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CURRENT ECONOMIC
and
FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

January 8, 1969

CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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SUMMARY AND OUTLOOK

Outlook for economic activity

The economy has entered the new year showing evidence of a growing imbalance between output and consumption. Although growth of GNP in the fourth quarter appears to have been about as large as in the previous quarter, the rise was mainly sustained by substantial inventory accumulation. Income growth slowed and the increase in personal consumption expenditures moderated significantly--reflecting particularly a drop in auto sales, but moderation in the rise in non-durables as well. Although residential construction activity and business expenditures for plant and equipment apparently rose briskly in the fourth quarter, the increase in total final sales still dropped sharply to an estimated annual rate of $15 billion from $21 billion in the third quarter.

Growth in GNP is expected to slow markedly in the first and second quarters. With stock-sales ratios apparently moving up at year-end, and consumer expenditures expected to increase only moderately because of a further tax bite, stock building should ease, resulting in adjustments of production schedules. Output schedules for autos have already been lowered for January. Even if final sales were to advance at about the reduced fourth quarter rate, less intensive inventory buildup could reduce real growth in GNP to less than 3 per cent in the first quarter.

As slower growth in final demands continues to dampen incentives for inventory building, businessmen are also likely to start to trim their plans for capacity expansion, given the rather substantial industrial capacity available. The impact of credit restraint should also limit construction activity, particularly if there is widespread disintermediation at thrift institutions. Moreover, Federal spending for goods and services should be level to down by the spring quarter. Consequently, real growth in total GNP could be down to less than a 2 per cent annual rate by midyear. With overall demand easing, some reduction of price pressures may be anticipated, and the GNP deflator is likely to dip to less than a 3-1/2 per cent rate of increase by the second quarter.

Outlook for prices and resource use

The rise in industrial production in late 1968 exceeded earlier anticipations and the index for the fourth quarter is now expected to average close to 167.5, up at an annual rate of more than 5 per cent from the third quarter. Business efforts to reduce the recent excessive rate of inventory accumulation are likely to accompany a moderation of final demand pressures in the first half of this year, acting to slow the rise in industrial production.

At yearend, at an estimated 84.5 per cent, the rate of manufacturing capacity utilization was up appreciably from the summer low, but not quite up to the level prevailing from mid-1967 to mid-1968. With a shading off of the production rise now in prospect in the first half, the rate of capacity utilization will probably recede moderately again.

Demand for labor continued very strong through December, partly reflecting the upturn in manufacturing employment in recent months but mainly because of continuing rapid growth outside manufacturing. The unemployment rate last month remained at the 15-year low of 3.3 per cent reached in November.

There appears to be no let-up yet in labor pressure for large wage increases. First-year wage increases in early 1969 will probably continue the high 1968 pattern. However, with relatively few new settlements scheduled this year some easing of upward pressure on average wages in manufacturing can be expected--not enough, however, to avoid resumption of increases in unit labor costs in view of a probable slowing in production and productivity increases.

Prices of industrial commodities at wholesale and consumer prices generally continue to rise at a rapid pace. An exceptionally large flurry of industrial price increases takes effect early this month. In general, current strong upward price movements reflect accumulated labor and other cost increases, strong business investment demands, and pervasive expectations of persistence of inflationary pressures. As the latter recede under the weight of excessive inventories, monetary and fiscal restraint, and shifting expectations, price increases are likely to slacken.

Outlook for supply of funds

The further rise in the prime rate at major banks to 7 per cent appears to have been triggered more by the developing squeeze on funds available at banks than by any exceptional strength in loan demands. In addition to the heavy continuing run-off of their CD's, major banks have been forced to pay as much as 8 per cent on call money borrowed in the Euro-dollar market, and the availability of these funds has apparently been somewhat constricted, although to some extent perhaps only temporarily. In December, CD attrition at all banks amounted to about $1.3 billion. If rates on short-term market instruments remain close to or above their new recent highs, CD run-off in January could easily be as large as in December, with the bulk of the decline continuing to be centered on the largest money market banks. Smaller regional banks, which have focused heavily on less interest-sensitive customer-oriented deposits, seem more likely to be able to continue rolling-over the bulk of their prospective maturities.

Inflows of consumer-type time and savings deposits at commercial banks are also likely to shrink from their rapid pace of late 1968, in view of the record yields on competitive market instruments and the reduced consumer savings rate projected for the first quarter. Inquiries at banks by savers interested in obtaining high yielding Treasury securities, and the increase in the size of the non-competitive tender in the most recent Treasury bill auction suggest that the levels to which yields have now moved are again eliciting an interest in transfers of savings to market securities.

Inflows of savings to nonbank thrift institutions are also likely to be increasingly affected by this desire of the public for higher interest earnings, particularly during the crucial dividend reinvestment period now underway. While information thus far available on thrift institution experience does not suggest any sharp deterioration in the early days of the reinvestment period, this evidence is too fragmentary to support a firm conclusion about the whole period. In any event, with a record volume of commitments already outstanding at savings and loan associations and savings banks, these institutions can be expected to cut back further on new commitments in the period ahead, and to repay borrowings in less than usual seasonal amounts. These possibilities, which have recently been accentuated by the likelihood of more than seasonal reduction in mortgage takings by commercial banks, suggest that upward pressure on mortgage yields will continue.

Demand deposits at banks are also expected to expand at a slower rate than they did in the fourth quarter. With GNP projected to rise at a reduced pace, need for transactions balances should moderate. In addition, demand balances would normally be under some pressure as a result of high yields on competing instruments and the reduced availability of credit. Finally, a further drain on private deposits will develop in January as Treasury balances are built-up by new cash financing.

Credit demand outlook

Credit demands at banks and in securities markets, while likely to remain fairly strong during January and February, are not expected to be significantly larger than they have been--taken in toto. A large source of demand will be the Federal Government, which in this month and next will need to raise $3 to 4 billion of new money. Market pressures arising from this borrowing should be moderated, however, by the outlook for unusually heavy seasonal Treasury debt repayment starting in late March and running through June.

Bond volume in both corporate and municipal markets is also expected to be relatively large in January and February. In the case of corporate issues, public offerings are likely to average slightly above the 1968 pace. Although it is possible that increasing concern about the general availability of funds will lead to additional, anticipatory borrowing, some businesses with firm lines of credit already secured at banks may very well defer capital market borrowing in the hope of obtaining lower rates later on. In the case of the tax-exempt market, with the flood of industrial revenue offerings now halted, new issue volume seems likely to fall short of last year's record pace. Growing constraints on bank participation, along with the further rise in bond yields set-off by the latest prime rate increase, may well lead to further postponements. Even so, general State and local government demands for funds appear to be strong enough to maintain the volume of new issues at a relatively high level.

Expansion of business loans at banks in January is expected to be relatively moderate, aside from a very large participated loan to facilitate the Atlantic-Sinclair merger early in the month. For the quarter as a whole, business financing requirements are still expected to be fairly sizable, although some slowing in the rise of plant and equipment expenditures, and inventory accumulation is anticipated. The further rise in the prime rate, together with more selective policies currently being adopted by some large banks, should help to restrain the rate of new borrowing at banks.

With overall credit demands not expected to show any significant tendency to accelerate, the near-term course of interest rates will continue to be especially sensitive to changes in supplies of funds and to marginal shifts in market expectations. Even before the latest change in the prime rate, market participants apparently were being pulled in two directions on their outlook for interest rates. Question was being raised, on the one hand, whether incompatibility between the recent trend of consumer spending and projected business spending might lead to a slowing of the latter. On the other hand, the extent of the squeeze on major banks in CD and Euro-dollar markets was being watched carefully for signs of a developing credit crunch. Following a period of adjustment to the prime rate change, interest rate movements in the weeks ahead will depend importantly on how the balance between these two influences on expectations actually appears to be working out.

Balance of payments outlook

Partly in consequence of the East Coast and Gulf ports strike that began December 20, no early improvement can be expected in the merchandise trade balance or in net exports of goods and services. In the three months September-November the trade surplus was under $1 billion, annual rate. By the second quarter, the rise in exports -- boosted by a post-strike catch-up -- and in investment income receipts should begin to exceed growth in payments for imports and other net current transactions.

Very large private and official capital inflows at the year-end swung the over-all balance on the liquidity basis into surplus for the fourth quarter. The private capital inflows appear to have been much larger than the control programs for banks and direct investors required. Since they had their counterpart mainly in a decline in liabilities of U.S. banks to their foreign branches, the year-end inflows had little effect on the official settlements balance.

The near-term outlook for flows of foreign private capital is in many respects obscure. There is little likelihood of further expansion in foreign purchases of U.S. equities, which have been very large in recent months. In the short-term funds markets, U.S. banks have recent been bidding up Euro-dollar interest rates to unusually high levels, but whether large supplies of funds will be obtainable through the Euro-dollar market is doubtful in view of the cessation of large withdrawals from sterling and the French franc.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per Cent Change: Year Ago*	Per Cent Change: 2 Yrs. Ago*
Civilian labor force (mil.)	Dec'68	79.5	79.0	78.5	1.3	3.6
Unemployment (mil.)	"	2.6	2.6	2.9	-10.6	-9.9
Unemployment (per cent)	"	3.3	3.3	3.7	--	--
Nonfarm employment, payroll (mil.)	"	69.2	68.9	67.1	3.2	6.0
Manufacturing	"	19.9	19.9	19.6	1.7	1.7
Other industrial	"	8.4	8.3	8.2	2.2	3.2
Nonindustrial	"	40.9	40.8	39.3	4.1	8.8
Industrial production (57-59=100)	Nov'68	167.4	165.7	159.8	4.8	5.2
Final products	"	167.7	166.7	160.1	4.7	5.5
Materials	"	167.4	164.8	160.1	4.6	5.3
Wholesale prices (57-59=100)1/	"	109.6	109.1	106.2	3.2	3.5
Industrial commodities (FR)	"	109.0	108.8	106.3	2.5	4.1
Sensitive materials (FR)	"	108.4	107.9	102.3	6.0	6.4
Farm products, foods & feeds	"	108.3	107.4	103.4	4.7	1.1
Consumer prices (57-59=100)1/	"	123.4	122.9	117.8	4.8	7.7
Commodities except food	"	115.3	114.7	111.1	3.8	7.0
Food	"	120.5	120.9	115.6	4.2	5.0
Services	"	137.4	136.6	129.6	6.0	10.2
Hourly earnings, mfg. ($)	Dec'68	3.08	3.08	2.89	6.6	12.0
Weekly earnings, mfg. ($)	"	125.77	125.59	118.04	6.5	11.5
Personal income ($ bil.)2/	Nov'68	707.0	703.2	644.9	9.6	16.8
Corporate profits before tax ($ bil.)2/	QIII'68	92.7	91.8	80.8	14.7	6.9
Retail sales, total ($ bil.)	Nov'68	28.9	28.7	26.4	9.5	12.6
Autos (million units)2/	"	8.8	9.1	7.3	21.3	7.1
GAF ($ bil.)	"	7.8	7.6	7.3	6.4	13.7
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,677	1,562	1,590	5.5	72.0
Factory workweek (hours)	Dec'68	40.7	40.8	40.7	0.0	-0.5
New orders, dur. goods ($ bil.)	Nov'68	29.6	30.3	25.9	14.6	17.7
New orders, nonel. mach. ($ bil.)	"	5.3	5.4	4.5	17.6	23.7
Common stock prices (1941-43=10)	Dec'68	106.48	105.40	95.30	11.7	30.9
Inventories, book val. ($ bil.)	Nov'68	153.2	152.1	142.6	7.5	12.9
Gross national product ($ bil.)2/	QIII'68	871.0	852.9	795.3	9.5	15.6
Real GNP ($ bil., 1958 prices)2/	QIII'68	712.3	703.4	675.6	5.4	8.0

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Jan. 3	4-week average	Last 6 months High	Last 6 months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	5.84	6.07	6.50	5.08
U.S. Treas. bills, 3-mo., yield (per cent)	6.20	6.06	6.22	4.96
U.S. Treas. bills, 1-yr., yield (per cent)	6.20	6.07	6.38	5.10
Net free reserves 2/ ($ millions)	-488	-366	+ 21	-488
Member bank borrowings 2/ ($ millions)	1,318	765	1,318	337
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds 1/	6.29	6.18	6.32	5.45
20-year U.S. Treas. bonds 1/	5.97	5.92	6.06	5.18
Corporate new bond issues, Aaa adj. 8/	-- 10/	6.94	7.02	6.13
Corporate seasoned bonds, Aaa 1/	6.50	6.50	6.55	5.95
Municipal seasoned bonds, Aaa 1/	4.57	4.54	4.57	3.80
FHA home mortgages, 30-year 3/	--	7.36	7.52	7.28
Common stocks, S&P composite series 4/				
Prices, closing (1941-43=10)	103.99	105.66	108.37	96.63
Dividend yield (per cent)	2.99	2.94	3.13	2.87

	Latest month	Amount	3-month average	Change from year earlier: Latest month	Change from year earlier: 3-month average
New Security Issues (N.S.A., $ millions)					
Corporate public offerings 5/	Feb. 1969 e/	1,000	1,058	23	-146
State & local govt. public offerings	Feb. 1969 e/	1,000	1,000	-153	-170
Comm. & fin. co. paper (net change in outstandings) 6/	Nov. 1968	+1,381	+495	+1,011	+385

	Latest month	Out-standings Latest month	Change: Latest month	Change: 3-month average	Annual rate of change from: Pre-ceding month	3 months ago	12 months ago
Banking (S.A.)		($ billions)			(per cent)		
Total reserves 1/	Dec. '68	26.98	0.25	0.19	11.2	8.8	7.3
Credit proxy 1/	Nov. '68	293.8	2.9	2.6	12.0	11.1	7.7
Bank credit, total 6/	Nov. '68	381.6	2.0	3.7	6.3	12.1	10.8
Business loans	" "	94.3	1.6	1.0	20.7	12.7	11.1
Other loans	" "	156.1	1.9	2.1	14.8	17.1	13.3
U.S. Govt. sec.	" "	61.0	-3.2	-1.0	-59.8	-18.2	--
Other securities	" "	70.2	1.7	1.6	29.8	28.7	16.2
Total liquid assets 1/ 6/	Nov. '68	697.6	2.8	4.6	4.8	8.1	7.7
Demand dep. & currency 1/	Dec. '68	193.1	1.1	1.2	6.9	7.6	6.5
Time & sav. dep., comm. banks 1/	" "	204.3	2.4	2.6	14.3	15.7	11.3
Savings, other thrift instit. 6/	Nov. '68	195.0	1.2	1.3	7.4	8.2	6.2
Other 6/ 7/	" "	108.5	-2.7	--	-29.1	0.4	7.9

N.S.A. -- not seasonally adjusted. S.A. -- Seasonally adjusted.
e. Estimated by F.R.B. 1/ Average of daily figures. 2/ Average for statement week ending Jan. 8. 3/ Latest figure is monthly average for Nov. 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 Jan. 12. 10/ No new issues.

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

	1 9 6 7			1 9 6 8				
	Year	III	IV	I	II	III [p]	Oct. [p]	Nov. [p]
				Seasonally adjusted				
Goods and services, net 1/	4,769	1,359	848	326	592	878		
Trade balance 2/	3,477	1,085	319	57	5	262	-140	110
Exports 2/	30,468	7,626	7,478	7,924	8,325	8,840	2,532	2,945
Imports 2/	-26,991	-6,541	-7,159	-7,867	-8,320	-8,578	-2,672	-2,835
Services balance	1,292	274	529	269	587	616		
Remittances and pensions	-1,275	-358	-263	-266	-286	-300		
Govt. grants & capital 3/	-4,211	-988	-1,008	-1,164	-1,072	-953		
U.S. private capital	-5,505	-1,788	-1,638	-707	-1,448	-1,768		
Direct investment	-3,021	-902	-815	-374	-1,035	-1,102		
Foreign securities	-1,266	-476	-332	- 385	-83	-313		
Banking claims	-459	-435	95	303	196	-194	*-184	*-79
Other	-759	24	-586	-251	-526	-159		
Foreign capital, nonliquid	3,186	766	353	1,367	2,479	1,740		
Official foreign accounts	1,274	18	150	344	927	430		
Long-term deposits	820	-215	147	122	145	118		
U.S. Govt. liabilities	454	233	3	222	782	312		
International institutions 4/	314	117	30	-94	-20	51		
Other 5/	1,598	631	173	1,117	1,572	1,259		
Errors and omissions	-535	207	-34	-243	-429	444		
		Balances, with and without seasonal adjustment (- deficit)						
Liquidity balance, S.A.		-802	-1,742	-687	-164	41		
Seasonal component		-410	-159	428	236	-491		
Balance, N.S.A.	-3,571	-1,212	-1,901	-259	72	-450	-584	-421
Official settlements bal., S.A.		247	-1,082	-556	1,528	444		
Seasonal component		-272	-314	646	35	-353		
Balance, N.S.A. 6/	-3,405	-25	-1,396	90	1,563	91	-447	-300
			Reserve changes, N.S.A. (decrease -)					
Total monetary reserves	-52	375	181	-904	137	571	-207	1,233
Gold stock	-1,170	-92	-1,012	-1,362	-22	74	33	109
Convertible currencies	1,024	462	1,145	401	-267	474	-250	952
IMF gold tranche	94	5	48	57	426	23	10	172

1/ Equals "net exports" in the GNP, except for latest revisions.
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.
*/ N.S.A.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. The rise in current dollar GNP in the quarter just ended apparently exceeded the $18 billion increase in the previous quarter. However, the past three months were characterized by mixed signs of strength and weakness in the private economy, and by a leveling-off in Federal expenditures. Outlays for residential construction turned up, investment in plant and equipment apparently rose strongly and the rate of inventory accumulation accelerated sharply. But consumer outlays increased only about half as much as in the third quarter, and the rise in total final sales is estimated at about $15 billion compared with over $21 billion in the previous quarter.

Economic expansion is expected to slow markedly over the first half of this year, as business adjusts production to a continuation of the more moderate rise in final sales which characterized the fourth quarter. Inventory accumulation, which contributed substantially to the rise in GNP in the fourth quarter is likely to be curtailed as stocks become top-heavy, and firmer credit restraint also will limit investment, particularly in residential construction.

Slackening in consumer demand for goods in the fourth quarter was general. There was no rise at all in durable goods outlays--unit sales of domestic autos declined somewhat in November from the peak October rate of 9.1 million and fell substantially further in December to a rate of only 8.2 million. This reduced the average annual rate of sales from 9.0 million in the third quarter to 8.7 million in the fourth. Nondurable goods sales were not much above mid-summer levels in November and apparently also in December.

PER CENT CHANGES IN VALUE OF RETAIL SALES

	1968			
	QI	QII	QIII	QIV[e/]
Total retail sales	4.7	2.0	2.9	-0.5
Total less autos	4.0	1.5	1.9	0.7
Durables	5.9	3.1	5.2	-3.1
Durables less autos	2.7	1.2	2.8	0.2
Nondurables	4.2	1.5	1.8	0.7

Some potential sales of both durable and nondurable goods may have been lost in December because of the influenza epidemic. But the easing of consumer demand in the fourth quarter likely reflected the more moderate growth of disposable income after midyear and perhaps also reluctance of consumers, who had cut their saving rate sharply in the third quarter, to reduce it further in the fourth. In addition, the intensification of inflationary fears in the fourth quarter may have been a factor. Expectations of inflation apparently make consumers apprehensive; somewhat paradoxically, rather than buying more heavily, they tend to save for precautionary reasons. The latest Michigan survey of consumer attitudes taken in November and early December indicates that people do not regard the present as a favorable time to buy big-ticket items.

Businessmen, on the other hand, appear to have been more optimistic than consumers. Outlays for construction and fixed investment rose briskly in the fourth quarter. Manufacturers' new orders for machinery and equipment apparently averaged substantially higher than in the third quarter as did industrial output; unemployment was lower as employment climbed further.

The rate of inventory accumulation rose substantially in the fourth quarter from the moderate third quarter pace. The book value of inventories in October-November rose at an annual rate of about $15 billion, more than half of which was in trade. Moreover, in view of an estimated easing in retail sales in December and a further sizable increase in industrial production, it seems likely that there was a further climb of substantial proportions. Thus, even after allowing for inventory valuation, we have estimated that nonfarm business inventories may have been accumulated at an annual rate of $12 billion last quarter. The faster pace of inventory-building is estimated to have added as much as $4.5 billion to increase in GNP, whereas, in the preceding quarter, a decline in the annual rate of accumulation subtracted nearly $3.5 billion.

Capital investment is also believed to have contributed significantly to economic growth in the fourth quarter, even if--as we assume--the ambitious plans of businessmen for spending in the fourth quarter were not fully realized. The projected climb from last spring is one of the fastest on record, and is particularly noteworthy in view of the absence of those factors which are usually associated with a capital goods boom, such as capacity shortages, or a preceding period of under-investment. The explanation seems to lie largely in longer-run optimism and in current and prospective rising costs of capital goods. With wages expected to continue to rise at a substantial rate, efforts to reduce unit labor costs also have been an important consideration.

The rise in residential construction outlays in October-December reflected a step-up in housing starts that began in the third quarter, and the further climb--probably to over 1.60 million--in the fourth quarter. Fourth quarter starts were higher than previously expected despite a firming in mortgage interest rates in November and December. The pick-up seems to be due in part to a desire of builders to accelerate take-down of the large outstanding backlog of mortgage commitments in order to avoid possible cancellations. An attempt to take advantage of commitments promptly could mean that the advanced November rate of 1.7 million starts might continue for several months until monetary restraint exerts pressure on the ability of mortgage institutions to carry out commitments at this rate.

Although the rise in current dollar GNP in the fourth quarter may have exceeded that of the third quarter, the rate of real growth may have edged down reflecting a rise in the GNP deflator from 3.4 per cent--2.8 per cent excluding the Federal pay raise in the third quarter--to 3.9 per cent, which is about the average rise in the first half of the year. (We have not been able to reconcile the sharp dip in the deflator in the third quarter, as officially estimated, with changes in major price series even after adjustment for comparability.)

In the current quarter, the rise in current dollar GNP is likely to be reduced to a rate of about $14 billion, and the rate of real growth may fall from almost 5 per cent to about 2-1/2 per cent. The decline from the fourth quarter would result largely from a decline in the rate of inventory accumulation after the fourth quarter step-up. By comparison, final sales are expected to continue to rise at approximately the fourth quarter rate. With starts at higher levels and commitments still large, residential construction outlays may rise somewhat further, while expenditures for plant and equipment are likely to continue sharply upward in view of expanded order backlogs and current plans for higher spending.

But gains in personal consumption expenditures are likely to continue moderate. Increases in disposable income this quarter are expected to be moderated by the January boost in social security taxes and by higher retroactive income tax payments. As a result, even with some further reduction in the rate of saving, the volume of consumption is not likely to be much greater than in the fourth quarter.

By the second quarter, the slowdown in the economy should be more perceptible, both in a smaller gain in current dollar GNP--which may be at a rate of around $11 billion--and in a further dip in the real growth to about 1-1/2 per cent. The imbalance between inventories and sales should be reflected in a further decline in the rate of inventory accumulation and in a slower rise of industrial production. In addition, tight conditions in the mortgage market seem likely to bring a reduction in housing starts in the second quarter to a rate of about 1.5 million units, and residential construction expenditures should begin to decline. Nor does it seem likely that the rate of expansion in investment in plant and equipment will be sustained. Consumer spending is also likely to show little vigor as the flow of personal income expands but slowly in response to production cut-backs and as tax payments are swollen further by "clean-up" payments on 1968 liabilities.

Although Federal expenditures for defense and other goods and services are leveling off, rising outlays for transfer payments, interest, and other items required by statute are still expanding. However, receipts have been rising more rapidly than expenditures since mid-1968, replacing the $10 billion (NIA) deficit of the second quarter with a small surplus last quarter; the surplus should continue to grow reaching an estimated annual rate of $6.5 billion in the second 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.	1968 I	1968 II	1968 III	1968 IV	1969 Projected I	1969 Projected II
Gross National Product	789.7	861.3	831.2	852.9	871.0	890.0	904.0	915.0
Final sales	783.6	853.2	829.1	842.1	863.5	878.0	894.0	907.0
Private	605.2	656.2	638.6	646.4	663.9	675.9	687.8	698.6
Personal consumption expenditures	492.2	534.0	519.4	527.9	541.1	547.6	555.6	563.5
Durable goods	72.6	82.5	79.0	81.0	85.1	85.0	85.0	85.0
Nondurable goods	215.8	230.6	226.5	228.2	232.7	235.0	238.3	242.0
Services	203.8	220.9	213.9	218.7	223.4	227.6	232.3	236.5
Gross private domestic investment	114.3	127.8	119.7	127.3	127.1	137.0	139.4	138.1
Residential construction	24.6	29.9	29.1	29.5	29.5	31.6	33.1	32.3
Business fixed investment	83.6	89.8	88.6	87.0	90.1	93.4	96.3	97.8
Change in business inventories	6.1	8.1	2.1	10.8	7.5	12.0	10.0	8.0
Nonfarm	5.6	7.8	1.6	10.4	7.3	12.0	10.0	8.0
Net Exports	4.8	2.5	1.5	2.0	3.3	3.3	2.8	5.0
Gov't. purchases of goods & services	178.4	197.0	190.5	195.7	199.6	202.1	206.2	208.4
Federal	90.6	100.0	97.1	100.0	101.2	101.5	103.0	103.0
Defense	72.4	78.9	76.8	79.0	79.6	80.0	81.0	81.0
Other	18.2	21.1	20.3	21.0	21.5	21.5	22.0	22.0
State & local	87.8	97.0	93.4	95.6	98.4	100.6	103.2	105.4
Gross national product in constant (1958) dollars	673.1	707.3	692.7	703.4	712.3	720.8	725.4	728.1
GNP implicit deflator (1958=100)	117.3	121.8	120.0	121.2	122.3	123.5	124.6	125.7
Personal income	628.8	685.6	662.7	678.1	694.3	707.2	718.0	728.5
Wages and salaries	423.4	463.2	448.3	457.6	469.0	478.0	486.9	494.5
Disposable income	546.3	588.7	574.4	586.3	592.7	601.5	608.0	615.6
Personal saving	40.2	40.3	40.8	44.0	37.1	39.2	37.3	36.9
Saving rate (per cent)	7.4	6.8	7.1	7.5	6.3	6.5	6.1	6.0
Corporate profits before tax	81.6	92.7	88.9	91.8	92.7	97.5	95.0	93.0
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	151.2	177.2	166.6	171.8	182.1	188.3	194.7	196.8
Expenditures	163.6	182.3	175.1	181.9	184.9	187.3	189.7	190.3
Surplus or deficit (-)	-12.4	-5.1	-8.6	-10.2	-2.8	1.0	5.0	6.5
Total labor force (millions)	80.8	82.3	81.9	82.2	82.4	82.6	83.1	83.5
Armed forces "	3.4	3.5	3.5	3.5	3.6	3.5	3.5	3.5
Civilian labor force "	77.3	78.8	78.4	78.7	78.8	79.1	79.6	80.0
Unemployment rate (per cent)	3.8	3.6	3.6	3.6	3.6	3.4	3.6	3.9
Nonfarm payroll employment (millions)	66.0	68.1	67.4	67.8	68.3	68.9	69.3	69.5
Manufacturing	19.4	19.8	19.6	19.7	19.8	19.9	19.9	19.8
Industrial production (1957-59=100)	158.1	164.7	162.1	164.2	165.2	167.4	169.0	169.6
Capacity utilization, manufacturing (per cent)	85.3	84.5	84.9	84.8	84.0	84.1	83.7	83.0
Housing starts, private (millions A.R.)	1.29	1.53	1.50	1.44	1.55	1.63	1.73	1.53
Sales new domestic autos (millions, A.R.)	7.57	8.59	8.19	8.44	9.01	8.72	8.75	8.50

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1967	1968 Proj.	1968 I	1968 II	1968 III	1968 IV (Projected)	1969 I (Projected)	1969 II (Projected)
	In billions of dollars							
Gross National Product	42.1	71.6	20.2	21.7	18.1	19.0	14.0	11.0
Inventory change	-8.6	2.0	-6.2	8.7	-3.3	4.5	-2.0	-2.0
Final sales	50.8	69.6	26.4	13.0	21.4	14.5	16.0	13.0
Private	28.6	51.0	19.4	7.8	17.5	12.0	11.9	10.8
Government	22.2	18.6	7.0	5.2	3.9	2.5	4.1	2.2
GNP in constant (1958) dollars	16.0	34.2	10.9	10.7	8.9	8.5	4.6	2.7
Final sales	24.0	32.7	16.9	2.8	12.0	4.3	6.5	4.5
Private	9.8	24.3	12.4	0.1	11.1	3.9	5.0	6.0
	In Per Cent Per Year							
Gross National Product	5.6	9.1	10.0	10.4	8.5	8.7	6.3	4.9
Final sales	6.9	8.9	13.2	6.3	10.2	6.7	7.3	5.8
Private	5.0	8.4	12.5	4.9	10.8	7.2	7.0	6.3
Personal consumption expenditures	5.7	8.5	13.7	6.5	10.0	4.8	5.8	5.7
Durable goods	3.0	13.6	25.9	10.1	20.2	-0.5	0.0	0.0
Nondurable goods	4.4	6.9	14.8	3.0	7.9	4.0	5.6	6.2
Services	8.2	8.4	8.2	9.0	8.6	7.5	8.3	7.2
Gross private domestic investment	-5.4	11.8	-6.9	25.4	-0.6	31.2	7.0	-3.7
Residential construction	-0.8	21.5	8.4	5.5	0.0	28.5	19.0	-9.7
Business fixed investment	2.8	7.4	16.9	-7.2	14.3	14.6	12.4	6.2
Gov't. purchases of goods & services	14.2	10.4	15.3	10.9	8.0	5.0	8.1	4.3
Federal	17.1	10.4	15.4	11.9	4.8	1.2	5.9	0.0
Defense	19.5	9.0	11.8	11.5	3.0	2.0	5.0	0.0
Other	8.3	15.9	27.4	13.8	9.5	0.0	9.3	0.0
State & local	11.4	10.5	15.1	9.4	11.7	8.9	10.3	8.5
GNP in constant (1958) dollars	2.4	5.1	6.4	6.2	5.0	4.8	2.6	1.5
Final sales	3.7	4.9	10.0	1.6	6.9	2.4	3.7	2.5
Private	1.9	4.6	9.3	0.1	8.2	2.8	3.6	4.3
GNP implicit deflator	3.1	3.8	3.5	4.2	3.4*	3.9	3.7	3.4
Personal income	7.2	9.0	10.8	9.3	9.6	7.4	6.1	5.8
Wages and salaries	7.3	9.4	10.9	8.3	10.0	7.7	7.4	6.2
Disposable income	6.8	7.8	10.6	8.3	4.4	5.9	4.3	5.0
Corporate profits before tax	-4.7	13.6	16.4	13.0	1.7	20.7	-10.3	-8.4
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	5.7	17.2	26.1	12.5	23.5	13.6	13.6	4.3
Expenditures	14.9	11.4	15.4	15.5	6.6	5.2	5.1	1.3
Nonfarm payroll employment	3.1	3.2	4.2	2.4	2.9	3.5	2.3	1.2
Manufacturing	1.0	2.1	2.0	2.0	2.0	2.0	0.0	-2.0
Industrial production	1.2	4.2	6.0	5.2	2.4	5.2	3.8	1.4
Housing starts, private	10.9	18.4	15.5	-16.3	29.7	21.5	23.3	-46.4
Sales new domestic autos	-9.7	13.5	40.6	12.0	27.3	-12.9	1.4	-11.4

* Excluding Federal pay increase, 2.8 per cent.

Industrial production. Industrial production in December is tentatively estimated to have increased about one per cent further from the preliminary November level of 167.4 per cent. At 169, the December index would be up 4 per cent from December a year earlier; for 1968 as a whole, the index would be about 4.4 per cent above 1967. Growth in industrial production in 1968 was thus much more in line with the long-term trend of 4.1 per cent than the 7.1 per cent average annual rate of increase in the period 1961-1966.

INDUSTRIAL PRODUCTION
Seasonally adjusted, quarterly averages

	Total index, 1968			
	Quarter I	Quarter II	Quarter III	Quarter IV(e)
Indexes	162.1	164.2	165.2	167.4
Per cent change from previous quarter, annual rates	6.0	5.2	2.4	5.2

Output gains in December are estimated to have been stronger for business equipment and industrial materials than for consumer goods. Auto assumblies were reduced to a seasonally adjusted annual rate of 8.9 million units from a rate of 9.2 million in October and November. With sales of new domestic autos down to an 8.2 million rate in December and stocks at new highs, production schedules for January have been cut 10 per cent from earlier plans to an annual rate of 8.3 million units. In December, output of television sets was reduced again as inventories remained high in relation to sales.

Production of most business equipment lines is expected to show further advances in line with the estimated increase in business expenditures on new capital equipment. Bolstering the upward movement of output of equipment has been a turn-around in production of farm and railroad equipment in the second half of 1968, following 1-1/2 years of decline amounting to 25 and 55 per cent, respectively.

Output of raw steel increased 10 per cent further in December and presumably production of steel mill shapes and forms also continued upward. Output of iron and steel is estimated to have been around 125 per cent of the 1957-59 average, up almost 20 per cent from the September-October low but 15 per cent below the midyear high which had been augmented by anticipation of a strike.

Capacity utilization. The December rate of manufacturing capacity utilization is estimated to be up further from the 84.1 per cent of November. This would be the third consecutive monthly increase and would return the operating rate to within a few tenths of a point of the level which prevailed last spring. The recovery of iron and steel and production again accounted for much of the increase in the operating rate. Production in the remainder of manufacturing increased only slightly further than capacity.

Utilization rates are above normal in the motor vehicle, aircraft, rubber, petroleum and nonferrous metals industries. Unused capacity remains appreciable for production of most other manufacturing products.

UTILIZATION RATES
(Per cent)

Industry	1967	1968						
	QIV	QI	QII	QIII	QIV(e)	Oct.	Nov.	Dec.(e)
Manufacturing	84.8	84.9	84.8	84.0	84.1	83.6	84.1	84.5
Primary processing industries	85.6	85.5	86.5	84.6	--	84.1	85.2	--
Advanced processing industries	84.3	84.4	83.6	83.5	--	83.2	83.3	--

Unit auto sales and stocks. Sales of new domestic autos declined further in the last selling period in December and for the month as a whole were at a seasonally adjusted annual rate of 8.2 million units, down 7 per cent from November but 11 per cent above the strike-reduced level of a year earlier. Sales in 1968 totaled 8.6 million units, up 13 per cent from 1967, which was affected by shortages due to strikes. Sales of imported cars totaled over 950,000 units, a new record and about one-fourth larger than in 1967. Thus, combined sales of domestic and imported cars in 1968 totaled 9.6 million units, of which imported cars accounted for 10 per cent.

Stocks of new domestic autos declined somewhat over the month. With sales down considerably, however, the inventory-sales ratio rose to a 56 days' supply, compared with 49 days at the end of 1967.

Consumer credit. Consumer use of instalment debt tapered off somewhat in November, although still remaining at a very high level. Credit outstanding increased during November at an annual rate of

$10 billion, compared to the $11.4 billion rate of increase in October (all figures on seasonally adjusted basis). The rate of growth for automobile, personal, and repair and modernization loans slowed. Only in the category "other consumer goods" loans did the rate of increase exceed that experienced in October. In this category, credit extended by retailers was especially strong, reflecting record GAF sales in November.

The November consumer credit figures are compared in the table with those of other periods. (All figures have just been revised to new benchmarks.)

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

	Extensions	Repayments	Net Change
1964, year	70.7	63.5	7.2
1965, year	78.6	70.0	8.6
1966, year	82.3	76.1	6.2
1967, year	84.7	81.3	3.4
1968			
QI	92.8	85.8	7.0
QII	95.6	87.2	8.4
QIII	99.4	89.4	10.0
October	102.4	91.0	11.4
November	99.5	89.4	10.0

<u>Consumer sentiment and buying intentions</u>. Willingness of consumers to spend their growing incomes has not changed in the last

three quarters, according to the index of consumer sentiment[1/] constructed by the Michigan Survey Research Center. Based on interviews between November 11 and December 13, the index for all families was 92.1 (February 1966 = 100), not significantly different from the 92.4 of May 1968 and the 92.9 of August 1968. The expression of intentions to buy new automobiles, however, was at a record high.

On the positive side, consumers in the latest survey were more optimistic than in August about business trends, both in the coming year and over the next five years. About 10 per cent of the respondents attribute this optimism to what the new Administration may be able to do, about the same percentages as in 1952 and 1960 when there were also changes in Administration. (More people than in 1952 and 1960, however, now think that business conditions may be bad because of a different Administration.)

On the negative side, although there was no change in the proportion of families reporting that they were either better off or worse off during 1968 than a year earlier, the proportion of families in November-December expecting to be better off in the next twelve months was lower than at any time during the last two years. (The latest Census

1/ The index of consumer sentiment is constructed from the responses of consumers to five questions, two relating to the evaluation of personal financial trends, two to the general economic outlook, and one to whether it is a good time to buy durable goods. The responses to each question are scored on a net change basis, i.e., favorable responses minus unfavorable responses. The five questions are equally weighted and the total converted to a base in which the responses in February 1966 equaled 100.

Survey of income expectations also had shown a deterioration.) Moreover, consumers' evaluation of whether it is a good time to buy cars, large household goods, and houses were also lower than in any other quarter in 1967 or 1968. Special questions asked on the survey, but not incorporated in the index of consumer sentiment, suggest that inflationary fears are the explanation of both the lower evaluation of personal financial prospects and the unfavorable buying conditions for consumer durables.

Despite this attitude regarding price increases, when consumers were asked directly about their intentions to purchase a new car, a larger proportion indicated that they intended to buy than at any time in the last four years. Responses to questions regarding the styling and special features of the 1969 models were more favorable than in any of the preceding three years.

In the opinion of the Survey Research Center, either less inflation or peace in Vietnam would substantially raise the proportion of after-tax income which consumers are willing to spend rather than save. This judgment is based on special survey questions asked over a period of more than 20 years which suggest that when consumers are worried about inflation they are more conservative in making discretionary purchases for durables. The Survey Research Center did not cite any particular survey results as the basis for their views about probable consumer reaction to peace, but since inflation and war are closely associated their inference may be reasonable.

INDEX OF CONSUMER SENTIMENT
(February 1966 = 100)

Date of study	All families	Families with income of $10,000 and over
1967 - November	92.9	96.0
1968 - February	95.0	95.4
May	92.4	94.3
August	92.9	94.6
November-December	92.1	94.3

Inventories and orders. Total inventory accumulation continued substantial in November, and for October and November combined book values increased by an average of over $1.2 billion, or close to $15 billion at an annual rate. Manufacturing inventories in November rose by $600 million, somewhat larger than the October (downward) revised increase of $450 million, but still not as high as the rate of accumulation anticipated by manufacturers for the fourth quarter as a whole. Trade inventories in November rose about $450 million and the October-November monthly average increase was $700 million, compared with $200 million in the third quarter. Automotive and general merchandise stores showed the largest November increases.

Inventory-sales ratios continue at somewhat reduced levels for manufacturing, wholesale, and nondurable retail trade. At durable goods retailers, the ratio rose in October and November and is the highest since April 1967.

New orders for durable goods in November declined 2 per cent following the sharp 7 per cent increase in October, but were still at a very high level and the backlog of unfilled orders rose 1 per cent. The ratio of unfilled orders to shipments increased slightly in durable goods industries, mainly as a result of increases in the primary and fabricated metals industries. Strong demands for metals evidently reflect high consumption and anticipation of price rises. A high level of shipments is reducing the backlog-shipments ratio in defense and business equipment industries; the continued reduction in this ratio suggests that a strong inventory buildup in this area is unlikely.

Construction and real estate. Seasonally adjusted value of new construction put in place turned upward in December to a new peak annual rate of $87.6 billion.1/ Nearly all of the rise was concentrated in outlays for private residential construction, which reached a new high under the impetus of a renewed advance in housing starts in November. Outlays for nonresidential construction apparently held near the moderately reduced November rate and just below the high reached last October. Public construction expenditures, after a downward benchmark revision averaging nearly 5 per cent over the June-November period, also rose in December, but remained below the peak now set at last February.

1/ This was associated with a 1 per cent downward revision in the overall level for November and other recent months mainly because of adjustments for public construction.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	December 1968 ($ billions) 1/	Per cent change from November 1968	Per cent change from December 1967
Total	87.6	+ 1	+ 8
Private	59.6	+ 1	+10
Residential	31.1	+ 2	+12
Nonresidential	28.5	--	+ 8
Public	28.0	+ 1	+ 3

1/ Seasonally adjusted annual rates; preliminary. Data for the most recent month (December) are confidential Census Bureau extrapolations. In no case should public reference be made to them.

For 1968 as a whole, outlays for new construction exceeded $84 billion, 11 per cent more than a year earlier, owing mainly to a 20 per cent advance in expenditures for residential construction. Since the year-to-year rise in construction costs, as estimated by the Census Bureau, averaged 5 per cent, all of the current-dollar increase for private nonresidential structures (5 per cent) and most of the rise for public construction (8 per cent) appear to have reflected increased costs rather than changes in physical activity.

Seasonally adjusted private housing starts, which had dipped in October, reversed direction in November and reached an annual rate of 1.68 million, the highest since February 1964. Single-family starts, as expected, dropped in November for technical reasons. But starts in the highly volatile multifamily sector spurted upward by nearly a third to a new high. On a regional basis, the increase from October to November was concentrated, with total starts in the South up a fourth to the highest rate reported for this region in the Census series which began in 1959.

PRIVATE HOUSING STARTS AND PERMITS

	November 1968 (Thousands of units)[1/]	Per cent change from	
		October 1968	November 1967
Starts	1,677	+ 7	+ 5
1-family	885	- 8	- 7
2-or-more-family	792	+32	+24
Northeast	186	-13	-20
North Central	362	- 8	-12
South	787	+25	+14
West	342	+ 5	+33
Permits	1,390	+ 1	+15
1-family	712	+ 3	+ 9
2-or-more-family	678	- 1	+23

1/ Seasonally adjusted annual rates; preliminary.

A 1.68 million unit rate of starts hardly seems sustainable over the long run under present or anticipated funds-flow conditions. However, mortgage commitments outstanding in recent months have been at record levels and building permits have also been relatively high at a time when shelter-demands and upward cost pressures have remained extremely strong. Under these circumstances and given the uncertainties raised by the strong signals of further tightening in mortgage and other financial markets, builders may be expected to resist the sharp winter drop in unadjusted starts usual at this season. Usually this amounts to as much as 25 per cent from November through February. If builders succeed in these efforts, starts on a seasonally adjusted basis may hold for a time at or even above the advanced November rate.

For the fourth quarter of 1968 as a whole, there is the possibility of an average seasonally adjusted rate of starts in excess of 1.6 million. This suggests a total for the year 1968 of about 1.53 million units or more than a fifth above the improved 1967 level and the same as in 1964. It also suggests a 1968 total for multifamily starts of as much as 615,000 units, a new high both absolutely and as a proportion (40 per cent) of total starts.

An additional factor which may influence real estate and mortgage market demands in 1969 is the second stage of the open-housing law which became effective at the start of the year. The previous stage of the law, passed last April, affected only certain Government-assisted dwellings estimated at about 900,000 units. The new stage, however, applies to most apartment units and to all new single-family homes in subdivisions and developments, aggregating around 20 million housing units or nearly a third of the total stock. In addition to other conditions affecting sales- and rental-transactions, this stage of the act also forbids racial or religious discrimination by mortgage lenders.

Personal income. Estimates of personal income show a slower rise in October and November--averaging $3.6 billion at annual rates--than in the third quarter when there was an extremely rapid average monthly gain of $5.3 billion. Since employment and hourly earnings rose strongly in December, a somewhat larger pickup in personal income is anticipated than in the two preceding months. In addition, upward revisions of both November and October employment estimates suggest that personal income increases for these months also may be adjusted upward. Nevertheless, the personal income rise for the fourth quarter as a whole is unlikely to be as large as in the two preceding quarters.

INCREASES IN PERSONAL INCOME, 1968
(Billions of dollars, seasonally adjusted annual rates)

	Average Monthly QI	Average Monthly QII	Average Monthly QIII	October	November
Personal income	$5.8	$4.6	$5.3	$3.5	$3.8
Wage and salary disbursements	2.7	3.3	3.5	2.1	2.5
Manufacturing	1.0	1.1	0.7	1.0	0.6
Nonmanufacturing	1.6	2.2	2.8	1.1	1.9
Other sources	3.1	1.2	1.8	1.4	1.3

Increases in wage and salary payments averaged $2.3 billion in October and November, down about one-third from the average increase over the summer and fall. The largest drop occurred in nonmanufacturing, where the third quarter rise included the Federal pay raise. In November, earnings growth reflected smaller gains in virtually all industries, apparently as an outgrowth of shortened workweeks--the workweek in private industry fell in November but edged back up in December.

Labor market. The labor market continued extremely tight through December. A sizable labor force increase was matched by strong job gains and the unemployment rate remained at its 15-year low of 3.3 per cent. (Confidential until released Thursday, January 9th.)

Wage increases also continued large, with hourly earnings averaging more than 7 per cent above year-earlier levels.

Nonfarm payroll employment rose strongly in December and, significantly, the increases for October and November reported earlier were revised upward. After showing little change last summer, manufacturing employment has risen strongly since September, with the largest gains in machinery and fabricated metals. Construction employment has also been in a sharp uptrend since summer, rising by approximately 100,000 since September in response to strengthening demands.

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

	October	November	December
Total	360	194	233
Manufacturing	51	25	62
Nonmanufacturing	309	169	171

* Adjusted for major strikes.

The average workweek in manufacturing declined from about 41 hours in September and October to 40.7 hours in December. The reduction reflected modest cutbacks in most industries and may reflect attempts to reduce expensive overtime.

With demand strong in industrial and construction activities, the supply of unemployed adult men was reduced further in December and their jobless rate edged down to 1.8 per cent, a post-World War II low.

Jobless rates for married men (1.4 per cent), and craftsmen (1.9 per cent) also reached new lows.

The unemployment rate for adult women, at 3.5 per cent in December, continued about as low as at any time since the Korean War. Further reductions in the jobless rate for adult women probably will be limited since a large portion of the rate is frictional--women entering and reentering the labor force.

Despite the scarce supply of adult male workers and strong demand conditions, joblessness continues very high among teenagers. Their rate, at 12.6 per cent in December, was half again as high as during the Korean War and has not shown any signs of a pronounced downtrend this year. The absence of significant improvement in teenage unemployment may reflect the fact that over half of the unemployed teenagers were still in school and seeking part-time employment and that approximately one-third had never held a job before.

With the labor market very tight, wage rates have continued to rise at a rapid pace. Hourly earnings of production and nonsupervisory workers on private payrolls were up to $2.93 in December, an increase of 20 cents (7.3 per cent) from a year earlier. Increases continued large in all industry groups.

AVERAGE HOURLY EARNINGS*

	December 1968	Per cent increase from year earlier
Private economy	$2.93	7.3
Mining	3.48	7.4
Construction	4.52	6.4
Manufacturing	3.10	6.5
Trade	2.44	7.0
Finance	2.84	7.2

* Of production and nonsupervisory workers on private nonfarm payrolls.

<u>Collective bargaining</u>. In 1969, about 2.7 million workers are covered by contracts involving renegotiation of wages--nearly two million fewer than last year--and a record 6 million will receive deferred wage increases (i.e., contractually specified second or third year raises). The median deferred wage increase scheduled to go into effect is 4.1 per cent compared to a now typical first-year wage increase of 7-1/2 per cent. Because of the small proportion of workers who will receive newly negotiated, or first-year, wage increases and the large proportion who will receive the smaller deferred increases, the average increase for workers covered by major collective bargaining agreements should be appreciably smaller in 1969 than 1968.

First-year wage increases averaging aoout 7.5 per cent became general early in 1968 and this pattern persisted throughout the year. With consumer prices still rising rapidly, it seems likely that the front-loading of wage increases will continue to be a major feature of contract settlements in the months ahead as workers attempt to catch up with past increases in living costs. In current negotiations in the oil refining industry, wage demands of the 60,000 member union continue this pattern. The union called a strike beginning January 4 but because the industry is highly automated, it is expected that production will continue at about current levels as supervisory personnel take over production jobs. Negotiations are also in progress for 50,000 mechanics employed by 8 major airlines.

No agreement on a new contract has been reached by the longshoremen and East and Gulf Coast shippers, and mord than 50,000 dock workers have been on strike since December 20. Two major issues remain to be settled; the jurisdiction of the longshoremen over loading and unloading containers, and the employers' guarantee of a minimum number of working hours annually. Agreement has apparently been reached, according to newspaper reports, on a wage and fringe package estimated at $1.60 per hour over a 3-year contract period. This would amount to an average annual increase in hourly compensation in the neighborhood of 10 per cent.

Wholesale prices. The rise in wholesale prices of industrial commodities, which was resumed in late summer following a period of little change last spring and early summer, continues at a sizable pace. Complete reports for November show a 0.2 per cent increase in the industrial average in that month--up from the earlier estimate of 0.1 per cent; the BLS estimates an 0.3 per cent increase in December; and a wave of price increases announced over the past month or so suggests an even larger increase in January.

Altogether, the BLS industrial commodity index increased 1.3 per cent from July to December (as now estimated)--or at an annual rate of 3.1 per cent, about the same as the run-up in the corresponding period of 1967. For the year 1968 the rise averaged 2.5 per cent, as compared with 1.5 per cent in 1967 when industrial prices showed virtually no change over the entire first half year.

Upward revision of the BLS November industrial price estimates was concentrated mainly in machinery and equipment--providing further confirmation of the resurgence in that sector--and in textiles and apparel--where price increases have been exceptionally large at wholesale and retail in recent months. The over-all November rise was limited by a 1.3 per cent decline in prices of steel mill products, attributable entirely to the very sharp abortive cut for hot-rolled steel sheets. Apart from steel, industrial prices rose nearly 0.3 per cent.

The 0.3 per cent further increase now estimated for December was heavily dominated by the continuing extraordinary rise in lumber and plywood prices. With softwood lumber up 3 per cent further and softwood plywood prices jumping 20 per cent, lumber and plywood combined accounted for nearly two-thirds of the total increase in the industrial average. Over the past two years, average lumber and plywood prices have now increased nearly 40 per cent, with over a third of the rise coming since last July.

In November, as noted in the last Green Book, the diffusion of price increases diminished moderately from the high October level--reversing the upswing that began in August. In December, the total number of product classes showing advances decreased considerably further. Apart from the lumber group, the chief increases reported were for nonferrous metals, steel scrap, and machinery and equipment.

The December industrial price estimate may well be subject to upward revision. Thus the present confidential estimate of an 0.1 per cent increase in machinery and equipment prices last month is unusually small compared with the increases reported for other recent months; in November the original estimate of an 0.2 per cent increase was later revised to an 0.4 per cent increase--more in line with the rate of increase from August to October.

But, the BLS December pricing date, the 10th, was too early to catch some increases announced in late November and early December. An unusually large collection of price increases appear to be taking effect by this month's BLS pricing date (the 14th). Products affected include--in addition to a variety of metals and metal products referred to in the paragraph below--asbestos, refractory products, a number of chemicals, glass fibers and yarns, glass containers, folding cartons, envelope paper, newsprint, carpets, new autos (to cover headrests), and various types of machinery.

A major item in the industrial price rise to be reported for this month is the restoration by steel mills of most of the sharp cut in hot-rolled steel sheets made in early November, and the boosting of prices of a number of steel mill products not raised last August (including some affected by the recent large increase in the price of nickel). It is possible that average prices of steel mill products will show a rise of nearly 2 per cent this month (accounting for roughly 0.1 per cent in the industrial commodity total), to a level around 0.5 per cent above September--October and 3 per cent above last July. In addition, copper markets appear to be "boiling over" again. Unexpectedly high business activity in Europe, as well as in the U.S., has been putting pressure on copper prices, with stocks still limited by last year's domestic strike. Prices of copper scrap and foreign copper have been increasing in recent months, and just recently one minor and two major domestic producers have raised the price of domestic primary copper, from the 42 cents per lb. established last April following settlement of the strike, to 45 cents and 44 cents, respectively. Copper and brass mills meanwhile have scheduled price increases on virtually all types of products.

Consumer prices. The consumer price index rose 0.4 per cent in November to 123.4 per cent of the 1957-59 average, 4.8 per cent above a year earlier. This is the largest year-over-year rise since 1951.

The October-to-November rise was less than the unusually large October increase of 0.6 per cent and it appears likely that the December index will show no more than the November increase--and perhaps less. Nevertheless, thanks in large part to the extraordinary October spurt, the increase in the CPI for the fourth quarter as a whole, on a seasonally adjusted basis and excluding mortgage interest charges for rough comparability with the GNP deflator for consumption expenditures, will undoubtedly exceed the third quarter increase.

Both with and without allowances for usual seasonal changes average retail prices of consumer products showed much less rise in November than in October. Food prices, which had spurted contra-seasonally in October, showed about the usual seasonal decline in November. Prices of nes autos, which had increased 4.5 per cent in October--1 per cent more than expected seasonally--showed about the usual 1 per cent further seasonal rise in November. Moreover, the rise in apparel prices--although continuing at a greater-than-seasonal pace--slackened off appreciably from the extraordinarily rapid August-October rate of increase.

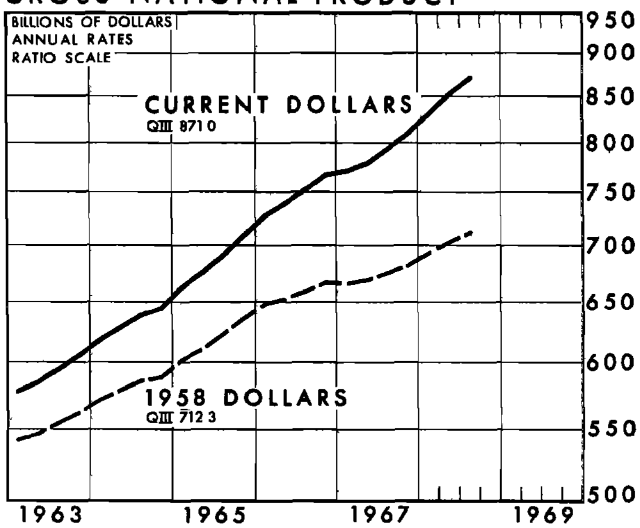
Average prices of consumer services on the other hand, increased considerably more in November than in October (0.6 per cent vs. 0.4 per cent), mainly because of a large jump in "utilities and public transportation." The latter reflected a sharp spurt in gas rates, due to the quasi-seasonal (and archaic) institution of higher winter rates in 2 cities; increases in water and sewerage charges; and higher local transit rates in 5 cities. Costs of medical and most other services continued up at about the sizable pace of other recent months.

A jump in "home purchase costs" also contributed significantly to the November increase in the CPI. This is an unpublished (and confidential) component classified under, and accounting for one-third of the wieght of, the regularly published "durable commodities" index; but it should more properly be classified as a service. The increases in home purchase costs and in utilities and public transportation services, which together account for a little more than one tenth of the CPI base-period weight, accounted for roughly one-third of the November rise in the CPI.

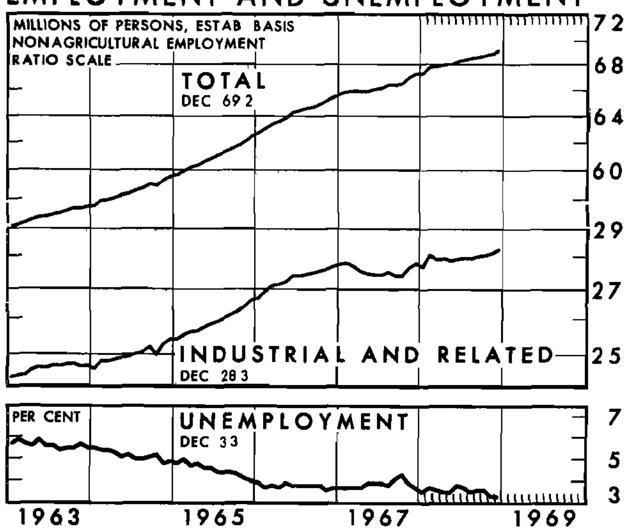
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

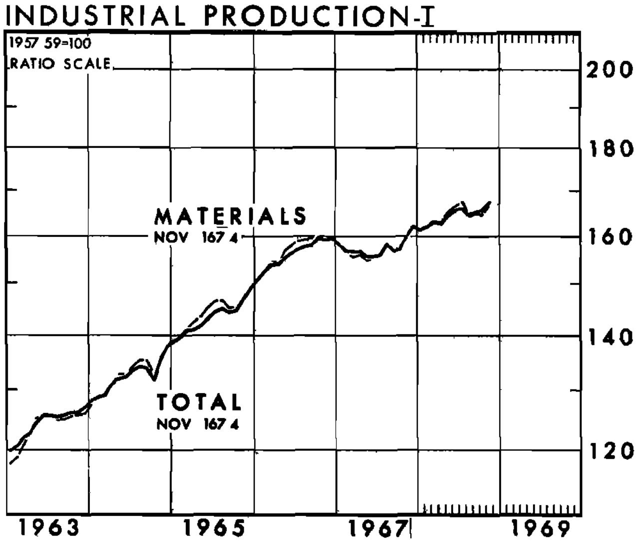
GROSS NATIONAL PRODUCT



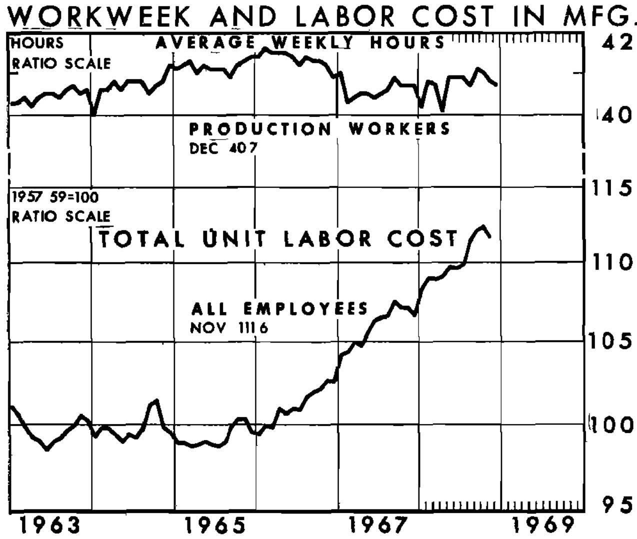
EMPLOYMENT AND UNEMPLOYMENT



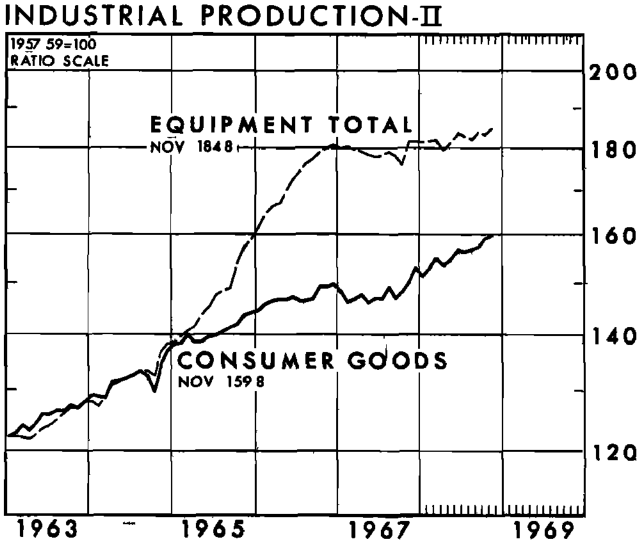
INDUSTRIAL PRODUCTION-I



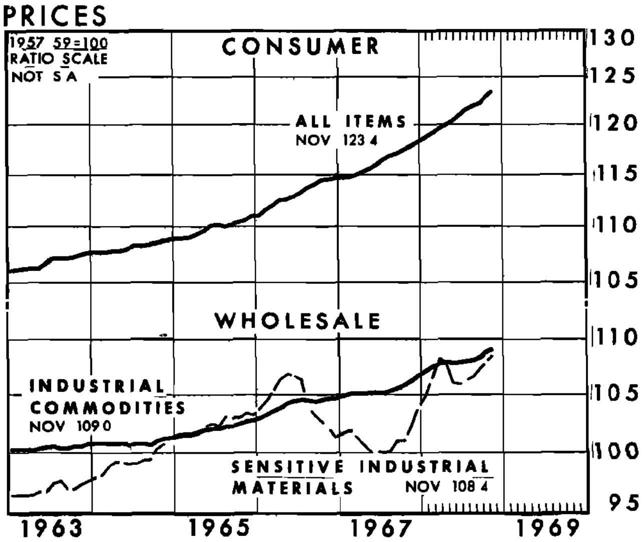
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



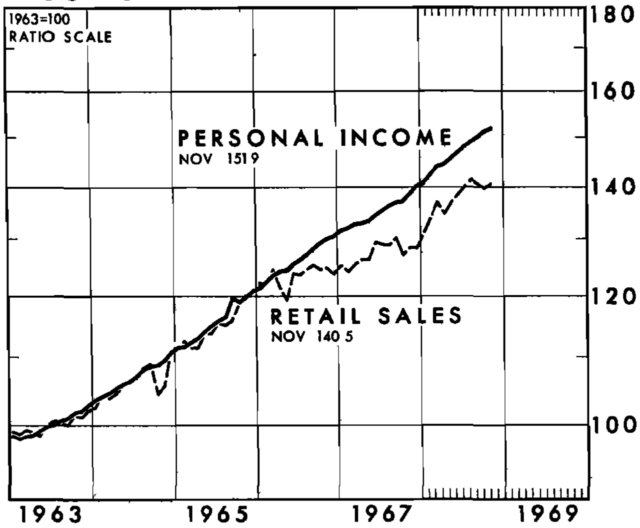
PRICES



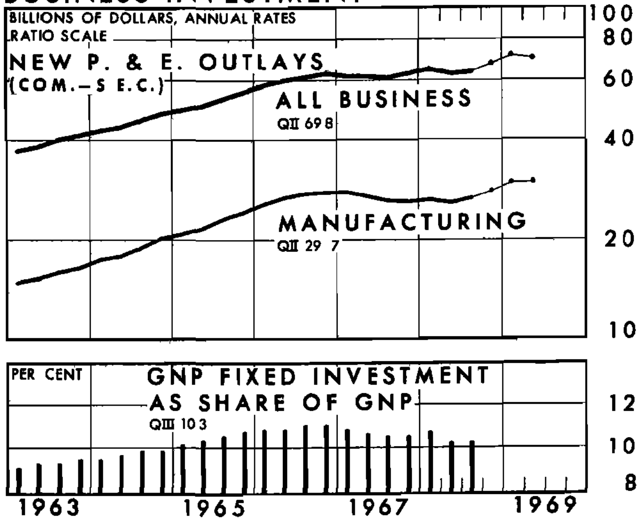
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

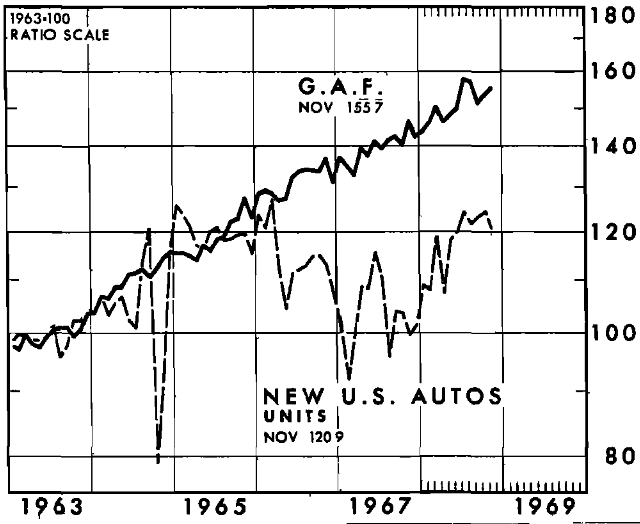
INCOME AND SALES



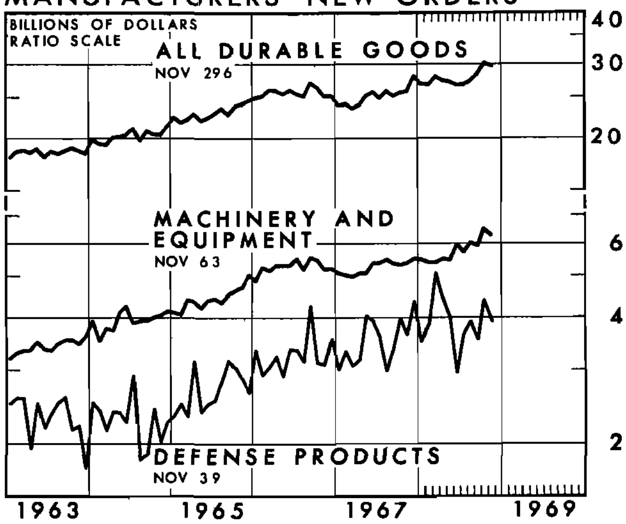
BUSINESS INVESTMENT



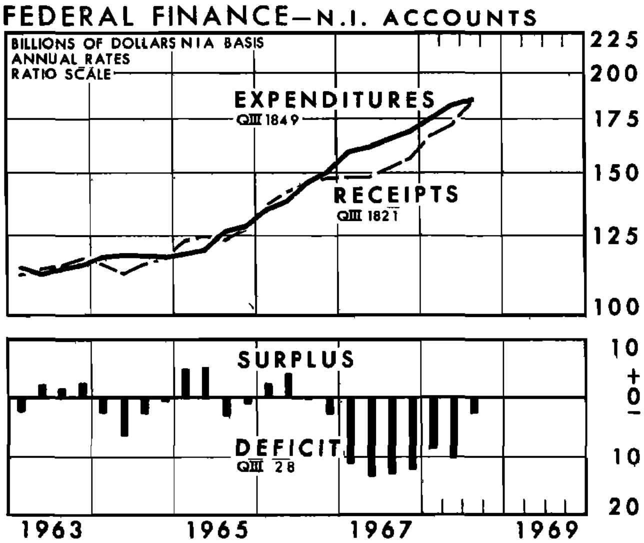
RETAIL SALES



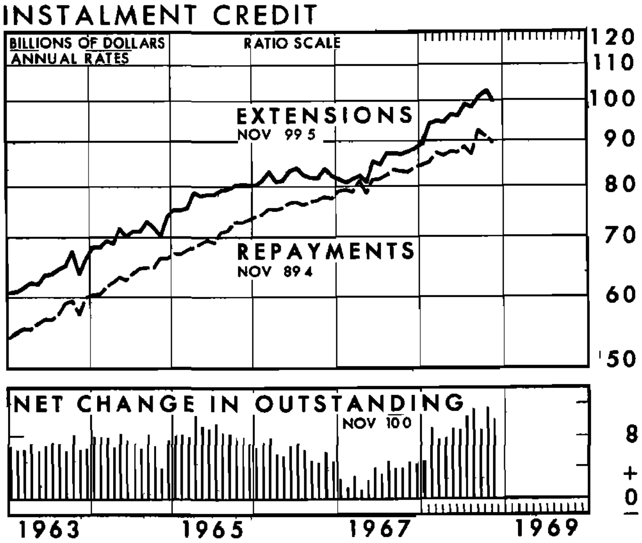
MANUFACTURERS' NEW ORDERS



FEDERAL FINANCE—N.I. ACCOUNTS



INSTALMENT CREDIT



DOMESTIC FINANCIAL SITUATION

Bank credit. Expansion of total loans and investments at all commercial banks in December, on an end of month basis, is estimated to have continued at about the reduced rate of growth in November, despite a Treasury financing and increased corporate tax payments. Moreover, with the exception of the small financing-related increase in bank holdings of U. S. Government securities, the increase in all other major categories of bank loans and investments moderated substantially from the pace of recent months.

NET CHANGE IN BANK CREDIT
All Commercial Banks
(Seasonally adjusted annual rates, in per cent)

	1968					
	1st Half	July-Aug.	Sept.-Oct.	Nov.	Dec.1/	Year1/
Total loans & investments2/	6.5	21.1	14.9	6.3	6.6	10.7
U.S. Gov't. securities	2.3	34.8	2.8	-59.8	3.9	2.5
Other securities	8.1	15.0	27.5	29.8	8.5	15.1
Total loans	7.2	19.5	14.4	17.0	6.7	11.7
Business loans	7.6	12.1	8.5	20.7	6.4	9.8
All other loans	6.9	24.2	18.0	14.8	6.9	12.9
MEMO:						
Credit proxy3/	5.5	16.2	10.7	11.7	11.2	9.4

1/ All December rates are preliminary estimates based on incomplete data and are subject to revision.
2/ Last-Wednesday-of-the-month data, except for June and December which are last-day-of-the-month.
3/ Monthly average of daily figures, adjusted to include Eurodollar borrowings. On an end-of-month basis, the increase in the credit proxy for November and December was 6.5 per cent and 7.2 per cent, respectively.

Following a large decline in November, bank holdings of U. S. Government securities were up slightly in December as banks underwrote nearly all of a $2 billion Treasury financing early in the month. Although banks apparently retained a larger-than-usual amount of these tax bills--probably in part a response to the rising level of bill rates over the month--they continued to liquidate holdings of longer-term Governments.

Banks sharply reduced the rate at which they took other securities into portfolio during December, as compared to the rapid pace of recent months. Moreover, December acquisitions were more concentrated in short-term municipals than in the previous two months and may have reflected efforts by banks to become more liquid in preparation for possible large CD run-offs.

Expansion of bank loans in December also slowed considerably from the rapid rate that has generally prevailed since mid-year, reflecting mainly reduced borrowing by both business and financial sectors. Taken together, however, the November-December growth in business loans remained at a substantial 13.5 per cent, and may have reflected, in part, business borrowing to finance increased plant and equipment expenditures and inventory accumulation.

Virtually all of the December increase in business loans occurred during the tax and dividend period. While business borrowing to meet tax payments was considerably larger than last year, the ratio of business loans to corporate tax liabilities remained about the same as in December 1967. By industry, only retail trade, chemicals, and textiles showed unusual strength for the month as a whole. Largely in response to rising interest rates--including the mid-December increase in the discount rate--banks raised their prime rates to 6.75 per cent in the latter part of the month and to 7.0 per cent in early January.

Of the other major loan categories, only consumer and real estate are estimated to have sustained the increased rate of growth of recent months. Security loans declined for the third month in a row as dealers reduced their positions sharply at month-end.

Bank deposits. Time and savings deposits at all commercial banks, on a daily average basis, are estimated to have risen at about a 14.5 per cent annual rate in December, only slightly below the average monthly increase since mid-year. The December rise reflects larger-than-usual CD inflows in late November and early December as well as continued large inflows of consumer-type deposits.

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

	1965 Nov. 24-Dec. 22	1966 Nov. 30-Dec. 28	1967 Nov. 29-Dec. 27	1968 Nov. 27-Dec. 25
Total time & savings deposits	170	1,112	- 160	184
Consumer-type deposits	n.a.	373	311	452
Savings deposits	142	175	114	3
Time deposits, IPC (other than CD's, IPC)	n.a.	198	197	449
Negotiable CD's	-663	161	-801	- 814
All other time deposits 1/	n.a.	578	330	546

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

N.A. - not available.

Although most large banks are reported to have been paying maximum rates on all maturities of CD's since late November, they were able to add somewhat to their outstandings in early December and to keep run-offs during the tax and dividend period to about normal proportions. However, as money market rates continued to rise, CD ceilings became progressively more non-competitive, and banks--particularly the major money market institutions--have found it increasingly difficult to replace maturing issues. In the last two weeks of the month, banks in New York and Chicago lost nearly $600 million in CD's, in sharp contrast to net increases in outstandings in comparable periods of most recent years. Other banks, however, where depositors are less interest sensitive and customer-bank relationships are more important, were able to increase their outstanding CD's in the week ending December 25. For the month as a whole, it is estimated that all large banks had CD run-offs of about $1.3 billion, some $500 million more than usual. Given current interest rate relationships and the large amount of CD's maturing in January--$6.4 billion or about 27 per cent of total outstandings--it is likely that major money market banks will experience serious CD attrition in January.

With the high cost and apparent reduced availability of Eurodollars, major banks have been either unwilling or unable to utilize this source of funds to offset recent CD outflows. In the four weeks ending January 1, bank liabilities to their foreign branches fell by nearly $1.4 billion--approximately twice the usual year-end decline--bringing the amount outstanding down to just over $6 billion.

In spite of the recent increase in market rates of interest, inflows of consumer-type deposits at large banks have continued to be large. The December increase, however, was almost completely concentrated in time certificates and open accounts, with passbook savings deposits remaining virtually unchanged after having grown appreciably in the previous two months. Savings deposit inflows at country banks also were somewhat less than in comparable periods of recent years. Apparently some funds have been diverted from passbook savings as more banks have recently expanded the types of time certificates and open accounts offered to the public.

After increasing rapidly in November, growth in the money stock, measured on a daily average basis, slowed somewhat to about a 7 per cent annual rate, while U.S. Government deposits declined for the third consecutive month. The December increase brought the growth in the money stock in the second half of the year to 6.1 per cent, compared with 6.6 per cent in the first half and with 6.4 per cent over the year 1967.

Nonbank depositary intermediaries. Developments during the current reinvestment period should provide an important test of the ability of the thrift institutions to withstand the pull of the much higher yields now available on market securities.[1/] Only partial data are available, but they suggest that so far the current outflow is running only moderately higher than at the same time last year for the savings banks; at savings and loans, outflows during the grace period were 25 per cent larger than in the similar 1967 period, with most all of the greater withdrawals accounted for by associations in the San Francisco district. It should be noted, however, that throughout 1968 the experience during the grace period before month-end was not an accurate indicator of results for the total reinvestment period, probably because of the increased importance of certificate accounts that mature on a specified date.

1/ The reinvestment period consists of the last three business days in December (grace days) and up to the firsr ten calendar days of January.

REINVESTMENT PERIOD OUTFLOWS

15 LARGEST SAVINGS BANKS IN NEW YORK
(In millions of dollars; not seasonally adjusted)

	Net Outflow	Net Adjusted Outflow: 1/ In dollars	As per cent of deposits
December 3-Day Grace Period			
1965	139.0	58.1	.38
1966	123.6	45.7	.29
1967	186.2	64.6	.37
1968	198.4	82.7	.45
First Day of January			
1966	49.9	49.9	.33
1967	12.4	12.4	.08
1968	24.7	24.7	.14
1969	21.0	21.0	.11

1/ Adjusted for repayment of passbook loans made earlier to save interest.

SAVINGS AND LOAN ASSOCIATIONS
(Millions of dollars not seasonally adjusted)

	Net Outflow: December 3-Day Grace Period 1966	1967	1968
All Insured Associations:	-558	-442	-553
San Francisco District	-102	- 85	-210
All Other	-456	-357	-343

Note: Universe estimates based on an FHLBB sample.

The Home Loan Banks reported that S&L demand for advances had been substantially the same as it was last year. During November, there was virtually no change in S&L borrowed funds outstanding, and there was a seasonal rise in their liquidity ratios. Although outstanding commitments continued high, they were less burdensome relative to cash flow; in November the ratio of savings and loans' outstanding commitments to three-month cash flows was slightly below the previous low point this year, though higher than in any month during 1967.

During November, the rate of growth in total savings at the two major institutions slackened somewhat to the pace of the first three quarters. The pattern showed divergence, as savings banks--including those in New York--showed considerable strength and the savings and loans showed a decline from the pace of the previous three months; the deceleration of S&L inflows is now estimated to have continued in December.

GROWTH IN SAVINGS AT NONBANK INTERMEDIARIES
(Seasonally adjusted annual rate, in per cent)

	Mutual Savings Banks	Savings & Loans	Both
1967 I	9.6	9.4	9.5
II	10.8	11.1	11.0
III	8.6	9.7	9.4
IV	7.0	6.2	6.4
1968 I	7.2	5.6	6.1
II	6.6	5.6	5.9
III	6.3	6.0	6.1
IV	n.a.	5.8e/	n.a.
1968			
Oct.	6.9	7.4	7.2
Nov.p/	7.4	5.5	6.1
Dec.	n.a.	4.6e/	n.a.

p/ Preliminary.
e/ Estimated.
n.a.--Not Available.

Mortgage market. Tightening in the sensitive secondary market for FHA and VA home mortgages apparently continued through the early part of the dividend reinvestment period. Along with the increase in other capital market rates, implicit yields on FNMA's 6-month forward-purchase commitments rose further in recent weeks, as shown in the table. By the January 6 auction, average secondary market yields had returned close to the high posted early last June, and were 50 basis points above the end-of-September low. This and other developments indicated that discounts on these 6-3/4 per cent Government-underwritten mortgages were becoming large enough to increasingly limit the willingness of lenders to supply such credit as well as the ability of market participants to absorb the costs.

FNMA WEEKLY AUCTIONS
(6-month forward commitments)

Auction Date	Accepted bids ($ millions)	Implicit private market yield (per cent)
1968 high, June 10	44.8	7.71
December 2	25.8	7.46
9	23.5	7.51
16	32.6	7.57
23	31.6	7.60
30	32.2	7.65
January 6	28.4	7.66

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, 1968.

In the primary home mortgage market, FNMA field reports made toward the end of December suggested that credit demands (particularly for conventional mortgages) were slackening, but by somewhat less than the usual sharp seasonal amount. Under these circumstances, lenders in most major areas were still able to accommodate the declining volume of loan requests at exceptionally high interest rates. Even so, a number of areas reported some tightening in credit availability last month, as more lenders adopted a wait-and-see attitude about market performance through the reinvestment period and the policies of the incoming administration.

The total dollar volume of outstanding mortgage commitments of all S&L's and New York State savings banks rose a little further in November to a new high, after adjustment for seasonal variation, despite a slight decline for S&L's alone. The aggregate commitment backlog of both lenders--chiefly for residential mortgages--was 12 per cent above mid-year and 14 per cent above a year earlier when average per-unit mortgage amounts were undoubtedly lower. The backlog was equivalent to about a 4-month volume of mortgage takings at the seasonally adjusted rate of loan closings reported by these lenders in November.

Over 1968 as a whole, tentative estimates suggest that the net increase in residential mortgage credit extended by all types of lenders may have been as much as $2-1/2 billion larger than in 1967; this expansion occurred despite a year-to-year drop during 1968 of around $4-1/2 billion in aggregate net savings flows to all S&L's and savings banks. Appendix A discusses in more detail how aggregate net mortgage flows expanded in 1968 despite reduced savings inflows to the thrift institutions, and points out some implications for 1969.

Corporate and municipal bond markets. From mid-December through early January yields on corporate and municipal bonds fluctuated in a narrow range around their 1968 highs. However, most of the activity in the market had consisted of secondary market trading--particularly tax swapping--and the absence of new issues had hindered an accurate test of the current state of the market. The seasonal lull in new issue activity during the year-end period, however, had the constructive effect of giving dealers an opportunity to reduce their bonds held in syndicate as well as adjust their inventory positions. As a result, dealers bid aggressively for the new issues early this week, but found sales to be very slow. Within minutes after the awarding of a large Telephone issue Tuesday, the prime rate was raised and generated a significant rise in yields. New offerings of corporate and municipal bonds priced prior to the prime rate action are unattractive and not likely to sell out at their original terms.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa		State and local Government	
	New	Seasoned		
	With call Protection		S&P High Grade	Bond Buyer's (mixed qualities)
1968				
Low	6.13(8/30)	5.95(9/13)	4.15(8/9)	4.07(8/9)
High	6.92(12/13)	6.53(12/27)	4.93 (12/27)	4.85(12/27)
Week ending:				
Dec. 6	6.81	6.33	4.83	4.76
13	6.92	6.45	4.93	4.82
20	6.86	6.48	4.93	4.84
27	--	6.53	4.93	4.85
Jan. 3	--	6.55	4.93	4.85

Market participants have been focusing on the very heavy volume of corporate bonds expected this month. Flotations of public corporate bonds are estimated at $1.1 billion in January, nearly double the December volume which was held down by seasonal factors and by about $200 million of postponements. While the January calendar has continued to build up recently, the bulk of the volume nonetheless consists of utility issues whose January offering was announced some time ago. Thus, it does not appear that this large volume is significantly accounted for by recent decisions to borrow in advance of needs, certainly not by industrial firms. Some issues, however, may have been scheduled for January in hopes of catching the typical yield downturn associated with the beginning of a new year and an enlarged reinvestment demand. The total volume of corporate security offerings, including private placements and stock issues is estimated at $1.9 billion in January, slightly above the 1968 average monthly volume.

CORPORATE SECURITY OFFERINGS 1/
(Millions of dollars)

	Bonds					
	Public Offerings 2/		Private Placements		Total bonds and stocks	
	1967	1968	1967	1968	1967	1968
YEAR - Monthly avg.	1,249	892e	580	559e	2,066	1,800e
November	645	935e	551	500e	1,500	1,810e
December	1,087	575e	1,020	900e	2,385	1,675e
	1968	1969	1968	1969	1968	1969
January	903	1,100e	546	500e	1,771	1,900e
February	796	800-1,000e	585	500e	1,607	1,500-1,700e

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

Looking farther ahead, the February calendar is currently very light with only about $200 million of corporate bonds scheduled. However, it seems likely that the ultimate volume of public offerings in February will be in the $.8 billion to $1.0 billion range, given underwriter reports of issues in the pipeline and the ample time available to place issues on the February calendar. This would put the February volume somewhat below that of January, partly due to the unusual concentration in January of public utility issues--some of which normally might have been scheduled for February.

In the municipal market, the December volume of new issues totaled about $1.1 billion. Included in this volume were nearly $400 million of industrial revenue issues, which represented the final offerings of such issues over $5 million to receive tax-exemption privileges. But the large volume of industrial issues was partially offset by more than $250 million of postponements, so that the total amount of offerings dropped significantly below the average monthly volume for the year.

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

	1967	1968
YEAR - Monthly avg.	1,230	1,364e
November	1,401	1,025e
December	1,182	1,100e
	1968	1969
January	1,175	1,000e
February	1,153	1,000e

e/ Estimated.
1/ Data for for principal amounts of new issues.

State and local government offerings in January and February are tentatively estimated at $1.0 billion per month. These estimates implicitly assume that there will continue to be a significant volume of postponements, given current yield levels. (In the early days of January about $100 million of new issues were postponed indefinitely.) However, the volume might exceed current estimates if interest rates decline significantly or if some borrowers accelerate their financing plans.

Stock market. After reaching new highs in early December, most common stock price indices levelled out, and, following the increase in the discount rate (December 18), all moved moderately downward. On Monday, January 6, price declines were pronounced in all indexes and appeared to be widely distributed among issues. The decline continued on Tuesday, accelerating after the increase in the prime rate.

Owing to tax-motivated transactions, stock price movements at the end of the year are often not indicative of underlying trends, but developments among individual issues suggest that the shift to additional monetary restraint--and the expectations for further tightening--had some effect on prices. For example, several stocks related to the housing industry, which had been advancing rapidly until the discount rate increase, dropped over 10 per cent between December 18 and the end of the year.

Until the holidays, trading volume had been extremely heavy; the decline in activity during the weeks of Christmas and New Year may well represent only a holiday lull. However, the industry felt that the back-office problem had been reduced sufficiently to permit the return to a 5-day trading week, which began January 2. Although trading time each day was reduced 90 minutes--thereby reducing by two the number of weekly trading hours from those allowed during the 4-day week-- the Securities and Exchange Commission has voiced displeasure with the new system. The SEC expects that the added day allowed salesmen to encourage customer transactions will result in greater volume despite the reduced number of hours available for transactions. They point out, in support of their expectation, that past experience with a reduced number of hours (August 1967) proved unsuccessful.

STOCK PRICE INDICES

	Dow-Jones Industrials	New York Stock Exchange Index	American Stock Exchange Index
1968			
Mid-July high	932.72	57.69	30.28
Early August low	869.65	54.18	28.82
Early December high	985.21	61.27	33.25 1/
1969			
January 7	925.72	57.35	31.68
Per cent decline early Dec. high to Jan. 7	- 6.0	-6.4	- .47

1/ Occurred December 20.

AVERAGE DAILY TRADING VOLUME
(Millions of shares)

	New York Stock Exchange	American Stock Exchange
1968 Average	13.0	6.4
1968 - Week ending:		
December 13	16.2	9.0
20	16.6	8.7
27	11.4	7.2
1969		
January 3	11.6	6.8

Because of technical difficulties in data collection, preliminary estimates of the level of margin debt at the end of November are only now available. These very tentative figures suggest that brokerage customers increased their margin debt by about $70 million during that month of rapidly rising stock prices. This was the first monthly increase since June, but since the October outstanding debt was revised downward by a similar amount, total outstanding debt remained at $6.3 billion. Purpose loans to non-brokers (for both stocks and bonds) reported by large weekly-reporting banks also rose about $70 million during November, and by an additional $60 million last month.

Government securities market. Since the last meeting of the Committee, the discount rate increase, firming of open market policy, and two 1/4 point increases in the prime rate at banks, have all combined to boost yields throughout the Government security list to new record highs. After reaching an initial peak just before Christmas , yields had retraced a sizable part of their initial run-up by the start of the New Year, but the second move in the prime rate--to 7 per cent--then raised most yields back, close to or above their pre-Christmas peaks. Over the full period bill rate increase range generally from 30 to 50 basis points, and coupon issues posted advances of as much as 3/8 of a percentage point.

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

	1968				1969	
	Highs	Nov. 26	Dec. 17	Dec. 24	Jan. 2	Jan. 7
Bills						
1-month	6.35 (12/23)	4.90	5.75	6.30	6.20	6.25
3-month	6.29 (12/24)	5.46	5.96	6.29	6.14	6.25
6-month	6.41 (12/24)	5.56	6.00	6.41	6.29	6.42
1-year	6.47 (12/24)	5.56	5.84	6.47	6.14	6.18
Coupons						
3- year	6.52 (12/23)	5.58	6.11	6.51	6.32	6.44
5-year	6.34 (12/24)	5.71	6.06	6.34	6.25	6.43
10-year	6.27 (12/24)	5.76	5.97	6.27	6.10	6.14
20-year	6.12 (12/24)	5.63	5.84	6.12	5.92	6.08

The abruptness of the yield mark-up on Treasury issues reflected in large measure an intensification of pressures on major money market banks. In the face of heavy current and expected CD attrition, resulting higher Federal funds rates, and sharply increased rates on Euro-dollars, these banks boosted their new loan rates to dealers to rates generally in excess of 6-1/2 per cent and on occasion as high as 7-1/4 - 7-1/2 per cent. With their financing costs at these high levels, and with the lack of Federal Reserve action on Regulation Q ceilings suggesting the possibility of a period of relatively severe credit tightness, dealers became reluctant bidders for securities and attempted to cut-back their existing inventories. In coupon issues this latter process was made more difficult during the closing weeks of the year by the fact that banks taking 1968 as a capital loss year for tax purposes were attempting to liquidate a sizable volume of longer maturities.

With the start of the new year, the weight of bank selling in the coupon market was lifted. At the same time, some analysts began to focus on the possible implications for interest rates later in the year of the divergent trends that seemed to be developing between consumer and business spending. With some market participants sensitive to this latter view, and others focussing more on the developing squeeze on banks, market expectations were being pulled in two directions, and some investor demand for coupon issues appeared. Most recently, the further increase in the prime rate has apparently reemphasized market concern about the likely degree of near-term credit squeeze, and contributed to the resulting sharp back-up of yields.

Higher yields have on occasion attracted a fairly sizable investor interest in bills. As shown in the accompanying table, dealer bill positions declined by nearly $1.5 billion after December 17, even though they took on awards of new issues in bill auctions totalling $3.3 billion. Bank buying--primarily for statement date purposes--was notably good; and some of the pick-up in other investor interest reflected purchases by holders of maturing CD's. Some scattered evidence of increased small investor interest in Treasury bills has also developed recently. Although non-competive bidding in bill auctions late in December was only about normal, despite the sharp run-up of rates, the first regular auction of 1969 attracted a significantly greater than normal non-competitive interest.

DEALER POSITIONS IN GOVERNMENT SECURITIES[1/]
(Millions of dollars)

	December 2	December 16[2/]	January 6[2/]
Total	4,112	4,065	2,557
Treasury bills	3,257	3,377	2,020
Coupon issues	855	688	537
Due within 1 year	190	197	290
1-5 years	118	166	78
over 5 years	547	325	169

1/ Monday figures.
2/ Total dealer awards in auctions of December 16, December 20, December 23, December 27 were $3.3 billion.

Rates on most short-term instruments other than Treasury bills also moved up in the week following the shift to tighter monetary conditions. And since then, some rates have shown some further upward movement.

SHORT-TERM INTEREST RATES

	1968				1969
	Highs	Nov. 26	Dec. 17	Dec. 24	Jan. 7
1-month					
CD's (prime NYC)					
Highest quoted new issue	5.50 (1/2)	5.50	5.50	5.50 (12/19)	5.50
Secondary market	6.45 (1/2)	5.95	6.15	6.38	6.45 (1/2)
3-month					
Bankers' acceptances	6.50 (1/7)	6.00	6.12	6.50	6.50
Federal agencies	6.11 (5/17)	5.77 (11/21)	6.07 (12/13)	6.14 (12/29)	6.45 (1/2)
Finance paper	6.25 (1/7)	5.88	6.00	6.25	6.25
CD's (prime NYC)					
Highest quoted new issue	6.00 (1/7)	6.00 (11/21)	6.00 (12/12)	6.00 (12/19)	6.00
Secondary market	6.75 (1/7)	6.05 (11/21)	6.20 (12/12)	6.25 (12/19)	6.75
6-month					
Bankers' acceptances	6.62 (1/7)	6.13	6.25	6.62	6.62
Commercial paper	6.25 (1/7)	6.00	6.12	6.25	6.25
Federal agencies	6.25 (5/24)	5.91	6.17 (12/13)	6.25 (12/20)	6.59 (1/2)
CD's (prime NYC)					
Highest quoted new issue	6.25 (1/7)	5.75 (11/21)	6.25 (12/12)	6.25 (12/19)	6.25
Secondary market	6.88 (1/7)	6.20 (11/21)	6.30 (12/12)	6.40 (12/19)	6.88
1-year					
Prime municipals	3.90 (1/2)	3 20 (11/21)	3.65 (12/13)	3.75 (12/20)	3.90 (1/2)

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

Federal finance. Current staff projections of Federal receipts and outlays on a unified budget basis still show an estimated deficit of $2 billion for fiscal year 1969, in contrast to President Johnson's recent statement predicting a small surplus. The President's statement reiterated a belief that fiscal year Federal spending will be held down to the $184.4 billion figure first projected in the Summer Budget Review. To become effective, however, this estimate would require significant further cut-backs in Federal outlays, other than transfer payments, over the remaining months of the year.

The Board staff estimate still assumes moderate increases in Federal outlays from recent levels, mainly in Vietnam-related defense spending. While the Treasury balance in the latter half of December ran somewhat higher than the staff forecast, the extent of the change does not suggest any reason to revise the earlier estimate that fiscal year receipts will total nearly $185 billion, slightly less than the figure implied in the President's statement. Final Administration estimates of fiscal 1969 receipts and expenditures to be shown in the January Budget Document are not yet known.

Staff estimates of Treasury cash flows for the first quarter of 1969 suggest that the Treasury may have to raise $3 to $4 billion of additional new money before its balance is replenished by inflows of tax receipts in March and April. The bulk of the new money need will have to be met by early March. The first step in raising these funds is expected to be an offering of perhaps $1.5 to $2.0 billion of tax bills, with payment probably in the third week of January. Additional funds could be raised at mid-February in connection with the refunding of February note and bond maturities, $5.4 billion of which are held by the public.

Tax receipts expected in the latter half of March should permit the Treasury to repay the $2.0 billion of tax bills that mature on March 24, and still move into April with an operating cash balance of about $4.0 billion. Over the remainder of the fiscal year the Treasury is expected to accomplish debt repayment of $8.5 billion.

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

	Fiscal years			1967		1968				1969	
	1967	1968	FR Board 1969e/	III	IV	I	II	III	IVe/	Ie/	IIe/
Quarterly data, unadjusted											
New budget:											
Surplus/deficit	-8.8	-25.2	-2.1	-8.9	-10.6	-8.6	2.9	-3.2	-7.8	-3.4	12.4
Receipts	149.6	153.7	184.6	35.3	32.0	36.2	50.1	43.6	38.9	43.0	59.1
Total expenditures and net lending	158.4	178.9	186.7	44.1	42.7	44.8	47.2	46.9	46.8	46.4	46.7
Means of financing:											
Total borrowing from the public	2.9	23.1	4.2	8.5	10.5	6.7	-2.6	7.7	3.6	1.5	-8.6
Decrease in cash operating balance	5.2	.4	-3.2	-1.0	1.1	.2	.1	-3.3	3.9	.7	-4.5
Other 1/	.7	1.7	1.1	1.4	-1.0	1.8	-.4	-1.1	.3	1.2	.7
Cash operating balance, end of period	5.7	5.3	8.5	6.7	5.6	5.4	5.3	8.6	4.7	4.0	8.5
Seasonally adjusted annual rate											
Federal surplus/deficit in national income accounts	-6.7	-11.9	2.4	-12.9	-12.2	-8.6	-10.2	-2.8	1.0	5.0	6.5
Receipts 2/	147.8	160.8	190.5	152.2	156.4	166.6	171.8	182.1	188.3	194.7	196.8
Expenditures	154.3	172.7	188.1	165.1	168.6	175.1	181.9	184.9	187.3	189.7	190.3

e--Projected.
1/ Includes various accrual items, such as deposit fund accounts and clearing accounts.
2/ Retroactive corporate surtax liability is included beginning first quarter 1968. Quarterly receipts do not add to fiscal year totals due to seasonal adjustment of social security taxes.

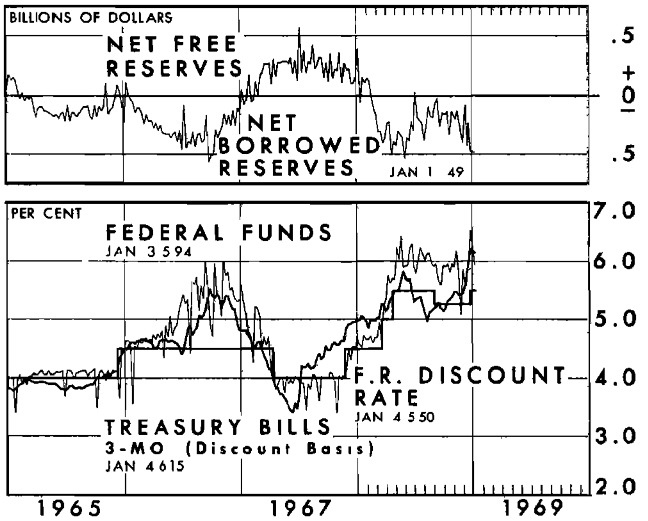
PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	Dec.[a]	Jan.	Feb.-March
Borrowing operations			
New cash raised			
Weekly bills	--	--	--
Tax bills	1.9	1.5	--
Coupon issues	---	--	2.5
PC's	--	--	--
Other (agency, debt repayment, etc.)	-.7	--	-2.5
Total net borrowing from public	1.2	1.5	--
Plus: Other net financial sources[b]	--	.9	.3
Plus: Budget surplus or deficit (-)	.7	-1.1	-2.3
Equals: Change in cash balance	1.9	1.3	-2.0
Memorandum: Level of cash balance end of period	4.7	6.0	4.0

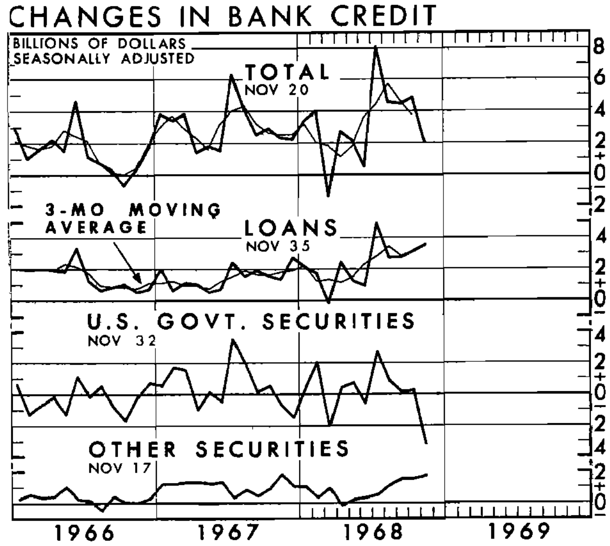
a/ Actual and estimated data.
b/ Checks issued less checks paid and other accrual items.

FINANCIAL DEVELOPMENTS - UNITED STATES

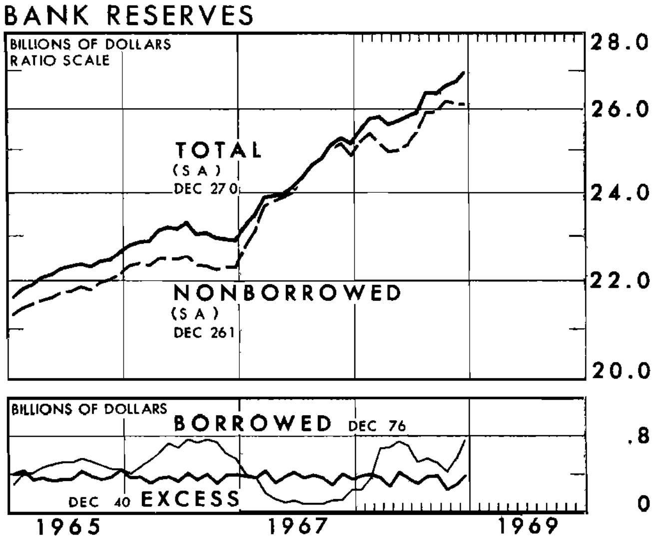
FREE RESERVES AND COSTS



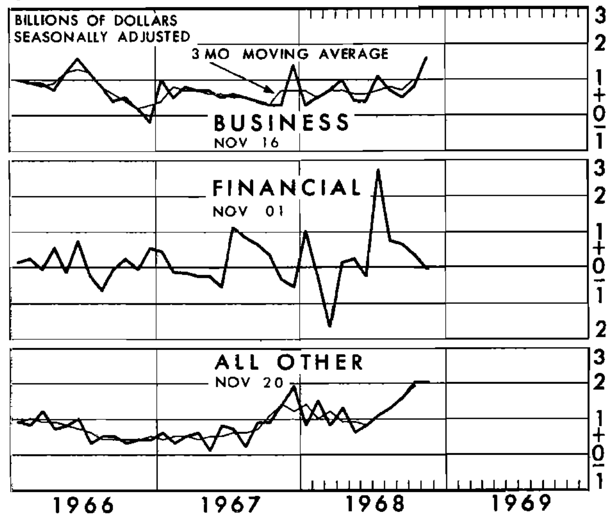
CHANGES IN BANK CREDIT



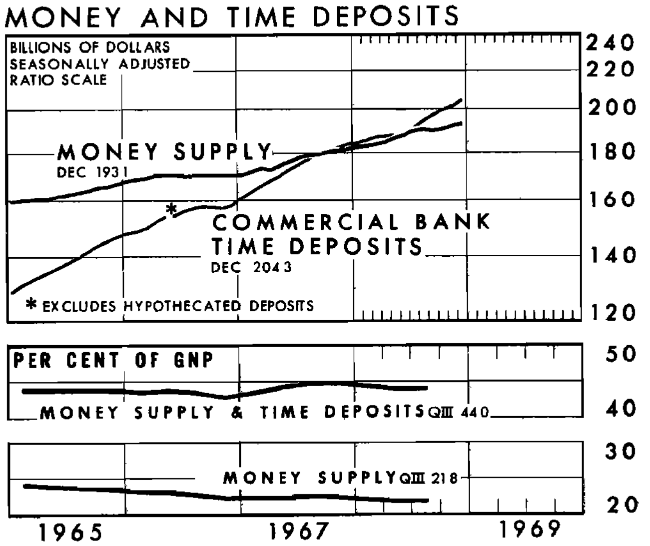
BANK RESERVES



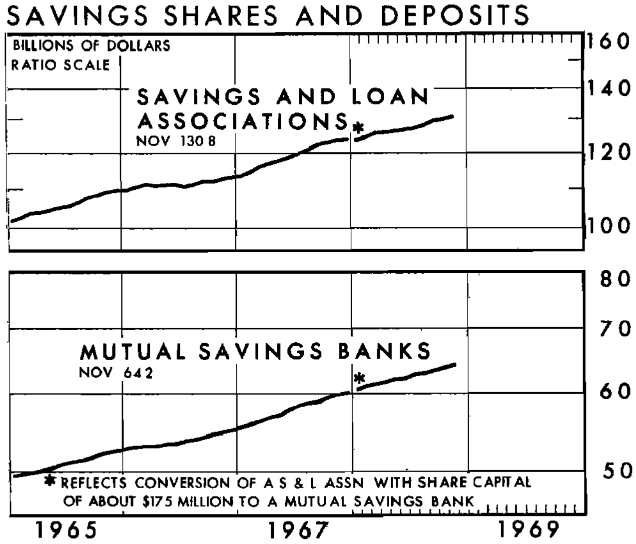
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

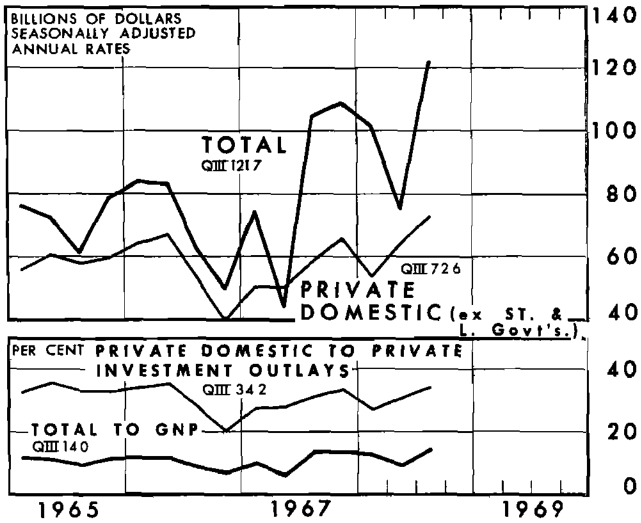


SAVINGS SHARES AND DEPOSITS

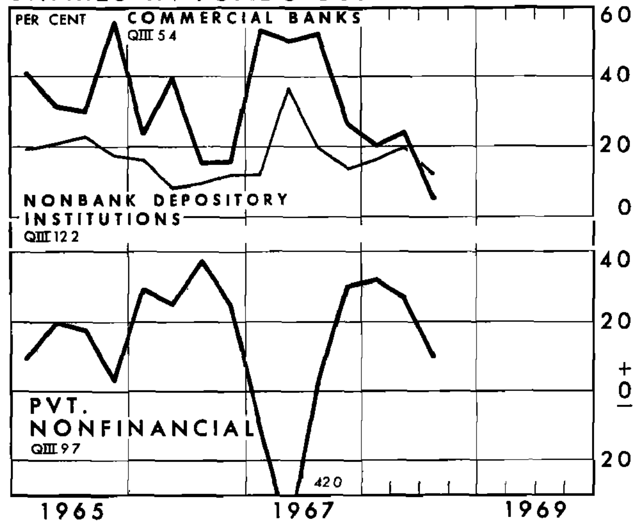


FINANCIAL DEVELOPMENTS - UNITED STATES

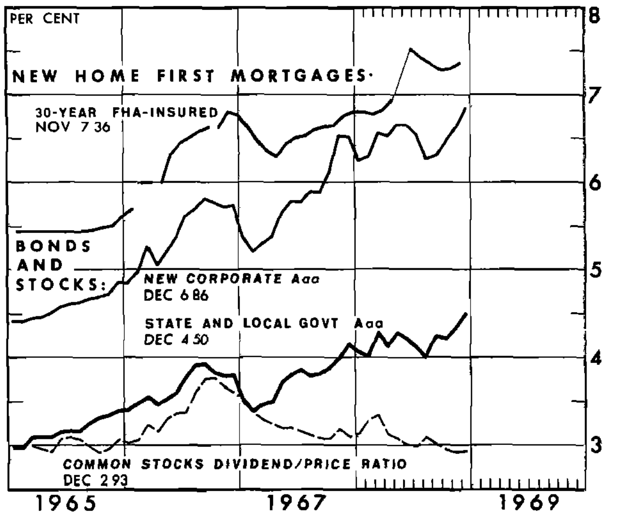
NET FUNDS RAISED-NONFINANCIAL SECTORS



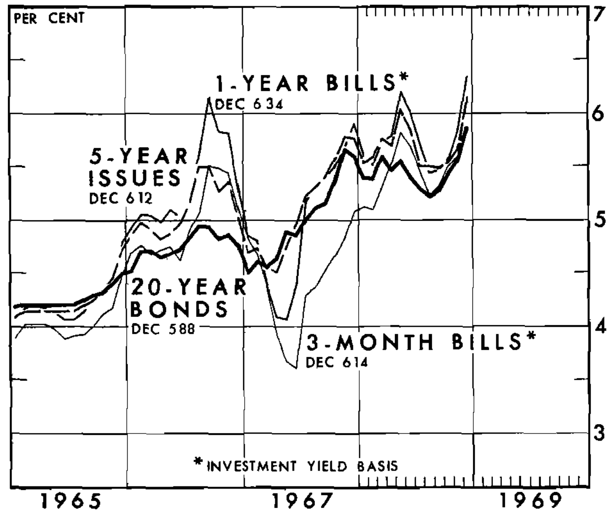
SHARES IN FUNDS SUPPLIED



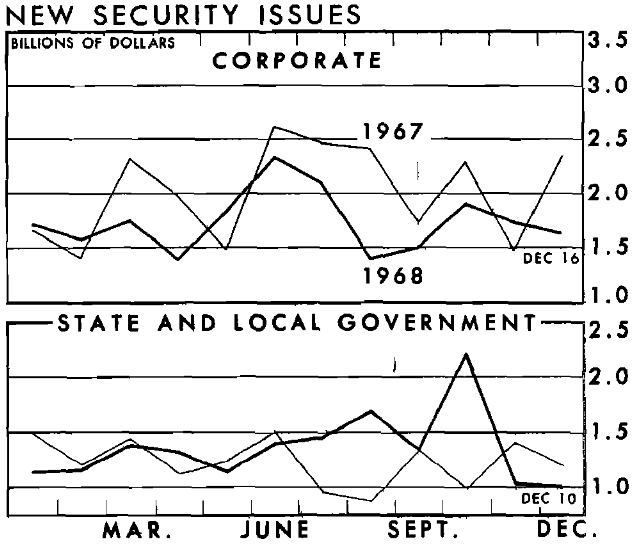
MARKET YIELDS



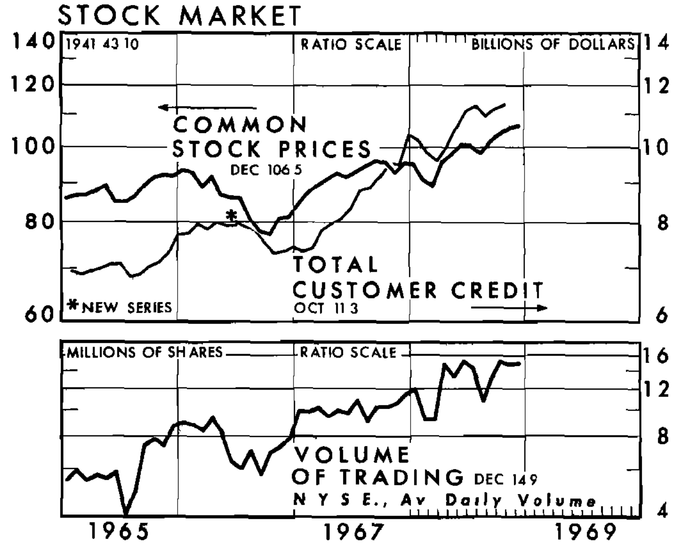
MARKET YIELDS—U S GOVT SEC



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

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U.S. balance of payments. As a result of year-end receipts far greater than anticipated, the balance of payments for the fourth quarter of 1968, and for the year as a whole, registered a surplus on both of the conventional measures. On the liquidity basis the balance shifted into surplus about mid-December, after having registered a deficit of about $1 billion in October-November (not seasonally adjusted). In the final week of December a massive surplus of $1.6 billion was reported, which yielded a surplus for the quarter (seasonally adjusted) of about $1.2 billion. If this preliminary result is reasonably accurate, the year will show a liquidity surplus of some $400 million.

Some of the improvement in December resulted from larger receipts from foreign governments under financing arrangements worked out by the Treasury, though for the entire quarter such receipts (shown in the table that follows) were not markedly greater than in the preceding two quarters. In the fourth quarter there were also receipts of over $200 million from investments in nonliquid assets by international institutions which had sold bonds in the U.S. market as well as other receipts from governments not recorded in the table, such as prepayments for arms purchases and repayments of certain loans, that totalled about $200 million.

SUMMARY OF FINANCING ARRANGED WITH FOREIGN GOVERNMENTS
(millions of dollars)

	1967	1968 Total	I	II	III	IV
1. Long-term deposits 1/	+940	+515	+138	+145	+118	+114
2. U.S. Agency securities 1/	+28	-6	+10	+4	--	-20
3. Advance debt repayments 1/	+6	+266	+42	+3	+55	+166
4. Nonliquid Treasury issues 2/	+32	+300	+22	+2	+31	+245
5. Canadian Government transactions						
a. Nonliquid Treasury issues	+170	+1,020	+100	+500	+250	+170
b. Other	+59	-121	-36	-72	--	-13
6. German transactions	+250	+625	+125	+250	+125	+125
7. U.K. transactions	-516	+25	-16	--	--	+41 3/
Total, selected transactions	+969	+2,624	+385	+832	+579	+828

1/ Excludes Canada and the U.K.
2/ Excludes Canada and Germany; includes Ex-Im participations.
3/ Does not take into account postponement of $138 million due on postwar loan.

In addition, very large year-end receipts appear to have been generated by U.S. private investors. Some of the banks shifted approximately $300 million of credits to foreigners from head office to branch books (reducing both bank loans outstanding and liabilities to banks abroad) and direct investor companies are believed to have repatriated in the last week of the year more than $500 million of liquid funds they had been holding as Euro-dollar deposits. There is no direct measure of the latter amount but it is roughly consistent with estimates made by the OFDI. For some companies the inflow may have been necessary to reduce outflows for the year to allowable amounts, but the greater part probably had the effect of bringing some investors well below their 1968 ceilings, and is therefore potentially available for outflows this year.

The liquidity surplus registered in 1968 was the first since 1957, and represents a net improvement of $4 billion over the 1967 deficit of $3.6 billion. Since the merchandise trade deficit for the year, as discussed below, probably did not exceed $1/2 billion, compared to a $3-1/2 billion surplus in 1967, the net improvement in all other above-the-line transactions would have had to be on the order of $7 billion. Some of the elements of the improvement were the following:

a) Financing arrangements with foreign governments of the type shown in the preceding table yielded about $1.7 billion more in 1968 than in 1967.

b) In the case of direct investments it seems quite possible that the goal of reducing direct investments (including reinvested earnings) by $1 billion from the 1967 amount was exceeded, perhaps by $1/2 billion. Some of this appears as higher income receipts, but most will be reflected in the accounts as a reduction in deposits built up abroad out of the proceeds of foreign loans.

Another aim of the direct investment controls was to reduce liquid assets held abroad (other than the proceeds of foreign borrowings), to 1965-66 average levels by mid-June. This brought a net inflow of over $200 million in 1968 whereas there had been an outflow of about that size in 1967.

c) Banking claims on foreigners (including claims held for the account of customers) probably did not increase as much in the fourth quarter as they normally would for seasonal reasons, because of the shifts of loans to branches mentioned above. If so, there was a net inflow of bank-reported claims of about $1/2 billion in 1968, reversing a net outflow of $750 million in 1967 -- a net gain of $1-1/4 billion.

d) Foreign private investors brought in considerably more capital for long-term investment in 1968 than in 1967. Portfolio investments in U.S. equity securities were about double the $800 million registered in 1967, and inflows for direct investment were probably larger by $100 million or more.

The transactions cited above -- some of which are largely guesswork at this stage -- add up to a net improvement over 1967 of over $5-1/2 billion. There are other transactions that resulted in larger payments to foreigners in 1968 -- such as interest payments on foreign holdings of U.S. obligations, which increased considerably as holdings grew and interest rates rose -- so that the items for which estimates are offered fall far short of accounting for the whole improvement in the liquidity balance last year.

Measured on the official settlements basis there was also a sizable surplus in December, offsetting deficits in October and November, so that there was a small surplus of perhaps $200 million for the entire fourth quarter, seasonally adjusted. This surplus was much less than that on the liquidity basis since it was not affected by investments by foreign official agencies in nonliquid assets, or by the transactions mentioned above that resulted in a large drop in liabilities to foreign branches.

For the year there was a major improvement in the official settlements balance from a deficit of \$3.4 billion in 1967 to a surplus of about \$1.6 billion. Liabilities to foreign official accounts dropped by \$3/4 billion in 1968 as against an increase of \$3.4 billion in 1967. Within those totals there was also a major shift out of liquid liabilities to foreign official accounts and into various nonliquid types of holdings.

U.S. official reserves gained \$1.1 billion in the fourth quarter and \$880 million for the year, whereas there was practically no change in 1967. The gold stock made modest gains after the loss of \$1.4 billion in the first quarter, as purchases from France exceeded sales to other countries, so that the loss for the year of \$1.2 billion was about the same as in 1967. However, the IMF gold tranche position was fully reconstituted by the end of the year, and holdings of convertible currencies increased by \$1.2 billion, slightly more than in 1967. In both years there were large increases in holdings of sterling, and in 1968 a sizable increase in holdings of French francs.

Euro-dollar market. Euro-dollar interest rates, which had been advancing throughout the fourth quarter, reached record levels in the closing weeks of 1968 and continued to advance in the first week of the new year, reaching new highs on January 8.

Some of the pre-year-end firming of rates can no doubt be attributed to year-end window-dressing repatriations by European commercial banks. However, the only central bank whose market intervention in the last few weeks of December clearly reflected large scale

SELECTED U.S. MONEY MARKET RATES
AND EURO-DOLLAR RATES
(weekly average of daily figures)

Average for week ending	(1) Call Euro-$ Deposit	(2) Federal Funds	(3) = (1)-(2) Differential	(4) 3-month Euro-$ Deposit	(5) 3-month Treasury Bill	(6) = (4)-(5) Differential
Dec. 11	6.54	5.82	.72	7.04	5.75	1.29
18	6.54	6.00	.54	7.07	5.93	1.14
25	7.51	6.21	1.30	7.33	6.21	1.12
Jan. 1	7.21	5.95	1.26	7.17	6.21	.96
7*	7.59	6.67	.92	7.36	6.16	1.20
Net change since Dec. 11	+1.05	+.85	+.20	+.32	+.41	-.09

*/ 4-day average.

repatriations of private funds was the Swiss National Bank; that bank purchased $750 million from the market, on a short-term swap basis, but returned a nearly equal amount of funds to the Euro-dollar market for its own account. Since year-end a reverse flow from Switzerland is evidenced by weakening of the Swiss franc exchange rate.

Market operations by the German Federal Bank in the last two weeks of December and first week of January resulted in substantial net deliveries of dollars to the exchange market. The combined effect of the Bundesbank's spot and swap operations (net of receipts on maturing forward contracts to receive dollars) was to deliver about $400 million to the exchange market in the last two weeks of December and an additional $850 million in the first week of January. Some substantial part of these funds may have gone to the Euro-dollar market.

To explain Euro-dollar market conditions in recent weeks one must probably look to money market developments in the United States since mid-December and the consequent stepping up of bidding for Euro-dollar funds by American bank branches.

Recent changes in the liabilities of U.S. banks to their own foreign branches would seem on the surface to suggest that despite active bidding the branches were losing deposits. Total liabilities of American banks to their foreign branches declined by nearly $1.4 billion in the three weeks ending December 31; the largest decline (over $900 million) occurred in the last week of the year. However, as noted earlier, the decline in liabilities to branches in the last week of 1968 probably reflected in large part sales of loans by head offices to their branches and shifts of deposits by U.S. direct investors from foreign branches to head offices. By January 6 the liabilities of New York banks to their branches abroad had increased by over $300 million since the year end.

Recent exchange market developments. Since mid-December foreign exchange markets have been relatively calm. The price of gold has risen to $42.45 an ounce, its second highest level since gold markets were reopened following the crisis last March. The advance in the gold price is generally attributed to comments in the U.S. about the price of gold and renewed tensions in the Middle East.

The sterling exchange rate has held in a very narrow range around $2.3845 since mid-December with only small and intermittant net support from the Bank of England. The discount on forward sterling -- which rose above 7 per cent per annum on three-month contracts during the second week of December -- has since gradually narrowed with minor support from the Bank of England, and the discount on three-month sterling is currently 3.4 per cent per annum.

Funds continue to flow out of Bundesbank reserves as noted above, and that bank has gradually raised its selling rate for dollars to its current equivalent of 24.99 cents mark, slightly below the mark par rate of 25.00 cents. The Swiss franc and guilder exchange rates rose to their upper limits against the U.S. dollar in late December as commercial banks in those countries repatriated funds to meet year-end needs. Since year-end both these currencies have weakened as the reverse flow of funds from the Netherlands and Switzerland got under way.

The Bank of France continues its policy of operating in the exchange market within rather narrow limits and there has been little movement in the exchange rate. Apparently that bank made large purchases of foreign currencies during December as a result of changes in French exchange regulations, and repaid borrowings from other central banks. The discount on three-month forward francs in markets outside France continues at about 9 per cent per annum.

Demand for the Canadian dollar increased at mid-December after announcement of the U.S.-Canadian agreement to a more flexible arrangement regarding the ceiling on Canadian reserves. The Bank of Canada also raised its bank rate by 1/2 percentage point to 6-1/2 per cent, following the Federal Reserve discount rate increase. Recent demand on the part of Canadian banks for forward Canadian dollars in connection with renewals of swap deposits by their customers has eliminated the discount on forward Canadian dollars.

U.S. foreign trade. In November, the U.S. trade balance was in surplus, following a deficit in October, as exports increased more than imports. The erratic movement in the trade balance in the past few months stemmed largely from the threats of dock strikes -- first in October and again in December. A strong export surplus is expected to have occurred again in December as traders accelerated cargo movements, particularly outbound, to beat the end of the Taft-Hartley injunction on December 20. This may be followed, however, by deficits in the early months of the year if the strike, now in effect, persists through January.

Even with a large export surplus in December, it appears that the surplus in calendar 1968 will probably be about $1/2 billion, on the balance of payments basis. This would be $3 billion less than in either 1966 or 1967, and the smallest in the post World War II period. For the five months July-November combined, the export surplus was at an annual rate of $600 million (balance of payments basis), compared with a less than $100 million rate in the first half of the year.

Only a relatively small portion of the deterioration in the trade balance from 1967 to 1968 -- about 20 per cent -- can be attributed to actual or threatened strikes in the copper and steel industries, which boosted imports and limited exports of these products. The major element in the worsening of our trade position last year was the extraordinarily large increase in all types of imports. In January-November 1968 monthly imports averaged nearly 25 per cent higher than in 1967. This compares with an annual increase of 9 per cent from 1960 to 1967. The expansion in exports last year, although not nearly as great as in imports, nevertheless was also unusually large, about 10 per cent contrasted to the 6.5 per cent growth rate from 1960 to 1967.

Imports in 1968 rose much more rapidly than domestic expenditures -- nearly 2-1/2 times as fast. In value terms the ratio of imports to GNP in the first three quarters averaged 3.9 per cent, the highest on record. In 1966 and 1967 the ratio was 3.4 and the average from 1960 to 1965 was under 3 per cent. At current levels of GNP the rise of .5 of a percentage point in this ratio from 1967 to 1968 is equivalent to over $4 billion more of imports than if the 1967 ratio had prevailed.

The rate of increase in imports was particularly high from the latter half of 1967 to the first half of 1968, a rate of 36 per cent per year. The increase in imports to the next 5-months period, July through November, was much slower -- less than 10 per cent per year. The greatest expansion was in automobiles, both U.S. types from Canada and foreign types from Europe and Japan, other consumer goods, and machinery and capital equipment. The value of imports of cars from Canada and from other sources were each about 60 per cent greater in 1968 than in 1967. Other consumer goods rose by more than 25 per cent and capital equipment by 17 per cent. Purchases of foreign foods and industrial materials other than steel and copper also increased but more moderately -- about 13 per cent.

The large advance in imports of foreign consumer goods must be attributed partly to the attractive style and design of foreign products and to the widening of the spread between foreign and domestic prices. The unit value index (roughly representing prices) for imports of finished manufactured goods is estimated to have increased by less than 1 per cent from 1967 to the average of the first 9 months of 1968, compared with a rise of about 3.5 per cent in domestic consumer prices of nonfood commodities.

Arrivals of cars, both from Canada and other sources, and other nonfood consumer goods, continued to advance in the second half of the year, but only at one-half to one-third the rate of expansion in the first half of the year. The large inventory buildup in European and Japanese cars has apparently eased. Anticipation of lower prices after January 1, 1969, when the second stage of the Kennedy Round of tariff reductions became effective may also have induced importers to postpone some purchases of other foreign consumer goods until then.

Slackening in the rate of increase in imports in the second half of 1968 was most marked in industrial materials. Aside from copper and steel, purchases of other foreign metals, raw wool, paper products, etc. rose at a rate of about 25 per cent between the latter half of 1967 and the first half of 1968, and then showed no further change in the July-November period. With domestic investment outlays projected to increase and new orders for durable goods on the rise, it may be expected that imports of metals and other industrial goods may swing up again in early 1969.

Exports rose from the first half of 1968 to July-November at a rate of 12.5 per cent per year, only slightly below the rate of increase recorded for the preceding half-year. The entire gain was in nonagricultural commodities; shipments of agricultural products fell mainly because of a drop in P.L. 480 shipments of wheat to India and Pakistan.

In contrast to the early part of the year when increased deliveries of aircraft and of automobiles and parts (the latter principally to Canada) accounted for the bulk of the nonagricultural gain, the advance in the second half of 1968 was more broadly based and included larger shipments of machinery, chemicals, and nonfood consumer goods. By areas the export expansion also shifted in the last half of 1968 -- from the less developed countries to Western

Europe, particularly the EEC countries. Sales to Japan expanded further but exports to Canada, aside from automotive deliveries, remained sluggish.

With output in the industrial countries expected to continue to expand and the rate of investment outlays in Germany projected to rise sharply in 1969 as utilization there approaches capacity, these markets for U.S. exports should be even more buoyant in 1969.

Economic activity in major industrial countries. Through the first three quarters of 1968, industrial production in most of the OECD countries continued to advance strongly above the relatively depressed levels of the first half of 1967. By the July-September quarter output had increased by 8 per cent over the corresponding period of 1967 for the European OECD countries taken together. Some countries, notably Japan and Germany, showed considerably larger increases. In early autumn, however, German industrial production eased off a little from its peak in August.

INDUSTRIAL PRODUCTION
(1967 = 100)

	1967	1968			
	Q-4	Q-1	Q-2	Q-3	Sept.-Oct.
OECD-Europe	103	103	103	108e.	n.a.
France	103	105	88	107	110
Germany	105	104	111	114	113
Italy	102	103	105	105	n.a.
U.K.	102	104	104	105	104
Japan	107	109	115	120	122
Canada	102	102	105	105	107
United States	101.0	102.5	103.8	104.5	104.6a/

e = estimated.
a/ November was 105.9, preliminary.

Real GNP in the European OECD countries is estimated to have risen 5-1/4 per cent from the second half of 1967 to the half year just ended. As the next table shows, growth in activity was not steady over the course of the year -- in the most obvious case, French GNP was severely hit by the spring disorders.

CHANGES IN REAL GNP (SEASONALLY ADJUSTED)
(Per cent per year)

	Change from preceding halfyear				Change from year 1968 to 1969 Forecasts	
	Actual	Est.	Forecast (OECD)			
	1968 1st H.	1968 2nd H.	1969 1st H.	1969 2nd H.	OECD	FRB
OECD Europe:	4-1/4	6	4-1/4	4	4-1/2	...
France 1/	-5.	19	2 a/	0 a/	5 to 6-1/2	5-1/2 to 6
Germany	5.8	8	4-1/4	3-3/4	5	5-1/2
Italy 1/	5.4	5	5-1/2	6-3/4	5-1/2	5-1/2
U.K. 1/	4.5	2-3/4	2	3	2-1/4 to 3-1/4	3
Japan	10.8	11	7-1/2	12	9-1/2	10
Canada	6.2	3-3/4	3-1/4	5-1/4	4	4-1/2

1/ Gross Domestic Product.
a/ Estimated implications of OECD's forecast for year 1969.

One striking aspect of 1968 developments was the stimulus provided in many countries by exports, resulting largely from the strong demand in the United States and Britain. Total exports of the European OECD countries increased in dollar value by 16 per cent from the third quarter of 1967 to the third quarter of 1968. In Germany, and in France prior to the strikes, rising export demand as well as expansionary policy actions accelerated growth. In Italy, the strength of export demand compensated in part for an unexpected weakening of domestic demand. In Japan, the balance of payments improvement brought by corrective monetary measures and by the export boom permitted an easing of monetary policy. Even in Britain, the export sector provided the major stimulus for expansion after the spring of 1968.

Looking ahead into 1969, the stance of economic and financial policy in each country is a key factor to take into account. For the

United Kingdom, it continues to be essential to reach a position which the U.K. can make progress in repaying its massive foreign debts and building up its foreign exchange reserves. In France, too, the balance of payments position is now the dominant influence on policy, although the need to avoid serious unemployment and domestic strife may make itself strongly felt next year.

Germany and Italy, with large surpluses in their external current account balances, are continuing to follow policies designed to stimulate domestic demand.

A slowdown in growth of both GNP and international trade of the industrial countries will probably begin to show up in half-yearly figures for the first half of 1969, as the OECD's forecasts suggest. Restrictive policy actions recently taken in the United States, Britain, and France, will tend to hold down growth in trade in the first part o. the year. On the other hand, imports by Germany, Italy, Canada, and Japan, which rose rapidly last autumn after pausing earlier in 1968, may continue to increase fairly steadily. The OECD Secretariat has forecast an increase in the total value of OECD trade of 7 per cent from the second half of 1968 to the second half of 1969 -- compared to an increase of 15 per cent a year earlier.

The trade balances of the U.K. and France should improve; those of the other countries should deteriorate. GNP is expected to grow much more slowly from the second half of 1968 to the second half of 1969 than over the preceding two half years in France, and moderately slower in most of the other industrial countries. Perhaps only in Italy will GNP increase more than over the preceding period.

Such forecasts as these assume gradual restoration of confidence in the French franc and in sterling. New setbacks for those currencies could induce further restrictionary policy actions which would reinforce the expected slowdown in 1969. On the other hand, if the international financial position improves rapidly some of the restrictive measures taken in 1968 might be gradually eased in the course of 1969.

Despite restrictive fiscal and credit policies, economic activity in France in the first quarter of 1969 is likely to be higher than in the last quarter of 1968. Exports, spurred by the border tax adjustment and by subsidies still in effect this month, should expand vigorously. Imports may decline, as the impact of higher border taxes on imports will be reinforced by the stringent restrictions on obtaining forward exchange cover. Retail sales reached record levels in November and were probably even higher in December, in anticipation of price increases after the yearend. There will now be a need to replenish retail inventories.

French Government policy aims at a marked slowing of the rise in activity before midyear. The impact of the price increases in January resulting from delayed application of new value-added tax rates domestically -- these could be as high as 2 per cent -- will depress consumers' real takings. Once restocking is completed, new orders should fall -- at least if fears of franc devaluation subside.

The outcome of wage negotiations in March will be significant. It is not certain that the labor rank and file will follow their leadership, who are now giving the Government a qualified backing. The French Government may be willing to accept a single one-step wage increase of 4 per cent this year. Even if the wage rise is no greater than that, prices are likely to increase in the course of 1969 by more than the target rate of 4 per cent. To add to the difficulties ahead, if output levels off as expected, unemployment almost certainly will rise.

Late in December, the German Government announced several expansionary measures, including a significant increase in public expenditures over previous plans, special investment bonuses in depressed areas, and continuation of the easy monetary policy. Further measures are under consideration. These measures should strengthen domestic demand, and, in the longer run, help reduce the German economy's dependence on exports.

The impact of the November reduction in export border rebates was delayed as all foreign deliveries through December 23 were exempted. This may have led to strongly enlarged German exports in December, with an offsetting dip in January. However, all signs point to a recovery of exports in February and March.

German real GNP is likely to be at least 5-1/2 per cent greater in 1969 than in 1968. Following the expansion at a rate of 8 per cent per year in the second half of 1968, some slowing should appear in the first half of this year. With fuller utilization of plant and labor resources, growth in activity may slow down to a 4 per cent rate later in the year.

Given the buoyancy of internal demand and the lowering of import prices by the border tax adjustment, the value of imports in the second half of 1969 may be about 13 per cent higher than a year earlier. (Last year's second-to-half-to-second-half increase under conditions of very rapid domestic expansion was over 20 per cent.) Since the export rise should be of the order of magnitude of 5 per cent, the trade surplus should be reduced somewhat.

The Italian authorities seek a more rapid advance in activity after the disappointing developments this past year, when the rise in real domestic demand between second halves of 1967 and 1968 fell to an estimated 5 per cent. Even with the strong advance in exports, real GDP increased less than 5-1/2 per cent. The Rumor Government and the Bank of Italy consider that a real GDP expansion in 1969 of 6 or 7 per cent is feasible without producing any pressure on prices; the government is banking on substantial increases in both public and private investment.

There is, however, good reason -- as the OECD Secretariat has suggested -- to doubt that the year-over-year increase in real GDP will exceed 5-1/2 per cent. Difficulties lie largely on the side of demand. The increase in exports is projected at only 10-1/2 per cent from 1968 to 1969, compared with an estimated 14-1/2 per cent the year before. Increases in Italian public investment typically encounter lengthy administrative delays. Similarly, the impact of measures taken late in the summer of 1968 to stimulate private investment may be slow in coming because of the presence of much unused capacity. On the other hand, expansion should be helped by a resumption of inventory accumulation and by a decline in the saving ratio; real private consumption may rise 5-1/2 per cent in 1969, compared to an estimated 4-1/4 per cent in 1968.

Italy ran an extraordinarily large current account balance of payments surplus in 1968 -- an estimated $2.4 billion, or nearly 3-1/2 per cent of GDP. A significant reduction in that surplus in 1969 is unlikely. Consequently, the over-all surplus, which last year was about $700 million, would shrink only if net outflows of nonbank capital became even larger than the $1.7 billion recorded last year. Although the expansion of imports should be much larger than the 5 per cent rise in 1968, the forecast year-over-year increase of 13 per cent will cut the trade surplus very little, given the projected export rise.

Gross product in the United Kingdom should expand more slowly in 1969 than it did in 1968 -- about 3 per cent in real terms, compared to the estimated 3-3/4 per cent in 1968.

The expected slowdown will result from policy measures designed to cut back domestic demand for consumption so as to free resources for the investment and export sectors, and measures to reduce demand for imports in particular. The forecast assumes that the substantial productivity gain experienced in 1968 was largely cyclical and cannot be sustained in 1969, and that capacity limitations are beginning to be felt in some industries.

As a result of severely restrictive policies, consumer expenditure may rise, in real terms, by only about 1 per cent from 1968 to 1969, with the increase occurring mainly in the second half. If the growth in money earnings cannot be adequately controlled, this estimate could prove unrealistically low. Government expenditure is expected to remain fairly stable. Fixed investment expenditures by industry have been rising less than anticipated, but the Board of Trade now sees an increase of 10-14 per cent for 1969 over 1968 in value terms. Investment depends crucially on confidence in the Government and the economy.

British exports have shown increased strength since the devaluation and in the six months from April-May to October-November rose at a rate of 24 per cent per year. With the expected slowdown in growth of world trade and perhaps increasing difficulties with export delivery dates due to higher capacity utilization, U.K. exports are projected (by OECD) to expand by 6-1/2 per cent from the latter half of 1968 to the second half of 1969.

Given the trend of imports, and the recent measures taken to restrict them, the expected growth of exports should yield a trade surplus after the middle of this year. Since the U.K. runs a large surplus on services and transfers -- at an annual rate of over $700 million in the first three quarters of 1968 -- a surplus on current and long-term capital account should develop in early 1969, and may reach an annual rate of about $600-$700 million in the second half of 1969. This would fall short of the $1.2 billion target set at the time of the 1967 devaluation, but further gains would be hoped for thereafter.

Demand forces remained strong in Japan at the end of 1968, and a November survey of business enterprises by the Bank of Japan forecasted a continued strong rise in industrial production in coming months.

The Japan Economic Research Center, like most private Japanese forecasters, expects a gain in real GNP for the fiscal year beginning in April of 12 per cent, in contrast to the official estimate of 10 per cent. From the latter half of 1968 to the second half of 1969 the Center projects a rise of over 20 per cent in the value of fixed investment outlays and a 16 per cent rise in value of merchandise exports. These expectations may be overly bullish. If the growth in world trade slows in 1969 as expected, the OECD Secretariat looks for a Japanese export rise of only 8 per cent. Its forecast of GNP is similar to the official Japanese estimate.

In Canada real GNP rose an estimated 5 per cent from the latter half of 1967 to the second half of 1968. Domestic demand provided the major stimulus to economic activity in the second half, whereas more rapid growth in the first half had been due to a strong export performance. In 1969 the rate of growth should be about the same as in 1968. The forecast 1969 price rise of 3-1/2 per cent -- also the same as in 1968 -- is slightly higher than the Government's forecast of a few months ago, when it appeared that price rises were abating somewhat. Indeed, inflationary pressures are now the major concern of Canada's policymakers -- a concern evidenced in the December increase in the Bank of Canada's discount rate.

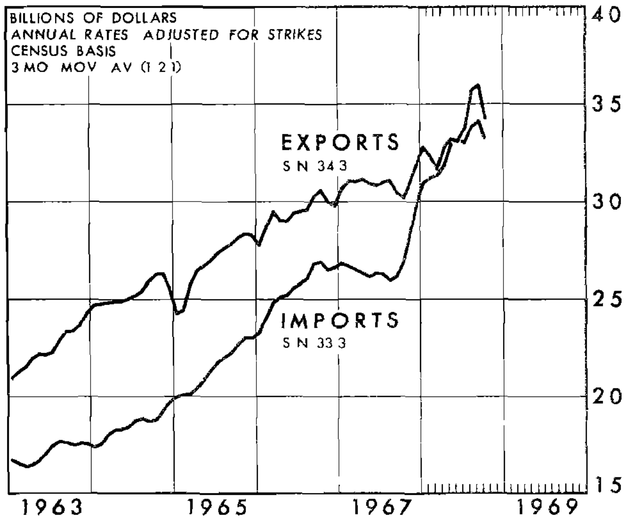
The OECD forecasts that Canadian exports will increase from second half to second half by 8 per cent, while imports will rise by

7 per cent; the current account deficit for the calendar year (including services) would correspondingly be about US$ 650 million, up sharply from the estimated $230 million in 1968 though not much changed from the rate in the latter half of last year. Even this level of current account deficit may prove an underestimate, since with current dollar GNP expanding at a rate of about 8 per cent, imports may increase by as much as 10-12 per cent, as some private Canadian forecasts suggest.

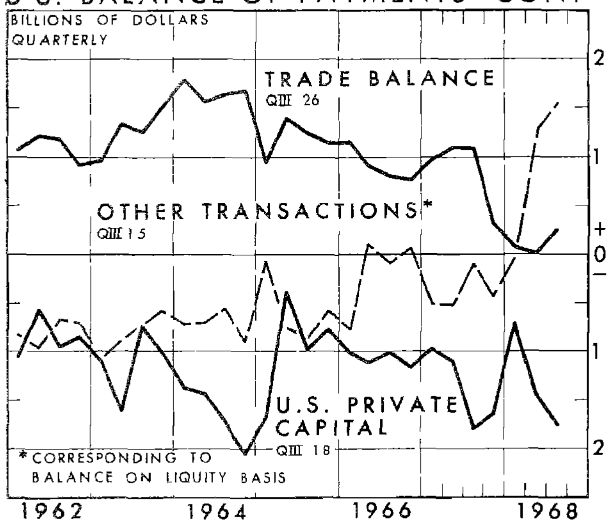
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

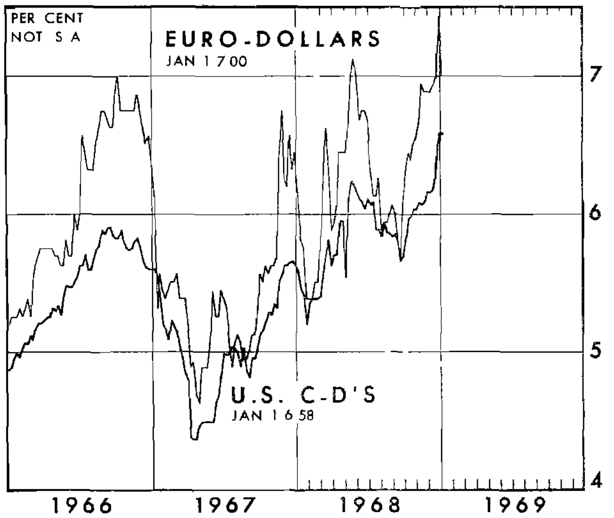
U S MERCHANDISE TRADE



U S. BALANCE OF PAYMENTS—CONT



90-DAY RATES



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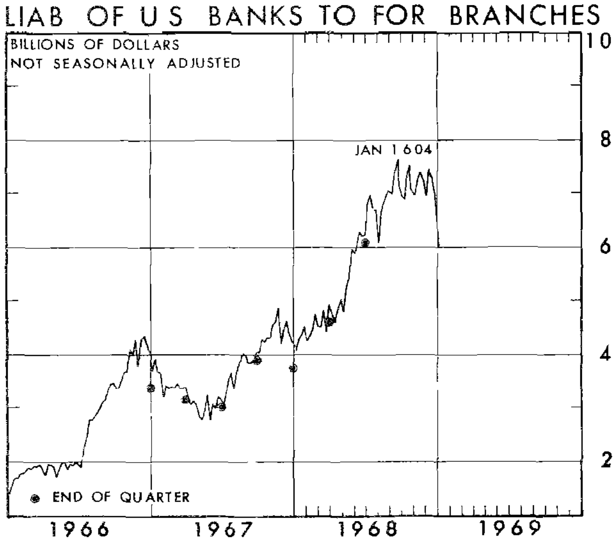
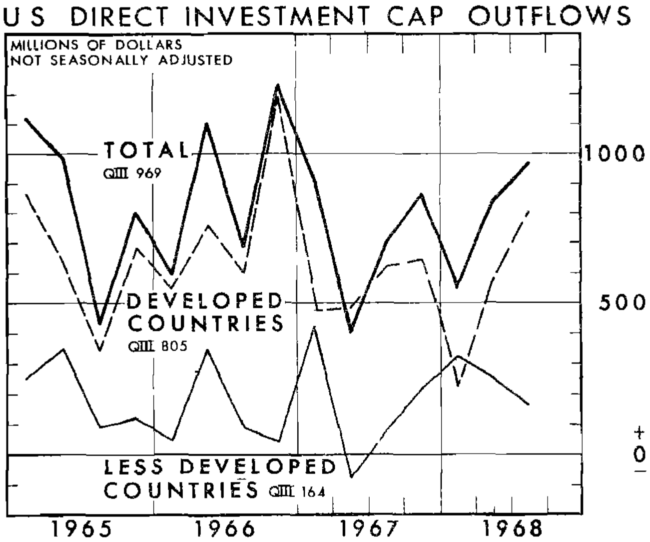
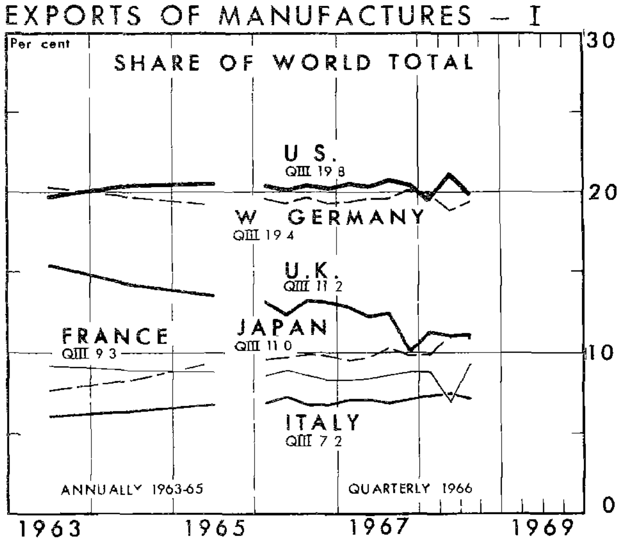


U S DIRECT INVESTMENT CAP OUTFLOWS



EXPORTS OF MANUFACTURES — I



APPENDIX A: FINANCING RESIDENTIAL CONSTRUCTION IN 1968*

Even though savings flows to nonbank thrift institutions dropped by about a fourth in 1968 from their record 1967 level, residential construction increased sharply. In no other postwar year has there been such a contrast between the reduced volume of savings available to the traditionally dominant residential mortgage lenders and the upward course of housing activity. This Appendix provides some perspective about other sources of financing last year, and assesses the implications for 1969 credit flows.

Activity in 1968

Net savings inflows to savings and loan associations and mutual savings banks fell during 1968 nearly $4-1/2 billion below their record 1967 high --the second largest annual reduction of the past two decades. Housing activity, on the other hand, rose considerably in both real and financial terms. Housing starts rose by approximately 200,000 units, or by a sixth; outlays for new residential construction expanded by more than $5 billion, or a fifth. The number of transfers of existing homes probably picked up a tenth or more, according to the National Association of Real Estate Boards, in a period when average per-unit transaction prices increased about 5 per cent.

Part of the strength in housing activity during early 1968 resulted from the lagged upward momentum of housing starts and transfers that emerged in 1967 when savings flows to nonbank thrift institutions reached a record high. Bolstered by a growing backlog of demand and rising cost pressures, however, most of the strength in last year's housing market undoubtedly can be attributed to such other factors as the following, which were of varying but cumulative importance:

--increased flows of funds available to thrift institutions from sources other than net savings inflows--chiefly from net borrowing by S&L's from the Federal Home Loan Banks;

--more intensive use by thrift institutions of residential mortgage funds to finance market transactions rather than other purposes;

--greater borrower reliance on lenders other than the thrift institutions--particularly commercial banks--for mortgage credit;

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* Prepared by Robert M. Fisher, Senior Economist, Capital Markets Section, Division of Research and Statistics.

--a marked further shift toward new multifamily projects with lower per-unit capital requirements than single-family structures; and

--greater borrower reliance on non-mortgage credit (and probably cash) to finance new residential construction.

Additional information bearing on these points is discussed below.

Other sources of funds for thrift institutions. Through November 1968, net savings inflows to insured savings and loan associations were down by more than $3.2 billion relative to the same 1967 period. Total sources of S&L funds, in contrast, were $350 million larger in 1968, primarily reflecting a switch to a position of net borrowing ($650 million) in the first 11 months of last year from a position of net loan repayment ($2.7 billion) over the same months of 1967.

Aided by this net source of additional funds, loans closed by insured S&L's through November 1968 were up by $1.7 billion, or a tenth, over the same 1967 period. S&L holdings of all types of mortgages expanded by $1.2 billion more in 1968 than in 1967. The backlog of S&L commitments--primarily for residential mortgages--was more than a tenth higher in November 1968 than a year earlier, partly reflecting expectations of improved savings inflow performance through next spring.

No comparable data are available for all mutual savings banks.

Greater propensity of thrift institutions to finance housing transactions. Insured savings and loan associations directed a larger share of their total new loans closed through November 1968 toward financing housing transactions and relatively less toward other purposes (such as financing nonresidential structures, land, and refinancing) than they did in the same 1967 period. As a result, these associations advanced approximately $1 billion more new funds toward housing construction and purchase than they would otherwise have done if the 1967 loan-mix had remained unchanged.

Comparable information for all mutual savings banks is not available.

Greater reliance on lenders other than thrift institutions. Commercial banks, FNMA-GNMA, and "individuals and others" provided significantly greater support to the residential mortgage market in 1968 than they did in 1967. Altogether, net acquisitions of residential mortgages by these three groups expanded by an estimated $2 billion more last year than the year before. Net mortgage takings by the thrift institutions, in contrast, probably increased only $500 million more than in 1967, due to a cut-back by mutual savings banks which invested heavily in the bond market. Net residential mortgage acquisitions by life insurance companies--also substantial securities investors--declined year-over-year by an estimated $300 million.

Stepped-up net lending on residential mortgages by commercial banks--amounting year-over-year to perhaps more than $800 million--accounted for the largest single sector of increased market support in 1968. Expanded net mortgage takings by commercial banks exceeded even the enlarged year-over-year $700 million increase in net acquisitions by FNMA-GNMA. Increased net acquisitions by "individuals and others" partly reflected take-backs of junior mortgages in sales of residential properties on which buyers assumed existing first mortgages carrying rates well below prevailing costs of new credit.

Field reports of such junior mortgage financing and mortgage loan assumptions were numerous last year, although the precise extent of these activities cannot be measured. One indirect indication is provided by evidence of a continued reduced volume of prepayments on mortgages on all types in 1968--a source of funds that tends to vary inversely with loan assumptions. By the third quarter of last year, life insurance companies reported that mortgage prepayments in full were running as much as one-fourth below the same 1967 period.

Shift to multifamily projects. Dwellings in new apartments accounted for around seven-tenths of the total year-over-year increase in private housing starts during 1968. The further shift toward multifamily construction helped to economize on the use of mortgage or other credit per start. Based on construction contract data through November, a new apartment unit required only three-fifths as much capital as an average single-family unit. (Land costs per unit, too, averaged lower for apartments than for 1-family homes.) During 1968, the change in structure mix, in effect, reduced funds required for residential construction contracts by about $725 million below the amount that would have otherwise been needed had the 1967 pattern prevailed.

Of perhaps even greater importance, the construction and rental of new multifamily dwellings is less dependent on the sale and financing of existing homes than is typically the case for new 1-family housing. In the latter case, used-home transactions may absorb as much as half of all net new funds required. Compared with single-family starts, therefore, new multifamily units may impose a smaller aggregate drain on the mortgage market in particular and the capital market in general.

Greater reliance on non-mortgage financing. Last year's upsurge in multifamily starts--as well as heightened expectations of inflation and further growth of conglomerate corporations--all worked toward increasing the reliance of residential construction on non-mortgage markets as a source of financing in 1968.

A factor in the construction of apartment buildings is that they afford both lenders and developers a broader range of debt and equity financing options than single-family construction ordinarily provides. Included among such options--depending on legal constraints which vary by type of lender--is the opportunity to negotiate mortgage loans on rental structures which allow lenders to participate in property earnings, either as additional interest or as a return to equity.

Mortgage loan participation features of these kinds became fairly widespread in 1968 on income-producing properties of all types. This was a year, of course, when availability rather than cost of mortgage credit was the limiting constraint on loan demand and when prospects of accelerated inflation in rental-property values were heightened by the lure of interim tax shelter (against the 1968 surtax as well) plus longer-run capital gains.

A somewhat larger source of additional funds for both residential and nonresidential construction in 1968 came from borrowing by real estate firms in the securities market. During the first three quarters of 1968, stock and bond financing by the real estate industry was up by $151 million, or by more than two-fifths, above the same 1967 period.

Perhaps an even large source of funds came last year from joint residential-development ventures involving industrial and other non-building firms, including building suppliers. Boise Cascade, Gulf Oil, and other partners, for example, announced plans to build a $320 million resort-residential community near Las Vegas. Life insurance companies also invested a net additional $7 million in residential real estate, based on reports through October 1968.

Finally, more residential builders were absorbed during 1968 by industrial and other non-construction firms, thereby helping to shore up the capital position and financing potential of a traditionally capital-short industry. In perhaps the most dramatic merger, IT&T acquired Levitt and Sons, formerly the nation's largest independent homebuilder (about 5,000 dwellings in 1967).

Implications for 1969

Last year's developments in the financing of residential construction point to at least three areas of significance for 1969.

1. The behavior of total sources of funds for nonbank thrift institutions, particularly the strategic S&L's. If net savings inflows to S&L's should decline further this year--a likely event if current levels of market yields persist for long--these lenders could maintain their total sources of investable funds close to 1968 levels only by borrowing from the Federal Home Loan Bank System. Such borrowing might have to be heavy if loan repayments (another important source of S&L funds) should fall off in 1969 as a result of a higher structure of mortgage rates. Whether S&L's might be willing to borrow possibly several billion dollars from the FHLB System at a time of decelerating savings inflows seems uncertain, at best.

At present, the Federal Home Loan Banks are prepared to meet up to $1.6 billion in advances to member associations--at rates which now run 5-3/4 to 6 per cent--without going to the market for net new funds. But even if S&L's had available the same volume of investable funds in 1969 as in 1968, they would have somewhat less leeway to make new mortgage commitments this year since their outstanding commitments toward the end of 1968 were much higher relative to S&L total cash flows than they were a year earlier.

2. Commercial bank support. Crucial support for the residential mortgage market last year came from net loan acquisitions by commercial banks in record or near-record volume, which increased bank net takings year-over-year by about a third. Whether commercial banks could acquire construction and permanent residential mortgages in 1969 in even greater volume than in 1968 will depend, of course, largely on the course of their inflows of time and savings deposits--under the influence of Regulation Q--and the strength of other loan demands. At present, the prospect for a further substantial increase in bank support for the residential mortgage market this year hardly seems bright; unless bank opportunities to bid for CD's improve, a substantial decline in their savings flows appears in prospect.

3. Support from FNMA and nonbank diversified lenders. FNMA acquired a large volume of residential mortgages in 1968, and accumulated a sizeable amount of new loan-purchase commitments for future take-down in 1969 at the option of the sellers. If mortgage rates this year should remain well above 1968 levels and if yields on home mortgages should continue unfavorable relative to bond yields, FNMA new commitments in 1969 might come under some restraint by reason of the necessity of picking up and financing 1968 loan-purchase commitments made when the rate structure was much lower.

Moreover, unless the depressed yield spread favoring home mortgage investment improves substantially, market support from such yield-conscious diversified investors as life insurance companies and savings banks could dwindle even further this year, despite continuing interest of these investors in multifamily (as contrasted with single-family) mortgages carrying more flexible rates.

While prospects for housing finance thus seem more than usually uncertain for 1969, underlying strengths clearly distinguish the current market from conditions prevailing in late 1965 and 1966. Not only are underlying shelter demands much stronger, but the mix of housing starts has shifted further toward multifamily units which, albeit quite volatile, offer broader investment incentives for lenders and developers alike and require smaller capital outlays per unit than single-family dwellings. Moreover, sources of equity funds for housing--always in short supply--have broadened to the point where lenders, building materials suppliers, and formerly non-real-estate investors as well as buyers have all become a source of support, particularly in view of tax-shelter incentives and expectations of further inflation. These differences--as well as the raising of usury limits in some States, liberalization of lender investment powers, and temporary removal of statutory ceilings on FHA and VA mortgage rates--have helped to ease some of the structural barriers formerly restricting investment in residential mortgages.