower than yields on dollar Euro-bonds. New issues of foreign DM bonds have been large in recent months. The Bundesbank in its latest Monthly Report has expressed the view that this development, which is desirable for the balance of payments, creates no problem for the domestic capital market that would call for special controls. See Appendix D.

Swiss short-term interest rates, which rose last autumn and fell in January along with Euro-dollar rates and German rates, have held steady at a low level in recent months.

It appears from press and embassy reports that the French authorities are continuing to pursue the moderately expansionary monetary policy which prevailed in 1967 when the money supply was allowed to increase at a slightly higher rate than real GNP.

Short-term interest rates have risen moderately. Bond yields declined a little in April, but are still above the 1967 average.

Further steps in the program of reform of financial markets have been taken. Restrictions on new capital issues other than those of oil companies were removed on April 15, except for the requirement that issues of more than FF 15 million ($3 million) must be scheduled by the underwriting banks with the government. In addition, new techniques for floating bond issues will involve lower commissions and higher coupon rates.

In Italy, long-term bond yields have continued to rise very gradually. Expansion of bank credit and the money supply remains fairly rapid, but has decelerated a little. While the balance of payments continues to provide liquidity to the banking system, central bank credit to the Treasury has declined somewhat since mid-1967 and the banks have had to increase their borrowings from the Bank of Italy.

Despite a rise in the level of economic activity and a decline in official external reserves, interest rates tended to move downward in Belgium during the first four months of 1968. The National Bank of Belgium encouraged this tendency by reducing the discount rate on March 7 from 4 per cent to 3.75 per cent. Bond yields have also declined a little. Monetary policy in the Netherlands has retained the relatively easy stance of last year. Short-term rates have tended to decline somewhat from January levels, while long-term rates have risen slightly.

The most important recent influence on Swedish interest rate levels was the reduction from 6 to 5-1/2 per cent in the Bank of Sweden's basic discount rate, effective February 9. This action reversed in part the 1 per cent rate increase in mid-December, when there was a flurry of speculative pressure in exchange markets and a sizable drain on official reserves. The recent quickening of economic activity in Sweden, reflecting the strengthened cyclical revival in Germany, suggests that the Swedish authorities may delay any further discount rate reduction until other central banks signal the way.

Thus far in 1968 Canadian monetary policy has been largely dominated by the need to deal with serious pressures on Canada's foreign exchange reserves and with continuing inflation. The Bank of Canada's reactions to these problems and to increases in U.S. money market rates forced both short- and long-term rates to extraordinarily high levels by late March. An easing of the pressures on the Canadian dollar in foreign exchange markets then created expectations of somewhat easier monetary conditions later in the year, and long-term rates declined somewhat during the first half of April. During the last few weeks, with U.S. rates rising, Canadian long-term rates have risen somewhat, but remain below the March peak. Short-term rates, however, have not come down at all.

The announcement of the U.S. balance of payments program at the first of the year caused immediate pressure on the Canadian exchange market, and the Bank of Canada reacted by raising the bank rate by a full percentage point on January 21. The Treasury bill rate rose one percentage point between mid-January and the end of February. Yields on medium- and long-term issues rose less than half as much during this period, but continued to rise rapidly on into March.

Serious pressures on Canadian foreign exchange reserves continued into March, and the Bank of Canada consequently matched the 1/2 percentage point increase in the U.S. discount rate on March 17. Pressures on the Canadian dollar were finally eased in late March by two factors: the exclusion of Canada from the U.S. balance of payments program earlier that month, and the gold pool communiqué of March 17.

The calming of the exchange market and the final passage of Canada's income tax surcharge on March 15 were greatly encouraging to the bond market. After the completion of a sizable government bond flotation on April 1, yields on Canadian medium- and long-term bonds fell by almost 40 basis points. As already noted, these yields have subsequently risen somewhat. Increased official optimism about the Canadian balance of payments and market confidence in the Canadian dollar is suggested by the fact that the Bank of Canada did not match the April Federal Reserve discount rate increase -- which, however, is not so remarkable in view of the fact that the Canadian rate is already at 7-1/2 per cent.

Credit conditions have remained tight in Japan. The rate of credit expansion has slackened a little, and interest rates have increased further.

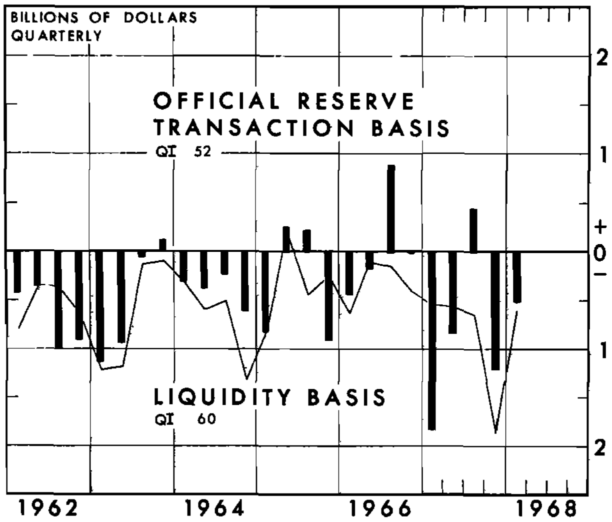
During January-February commercial bank loans and discounts were up 15 per cent from a year earlier, a slightly smaller rate of expansion than earlier. Banks have reportedly grown increasingly cautious in their lending, in response to Bank of Japan guidelines on credit expansion and rediscounting.

The average rate on commercial bank loans and discounts, which reached a low of 7.28 per cent last August, has been rising steadily and in March was 7.49 per cent. Yields on most classes of bond issues have increased since last September. The over-month-end call loan rate rose to 8.76 per cent by February 20 and has remained at that level since. On April 23 the interest rate for dollar import acceptance credits was raised again from 8.375 per cent to 8.625 per cent, and there was a further increase to 8.725 per cent on May 9.

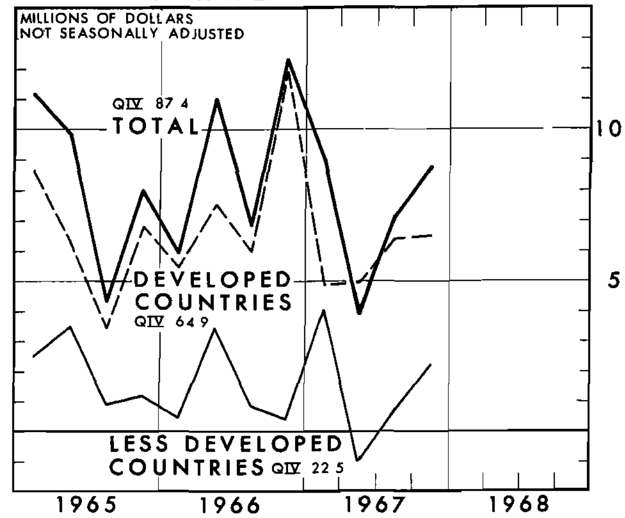
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

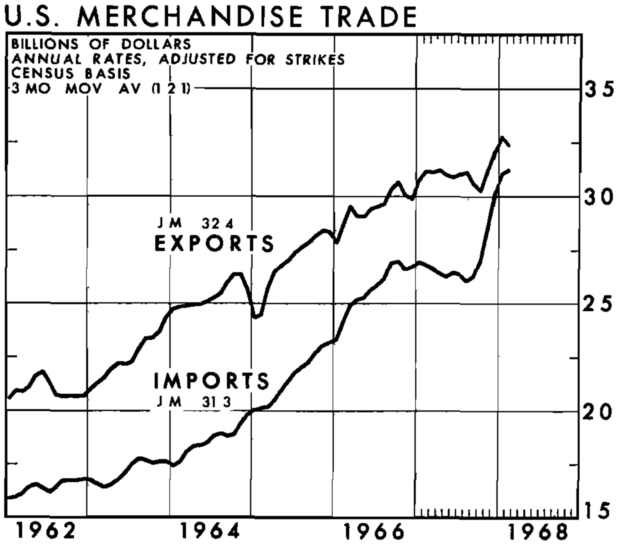
U.S. BALANCE OF PAYMENTS



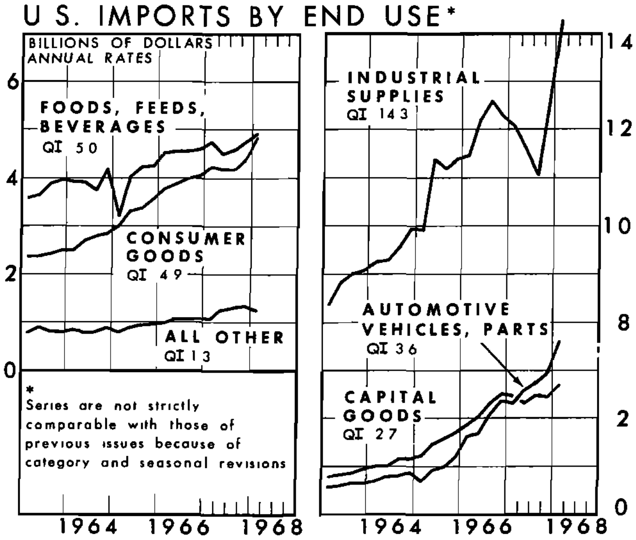
U.S. DIRECT INVESTMENT CAP OUTFLOWS



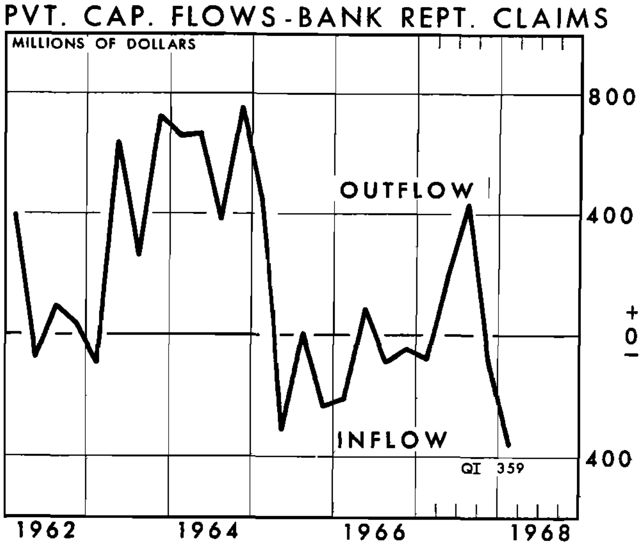
U.S. MERCHANDISE TRADE



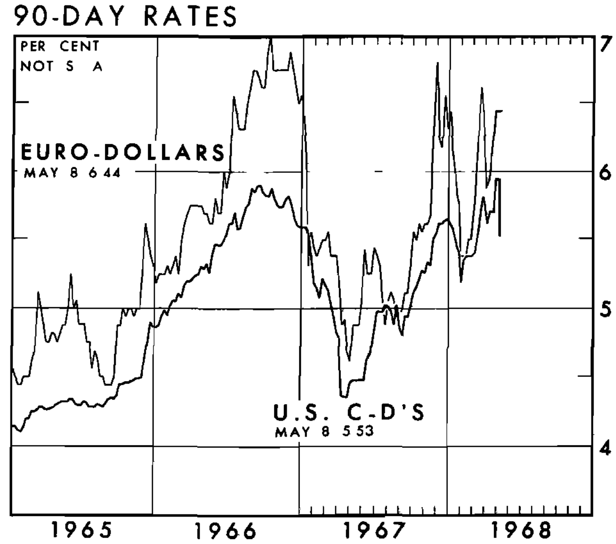
U.S. IMPORTS BY END USE*



PVT. CAP. FLOWS-BANK REPT. CLAIMS



90-DAY RATES



APPENDIX A: CHANGES IN CEILING MORTGAGE RATES AND FNMA OPERATIONS*

Two recent structural changes in the residential mortgage market have enhanced the competitive position of FHA and VA mortgages relative to conventional mortgages and other types of investments. These changes should eventually promote improved adjustments in a sector of the housing market that now accounts for about a fifth of all transactions. However, their near-term effect will probably contribute only marginally to the total flow of mortgage credit.

FHA and VA ceiling rates. On May 7, the President approved Public Law 90-301, which suspends until October 1, 1969, statutory limits applicable to interest rates on all FHA and VA mortgage programs The limits had formerly been 6 per cent on home loans, and from 5-1/4 to 6 per cent on multifamily loans. Such ceilings had become increasingly unrealistic for some time, as yields required by lenders on home mortgages rose to a postwar high of nearly 7 per cent in April. To attract investors under these conditions, FHA and VA loans carrying contract rates of 6 per cent or less had to be discounted to an increasing extent that inhibited lending as well as borrowing.

The same legislation also authorized a regulatory rate ceiling adequate "to meet the mortgage market." Acting under this authority, FHA specified an across-the-board limit of 6-3/4 per cent for all market-rate programs, and VA also set a 6-3/4 per cent ceiling on home loans that it guarantees. (As before, an additional insurance premium of 1/2 of 1 per cent will continue to be required on FHA-insured mortgages.)

The new higher contract interest rates, which helped to reduce the exceptionally large discounts formerly prevailing on FHA and VA loans, accordingly eased pressures toward higher home prices. Since Government regulations require sellers to absorb all but 1 point of any discount, the large discounts in some cases had been capitalized in whole or in part in higher prices of new and used homes purchased with Government-underwritten loans. In other cases, they had caused sellers to refuse to offer their homes for sale subject to FHA and VA loans, and had compelled buyers to resort, where possible, to other forms of financing under less liberal loan-to-value or maturity limits.

Other structural problems, however, will continue to restrain lending on Government-underwritten home mortgages in some areas during coming months. Currently, 3 States with 6 per cent usury ceilings do not except VA loans. In a number of additional States, FHA and VA loans are excepted only for certain types of lenders and not for others.

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* Prepared by Robert M. Fisher, Senior Economist, Capital Markets Section.

Pending new legislation, rates on affected Government-underwritten loans in such States must accordingly remain at the 6 per cent limit applicable to conventional mortgages as well. For this and other reasons, efforts have been accelerated in a number of States to raise usury ceilings and/or permit more exceptions from them, thereby easing this barrier to home-mortgage investment.

Finally, another provision of the legislation signed by the President raised the maximum amount of guarantee on VA home mortgages to $12,500 from $7,500.

FNMA operations. Under the so-called Free Market System, inaugurated May 6, the Federal National Mortgage Association established a weekly auction-type procedure for pricing its forward commitments to purchase FHA and VA home mortgages under its secondary market operations. Under this System, FNMA announces in advance the total volume of purchase commitments it will accept each week, subject to FNMA approval of bids. Approved sellers are invited to submit competitive or non-competitive bids covering mortgages for delivery at the seller's option to FNMA within 3 or 6 months (on new or used houses) or within 12 months (on houses not yet started). For each auction, FNMA specifies more or less standard conditions governing maximum and minimum bid amounts, acceptable loan characteristics, and purchase fees and other charges.

Under its former practice, FNMA set purchase prices for mortgages on new or used houses for delivery within 2-1/2 months (immediate purchase) or usually 12 months (standby commitments), and the market determined the volume of offerings. Since FNMA's price schedule was changed infrequently, mortgage offerings to FNMA rose sharply when FNMA prices remained well above prices prevailing in the private market. When its own resources were under pressure, FNMA also imposed certain non-price restrictions from time to time as an additional means of limiting offerings. This practice created uncertainty among private sellers about what FNMA might do next and inefficiency in FNMA's ability to adjust its support to meet the most pressing requirements of individual local markets.

FNMA's new Free Market System will accordingly give FNMA direct control over its weekly volume of offerings, and permit more realistic pricing and allocation of what commitments are auctioned each week. At the same time, FNMA's purchase prices should become more directly attuned to changes in yields on competitive long-term investment.

FNMA's auction bids imply that secondary market yields on FHA and VA home mortgages rose markedly during the first three weeks of May. While informal reports from other sources also indicate a rapid rise, the increase suggested by the FNMA bids undoubtedly also reflects private market inexperience with FNMA's new operating procedure. In time, however, the bid price data may well prove to be relatively precise weekly indicators of trends in secondary market yields on FHA and VA home mortgages to be delievered within the prescribed time limits. In interpreting the results, allowance will always have to be made, of course, for any changes in FHNA's weekly auction limit and for possible differences in the quality of mortgages offered to FNMA compared with the quality of loans sold to private investors.

In its first three auctions, FNMA accepted total weekly bids of $40 million (May 6) and $50 million (May 13 and 20), and announced limits of $50 million and $60 million on the auctions of May 27 and June 3, respectively. These limits are close to the weekly average volume of mortgages offered to FNMA earlier in 1968 under its former procedure. This suggests that FNMA's support of the market will continue to be quite large in coming months if mortgage yields required by lenders remain high. Prospective builders of homes not yet under construction may come to find FNMA's 12-month purchase commitments of special help if private lenders cut back hard on their longer-term commitments.

APPENDIX B: LIFE INSURANCE POLICY LOANS AND COMMITMENTS IN THE FIRST QUARTER*

An estimated $2.9 billion cash flow was invested by a sample of life insurance companies in the first quarter. This represented a fairly normal first quarter volume and showed a normal seasonal reduction from the fourth quarter. Sources of investment funds--return flows from mortgages and securities and funds from insurance sales, as well as short-term bank borrowings--also followed generally typical first-quarter patterns.

An increase in policy loans made by the sampled companies during the first quarter decreased funds available for other investments by 7.5 per cent, as shown in Table 1. The growth in policy loans represented a normal seasonal phenomenon, however, which has occurred regularly in every first quarter since 1957, except in 1967 when special conditions prevailed. The share of net investment funds absorbed by policy loan growth has nevertheless remained relatively large by pre-1966 standards. Moreover, among 15 companies that account for the bulk of policy loans in the industry, February through April in 1968 show increased policy-loan activity over prior years.

NET INCREASE IN POLICY LOANS AT SELECTED LIFE INSURANCE COMPANIES 1/

	Per cent of total investment funds				
	1964	1965	1966	1967	1968(p)
Q I	4.3	3.8	4.1	8.2	7.5
Q II	4.4	4.3	8.6	8.1	
Q III	3.7	3.9	16.4	6.3	
Q IV	2.9	2.9	15.8	5.0	

1/ Sample of companies representing about two-thirds of industry assets. THESE DATA ARE STRICTLY CONDIFENTIAL.

The current structure of interest rates favors policy-loan borrowing even more strongly than in earlier years. While borrowing rates on outstanding policy loans have generally remained at 5 per cent, other interest rates have risen substantially since 1966. Scattered reports suggest that the bulk of current policy-loan borrowers may be individuals borrowing relatively small amounts, while in 1966 there was evidence that many were relatively large business borrowers.

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

Although these policy-loan indices suggest increased activity this year, it should be noted that the industry undoubtedly has less of its expected future cash flow committed now than was the case in late 1965-early 1966. 1/ The industry appears to have more leeway now to accommodate unexpectedly large increases in policy loans and decreases in fund inflows available for other investments.

A slackening in the first-quarter volume of new commitments indicates a rather cautious industry posture. As indicated in Table 2, however, the stock of commitments outstanding remained at near-peak levels. Despite unprecedented yields available on corporate direct placements, their volume of new commitments was relatively modest in the first quarter. An important factor underlying this relative increase in mortgage commitments is the industry's "Billion Dollar Program", a plan to provide funds for urban projects, of which around $400 million has been committed.

FORWARD INVESTMENT COMMITMENTS OF SELECTED LIFE
INSURANCE COMPANIES 1/
(not seasonally adjusted)

	First Quarter			
	1965	1966	1967	1968
NEW COMMITMENTS				
Total ($ millions)	2,927	3,561	1,964	2,870
Per cent allocated to:				
Mortgages & real estate	63.9	59.6	59.7	64.8
Securities	36.1	40.4	40.2	35.2
OUTSTANDING COMMITMENTS				
Total ($ millions)	7,789	9,539	9,113	11,441
Per cent allocated to:				
Mortgages & real estate	73.3	71.3	66.1	64.1
Securities	26.8	28.7	33.9	35.9

1/ Sample of companies representing about 70 per cent of industry assets. THESE DATA ARE STRICTLY CONFIDENTIAL.

1/ The ratio to expected cash flow of commitments expected to be taken down within 6 months ranged between 74 per cent and 79 per cent during 1967 as a whole, versus a 1966 range of 84 per cent to 89 per cent. This index is not yet available for the first quarter.

APPENDIX C: ESTIMATED IMPACTS OF CREDIT MARKET CONDITIONS ON STATES AND LOCAL GOVERNMENT FINANCING AND CAPITAL OUTLAYS*

Results of the 1966 State and local borrowing survey, though preliminary, may be helpful in estimating the real impacts of recent restrictive credit conditions on that sector's borrowing and capital outlays. 1/ Summary tabulations, adjusted to take into account the response rate and the relative sample size, indicate that about $1.75 billion of long-term borrowing was abandoned or postponed beyond 1966 because of high interest rates. This led to an estimated $280 million of contract award cut-backs or deferrals, about one-fifth of which were not felt until 1967.

The year 1967 brought its own round of borrowing postponements evidently exceeding the total for 1966. Although we have no direct sample information, given certain assumptions it appears that perhaps $2.1 billion worth of long-term borrowing was postponed beyond 1967 for interest cost reasons. If the response pattern was similar to that of 1966, this implies contract award reductions and postponements of about $350 million emanating from the 1967 borrowing difficulties. Likewise, reported borrowing postponements in the first four months of 1968 may have generated thus far about $70 million in contract award reductions. If these trends continue, about $300 million of contract award reductions can be expected in 1968.

Three important factors should be considered in appraising these estimates. First, contract capital spending is not the only State and local budget item adversely effected. Certain noncontract work was probably also reduced. Additionally there was a yet undetermined amount of cutbacks and stretch-outs of current outlays to support unfunded capital projects. Second, contract award reductions will have delayed impacts on the actual stream of expenditures because of

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* Prepared by John Petersen, Economist, Capital Markets Section.

1/ The borrowing survey covered only 1966 and no directly comparable information is available for 1967 and 1968. Historical ratios between the survey results and series which are currently available must therefore be used. To develop the estimates above, it is assumed that the proportion of total borrowing reductions for the year to that total reported in the financial press remained the same as it was in 1966. In 1966, the latter reported $1.074 billion of borrowing postponements and reductions as compared to our survey estimate of $1.725 billion caused by interest rate factors alone. It has also been assumed that the amount of contract award reductions was the same proportion of total long-term borrowing reductions in both 1967 and the early part of 1968 as it was in 1966.

the structural lags involved in construction and payment phasing.[1/] Third, there are numerous multiplier or secondary effects that radiate from State and local government contract and spending reductions into other sectors of the economy. These effects require time to cumulate and will amount to much more than the primary effects estimated above.

1/ A follow-up survey is underway to get more information on the lagging and secondary impacts involved in both borrowing and contract award reductions by State and local governments.

APPENDIX D: FOREIGN BOND ISSUES IN GERMANY

Over the past year or so but more particularly since the beginning of this year, there has been a substantial growth of foreign bond issues denominated in German marks (DM) on the German capital market. In recent months these bonds have generally been issued with coupons of 7 per cent; by comparison, recent domestic issues have carried coupons of 6-1/2 per cent. The substantial increase in the amount of foreign bond issues coming to the German capital market and the higher rates of interest offered on these issues has created some concern that these developments might endanger the continued recovery of the bond market and lead to a new rise in German interest rates. There has in fact been speculation in the financial press that some measures would be taken to control the volume of new foreign bond issues. The Bundesbank addresses itself to this situation in its April Monthly Report. The Bundesbank concludes that: 1) the greater foreign demand for capital market financing is not endangering the capital market because a strong increase in the supply of investment funds has accompanied the growth of demand for funds; 2) it is therefore not necessary to reconsider capital market policy with reference to foreign bond issues; 3) a net outflow of capital from the country is "natural and desirable" in view of the overall balance of payments surplus.

Background of the situation. In 1967, Germany exported a net total of $898 million of long-term capital (private and public); of this sum, $546 million consisted of total long-term private capital and $40 million of that, or 4.5 per cent of the grand total, represented German purchases of foreign DM-denominated bonds issued on the German capital market. Sales to Germans of such bonds were equivalent to only about 1 per cent of total net sales of bonds of domestic issuers.

What has now given rise to some uneasiness in Germany is the fact that in the first quarter of 1968 private long-term capital amounting to $416 million has already been exported, more than three-fourths of the sum exported during the whole of 1967. Within the first four months of 1968, foreign DM-denominated bond issues on the German capital market (sold to foreigners as well as German investors), had reached the total ($183 million) issued during the course of 1967.

This development is the result of the decline in German interest rates relative to those prevailing in other major financial centers. Prior to 1967, the interest rate structure in Germany was one of the highest of any of the major industrialized countries. The gap which existed previously between bond yields on the German and other capital markets has not only closed but the opposite situation has arisen and foreign bond yields are now in many instances higher than German yields. For instance, yields on Euro-dollar bonds[1/] and on U.K., Dutch and Canadian government bonds were 7.52, 7.25, 6.45, and 6.64 per cent respectively in the first week of May; the yield on 6 per cent German public authority bonds was 6.46 per cent at the same time.

The Bundesbank's analysis. The Bundesbank stresses the point that capital outflows, *per se*, are not harmful to the capital market and are in fact desirable given the German balance of payments surplus. It is true that the amount of foreign bond issues rose sharply in the first four months of this year. However, the bond market actually strengthened since the beginning of the year and in April yields declined 19 basis points despite a particularly heavy slate of new foreign bond issues. The market strengthened sufficiently, in fact, to allow the Bundesbank to halt the support purchases necessary in earlier months and to place some of its earlier purchases back into the market. (The Bundesbank observed, however, that the capital market was seasonally very liquid in the first quarter and that flotations of the volume of the first quarter could not be anticipated for following quarters.)

The decline in domestic bond yields furthermore proves groundless the fear that the higher yield on foreign bonds would, itself, force up rates on domestic issues. It is normal that yields on foreign-issued bonds are higher than those on domestic issues in the same market. For example, this situation exists presently in the Netherlands and Switzerland and was the case also in Germany before 1964, when announcement of the 25 per cent coupon tax led to large-scale selling of German bonds by foreigners and a sharp fall in domestic bond prices. Some of the money that left German bonds was promptly reinvested in foreign DM bonds, which were not subject to the coupon tax. This series of developments led to the unusual situation of before-tax yields on domestic bonds being higher than those on foreign bonds through 1965 and 1966. Even after more than a year of rising

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1/ Average of yields on four foreign government dollar bonds quoted in London.

German bond prices yields on those securities remained above yields on foreign DM bonds until October 1967.

Foreign bond flotations on the German capital market

Most foreign bond issues floated in Germany have taken the form of DM-denominated bonds. A few bonds have been denominated in foreign currency (U.S. dollars or sterling). There have been no unit of account bonds issued.

Foreign bonds began to come to the German market in substantial numbers only in 1964. The growth of foreign issues since then is apparently the result of various balance of payments measures taken by the United States beginning with the IET in 1963, and the announcement of the German coupon tax in March 1964, which led to a decline in the interest rate on foreign bonds in Germany.

Of the foreign issuers making use of the German capital market since 1964, Luxembourg (the seat of many international holding companies), the United States and Japan have been the most important. (See Table 1.) And since borrowing by Luxembourg probably largely represents borrowing by subsidiary companies of U.S. parent firms, it would seem that the United States has been directly and indirectly the single largest foreign borrower on the German market.

The net burden of foreign bond issues on the German market

Although a significant and growing volume of foreign bonds have been issued in Germany, they have actually placed a smaller net burden upon German savings than is indicated by gross flotation figures. (See Table 2.) Of the total $876 million DM-denominated bonds issued by foreigners in Germany from 1964 through 1967, only $283 million or one-third of the total have actually remained in Germany. In fact, in 1967 only one-fourth of total foreign bond issues remained in German possession.

So far in 1968, however, three-quarters of total foreign bond sales have remained in Germany. Although it is unlikely that this entire amount will in fact remain in German hands -- resale of these securities to foreigners or sale to them of securities remaining with consortium banks after the official subscription period can still occur during the remainder of the year -- this development nonetheless suggests a significant shift in German investor interest. Given the change in the relative interest levels in Germany and other capital markets, the Bundesbank believes that German investors will continue to buy larger portions of foreign bonds issued in Germany than they did in previous years.

Table 1. Foreign Bonds Issued on the German Capital Market in Foreign and Domestic Currency - according to Country of Origin 1/
(millions of dollars; face value)

	1964-1967	1964	1965	1966	1967	IQ 1968
Luxembourg	186	--	56	69	61	--
United States	148	--	55	56	37	--
Japan	110	75	35	--	--	25
European Coal & Steel Community	67	25	38	2	3	--
Internat. Bk. for Reconstruction & Development	63	--	63	--	--	30
Finland	54	48	6	--	--	--
Norway	43	10	13	--	20	19
Switzerland	43	13	15	--	15	--
South Africa	41	--	13	25	4	--
Italy	27	--	27	--	--	--
United Kingdom	25	--	25	--	--	--
European Investment Bank	22	20	--	--	2	1
Austria	14	--	--	--	14	25

1/ Totals may not add due to rounding.

Source: Bundesbank Monthly Report, April 1968, p. 5.

Table 2. Sale and Placement of DM-bonds Issued by Foreigners In Germany[1]

(millions of dollars)

	Gross Sales[2] of new Issues (1)	Placement in Ger. in year of issue (2)	Col. (2) as % of Col. (1) (3)	Transactions in outstanding foreign DM-bonds: Sales by Foreigners (4)	Purchases by foreigners (5)	Net (6)	Net German purchase of foreign DM-bonds (7)
1964	221	86	39	--	19	-19	68
1965	321	113	35	--	29	-29	83
1966	153	38	25	6	26	-20	18
1967	181	47	26	6	13	- 7	40
Total	876	283	32	12	86	-74	210
I.Q. 1968	99	77	78	9	9	--	76

1/ Totals may not add due to rounding.
2/ Issue value.

Source: Bundesbank, Monthly Report, April 1968, p. 8.

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