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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff  
Board of Governors  
of the Federal Reserve System

October 23, 1968

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**SUMMARY AND OUTLOOK**

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**Outlook for economic activity**

The imminence of major events which could modify the economic outlook--the election, the status of peace negotiations--makes short-term forecasting particularly hazardous at the moment. As a best guess at this time, the staff expects growth in economic activity to moderate somewhat further in the current (fourth) quarter.\* The rate of growth of real GNP in the current period is now expected to dip to about 3-1/2 per cent, as compared to the 5 per cent increase shown by preliminary data for the third quarter. On the other hand, the rate of price increases as measured by the GNP deflator (excluding Federal) is expected to rise again following a surprisingly large deceleration in July-September which was partly the result of special circumstances.

Gains in consumer expenditures are not likely to be as large in the fourth quarter as in the third. Auto sales remain strong, but are unlikely to show further growth of the kind that provided such buoyancy in the third quarter. Other sectors of consumer buying after rising briskly in July and August, have apparently shown little further increase since that time.

The rise in business fixed investment in the third quarter reflected in part special factors and fourth quarter outlays should be about in line with the small increase suggested by the Commerce-SEC

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\* Tables containing GNP and Flow of Funds projections through 1969 will be distributed to the Committee October 25 along with the Greenbook Supplement.

survey. Although the recent exemption of CCC and Medicaid from spending curbs will lift fiscal year expenditures, only a modest further rise in Federal outlays is expected in the fourth quarter.

Residential construction expenditures should show a larger rise this quarter in light of the rapid revival in housing starts over the summer.

#### Outlook for prices and resource use

The sharp decline in steel output appears to be over and, with auto production scheduled at a new high for the year, industrial production now appears to be moving up again at a slow pace. The production decline in August and September brought the rate of manufacturing capacity utilization down from 85 per cent in June to about 82.5 per cent in September, and only a little recovery is in prospect for the remainder of the year. Accompanying the drop in production, manufacturing employment has been showing little change. Altogether, the rise in nonagricultural employment is expected to slacken somewhat in the current quarter and the unemployment rate is expected to rise slowly from the low September rate of 3.6 per cent.

Among the unexpected developments in the third quarter was a large drop in the rate of increase in the GNP deflator for consumption while consumption expenditures spurted sharply. This price development reflected in part a substantial slowing in the rise of average prices of nondurable goods when food prices stabilized (a supply development) following a sharp advance over the preceding 6 months. In part, also

it reflected slackening in the earlier rapid advance in service prices. New car prices were about unchanged despite the bulge in sales, and this acted to moderate the over-all consumer price rise. This month and next new car prices will be up moderately with the shift to new models. The rise in average prices of nondurable goods will probably continue. Overall, the GNP deflator for the private economy is likely to accelerate although to a pace below that of the first half of the year.

Continued strong upward pressures on wage rates, along with hope for renewed expansion in industrial demands following an unusually prompt run-off in excessive steel inventories, has contributed to the step-up in industrial prices since mid-August. However, by early next year, some easing of upward wage pressures is expected to begin. Along with the slowing anticipated for consumer (and other) demands, this may lead to reduction in the rate of increase in prices of industrial commodities--at retail and wholesale--and also may contribute to further slackening of the still rapid upward movement in service prices.

#### Outlook for credit demands

The course of interest rates between now and year-end may be as much, or more, influenced by expectational factors as by credit demanded and supplied. Demand factors themselves might exert some, but probably not substantial, upward pressure on long-term interest rates between now and year-end. The corporate bond market is currently in an improved technical position; inventories of corporate underwriters have been reduced, and the fairly moderate external financing needs of

corporations should tend to keep the volume of publicly offered new issues below the \$1 billion per month pace. In the tax-exempt market, however, the volume of offerings is expected to continue large.

As of this writing, the specifications of the Treasury mid-November refunding (to be announced Wednesday, October 23) are still unknown. It is unlikely that the financing will result in any substantial amount of intermediate-term securities being pressed on the market, and thus may not exert very much direct pressure on the neighboring long-term market. But the refunding, together with tax bills offered in late November or early December, could tend to sustain upward pressures on interest rates in shorter-term market sectors, though the extent would depend on whether the financing is a cash or rights offering. Any significant further rise in short-term rates could lead to higher long-term rates through effects on dealer financing costs and on expectations about monetary policy intentions.

Business demands for short-term credit from banks and in the commercial paper market are likely to be a marginal factor exerting upward pressure, at least of seasonal proportions, on the interest rate structure. Demands for business loans from banks have accelerated somewhat recently. With inventory accumulation in the fourth quarter expected to be fairly sizable, business loan demands on banks may continue at near their recent pace. Borrowings in the commercial paper market, where costs currently are relatively attractive, are expected to continue to rise.

Outlook for supply of funds

Assuming no change in monetary policy, the supply of funds to the credit market through financial institutions is unlikely to grow more rapidly than in recent months. Interest rates sustained above their summer lows, and a continued reduced rate of personal savings, should serve to keep net inflows of funds into time and savings accounts at banks and thrift institutions, taken together, at a moderate pace.

Growth in time and savings deposits of banks has slowed somewhat in the past two months. There has been a sharp reduction in the rate at which banks have added to outstanding CD's once they had been rebuilt to earlier peak levels following the tax increase, accompanied by a partly offsetting acceleration in inflows of consumer-type time deposits. Meanwhile, net savings inflows to nonbank savings institutions have not shown any significantly greater expansionary tendency since the tax increase.

The continued modest pace of savings inflows to thrift institutions makes it unlikely that much further improvement can be expected in the rate of new mortgage commitments. Outstanding mortgage commitments, and expected takedowns, are already relatively large, as thrift institutions appear to have anticipated a somewhat better inflow of funds.

With little prospect in the near term for any further improvement in the supply of funds going into mortgages, and with mortgage demands remaining large, a further decline in home mortgage yields is unlikely, and some rise could develop. The rise in yields on alternative

bond market instruments during recent weeks has erased part of the previous improvement in relative attractiveness of mortgage investments. And unless there is a shift in the prevailing view that stocks are a better bet than bonds over the long run, prospects are that institutional and individual investors' buying patterns will tend to keep yields on debt instruments relatively high.

#### Balance of payments

During the fourth quarter of 1968, the liquidity deficit before special transactions is likely not to differ much from the average \$3-1/2 billion annual rate recorded during the first nine months of the year, and to be somewhat above the \$2-1/2 billion rate (preliminary) for the third quarter. An expected modest improvement in the trade balance seems likely to be offset by a shift toward less favorable flows of private U.S. and foreign nonliquid capital.

A deficit of \$3-1/2 billion for the year 1968 would represent some improvement compared with the record 1967 deficit of \$4.8 billion before special transactions, but would be larger than in any other year since 1960. The strong upsurge of merchandise imports since 1965 has had an impact on the trade balance that is proving very difficult to reverse, and the deficit has been held to its present level only by means of large inflows of foreign equity capital (into U.S. stocks) and controls over outflows of U.S. capital.

Reappraisal of the outlook for 1969, in the light of the recent greater-than-expected strength in the U.S. economy, still leads



to the conclusion that the liquidity deficit before special transactions will probably diminish somewhat further next year, but will remain large enough to constitute a serious policy problem.

The published liquidity deficit, which is being held below \$1-1/2 billion this year thanks to very large receipts from special official transactions, will probably increase next year as the scope for new special transactions narrows. The balance on the official settlements basis, which was in surplus during the spring and summer of 1968 when inflows of private foreign liquid funds were large, appears to have reverted to deficit in October and is likely to show a deficit next year.

## SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per Cent Change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Yrs. Ago*
Civilian labor force (mil.)	Sept '68	78.8	78.7	77.8	1.3	3.7
Unemployment (mil.)	"	2.9	2.8	3.2	-9.3	0.5
Unemployment (per cent)	"	3.6	3.5	4.1	---	---
Nonfarm employment, payroll (mil.)	"	68.5	68.3	66.1	3.5	6.1
Manufacturing	"	19.8	19.8	19.3	2.4	1.8
Other industrial	"	8.2	8.2	8.1	2.2	2.4
Nonindustrial	"	40.5	40.4	38.8	4.4	9.1
Industrial production (57-59=100)	"	163.4	163.9	156.8	4.2	3.4
Final products	"	164.6	164.6	157.0	4.8	5.1
Materials	"	162.0	162.9	156.7	3.4	1.5
Wholesale prices (57-59=100) <sup>1/</sup>	Aug '68	108.7	109.1	106.1	2.5	1.8
Industrial commodities (FR)	"	108.1	108.0	105.4	2.6	3.4
Sensitive materials (FR)	"	106.6	106.3	100.2	6.4	2.6
Farm products, foods & feeds	"	107.7	109.4	105.2	2.4	-3.2
Consumer prices (57-59=100) <sup>1/</sup>	"	121.9	121.5	116.9	4.3	7.1
Commodities except food	"	113.5	113.2	109.4	3.7	6.5
Food	"	120.5	120.0	116.6	3.3	4.1
Services	"	135.5	134.9	128.2	5.7	10.2
Hourly earnings, mfg. (\$)	Sept '68	3.03	3.02	2.85	6.3	10.2
Weekly earnings, mfg. (\$)	"	123.61	122.62	116.30	6.3	8.8
Personal income (\$ bil.) <sup>2/</sup>	"	698.6	694.1	637.0	9.7	17.1
Corporate profits before tax (\$ bil.) <sup>2/</sup>	QII '68	91.8	88.9	80.3	14.3	7.2
Retail sales, total (\$ bil.)		n.a.	n.a.	n.a.	n.a.	n.a.
Autos (million units) <sup>2/</sup>	Sept '68	8.9	8.9	7.6	17.1	6.2
GAF (\$ bil.)		n.a.	n.a.	n.a.	n.a.	n.a.
Selected leading indicators:						
Housing starts, pvt. (thous.) <sup>2/</sup>	Sept '68	1,598	1,514	1,445	10.6	52.5
Factory workweek (hours)	"	40.9	40.6	40.9	0.0	-1.0
New orders, dur. goods (\$ bil.)	Aug '68	26.8	26.6	25.9	3.5	6.5
New orders, nonel. mach. (\$ bil.)	"	4.8	4.9	4.5	7.0	12.4
Common stock prices (1941-43=10)	Sept '68	101.34	98.11	95.81	5.8	30.2
Manufacturers' Inventories, book val. (\$ bil.)	Aug '68	86.9	85.8	81.9	6.1	16.3
Gross national product (\$ bil.) <sup>2/</sup>	QIII '68	870.8	852.9	795.3	9.5	15.6
Real GNP (\$ bil., 1958 prices) <sup>2/</sup>	"	712.0	703.4	675.6	5.4	8.0

\* Based on unrounded data. <sup>1/</sup> Not seasonally adjusted. <sup>2/</sup> Annual rates.

n.a. Not available.

## SELECTED DOMESTIC FINANCIAL DATA

	Week ended	4-week	Last 6 months				
	Oct. 19	average	High	Low			
<b>Money Market <u>1/</u> (N.S.A.)</b>							
Federal funds rate (per cent) <u>2/</u>	5.79	5.90	6.42	5.59			
U.S. Treas. bills, 3-mo., yield (per cent)	5.35	5.25	5.82	4.96			
U.S. Treas. bills, 1-yr., yield (per cent)	5.34	5.24	5.99	5.10			
Net free reserves <u>2/</u> (\$ millions)	-178	-220	21	-551			
Member bank borrowings <u>2/</u> (\$ millions)	518	484	823	374			
<b>Capital Market (N.S.A.)</b>							
<b>Market yields (per cent)</b>							
5-year U.S. Treas. bonds <u>1/</u>	5.56	5.51	6.15	5.45			
20-year U.S. Treas. bonds <u>1/</u>	5.47	5.38	5.65	5.18			
Corporate new bond issues, Aaa adj. <u>8/</u>	6.57	6.50	6.83	6.13			
Corporate seasoned bonds, Aaa <u>1/</u>	6.10	6.05	6.29	5.95			
Municipal seasoned bonds, Aaa <u>1/</u>	4.22	4.20	4.42	3.80			
FHA home mortgages, 30-year <u>3/</u>	--	7.28	7.52	6.94			
Common stocks, S&P composite series <u>4/</u>							
Prices, closing (1941-43=10)	104.82	103.51	104.82	95.32			
Dividend yield (per cent)	2.90	2.95	3.14	2.90			
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	<b>Latest month</b>	<b>Amount</b>	<b>3-month average</b>	<b>Change from year earlier Latest 3-month month average</b>			
<b>New Security Issues (N.S.A., \$ millions)</b>							
Corporate offerings <u>5/</u>	Nov. '68 <u>e/</u>	1,100	1,142	+ 151 - 161			
State & local govt. public offerings	Nov. '68 <u>e/</u>	1,600	1,642	+ 199 + 403			
Comm. & fin. co. paper (net change in outstandings) <u>6/</u>	Aug. '68	+ 988	+ 772	+1,216 + 856			
<hr/>							
	<b>Latest month</b>	<b>Out-standings Latest month</b>	<b>Change Latest 3-month average</b>	<b>Annual rate of change from Pre-ceding month 3 months ago 12 months ago</b>			
<b>Banking (S.A.)</b>							
		(\$ billions)		(per cent)			
Total reserves <u>1/</u>	Sept. '68	26.40	- 0.04	0.19	- 1.6	9.0	6.5
Credit proxy <u>1/</u>	"	288.0	2.1	3.1	8.8	13.2	7.3
Bank credit, total <u>6/</u>	"	373.4	4.3	5.4	14.0	18.0	10.1
Business loans	"	92.5	0.5	0.7	6.5	9.3	9.7
Other loans	"	150.6	2.3	2.5	18.6	21.3	11.1
U.S. Govt. sec.	"	63.5	0.1	1.0	1.9	19.8	3.4
Other securities	"	66.9	1.5	1.2	27.5	22.1	15.9
Total liquid assets <u>1/</u> <u>6/</u>	"	687.7	4.0	5.4	7.0	9.6	7.6
Demand dep. & currency <u>1/</u>	"	189.3	- 0.9	0.6	- 5.7	4.1	5.7
Time & sav. dep., comm. banks <u>1/</u>	"	196.7	2.9	2.8	18.0	18.1	9.6
Savings, other thrift instit. <u>6/</u>	"	192.8	1.7	1.3	10.7	8.0	6.3
Other <u>6/</u> <u>7/</u>	"	108.9	0.3	0.7	3.3	7.9	9.3

N.S.A. -- not seasonally adjusted.

S.A. -- seasonally adjusted.

e. Estimated by F.R.B. 1/ Average of daily figures. 2/ Average for statement week ending Oct. 16. 3/ Latest figure is monthly average for Sept. 4/ End of week closing prices; yields are for Friday. 5/ Corporate security offerings include both bonds and stocks. 6/ Month-end data. 7/ U.S. savings bonds and U.S. Government securities maturing within 1 year. 8/ Adjusted to Aaa basis. 9/ Federal funds data are 7-day averages for week ending Sunday; latest figure is for week ending October 20. In prior reports, data were 5-day averages for week ending Friday.

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

	1 9 6 7				1 9 6 8			AUG.	SEPT.
	I	II	III	IV	I	II			
Seasonally adjusted									
Goods and services, net <u>1/</u>	1,293	1,269	1,359	848	356	492			
Trade balance <u>2/</u>	975	1,098	1,085	319	87	9		24	
Exports <u>2/</u>	7,661	7,703	7,626	7,478	7,924	8,302		2,871	
Imports <u>2/</u>	-6,686	-6,605	-6,541	-7,159	-7,837	-8,293		-2,847	
Services balance	318	171	274	529	269	483			
Remittances and pensions	-262	-392	-358	-263	-266	-280			
Govt. grants & capital <u>3/</u>	-1,176	-1,039	-988	-1,008	-1,164	-1,101			
U.S. private capital	-975	-1,104	-1,788	-1,638	-646	-1,230			
Direct investment	-653	-651	-902	-815	-374	-1,034			
Foreign securities	-259	-199	-476	-332	-385	-81			
Banking claims	79	-198	-435	95	364	204			
Other	-141	-56	24	-586	-251	-319			
Foreign capital, nonliquid	865	1,202	766	353	1,365	2,171			
Official foreign accts.	382	724	18	150	331	923			
Long-term deposits	304	584	-215	147	119	160			
U.S. Govt. liab.	78	140	233	3	212	763			
Int'l. institutions <u>4/</u>	70	97	117	30	-92	-19			
Other <u>5/</u>	413	381	631	173	1,126	1,267			
Errors and omissions	-250	-458	207	-34	-305	-222			
Balances, with and without seasonal adjustment (- deficit)									
Liquidity balance, S.A.	-505	-522	-802	-1,742	-660	-170			
Seasonal component	267	302	-410	-159	411	303			
Balance, N.S.A.	-238	-220	-1,212	-1,901	-249	133			
Official settlements									
balance, S.A.	-1,764	-806	247	-1,082	-535	1,459			
Seasonal component	485	101	-272	-314	629	102			
Balance, N.S.A. <u>6/</u>	-1,279	-705	-25	-1,396	94	1,561			
Reserve changes, N.S.A. (decrease -)									
Total monetary reserves	-1,027	419	375	181	-904	137	303	207	
Gold stock	-51	-15	-92	-1,012	-1,362	-22	-5	74	
Convertible currencies	-1,007	424	462	1,145	401	-267	294	136	
IMF gold tranche	31	10	5	48	57	426	14	-3	

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 institutions (except IMF) and by not counting as receipts (+) increases in certain nonliquid liabilities to foreign official institutions.

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THE ECONOMIC PICTURE IN DETAIL

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The Nonfinancial Scene

Gross national product. According to preliminary official estimates, the GNP rose at a rate of \$18 billion last quarter, much more vigorously than we had anticipated earlier on the basis of fiscal and monetary restraints. The rate of expansion in real GNP was close to 5 per cent, down only moderately from the over 6 per cent rate in the first half. The official figures also show a pronounced slowing in the rate of price increase, as indicated by the GNP deflator, from a 4.0 per cent annual rate in the second quarter to 2.9 per cent in the third quarter (excluding the effect of the Federal pay raise).

The official figures for the third quarter differ from our last projections in several major respects: consumer expenditures, inventory accumulation, and plant and equipment outlays were larger and, paradoxically, the rate of price advance was slower.

Some of the discrepancies between the official estimates and our recent projections are puzzling. For example, the vigor of retail sales and the leveling off in industrial production in the third quarter, and an anticipated run-off in steel stocks would have suggested that our estimate of the inventory buildup was too large rather than too small. Since the inventory estimate included in the preliminary official GNP estimate is based on only two months' data, it may be that September data and subsequent revisions will cast a different light on the picture.

Similarly, the marked slowing shown in the consumer price component of the GNP rise is puzzling. Some of the factors involved are discussed in the price section later. Our evaluation is that the slowing which occurred is partly attributable to special factors, and that a somewhat faster rise will be resumed this quarter.

There is less reason to be skeptical of the figures showing a strong rise in personal consumption expenditures. Retail sales jumped in July, edged up further in August and held at that advanced level in September. While our earlier estimates had been premised on the assumption that consumers would adjust initially to the tax increase by dipping into the very high savings stream, that adjustment was larger than expected. The decline in the saving rate was 1.3 points (from a revised second quarter rate) to 6.2 per cent. In addition--because of a higher rate of inventory accumulation, the rise in fixed investment, and the multiplier effects of buoyant consumer buying--the flow of disposable income was better maintained than we had expected earlier.

Because of the unexpected strength of final demand last quarter we have increased our fourth quarter estimate of the rise in GNP to \$15 billion, still moderately below the third quarter increase. Growth in real GNP is expected to fall from an annual rate of 5 per cent to a rate of 3-1/2 per cent.

Gains in business investment and Government spending are both expected to slow somewhat in this quarter, and although residential outlays will rise substantially, the major source of further expansion is likely to be consumption expenditures. The rise in consumer spending

last quarter would have been unusually large even without the effects of the surcharge, which reduced the expansion in disposable income to about a \$6 billion annual rate--about half the rise in the preceding quarter. But the dip in the rate of saving was also unusually sharp, dropping the level well below those prevailing in the preceding two years, partly as a result of near-record sales of automobiles.

The increase in consumption appears likely to be more modest this quarter. There are two considerations which suggest that the saving rate is not likely to continue downward in the fourth quarter. One is that the flow of disposable income will rise again, and the second is that a further rise in auto sales seems unlikely after the third quarter spurt--in fact, some decline in unit sales if not in expenditures for autos seems more likely. If durable goods sales level off, the saving rate should also tend to stabilize, even if the generous further increase in expenditures for nondurable goods and services we have assumed occurs.

Consumer-type inventories are likely to be stock-piled at a higher rate this quarter if sales rise more slowly than in the third quarter. Our projected level of nonfarm inventory investment of \$7.6 billion in the fourth quarter implies gross accumulation of \$9.5 or \$10 billion, apart from the run-down of steel stocks.

Last quarter there was little change in expenditures for new homes, reflecting in part the lower level of starts in the second quarter. The current quarter should see a relatively sharp advance,

however, since the rate of starts rose by over 100,000 units to 1.55 million units last quarter. While some decline in starts might reasonably follow this spurt, we believe that housing demand will remain strong and should sustain starts at a rate of 1.5 million or more for the quarter.

Expenditures for new plant and equipment are expected to rise by about one billion dollars this quarter following a rise of over \$3 billion last quarter. However, one-half of the third quarter increase reflected a recovery from a second quarter dip. Outlays for automobiles for business use and for farm equipment were strong last quarter, adding to the rise in fixed business investment previously forecast in the survey of investment intentions. Fleet and other business sales of autos will probably remain high in the current period.

In the Government sector, Federal spending responded somewhat more promptly and drastically to the Budget cuts required by the Revenue and Expenditure Control Act than we had thought likely. Both defense and nondefense purchases leveled off following the Federal pay raise in July, and, outside a jump of a half billion dollars in the nondefense category as CCC purchases accelerate this quarter, little change is expected.

Corporate profits before tax have been maintained near the first quarter peak rate owing to the unexpectedly strong business picture. With the continued strong rise in personal income, and the surtax, Federal receipts rose at an annual rate of about \$10 billion



last quarter and the deficit is estimated to have dropped very sharply-- from over \$10 billion to \$3.5 billion or possibly less. It should remain close to this rate in the current period as both receipts and expenditures increase moderately.

State and local government outlays are continuing to grow as employment and wage rates continue a strong upward trend. However, a slowing in the rise in Federal grants is expected to exert a drag on State-local purchases in the current 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)

	1967	1968 Proj.	1967		1968			Proj. IV
			III	IV	I	II	III	
Gross National Product	789.7	860.2	795.3	811.0	831.2	852.9	870.8	885.8
Final sales	783.6	853.0	789.9	802.7	829.1	842.1	863.1	877.7
Private	605.2	656.0	610.3	619.2	638.6	646.4	663.6	675.2
Personal consumption expenditures	492.2	534.6	495.5	502.2	519.4	527.9	541.3	549.6
Durable goods	72.6	82.7	73.1	74.2	79.0	81.0	85.3	85.5
Nondurable goods	215.8	231.0	216.4	218.4	226.5	228.2	232.7	236.4
Services	203.8	220.9	205.9	209.6	213.9	218.7	223.3	227.7
Gross private domestic investment	114.3	126.3	114.7	121.8	119.7	127.3	127.4	130.5
Residential construction	24.6	29.8	26.0	28.5	29.1	29.5	29.4	31.2
Business fixed investment	83.6	89.3	83.3	85.0	88.6	87.0	90.2	91.2
Change in business inventories	6.1	7.2	5.3	8.3	2.1	10.8	7.7	8.1
Nonfarm	5.6	6.8	4.8	7.1	1.6	10.4	7.6	7.6
Net Exports	4.8	2.3	5.4	3.4	1.5	2.0	2.6	3.2
Gov't. purchases of goods & services	178.4	197.1	179.6	183.5	190.5	195.7	199.5	202.5
Federal	90.6	100.1	91.3	93.5	97.1	100.0	101.1	101.9
Defense	72.4	78.9	72.9	74.6	76.8	79.0	79.7	80.0
Other	18.2	21.2	18.4	19.0	20.3	21.0	21.4	21.9
State & local	87.8	97.0	88.4	90.0	93.4	95.6	98.4	100.6
Gross national product in constant (1958) dollars	673.1	706.5	675.6	681.8	692.7	703.4	712.0	718.0
GNP implicit deflator (1958=100)	117.3	121.7	117.7	118.9	120.0	121.2	122.3	123.4
Personal income	628.8	685.5	633.7	645.2	662.7	678.1	694.0	707.0
Wages and salaries	423.4	463.2	426.3	436.4	448.3	457.6	468.6	478.3
Disposable income	546.3	589.1	550.0	559.6	574.4	586.3	592.6	602.9
Personal saving	40.2	40.1	40.5	43.4	40.8	44.0	36.8	38.6
Saving rate (per cent)	7.4	6.8	7.4	7.8	7.1	7.5	6.2	6.4
Corporate profits before tax	81.6	90.7	80.8	85.4	88.9	91.8	91.0*	91.0
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	151.2	176.1	152.2	156.4	166.6	171.8	181.4*	184.5
Expenditures	163.6	182.4	165.1	168.6	175.1	181.9	184.8	187.8
Surplus or deficit (-)	-12.4	-6.3	-12.9	-12.2	-8.6	-10.2	-3.4*	-3.3
Total labor force (millions)	80.8	82.4	81.1	81.6	81.9	82.2	82.4	82.9
Armed forces "	3.4	3.6	3.5	3.5	3.5	3.5	3.6	3.6
Civilian labor force "	77.3	78.8	77.6	78.2	78.4	78.7	78.8	79.3
Unemployment rate (per cent)	3.8	3.6	3.9	3.9	3.6	3.6	3.6	3.8
Nonfarm payroll employment (millions)	66.0	68.1	66.1	66.7	67.4	67.8	68.3	68.7
Manufacturing	19.4	19.7	19.3	19.5	19.6	19.7	19.8	19.7
Industrial production (1957-59=100)	158.0	164.0	157.2	159.5	162.1	164.0	164.3	165.5
Capacity utilization, manufacturing (per cent)	85.3	84.0	84.3	84.7	84.9	84.8	83.4	82.9
Housing starts, private (millions A.R.)	1.29	1.50	1.41	1.45	1.50	1.44	1.55	1.52
Sales new domestic autos (millions, A.R.)	7.57	8.59	7.57	7.44	8.19	8.44	8.98	8.75

\* Projected.

CHANGES IN GROSS NATIONAL PRODUCT  
AND RELATED ITEMS

	1967	1968 Proj.	1967		1968			Proj. IV
			III	IV	I	II	III	
-----In billions of dollars-----								
Gross National Product	42.1	70.5	15.1	15.7	20.2	21.7	17.9	15.0
Final sales	50.8	69.4	11.9	12.8	26.4	13.0	21.0	14.6
Private	28.6	50.8	9.6	8.9	19.4	7.8	17.2	11.6
GNP in constant (1958) dollars	16.0	33.4	6.4	6.2	10.9	10.7	8.6	6.0
Final sales	24.0	32.8	3.5	3.4	16.9	2.8	11.5	5.6
Private	9.8	24.4	3.1	2.8	12.4	0.1	10.7	5.0
-----In Per Cent Per Year-----								
Gross National Product	5.6	8.9	7.7	7.9	10.0	10.4	8.4	6.9
Final sales	6.9	8.9	6.1	6.5	13.2	6.3	10.0	6.8
Private	5.0	8.4	6.4	5.8	12.5	4.9	10.6	7.0
Personal consumption expenditures	5.7	8.6	4.2	5.4	13.7	6.5	10.2	6.1
Durable goods	3.0	13.9	-1.6	6.0	25.9	10.1	21.2	0.9
Nondurable goods	4.4	7.0	2.0	3.7	14.8	3.0	7.9	6.4
Services	8.2	8.4	8.5	7.2	8.2	9.0	8.4	7.9
Gross private domestic investment	-5.4	10.5	26.4	24.8	-6.9	25.4	0.3	9.7
Residential construction	-0.8	21.1	58.1	38.5	8.4	5.5	-1.4	24.5
Business fixed investment	2.8	6.8	2.9	8.2	16.9	-7.2	14.7	4.4
Gov't purchases of goods & services	14.2	10.5	5.2	8.7	15.3	10.9	7.8	6.0
Federal	17.1	10.5	5.8	9.6	15.4	11.9	4.4	3.2
Defense	19.5	9.0	4.4	9.3	11.8	11.5	3.5	1.5
Other	8.3	16.5	11.2	13.0	27.4	13.8	7.6	9.3
State & local	11.4	10.5	5.5	7.2	15.1	9.4	11.7	8.9
GNP in constant (1958) dollars	2.4	5.0	3.8	3.7	6.4	6.2	4.9	3.4
Final sales	3.7	4.9	2.1	2.0	10.0	1.6	6.6	3.2
Private	1.9	4.6	2.4	2.1	9.3	0.1	7.9 <sup>1/</sup>	3.6
GNP implicit deflator	3.1	3.8	3.8	4.1	3.7	4.0	3.5 <sup>1/</sup>	3.5
Personal income	7.2	9.0	7.8	7.3	10.8	9.3	9.4	7.5
Wages and salaries	7.3	9.4	8.3	9.5	10.9	8.3	9.6	8.3
Disposable income	6.8	7.8	6.3	7.0	10.6	8.3	4.3	7.0
Corporate profits before tax	-4.7	11.2	2.5	22.8	16.4	13.0	-3.5 <sup>2/</sup>	0.0
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	5.7	16.5	10.8	11.0	26.1	12.5	22.3 <sup>2/</sup>	6.8
Expenditures	14.9	11.5	8.9	8.5	15.4	15.5	6.4	6.5
Nonfarm payroll employment	3.1	3.2	2.4	3.6	4.2	2.4	2.9	2.3
Manufacturing	1.0	1.5	-2.1	4.1	2.0	2.0	2.0	-2.0
Industrial production	1.1	3.8	3.3	5.9	6.5	4.7	0.7	2.9
Housing starts, private	10.9	16.3	65.9	10.8	15.5	-16.3	30.0	-7.2
Sales new domestic autos	-9.7	13.5	-26.6	-6.9	40.6	12.0	25.6	-10.2

<sup>1/</sup> Excluding Federal pay increase, 2.9 per cent.    <sup>2/</sup> Projected.

Industrial production. Industrial production, following a 1.3 per cent decline from July to September, probably rose slightly in October. Steel production, which was severely curtailed in August and September and which was the major cause for the decline in the total index, turned up in early October. Auto schedules for October indicate a new high in output for the year. Under the impetus of the advanced level of retail sales, production of some other consumer goods should be maintained or increase moderately. Output of business equipment is estimated to remain at about its present level. The decline in coal production because of strikes may be about offset by increases in some other nondurable materials.

In 1968, the total index, excluding steel, rose from January to July at an annual rate of 4.6 per cent, followed by a leveling off during August and September, as shown in the table.

INDUSTRIAL PRODUCTION  
MAJOR MARKET GROUPINGS  
(1957-59 = 100)

	Jan.	June	1968 July	Aug.	Sept. <sup>P</sup>
Total index, excl. steel	162.8	166.3	166.6	166.7	166.7
Consumer goods	151.3	156.4	156.2	156.5	156.7
Equipment, incl. defense	181.4	183.0	182.3	181.8	181.8
Materials, excl. steel	165.3	168.5	168.7	168.5	168.4

p-preliminary

On a quarterly average basis, the production index, again excluding steel, rose from the first quarter to the second quarter, and

again in the third quarter. As shown in the table below, the increase from the first quarter to the third quarter was at an annual rate of 3.8 per cent. Gains in output in this period, while they were widespread among consumer goods, were sparked by a 20 per cent increase in auto production. Growth in output of consumer staples has been in line with its long run trend, but the rates of increase in production of apparel and home goods have been below their usual trends. Output of defense equipment leveled off in the second quarter but rose substantially in the third quarter. Production of business equipment, however, has edged downward so far in 1968. In terms of their long-term growth rates, output of durable materials excluding steel has been below its trend and production of nondurable materials has been on its trend.

INDUSTRIAL PRODUCTION  
QUARTERLY AVERAGES

	1968			Per cent change Q I to Q III (annual rates)
	Q I (1957-59 = 100)	Q II	Q III	
Total index	162.1	164.0	164.3	2.8
Total, excl. steel	163.6	165.1	166.7	3.8
Consumer goods	153.1	154.8	156.5	4.4
Autos	164.6	177.5	181.2	20.0
Home goods & apparel	153.2	152.5	154.4	.9
Business equipment	183.2	182.6	182.4	-.8
Defense equipment	176.2	176.7	180.7	5.2
Materials	162.1	164.8	163.9	2.2
Durables	155.7	158.7	154.7	- 1.2
Excl. steel	160.3	162.1	163.0	3.4
Steel	137.6	146.0	122.3	-22.2
Nondurables	168.7	171.1	173.5	5.6

Capacity utilization. The rate of manufacturing capacity utilization declined to 82.6 per cent in September from 83.1 per cent in August. If manufacturing production increases somewhat in October as now expected, the operating rate will show little change. At its present level the utilization rate is more than 2 points below its second quarter average, but about two-thirds of this decline was accounted for by steel.

The industry pattern of operating rates remains about the same as in other recent months. Utilization rates appear to be above normal in the motor vehicle, rubber, petroleum, and aircraft industries. Unused capacity exists for the production of most other manufacturing products.

CAPACITY UTILIZATION RATES  
(per cent)

Industry	1967		1968					
	QIII	QIV	QI	QII	QIII	Aug.	Sep.	Oct. (e)
Manufacturing	84.3	84.7	84.9	84.8	83.4	83.1	82.6	82.6
Primary processing industries	83.0	85.3	85.5	86.4	83.6	82.8	81.9	--
Advanced processing industries	85.2	84.3	84.4	83.6	83.3	83.4	83.0	--

(e) - estimated

Retail sales. The total value of retail sales in September showed no change from the high August level, according to the advance release. Durable goods stores enjoyed a 2 per cent month-to-month gain,

while sales of nondurable goods declined 1 per cent. Over-the-year, total sales in September were up about 8 per cent.

The latest Census release is the first to reflect a new sample of retailers. According to these revised data, month-to-month increases in sales were larger in May and June, but smaller in July, than had been indicated by the old sample. The new figures, in contrast to the old, show a sizable further increase in August, and sales from July through September now average about 3 per cent above the second quarter. Revised data for the entire sample overlap period beginning in August 1967 are not yet available.

VALUE OF RETAIL SALES

	Per Cent Change from Previous Month	
	New sample	Old sample
March	+2.3	+2.6
April	-1.7	-1.8
May	+1.7	+1.4
June	+1.3	+1.1
July	+1.1	+2.4
August	+1.0	+0.3
September	0	

Unit sales and stocks of autos. Sales of new domestic autos in the first 20 days of October imply a seasonally adjusted annual rate for the month of about 8.7 million units, well above the strike-reduced level of 7.6 million units a year earlier and close to the high third quarter rate. Stocks of new domestic autos changed little in this period and represented a 48 days supply at the current sales rates, down from the 50 days average supply in the first 9 months of this year.

Consumer credit. The amount of consumer installment credit outstanding continued to increase rapidly in September. Early reports from commercial banks, however, suggest an increase at a seasonally adjusted annual rate of only around \$8 billion. While this rate would be well above the average increase so far this year, it would represent a sizable decline from August--when a combination of rapid new borrowing plus a slower rate of repayments pushed the expansion of installment credit outstanding to an all time record annual rate of over \$10 billion.

Business inventories. Retail and wholesale inventories declined nearly \$400 million (book value) in August, while retail and wholesale sales increased somewhat. The trade inventory cut-back partly offset the large August rise in factory stocks, and for manufacturing and trade combined the increase in stocks amounted to \$650 million, about in line with the third quarter GNP nonfarm inventory investment estimate.

CHANGE IN BOOK VALUE OF INVENTORIES  
(millions of dollars; seasonally adjusted)

	1968		
	Q II (monthly average)	July	August(p)
Total manufacturing & trade	1,154	522	650
Manufacturing	608	247	1,028
Durable goods	382	19	681
Nondurable goods	226	228	347
Trade	546	275	-378
Wholesale	160	72	-180
Retail	386	203	-198

(p) - preliminary



Manufacturers' orders and shipments. New orders received by durable goods manufacturers rose 3.2 per cent in September, back to the peak reached at the end of last year. The rise shown for August has been revised up somewhat, to 1.5 per cent.

The September rise reflected large gains in orders for machinery and for all other major durable goods industries except aircraft and shipbuilding, which were down sharply. Aircraft orders, which had risen about 5 per cent in August, were off 26 per cent in September.

Shipments by durable goods manufacturers in September rose 4.4 per cent following a decline now shown at nearly 5 per cent for August (after upward revisions of July and August figures). Shipments of all producers, except electrical machinery, rose in September.

Unfilled orders of durable goods producers as a group were about unchanged from August, despite a decline in the aircraft backlog due to the sharp drop in new orders.

Residential construction and real estate. Seasonally adjusted private housing starts--already unexpectedly high--rose in September to a 1.6 million unit rate. This was a new peak for the year and brought the average for the third quarter to 1.55 million, nearly 8 per cent above the reduced second quarter average and 3 per cent higher than the advanced rate in the first quarter. As a result, the average for all three quarters reached 1.50 million, somewhat above the level for all of 1965.

Unlike August, single family starts led the September increase, but multifamily starts also moved higher to match the near-record high reached last April. Regionally, the Northeast and West accounted for almost all of the total rise.

Seasonally adjusted building permits, which were revised upward by 4 per cent for August also increased in September, to the highest rate since last March. The advance was mainly in multifamily units, however. While the rate of total permits dropped by 10 per cent in the Northeast, they rose in all other regions by amounts ranging from 9 per cent in the South to 18 per cent in the North Central states.

PRIVATE HOUSING STARTS AND PERMITS

	September 1968 (Thousands of units) <u>1/</u>	<u>Per cent change from</u> August 1968/September 1967	
Starts	1,598	+ 6	+11
1 - family	931	+ 8	+ 1
2 - or-more-family	667	+ 2	+28
Northeast	303	+20	+ 1
North Central	346	+ 1	+ 8
South	619	- 1	+11
West	330	+13	+23
Permits	1,405	+ 9	+18
1 - family	697	+ 4	+ 5
2 - or-more-family	708	+15	+35

1/ Seasonally adjusted annual rates; preliminary.

Altogether, the third quarter starts performance was appreciably stronger than could be expected from the rate of net savings inflows realized so far this year by major lenders. Pent-up demands accumulated over most of the past three years and general expectations of further increases in construction costs and property values were, of course, important factors in this development. But these factors were already in operation earlier this year. Lender expectations of improved availability of mortgage funds aroused by the fiscal package which was finally passed last June has contributed to the upturn, as has the apparent confirmation of easier mortgage market conditions through most of the quarter. Of key importance, however, has been the improved inter-regional flow of mortgage funds resulting from the upward adjustment in usury ceiling rates, which were long-anticipated and which culminated in early July. The major impact of this change was concentrated in the Northeast states, and this region alone accounted for as much as seven-tenths of the over-all expansion in the rate of starts from the second to the third quarter of this year.

Sustaining the third quarter rate for an extended period would seem to require further improvement in net savings inflows to major lenders. Meanwhile, however, indications are that residential builders have been helped both directly and indirectly by increased reliance of the real estate market as a whole on equity financing and other sources of funds outside regular mortgage market channels. (See the section on mortgage market developments.) Moreover, lenders

apparently have based their willingness to make a large volume of commitments on expectations that further improvements in funds-flows will come in time to meet future take-downs, particularly for multifamily structures, which have relatively long construction periods. Under these circumstances, while some decline in starts after the unexpectedly sharp third quarter advance may develop, it may not be appreciable. Thus, starts in the fourth quarter as a whole could hold fairly near the advanced annual rate of 1.55 million units in the third quarter.

Personal income. Reflecting advances in all types of income, personal income rose by \$4-1/2 billion in September to an annual rate of \$698-1/2 billion. Because of a slower rise in transfer payments and dividends, the over-all advance was somewhat below those of July and August.

Wage and salary income--which rose \$3 billion to \$471-3/4 billion--continued to increase at about the same rapid pace as in July and August. Approximately half the September increase occurred in the commodity-producing industries, where manufacturing posted an increase of 3/4 of a billion after rising by less than half that amount in August. Construction payrolls increased substantially for the first time since February as a large number of workers returned to work after extended strikes.

For the third quarter as a whole, wage and salary payments averaged \$468.6 billion at annual rates, up by \$11 billion from the second quarter. The rate of increase was up from the second quarter in the government sector largely because of the Federal pay raise.

INCREASES IN WAGE AND SALARY PAYMENTS  
(In per cent)

	QIV 1967 to QI	QI 1968 to QII	QII to QIII 1968
Total	2.7	2.1	2.4
Private	2.8	2.0	2.1
Government	2.4	2.4	3.4

The rapid rate of increase in wage and salary payments primarily reflects the strong uptrend in wage levels rather than substantial employment gains. Contractual wage increases have been very high this year and, in the first half, compensation per manhour in the private economy rose by over 7 per cent from a year earlier. Increases in wage and salary rates accounted for an estimated two-thirds of the over-all increase in gross wage and salary payments between the first nine months of 1967 and the comparable period in 1968, while employment increases accounted for about one-third. With the end of a major bargaining round in typically high wage durable goods manufacturing, and some anticipated easing in the demand for labor, the rate of increase in gross wage and salary payments should ease somewhat in coming quarters.

Industrial relations. The heavy collective bargaining schedule of 1968 involving close to 4 million workers has about reached its end. Still outstanding is a settlement in the negotiations between longshoremen and East and Gulf Coast shippers where an 80-day Taft-Hartley injunction was obtained enjoining the union from a strike until December 20. In the 1965 negotiations the union resumed their strike for 33 days at the end of a similar injunction period before agreement was reached on a new contract.

A contract settlement was reached October 14 between the Bituminous Coal Operators and 80,000 miners ending wildcat strikes which began October 1. The contract provided above average annual wage increases but the fringe increases were relatively low, so that the

average annual increase in employment costs is estimated to be in line with the 6 to 6-1/2 per cent average package increase negotiated this year. The wage increase alone averaged 8 per cent over the life of the contract compared with a 5 per cent average in other major contracts. The first-year increase of 10 per cent in wages was also well above the pattern of 7-1/2 per cent average increases in other major contract settlements this year.

Fewer workers will be affected by wage reopenings next year in collective bargaining agreements--about 2-3/4 million workers compared to almost 4 million this year. Deferred wage increase, or increases negotiated in contract settlements in 1968 or earlier years, will play a much more important role. More than 5-1/2 million workers will receive deferred increases in the 4 to 4-1/2 per cent range in 1969.

Labor market. Demands for labor continued relatively strong as the economy entered the fourth quarter. The unemployment rate edged up to 3.6 per cent in September, equal to its average thus far in 1968, and continued near frictional levels for adult men (2.2 per cent). Reflecting the firm employment picture through mid-October, insured unemployment remained well below year-earlier levels as it has all year.

Despite the firm over-all picture, there were some signs of easing in September. The rate of increase in nonmanufacturing employment appeared to be slowing from its July-August pace, manufacturing employment showed a very small decline for the third consecutive month, and labor force growth continued to lag, contributing to the maintenance of low unemployment.

After making allowances for employment increases resulting from reduced strike activity--mainly in construction--nonfarm payroll employment rose by about 95,000 in September. As in other recent months, the bulk of the increase was in the nonindustrial sector where employment was up 80,000 over the month. Employment gains were relatively small in trade--where retail sales held steady over the month--and in State and local government. Reflecting legislative restrictions on replacement hiring, Federal Government employment dropped another 13,000 to a level nearly 60,000 below its June peak.

The pattern of more moderate employment growth represents a continuation of the slower growth which emerged in the second quarter of this year. Although the June-to-September increase in nonfarm employment was nearly the same as in the previous three-month period, the composition was appreciably different. Employment has been unusually stable in manufacturing this summer, following a sharp gain between March and June. Federal civilian employment has declined since June. In contrast, trade, services, and State and local government employment rose more rapidly from June-September than in the three previous months and the downtrend in construction employment gave way to a moderate increase.



CHANGES IN NONFARM PAYROLL EMPLOYMENT  
(In thousands, seasonally adjusted)

	December 1967 to March 1968	March to June 1968	June to September 1968
Total	596	430*	372*
Manufacturing	14	170	-25
Construction	55	-109*	12*
Trade	206	87	113
Finance and service	121	76	174
Government			
State and local	155	102	113
Federal	9	77	-57

\* Adjusted to exclude the effect of strikes in construction.

The factory workweek bounced back up to 40.9 hours in September--about the previous high for the year--after dipping sharply in August. A late model changeover in autos dropped the workweek in the transportation equipment group by nearly 1 hour in August, then pushed it up by the same amount in September. In primary metals, where the steel inventory adjustment problem has generated only modest layoffs, average weekly hours were down 2 full hours from the April peak.

Labor force growth continued at a sub-normal rate in September. At 78.8 million, the work force was only slightly higher than 6 months ago and was up only 1 million from a year earlier. This year-to-year increase was about 400,000 short of the expected "normal" rise. The pattern of slower growth--which reduces the competition for jobs and can arise from any number of forces including easier labor demand--was not concentrated in any particular age-sex group. The recent smaller increases in the labor force have paralleled the more moderate employment advances of recent months and have been partially responsible for the maintenance of low unemployment levels this summer.

CIVILIAN LABOR FORCE  
(Seasonally adjusted)

	Level	Change from previous quarter	Unemployment rate
		(In thousands)	(In per cent)
<u>1967</u>			
III	77,633	790	3.9
IV	78,178	545	3.9
<u>1968</u>			
I	78,418	240	3.6
II	78,658	240	3.6
III	78,835	177	3.6

Consumer prices. As pointed out in the October 2 Greenbook, the rise in consumer prices slowed appreciably over the 3-month period from May to August, after allowing for usual seasonal changes in retail prices of commodities (especially foods) and after setting aside the sharp spurt in mortgage interest charges as measured in the CPI. The abrupt jump in mortgage interest between May and August was a special-- and presumably temporary--phenomenon of dubious relevance to the underlying course of "consumer prices"; it was not reflected in (GNP) consumption expenditures nor in the implicit price deflator for consumption expenditures.

Slowing of the rise in consumer prices during the summer months has been confirmed by the preliminary (and confidential) OBE estimates of the implicit deflator for consumption expenditures in the third quarter. No additional CPI data have become available since the

last Greenbook; the CPI for September will be released early next week. The deflator for consumption expenditures is, of course, based primarily on the CPI.<sup>1/</sup> The present third quarter deflator thus involves price estimates for September.

Comparison of quarterly movements of the CPI and the PCE deflators cannot be made accurately at aggregate levels because of internal differences in weights, coverage, and (probably) seasonal measurement. However, a rough comparison is provided in the table below for the first three quarters of this year. In developing the CPI figures shown in the upper tier of the table, a few major weight and coverage adjustments have been made to partially adapt the CPI changes to PCE concepts. (Changes in the regularly published CPI [not seasonally adjusted] are shown--for comparison--as the first item in the table.) The third quarter changes shown for the CPI--like those for the PCE deflators--incorporate estimates for September.

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<sup>1/</sup> In the base year (1958) for the constant dollar GNP figures, two-thirds of the individual components of aggregate consumption expenditures were deflated by CPI series. Conversely, of course, it is of interest that one-third of the PCE deflators were based on other price series not included in the CPI.

CHANGES IN CONSUMER PRICES  
(per cent changes in seasonally adjusted data at annual rates)

	1968		
	QI	QII	QIII <sup>pe</sup>
Regularly published CPI	4.1	4.7	5.0
A. Based on CPI components:			
1) "CPI" adjusted <u>1/</u>	4.8	4.3	3.3
a) Durable goods <u>2/</u>	3.3	2.0	1.8
b) Nondurable goods <u>3/</u>	4.5	4.5	3.0
c) Services <u>4/</u>	5.6	5.0	4.2
B. Implicit deflators, personal consumption expenditures:			
1) Aggregate PCE	3.8	4.1	2.4 <sup>5/</sup>
a) Durable goods	2.0	2.0	0.8 <sup>5/</sup>
b) Nondurable goods	4.2	4.2	2.8 <sup>5/</sup>
c) Services	4.5	5.1	3.8 <sup>5/</sup>

- 1/ "CPI" is calculated by combining the 3 sub-series below with weights based on durable-nondurable service breakdown of personal consumption expenditures in QIV 1967.
- 2/ BLS series for new cars and for other durables (excluding used cars and home purchase) combined with QIV 1967 PCE weights.
- 3/ Regularly published BLS series, including food away from home and newspapers, magazines, and books.
- 4/ Excluding mortgage interest charges. Not seasonally adjusted because series is assumed to show no seasonal variation.
- 5/ Confidential.

The rise in consumer prices slackens much more abruptly in the third quarter when measured by the implicit deflator for PCE than by the CPI. This difference is concentrated to a large degree in the durable goods sector, and it may relate partly to the spurt in auto sales in the third quarter which was apparently accompanied by no change in new car prices (as indicated by the BLS seasonally adjusted

series).<sup>1/</sup> The third quarter decline in the rate of increase in service prices was also more pronounced in the implicit PCE deflator than in the CPI series. The downward shift in the rise in average prices of nondurable goods in the third quarter reflected primarily the near leveling off in food prices following the sharp rise over the preceding 6 months.

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<sup>1/</sup> The implicit deflator incorporates current period weights (the Paasche formula), whereas the CPI incorporates base period weights (Laspeyre).

Wholesale prices. Final BLS data have confirmed the preliminary estimate of an 0.3 per cent increase in wholesale prices of industrial commodities in September (Confidential until release, probably October 29). Average prices of farm products and processed foods and feeds also rose as estimated--with a 29 per cent jump in egg prices accounting for over 2/3 of the increase--and the total wholesale price index was up 0.4 per cent to 109.1 per cent of the 1957-59 average.

Increases for steel mill products and for lumber and plywood were larger than estimated by the BLS a month ago, and these three materials accounted for half of the rise in the industrial average. The lumber and plywood price advances (coupled with sizable further increases in prices of manmade fiber broadwoven goods and hides and skin) resulted in a large further rise in the FR index of sensitive industrial materials--to a level almost 1-1/2 per cent above the low reached in June. Average prices of steel mill products increased 2.3 per cent, contributing to an abrupt, 0.4 per cent step-up in the FR index of "other" (sluggish) materials, which had been stable for four months. With the September advance, prices of steel mill products have increased 4.7 per cent since mid-1967--more than over the preceding 6 years.

While steel and lumber-plywood were the major elements in the renewed pick-up in industrial prices in September, prices of many other items also rose. Altogether nine of the thirteen major sub-groups of the BLS industrial commodity total showed increases, and among the

225 industrial product classes price increases were effected for 106-4 or 47 per cent. The latter figure compares with this year's low of 39 per cent in July, when the BLS industrial average was unchanged, and with the year's high of 58 per cent in February, when the industrial index increased 0.5 per cent.

The bulk of the industrial price increases were for materials. The special FR index for industrial products increased only 0.1 per cent; average prices of producers' equipment (particularly machinery) rose 0.3 per cent--the largest rise since April--while prices of consumer products remained unchanged for the third month. Price increases for 1969 model autos (averaging 1.2 per cent, as compared with 2 per cent a year ago on 1968 models) will appear in the October index and will act to raise both the producer and consumer product indexes.

WHOLESALE PRICES OF INDUSTRIAL COMMODITIES  
(Special FR groupings based on BLS data; 1957-59=100)

	1968			
	June	July	August	September <sup>1/</sup>
All industrial commodities	107.9	108.0	108.1	108.4
Materials	106.4	106.5	106.6	107.0
Sensitive	105.9	106.3	106.6	107.4
Other	106.8	106.8	106.8	107.2
Products	109.9	110.0	110.0	110.1
Consumer nonfoods	107.5	107.5	107.5	107.5
Producers' equipment	115.1	115.2	115.4	115.7

<sup>1/</sup> Confidential until release of wholesale price index by BLS probably on October 29.

Farm debt in mid-1968. Total debt of farm operators increased 9 per cent during fiscal 1967-68, to an estimated \$53 billion on June 30, 1968. The percentage increase was the same as in the preceding year, and a little less rapid than the average annual rise for the period since 1963. Debt secured by farm real estate rose faster than non-real-estate debt, the opposite of the growth pattern in fiscal 1966-67.

In fiscal 1967, expansion in farm real estate debt was dampened by lender policies limiting loans for longer term purposes and giving priority to loans for essential non-postponable financing of productive farm operations. In fiscal 1968, and so far in fiscal 1969, lenders, because of direct and indirect effects of tight credit, have continued to screen loans very carefully, but farmers may have sought credit a little less aggressively because of discouraging income prospects and high interest rates. Demand for non-real-estate credit, although raised by a continued advance in operating costs have probably been softened a little by cutbacks in 1968 acreages of some crops and by larger direct payments to farmers associated with these cutbacks.

Growth in non-real-estate debt owed by farmers to all the major lenders was less in fiscal 1968 than in the preceding year. Loans outstanding of the production credit associations and related livestock associations showed the largest increase and loans of the Farmers Home Administration, the least. Loans outstanding at commercial banks, the largest lender of non-real-estate secured loans to farmers, increased 7 per cent.



Real estate secured loans outstanding increased 10 per cent in fiscal 1968 with commercial banks and Federal land banks showing increases of 15 and 13 per cent, respectively. Farmers Home Administration holdings of direct loans decreased 8 per cent. However, Farmers Home Administration holdings of insured farm ownership and rural housing loans increased 41 per cent, an aggregate increase of \$750 million. In fiscal 1968, the agency, under its authority to insure loans and to make loans to be sold and insured, sold nearly a billion dollars worth of insured loan paper directly to private investors, such as pension funds and banks, and to brokers for resale. These insured loans are not included in the debt totals shown in the table except for amounts held in the farm real estate portfolios of commercial banks. Increased investment in Farmers Home Administration insured loans by commercial banks during fiscal 1968 may account for some of the sharp rise in farm real estate loans of banks shown in the table.

**INDEBTEDNESS OF FARM OPERATORS IN MID-1968**  
Amounts Outstanding by Security and Credit Source

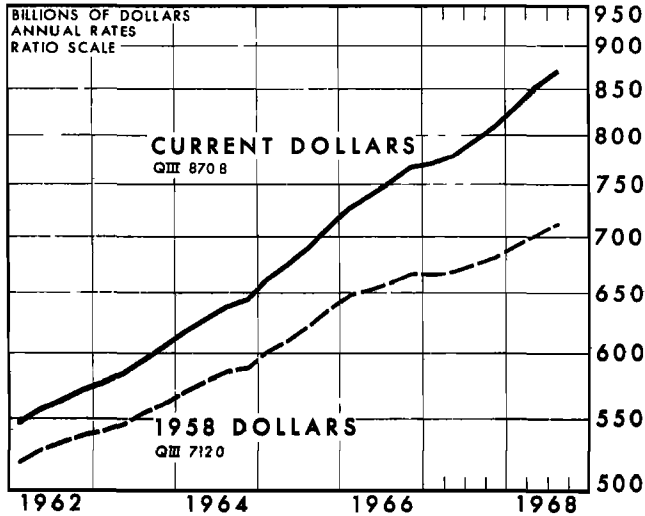
	Amount outstanding June 1968 (billions)	Per cent change		
		June 1966 to June 1967	June 1967 to June 1968	Annual average since June 1963
<b>Non-real-estate</b>				
Commercial banks	\$10.0	10.0	6.9	8.1
Prod. credit assns. <sup>1/</sup>	4.3	15.8	12.1	12.1
Farmers Home Admin.	.9	5.6	3.8	6.0
Nonreporting creditors	<u>10.8</u>	<u>11.2</u>	<u>8.1</u>	<u>9.0</u>
Total	<u>26.0</u>	<u>11.2</u>	<u>8.1</u>	<u>9.0</u>
<b>Real estate</b>				
Commercial banks	\$ 3.8	8.1	15.3	10.8
Federal land banks	5.9	12.3	12.7	13.3
Insurance companies	5.7	4.0	6.7	9.8
Farmers Home Admin.	.5	- 7.9	- 8.3	- 2.7
Individuals and other	<u>10.8</u>	<u>7.8</u>	<u>10.2</u>	<u>10.8</u>
Total	<u>26.8</u>	<u>7.5</u>	<u>10.2</u>	<u>10.7</u>
Grand total	<u>\$52.8</u>	<u>9.3</u>	<u>9.2</u>	<u>9.9</u>

<sup>1/</sup> Includes loans outstanding of other financial institutions discounting with the Federal Intermediate Credit Banks. Outstandings of these institutions amounted to \$202 million on June 30, 1968.

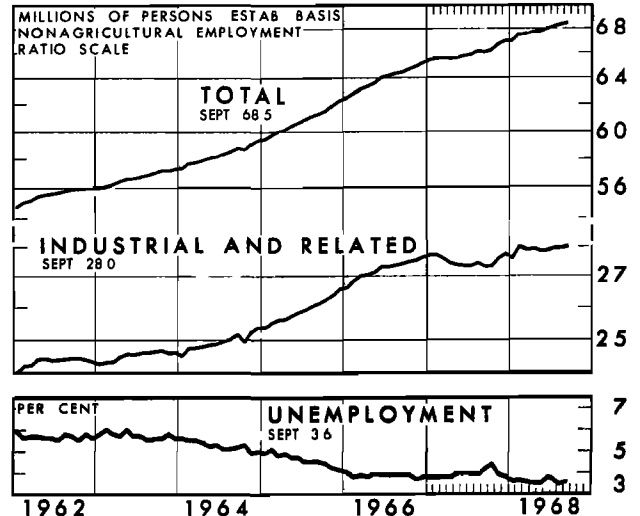
# ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

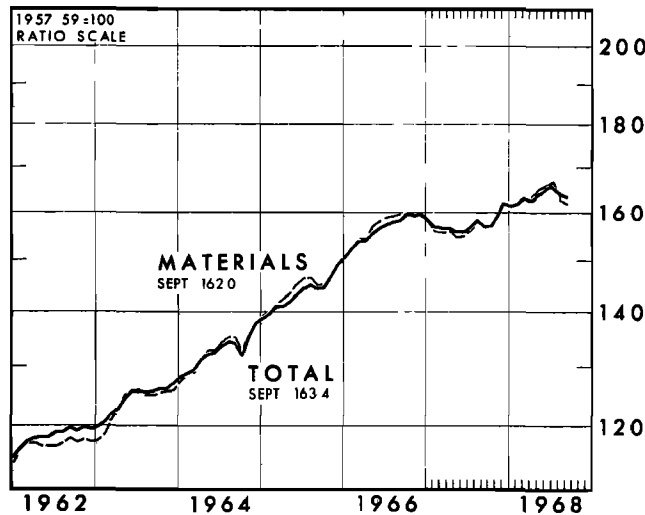
## GROSS NATIONAL PRODUCT



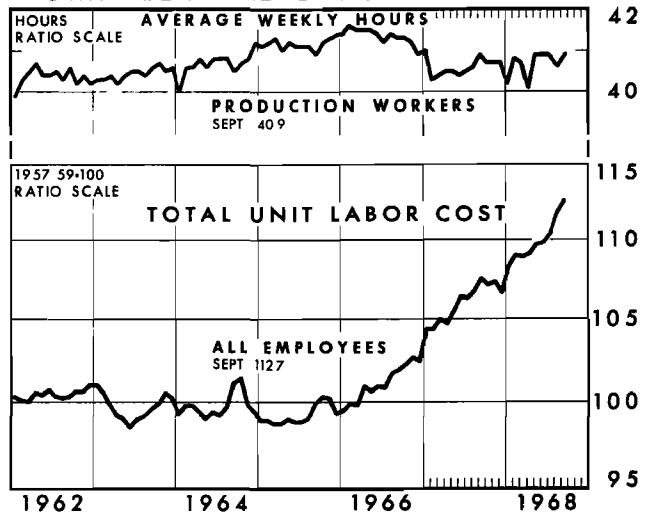
## EMPLOYMENT AND UNEMPLOYMENT



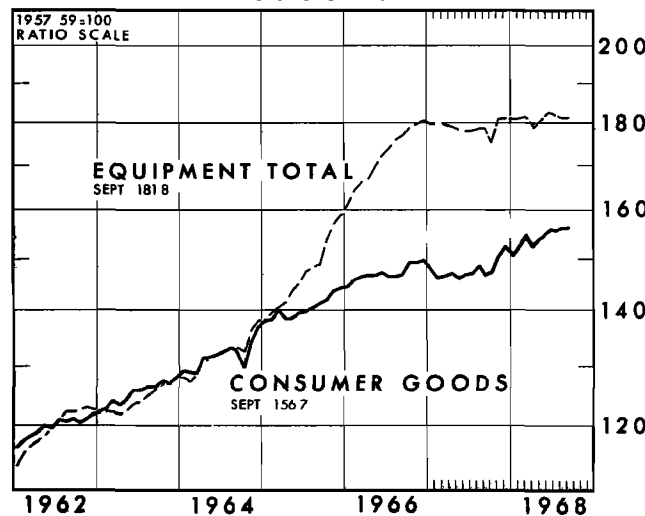
## INDUSTRIAL PRODUCTION-I



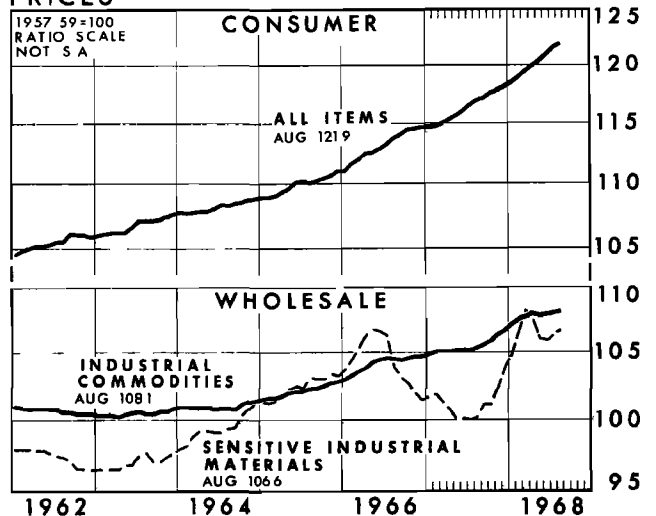
## WORKWEEK AND LABOR COST IN MFG.



## INDUSTRIAL PRODUCTION-II



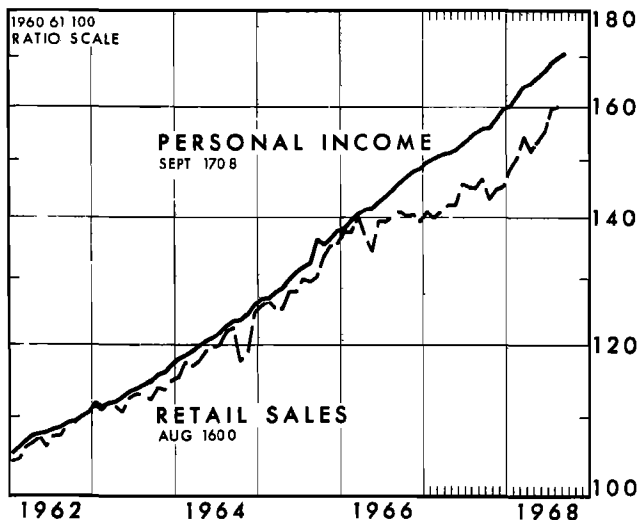
## PRICES



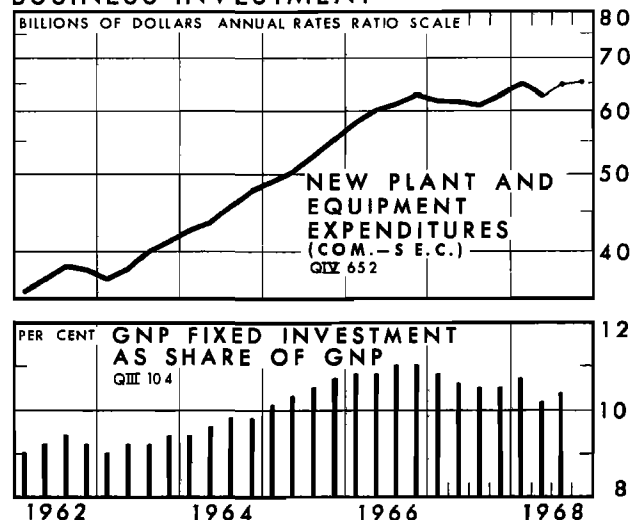
# ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

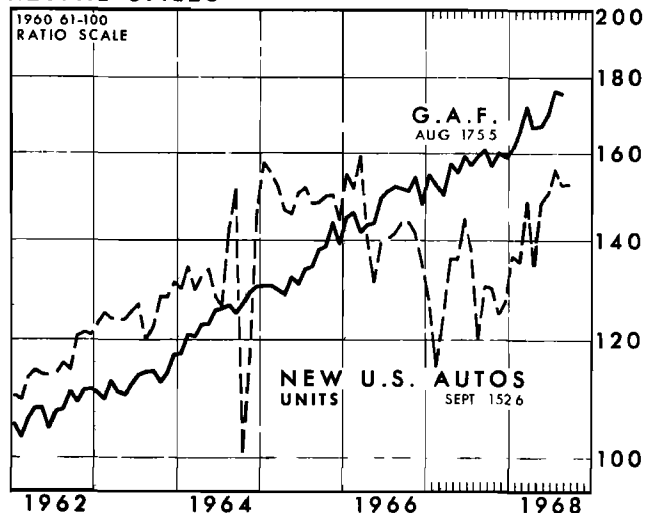
## INCOME AND SALES



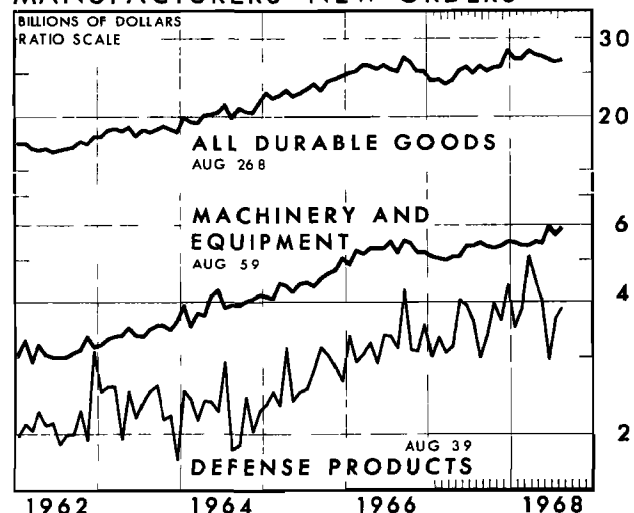
## BUSINESS INVESTMENT



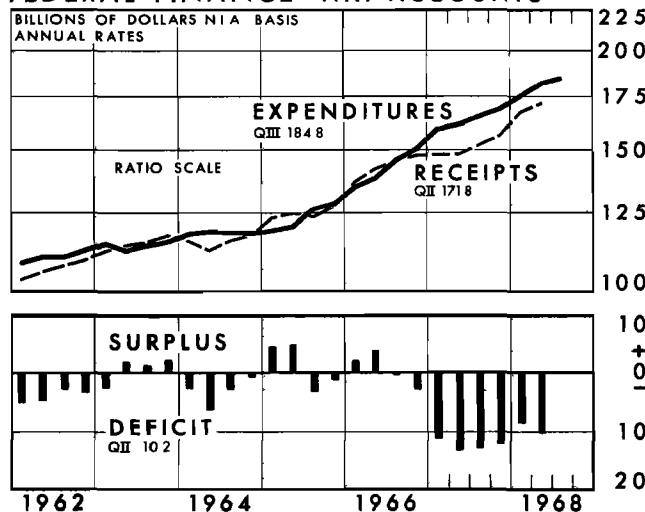
## RETAIL SALES



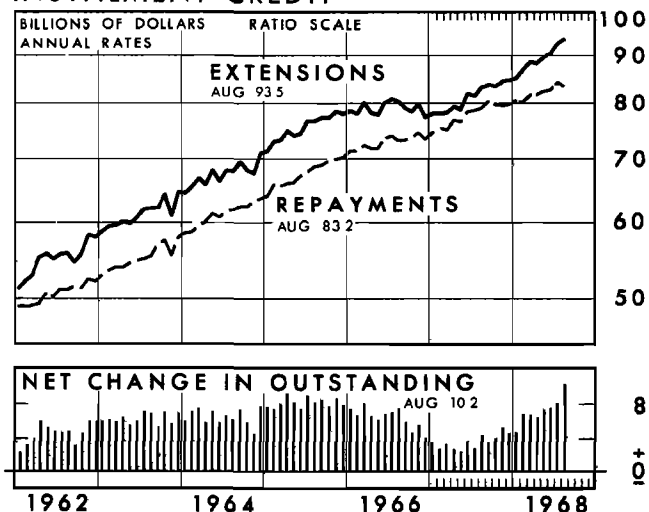
## MANUFACTURERS' NEW ORDERS



## FEDERAL FINANCE—N.I. ACCOUNTS



## INSTALMENT CREDIT



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DOMESTIC FINANCIAL SITUATION

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Bank credit. Data for weekly reporting banks suggest that expansion in total loans and investments remained substantial during early October. Much of the increase appears to reflect further loan expansion, with growth in business loans showing renewed strength. For the entire month of October, bank credit--measured on a daily average basis and adjusted to include changes in Euro-dollar borrowing--is projected to increase at about an 11.0 per cent annual rate, or at approximately the pace of September.

As in September, holdings of Government securities at large banks have shown little change so far in October, after having increased rapidly in July and August. The relatively large amount of Treasury securities now held (together with the prospect of new issues in a late October financing), and the continued strength in loan demand possibly explain why banks have made no further acquisitions of Government securities in recent weeks.

However, large banks did continue to add to their holdings of municipals--both long and short-term--and agency issues in early October, although at a rate somewhat reduced from the rapid pace of the third quarter. All of the recent increase took place at banks outside New York, while banks in New York liquidated small amounts of these securities.

Following a slowdown in September, growth in business loans at large banks appears to have picked up again in early October. Nearly

half of the rise was in retail trade, and may represent, in part, increased bank borrowing by some automobile dealers following the expiration of the temporary credit extended to dealers by automobile manufacturers during the model change-over period. Loans to services, transportation equipment, wholesale trade, and construction industries also rose more than normal, the latter probably associated with the recent increase in housing starts.

Security loans expanded moderately further at large banks during the first two weeks in October, as dealers continued to maintain relatively high inventories. Consumer loans continued to expand at about the increased pace of recent months, while growth in real estate loans appears to have accelerated somewhat further.

Bank deposits. Time and savings deposits at all commercial banks in October are projected to increase by an additional \$2.5 billion, on a daily average basis--slightly below the average monthly increase over the third quarter--or at about a 15.5 per cent annual rate. At large banks, inflows both of CD funds and of consumer-type time and savings deposits remained relatively large early in the month.

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

	1965 Sept. 29- Oct. 13	1966 Sept. 28- Oct. 12	1967 Sept. 27- Oct. 11	1968 Sept. 25- Oct. 9
Total time and savings deposits	694	-463	410	1,027
Consumer-type deposits	n.a.	10	395	617
Savings deposits	267	-152	65	152
Time deposits, IPC (other than CD's, IPC)	n.a.	162	330	465
Negotiable CD's	135	-351	171	439
All other time deposits <sup>1/</sup>	n.a.	-122	-156	-29

<sup>1/</sup> Consists primarily of time deposits held by State and local governments and by foreign institutions.

n.a. - Not available.

Following a less-than-normal decline over the September tax and dividend period, outstanding CD's at large banks rose rapidly towards the end of the month and into early October as banks continued to seek CD funds with which to meet sustained loan demand. However, in order to attract the desired amount of these funds, large banks recently have had to raise their offering rates slightly--to about the levels prevailing prior to the reductions in the prime rate in late September. About two-thirds of the recent rise in CD's took place at New York City banks and may also reflect to some extent the increase in the cost of Euro-dollars relative to that of CD's over the last few weeks. (Following a \$1.4 billion increase from the end of July through the September tax date, bank liabilities to foreign branches fell about \$700 million over the three weeks ending October 9, although rising by \$350 million in the following week.)

Inflows of consumer-type time and savings deposits at large banks--after having shown a steadily increasing rate of growth in recent months--rose rapidly during the first two weeks following the interest-crediting period at the end of September. Savings deposits increased sharply--primarily in the San Francisco district, which holds approximately one-third of all savings deposits at large banks--probably reflecting, in large part, quarterly crediting of interest to existing deposits. Inflows of time certificates and open accounts were also much larger than in recent months, and may represent some diversion of funds from other savings outlets in response to the recently increased promotional campaigns of banks.

After showing little net change since early July, the money stock has risen fairly substantially since late September. This rise in part reflected a sharp drop in U. S. Government deposits prior to payment of the newly issued tax bills. In addition, the recent resurgence of stock market activity may have contributed to the build-up of private money balances. During the first half of October the outstanding money stock averaged 190.7 billion, up 5.8 per cent from a year ago, and up 4.5 per cent (annual rate) from the June-July average.

Nonbank depository intermediaries. Total net savings inflows to nonbank depository institutions were little different on balance in the third quarter than earlier in the year. At savings and loan associations, inflows improved in August and September from the July low point, and the third quarter rate was fractionally higher than in the

first half of the year. While inflows at mutual savings banks also have increased since July, deposit expansion for the third quarter as a whole has been slower than in the past three quarters. However, as indicated in the next section, both institutions have continued to increase their outstanding mortgage commitments despite only modest improvement in inflows.

SAVINGS FLOWS TO THRIFT INSTITUTIONS  
(Seasonally adjusted; annual rates in per cent)

	Mutual Savings Banks	Savings and Loan Associations	Both
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	5.7	6.2
II	6.7	5.9	6.1
III <sup>p/</sup>	6.1	6.0	6.1
July	5.7	4.4	4.8
August	6.1	6.5	6.4
September <sup>p/</sup>	6.5	7.1	6.9

p/ Preliminary.

The most recent data suggest no further improvement for the nonbank depository institutions. Savings flows during the recently-concluded reinvestment period showed less strength than a year earlier, continuing a pattern set at the beginning of 1968.



SEPTEMBER OCTOBER REINVESTMENT PERIOD SAVINGS FLOWS  
(Millions of dollars, not seasonally adjusted)

	Mutual Savings Banks <u>1/</u>	Savings and Loan Associations <u>2/</u>
1966	-165	-618
1967	-156	260
1968	-177	44

1/ 15 largest savings banks in New York City. Savings flows excluding interest credited for the last 3 business days of September and the first 5 business days of October.

2/ Based on a sample of 480 associations. Savings flows excluding dividends credited for the last 3 business days of September and the first 10 calendar days of October.

Mortgage market developments. After the first week in October, there were scattered indications that conditions, at least in the secondary mortgage market, were beginning to tighten again, following a period of gradual easing which had prevailed since mid-June. With returns on other capital market instruments rising even faster, yields on FNMA's forward purchase commitments of Government-underwritten home mortgages edged higher in both the October 14 and 21 auctions, as shown in the table, despite an increase in the volume of auction bids that FNMA accepted.

FNMA WEEKLY AUCTIONS  
(6-month forward commitments)

Auction date	Accepted bids (\$ millions)	Implicit private market yields (per cent)
1968 high, June 10	44.8	7.71
September 3	37.6	7.23
9	39.0	7.22
16	29.9	7.19
23	21.0	7.17
30	24.8	7.16
October 7	22.9	7.16
14	30.0	7.18
21	30.7	7.20

Note: Average secondary market yield after allowance for commitment fee and required purchase and holding of FNMA stock, assuming prepayment period of 15 years for 30-year Government-underwritten mortgages. Yields shown are gross, before deduction of 50 basis point fee paid by investors to servicers. The first auction date was May 6.

In September and early October, in contrast, easing had continued in the home mortgage market, even though savings experience at the thrift institutions improved only moderately during September. Last month, yields on certain FHA-insured home mortgages traded in the secondary market declined for the third consecutive time. And a number of savings and loan associations on the West Coast started the fourth quarter by cutting their prime mortgage lending rates by 1/4 of 1 per cent or more.

Although interest rates on conventional new-home mortgages again edged down in 3 out of 6 major geographic regions during September, they rose slightly in the Northeast where adjustments to earlier usury-

ceiling increases were continuing. Thus the national average for these conventional loans remained unchanged at a record 7.30 per cent, as shown in the table. This was some 65 basis points above a year earlier and 150 basis points above the 1963-65 plateau.

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)
<u>1967</u>					
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
<u>1968</u>					
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	38	6.94	42	7.9
May	7.15	49	7.50 <sup>e</sup>	84 <sup>e</sup>	6.1 <sup>e</sup>
June	7.25	60	7.52	87	6.3
July	7.30	76	7.42	88	5.5
August	7.30	104	7.35	109	5.0
September	7.30	100	7.28	98	4.4

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 through April 1968. Data for May 1968 estimated by Federal Reserve based on the new 6-3/4 per cent regulatory rate, on which a change of 1.0 points in discount is associated with a change of 12 to 13 basis points in yield. Gross yield spread is average mortgage return, before deducting servicing fees, minus average yield on new issues of high grade corporate bonds.

Since returns on new issues of high-grade corporate bonds also changed little during September as a whole, the gross yield spread favoring investment in conventional or Government-underwritten home mortgages continued at around 100 basis points. Although this margin was still well below earlier highs, it was the widest in more than a year. With corporate bond yields rising markedly in October, however, the yield spread favoring mortgages probably became much less attractive.

As lenders sought to lock up the record or near-record mortgage yields prevailing in September, credit availability improved sharply in the residential mortgage market, according to FHA and FNMA field reports, apparently reflecting expectations of more positive improvements in lender cash flows than have yet appeared. By the end of the month, local supplies of mortgage funds were reported to be adequate to meet demands for long-term credit in nearly all major areas. Such credit demands, according to FNMA field reports, generally continued strong in the face of high credit costs, in part because some borrowers were said to be anxious to buy now as a hedge against expected further increases in house prices.

Reflecting these supply and demand pressures, the mortgage commitment backlog at all savings and loan associations and at New York State mutual savings banks rose in September for the third consecutive month, after allowance for seasonal variation. By month-end, the aggregate dollar volume of the commitment backlog available for future take-down at these thrift institutions was 7 per cent above mid-year and 12 per cent above a year earlier.

During the third quarter as a whole, mortgage holdings of all lenders expanded at a rate that was little changed from the first-half pace, according to tentative Federal Reserve estimates. The net expansion in all types of mortgage credit outstanding--at a seasonally adjusted annual rate approximating \$25 billion--thus continued well above the average for the first three quarters of 1967 but somewhat below last year's fourth-quarter high reached when recovery from the late-1966 low was still underway. As might be expected from the high mortgage interest rates now prevailing, a larger than usual share of total credit extensions this year has apparently been concentrated in financing real market activity. Thus loans closed through September 1968 by insured savings and loan associations for refinancing purposes--rather than for construction or purchase--have declined both relatively and absolutely below their year-earlier volume.

There has also been greater reliance this year on financing techniques which by-pass the use of additional high-cost mortgage credit altogether. In the residential mortgage market, used-home buyers have apparently been increasing their assumption of existing mortgages bearing interest rates considerably below those currently available on newly-made mortgages. For multifamily and other income properties, direct real estate investment by life insurance companies has been stepped up further through August, although not by enough to offset a continued year-over-year decline in the amount by which these institutions have been expanding their mortgage portfolios.

Life insurance policy loans. Net increases in policy loans abated somewhat during September but nevertheless continued at the high rate begun early this year. Altogether, the cumulative net increase during the first three quarters of 1968 nearly matched the high reached in the comparable period of 1966.

NET CHANGE IN POLICY LOAN HOLDINGS  
 15 Life Insurance Companies\*  
 (\$ millions; not seasonally adjusted)

	1965	1966	1967	1968
I	80	126	190	181
II	102	210	162	247
III	89	334	130	219
9-month total	271	670	482	647

\* These companies account for two-thirds of industry policy loan activity.

According to another sample, policy loan increases in the second quarter absorbed 10 per cent of total investable funds--a high exceeded only by the 16 per cent in the second half of 1966. Eleven of the 34 companies sampled reported that policy loans accounted for over 20 per cent of their total investment funds, and 2 of these reported that more than 50 per cent of these funds were absorbed by policy loans. Only once, during the latter part of 1966, have more companies reported a comparable volume of such loans.

Unlike 1966, the industry had anticipated this development in view of the outlook for continued high cost of other credit sources and the increased consumer awareness of this source that resulted from the 1966 experience. Thus, in contrast to 1966, insurance companies planned much more leeway in relating commitment takedowns to expected cash flows; as a result, there have been no reports of commitment takedowns being re-scheduled because of policy loan pressures. Although information about current policy loan borrowers is limited, activity is reported to be concentrated in small loans; in 1966, evidence suggested that relatively large business loans were made because of the reduced availability of commercial bank credit.

Corporate and municipal bond markets. Yields on corporate and municipal bonds advanced sharply during the first half of October as market sentiment deteriorated amid a continuing flow of bullish economic comment and data at a time when there was a substantial volume of new issues concentrated in a short period of time. Following the upward drift of previous weeks, the early October developments have erased in both markets about two-thirds of the yield decline following passage of the surtax. Early in the week of October 18, however, the rumors of new developments on the Vietnam peace front produced a turnaround in the capital markets. These rumors dominated the views of market participants--apparently offsetting completely the publication of the unexpectedly large third quarter GNP estimate--and underwriters priced new issues at lower yields as investors snapped up older offerings.

Within 48 hours, yields on comparable issues declined about 10 basis points, hence producing an essentially unchanged average level of yields for the last week shown on the table, despite the continued upward momentum of yields in the early part of that week.

BOND YIELDS  
(Weekly averages, per cent per annum)

	Corporate Aaa		State and local government	
	New	Seasoned	S&P High	Bond Buyer's
	With call		Grade	(mixed qualities)
	protection			
<u>1968</u>				
Low	6.12 (2/2)	5.95 (9/13)	4.15 (8/9)	4.07 (8/9)
High	6.83 (5/24)	6.29 (6/7)	4.68 (5/24)	4.71 (5/24)
Week ending:				
Sept. 6	6.23	5.95	4.48	4.44
13	6.29	5.95	4.43	4.43
20	6.25	5.98	4.45	4.35
27	6.26	6.00	4.47	4.30
Oct. 4	6.31	6.02	4.45	4.36
11	6.56	6.06	4.55	4.49
18	6.57*	6.10	4.60	4.51

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

The estimated October volume of corporate bond offerings in the public market has been raised \$150 million to \$1 billion. This increased volume does not appear to indicate a new surge of corporate bond flotations, but rather represents the addition to the calendar of a significant number of relatively small issues whose timing was previously listed as indefinite. Given the wide swing in yields over the past few weeks, however, some borrowers may reevaluate their planned



timing of financing, with the resultant possibility that the final October volume may be less than \$1 billion. As a partial offset to the increased public volume, estimated takedowns of private placements in October have been reduced to \$500 million--\$200 million below the seasonally higher September. The latest data continues to show a generally weak pattern of private placement takedowns with no pick-up from earlier months this year. Total corporate security offerings in October--including bonds and stock--are estimated at about \$1.8 billion, little changed from the third quarter monthly average.

CORPORATE SECURITY OFFERINGS<sup>1/</sup>  
(Millions of dollars)

	Bonds				Total bonds and stocks	
	Public Offerings <sup>2/</sup>		Private Placements			
	1967	1968	1967	1968	1967	1968
QI monthly avg.	1,088	822	604	575	1,821	1,726
QII monthly avg.	1,339	1,035	489	548	2,069	1,901
QIII monthly avg.	1,534	882e	517	552e	2,277	1,790e
September	902	725e	647	700e	1,763	1,725e
October	1,375	1,000e	566	500e	2,409	1,800e
November	645	850e	551	500e	1,500	1,600e

e/ Estimated.

1/ Data are gross proceeds.

2/ Includes refundings.

Corporate public bond offerings currently scheduled for November total about \$600 million, with the ultimate volume estimated at about \$850 million. While this places November \$150 million below October, volume continues at a relatively strong pace largely due to a

heavy calendar of public utility issues. The estimated decline in total security offerings in November--to \$1.6 billion--reflects the drop-off in public bond issues and a slightly lower volume of stock offerings.

In the municipal market, expected new issues in October have ballooned to a record \$2.0 billion--\$.3 billion above the previous high set in August. Accounting for the bulk of this outsized volume is the coincidental issuance of bonds by several large borrowers--such as New York City, State of California, New Jersey Turnpike Authority, and Maryland State Roads Commission. Additionally, the October borrowings include about \$300 million of industrial revenue bonds and \$100 million of accelerated California school district issues. The California case represents an attempt to market bonds prior to the November elections since a proposition on the ballot would, if passed, severely restrict future borrowing authority.

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

	1967	1968
QI monthly average	1,391	1,240
QII monthly average	1,294	1,269
QIII monthly average	1,050	1,485e
September	1,340	1,325e
October	975	2,000e
November	1,401	1,600e

e/ Estimated.

1/ Data are for principal amounts of new issues.

Municipal offerings in November are expected to aggregate about \$1.6 billion, substantially below October but still unusually high. In this month also, several large borrowers have scheduled offerings and industrial revenue issues are likely to be sizable.<sup>1/</sup> Due to the frequent rescheduling of issues in a congested and unstable market, the November estimate should be viewed as highly tentative at this date. But the necessitous nature of the revenue bond issuers and the large number of other potential borrowers would suggest that municipal offerings are not likely to show any substantial moderation over the near term, even if unfavorable market conditions persist.

Stock market. The advance in common stock prices, which began in early August, was sustained in October, with trading volume at near-record levels. Continued back-office difficulties associated with the increased trading volume led the Exchanges to extend the 4-day trading week at least through the end of the month.

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<sup>1/</sup> The previously reported amendment raising the size of industrial revenue issues exempted from Federal income taxes after the first of the year from \$1 million to \$5 million has now been signed into law. Despite this amendment, the volume of such financing will still decline sharply after January 1.

## STOCK PRICES

	Dow-Jones Industrials	New York Stock Exchange Index	American Exchange Index
Mid-July high	932.72	57.69	30.08
Early-August low	869.65	54.18	28.82
Per cent decline from mid-July to early August	-5.9	-6.1	-4.2
October 22	963.14	58.79	30.92
Per cent increase from early August to October 22	11.1	10.9	10.7

AVERAGE DAILY TRADING VOLUME  
(In millions of shares)

	New York Stock Exchange	American Stock Exchange
July	14.3	6.6
August	10.8	4.8
September	13.4	6.5
Week ending:		
October 4	16.4	7.6
11	14.5	6.5
18	15.4	6.9

The rise in prices has been broadly based and, as indicated in the table above, most pronounced among seasoned issues such as those represented by the Dow-Jones Industrial Average. The continuing flow of information implying a vigorous economy and, more recently, the new rumors of progress in the Vietnam negotiations have apparently been the prime stimulants to the broad advance.

Institutions--the major cash customers in the stock market-- were apparently responsible for a significant portion of the recent increase in stock prices; certainly margin customers were not. In September the margin debt of brokers' customers declined \$70 million (preliminary)--the third decline in as many months.<sup>1/</sup> Purpose loans to nonbrokers at weekly reporting banks rose again in September, this time by \$27 million, but the significance of the increase is clouded by the fact that this figure includes loans on bonds as well as OTC stocks. Despite the sharp increase in stock prices, the large proportion of customers whose accounts were in restricted status limited the increase in special miscellaneous balances at brokers to \$30 million, or 0.5 per cent.

U. S. Government securities market. After a very brief downward adjustment immediately following the last Committee meeting, yields in the U. S. Government securities markets have resumed the upward drift underway since the end of September.

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<sup>1/</sup> Despite an upward revision in the August statistic, such debt still declined in each of the last three months, by a total of 4.5 per cent.

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

	1968					
	Highs	Aug. 5 <sup>1/</sup>	Oct. 15 <sup>2/</sup>	Sept. 10	Oct. 8	Oct. 21
<u>Bills</u>						
1-month	5.70 (5/21)	4.95	5.18	5.10	5.22	5.24
3-month	5.92 (5/21)	4.89	5.38	5.30	5.35	5.36
6-month	6.08 (5/21)	5.12	5.45	5.33	5.41	5.43
1-year	6.03 (5/21)	5.04	5.36	5.26	5.28	5.35
<u>Coupons</u>						
3-year	6.36 (5/21)	5.41	5.57	5.47	5.53	5.51
5-year	6.21 (5/21)	5.48	5.60	5.54	5.56	5.56
10-year	6.02 (5/21)	5.37	5.65	5.51	5.57	5.58
20-year	5.77 (3/14)	5.16	5.52	5.31	5.42	5.43

1/ Summer lows.

2/ Recent highs.

Aside from recent shifts in Vietnam prospects, two factors have been primarily responsible for movements in yields in the Government's market during October. First, there has been a growing concern in the market--a concern heightened by continued buoyant business news and relatively high money rates--that System operations may be leaning in the direction of firmer monetary conditions. Secondly, upward pressures on short-term rates have tended to produce sympathetic yield movements in longer Government issues, which have been intensified by yield increases in the corporate and municipal markets in the process of marketing the relatively large volume of recent new issues.

Dealers' positions in both bill and coupon issues have declined somewhat in the last three weeks, continuing the general trend begun in late September, but their holdings still remain moderately

large. This is particularly true for coupon issues in the over 5-year area, where progress in reducing positions in 5- to 10-year maturities has been fairly steady, but in small steps. Nonetheless, in an environment characterized by relatively high day-to-day financing costs and uncertainty about the extent and form of the Treasury's near-term financing plans dealers have continued to express some nervousness about their positions.

A good deal of the market's pessimism was offset by the Vietnam de-escalation rumors, and rates moved down accordingly. In particular, the Treasury's recent \$3 billion tax bill offering was bid for considerably more aggressively than might otherwise have been the case. Selling of the bills by banks in the secondary market has reportedly been fairly slow since the auction. Even so, in the most recent weekly Treasury bill auction, dealer interest was not strong, and the 3-month bill was issued at an average rate of 5.40 per cent, and stopped out at 5.45 per cent.

Several other short-term rates--including CD offering rates and bankers' acceptances--have also moved up since the October 8 meeting of the Committee.

DEALER POSITIONS IN GOVERNMENT SECURITIES<sup>1/</sup>  
(Millions of dollars)

	September 11	October 2	October 16
Total	<u>5,350</u>	<u>4,713</u>	<u>3,645</u>
Treasury bills	3,737	3,574	2,604
Coupon issues	<u>1,613</u>	<u>1,139</u>	<u>1,041</u>
Due within 1 year	436	302	349
1-5 years	242	150	119
5-10 years	812	584	472
over 5 years	935	687	573

<sup>1/</sup> Weekly averages of daily figures.

SHORT-TERM INTEREST RATES

	1968				
	Highs	Aug. 5 <sup>1/</sup>	Sept. 10	Oct. 10	Oct. 21
<u>1-month</u>					
CD's (prime NYC)					
Highest quoted new issue	5.50 (10/10)	5.50	5.50	5.50	5.50
Secondary market	6.20 (5/31)	5.85	5.75	5.75	5.95
<u>3-month</u>					
Bankers' acceptances	6.13 (5/24)	5.62	5.62	5.75	5.88
Federal agencies	6.11 (5/17)	5.46	5.45	5.62	5.53
Finance paper	6.13 (6/25)	5.75	5.62	5.75	5.75
CD's (prime NYC)					
Highest quoted new issue	6.00 (7/18)	5.90	5.75	5.80	5.85
Secondary market	6.20 (5/31)	5.88	5.85	5.95	6.00
<u>6-month</u>					
Bankers' acceptances	6.25 (5/24)	5.75	5.75	5.88	6.00
Commercial paper	6.25 (7/25)	5.88	5.88	5.75	5.88
Federal agencies	6.25 (5/24)	5.61	5.56	5.66	5.63
CD's (prime NYC)					
Highest quoted new issue	6.25 (7/11)	5.88	5.75	5.62	5.62
Secondary market	6.40 (5/31)	6.00	5.90	5.97	6.00
<u>1-year</u>					
Federal agencies	6.01 (5/31)	5.65	5.60	5.85	5.72
Prime municipals	3.90 (5/31)	3.00	2.90	3.00	3.10

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

<sup>1/</sup> Summer lows.



Federal finance. The fourth quarter outlook for Federal finance is more than usually uncertain. Growth in the level of spending slackened considerably in the third quarter (on a national income accounts basis) particularly in the defense sector, and staff estimates now call for an equally moderate increase in the fourth quarter. But it is not clear to what extent the third quarter experience may already reflect the statutory spending constraints enacted by Congress last June, or how much further these limits may be expected to bite during the fourth quarter. On the receipts side of the budget also, forecasters are presently taking somewhat different views of the fourth quarter. This seems to be due largely to differences of interpretation as to the significance for the fourth quarter of the unexpectedly large receipts from withheld income taxes in September.

In these circumstances forecasts of Treasury cash borrowing requirements over the remainder of the calendar year tend to vary more than usual. Board staff estimates still show a fourth quarter cash deficit of nearly \$9 billion. A part of this deficit is being financed by drawing down the unusually large (\$8.6 billion) cash balance available at the end of September, and the Treasury has already borrowed an additional \$3 billion in June tax bills for payment on October 24. Nevertheless, Board staff estimates--in contrast to current market expectations--indicate that even with \$2.0 billion of further net cash borrowing in late November, the Treasury would end the calendar year with a balance of only \$4.9 billion, and would probably have to borrow temporarily from the Federal Reserve around mid-December when the balance drops to a seasonal low.

At the close of business on October 23, the Treasury is expected to announce plans for its mid-November refunding. This refunding will refinance \$3.9 billion of publicly-held issues maturing at that time, and possibly also will include \$1.6 billion of publicly-held issues maturing in December. The Treasury is also likely to indicate any other financing plans for later in the calendar year, which will depend to some extent on the form and scope of the mid-November refunding.

PROJECTION OF TREASURY CASH OUTLOOK  
(In billions of dollars)

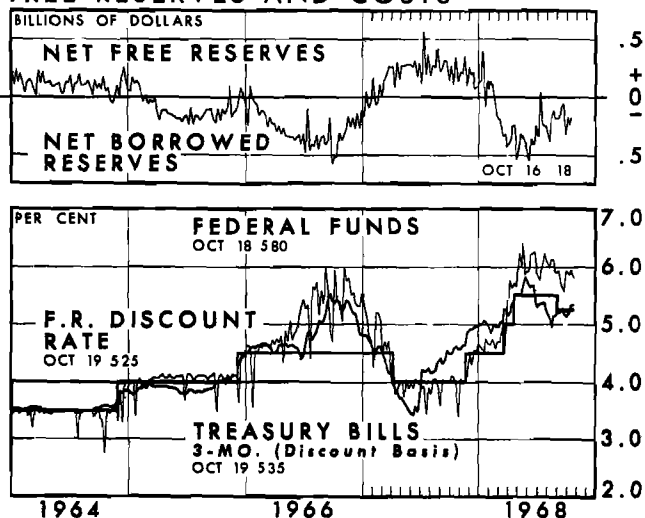
	Sept. <sup>a/</sup>	Oct.	Nov.- Dec.
<u>Borrowing operations</u>			
New cash raised			
Weekly bills	.4	.2	--
Tax bills	--	3.0	3.0
Coupon issues	--	--	--
PC's	--	--	--
Other (agency, debt repayment, etc.)	<u>.3</u>	<u>.3</u>	<u>-1.0</u>
Total net borrowing from public	.7	3.5	2.0
Plus: Other net financial sources <sup>b/</sup>	.7	.3	- .8
Plus: <u>Budget surplus or deficit (-)</u>	2.6	-5.7	-3.0
Equals: <u>Change in cash balance</u>	4.0	-1.9	-1.8
Memorandum: Level of cash balance end of period	8.6	6.7	4.9

a/ Actual and estimated data.

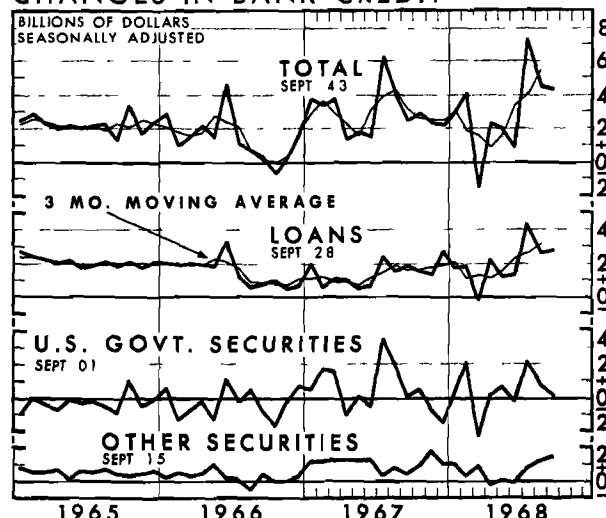
b/ Checks issues less checks paid and other accrual items.

# FINANCIAL DEVELOPMENTS - UNITED STATES

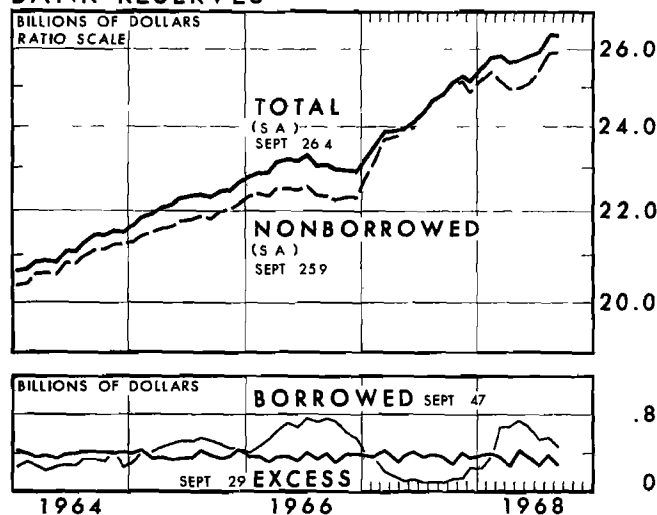
## FREE RESERVES AND COSTS



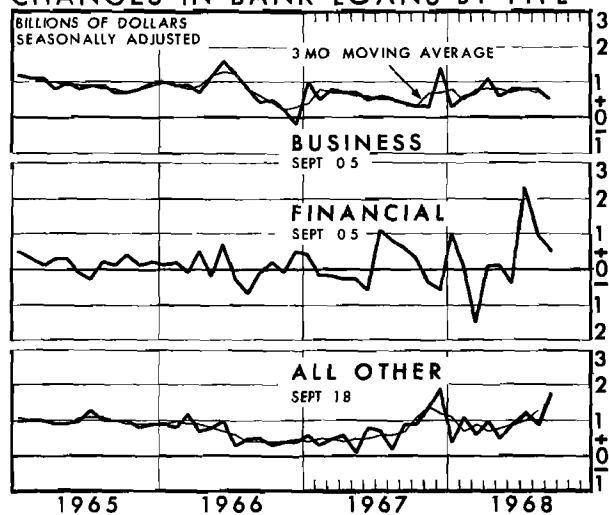
## CHANGES IN BANK CREDIT



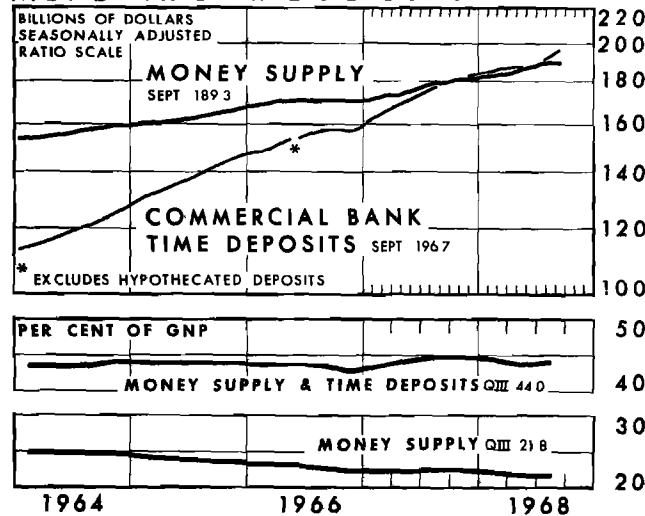
## BANK RESERVES



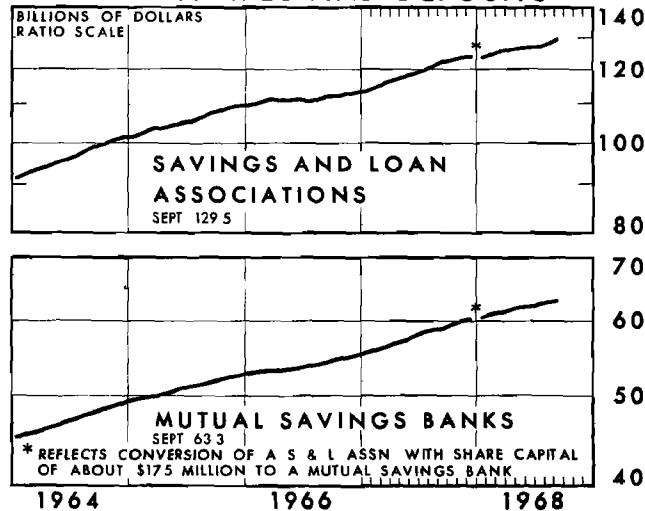
## CHANGES IN BANK LOANS-BY TYPE



## MONEY AND TIME DEPOSITS

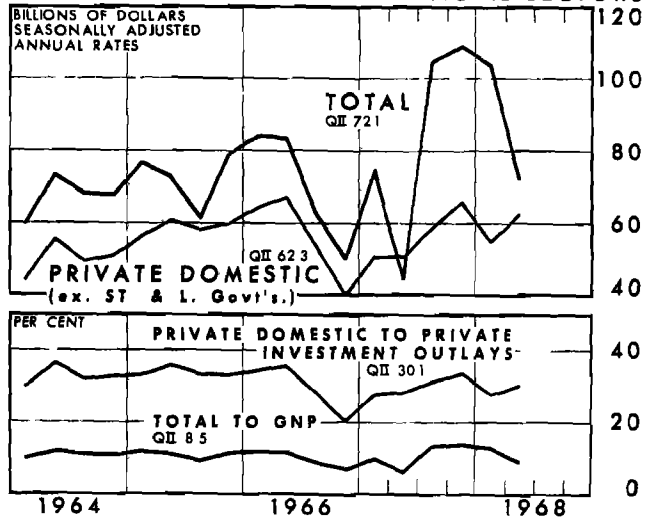


## SAVINGS SHARES AND DEPOSITS

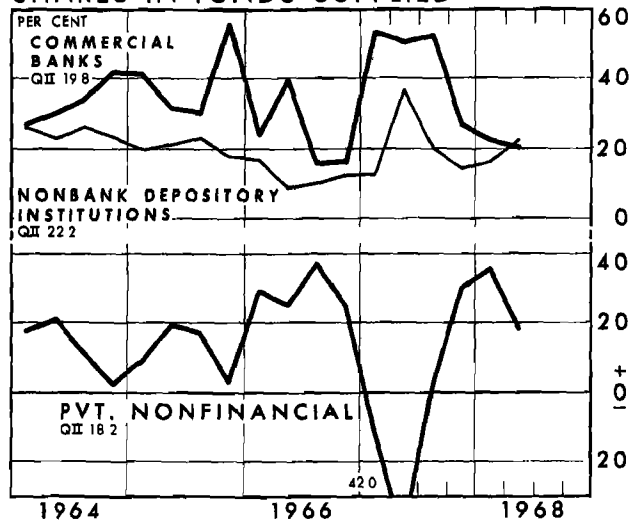


# FINANCIAL DEVELOPMENTS - UNITED STATES

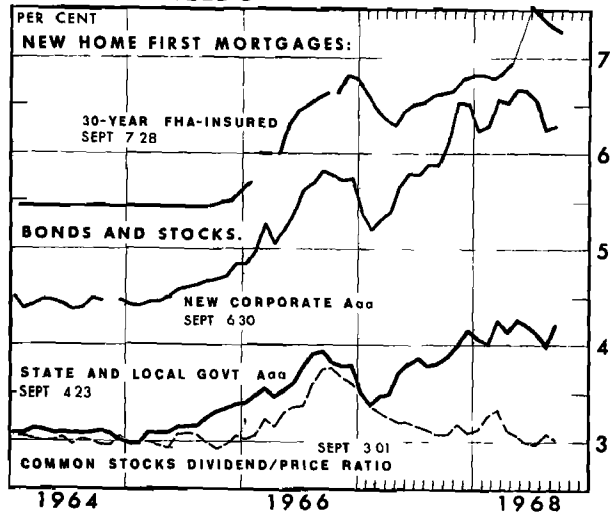
## NET FUNDS RAISED - NONFINANCIAL SECTORS



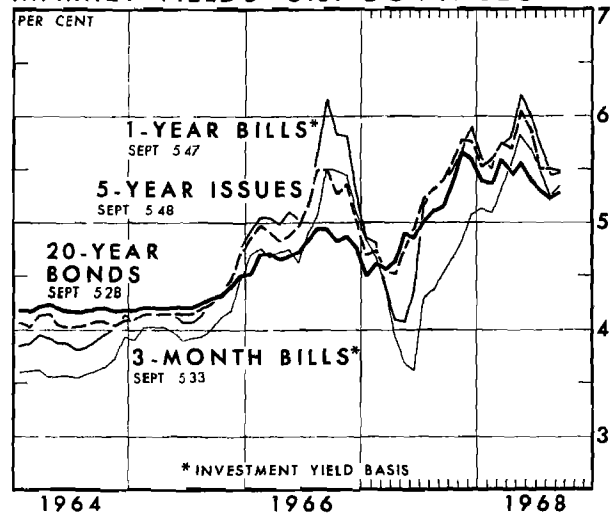
## SHARES IN FUNDS SUPPLIED



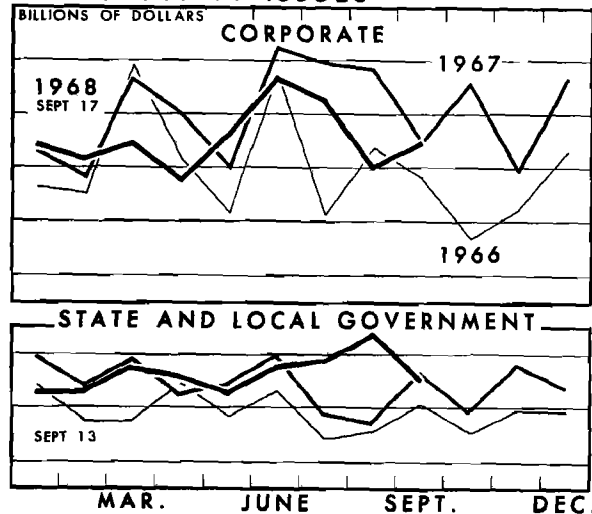
## MARKET YIELDS



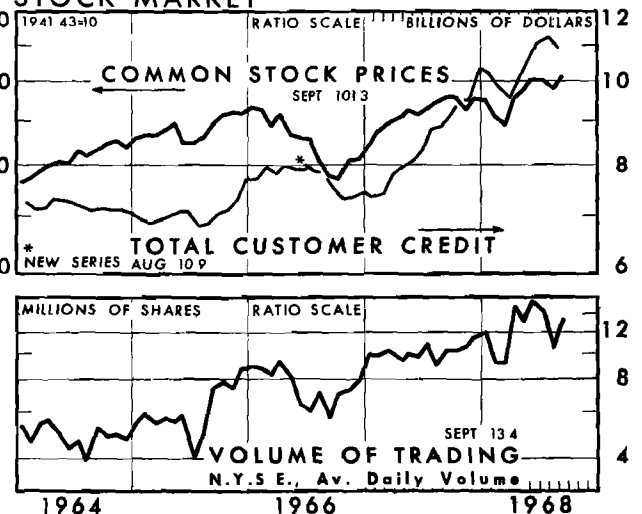
## MARKET YIELDS - U.S. GOVT. SEC



## NEW SECURITY ISSUES



## STOCK MARKET



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 INTERNATIONAL DEVELOPMENTS
 

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<u>Contents</u>	<u>Page</u>
Exchange market developments	IV - 1
U.S. balance of payments	3
U.S. foreign trade	5
Payments balances of other industrial countries	9

Exchange market developments. Activity in foreign exchange markets during the first three weeks of October was relatively uneventful. Demand for sterling, the Canadian dollar and the Swiss franc continued firm while there was significant easing of the speculation which had favored the German mark during most of September. Selling pressure on the French franc apparently eased.

The price of gold has not shown much net change in October. It opened the month at \$39.45 an ounce, eased during the week of the IMF meetings, spurted to just under \$40.00 in response to South Africa's rejection of the G-10 compromise gold marketing proposal, and has since fallen back to around \$39.00 an ounce.

Sterling traded in a range between 238.84 and 239.07 during the first three weeks of October. Demand has been generally firm and the Bank of England has been able to purchase a modest amount of dollars in the exchange market, although the market at times has reflected nervousness over the reliability of Labor party support of the Wilson austerity program, wildcat London dock strikes, and a threatened nationwide engineering union strike (which has now been postponed until late November). The market did not react either way to the September trade figures, which were little changed from those for August.

The discount on forward sterling has narrowed appreciably -- probably indicating enhanced confidence in the pound. On 3-month contracts the discount narrowed to around 1.3 per cent per annum by October 21 from 2.0 per cent in late September. The narrower forward discount has resulted in a covered interest arbitrage opportunity favorable to investment in sterling hire-purchase deposits vis-à-vis Euro-dollars and it has been reported that funds have begun to flow into sterling on this basis, contributing to the spot demand.

Speculative demand for the German mark was reversed about the beginning of October and since then the mark has generally been under selling pressure. The Bundesbank has sold over \$400 million (net) in the spot market so far in October, not allowing the exchange rate to move below 25.094. In addition it has done over \$600 million in swaps with commercial banks -- selling dollars spot and buying them forward. This was done to offset almost equal payments the Bundesbank received from maturing swaps contracted early last month.

It has become more difficult to get a precise indication of the extent of current selling pressures on the French franc because the Bank of France has begun to do offsetting swaps with French commercial banks -- buying U.S. dollars spot and selling them forward -- for which data are not available. Bank of France losses net of these swaps have been very moderate so far in October, although the exchange rate has been above its lower support limit on only six trading days since October 1.

A strongly favorable trade balance continues to keep the Canadian dollar exchange rate at its upper limit, although the Bank of Canada has not had to intervene in the exchange market this month. Tight financial market conditions in Switzerland and the Netherlands reportedly are responsible for the currently strong demand for the Swiss franc and guilder. Earlier in October there had been some weakness in the guilder associated with capital flows.

U.S. balance of payments. The preliminary monthly data for September showed a somewhat better outcome for the month than had been estimated on the basis of weekly reports, so that in the third quarter the liquidity deficit before special transactions was probably closer to an annual rate of \$2-1/2 billion than the \$3 billion rate estimated earlier. For the first nine months of 1968 the liquidity deficit before special transactions totalled \$2.6 billion, (\$3-1/2 billion annual rate) compared to a nine-months total of \$3.3 billion last year. Most of the difference is in the third quarter total, which was \$1.1 billion last year as against some \$650 million this year.

It will be recalled that in the final quarter of 1967 the liquidity deficit before special transactions soared to \$1.5 billion (S.A.), under the combined pressure of a deteriorating current account and a continuation of very large outflows of private U.S. capital. In fact, in most recent years the liquidity deficit has tended to deteriorate in the fourth quarter even after allowing



for seasonal influences in the various categories of transactions, though not to the same extent as last year. This year there are grounds for reasoning that the fourth quarter outcome should not show a significant worsening from the annual rate of about \$3-1/2 billion registered in the first three quarters, though there will probably be a worsening from the third quarter rate. The balance on goods and services is expected to show a modest improvement as the trade balance makes further gains. On capital account, it seems plausible to expect further sizable foreign purchases of U.S. equity securities, while the restrictions on outflows of U.S. private capital should prevent a recurrence of the large outflows of non-bank capital that occurred in the closing months of 1967, though considerable leeway remains for bank credits to foreigners.

The figures given above differ very substantially, of course, from the published liquidity deficits, which reflect the inclusion of receipts from special transactions. As shown in Appendix A, the published liquidity deficits show an improvement from \$660 million in the first quarter to \$170 million in the second, and probably to a still smaller figure in the third. On this basis the liquidity deficit during the first nine months was at an annual rate of only about \$1-1/4 billion. To maintain a similarly low figure in the fourth quarter will require further strenuous efforts by the Treasury to have large additional amounts of foreign official reserve holdings lodged in non-liquid forms in the United States.

Information on transactions in September is still very meager. Some indications of the outcome for exports and imports are given below. On bank lending, partial reports under the VFCR indicate an increase of claims in September on the order of \$50-\$100 million. For the third quarter as a whole this would give a small net unadjusted inflow. The seasonal adjustment, largely based on experience before the restraint programs, will convert this to a sizable outflow, but there is in fact very little indication of a general rise in bank lending to foreigners.

Net foreign purchases of U.S. equity securities appear to have been somewhat under \$100 million in September, as they were in August. Though high by standards of earlier years, this rate is somewhat lower than in the first seven months of the year. U.S. net purchases of foreign equity securities rose to \$80 million in August and rose further in September, but this spurt in purchases represents direct investments by U.S. companies in two U.K. tobacco companies out of funds borrowed abroad, so that there was no net impact on the balance of payments.

U.S. foreign trade. The official trade statistics for U.S. exports and imports in September are not yet available but partial data (duty receipts, number of export documents, etc.) suggest an increase in the export surplus for that month. In both August and September, exports to a considerable degree, and imports to a lesser extent, were inflated by an acceleration in

shipments in anticipation of an East Coast and Gulf Coast longshoremen's strike on October 1. The strike, which did start on that date, was almost immediately halted by an injunction under the Taft-Hartley Act. The 80 day "cooling-off" period of the injunction will last until December 20.

Following the short-lived strike, port activity at New York in the first part of October was reported to be less than 30 per cent of normal; between 10-14 days are needed for sufficient pipeline cargo to accumulate to permit resumption of cargo movement at the usual pace. This suggests that exports, and to some extent imports, in October may drop sharply from the expanded September volume.

Including an estimate for September, the third quarter export surplus may have approximated an annual rate of a little more than \$1 billion (balance of payments basis), compared to the less than \$1/4 billion rate in the first half of the year.

Exports in the third quarter are estimated to have been at a rate about 8 per cent higher than in the first six months of 1968. Shipments of agricultural commodities were approximately 5 per cent below the rate of the first six months. Exports of such products were reported to have slipped badly in September, principally because of lower commercial sales of wheat and corn, and PL 480 deliveries of wheat. This decline reflects, in large part, the world-wide abundance of grain supplies. But commercial sales of wheat were particularly heavy in August as foreign buyers

sought to avoid paying the higher prices that became effective with implementation of the new Industrial Grains Arrangement by the U.S. in late August.

Despite a drop in deliveries of commercial aircraft in September to the second lowest monthly amount this year, exports of nonagricultural commodities are estimated to have expanded further in that month and in the third quarter, reflecting not only the strike induced acceleration but also a pick up in deliveries of automotive equipment to Canada. Export orders for machinery through August continue their slow rise and the backlog of such orders remains high.

Imports in September are estimated to have increased, possibly exceeding the record rate of last June. For the entire third quarter, it appears that imports were slightly higher than in the second quarter. The rate of expansion, however, was apparently much lower than in the spring quarter. The ratio of imports to the GNP in the third quarter is estimated to have been 3.9 per cent, nearly the same as the ratio in the second quarter.

Imports of finished goods, including such items as machinery, automobiles, textile and other nonfood consumer goods, have been particularly strong in the last few months, accounting for a greater share of total imports than in the early part of the year.

Cars from Canada in September are thought to have increased sharply, as Canadian production of the new 1969 models accelerated. Imports of coffee continued to exceed current use, suggesting that the heavy accumulation of inventories in the first half of the year continued through September.

Payments balances of other industrial countries. Changes in the underlying payments position of other important industrial countries in the second and third quarters were reinforced in some cases by speculative flows based on possible exchange rate alterations. The French franc, long regarded as a strong currency, fell under speculative attack in the spring as uncertainty arose as to whether the French economy could absorb large wage and price increases without a change in the parity of the franc. As a result of this speculation, France experienced a reserve drain of \$3.3 billion in the second and third quarters, financed half by a reduction in official reserves of gold and dollars and half by drawings on the IMF and central bank credits.

Speculation also arose this summer about a possible German mark revaluation. This speculation stemmed from uncertainty as to Germany's ability to maintain private capital outflows big enough to offset Germany's large trade surplus. Official reserve accruals were held down partly through continued long-term capital outflows and partly through Bundesbank DM/dollar swaps with commercial banks; a large portion of these swaps carry through the turn of the year, which may help to ease year-end strains on foreign exchange markets.

Italy continued to realize large payments surpluses during the second and third quarters; the Italian surplus in the first three quarters was even larger this year, at \$514 million, than in the same period last year, when the surplus totaled \$383 million. Switzerland's surplus has also been of large magnitude this year.

The United Kingdom, on the other hand, appeared to be making some progress in bringing its payments back into balance. The improvement took place on both trade and long-term capital accounts. The failure of U.K. imports to decline is, however, still a cause for grave concern.

Canada and Japan moved into payments surplus during the period. Canada recovered completely during the second and third quarters from the March run on the Canadian dollar. Japan's external balance, in substantial deficit a year ago, moved into a surplus position by the second quarter of 1968. Of the smaller countries, the Netherlands improved its payments positions somewhat, while Sweden's small surplus shrank further.

On the whole, however, imbalances in world payments still continue to be serious enough to generate recurrent speculation about the possibility of exchange rate alterations in the coming months.

The greatest payments and reserve shift during the second and third quarters was experienced by France. Information regarding changes in French commercial bank net foreign positions is available only through July, but in the April-July period improvement of \$1.3 billion in commercial banks' net external position offset official reserve losses to a considerable extent. Consequently the overall balance of payments deficit in April-July-- as measured by changes in net official and commercial bank external positions--amounted to \$1,013 million. (See Tables 1 and 2.) This contrasts with an overall surplus of \$111 million in April-July 1967 and a deficit of \$257 million in the six months ending March 1968. The improvement of

COMBINED CHANGES IN NET COMMERCIAL BANK AND NET  
OFFICIAL EXTERNAL MONETARY POSITIONS OF SELECTED COUNTRIES  
(millions of dollars)

	Six Months Ending			April--August	
	Sept. 1967	Mar. 1968	Sept. 1968	1967	1968
United Kingdom <sup>1/</sup>	- 583	- 954 <sup>a/</sup>	n.a.	-164	- 572
Belgium	+ 4	+ 72	n.a.	- 48	- 16
France	+ 103	- 257	n.a.	+111 <sup>b/</sup>	-1,013 <sup>b/</sup>
Germany	+ 205	+ 622	n.a.	+203	- 276
Italy	+ 628	- 183	+ 690	+524	+ 621
Netherlands	- 2	+ 68	n.a.	- 72	+ 7
Switzerland	+ 140	+ 184	n.a.	n.a.	n.a.
Sweden	+ 125	- 130	+ 34	+148	+ 44
Canada	+ 337	- 407	n.a.	+307	+ 835
Japan	- 190	- 344	n.a.	-232	+ 567

CHANGES IN NET OFFICIAL RESERVES<sup>2/</sup> OF SELECTED COUNTRIES  
(millions of dollars)

	Six Months Ending			April--August	
	Sept. 1967	Mar. 1968	Sept. 1968	1967	1968
United Kingdom <sup>1/</sup>	-1,280	-2,119 <sup>a/</sup>	n.a.	-815	- 738
Belgium	+ 120	+ 68	- 72	+112	+ 4
France	+ 97	+ 90	-3,306	+ 72	-2,736
Germany	- 86	+ 466	+ 646	-204	+ 348
Italy	+ 696	- 158	+ 262	+602	+ 237
Netherlands	+ 61	+ 70	- 57	+ 20	- 38
Switzerland	+ 6	- 20	+ 98	+ 29	+ 87
Sweden	+ 25	- 111	+ 39	+ 27	+ 38
Canada	+ 12	- 765	+ 651	- 14	+ 644
Japan	- 68	- 51	+ 385	-104	+ 244

<sup>1/</sup> United Kingdom data STRICTLY CONFIDENTIAL.

<sup>2/</sup> Including changes in IMF and GAB.

<sup>a/</sup> Excludes the addition of \$490 million to reserves in November 1967 resulting from the liquidation of U.S. securities held by the U.K. Treasury.

<sup>b/</sup> April-July.

Source: Confidential BIS data.



commercial banks' net external position in April-July 1968 reflected the results of several types of transactions: (1) a decrease in French banks' franc and foreign currency liabilities to foreigners as the latter sought to get their funds out of francs and out of the country; (2) an increase in franc denominated claims on foreigners as the latter increased their franc borrowings and presumably sold the francs for foreign currencies in hopes of realizing a profit if the franc were devalued before the loan matured; and (3) an increase in foreign currency assets as French residents shifted out of francs into foreign currencies and deposited the foreign currencies with banks in France.

Official reserve losses have continued in October. Transactions through the Federal Reserve Bank of New York would indicate net losses of more than \$100 million; in addition the Bank of France is reported to be engaging in swaps with French commercial banks, buying dollars spot and selling them forward, and using the spot dollars thus acquired.

France is expected to end the year with a substantial balance of payments deficit and to incur another large deficit in 1969. The seasonally-adjusted trade account (f.o.b. basis) swung into deficit following the strikes in the second quarter and remained in deficit in the third quarter. According to national accounts forecasts just released, for 1968 as a whole imports from outside the franc area are expected to increase by 13.4 per cent while exports are expected to grow by 12.1 per cent. In 1969, the projected import and export growth rates are 15.1 and 12.9 per cent respectively. With imports on an f.o.b. basis,

these projections would yield trade deficits of approximately \$200 million in 1968 and \$500 million in 1969, compared with an actual deficit of \$67 million in 1967. The overall current account deficits for 1968 and 1969 are expected to be even larger since the services account is also expected to swing into deficit.

Germany's overall balance of payments shifted from the surplus which had been maintained on the whole since early 1966 to a small deficit in the second quarter of this year, and continued to run monthly deficits through August. The emergence of a net debit in Germany's external transactions resulted from a large-scale net export of private capital--primarily long-term--which arose as a consequence of unusually easy credit conditions in Germany and resulting low interest rate levels relative to those in other major financial centers. This net outflow of private capital was large enough, in combination with outflows on services, donations and official capital accounts, to more than offset Germany's extremely large trade surplus. The resulting overall deficit amounted to \$77 million in the second quarter and \$199 million in July-August.

Despite this development, rumors of a possible DM revaluation have been encouraged by the prospect that the very large trade surplus would continue for some time and the possibility that the net private capital outflow could not be sustained. In late August and early September, speculation erupted and the Bundesbank found it necessary to purchase about \$1.8 billion in order to support the rate for the dollar on the exchange market, The Bundesbank entered into dollar/DM swaps with

commercial banks, selling dollars spot and buying them forward at rates more favorable than those in the market, in order to keep these funds from accruing to its foreign exchange reserves. Swaps made at the end of August and in the first two weeks of September amounted to \$1.8 billion, of which approximately \$500 million matured in the first half of October. Most if not all of the maturing swaps were renewed; the Bundesbank made it particularly attractive for banks to renew their cover for a three-month period, i.e., past the turn of the year, in order to minimize the customary year-end capital inflow produced by German commercial bank window dressing.

The April-August payments deficit was financed by a drawing down of commercial bank net foreign assets. The decline in commercial banks' foreign positions has been greater than the overall deficit so that German net official reserves rose. (See Tables 1 and 2.) Commercial banks may have drawn on their foreign positions to build up their domestic liquidity positions or to help meet domestic credit demand. More recently, as speculative expectations have subsided, the DM has weakened on the exchange markets. In the period October 1-23, the Bundesbank has experienced a reserve drain of \$420 million.

The April-July period showed an improvement in the United Kingdom's balance of payments and reserves. Net official reserve losses were reduced from \$1.4 billion in the first quarter to \$1.0 billion in the second quarter, and there was a net reserve gain of \$274 million in July-August.

The improvement in the overall payments balance resulted from improvements on both trade and long-term capital accounts. The U.K.'s trade deficit (on a seasonally-adjusted balance of payments basis) declined in the second quarter to \$526 million from an average of \$662 million in the two preceding quarters and declined further in the third quarter to \$329 million. This improvement reflected a substantial increase in exports, particularly in the third quarter when they averaged 7 per cent higher than in the first quarter. Import performance, however, has been disappointing as imports have remained very high despite devaluation and a restrictive domestic policy. Imports in the third quarter were 2 per cent higher than first quarter levels. Imports of food and manufactures have declined somewhat, giving some evidence that the Government's policy of restraint is having some effect in lowering consumer demand. However, fuel and basic material imports have risen both in volume and value.

An improvement in the second quarter on official long-term capital account also helped the balance of payments. Part of the improvement represented receipt of a 4-1/2 year, \$50 million loan from the German Government, extended as part of Germany's military offset payment to the U.K. A small improvement over first quarter results would still have been realized, however, without this receipt.

Despite these improvements, the U.K.'s progress in eliminating its balance of payments deficit is about six months behind the schedule envisaged at the time of devaluation. British officials now estimate that the 1968 balance of payments deficit on current and long-term capital

transactions will approximately equal the 1967 deficit of \$1.2 billion. This estimate implies a \$240 million deficit in the second half of this year, which would combine a deficit exceeding this amount in the third quarter with a small surplus in the last quarter. The surplus is expected to rise during the course of 1969 to an annual rate of \$700 million to \$1.0 billion in the second half of the year.

Italy's external accounts showed a substantial surplus in the second and third quarters, the period of seasonal strength of the Italian balance of payments. This year's surplus was considerably larger than in the comparable period of 1967.

Through August, the Italian trade balance continued to be much more favorable than in 1967. Export receipts were 12 per cent higher than a year earlier in the second quarter and 18 per cent higher in July-August. Import payments were up from a year earlier by only 1 per cent in the second quarter and 5 per cent in July-August. These increases in imports were, on average, much smaller than in 1967 (when they were 8 per cent above 1966), partly because of the slower rate of expansion of domestic economic activity this year.

The net outflow of private capital has continued to run well ahead of 1967 results, and the increase has offset a significant part of the improvement in the trade balance. In the April-August period net capital outflows totaled \$465 million compared to an outflow of \$303 million in the comparable 1967 period. The increase in the net private capital outflow in the first half of the year, and probably in the third quarter

as well, took the form chiefly of larger exports of Italian banknotes; in addition, foreign portfolio investment in Italy declined while Italian portfolio investment abroad increased.

The major part of Italy's payments surplus was financed by an improvement in the net foreign position of the commercial banks, the first time in about two years that the banks' foreign positions had shown any appreciable increase. This improvement is apparently not the result of any easing of the Bank of Italy's policy of severely limiting the volume of its new lira/dollar swaps with the commercial banks. Rather, banks are said to have let some foreign currency loans to residents run off because of a weakening of loan demand in Italy and to have placed the funds in foreign markets.

Overall balance of payments figures for Switzerland, which are available only through the second quarter, show the payments surplus continuing at a very high level. The surplus amounted to \$291 million in the first quarter and \$396 million in the second quarter; last year the first quarter recorded a surplus of \$80 million and the second a nominal deficit of \$4 million. The large increases in the overall surplus appear to reflect inflows of speculative capital in the first two quarters of this year; an improvement of only \$102 million in the unadjusted trade account in the first half of the year is not sufficient to explain the increase; moreover, the export of funds from Switzerland as a result of foreign bond flotations in the country was only \$24 million greater than in the first half of last year.

The first quarter surplus was probably affected by speculative flows out of dollars or sterling into Swiss francs, motivated by the same fears that resulted in the rush to buy gold. In the second quarter, the flight of French capital to Switzerland was very heavy, much of it in the form of French banknotes. In mid-July, the Swiss National Bank informed the American Embassy that the flow of French capital into Switzerland since the start of the unrest in France was estimated by them at about \$1 billion.

Canada recovered completely in the second and third quarters from the March speculative attack on the Canadian dollar. The overall payments surplus for the April-August period amounted to U.S. \$835 million compared to a deficit of \$407 million in the preceding six month period. Canada's official reserves increased by U.S. \$651 million during the second and third quarters, thus recouping most of the \$816 million lost in the first quarter. Official holdings of gold and U.S. dollars at the end of September amounted to \$2,534 million, very near the reserve ceiling agreed upon between Canada and the United States.

A major factor in the dramatic turnaround of Canada's balance of payments was the massive reversal of capital flows. Complete balance of payments data, available only through the second quarter, show a swing from a net capital outflow of \$486 million in the first quarter to a net inflow of \$571 million in the second quarter. The improvement in the capital account was about evenly divided between long- and short-term flows. In the second quarter Canada borrowed \$275 million in European capital markets,

a large part of which consisted of government borrowing for reserve purposes. Normally Canada does most of its foreign borrowing in the U.S. capital market.

Canada also registered a notable improvement between the first two quarters in its current account. This was primarily attributable to an increased merchandise surplus and most of this improvement was gained in trade with the United States.

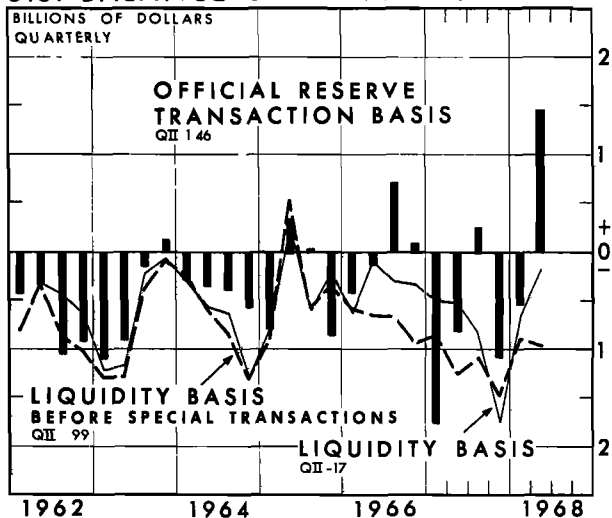
Japan also registered a large swing in its balance of payments from substantial deficit in 1967 to a surplus position as of the second quarter of this year. In April-August Japan's external surplus totaled \$567 million in contrast to a deficit of \$232 million registered in the same period of 1967. The swing into surplus has resulted mainly from a large improvement on trade account as domestic demand pressures have abated while foreign demand has accelerated sharply. Exports in the third quarter were 25 per cent higher than in the same period a year earlier; the export boom has been significantly supported by heavy demand from the United States. Imports rose 9 per cent over the same period. The seasonally-adjusted trade balance consequently swung from a deficit of \$312 million in the third quarter of 1967 to a surplus of \$95 million in the third quarter this year.



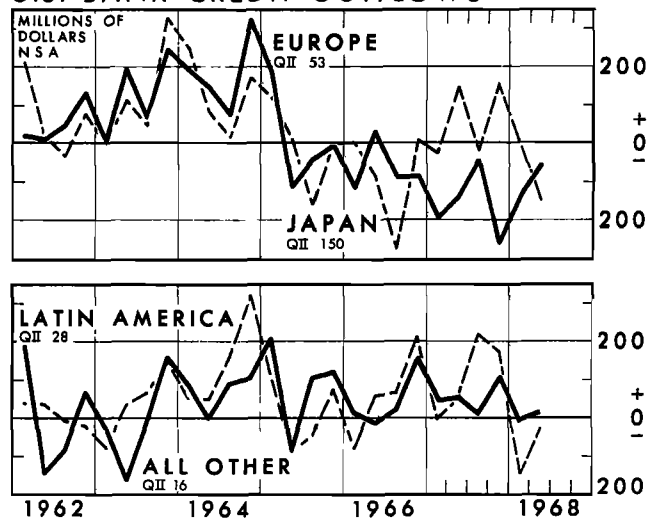
# U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

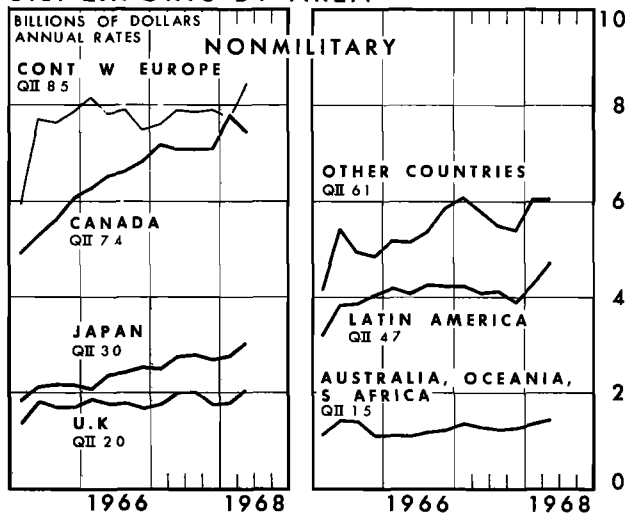
## U.S. BALANCE OF PAYMENTS



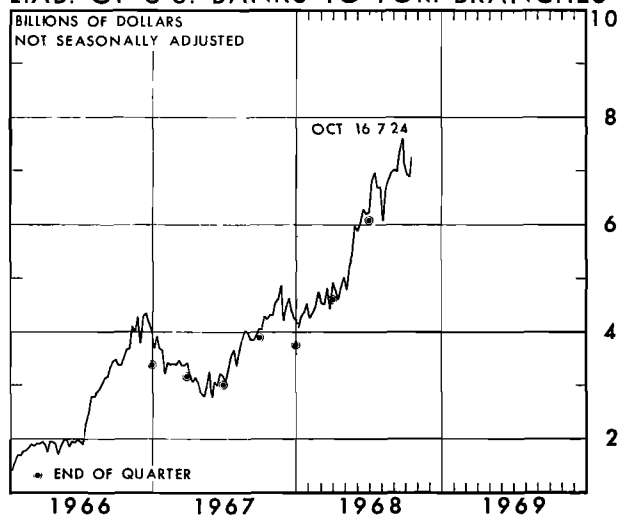
## U.S. BANK CREDIT OUTFLOWS



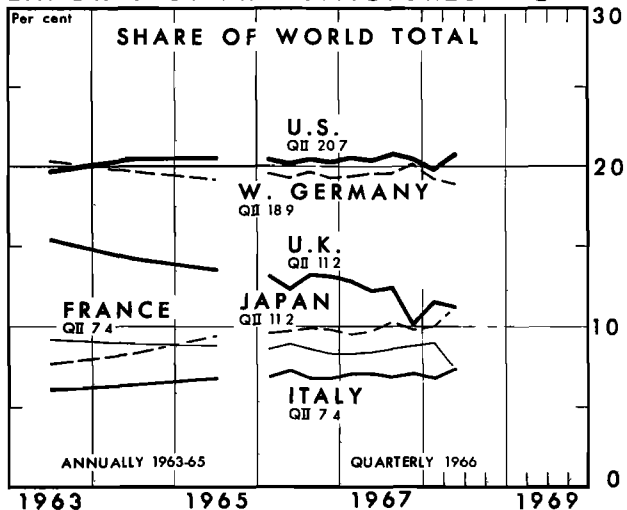
## U.S. EXPORTS BY AREA



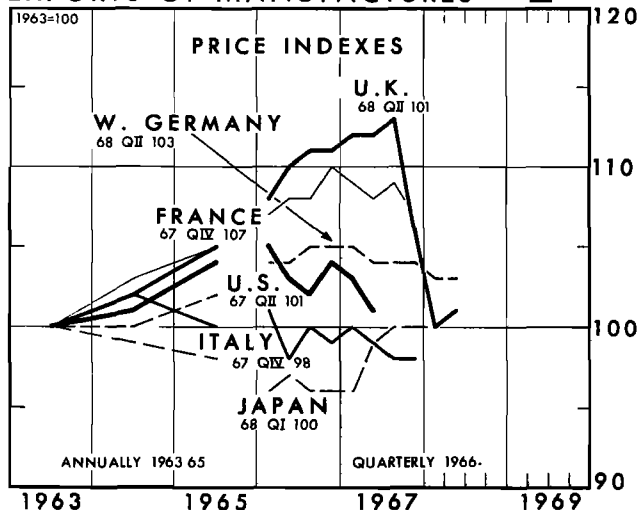
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## EXPORTS OF MANUFACTURES - I



## EXPORTS OF MANUFACTURES - II



APPENDIX A  
MEASURES OF THE U.S. BALANCE OF PAYMENTS AND SELECTED "SPECIAL" TRANSACTIONS  
(millions of dollars) 1/

	1 9 6 7				1 9 6 8		
	QI	QII	QIII	QIV	QI	QII	QIII <sup>P</sup>
1. Liquidity balance, NSA (deficit -)	-238	-215	-1,228	-1,897	-252	+136	-568
Seasonal adjustment	-267	-302	+410	+159	-411	-303	+450
Liquidity balance, SA	-505	-517	-818	-1,738	-663	-167	-118
2. <u>SELECTED "SPECIAL" TRANSACTIONS</u>							
A. Investments in long-term deposits:							
* By foreign governments 2/	+304	+442	-7	+190	+135	+160	+17
By int'l. and regional institutions	+70	+24	+54	+35	-55	+22	-27
B. Investments in U.S. Govt. Agency Securities:							
By foreign governments 2/	--	--	--	+28	+10	+4	--
By int'l. and regional institutions	-6	+72	+67	-12	-39	-42	+67
C. U.K. official transactions:							
Long-term deposits	-1	-50	-1	-20	-16	--	--
* Liquidation of U.S. securities							
other than Treasury issues	+9	+52	+52	-552	--	--	--
D. Canadian Govt. transactions							
Long-term deposits	--	+200	-200	--	--	--	--
Net purchases of nonmktble.,							
nonconvert. U.S. Govt. Securities	--	--	+200	-30	+100	+500	+250
* Other	--	+30	--	--	-35	-72	--
* E. Nonscheduled debt repayment	--	*	+6	*	+42	+3	+65
F. Transactions in nonmktble., nonconvertible							
U.S. Govt. Securities 2/	-1	-3	+123	+124	+115	+252	+159
(of which are German transactions)			(+125)	(+125)	(+125)	(+250) <sup>3/</sup>	(+125)
TOTAL SELECTED "SPECIAL" TRANSACTIONS	+375	+767	+294	-237	+257	+827	+531
3. <u>LIQUIDITY DEFICIT BEFORE REDUCTION BY</u>							
<u>"SPECIAL" TRANSACTIONS</u>	-880	-1,283	-1,112	-1,501	-920	-994	-649
4. Official settlements balance, NSA (deficit -)	-1,279	-710	-20	-1,403	+94	+1,558	n. a.
Seasonal adjustment	-485	-101	+272	+314	-629	-102	
Official settlements balance, SA	-1,764	-811	+252	-1,089	-535	+1,456	
5. "SPECIAL" TRANSACTIONS AFFECTING OFFICIAL							
SETTLEMENTS BALANCE (Items marked * above)	+9	+82	+58	-524	+17	+60	+65
6. <u>OFFICIAL SETTLEMENTS BALANCE BEFORE</u>							
<u>REDUCTION BY "SPECIAL" TRANSACTIONS</u>	-1,773	-893	+194	-565	-552	+1,396	n. a.

1/ Figures may not add because of rounding.

2/ Excluding the U.K. and Canada

3/ \$125 million of which was sold to German commercial banks, thus affecting both measures of the

U.S. balance of payments