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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

July 21, 1971

TABLE OF CONTENTS

SUMMARY AND OUTLOOK

Nonfinancial

Real GNP increased at an annual rate of 3.6 per cent in the second quarter, according to the preliminary Commerce estimate. This was somewhat more than the staff projection of four weeks ago, and reflected a smaller increase in the GNP implicit deflator than we had expected rather than a larger increase in nominal GNP. Consumer spending showed considerable strength, while residential construction activity moved up strongly further. In June, housing starts remained at close to a 2 million unit annual rate. A part of the rise in domestic sales reflected an upsurge in imports. Industrial production rose further in June and for the second quarter advanced at a 4 per cent annual rate.

Retail sales were appreciably stronger in the second quarter than had been indicated earlier. April sales were revised up considerably and a sizable increase was reported for June. For the quarter as a whole, sales at nondurable goods outlets rose substantially. Total unit auto sales remained at about the first quarter rate, with sales of domestic-type cars off slightly and imports up further.

Book value of inventories rose at about the same moderate rate in May as in April, and a little faster than in the first quarter. Much of the growth continued to be in steel and autos, with some further liquidation in durable goods manufacturing apart from the steel buildup.

The overall business stock-sales ratio was again unchanged, at a level considerably improved from early this year.

The sharp decline in the unemployment rate in June, to 5.6 per cent from 6.2 per cent in May, is apparently attributable largely to problems of seasonal measurement. The labor force also showed a large decline as did nonfarm employment. The insured unemployment rate rose slightly further in June, while initial claims most recently have been edging down.

The wholesale price index rose appreciably further from May to June, with prices up for both farm and food products and for industrial commodities. Among the latter, the rise in intermediate materials continued especially strong, with lumber and wood products and textiles up considerably.

Outlook. Prospects for the second half of 1971 appear to have strengthened somewhat recently, and we are now projecting an increase in current dollar GNP averaging $23 billion a quarter, $1-1/2 billion more than four weeks ago. Real GNP is projected to rise at an annual rate of 3.8 per cent, revised up from 3.2 per cent. We continue to assume no steel strike, but current dollar GNP is now expected to increase more in the fourth than in the third quarter, primarily because the military pay raise bill is now assumed to be effective around October 1 rather than July 1. For the year 1971 as a whole, GNP is projected at $1,052 billion.

We have raised the earlier projection of the rise in consumer spending for the last half of this year on the basis of recent vigor in retail sales. We continue to assume that the saving rate will decline from its exceptionally high level, which was further boosted in the second quarter by the retroactive payment in late June of increased social security benefits. We have also raised inventory accumulation slightly, as a likely response to stronger consumer demand. But net exports now are assumed to be negative in view of the recent strength of imports. Changes in other demand sectors are about the same as projected in the preceding Greenbook.

Expansion is projected to accelerate in the first half of 1972, with real GNP rising at an annual rate of 5.3 per cent over the two quarters. Consumer spending is expected to continue to expand at a fairly rapid pace. Inventory investment is projected to rise substantially in response to higher levels of final sales and to the end of the workdown of excessive steel stocks. And business fixed investment is expected to begin to pick up.

We continue to project some moderation in the rate of increase of the private fixed-weight GNP price deflator over the next year, to about 4-1/2 per cent in the fourth quarter and to 4-1/4 per cent in the second quarter of next year. The increase in the second quarter of this year is officially estimated at 4.9 per cent, down from the first quarter but equal to the 1970 rise on average. Recent wage developments, along with the pattern of sustained increases in price quotations, do not promise much progress on this score, even if productivity should rise somewhat more rapidly with faster economic recovery.

Financial

The recent tightening of the money market and the one-fourth point rise in the discount rate were followed by increases of 10 to 25 basis points in bill rates and up to 15 basis points in bond yields. Prior to the discount rate announcement, short-term rates had edged up since the last Committee meeting while long-term rates had declined somewhat.

Credit demands of the business sector appear to have moderated in recent weeks. Outstanding business loans at banks declined sharply in June and have shown essentially no growth over the last year. The amount of commercial paper placed by businesses through dealers declined for the fifth consecutive month. With regard to longer-term borrowing, corporate bond offerings were still large in June, but market participants were emphasizing the expected declining volume this summer. In this environment, Treasury financing operations in late June and early July were absorbed easily.

Inflows of consumer-type interest-bearing deposits to all depository institutions in June remained at about the same relatively high rate as in May. During the recently-concluded reinvestment period nonbank thrift institutions experienced no major attrition of deposits; in fact, S&L s experienced net inflows. Commercial banks, on the other hand, appear to have had weaker consumer-type time and savings deposit inflows in the early weeks of the month, and there were reports that some banks have increased offering rates on such deposits.

Outlook. Assuming short-term rates rise only a little further as they adjust to the recent increases in the Federal funds and discount rates, a downdrift in long-term market rates is a reasonable expectation for the third quarter since corporate and municipal demands on capital markets appear to be moderating. Nonfinancial corporations seem to have completed a significant proportion of their financial restructuring. While this development should reduce loan repayments at banks, the higher level of corporate cash flows and liquidity and the very modest growth in inventories expected this quarter do not suggest that either banks or the money market will be required to extend a large volume of credit to businesses. Thus, if deposit inflows do not deteriorate, banks will have ample resources to finance U. S. Government and State and local Government demands.

In part, the expected lower State and local financing demands in the third quarter reflect a reduced financing backlog, but the current interest rate level is also constraining the new issue pace of smaller units and those with lower credit ratings. The Treasury is expected to borrow, net, only about $7 billion this quarter, one-fourth of which was already completed early this month, and another one-fourth involves a special issue to the Bundesbank. A major factor in the moderate Treasury financing demands over the summer months is the Treasury's decision to run a relatively low cash balance; this pattern of debt management implies a significant increase in financing volume in the fourth quarter.

Funds for residential mortgage investment should remain ample this summer. Inflows to thrift institutions are expected to remain relatively large, although below the second quarter pace. Moreover, even if shor-term yields rise further, withdrawals will tend to remain limited by the increased proportion of deposit accounts in higher rate term form with early withdrawal penalties. In addition, mortgage repayments are likely to remain large and the FHLB's are expected to increase their lending to S&L's. As a result, conventional mortgage rates may change little further. At the same time, with discounts acting as a constraint on new credit extensions, the seven per cent contract interest rate still prevailing on new FHA-and VA-underwritten mortgages may need to be adjusted upward by administrative action to bring it more closely in line with other rates.

Balance of Payments

U. S. merchandise imports, which had risen extremely sharply between March and May, held at about the May level in June according to preliminary indications. The second-quarter rate of imports was almost one-fifth above the level a year earlier. With second-quarter exports only slightly higher than a year ago, the trade balance in the second quarter now appears to have been a deficit of between $3 and $4 billion annual rate, unprecedented since World II. (At the time of the Committee's last meeting the projection for the second-quarter trade balance was minus $2 billion, annual rate.) This means that the preliminary estimate in the GNP accounts for net exports of goods and services in the second quarter is likely to be revised down to a negative rate of more than $1 billion.

The present outlook is that net exports of goods and services should continue in coming quarters near minus $1 billion, with moderate advances in both exports and imports. The export projection assumed much stronger growth of demand abroad, particularly in Canada and Japan, than has been evident so far this year. The main reason for not expecting a further deterioration in the goods and services balance in the second half of the year is that some of the recent sharp rise in imports can be ascribed to inventory buildups (e.g., in steel, lumber, and coffee) which may not continue, and some of it reflects an abrupt upward shift in imports (e.g., of petroleum) not likely to be repeated immediately.

The mammoth size of the official settlements deficits in the first and second quarters ($5.7 billion and about $6 billion respectively--seasonally adjusted quarterly amounts) was due primarily to flows of capital responding to interest rate differentials and expectations of exchange rate changes. Between the two quarters there were important changes in the character of these flows, and the worsening in the goods and services balance, in quarterly terms, by more than $1 billion was an important factor keeping the deficit so large.

In the first quarter there was a $3 billion net outflow to U. S. bank branches abroad and other foreign banks, reducing total U. S. bank and Government liabilities to commercial banks abroad by that amount on balance. In the second quarter interest rate differences became less significant, while the influence of exchange rate uncertainties mounted. There was relatively little further net runoff in the liabilities to commercial banks, but U. S. nonfinancial corporations and other U. S. and foreign investors apparently had much larger recorded and unrecorded outflows of capital (and smaller inflows) than in the first quarter, despite sizable temporary repatriations of corporate funds at midyear.

In the first week or two of July much of the midyear repatriations of corporate funds seem to have been reversed. Apart from that reversal, net flows of funds responding to exchange rate prospects and interest rates may continue for a while to be much smaller than before. There may be further movements into the Japanese yen, and flurries such as the buying of French francs in the past two weeks, but the German authorities aim at inducing further movements out of the German mark--which should be helped by the fact that the exchange rate for the mark is now more than 5 per cent above its par. The interest rate differentials between Eurodollar deposits and comparable U. S. instruments--whether viewed as sources of funds for banks or as outlets for short-term investments by nonbanks--are now small enough to constitute far less of a threat to the U. S. payments position than they did earlier this year.

Even if there should be little net outflow of "liquid" capital, the over-all deficit in coming months is likely to be large, given the present outlook for merchandise trade and the possibility that foreigners' purchases of U. S. securities may continue at a relatively low level.

July 20, 1971

I -- T - 1

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1971				Per Cent Change* From		
	March	April	May	June	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	83.5	83.8	84.2	83.1	-1.2	-0.4	1.1
Unemployment rate (%)	6.0	6.1	6.2	5.6	--	--	4.8 [4/]
Insured unempl. rate (%)	3.9	4.0	4.2	4.4	--	--	3.7 [4/]
Nonfarm employment, payroll (mil.)	70.7	70.7	70.9	70.6	-0.4	-0.1	-0.1
Manufacturing	18.7	18.7	18.7	18.6	-0.6	-0.4	-4.5
Nonmanufacturing	52.0	52.0	52.2	52.0	-0.4	0.0	1.6
Industrial production (57-59=100)	165.5	166.2	167.3	167.9	0.4	1.5	-0.5
Final products, total	163.4	163.4	164.7	165.3	0.4	1.2	-1.1
Consumer goods	166.2	167.1	168.5	169.5	0.6	2.0	4.1
Business equipment	170.5	169.5	170.3	169.5	-0.5	-0.6	-9.8
Materials	168.0	169.3	170.2	170.6	0.2	1.5	-0.4
Capacity util. rate, mfg.	72.9	73.1	73.4	73.3	--	--	77.4 [4/]
Wholesale prices (1967=100) [1/]	113.0	113.3	113.8	114.3	0.4	1.2	3.6
Industrial commodities (FR)	112.6	113.1	113.4	113.7	0.3	1.0	3.6
Sensitive materials (FR)	111.1	113.1	113.3	113.6	0.3	2.3	-0.8
Farm products, foods & feeds	113.4	113.3	114.3	115.4	1.0	1.8	3.3
Consumer prices (1967=100) [1/] [5/]	119.8	120.2	120.8	n.a.	0.5	1.2	4.4
Food	117.0	117.8	118.2	n.a.	0.3	2.0	2.9
Commodities except food	115.5	115.8	116.6	n.a.	0.7	1.2	4.1
Services	126.6	126.8	127.5	n.a.	0.6	0.7	5.6
Hourly earnings, pvt. nonfarm ($)	3.38	3.39	3.41	3.42	0.3	1.2	6.5
Hourly earnings, mfg. ($)	3.52	3.54	3.55	3.57	0.6	1.4	6.3
Weekly earnings, mfg. ($)	140.02	140.67	141.65	142.80	0.8	2.0	6.8
Net spend. weekly earnings, mfg. (3 dependents 1967 $) 1/ 5/	101.39	100.62	101.81	n.a.	1.2	1.0	2.2
Personal income ($ bil.) 2/	840.1	844.7	850.1	870.3	2.4	3.6	8.6
Retail sales, total ($ bil.)	32.3	32.8	32.5	33.0	1.6	2.4	8.3
Autos (million units) 2/	8.6	8.3	8.4	8.2	-3.0	-5.0	-0.6
GAAF ($ bil.) 3/	8.9	9.0	8.9	9.1	3.2	2.6	11.3
12 leaders, composite (1967=100) [5/]	122.6	124.1	124.9	n.a.	0.6	4.2	9.8
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/	1,959	1,912	1,959	1,982	1.2	1.2	42.3
Factory workweek (hours)	39.9	39.8	39.9	40.0	0.3	0.3	0.5
Unempl. claims, initial (thous.)	297	283	304	307	-0.9 [6/]	-3.4 [6/]	1.7 [6/]
New orders, dur. goods, ($ bil.) [5/]	31.8	30.6	31.1	n.a.	1.4	-2.5	3.6
Capital equipment	8.9	8.4	8.6	n.a.	2.3	-2.6	-0.8
Common stock prices (41-43=10)	99.60	103.04	101.64	99.72	-1.9	0.1	31.9

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l. merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ Per cent calculated to May 1971. 6/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	Averages 1970 QIII	1970 QIV	1971 QI	1971 QII	1971 June	Week ended July 14
Interest rates, per cent						
Federal funds	6.71	5.57	3.86	4.56	4.91	5.13
3-mo. Treasury bills	6.33	5.35	3.76	4.26	4.75	5.35
3-mo. Federal agencies	6.67	5.50	3.78	4.43	4.89	5.40
3-mo. Euro-dollars	8.34	7.46	5.50	6.72	7.15	6.41
3-mo. finance co. paper	7.42	6.12	4.48	4.74	5.24	5.51
4-6 mo. commercial paper	7.85	6.28	4.57	5.05	5.45	5.75
Bond buyer municipals	6.33	5.92	5.25	5.74	5.95	6.06
Aaa corporate-new issues	8.51	8.26	7.33	7.83	7.90	7.87
20-year Treasury bonds	6.96	6.57	6.00	6.24	6.38	6.33
FHA mortgages, 30-year	9.06	8.76	--	n.a.	n.a.	--

	1970 QII	1970 QIV	1971 QI	1971 QII	1971 June
Change in monetary aggregates (SAAR, per cent)					
Total reserves	19.1	6.6	11.0	6.8	0.7
Nonborrowed reserves	24.4	9.4	11.0	5.5	-5.7
Credit proxy	24.1	15.1	17.0	9.7	5.7
Credit proxy + nondep. funds	17.2	8.3	10.9	6.5	6.6
Money supply	6.1	3.4	8.9	11.3	9.1
Time and savings deposits	32.2	21.8	27.3	13.5	14.3
Deposits at S&L's and MSB's	9.3	11.6	23.3	17.1	14.6
Bank credit, end-of-month 1/	13.9	8.5	12.2	7.3	10.3
Treasury securities	25.9	6.2	19.8	10.4	55.8
Other securities	20.3	36.5	27.9	15.7	8.9
Total loans 1/	9.8	1.2	6.3	4.0	1.6
Business 1/	1.8	-4.9	1.0	2.8	-9.5

	QII	QIV	QI	QII	June
Change in commercial paper ($ millions)					
Total (SA)	-4,232	-760	-2,581	-941	-717
Bank-related (NSA)	-2,985	-2,269	-657	41	-16

	1970 Half-1	1970 QII	1970 June	1971 Half-1	1971 QII	1971 June
New security issues (NSA, $ millions)						
Total corp. issues	18,445	10,468	3,389	23,897e	11,707e	4,100e
Public offerings	15,900	9,185	2,952	20,708e	10,033e	2,952e
State and local government bond offerings	7,837	3,728	1,085	12,536e	5,894e	1,900e
Fed. sponsored agency debt (change)	5,177	1,542	728	-1,297e	-266e	277e
Fed. govt. debt (change)	-4,404	-6,386	-3,156	-3,301e	1,726e	-200e

n.a. - Not available. e - Estimated. p - Preliminary.
SAAR - Seasonally adjusted annual rate. NSA - Not seasonally adjusted.
1/ Adjusted for loans sold to bank affiliates.

I -- T - 3

U.S. Balance of Payments

In millions of dollars; seasonally adjusted

	1 9 7 1 p/				
	I	II	Apr.*	May*	June*
Goods and services, net 1/	1,051				
Trade balance 2/	272		-290	-299	
Exports 2/	11,032		3,452	3,674	
Imports 2/	-10,760		-3,742	-3,973	
Service balance	779				
Remittances and pensions	-351				
Govt. grants & capital, net	-1,031				
U.S. private capital (- = outflow)	-2,024				
Direct investment abroad	-1,357				
Foreign securities	-362		-129	-134	
Bank-reported claims--"liquid"	-72		74	-444	
" " " other	-50		-139	-565	
Nonbank-reported claims--"liquid"	-160		-17	-78	
" " " other	-23				
Foreign capital (excl. reserve trans.)	-2,080				
Direct investment in U.S.	50				
U.S. corporate stocks	75		-1	10	
New U.S. direct investment issues	392				
Other U.S. securities (excl. U.S. Treas.)	32				
Liabilities to:		e/-242	-259	-618	e/880
Commercial banks abroad, "liquid"	-3,025		-476	-560	
Other private foreign, "liquid"	70		57	-119	
Intl. & regional institutions, "liquid"	268		160	61	
" " " , nonliquid	26				
Banks and others, nonliquid	32				
Foreign official reserve claims	4,841	e/5,162	2,372	4,797	e/-1,607
"Liquid"	5,065	5,312	2,455	4,806	-1,557
Other	-224	-150	-83	-9	-50
U.S. monetary reserves (increase, -)	862	838	35	496	307
Gold stock	109	456	38	357	61
Special drawing rights 3/	125	196	--	196	--
IMF gold tranche	255	252	-2	4	250
Convertible currencies	373	-66	-1	-61	-4
Errors and omissions	-1,268				
BALANCES (deficit -) 3/					
Official settlements, S.A.	-5,703	e/-6,000			
" " , N.S.A.	-5,403	e/-6,400	-2,407	-5,293	e/1,300
Net Liquidity, S.A.	-2,784				
" , N.S.A.	-2,638		-2,205	-4,153	
Adjusted liquidity, S.A. 4/	-3,016	-5,758			
" " , N.S.A.	-2,896	-6,403	-2,148	-4,675	420

* Monthly, only exports and imports are seasonally adjusted. e/ Estimate.

1/ Equals "net exports" in the GNP, except for latest revisions.

2/ Balance of payments basis which differs a little from Census basis.

3/ Excludes allocations of SDRs: $867 million on 1/1/70; and $717 million on 1/1/71.

4/ Measured by changes in U.S. monetary reserves, all liabilities to foreign official reserve agencies and liquid liabilities to commercial banks and other foreigners.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. GNP increased by $19.7 billion in the second quarter according to preliminary OBE estimates--about equal to the projection in the last Greenbook. In real terms, however, the rise was somewhat stronger than projected--3.6 per cent--as the rate of increase in the implicit GNP deflator slowed from 5.3 in the first quarter to 4.2 per cent. The rate of increase of the fixed weight deflator for private GNP also moderated, but only to a 4.9 per cent annual rate, about as projected.

A feature of second quarter GNP developments was the surprising strength in consumer outlays, which rose by $15-1/2 billion; consumer purchases of durable and nondurable goods each rose by $1.7 billion more than projected. Nevertheless, with disposable income up sharply, in part because of the retroactive boost in Social Security benefits, the saving rate, at 8.3 per cent (revised), remained extremely high.[1/]

The additional strength in consumer demand became evident only recently with the strong gain in June retail sales along with upward revisions in sales for previous months. The increase in durables occurred despite a slightly reduced rate of unit sales of domestic cars. Sales of foreign cars continued to rise and demand for used cars was strong. Apparently, there were also good gains in durable

1/ The second quarter preliminary GNP figures are consistent with revised Commerce Department estimates for the period QI-1968 through QI-1971. Revised statistics are presented and discussed in an attachment to the Greenbook.

goods sales at department stores. The rise in nondurables reflected particularly large sales increases at general merchandise and department stores, although all major groups of stores reported relatively good gains.

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rates)

	QI		QII	
	OBE Former Estimate	OBE Revised	Proj. of 6/23/71	OBE Prelim.
	------------Billions of dollars----------			
GNP	30.8	32.4	20.0	19.7
Final sales	33.0	32.9	17.0	18.2
Personal consumption	19.4	19.9	11.8	15.5
Residential construction	3.6	3.6	2.4	2.9
Business fixed investment	3.8	3.5	1.4	1.8
Net exports	.7	1.5	- .8	-4.1
Federal purchases	.2	.8	- .8	- .7
State & local purchases	5.2	3.6	3.1	2.7
Inventory change	-2.2	- .5	3.0	1.5
	------------Per Cent Per Year------------			
Real GNP	7.1	8.0 1/	3.2	3.6 1/
GNP deflator	5.6 2/	5.3 1/	4.6	4.2 1/

1/ At compound rates.
2/ Excluding effects of Federal pay increase, 4.6 per cent.

Offsetting the unexpected strength in consumer demand was a sharp deterioration of the net export position and a smaller than projected rise in inventory investment. The Commerce Department estimates that net exports dropped to virtually zero in the second quarter from an upward revised level of over $4 billion in the first quarter. Some recent figures for June suggest that second quarter net exports may have been even weaker than the preliminary estimate. The increase in inventory investment fell short of our projections by $1-1/2 billion, reflecting an upward revision of about this amount in the first quarter level. Steel stockpiling apparently peaked earlier in the year than expected and slackened in the second quarter. Durable goods manufacturers were also continuing to liquidate excess stocks of in-process and finished goods in order to bring inventories into better balance with sales.

Residential construction activity continued its upward course with new private residential housing starts for the quarter totaling 1.95 million, annual rate, as we had projected. Business fixed investment also rose slightly more than expected, but outlays by State and local governments fell short of the projected rise by about $.4 billion, following a sharp downward revision of their construction expenditures in the first quarter.

We now expect a somewhat smaller GNP increase for the third quarter--$19.0 billion rather than $21 billion, since it appears that the military pay increase which we had assumed to take effect in July will be delayed to the fourth quarter. This change alone reduces our former projection of third quarter Federal purchases by over $2-1/2 billion. Nevertheless, we anticipate a strong gain in consumer outlays. The improved showing of retail sales from March through June and a rise in consumer confidence as reported in several surveys suggest a somewhat healthier atmosphere in consumer markets, and some reduction in the high saving rate shown by the revised GNP figures seems likely.

We continue to assume settlement of steel wage negotiations without a strike. Other sectors of demand are projected about as in the preceding Greenbook: a moderate further gain in residential construction expenditures and a slightly larger increase than in the last quarter in State and local outlays. Little increase is anticipated in business fixed investment and a sizable decline is likely in net inventory investment as a result of a run-off of excess steel stocks and some downward adjustment of high auto inventories.

With a military pay raise now anticipated in October and an improved tone in consumer markets, a somewhat stronger fourth quarter appears in prospect. We are projecting an increase of $27-1/2 billion, $5 billion more than formerly. The pay raise is projected to add about $2-1/2 billion to Federal outlays, with the extra income expected to augment consumption expenditures. Improved sales should also stimulate a somewhat higher rate of inventory accumulation than we had earlier projected.

For the second half as a whole, the somewhat more optimistic outlook for consumer spending and inventory investment is reflected in larger GNP gains. Projected real GNP growth is projected to average 3.8 per cent, annual rate, as compared to about 3-1/4 per cent projected in the previous Greenbook. The modest real growth expected this quarter (about 2-1/2 per cent, annual rate) is likely to be insufficient to

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rates)

	QIII Proj. of 6/23/71	QIII Current	QIV Proj. of 6/23/71	QIV Current
	----------Billions of dollars----------			
GNP	21.0	19.0	22.5	27.5
Final sales	24.1	22.1	20.1	24.0
Personal consumption	14.1	16.0	14.1	15.8
Residential construction	1.4	1.6	1.3	1.3
Business fixed investment	.5	.5	.5	.5
Net exports	.0	-1.1	.0	.0
Federal purchases	3.9	1.1	.0	2.4
State & local purchases	4.2	4.0	4.2	4.0
Inventory change	-3.1	-3.1	2.4	3.5
	----------Per Cent Per Year----------			
Real GNP	2.5	2.7	4.0	5.0
GNP deflator	5.5 1/	4.5	4.4	5.3 2/

1/ Excluding the effects of military pay increase, 4.5 per cent per year.
2/ Excluding the effects of military pay increase, 4.4 per cent per year.

offset anticipated productivity gains and labor force growth and a renewed rise in unemployment is expected to persist into the autumn. But the additional strength now foreseen for late 1971 suggests that the unemployment rate may level off below 6-1/2 per cent toward year end.

A continued improvement in the rate of growth of real GNP is still anticipated for the first half of next year. A rise in the minimum wage, a scheduled increase in personal income tax exemptions, and a prospective Federal pay raise--should further stimulate consumer

GNP AND RELATED ITEMS, 1972
(Changes in seasonally adjusted totals at annual rates)

	QI		QII	
	Proj. of 6/23/71	Current	Proj. of 6/23/71	Current
	--------Billions of dollars--------			
GNP	27.0	28.0	26.0	27.5
Final sales	24.1	25.0	23.6	24.6
Personal consumption	14.9	15.6	15.9	16.1
Residential construction	1.2	1.2	.8	.9
Business fixed investment	1.2	1.2	2.8	2.8
Net exports	.0	.0	-.5	.0
Federal purchases	3.0	3.0	.8	.8
State & local purchases	3.8	4.0	3.8	4.0
Inventory change	2.9	3.0	2.4	2.9
	--------Per Cent Per Year--------			
Real GNP	4.8	5.1	5.1	5.6
GNP deflator	5.1 1/	5.1 1/	4.2	4.2

1/ Excluding effects of general Federal government pay increase, 4.3 per cent per year.

outlays. Another increase in Social Security benefits also seems likely. We expect the additional buoyancy of the economy and the strength in consumer outlays to be reflected in somewhat higher inventory investment than we had formerly projected. Increases in GNP in the first half of 1972 are now expected to average almost $28 billion a quarter, a rate of growth in real GNP of about 5-1/3 per cent--enough to cut unemployment to around 6 per cent by mid-year.

With price increases continuing at a fairly brisk pace, and little or no indication of moderation evident in wage settlements, we have only scant hope for a significant easing of overall price pressures. The annual rate of increase in the deflator is therefore still projected at 4-1/2 per cent in the fourth quarter, edging down only to 4-1/4 per cent by the second quarter of next year.

CONFIDENTIAL - FR

July 21, 1971

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income figures are billions of dollars, with quarter figures at annual rates.)

	1970	1971 Proj.	1970 I	1970 IIp	1970 III	1970 IV	1971 I (Projection)	1971 II (Projection)
Gross National Product	974.1	1052.0	1020.8	1040.5	1059.5	1087.0	1115.0	1142.5
Final purchases	971.3	1048.3	1017.6	1035.8	1057.9	1081.9	1106.9	1131.5
Private	751.9	814.5	789.4	805.6	822.6	840.2	858.2	878.0
Excluding net exports	748.3	813.9	785.2	805.5	823.6	841.2	859.2	879.0
Personal consumption expenditures	615.8	668.2	644.6	660.1	676.1	691.9	707.5	723.6
Durable goods	88.6	101.9	97.6	100.0	103.2	106.7	110.2	113.2
Nondurable goods	264.7	282.6	272.0	279.4	286.4	292.7	298.7	305.5
Services	262.5	283.7	275.0	280.7	286.5	292.5	298.6	304.9
Gross private domestic investment	135.3	149.4	143.8	150.1	149.1	154.4	159.8	166.4
Residential construction	30.4	39.7	36.4	39.3	40.9	42.2	43.4	44.3
Business fixed investment	102.1	106.0	104.3	106.1	106.6	107.1	108.3	111.1
Change in business inventories	2.8	3.7	3.2	4.7	1.6	5.1	8.1	11.0
Nonfarm	2.5	3.4	3.0	4.2	1.3	4.9	8.1	11.0
Net exports of goods and services	3.6	0.6	4.2	0.1	-1.0	-1.0	-1.0	-1.0
Gov't purchases of goods & services	219.4	223.9	228.2	230.2	235.3	241.7	248.7	253.5
Federal	97.2	97.3	96.7	96.0	97.1	99.5	102.5	103.3
Defense	75.4	72.3	73.0	72.0	71.3	72.7	74.2	74.2
Other	21.9	25.1	23.7	24.0	25.8	26.8	28.3	29.1
State & local	122.2	136.5	131.5	134.2	138.2	142.2	146.2	150.2
Gross national product in constant (1958) dollars	720.0	739.5	729.7	736.3	741.3	750.7	760.2	770.9
GNP implicit deflator (1958 = 100)	135.3	142.2	139.9	141.3	142.9	144.8	146.7	148.2
Personal income 1/	803.6	861.3	833.9	854.2	867.9	889.3	910.5	928.0
Wage and salary disbursements	541.4	579.4	562.3	572.6	583.1	599.6	614.3	627.2
Disposable income 1/	687.8	745.9	721.3	740.4	751.8	769.9	790.2	804.5
Personal saving 1/	54.1	58.6	58.1	61.4	56.5	58.5	62.9	60.7
Saving rate (per cent) 1/	7.9	7.9	8.1	8.3	7.5	7.6	8.0	7.6
Corporate profits before tax 1/	75.4	80.8	76.8	80.0	81.5	85.0	89.0	95.5
Corp. cash flow, net of div. (domestic) 1/	69.8	81.9	78.1	81.0	83.0	85.5	88.5	92.9
Federal government receipts and expenditures (N.I.A. basis)								
Receipts 1/	191.5	199.9	194.7	197.8	201.0	206.2	211.8	218.2
Expenditures	205.1	221.8	213.2	220.1	224.1	229.6	238.4	241.6
Surplus or deficit (-) 1/	-13.6	-21.8	-18.5	-22.3	-23.1	-23.4	-26.6	-23.4
High employment surplus or deficit (-) 1/	0.9	2.9	2.5	1.7	3.3	4.0	0.6	2.6
Total labor force (millions)	85.9	86.8	86.5	86.5	86.9	87.3	87.6	87.9
Armed forces "	3.2	2.8	3.0	2.8	2.8	2.7	2.6	2.6
Civilian labor force "	82.7	84.0	83.6	83.7	84.1	84.6	85.0	85.3
Unemployment rate (per cent)	4.9	6.1	5.9	6.0	6.2	6.4	6.3	6.1
Nonfarm payroll employment (millions)	70.7	70.9	70.6	70.7	71.0	71.3	71.7	72.2
Manufacturing	19.4	18.7	18.7	18.7	18.7	18.8	18.9	19.0
Industrial production (1957-59=100)	168.2	167.8	165.4	167.1	168.1	170.5	173.2	176.3
Capacity utilization, manufacturing (per cent)	76.6	73.2	73.1	73.2	73.2	73.2	73.7	74.2
Housing starts, private (millions A.R.)	1.43	1.97	1.81	1.95	2.05	2.08	2.10	2.10
Sales new domestic autos (millions, A.R.)	7.12	8.37	8.39	8.28	8.30	8.50	8.60	8.75

NOTE: Projection of related items such as employment and industrial production index are based on projection of deflated GNP. Federal budget high employment surplus or deficit (N.I.A. basis) are staff estimates and projections by method suggested by Okun and Teeters.

1/ Reflects effects of total additional depreciation allowable under Treasury's newly-approved "accelerated depreciation range" guidelines, which are effective as of the beginning of 1971.

CONFIDENTIAL - FR

July 21, 1971

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1970	1971 Proj.	1971				1972	
					Projection			
			I	IIp	III	IV	I	II
	Billions of dollars							
Gross National Product	45.0	77.9	32.4	19.7	19.0	27.5	28.0	27.5
Inventory change	-4.6	0.9	-0.5	1.5	-3.1	3.5	3.0	2.9
Final purchases	49.6	77.0	32.9	18.2	22.1	24.0	25.0	24.6
Private	39.9	62.6	28.4	16.2	17.0	17.6	18.0	19.8
Excluding net exports	38.3	65.6	26.9	20.3	18.1	17.6	18.0	19.8
Net exports	1.6	-3.0	1.5	-4.1	-1.1	0.0	0.0	0.0
Government	9.7	4.5	4.5	2.0	5.1	6.4	7.0	4.8
GNP in constant (1958) dollars	-4.7	19.5	13.8	6.6	5.0	9.4	9.5	10.0
Final purchases	-0.5	18.8	14.3	5.2	7.7	6.6	7.2	8.4
Private	5.7	19.0	15.0	5.6	4.6	5.2	6.4	7.3
	In Per Cent Per Year							
Gross National Product	4.8	8.0	13.8[1]	8.0[1]	7.3	10.4	10.3	9.9
Final purchases	5.4	7.9	13.4	7.2	8.5	9.1	9.2	8.9
Private	5.6	8.3	14.9	8.2	8.4	8.6	8.6	9.2
Personal consumption expenditures	6.2	8.5	12.7	9.6	9.7	9.3	9.0	9.1
Durable goods	-1.4	15.0	59.8	9.8	12.8	13.6	13.1	10.9
Nondurable goods	6.9	6.8	1.6	10.9	10.0	8.8	8.2	9.1
Services	8.4	8.1	9.1	8.3	8.3	8.4	8.3	8.4
Gross private domestic investment	-1.8	10.4	18.9	17.5	-2.7	14.2	14.0	16.5
Residential construction	-4.4	30.6	43.9	31.9	16.3	12.7	11.4	8.3
Business fixed investment	3.5	3.8	13.9	6.9	1.9	1.9	4.5	10.3
Gov't. purchases of goods & services	4.6	2.1	8.0	3.5	8.9	10.9	11.6	7.7
Federal	-2.0	0.1	3.3	-2.9	4.6	9.9	12.1	3.1
Defense	-3.8	-4.1	-1.1	-5.5	-3.9	7.9	8.3	0.0
Other	5.8	14.6	17.6	5.1	30.0	15.5	22.4	11.3
State & local	10.5	11.7	11.3	8.2	11.9	11.6	11.3	10.9
GNP in constant (1958) dollars	-0.6	2.7	8.0[1]	3.6[1]	2.7	5.0	5.1	5.6
Final purchases	-0.1	2.6	8.0	2.9	4.2	3.6	3.9	4.5
Private	1.0	3.3	10.4	3.8	3.1	3.5	4.2	4.8
GNP implicit deflator	5.5	5.1	5.3[1]	4.2[1]	4.5	5.3[2]	5.1[3]	4.2
Private GNP fixed weight index[4]	4.8	5.1	5.6[1]	4.9[1]	4.5	4.5	4.4	4.2
Personal income[5]	7.1	7.2	8.4	9.7	6.4	9.9	9.5	7.7
Wage and salary disbursements	6.2	7.0	11.0	7.3	7.3	11.3	9.8	8.4
Disposable income 5/	8.5	8.4	11.3	10.6	6.2	9.6	10.5	7.2
Corporate profits before tax[5]	-10.5	7.2	29.1	16.7	7.5	17.2	18.8	29.2
Federal government receipts and expenditures (N.I.A. basis)								
Receipts 5/	-2.7	4.4	11.4	6.4	6.5	10.3	10.9	12.1
Expenditures	8.2	8.1	6.5	12.9	7.3	9.8	15.3	5.4
Nonfarm payroll employment	0.6	0.3	2.5	0.6	1.7	1.7	2.2	2.8
Manufacturing	-3.8	-3.6	1.0	-1.4	0.0	2.1	2.1	2.1
Industrial production	-2.7	-0.3	6.6	4.1	2.3	5.7	6.3	7.2
Housing starts, private	-2.6	37.7	8.1	30.4	20.3	6.4	3.3	0.0
Sales new domestic autos	-15.9	17.5	216.4	-5.1	0.9	9.6	4.7	7.0

1/ At compounded rates.

2/ Excluding effects of military pay increase, 4.4 per cent per year.

3/ Excluding effects of general Federal government pay increase, 4.3 per cent per year.

4/ Using expenditures in 1965-IV as weights.

5/ Reflects effects of total additional depreciation allowable under Treasury's newly-approved "accelerated depreciation range" guidelines, which are effective as of the beginning of 1971.

Industrial production. Industrial production rose 0.4 per cent further in June and at 167.9 per cent was up 4 per cent from the November 1970 strike-induced low and was 3.8 per cent below the 1969 pre-recession peak.

Among those sectors showing output gains in June were home goods (furniture, TV, some appliances, etc.), consumer staples, defense equipment, and most materials. Production of autos was unchanged and output of business equipment and steel declined.

Changes in the total index in July and August will depend largely on curtailments now underway in the steel industry. The seasonal factor allows for a 12 per cent decline in steel output from June to July and an increase of 3 per cent in August. In both May and June, the total index excluding steel rose .8 of a point.

INDUSTRIAL PRODUCTION
1957-59=100, seasonally adjusted

	1969	1971			Per cent change	
	July1/	April	May	June	July 1969 to June 1971	QI 1971 to QII 1971
Total index	174.6	166.2	167.3	167.9	- 3.8	1.0
Consumer goods	164.4	167.1	168.5	169.5	3.1	2.0
Autos	178.7	153.9	161.4	160.7	-10.1	-2.9
Home goods	184.4	184.4	188.0	189.6	2.8	5.5
Apparel & staples	158.1	163.3	163.4	164.4	4.0	1.1
Business equipment	196.9	169.5	170.3	169.5	-13.9	-1.6
Defense equipment	169.9	108.1	109.7	110.9	-34.7	-3.9
Materials, total	176.5	169.3	170.2	170.6	- 3.3	1.3
Durable	167.0	152.8	154.2	153.5	- 8.1	2.0
Steel	145.3	141.9	144.0	142.6	- 1.9	6.8
Nondurable	186.4	186.3	187.1	188.3	1.0	.6

1/ Pre-recession peak.

Retail sales. Consumer buying in June turned out substantially higher than had been indicated by the weekly statistics. Total retail sales increased 1.6 per cent from May, with all major groups of stores participating in the rise. Durable goods sales increased 1.8 per cent, with gains in the automotive group and some recovery in sales of furniture and appliances. Nondurable sales increased 1.5 per cent, with sales of the general merchandise group particularly buoyant.

Gains in June followed large upward revisions in the sales data for March, April and May. These adjustments and the strong sales gain in June raise the estimate for the second quarter to a level 7.5 per cent above a year earlier, or about 3.8 per cent in real terms.

RETAIL SALES
(Percentage change from previous period)

	1971				
	I Q	II Q	April	May	June
Total sales	4.2	3.6	1.8	-1.0	1.6
Durable	13.4	5.1	2.7	-2.9	1.8
Automotive	24.3	6.8	2.9	-3.7	2.4
Furniture & appliances	5.6	-1.0	- .7	-4.3	1.5
Nondurable	.5	2.9	1.4	- .1	1.5
Food	1.1	2.8	1.2	1.6	.5
General merchandise	2.6	4.5	1.8	-1.3	4.0
GAAF	2.3	3.0	.7	-1.2	3.2
Total, excluding auto and nonconsumption items	.6	2.6	1.4	- .5	1.4
Total, deflated by all commodities CPI, seasonally adjusted	3.4	n.a.	1.5	-1.4	n.a.

Sales in the second quarter as a whole were up 3-1/2 per cent from the first quarter. Sales of durable goods were 5 per cent higher, as gains in the automotive group offset by a wide margin a 1 per cent decline in sales of furniture and appliances. Nondurable goods sales rose by 3 per cent, led by a strong gain at department stores, although all major groups of stores reported relatively large increases.

Unit auto sales. Sales of new domestic-type autos in the first 10 days of July were at an annual rate of 7.1 million units, down 5 per cent from a year ago and 16 per cent below the rate of the first 6 months of 1971. In large part the decline probably reflected the termination of several sales-incentive contests in the last selling period of June.

Total foreign and domestic sales were at a 9.9 million unit rate for June, up 4 per cent from a year earlier. The import share of the U.S. auto market was 16 per cent in June, compared with 11 per cent a year earlier. Economy class imports accounted for most of this increase. The market share of domestic type small cars has also risen substantially over the last year, while domestic type large cars experienced a decline.

U.S. AUTO SALES
(Percentage distribution, domestic and foreign 1/)

	1970	1971		
	June	April	May	June
Domestic				
Total	89.0	83.4	84.1	83.9
Large	77.7	64.9	64.6	63.5
Small 2/	11.3	18.5	19.5	20.4
Imports				
Total	11.0	16.6	15.9	16.1
Low priced	9.0	14.0	13.4	13.6

1/ Based on data that are not seasonally adjusted.
2/ Compacts and sub-compacts.

Consumer credit. Consumer instalment credit outstanding in May increased $5.9 billion, seasonally adjusted annual rate. This was well below the $8.0 billion rate of April but more than double the $2.7 billion rate in the first quarter. At the end of May total instalment credit outstanding was $100.7 billion, an increase of only $3.0 billion from a year earlier.

Seasonally adjusted extensions of automobile credit declined further in May after a small decrease in April. In part, the decline in extensions reflected a smaller proportion of cars sold on credit and a small decrease in the average size of contract on both new and used cars. However, the average contract for new cars is still nearly $200 higher than in the second half of 1970 (seasonally adjusted), while used car contracts are about $100 higher.

Conference Board Consumer Survey. The May-June survey by the Conference Board indicated a sharp conflict between consumer attitudes and expressed intentions to purchase autos and major appliances. Attitudes about the future turned less pessimistic last winter and this improvement in expectations generally continued in both the March-April and the May-June surveys, although pessimistic responses still outnumber optimistic replies by far.

Buying intentions for autos and major appliances, on the other hand, declined rather sharply in the latest survey, although they had turned upward along with expectations in the January-February survey. The percentage of families planning to buy an auto in the next six months declined from 8.8 to 7.8 per cent of all households. The per cent of households planning to purchase major appliances fell to 35.9 from 40.2 per cent in the last survey. Buying plans for homes remain at the high 3.1 per cent rate of the previous survey.

Experience at the Michigan Survey Research Center indicates that attitudes generally have more predictive value for future expenditures on consumer durables than explicit buying intentions for specific goods. This finding is particularly applicable when all attitudinal questions move in the same direction, as was true in the latest Conference Board Survey.

CONSUMER EXPECTATIONS AND INTENTIONS
Percentages of all households
Seasonally Adjusted

	1970		1971		
	May-June	Nov-Dec.	Jan-Feb.	March-April	May-June
	-----Appraisal of Present Situation-----				
Business conditions good	18.3	13.8	12.9	12.8	14.5
Jobs hard to get	28.1	39.2	41.8	46.9	43.1
	-----Expectations for Six Months-----				
Business conditions better	21.1	24.8	27.1	25.0	26.3
More jobs	17.6	21.3	21.0	21.3	21.7
Income will increase	25.3	23.8	22.1	23.7	26.6
	-----Plans to Buy Within Six Months-----				
Any auto	7.6	7.2	8.0	8.8	7.8
New auto	4.2	4.3	4.9	5.6	4.8
Home	1.8	2.1	2.6	3.1	3.1
Major appliance	37.6	33.2	35.2	40.2	35.9

Source: Conference Board.

Inventories. The book value of business inventories rose at a $7.6 billion annual rate in May, according to preliminary data--about the same as in April and only slightly higher than in the first quarter.

About half of the inventory growth in April and May came from steel stockpiling. But while durable goods manufacturers were building stocks of materials, they liquidated stocks of other in-process and finished goods, at a rate somewhat greater than in the first quarter. Auto dealers continued to add to their inventories. Outside of these major durable goods areas, there was an increase from the first quarter in the rest of manufacturing and trade.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES
Seasonally adjusted annual rates, billions of dollars

	1971		
	Q1	April	May (prel.)
Manufacturing and trade, total	5.9	7.0	7.6
Metal materials	1.1	3.6	3.2
Durable mfg. other than materials	-1.7	-2.4	-2.6
Retail auto dealers	5.0	1.3	4.6
Nondurable and misc. durable	1.5	4.4	2.4

Sales increased along with inventories in April and May and the inventory-sales ratio remained at 1.53 in May for the third month in a row; this was lower than at any time in 1970, and about the same as in May 1969 and the previous steel stockpiling period in May 1968. Since January, inventory-sales ratios have shown marked improvement, notably in durable goods manufacturing other than materials and in the nondurable and miscellaneous durable group. Nevertheless, there are signs of excess stocks in some categories. Inventories of steel mill shapes were higher in May relative to steel use than in any previous reported stockpiling period, according to data on tonnage which go back to 1962. Auto dealers were carrying 59 days' supply of new domestic-make autos in May and June, compared with 54 days' supply a year earlier. Finally, the reduction in durable goods manufacturers' stocks other than materials has not been as great as the decline in comparable unfilled orders, and this inventory-backlog ratio has been rising.

INVENTORY RATIOS

	1971		
	January	April	May (prel.)
Inventories to Sales:			
Manufacturing and trade, total	1.57	1.53	1.53
Durable mfg. other than materials	1.62	1.57	1.54
Retail auto dealers	1.58	1.56	1.68
Nondurable and misc. durable	1.32	1.30	1.29
Inventories to Unfilled Orders:			
Durable manufacturing, total	.817	.824	.836
Other than materials	.574	.575	.577

Construction and real estate. The seasonally adjusted value of new construction put in place in June was about unchanged from the record May rate, according to preliminary Census estimates. At an estimated annual rate of $103.5 billion in June, total construction activity was 15 per cent above a year earlier in current dollar terms and 6 per cent on a constant dollar basis.

There was a slight decline in June residential construction outlays. However, in projecting the residential component for June, Census under-estimated the June starts rate by some 80 thousand units. Had it not been for this, residential outlays would have risen for the tenth consecutive month in June and total construction would have exceeded the May rate.

NEW CONSTRUCTION PUT IN PLACE
(Seasonally adjusted annual rate)

	All	Private			Public
		Total	Residential	Non-residential	
	Billions of dollars				
1970 - Annual	91.3	63.1	29.3	33.8	28.3
1970 - IVQ	94.8	65.3	31.9	33.4	29.5
1971 - IQ(r)	101.3	70.7	35.4	35.3	30.6
- IIQ(p)	103.8	73.6	38.3	35.3	30.2
1971					
April (r)	103.8	74.2	38.0	36.2	29.6
May (r)	103.9	73.5	38.6	34.9	30.4
June (p) 1/	103.5	73.1	38.2	34.9	30.5
	Per cent change in June from a year earlier				
In current dollars	+15	+19	+38	+3	+7
In 1957-59 dollars	+6	+10	+30	-7	-2

1/ Data for the most recent month (June) are confidential Census Bureau extrapolations. In no case should public reference be made to them.

Seasonally adjusted private housing starts edged up slightly in June to an annual rate of 1,982 thousand units. For the second quarter, starts averaged 1.95 million units--8 per cent above the first quarter rate and more than 50 per cent higher than the low first and second quarters of a year earlier. Single-family units, which provided the major share of the second quarter starts advance, continued upward in June to an annual rate of almost 1.2 million units.

With residential mortgage commitments and building permits at extraordinarily high levels, some further increase in starts appears likely over the near-term. While the rate of increase is expected to slow, third quarter starts may well average in excess of a 2 million unit rate for the first time in over two decades.

PRIVATE HOUSING STARTS AND PERMITS
(Seasonally adjusted annual rates, in thousands of units)

	Starts			
	Total 1/	Per cent Single-family	Per cent FHA-insured 2/	Permits
			(FHA Series)	
1970 - Annual	1,434	57	29	1,324
1970				
IIQ	1,286	58	28	1,257
IIIQ	1,512	56	28	1,358
IVQ	1,777	58	35	1,593
1971				
IQ	1,813	55	24	1,608
IIQ	1,951	58	n.a.	1,794
1971				
April (r)	1,912	57	22	1,638
May (r)	1,959	57	21	1,927
June (p)	1,982	59	n.a.	1,817

1/ Apart from starts, mobile home shipments for domestic use in May--the latest month for which data are available--were at a seasonally adjusted annual rate of 473,000, 1 per cent below the record April rate, but 24 per cent above a year earlier.

2/ Based on unadjusted totals for all periods. FHA-insured starts include both subsidized and nonsubsidized units.

Personal income. Total personal income showed an unusually large increase in June to an annual rate of $870 billion, reflecting mainly the 10 per cent rise in Social Security benefit payments retroactive to January 1. The increase in Social Security benefits accounted for $16-3/4 billion of a total rise of over $20 billion, with the retroactive payment amounting to $13-1/4 billion. Excluding the increased Social Security payments, personal income advanced $3.5 billion, compared with an increase of $5.4 billion in May.

The increase in wage and salary disbursements slowed somewhat in June. Hours of work and hourly earnings continued to rise, but there was a substantial drop in employment and disbursements increased only $2 billion in June compared with a rise of $4.3 billion in May. Manufacturing payrolls advanced only $0.5 billion, $1 billion less than in May.

Labor market. Although the unemployment rate dropped from 6.2 per cent in May to 5.6 per cent in June, other evidence suggests no substantial improvement in the labor market. Both the civilian labor force and total employment declined sharply, the monthly rate of insured unemployment rose, and the number of workers on nonagricultural payrolls fell 310,000. The civilian labor force, seasonally adjusted, dropped by over one million, with the bulk of the decline among younger workers. Much of the drop in both unemployment and the civilian labor force appeared to be due to seasonal adjustment difficulties and the early enumeration week, which may have found a disproportionately large number of young people still in school. Insured unemployment and initial claims for unemployment benefits edged down in the early weeks of July.

Declines in unemployment were concentrated among workers who were either new entrants or re-entrants to the labor force, largely teenagers and young adults (20-24). In addition to seasonal adjustment problems, the declines apparently reflected the depressed state of the labor market which may have discouraged many workers from looking for jobs. Unemployment rates also moved downward moderately in June for adults and other categories, such as whites and Negroes, and blue- and white-collar workers.

The seasonally adjusted civilian labor force dropped from 84.2 million in May to 83.1 million in June. Since June 1970 the civilian labor force has increased by 918,000, with over half the increase occurring among young adult men, many of whom are returning veterans. The total labor force, however, was up by only 554,000 from June, 1970, about one-third of the "normal" growth anticipated from population increases and long-run trends in participation rates.

The number of wage and salary workers on nonfarm payrolls in June showed a less than seasonal increase, and as a result, seasonally adjusted employment in most industrial categories declined. The largest drop occurred in manufacturing, which fell 115,000 with much of the reduction in the metal and metal using industries. Payroll employment in trade was off 88,000, following a rise in May.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1970	1971	
	June	May	June
Total	4.8	6.2	5.6
Men aged:			
20 to 24 years	7.4	10.8	9.7
25 and over	2.9	3.6	3.3
Women aged:			
20 to 24 years	7.9	11.5	10.1
25 and over	3.8	4.8	4.5
Teenagers	14.9	17.3	15.8
White workers	4.3	5.7	5.2
Negroes and other races	8.4	10.5	9.4
Insured unemployed	3.7	4.2	4.4

For the second quarter as a whole, nonfarm employment increased only moderately after a relatively large first quarter gain centered in trade. In manufacturing, first quarter employment expanded slightly following the end of the GM strike but declined in the second quarter.

Firmness in the workweek has continued to provide one optimistic element in the labor market. Average weekly hours of production and nonsupervisory workers on private payrolls rose 0.1 hour in June to 37.1. In manufacturing the workweek rose 0.1 hour for the second consecutive month and at 40.0 hours was up 0.4 hour from the November trough. Typically, however, in previous recessions by six months after the trough the manufacturing workweek had moved up by about 1.0 hour.

NONFARM PAYROLL EMPLOYMENT
(Seasonally adjusted, in thousands)

	1970 QII	1971 QII	1970 QII	1970 QIII	1970 QIV	1971 QI	1971 QII
	Change from previous year		--Change from previous quarter--				
Total	701	-136	-252	-361	-321	444	102
Industrial	-595	-1043	-445	-334	-662	11	-57
Manufacturing	-593	-943	-345	-296	-631	48	-64
Mining	7	1	-5	-2	5	0	-2
Construction	-69	-110	-80	-73	6	-69	26
Transportation & P.U.	60	9	-15	37	-42	32	-17
Non-industrial	1297	905	200	-29	342	433	157
Trade	362	206	-7	-27	-7	206	26
Finance	134	101	21	1	34	38	29
Services	392	243	41	-4	145	93	10
Government	409	355	145	1	170	96	92

Earnings. Wage increases have continued to be rapid. In the second quarter of 1971 average hourly earnings of production workers on private nonfarm payrolls were up 6.5 per cent from a year earlier. In manufacturing and construction, the rise in earnings was larger than in the comparable periods of the preceding two years, reflecting sizable settlements in the current round of collective bargaining agreements. In the service industries, however, there appears to be a modest easing in the rate of wage increases.

AVERAGE HOURLY EARNINGS OF PRODUCTION
AND NONSUPERVISORY WORKERS

	Per Cent increases from second quarter a year earlier			
	1968	1969	1970	1971
Private nonfarm	6.3	6.8	6.0	6.5
Manufacturing	6.3	5.9	5.6	6.4
Mining	4.6	7.5	6.6	6.4
Construction	7.3	8.6	8.9	9.5
Transportation & P.U.	5.7	6.2	5.3	7.4
Trade	6.9	6.3	6.3	6.2
Finance	6.0	6.5	4.6	7.9
Services	5.9	8.2	7.8	7.5

Industrial relations. Some key strikes began this month which are likely to have considerable impact on income and production but because of timing their effect on payroll employment in July will be relatively small. Close to half a million members of the Communication Workers Union who went on strike July 14 are scheduled to return to work this week following agreement reached on a new three-year contract. Exclusive of cost of living adjustments, we estimate that wage and fringe benefits will rise by 22-1/2 per cent over the life of the contract, or at an average annual rate of about 7 per cent. This appears to be in line with package increases in the can, aluminum and auto industries. The telephone settlement for the first time includes a cost-of-living escalator clause. The clause is effective in the second and third contract years and provides for a 50-cent increase in weekly wages for each 0.5 point rise in the CPI over a 12-month period. This agreement is expected to set the pattern for contract settlements with 200,000 electrical workers now negotiating with the telephone company.

After prolonged negotiations on a national basis between the railroads and the United Transportation Union on a new agreement incorporating work rule changes recommended by a Presidential panel in November, the union called a selective strike (ruled permissible under a Supreme Court decision) against two railroads on July 16--the Southern Railway and the Union Pacific, involving about 50,000 workers. Strikes against the Southern Pacific and Norfolk and Western are scheduled for July 24 and for July 30 on the Sante Fe and five smaller carriers. As they announced before the strike, carriers not affected by the strike have put into effect the work rule changes under negotiation. Layoffs of some workers have reportedly followed imposition of the work rules.

Contracts expired in the copper industry and in West Coast shipping on July 1 and over 50,000 workers have been on strike since then. The first copper settlement was reached July 18 when Magma Copper and 3,000 workers agreed to a wage package totaling 92 cents over three years, an unlimited cost-of-living clause effective May 1972, and a 50 per cent increase in pensions. This agreement has already set the pattern for a tentative agreement at Anaconda Copper and is expected to soon lead to settlements throughout the industry. In contract negotiations between 19,000 West Coast longshoremen and the Pacific

Maritime Association there appears no likelihood of an early agreement; a large wage increase and work guarantees are the main issues.

Collective bargaining in construction reaches a peak this month. Judging from the data released by the President's Construction Industry Stabilization Committee, collective bargaining agreements approved by the Committee provide more moderate first-year wage and benefit increases than were provided in major contracts negotiated in 1970, when the average first-year wage and benefit adjustment was over 19 per cent. Compared to 1970, there appear to be fewer increases of 25 per cent or more and many in the range from 7 to 13 per cent.

The postal unions reached a two-year agreement with the U.S. Postal Service on July 20. The settlement provides for a limited cost-of-living adjustment and a total wage increase of $1550 including a one-time $300 bonus. The cost of the package is estimated at $1 billion.

Important contract expirations in the near future include steel (July 31), bituminous coal, East Coast shipping and aerospace (all three on September 30); these key negotiations will involve over half a million workers.

Wholesale prices. Wholesale prices rose at an annual rate of 4.6 per cent in June, with substantial increases in industrial and other prices. Rising prices for intermediate materials, particularly for lumber and textiles, were mainly responsible for the 4.4 per cent rise in industrials; finished goods prices contributed relatively little, and crude materials declined. Since December, intermediate materials, which account for more than one half of the weight of industrial commodities, have risen at an annual rate of 5.5 per cent, compared to only 2.3 per cent for finished goods. This reverses the relation which was obtained in the second half of 1970. Over longer periods of time, these two tend to move together, so that a more rapid rise in finished goods prices may lie ahead.

WHOLESALE PRICES
(Per cent changes, seasonally adjusted annual rates)

	6-months		3-months		Monthly
	Dec 1969 to June 1970	June to Dec.	Dec 1970 to Mar 1971	March to June	May 1971 to June 1971
All commodities	2.4	2.2	5.4	4.7	4.6
Farm and food 1/	-1.8	-.4	11.3	3.2	5.4
Industrials	3.8	3.4	2.9	5.3	4.4
Crude materials 2/	8.5	.8	2.4	7.1	-1.9
Intermediate materials 2/	4.3	1.8	4.0	6.9	6.5
Finished goods 2/	3.2	5.2	2.9	1.8	1.1
Producer	4.1	6.0	3.9	2.8	4.2
Consumer 2/	2.7	5.1	2.2	1.5	.0
Durable	2.9	5.7	2.2	2.9	1.1
Nondurable 2/	2.8	4.7	1.5	.7	-1.1

1/ Farm products, and processed foods and feeds.
2/ Excludes food.

The drop in crude materials, after previous rather brisk increases, reflected declines in nonferrous and iron and steel scrap, hides and skins and crude natural rubber. Prices of natural gas continued to rise.

Intermediate materials included increases in lumber and wood products and in textiles, which have been showing considerable strength after a long period of weakness. In addition to lumber, gypsum products and other non-metallic building materials continued a strong advance. Since last December, building materials have advanced at an annual rate of over 12 per cent (unadjusted).

In the July WPI, industrial commodities will reflect the mid-June and July 1 advances in steel sheet prices, but these will be partly offset in the index by declines in steel scrap prices as mills cut back production. Since the June pricing date, prices of tires for passenger cars and trucks have been increased; prices of copper on outside markets have jumped as a result of the copper strike in the U.S.; prices of nylon for apparel have been raised by an important producer, and recent widespread increases in prices of nylon have been reported in both the U.S. and Europe; and prices of 1972-model trucks, about 4 per cent higher than for comparably equipped 1971 models, were set tentatively by a major producer.

In connection with the latter announcement, a comparison of recent yearly changes indicates that truck prices have increased more each year than have prices for passenger cars.

PRICE CHANGES
Passenger Cars and Motor Trucks
(Percentage change) 1/

Years	Passenger cars	Motor trucks
1960-65 2/	-3.1	- .2
1965-70 2/	11.8	20.3
1967	1.9	3.8
1968	1.5	2.5
1969	1.6	2.6
1970	6.2	9.0

1/ Measured from October to October for passenger cars and December to December for motor trucks.
2/ Total change over the period.

Increases in prices of fresh fruits and vegetables, grains, and vegetable oils were in large part responsible for the rise in the index of farm and food products. The outlook is now for bumper crops if corn yields are normal. Indication of continued serious blight are counterbalanced by the fact that about 60 per cent of acreage is planted to resistant types and blends, and planted acreage is 11 per cent larger this year than last.

GNP price indexes. The rise in the implicit GNP deflator slowed from an annual rate of 5.4 per cent in the first quarter to 4.2 per cent in the second (preliminary), reflecting a less rapid increase in prices in the private economy and a much smaller rise in the deflator for Government purchases following the first quarter Federal pay increase. This brought the rise in the GNP deflator to a rate about 2 percentage points below that in the fourth quarter, when, in addition to sharp prices advances, there was an adverse shift in the composition of product. In that period, sales and output of automobiles, which have a relatively low deflator, were greatly curtailed because of the strike.

GNP PRICE INDEXES
(Per cent change, annual rates)

	Year			1970		1971	
	1968	1969	1970	QIII	QIV	QI	QIIp
GNP							
Deflator	4.0	4.8	5.5	5.0	6.3	5.4	4.2
Fixed-weight index 1/ 2/	4.2	5.0	5.4	4.9	5.3	6.6	4.8
Gross private product							
Deflator	3.6	4.5	4.9	4.9	6.2	4.5	4.2
Fixed-weight index 1/ 2/	3.8	4.7	4.8	4.8	5.2	5.6	4.9

1/ 1965-IV weights.
2/ Confidential.

A more meaningful contour of price developments is revealed by the fixed-weight index for private GNP which is not affected by changes in composition of product; this index indicates that the rate of price increase reached a high in the first quarter at an annual rate of 5.6 per cent, but declined appreciably in the second quarter to about the average rate of 1969 and 1970.

According to confidential data, prices for consumer goods and services rose considerably less rapidly in the second quarter than in the two previous periods. Durable goods rose relatively little, since the record auto price increase of 1970-71 was fully reflected by the end of the first period, and the rise in service costs was the slowest since last year's third quarter.

FIXED-WEIGHT INDEXES
Selected Components, Gross Private Product1/2/
(Quarterly per cent change at annual rates)

	1970	1970		1971	
	Year	III	IV	I	IIp
Gross Private Product	4.8	4.8	5.2	5.6	4.9
Consumption expenditures	4.7	3.8	5.1	5.3	4.5
Durable goods	2.6	3.2	6.7	7.3	1.5
Nondurable goods	4.7	2.6	3.3	3.0	4.6
Services	5.4	5.4	6.4	7.2	5.6
Fixed investment	5.1	8.2	6.2	5.1	6.2
Nonresidential structures	8.1	14.3	9.8	2.9	12.4
Producers' durables	4.4	4.2	6.2	4.4	1.9
Residential structures	3.3	8.7	2.4	9.0	6.9

1/ QIV-1965 weights.
2/ Investment in inventories and imports and exports are included in total index, but not shown separately.

NOTE: Confidential.

Farm prospects. According to the July 1 report, acreage planted to crops is 4 per cent larger than last year--in line with planting plans reported in January and March but with a different mix of crops. Far more corn, sorghum, and spring wheat and less oats, soybeans, and flaxseed have been planted than pre-season intentions surveys had indicated.

PLANTED ACREAGE OF 1971 CROPS, JULY 1
(acres in thousands)

	Number of acres	Change from 1970 Acres	Change from 1970 Per cent
Total, 59 crops	313,976	13,092	4.4
Corn, all purposes	74,651	7,480	11.1
Sorghum, all purposes	20,714	3,422	19.8
Barley	11,182	747	7.2
Oats	21,926	-2,566	-10.5
Hay 1/	63,589	355	.6
Winter wheat	38,666	258	.7
Spring wheat	15,708	4,558	40.9
Soybeans	43,637	305	.7
Flaxseed	1,718	-1,286	-42.8
Cotton	12,399	457	3.8
Other crops 2/	9,786	- 639	- 6.1

1/ Acreage for harvest.
2/ Principally rice, peanuts, tobacco, sugar crops, potatoes, dry edible beans and peas, and vegetables for processing and fresh market.

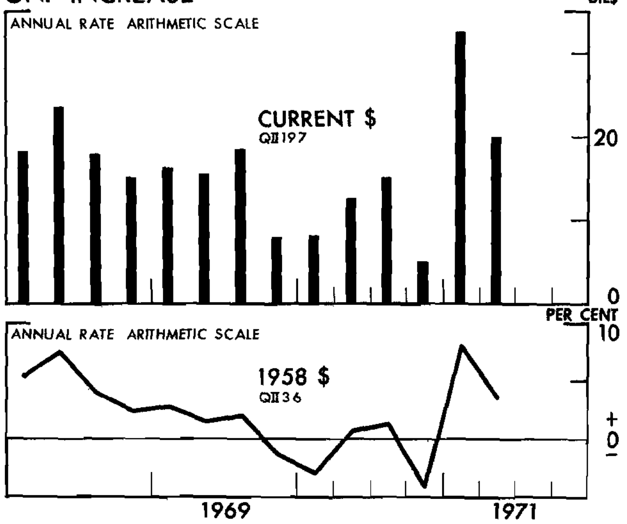
Acreage of feed grains is up 8 per cent from last year. Corn acreage is 11 per cent larger nationally. If blight damage to corn yields is no greater than last year, it seems likely that feed grain supplies will be adequate to meet domestic and foreign demands in the year ahead and possibly permit a little rebuilding of stocks. Ample food grain supplies are in prospect but soybean and cotton supplies are likely to continue in close balance with demand.

According to the June pig crop report, more hogs are available for summer markets than had been expected and output for the seasonally flush fall and winter markets will probably be down no more than 2 to 3 per cent from last year. However, by early 1972, output may dip below a year earlier by 7 to 8 per cent. A little more beef is expected to be available than a year earlier through the rest of the year reflecting larger marketings of fed cattle and cows. Average slaughter cattle weights are expected to be a little lighter than last year. The effect of these supply prospects on meat prices during the rest of the year may be to moderate the usual midsummer rise in prices and to limit the seasonal decline this fall. Higher pork prices are likely in early 1972.

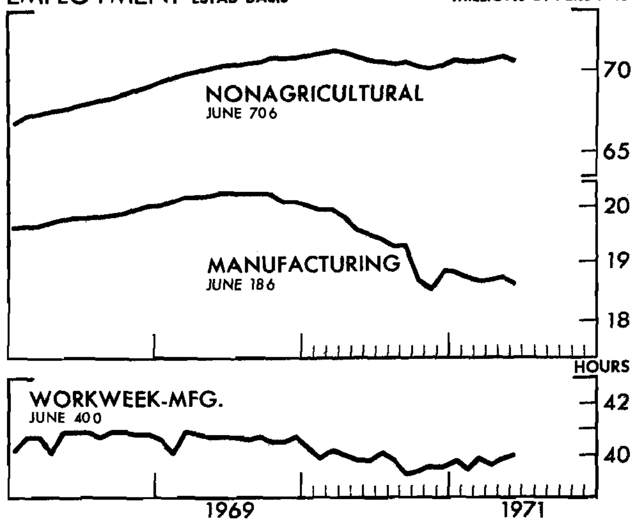
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

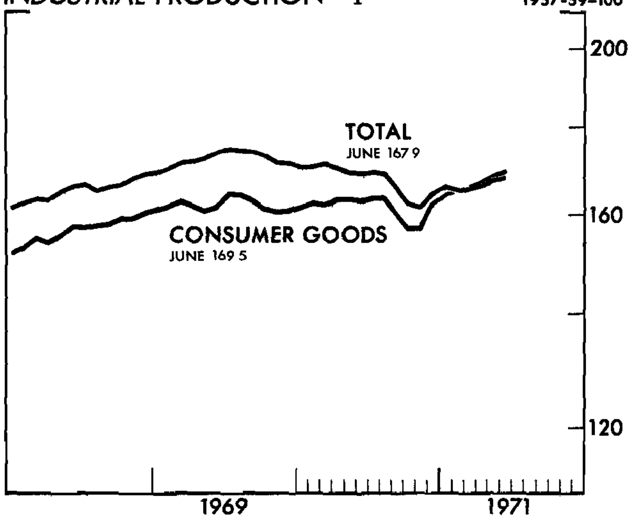
GNP INCREASE



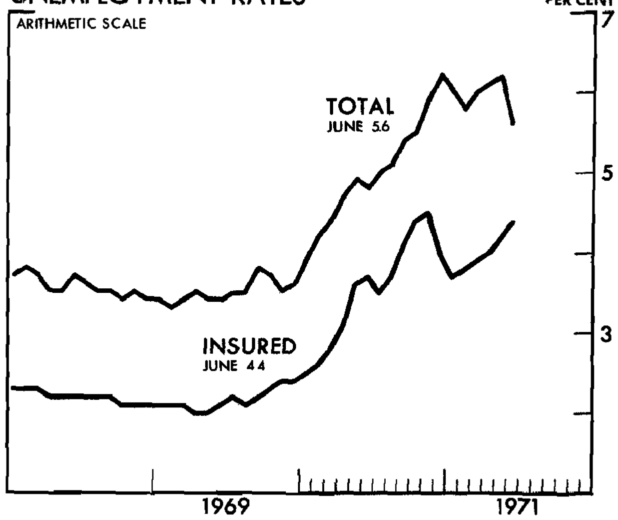
EMPLOYMENT ESTAB BASIS



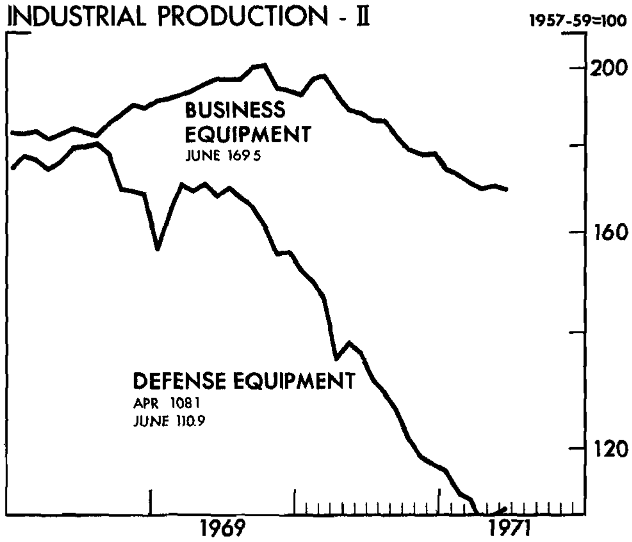
INDUSTRIAL PRODUCTION - I



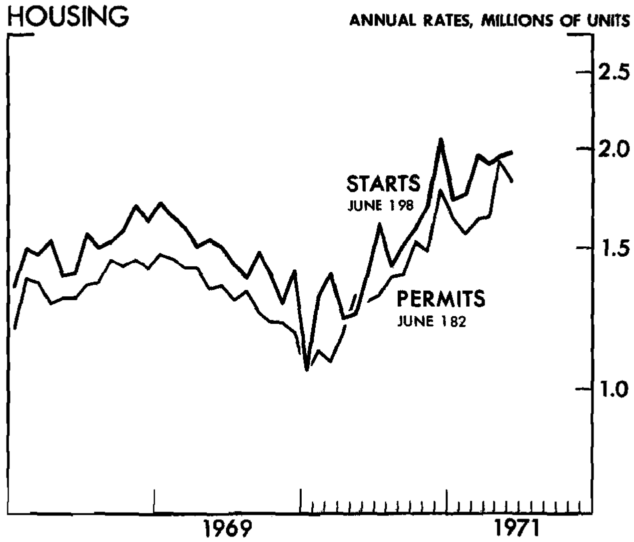
UNEMPLOYMENT RATES



INDUSTRIAL PRODUCTION - II



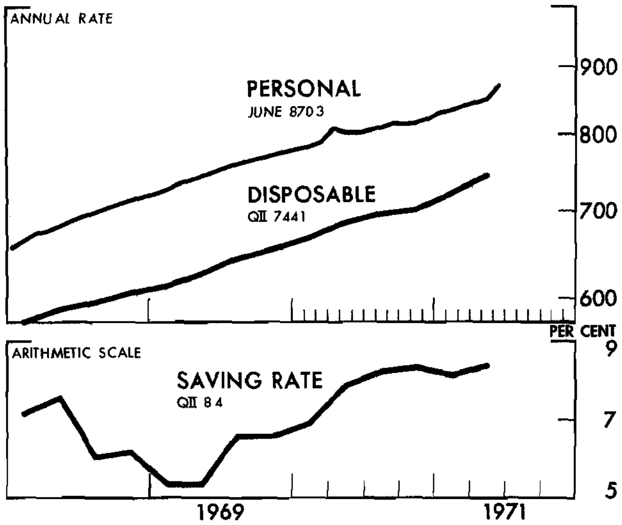
HOUSING



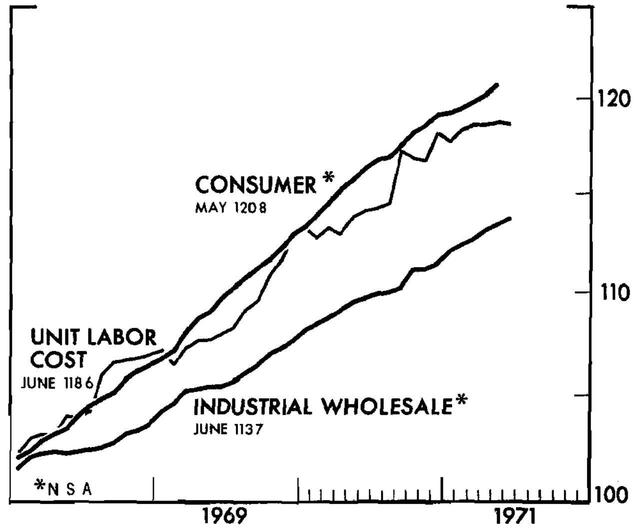
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

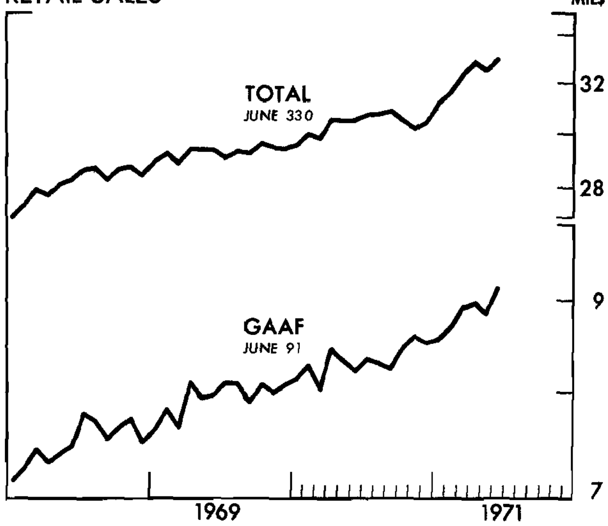
INCOME



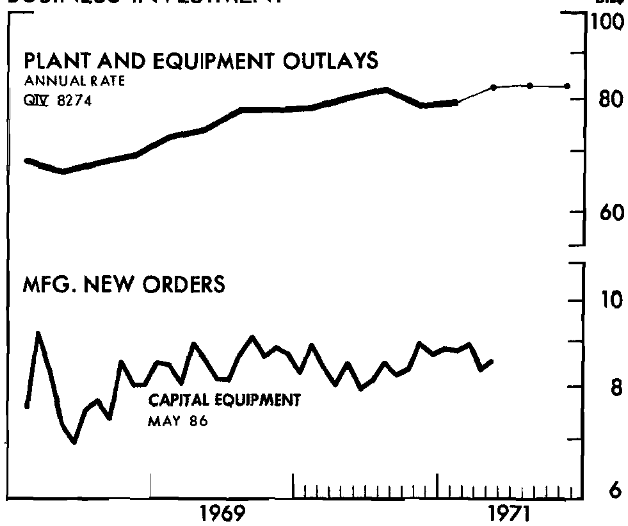
PRICES AND COSTS



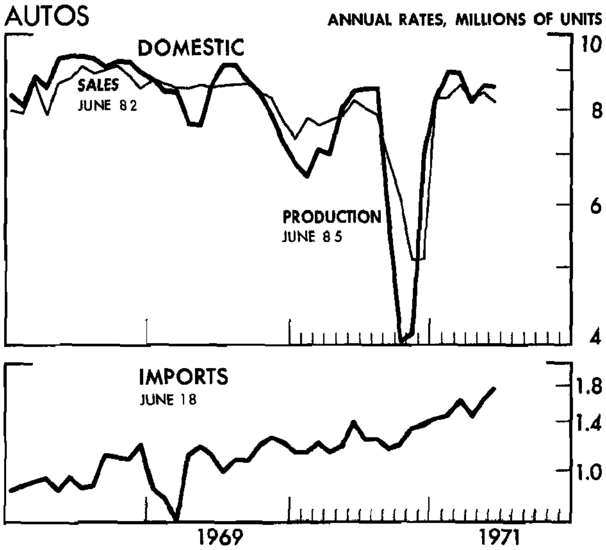
RETAIL SALES



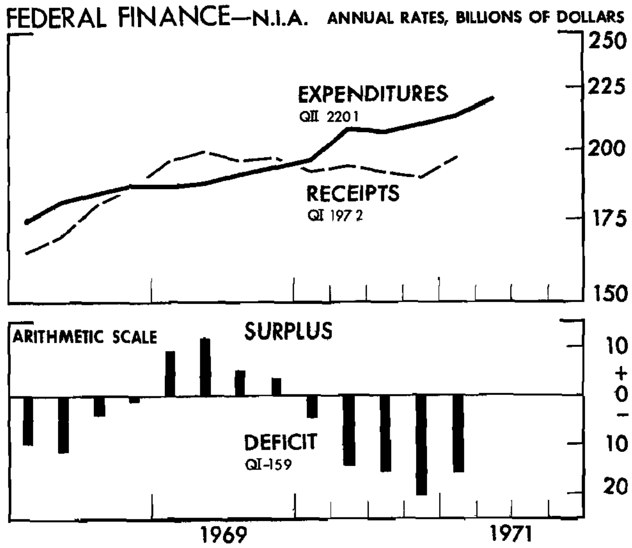
BUSINESS INVESTMENT



AUTOS



FEDERAL FINANCE—N.I.A.



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Bank credit. Final estimates for June indicate that commercial bank credit adjusted for loan transfers, increased at a seasonally adjusted annual rate of about 10 per cent last month (last Wednesday of month basis). A very sharp expansion in holdings of U. S. Treasury securities accounted for the bulk of this increase, reflecting bank participation in the Treasury's late-month financing operation, on which banks received full tax and loan credit. An unusually large volume of the 16-1/2 month notes sold in this financing was acquired by smaller commercial banks, which apparently found the 6 per cent coupon on the issue attractive. During the first week in July, bank holdings of Treasury issues rose further, reflecting acquisitions of the new September tax bill. Only a minimal amount of the short-term notes acquired in late June were sold in early July, suggesting that, as in the case of smaller banks, large institutions' purchases of these securities were primarily for their own account.

COMMERCIAL BANK CREDIT ADJUSTED FOR LOANS
SOLD TO AFFILIATES 1/
(Seasonally adjusted percentage changes, at annual rates)

	1970	1971				
	2nd Half	1st Halfp	QI	QIIp	May p	Junep
Total loans & investments 2/	11.3	9.9	12.2	7.3	11.4r	10.3
U.S. Treasury securities	16.3	15.4	19.8	10.4	--	55.8
Other securities	29.3	22.3	27.9	15.7	15.4r	8.9
Total loans	5.5	5.2	6.3	4.0	12.5r	1.6
Business loans 3/	-1.6	2.0	1.0	2.8	18.2	-9.5
Real estate loans	4.8	9.4	8.3	10.3	8.1	14.4

1/ Last Wednesday of month series.
2/ Includes outstanding amounts of loans reported sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
3/ Includes outstanding amounts of business loans reported sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
Note: Beginning June 30, 1971, Farmers Home Administration insured notes totaling approximately $700 million are included in "other securities" rather than in "real estate loans". Annual rates have been adjusted to take account of this reclassification.

p -- preliminary.
r -- revised.

June acquisition of other securities (mainly State and local notes and bonds and Federal agency issues) were well below those of May and earlier months of the year. The rate of bank acquisitions of municipal securities has been decelerating for several months, presumably in reaction to uncertainty over the future course of interest rates, particularly long-term rates; banks have been concentrating their purchase on shorter-term issues in recent months.

Total loans increased only slightly in June after a very strong advance in May. Business loans declined sharply over the month, reversing a large part of the May increase. (There is some thought that a major portion of the May advance was the result of seasonal adjustment problems). Loans to nonbank financial institutions also dropped substantially in June. Real estate loans, on the other hand, rose very sharply and other major loan categories increased moderately. The rise in real estate loans, one of the largest monthly gains on record, was particularly strong in the San Francisco District where housing starts have increased markedly in recent months. Banks in California, facing large mortgage credit demands, increased their mortgage rates by one half a percentage point in early July.

The sharp drop in business loans in June reduced their rate of growth in the second quarter to less than a 3 per cent annual rate, and at mid-year business loans were only $200 million above their year-ago level. Continued weakness in loan demands prevails in various sections of the country, and, with the possible exception of loans to public utilities and firms providing services, in all industrial loan categories. Even loans to producers of machinery, primary metals and other fabricated metals have not displayed any strength in recent months despite the buildup in steel inventories. Moreover, the net repayments of business loans in June, and a continued apparent weakness in early July, occurred against the backdrop of developing moderation in capital market financing by businesses and a continued net reduction of outstanding commercial paper issued by nonfinancial corporations. These various developments taken together appear to reflect--at least for large businesses--improved liquidity positions and small present needs for working capital.

Available data suggest that essentially all of the weakness in business loans in June occurred at the large banks, continuing a trend in effect over the last year. A closer examination of bank credit developments in the second half of 1970, made possible by recently available benchmarks from call report data, indicates that business loans at non-weekly reporting banks over this period were quite strong in contrast to the very weak loan demand experienced by large banks. This divergence often emerges in recession and appears attributable to differences in the size of customer serviced by the two groups of banks. The predominantly smaller customers of smaller banks typically experience less pronounced movement in sales and inventory positions. Furthermore, they must rely on banks for their principal source of outside funds, while loan customers of weekly reporting banks can tap the open markets for funds; in the last year, large corporations have acquired funds in the capital market in sufficient volume to pay down part of their bank indebtedness.

Despite the recent weak business loan demands at large banks, a one-half point increase in the prime rate to 6 per cent became general in early July. This action was taken in response to the continued uptrend in open market rates, which had significantly raised the cost of funds to banks. This prime rate increase has again made banks a relatively more expensive source ofbborrowing than the commercial paper market.

Monetary aggretates. M_1 growth over the early part of July continued quite strong, but interpretation of underlying trends is difficult because of such factors as the quarterly OFDI reflow of funds, the distribution of retroactive social security payments in late June and the possible buildup in deposit balances in conjunction with the July AT&T financing operation. In June, the pace of advance in M_1 had slowed to about a 9 per cent annual rate, below May's very rapid rate of increase. Expansion of M_1 over the second quarter--at an 11.3 per cent annual rate--was higher than in the first quarter. The second quarter expansion in M_1 appears to have been fairly evenly distributed both geographically and by class of bank, although the distribution of the June growth was somewhat less even.

MONETARY AGGREGATES
(Per cent changes, seasonally adjusted at annual rates)

	1970	1971				
	QIV	QI	QII	April	May	June
1. M_1 (currency plus private demand deposits)	3.4	8.9	11.3	9.3	15.2	9.1
2. M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	9.2	17.8	12.6	12.1	14.1	11.3
3. M_3 (M_2 plus savings deposits at mutual savings banks and S & Ls)	9.7	19.0	14.7	16.1	15.3	12.3
4. Adjusted bank credit proxy	8.3	10.9	6.5	5.3	7.4	6.6

The pace of expansion in M_2 and M_3 also slowed to some extent in June, primarily reflecting the more moderate advance in M_1. However, despite the stronger second quarter advance in M_1, both M_2 and M_3 increased at a pace considerably below that for the first quarter, as inflows of interest-bearing deposits at thrift institutions fell well short of the exceptional first quarter rate. By historical standards, however, the recent growth rates still remained quite high.

Growth in time and savings deposits at commercial banks in June continued to be relatively strong despite the further rise in yields on competing market instruments (see table below). While the monthly rates of increase in time and savings deposits other than large CD's over the second quarter are well below those for the first quarter, the rate of inflow does not appear to have slowed significantly as the quarter progressed. The explanation for the maintenance of these deposit inflows is not clear. However consumers' savings rate have remained high and their demands for safe liquid assets may have been sustained by uncertainty over the economic outlook.

CHANGES IN INTEREST BEARING DEPOSTIS AT COMMERCIAL BANKS
AND OTHER FINANCIAL INSTITUTIONS
(Billions of dollars, seasonally adjusted)

	1st Q (Average monthly change)	April	May	June
Commercial bank time and savings deposits	+5.2	+2.2	+3.0	+3.0
(a) Large CD's	+ .6	- .5	+ .6	+ .6
(b) Other time and savings deposits	+4.6	+1.6	+2.4	+2.4
Savings deposits at mutual savings banks and S&Ls	+3.9	+4.4	+3.5	+2.8

In early July, however, the inflows of time and savings deposits other than large CD's did diminish. This perhaps reflects the temporary impact of AT&T's sale of preferred stock rights, but there is no indication of a parallel movement at nonbank institutions.

Bank sales of CD's over the month of June were about as large as in May, with foreign official institutions again accounting for a major share of the advance. Since the end of June, CD sales have accelerated largely because a sizeable share of the proceeds so far received from the AT&T financing have been invested in these instruments. These latter CD sales have been concentrated in short-term maturities, continuing the general trend underway in the second quarter toward a shortening maturity of CD sales. At prime New York City banks, the average maturity of CD sales declined to 1.7 months in June from over 5 months in March, as corporate treasurers placed a greater premium on short-term assets.

Nondeposit sources of funds increased on average in June primarily as a result of increased bank borrowing from their foreign branches. The increase early in the month appears to have been attributable to bank bookkeeping practices and borrowing for the purpose of maintaining reserve free borrowing bases. Such borrowing was apparently sustained over the remainder of the month by relative cost considerations, as the overnight Euro-dollar rate dropped below the Federal funds rate and remained in this position over most of the month. Since early July, however, the rate relationship has been reversed and, in the early weeks of the month, Euro-dollar borrowing declined.

Member banks also stepped up their borrowing from the Federal Reserve Banks after mid-June and in the statement week ended July 14, net borrowed reserves rose to $952 million, the highest level in a year. Money market banks accounted for most of the increase in borrowing, apparently in order to take advantage of the relatively low discount rate at a time when such banks generally have a "clean" record at the discount window.

Nonbank thrift institutions. Savings and loan associations and mutual savings banks both experienced a relatively favorable reinvestment period at the end of June and in early July. In both cases, however, the deposit patterns relative to other reinvestment periods earlier this year tended to confirm the modest slowdown in the rate of growth that began in May, reflecting in part the rising level of market yields relative to rates paid by the thrift institutions. The AT&T rights issue that coincided with this reinvestment period did not appear to induce withdrawals of unusually large proportions.

JUNE-JULY REINVESTMENT PERIOD NET DEPOSIT
FLOWS AT NONBANK THRIFT INSTITUTIONS
(In millions of dollars, not seasonally adjusted)

	1966	1967	1968	1969	1970	1971
Savings and Loan Associations						
End of June Grace Days	- 900e	-568	- 610	- 768	-460	-311
First 10 Days in July	-1,221	- 25	- 499	- 738	201	730
Total	-2,121	-593	-1,109	-1,506	-259	419
New York City Mutual Savings Banks*						
End of June Grace Days	- 228	-165	- 232	-316	-232	-109
First 5 Business Days in July	- 31	56	- 18	-103	-115	- 14
Total	- 259	-109	- 249	-418	-347	-123

* Data are for the 15 largest except for 1970 and 1971, when the sample size increased to 17.
e/ Estimated by staff at the FHLBB.

During the month of June, deposit growth at the mutual savings banks and the savings and loan associations was maintained at the pace that was set in May. While that rate shows a reduction from the exceptional pace of early 1971, it remains quite high by any other standard.

DEPOSIT GROWTH AT NONBANK THRIFT INSTITUTIONS
(Seasonally adjusted annual rates, in per cent)

	Mutual Savings Banks	Savings and Loan Associations	Both
1970 - QI	2.7	2.3	2.5
QII	6.4	7.2	7.0
QIII	6.9	10.6	9.3
QIV	10.5	12.1	11.6
1971 - QI	17.7	26.0	23.3
QII p/	14.8	18.2	17.1
1970 - 2nd half	8.8	11.5	10.6
1971 - 1st half p/	16.6	22.7	20.7
April*	19.0	23.2	21.8
May* p/	12.4	15.1	14.2
June p/	12.4	15.6	14.6

* Monthly patterns may not be significant because of difficulties with seasonal adjustment.
p/ preliminary.

Mortgage market. Following the 1/2 of 1 percentage point increase in the prime rate announced earlier this month, there were scattered reports of corresponding increases in rates on short-term construction loans and on interim-term credit for mortgage warehousing. On long-term credit, average returns on home mortgates edged higher again during June in both the primary and the secondary mortgage market, although field reports suggest that funds remained in ample supply in nearly all major areas. While gross yield spreads on home mortgages improved somewhat in June relative to new issues of corporate bonds, they continued quite unattractive to diversified lenders.

AVERAGE RATES AND YIELDS ON NEW-HOME MORTGAGES

	Primary market: Conventional loans		Secondary market: FHA-insured loans		
	Level (per cent)	Yield spread (basis points)	Level (per cent)	Yield spread (basis points)	Discount (Points)
1970					
Low	8.30 (Dec.)	-56 (June)	8.40 (Dec.)	1 (May)	3.1 (Nov.)
High	8.60 (July, Aug.)	50 (Dec.)	9.29 (Jan.)	99 (Feb.)	6.0 (Feb.)
1971					
January	7.95	71	7.80e	56e	2.5e
February	7.75	47	7.55e	27e	4.5e
March	7.60	14	7.32	-14	2.7
April	7.55	-2	7.37	-20	3.1
May	7.65	-36r	7.75	-36	6.1
June	7.70	-20	7.89	- 1	7.2

Note: FHA series; interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points. On FHA loans carrying the 7 per cent ceiling rate in effect since mid-February 1971, a change of 1.0 points in discount is associated with a change of 12 to 14 basis points in yield. Gross yield spread is average mortgage return, before deducting servicing fees, minus average yield on new issues of high grade corporate bonds with 5-year call protection.
e/ Estimated.
r/ Revised.

Discounts on Government-underwritten mortgages traded in the secondary market reached as much as 7.2 points in June--the most restrictive level in 1-1/2 years. Applications to FHA for mortgage insurance and requests to VA for appraisals on existing houses in June were running well below the unusually high seasonally adjusted rates attained in the early spring, when discounts were at this year's low. In contrast, similar activity on new homes has risen, as builders have apparently been more willing or able to absorb, or pass on, the increasing discounts than sellers of used homes.[1/]

As an alternative to relying on new low-downpayment FHA and VA loans carrying these large discounts, recent field reports indicate that assumptions of existing mortgages by used home buyers have become more frequent in some areas and that more used-home sellers have been taking back second mortgages in order to minimize buyers' out-of-pocket investments. The further increase in discounts on Government-underwritten mortgages during June reinforced trade expectations that the contract interest rate on such loans may soon be raised by administrative action above the current 7 per cent ceiling.

In FNMA's latest regular auction (July 12), offers received and bids accepted remained substantial. Discounts and implied yields on forward commitments to purchase FHA and VA mortgages edged higher, especially on 3-month commitments which have generally accounted for the bulk of regular auction activity in the past few months. During this period, many mortgage companies have held existing FHA and VA mortgages in warehouse without firm investor purchase commitments, awaiting more favorable prices. As mortgage prices have continued to

1/ Regulations permit up to 1 discount point to be paid by home buyers. Any additional points must be paid by home sellers, at least nominally.

recede, however, large amounts of these mortgages have been offered to FNMA for immediate delivery.[1/]

FNMA REGULAR PURCHASE AUCTIONS

	Amount of total offers		3-month commitments	
	Received	Accepted	Discount	Private market yield
	(Millions of dollars)		(Points)	(Per cent)
1971 - High	1,168 (5/10)	314 (4/26)	8.3 (6/1)	8.05 (6/1)
May 10	1,168	237	4.7	
24*	786	152	7.6	7.95
June 1*	322	147	8.3	8.05
14	638	191	7.4	7.91
28	539	263	7.4	7.92
July 12	606	241	7.8	7.98

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. Implicit yields shown are gross, before deduction of fee paid by investors to servicers of 38 basis points.

* Dollar limits were announced in advance by FNMA on the total offers it would accept.

Corporate and municipal securities markets. Conditions in the capital markets have improved somewhat over the last four weeks, reflecting mainly a lightening in the bond calendar. The market seemed to have discounted in advance the rise in short-term rates

1/ FNMA has announced that its next biweekly auction (July 26) will be confined exclusively to 3-month commitments, with a penalty fee imposed for non-delivery. With the exception of the special auction of June 9, FNMA's prior auctions have ordinarily permitted offers for delivery within 3, 6, or 12 to 18 months, and no non-delivery penalty fee has been charged.

that occurred over most of this period and the prime rate increase in early July. The immediate effect of the recent rise in the discount rate was only a slight rise in corporate rates. Yields on new high-grade corporate bonds in mid-July were about 25 basis points lower than in mid-June; and, while one widely followed index of tax-exempt yields is slightly above its mid-June level, it has dropped 20 basis points from the June 24 peak.

Stock prices have partly recovered from the late June decline. At the same time, combined NYSE and AMEX average daily trading volume, although still high by historical standards, has reached the lowest level recorded in 1971. Probably as a result of this diminished volume, fails to deliver--the generally accepted indicator of brokerage back-office problems--as of June 9 were also at their 1971 low, $1.2 billion.

BOND YIELDS
(Per cent)

	New Aaa Corporate Bonds 1/	Long-term State and Local Bonds 2/
1970		
Low	7.68 (12/18)	5.33 (12/10)
High	9.30 (6/9)	7.12 (5/28)
1971		
Low	6.76 (1/29)	5.00 (3/18)
High	8.23 (5/21)	6.23 (6/24)
Week of:		
June 18	8.05	6.00
25	7.84	6.23
July 2	7.89	6.19
9	7.87	6.06
16	7.82	6.03

1/ With call protection (includes some issues with 10-year protection).
2/ Bond Buyer (mixed qualities).

Public bond offerings in June reached a total of $2.3 billion, but the July volume now appears to be about $1.5 billion. With this reduced supply, underwriters were relatively aggressive in pricing new issues this month. However, in spite of reports of ample availability of investable funds, institutional buyers were reluctant to make purchases much below the 8 per cent yield level.

Scheduled public utility offerings, which were unusually light in July, will return to previously high levels over the next few months; but there does appear to be a moderation in the volume of industrial issues. The staff estimates that the August public bond total will be no higher than $1.7 billion.

New stock issue volume in July was boosted by the $1.4 billion AT&T offering, but the staff expects that the usual summer lull in market activity will be reflected in an August volume somewhat below the average for the first half of the year. Takedowns of private placements in the summer months are expected to edge up above the first-half average, since commitment activity has been quite strong this year. Total sales of corporate securities in both June and July are estimated to be about $4 billion, but the July figure is distorted by the AT&T offering. In August, total corporate security volume is expected to drop $1 billion.

CORPORATE SECURITY OFFERINGS
(Monthly or monthly averages in millions of dollars)

	BONDS			
	Public	Private	Stocks	Total
1970 - Year	2,099	403	713	3,245
First half	1,929	424	721	3,074
1971 - First half 1/	2,498	532	954	3,983
QI	2,790	505	769	4,063
QII e/	2,206	558	1,138	3,902
June e/	2,300	700	900	3,900
July e/	1,500	500	2,000 1/	4,000
August e/	1,700	500	800	3,000

1/ Including $1.375 billion of AT&T preferred stock.
e/ Estimated.

As in the corporate market, the summer months are expected to bring some tapering of the volume of tax-exempt debt offerings. Current interest rate levels are undoubtedly restricting sales of some revenue bonds and issues by lower-rated borrowers. But even with a somewhat reduced volume of offerings, a significant decline in yields is not likely to occur unless bank acquisitions increase; commercial bank purchases have been slackening in recent weeks and still appear to be mainly in the shorter maturities.

STATE AND LOCAL GOVERNMENT OFFERINGS
(Monthly or monthly averages in millions of dollars)

1970 - Year	1,515
First half	1,306
1971 - First half e/	2,089
QI	2,230
QIIe/	1,965
June e/	1,939
July e/	1,800
August e/	1,700

e/ Estimated.

Government securities market. Yields in the Treasury note and bond market have increased only moderately in the wake of the rise in the discount rate, with long-term rates moving about 10 basis points higher and intermediate-term yields gaining about 15 basis points. In the Treasury bill market, rate increases have been more pronounced, ranging from 10 to about 25 basis points--the 3-month bill is now bid at about 5.50 per cent, compared with 5.38 per cent just before the discount rate change and 5.22 per cent at the end of June.

MARKET YIELD ON U. S. GOVERNMENT AND AGENCY SECURITIES
(Per cent)

	1971		Weekly average for week ending			
	Daily highs 1/	Daily lows 1/	June 29	July 6	July 13	July 20
Bills						
1-month	5.33 (7/19)	2.07 (3/12)	4.75	5.07	5.19	5.25
3-month	5.53 (7/19)	3.22 (3/11)	4.93	5.32	5.37	5.45
6-month	5.77 (7/19)	3.35 (3/11)	5.15	5.49	5.50	5.63
1-year	5.84 (6/30)	3.45 (3/11)	5.69	5.76	5.60	5.70
Coupons						
3-year	6.78 (7/19)	4.27 (3/22)	6.56	6.74	6.64	6.68
5-year	6.88 (7/19)	4.74 (3/22)	6.68	6.83	6.74	6.79
7-year	6.93 (7/19)	5.15 (3/23)	6.78	6.91	6.84	6.86
10-year	6.73 (6/15)	5.38 (3/23)	6.63	6.69	6.64	6.65
20-year	6.56 (6/15)	5.69 (3/23)	6.45	6.42	6.35	6.32
Agencies						
6-month	6.05 (7/20)	3.67 (3/16)	5.73	5.83	5.89	5.94
1-year	6.47 (7/20)	3.93 (3/16)	6.22	6.34	6.35	6.40
3-year	7.12 (7/9)	4.70 (3/24)	6.96	7.10	7.11	7.09
5-year	7.34 (7/7)	5.12 (3/23)	7.18	7.33	7.30	7.26

1/ Latest dates of high and low rates in parentheses.

Prior to the discount rate increase, yields in the coupon sector of the Treasury market had edged lower from their advanced level reached in late June. Final investor demand was reportedly fairly active, and with dealer inventories other than in rights relatively low in anticipation of the August financing, prices were pushed higher. The terms of the refunding, to be announced July 21, will be outlined in the supplement.

DEALER POSITIONS IN GOVERNMENT AND AGENCY SECURITIES
(In millions of dollars)

	June Daily average	June 28	July 2	July 12	July 19
Treasury securities					
Total	2,733	2,569	2,635	2,736	2,843
Treasury bills (total)	2,207	2,042	2,262	2,374	2,348
Due in 92 days or less	541	397	749	773	939
93 days or over	1,666	1,645	1,513	1,601	1,409
Treasury notes and bonds (total)	526	527	373	363	495
Due within 1-year	268	327	311	337	500
1-5 years	116	144	13	16	18
Over 5 years	142	57	48	9	-23
Agency securities					
Total	777	676	794	881	775
Due within 1-year	386	317	333	425	404
Over 1-year	391	359	461	456	371

Treasury bill rates were marked higher in late June as market participants adopted a cautious attitude in the fact of uncertainty about the eventual level of the prime rate and about a possible rise in the discount rate. In addition, large foreign official sales of bills weighed heavily on the market in an atmosphere of relatively lackluster demand. As some of these factors abated, or -- as in the case of foreign official activity--were reversed, the market firmed somewhat until the recent increase in the Federal funds and discount rates.

In the market for Federal agency securities, issues since the last meeting of the Committee have raised a net total of about \$1.0 billion in new money, compared with a net repayment of \$0.2 billion in the preceding four weeks, and with a monthly average repayment of \$0.1 billion over the first five months of the year. This amount included \$400 million of an \$850 million FNMA financing at the end of June; and a Federal Home Loan Mortgage Corporation offering of \$150 million of 27-month notes and \$150 million of 25-year bonds. The latter were priced to yield 7.75 per cent and were reportedly very well received by the market.

Other short-term credit markets. Interest rates on short-term instruments in the private credit markets were generally unchanged to 1/8 of a percentage point higher between late June and mid-July. Three-month commercial paper was yielding 6.00 per cent at mid-month--the same as the new prime rate at commercial banks--while in late June the commercial paper rate had been 38 basis points above the 5-1/2 per cent prime rate. The spread between Treasury bills and commercial paper in the 3-month area was about unchanged during the first half of July--at around 65 basis points--before bill rates started adjusting to the discount rate hike.

Total commercial and finance company paper outstanding declined about \$700 million in June (seasonally adjusted) following a \$400 million drop in May. The change in nonbank related paper accounted for almost all of the decline. During the first half of 1971, total commercial and finance company paper fell by $3.5 billion to a level of just over $30.0 billion.. Bank-related paper declined $0.6 billion on balance to $1.7 billion over this period. Dealer-placed commercial paper dropped by $1.7 billion, while finance company paper declined by $1.2 billion.

COMMERCIAL AND FINANCE COMPANY PAPER
(End-of-month data, in millions of dollars)

	Peak values	1971		
	May 1970	April	May	June
Total commercial and finance paper 1/	39,318	31,163	30,730	30,013
Bank related 2/	7,600 4/	1,794	1,748	1,733
Nonbank related 3/	31,718	29,369	28,982	28,280
Placed through dealers	12,686	12,448	12,422	11,577
Placed directly	19,032 5/	16,921	16,560	16,703
		Net Change from Previous Month		
Total commercial and finance paper 1/		+209	-433	-717
Bank related 2/		+102	- 46	- 15
Nonbank related 3/		+107	-387	-702
Placed through dealers		-432	- 26	-845
Placed directly		+539	-361	+143

1/ Combines seasonally adjusted nonbank-related paper and seasonally unadjusted bank-related paper.
2/ Seasonally unadjusted.
3/ Seasonally adjusted.
4/ This component showed a peak of $7,820 in July 1970.
5/ This component showed a peak of $19,112 in April 1970.

SELECTED SHORT-TERM INTEREST RATES
(Wednesday Quotation--Discount Basis)

	1970		1971			Net change
	High	Lows	June 30	July 7	July 14	June30-July14
1-month						
Commercial paper	9.25	5.50	5.50	5.62	5.62	+.12
Finance paper	9.00	5.00	3.38	5.50	5.38	--
Bankers' acceptances	9.00	5.50	5.75	5.75	5.75	--
Certificates of Deposit--new issue 1/	7.75	5.00	5.25	5.38	5.38	+.13
Treasury bill	7.84	4.58	5.02	5.22	5.19	+.17
3-month						
Commercial paper	9.25	6.00	5.88	5.88	6.00	+.12
Finance paper	8.25	5.50	5.38	5.50	5.50	+.12
Bankers' acceptances	9.00	5.50	5.88	6.00	5.88	--
Certificates of Deposit--new issue 1/	6.75	5.50	5.50	5.62	5.62	+.12
Treasury bill	7.93	4.74	5.22	5.42	5.35	+.13
6-month						
Bankers' acceptances	9.00	5.50	6.00	6.13	6.00	--
Treasury bill	7.99	4.78	5.42	5.53	5.46	+.04
12-month						
Certificates of Deposit--new issue 1/	7.50	5.50	6.00	6.00	6.00	--
Treasury bill	7.62	4.74	5.84	5.65	5.56	-.28
Prime municipal notes	5.80	2.95	3.50	3.55	3.45	-.05

1/ Investment yield basis. Highs for certificates of deposit are ceilings effective as of January 21, 1970.

Source: Wall Street Journal's Money Rates for commercial and finance paper and bankers' acceptances; all other data from the Federal Reserve Bank of New York.

Federal finance. With the exception of the draft (and volunteer army) bill, which now calls for somewhat less spending than the staff had assumed ($900 million less, at annual rate) and the date of passage of which is still uncertain, there have been no recent significant fiscal policy changes that have affected staff estimates of receipts and expenditures. The recently passed public service jobs bill had already been allowed for in staff estimates. Our expenditure figures still include some provision for additional social security benefits beginning with calendar 1972, although Congressman Mills' proposed welfare and social security reform bill (HR-1) only provides for additional benefits as of July 1972.

However, as a result of the recent OBE regular annual revision of the income and product accounts for prior periods, staff projections of receipts and expenditures on an NIA basis have been significantly revised since the last Greenbook, to conform to the revised estimates of the current periods which serve as the jumping off point for the projections. A comparison of the staff's current and prior NIA projections is presented in the Table below.

The Commerce Department revisions lowered estimates of both Federal receipts and expenditures for prior periods, and the revised staff figures for FY 1971 and FY 1972 are correspondingly lower. Most of the lowering of the staff's receipts figures reflect a downward revision on the level of corporate profits tax accruals and in personal receipts. Expenditures were revised downward less than receipts so that the estimated deficit for fiscal 1971 and the projected deficit for fiscal 1972 are now a little larger. While figures for purchases of goods and services were lowered for fiscal years 1971 and 1972, figures for transfer payments to individuals in FY 1971 and to State and local governments in both fiscal years were revised upward somewhat, resulting in a small net reduction in expenditure figures.

Comparison of Actual and High Employment NIA Budget Figures, Before and After OBE Revision of the GNP Data*
(Billions of dollars)

	F. R. Board Staff Estimates (SAAR)					
	Fiscal 1971		Fiscal 1972		Calendar Year 1971	
	6-25 Greenbook	Current Greenbook	6-25 Greenbook	Current Greenbook	6-25 Greenbook	Current Greenbook
Surplus/deficit	-16.7	-19.2	-19.0	-24.6	-18.8	-22.0
Receipts	196.8	193.3	216.8	208.9	205.5	199.8
Expenditures	213.5	212.5	235.8	233.4	224.3	221.8
High employment*						
Surplus deficit	- .2	1.4	-.4	2.6	-.4	2.9

* The staff's high employment estimates use the Okun method for price deflation.

The revision of NIA statistics also affected the staff estimate of the high employment budget, as shown in the accompanying table. Federal expenditures were revised downward. High employment GNP and high employment Federal receipts were revised upward as a result of an upward revision of the price deflator for past periods.

The result of these revisions, caused by the OBE revisions, is a shift from estimated high employment deficits of negligible amounts to significant surpluses. The revised staff estimate now also indicates a small positive change in the high employment balance from fiscal 1971 to fiscal 1972 as a result of minor revisions in fiscal assumptions. Estimates of the high employment budget used by the OMB and by the CEA differ from the staff's estimates because of differences in accounting for price trends, the use of unified budget rather than NIA basis, and other differences in assumptions and procedures.

The unified budget deficit for FY 1972 is now estimated by the staff to be $23.4 billion. Newspaper reports indicate that the Joint Committee on Internal Revenue Taxation is projecting a deficit of $23.1 billion, and that the Office of Management and Budget is speaking in terms of a deficit of $20 and $25 billion or even as high as $35 billion. On the basis of present Administration programs and Congressional action, the staff knows of no justification for estimates as high as the latter figure.

The lawsuit against the Treasury's liberalized depreciation regulations may be reducing the anticipated impact of that measure. Many observers, despite the high actual projections of the budget deficit, are urging various quick-acting, self-limiting stimulative fiscal measures. At least two bills have been introduced that propose the adoption, retroactive to January 1, 1971, of tax relief measures that had been scheduled for 1972 and 1973--the increase in personal exemptions, increases in the standard deduction, and imposition of a 50 per cent ceiling rate on earned income. Other proposals, made at hearings of the House Ways and Means Committee, include special emergency grants to states and localities, extension of the unemployment benefit period, postponement of the scheduled increase in the social security wage base, and the unfreezing of certain appropriated funds.

The present cash balance projections assume no new financing, except for the already-scheduled increases in weekly 3-month bill offerings, until August 16, when net new money of $2.5 billion is expected. However, borrowing of this size would give an unusually low estimate--$4.4 billion--for the end-of-August balance.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	June	July	Aug.
Total net borrowing	-.2	4.2	2.6
Weekly and monthly bills	.1	.5	.1
Tax bills	-2.5	--	--
Coupon issues	2.3	1.8	3.1
As yet unspecified new borrowing	--	--	--
Other (debt repayments, etc.)	-.1	1.9	-.6
Plus: Other net financial sources[a/]	-1.1	-.2	-.4
Plus: Budget surplus or deficit (-)	3.2	-7.7	-2.9
Equals: Change in cash balance	1.9[b/]	-3.7	-.7
Memoranda: Level of cash balance, end of period	8.8[b/]	5.1	4.4
Derivation of budget surplus or deficit:			
Budget receipts	22.9	13.0	16.1
Budget outlays	19.7	20.7	19.0
Maturing coupon issues held by public	--	--	4.1
Net agency borrowing	.3	.6	.2

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

FEDERAL BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS 1/
(In billions of dollars)

	Fiscal 1971e/		Fiscal 1972e/		F.R. Board Staff estimates						
					Calendar Year	Calendar Quarters					
						1971				1972 e/	
	Jan. Budget	F.R. Board	Jan. Budget	F.R. Board	1971e/	I*	IIe/	IIIe/	IVe/	I	II
Federal Budget											
(Quarterly data, unadjusted)											
Surplus/deficit	-18.6	-22.2	-11.6	-23.4	-28.5	-8.2	2.4	-10.7	-12.0	-8.4	7.7
Receipts	194.2	188.8	217.6	210.6	194.1	44.1	57.1	48.7	44.2	50.8	66.9
Outlays	212.8	211.0	229.2	234.0	222.5	52.2	54.7	59.4	56.2	59.2	59.2
Means of financing:											
Net borrowing from the public	17.6	19.6	10.6	21.4	25.1	1.6	1.7	6.9	14.9	4.6	-5.0
Decrease in cash operating balance	n.a.	-.8*	n.a.	1.3	.1	3.6	-4.3	2.9	-2.1	1.8	-1.3
Other 2/	n.a.	3.4	n.a.	.7	3.2	2.9	.2	.9	-.8	2.0	-1.4
Cash operating balance, end of period	n.a.	8.8*	n.a.	7.5	8.0	4.5	8.8	5.9	8.0	6.2	7.5
Memo: Net agency borrowing 3/	n.a.	1.8	n.a.	n.e.	2.1	-1.0	-0.3	1.3	2.0	n.e.	n.e.
National Income Sector											
(Seasonally adjusted annual rate)											
Surplus/deficit	-15.0	-19.2	-4.2	-24.1	-21.8	-18.5	-22.3	-23.1	-23.4	-26.6	-23.4
Receipts	200.0	193.3	225.9	209.3	199.9	194.7	197.8	201.0	206.2	211.8	218.2
Expenditures	215.0	212.5	230.1	233.4	221.8	213.2	220.1	224.1	229.6	238.4	241.6
High employment surplus/deficit (NIA basis) 4/	n.a.	1.4	n.a.	2.6	2.9	2.5	1.7	3.3	4.0	.6	2.8

* Actual e--projected n.e.--not estimated n.a.--not available

1/ Reflects effects of total additional depreciation allowable under Treasury's newly-approved "accelerated depreciation range" guidelines, which are effective as of the beginning of 1971.

2/ Includes such items as deposit fund accounts and clearing accounts.

3/ Federally-sponsored credit agencies, i.e., Federal Home Loan Banks, Federal National Mortgage Assn., Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.

Footnote

continued

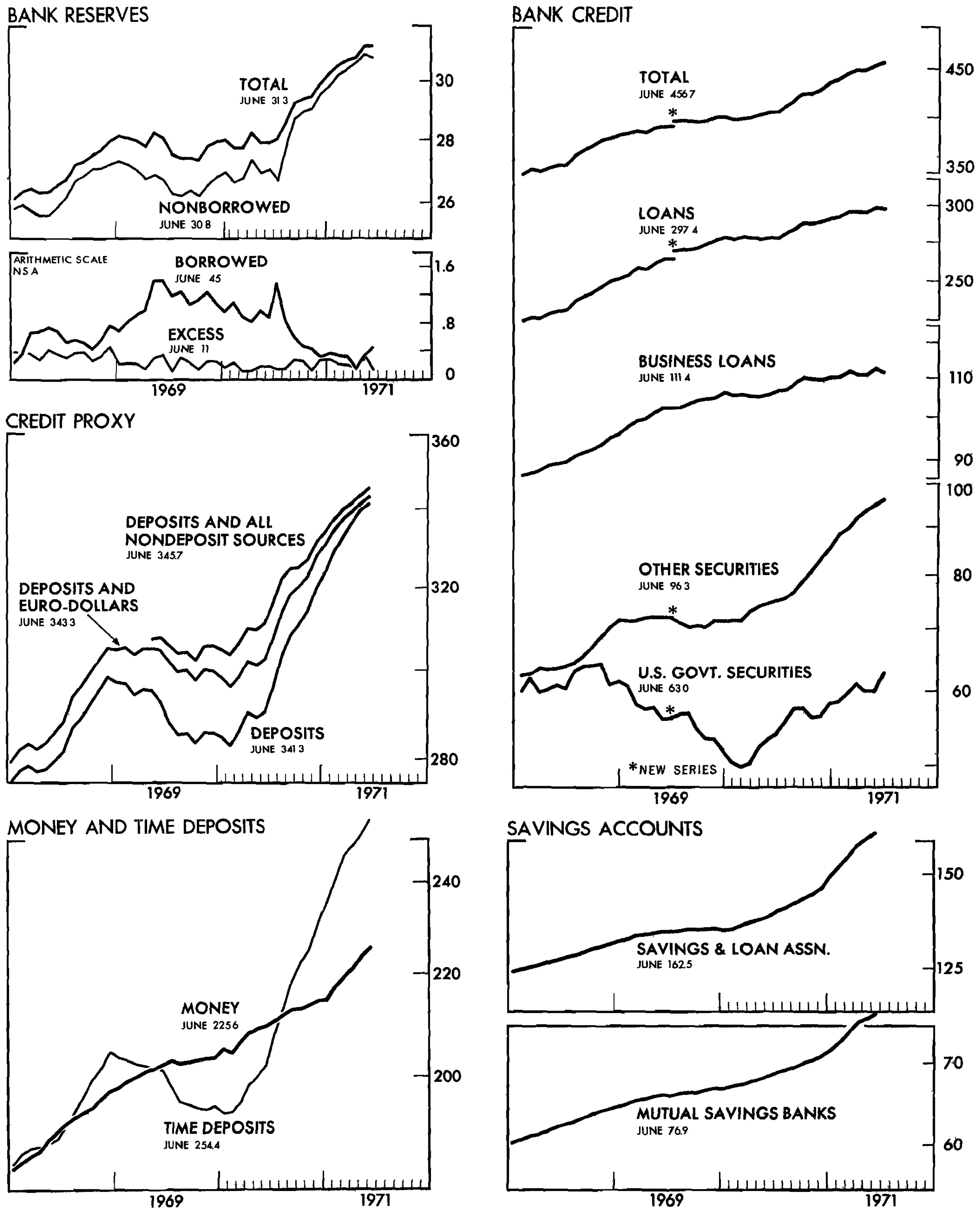
FEDERAL BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS[1/]

(In billions of dollars)

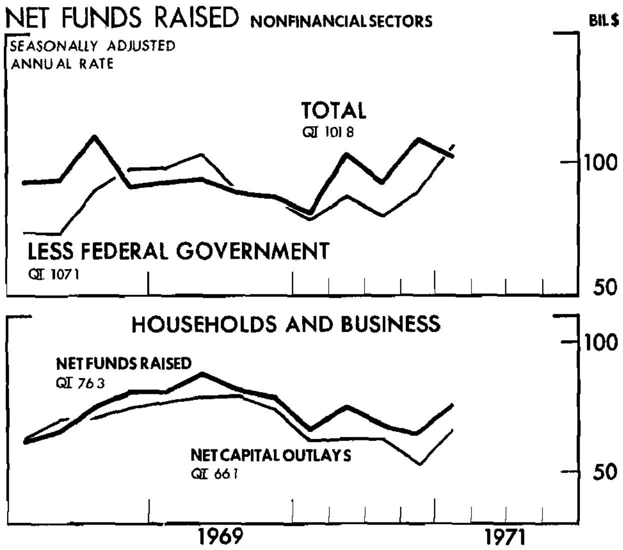
4/ Estimated by Federal Reserve Board Staff. The level of the estimated series shown here differs considerably from the estimates by the Council of Economic Advisers.

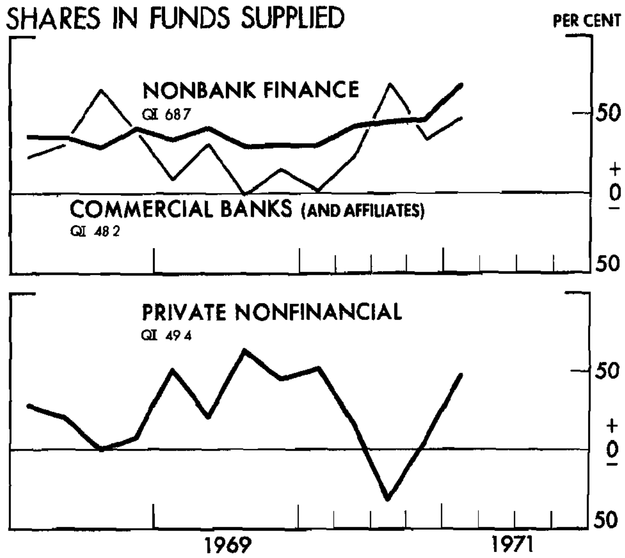
FINANCIAL DEVELOPMENTS - UNITED STATES

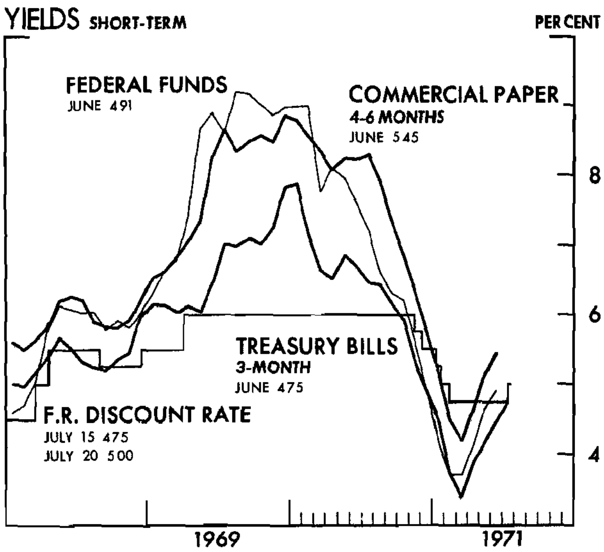
BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

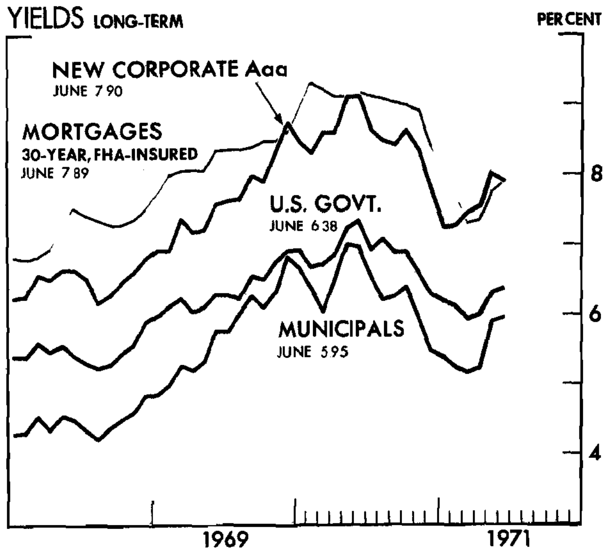


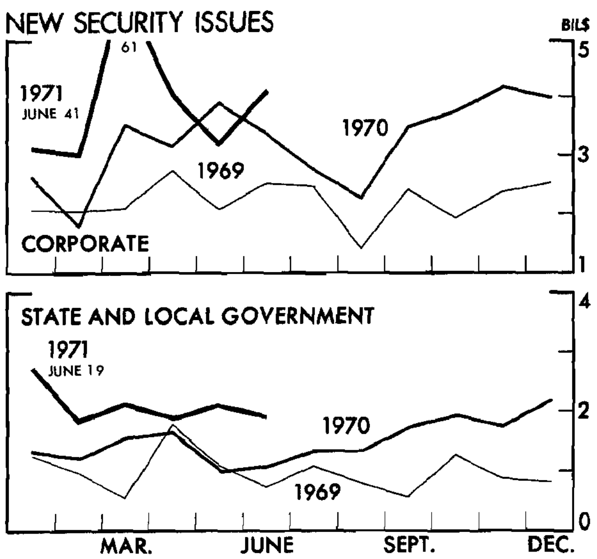
FINANCIAL DEVELOPMENTS - UNITED STATES

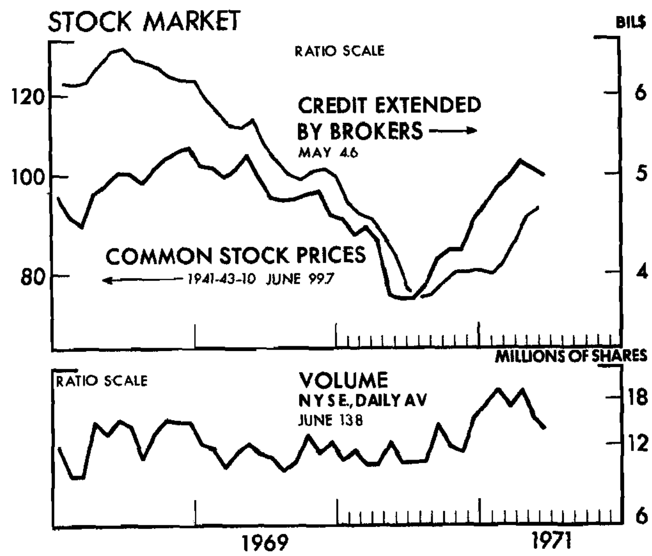












THE ECONOMIC PICTURE IN DETAIL

International Developments

U.S. balance of payments. Preliminary data indicate that the adjusted liquidity deficit in the second quarter[1/] was about $5-3/4 billion, seasonally adjusted. Monthly figures, not seasonally adjusted, show large deficits in April and especially May, followed by a moderate surplus in June which reflected quarter-end repatriations of funds by U.S. corporations in compliance with the controls on direct investments abroad. There was a large deficit in the first week of July as the window-dressing was reversed.

The liquidity deficit in the second quarter was about $2-3/4 billion larger than the first-quarter deficit. Nearly half of this worsening resulted from a deterioration in our trade balance -- from a surplus of $300 million in the first quarter to a deficit of about $1 billion in the second quarter, as described below. The remainder of the worsening was mainly in capital flows influenced by expectations of exchange rate changes. A major element contributing to the larger second quarter deficit was an increase in bank-reported claims on foreigners, much of which occurred during early May.

1/ Measured by financing items: changes in reserve assets, all liabilities to foreign official reserve agencies, and liquid liabilities to commercial banks and other foreigners.

Foreign purchases of new issues sold abroad by U.S. corporations to finance their foreign investments were markedly lower than the high level of sales recorded in the first quarter, while purchases of U.S. corporate stocks probably were down from the already-low first quarter amount.

These identified transactions account for about 80 per cent of the increase in the adjusted liquidity deficit. It seems likely that there was also a further increase in the large negative errors and omissions item.

On the official settlements basis, the seasonally adjusted deficit in the second quarter is estimated to have been about $6 billion, only slightly higher than in the first quarter. Whereas in the first quarter net repayments of liabilities to banks abroad had amounted to $3 billion, in the second quarter there was a decrease of only about $1/4 billion in such liabilities. This improvement offset most of the worsening in trade and other capital transactions.

The deficit on the official settlement basis for the second quarter -- estimated at $6.4 billion before seasonal adjustment -- was financed by an increase of about $5.6 billion in liabilities to foreign official reserve holders and a decline of $.8 billion in U.S. monetary reserves. The first quarter deficit on this basis had amounted to $5.4 billion; liabilities to foreign official institutions had increased $4.5 billion while U.S. monetary reserves declined $.9 billion.

Although the total decline in monetary reserves was about the same in both quarters, gold and SDR sales were larger in the second quarter when there was a large sale of gold to France for payment to the IMF. U.S. reserve holdings of convertible currencies declined in the first quarter, reflecting principally British repurchases of guaranteed sterling, and rose slightly in the second. The U.S. reserve portion in the Fund declined in both quarters.

Changes in liabilities to foreign official reserve holders are shown in the table. Germany's reserve holdings in this country increased by about $3 billion in April and May, but declined by more than $2 billion in June.

INCREASES IN LIABILITIES TO FOREIGN OFFICIAL INSTITUTIONS
(In billions of dollars)

	Q-1	Q-2 1/
Germany	2.0	.7
United Kingdom	1.0	1.6
Japan	1.0	1.8
	4.0	4.1
Other Western Europe 2/	1.0	1.5
Canada	.1	.1
All other	-.6	-.1
Total	4.5	5.6

1/ Partly estimated.
2/ Includes Bank for International Settlements.

<u>U.S. foreign trade</u>. Partial data indicate another large trade deficit in June -- the third successive month in which imports have exceeded exports. Imports in June are estimated to have been about equal to the high May value, while exports appear to have declined moderately. For the second quarter, it is estimated that the trade balance was a deficit of almost $1 billion (balance of payments basis) -- i.e., $3-1/2 billion, annual rate. This compares with a surplus at an annual rate of $1.1 billion in the first quarter, and is about twice as large as the deficit projected for the second quarter at the time of the last Committee meeting.

The emergence of a heavy trade deficit in the second quarter resulted from a very sharp acceleration in the rate of expansion of imports, while exports fell back after a bulge in the first quarter.

U.S. EXPORTS AND IMPORTS
(per cent changes from preceding periods)

	1970				1971	
	1Q	2Q	3Q	4Q	1Q	2Q[e]
Exports	+3.5	+3.2	+1.8	-2.4	+5.3	-2.7
Imports	+3.5	+1.0	+1.8	+3.2	+4.1	+8.4

e/ Includes estimates for June.

The recent upsurge in imports far outpaces the rise in domestic economic activity; the ratio of imports to GNP is estimated to have risen to over 4.5 per cent in the second quarter compared with 4.2

per cent in the first quarter. This strength in imports appears to be attributable only in part to such temporary factors as hedgebuying of steel and aluminum, advance shipments prior to the imposition of "voluntary" restrictions by foreign countries on exports to the United States, and perhaps accelerated purchases in anticipation of an East Coast dock strike threatened for October. Whether the current dock strike at West Coast ports was a factor in the extremely heavy arrivals of cars and other products from Japan in the second quarter is hard to judge, since slack demand within the Japanese economy would tend to produce the same result. There is no indication from the data on copper imports in April-May to suggest much buying of imported copper in advance of the present work stoppage in that industry.

Commodity details for June are not available. In April-May, the strong increase in imports included not only a further advance in automobiles, and other nonfood durable consumer goods of all types -- the major categories accounting for the import rise in the first quarter-- but also a decided pickup in arrivals of foodstuffs and industrial materials. There was a very sharp increase in arrivals of petroleum attributable to the easing in tanker rates and to more liberal quotas. Imports of lumber and plywood also advanced as housing starts remained high and domestic production turned up. Steel imports in April-May were high, but no higher than in the first quarter. Heavy coffee arrivals are believed to reflect, to some degree, early purchases in anticipation of a possible dock strike this fall.

The decline in exports in April-May brought them back down to only slightly above the average level (in value) of the second half of 1970. The decline, particularly in machinery and industrial materials, can be attributed in part to the slowing in growth of economic activity abroad. In addition, as indicated in the last Green Book, the U.S. share of world trade in manufactured goods declined further in the first quarter.

Shipments of agricultural commodities peaked in the first quarter and the April-May decline in such exports reflects prospects for better harvests abroad, and possibly a shortage in U.S. supplies of raw cotton, for which world demand is relatively strong. A further decline in exports of agricultural commodities is anticipated. Deliveries of commercial aircraft in April-May were unexpectedly strong, holding at the very high first quarter level, but June exports are estimated to have fallen off sharply. Schedules call for a much lower rate of aircraft deliveries in the second half of the year.

Since total exports are no longer being buoyed up by rising shipments of agricultural commodities and commercial aircraft, the projected improvement in U.S. exports during the remainder of the year rests on the hope of a much more decided expansion in growth abroad, especially in Canada and Japan, than has been displayed so far this year.

Euro-dollar market. The spread between interest rates in the United States and the Euro-dollar market (except that for day-to-day money) narrowed further between late June and the third week of July, as Euro-dollar rates continued to recede from their 1971 peak levels reached in the midst of foreign exchange market speculation in early May.

One- and three-month Euro-dollar rates have declined to about 6 and 6-1/4 per cent, respectively, in recent days, reducing the excess of these rates over the cost of domestic CD funds to U.S. banks to about 1/4 to 1/2 per cent (compared to excess costs of more than 2 per cent on average in late May and early June). Before the quarter-end a large amount of the funds moving out of German marks was apparently going temporarily into the over-night Euro-dollar market -- where rates averaged about 1/2 per cent below the Federal funds rate in the three weeks through June 30. Since the quarter-end the overnight Euro-dollar market has firmed and rates have been about equal to or slightly above the Federal funds rate on average.

SELECTED EURO-DOLLAR AND U.S. MONEY MARKET RATES

Average for month or week ending Wednesday	(1) Over-Night Euro-$1/	(2) Federal Funds2/	(3)= (1)-(2) Differential	(4) 3-month Euro-$ Deposit1/	(5) 60-89 day CD rate (Adj.)3/	(6) (4)-(5) Differential
1971						
Jan.-Mar.	4.68	3.87	0.81	5.52	4.41	1.11
April	5.05	4.15	0.90	5.92	4.41	1.51
May	8.52	4.63	3.89	7.04	4.97	2.07
June	4.89	4.91	0.02	7.15	5.47	1.68
June 16	4.64	4.89	-0.25	7.19	5.41	1.78
23	4.50	4.97	-0.47	6.99	5.66	1.33
30	4.40	5.07	-0.67	6.80	5.66	1.14
July 7	5.04	5.18	-0.14	6.61	5.79	0.82
14	5.25	5.13	0.12	6.41	5.79	0.62
21	5.43	5.43p	0.00p	6.31	5.79p	0.52p

1/ All Euro-dollar rates are noon bid rates in the London market; over-night rate adjusted for certain technical factors to reflect the effective cost of funds to U.S. banks.
2/ Effective rate.
3/ Offer rate (median, as of Wednesday) on large denomination CD's by prime banks in New York City; CD rate are adjusted for the cost of required reserves. p/ Preliminary.

Liabilities of U.S. banks to their foreign branches declined $0.8 billion to a total of $1.5 billion from June 23 to 30, in reaction to normal quarter-end positioning by various market participants, including repatriations by American companies under OFDI guidelines. These liabilities rose by about $0.6 billion in the following week; as of July 20 (the last date for which data are available as of this writing) these liabilities had declined to about $1.7 billion. Over the thirteen weeks of the second quarter -- from March 31 to June 30 -- liabilities to foreign branches plus branch holdings of special Ex-Im and Treasury securities showed little net change; U.S. banks' liabilities to other foreign banks showed a small net decline.

On the basis of partial data it is estimated that in the four week Euro-dollar reserve requirement computation period ended July 7 U.S. banks' Euro-dollar borrowings plus their foreign branches' holdings of special Ex-Im and Treasury securities averaged roughly $400 million <u>above</u> the previous four-week period. This increase in average positions probably reflected the favorable terms on which U.S. banks could obtain funds in the over-night Euro-dollar market during that four-week period. The increase need not have involved any increase in required reserves, as most banks had reserve-free bases in excess of liabilities to branches because of special security holdings.

<u>Foreign exchange markets</u>. Following several weeks of relative calm, the foreign exchange markets in July experienced renewed tensions, with the dollar weakening against most major foreign currencies. The Bank of France purchased $783 million in the first 16 days of July, mainly as a result of a flurry of speculation on a possible franc revaluation. The German mark advanced to a new high 5.6 per cent above parity, but the Bundesbank's dollar sales have slowed substantially from the June pace. The Japanese yen remained in excess demand at the ceiling rate, and the Bank of Japan purchased $566 million in the first three weeks of July. Several other European currencies also firmed sharply against the dollar.

The movement into francs appeared to be based upon speculation by some market participants that Germany and France might have reached some sort of agreement whereby new parities for the mark and the franc (as well as other EEC currencies) would be established prior to the adoption of a wider band for the EEC currencies as a group vis-a-vis the dollar, or that even if the franc were not revalued it would appreciate after the wider band was adopted. The Bank of France purchased just over $400 million in the week of July 12-16, but the franc subsequently slipped below its ceiling as speculative fervor abated, and the central bank has not intervened since July 16.

The German mark firmed very sharply after July 14 when the Bundesbank offered for the first time to sell dollars at a price lower than DM 3.50 (equivalent to a price for marks 4.6 per cent above parity). German authorities had apparently not been satisfied with the amounts of dollars they had been able to sell above the 3.50 level, in the face of some $2.1 billion coming into German reserves in July as forward contracts mature. As the Bundesbank raised its bid price for dollars, the market tended to move away from that rate, and the DM advanced as high as 5.6 per cent over par. At rates that high, the Bundesbank was unwilling to intervene, and has, in fact, sold only $230 million since it abandoned the 3.50 intervention rate. Forward contract maturities this month up to the 20th have been $1-1/4 billion and spot sales $1.0 billion.

Other European currencies, particularly the guilder and the Swiss franc, firmed in sympathy with the mark. The Belgian franc moved to its ceiling, possibly reflecting some spillover of the speculation in Franch francs, and the National Bank purchased some $40 million. Sterling held fairly steady in the mid-241.30's, and the Bank of England has not intervened in the spot market so far this month.

In official transactions this month, the System drew $40 million equivalent on the swap facility with the National Bank of Belgium, raising outstanding indebtedness on that line to $380 million. The U.S. Treasury sold $100 million equivalent of SDRs to the Netherlands and $50 million equivalent of gold to Switzerland.

In August the U.K. and France will be repaying $638 million and $600 million equivalent, respectively, to the IMF. France has already notified the U.S. Treasury of its intention to purchase the $191 million in gold required for its Fund repayment. Both Britain and France will have to obtain large quantities of various foreign currencies by direct purchase (for dollars) from foreign central banks, and it is likely that some of those banks will demand U.S. reserve assets in exchange for their increased dollar holdings.

Reserves and payments balances of major industrial countries. The main industrial countries outside the United States, taken as a group, continued to increase their official reserves at a very rapid rate in the first four months of this year, even before the large speculative inflows of May. Nine European countries, together with Canada and Japan, recorded increases in net official reserves totalling $6.4 billion (excluding SDR allocations). This figure rises to $8.4 billion after adjustment for the effects on reserves of the unwinding early in January of year-end repatriations by Swiss and German banks. Germany accounted for nearly one-half of the adjusted total.

The magnitude of the reserve gains of countries other than Germany may have contributed marginally to the foreign exchange crisis of early May which centered mainly on the exchange rate of the German mark against the dollar. Because of the persistent balance of payments deficit of the United States, and continued nervousness about the dollar, these countries' large combined reserve gains may have led to more speculative purchases of German marks and certain other currencies than otherwise would have been the case, thereby intensifying the immediate pressures on the exchange rates of these currencies.

Conditions in Germany itself, however, far more than any general weakness of the dollar, were the underlying cause of the German government's decision to float the mark on May 9. Heavy reserve gains -- $3 billion in January-April -- stemming mostly from foreign borrowing by German business enterprises, blunted the effectiveness of Germany's anti-inflationary monetary policy. When reserve gains were further swollen by massive speculative and hedging inflows in early May the German authorities felt that control over monetary conditions would be intolerably difficult. The Netherlands, Belgium, and Switzerland also experienced heavy speculative inflows in early May. These countries, along with Austria, were greatly affected by the German exchange rate action because their imports from Germany are large in relation to the total supply of goods and services in their economies. It was the inflow of private capital to Germany that, by inducing the floating of the mark, was the dominant

CHANGES IN OFFICIAL NET FOREIGN ASSETS 1/
(in millions of dollars; no sign = increase)

	1970		1971				
	Year	First Half	I	II	Apr.	May	June
France	1,819	1,044	325	591	47	446	98
Germany	5,965	1,651	2,095	799	867	2,168	-2,236
Italy	392	-651	563	21	174	-82	-71
United Kingdom	2,822	2,351	1,460	-8p	-62	-53	107p
Belgium	385	141	155	113	16	203	-106
Netherlands	617	65	230	-56	-155	146	-47
Sweden	4	-85	74	101	45	18	38
Canada	1,608	1,218	54	8	9	24	-25
Japan	1,008	282	803	1,992	245	1,069	678
Total for G-10 countries excluding United States	14,620	6,016	5,759	3,561	1,498	3,697	1,524
Switzerland	689	-48	-489	560	-53	162	451

1/ Excluding SDR allocations
p - Preliminary
Source: Confidential BIS data

factor touching off a floating of the Dutch guilder and revaluations of the Swiss and Austrian currencies by 7.07 and 5.05 per cent, respectively.

The major implications of the events of May for payments balances of the leading industrial nations cannot be seen at this time, if only because of the uncertainty over the future exchange rate levels of the mark and the guilder. In Germany, where the floating (but

BALANCE OF PAYMENTS SURPLUSES AND DEFICITS1/
(in millions of dollars; no sign = surplus)

	1970		1971			
	Year	First Half	I	Apr.	May	June
France	1,370	1,305	121	159	n.a.	n.a.
Germany	3,799	914	3,320	1,145	1,745	-1,004p
Italy	403	-531	369	98	118	n.a.
United Kingdom	1,410	1,511	1,049	-434	301	n.a.
Belgium-Lux.	112	137	119	-24	79	n.a.
Netherlands	455	160	80	100	45	n.a.
Sweden	81	-37	49	75	34	n.a.
Canada	1,694	717	-430	-71	14	n.a.
Japan	615	7	609	421	1,183	693p
Total for G-10 countries excluding United States	9,939	4,183	5,286	1,469	n.a.	n.a.
Switzerland	1,083 2/	290	742	n.a.	n.a.	n.a.

1/ As measured by changes in net foreign assets of official institutions (except SDR allocations) and commercial banks.
2/ This figure probably overstates somewhat the size of the 1970 surplus. It is based partly on a reported rise of $394 million in the net foreign assets of Swiss banks. The statistical coverage of Swiss banks' foreign assets and liabilities was increased beginning in December 1970.
p - Preliminary
Source: Confidential BIS data and FR estimates

not freely floating) mark has risen to a premium of more than 5 per cent over the official parity, the Bundesbank has encouraged an outflow of funds; and some of the early-May speculative inflow into Swiss francs has been reversed. In other European countries, developments since the May crisis have been mixed. The United Kingdom and France have had further large reserve gains; in July there has been speculation on an appreciation of the French franc. But Italy, Belgium, and the Netherlands registered appreciable reserve declines in June, all for reasons not yet fully evident. Outside Europe, Japan has incurred very large reserve gains because of a rapidly growing trade surplus coupled with intense speculation on a yen revaluation in the past two and one-half months. The Canadian dollar, which has floated since June 1, 1970, has recently lost some strength.

Germany's balance of payments surplus in January-April was $4.4 billion as measured by the increase in official and commercial bank net foreign assets, and of this amount $4.1 billion was accounted for by recorded net short-term borrowing by German firms and positive net errors and omissions. The likelihood that the conduct of monetary policy would continue, in the immediate future, to be seriously hindered by capital inflows was a main source of expectations of an exchange rate adjustment. A second factor was the continued strength of the trade account and the consequent expectation that any decided slowing of economic expansion in Germany would mean the emergence of a big current account surplus. The trade surplus has not contracted despite the 1969 mark revaluation and boom conditions in Germany, and the current account as a whole was about in equilibrium in the first five months of this year. The trade surplus in January-April was $3.7 billion at a seasonally adjusted annual rate, and was 13 per cent greater than a year earlier.

Official reserve gains of $2.2 billion in the first five days of May preceded a temporary suspension of official foreign exchange transactions and the move to a floating rate. After the mark was allowed to float, there was no official intervention in the exchange market in May, but since the beginning of June the Bundesbank has offered dollars in the exchange market, at an increasingly attractive rate, in order to syphon liquid funds from the economy and deplete bank reserves. By July 20 the exchange rate of the mark was 28.77 cents, 5.3 per cent above parity. Official reserves fell $2.2 billion in June, certainly in reflection of an exodus of hedgers' and speculators' funds but also reflecting some repayments of earlier borrowings by German companies. In the first 20 days of July, reserves rose an estimated $250 million because Bundesbank spot dollar sales of $1.01 billion were exceeded by $1.26 billion of maturing forward purchases.

The Netherlands' overall surplus in the first four months was at a higher annual rate than in 1970 because an increase in the net capital inflow outweighed an increase in the current account deficit, which latter is now projected to exceed $400 million for 1971 as a whole. The dependence of the overall surplus on short- and long-term capital imports made Dutch officials believe the guilder was not undervalued. The decision to float the exchange rate can be viewed as a move to end disruptive speculative inflows and to offset some part of the price-raising effects of an appreciation of the mark. In May, reserves rose $340 million before the guilder was floated. Since then, the Netherlands Bank has not intervened in the exchange market, but has made deliveries of dollars on maturing forward contracts with Dutch banks. The exchange rate is currently about 2 per cent above the official parity.

The balance of payments of Belgium-Luxembourg has continued strong this year. Official net foreign assets rose $443 million in January-May (excluding SDR allocations), exceeding the balance of payments surplus by a wide margin because commercial banks were net importers of funds. In June official net foreign assets declined $106 million even though there were only a reported $12 million of central bank intervention sales; Belgium may have made a net payment to the Common Market Agricultural Fund. The speculative inflows of early May and the German and Dutch exchange rate actions induced the Belgians to revise the regulations pertaining to flows of funds through the official and free exchange markets. This move will prevent inward as well as outward net capital flows of any large size other than shifts in leads and lags, but will not reduce the overall surplus, which has been solely on current account.

In Switzerland the balance of payments surplus, already very large in 1970, increased further to $742 million in the first quarter.

The current account is believed to have been about in equilibrium, and the overall surplus has been the consequence of a large net capital inflow. The Swiss decision to revalue by 7.07 per cent, while essentially a defensive, anti-inflationary measure, was also justified on balance of payments grounds. In the past decade the overall balance of payments has been in surplus in most years. The May rise of $162 million in official net foreign assets was the net result of a speculative inflow of nearly $700 million early in May, the subsequent outflow of about $300 million of those funds, and the swapping out of $250 million to Swiss commercial banks to reduce their liquidity. In June the BNS had intervention losses of $100 million; official reserves rose solely because of quarter-end inward swaps, which were reversed in July.

The United Kingdom, France, and Italy were relatively little affected by the May crisis, but their balances of payments will benefit from the appreciations of other currencies. In Britain the balance of payments surplus increased sharply in the first quarter, to $1 billion as measured by the change in official and commercial bank net foreign assets and $1.5 billion as measured by the change in offical assets alone. Interest rate differentials favorable to short-term sterling assets as compared with Eurodollar deposits (on an uncovered basis) contributed to large short-term capital inflows, and positive errors and omissions were huge, totalling over $900 million. The current account remained in surplus ($185 million). The months April and May together showed a relatively minor deficit, but in June the Bank of England's intervention gains were about $600 million. Official net foreign assets rose only $107 million in June; the Bank of England apparently swapped out large amounts of dollars. The current account surplus in the second quarter was probably $400 to $500 million. The trade balance has not shown any clear trend this year.

The balance of payments of France showed a $280 million surplus in January-April, and official net foreign assets increased a further $544 million in May-June. In the first 20 days of July the Bank of France had intervention gains of $783 million, the franc being strengthened by rumors of an exchange rate appreciation which would appear to be highly unlikely despite the present state of the French external accounts. Since the third quarter of 1970 there has been a decided improvement in the trade balance notwithstanding a faster expansion of domestic economic activity, but the overall surplus has continued to be a product of capital inflows rather than a surplus on current account.

The Italian balance of payments has remained strong this year in the face of continuing strikes, social tensions, political uncertainties, and easing monetary conditions. The trade balance has not undergone any important change this year. A $585 million overall surplus in the first five months reflected both a continuing large net inflow of capital and a current account surplus that is still substantial (in 1970 it was over $800 million on the transactions basis). A recorded net capital inflow of $740 million in January-April presumably overstates the actual inflow, since it omits trade credits; for all of last year there was a net outflow on trade credits of over $650 million. In January-May Italian companies borrowed a further $540 million in the Euro-bond market and in Eurodollar bank loans. A drop in Italian official reserves in June reflected _inter alia_ a $61 million payment to the Common Market Agricultural Fund.

The rapidity with which _Japan's_ balance of payments surplus has increased this year has been striking. As measured by the change in official plus commercial bank net foreign assets, Japan recorded a surplus of $2.9 billion in the first half of this year, compared with an even balance a year earlier. A trade surplus (imports f.o.b., payments basis) of $2.86 billion was twice as large as in the first half of 1970, the rise in export receipts accelerating somewhat to 24 per cent and the increase in import payments falling sharply to only 9 per cent. Because of the slowdown in Japanese economic activity in the past year, seasonally-adjusted imports (customs basis) underwent an actual decline from the third quarter of 1970 to May 1971.

Speculation that the yen might be revalued, kindled by the anticipation and materialization of exchange rate changes in Europe, was the main factor in swelling the payments surplus to about $1.2 billion in May and $700 million in June. The long-term capital, short-term capital, and errors and omissions accounts produced net inflows of $760 million in May and $192 million in June, compared with a monthly average of about $40 million in the preceding four months. Net purchases of Japanese stocks by foreigners, which averaged $125 million a month in January-April, are reported to have risen to $208 million in May and were $130 million in June.

The rise of $678 million in official net foreign assets in June fell short of reported Bank of Japan intervention gains of over $1 billion, perhaps because of additional deposits of dollars by the Finance Ministry with Japanese commercial banks. When the Ministry resumed making such deposits last March it was thought they might amount to $800 million in the ensuing several months. Bank of Japan intervention gains were $566 million in the first 20 days of July.

Effective August 10, the Bank of Japan will abolish its preferential lending rates for export finance. The export finance rates will be raised in most instances, and unified at a level equal to the basic discount rate (currently 5.5 per cent).

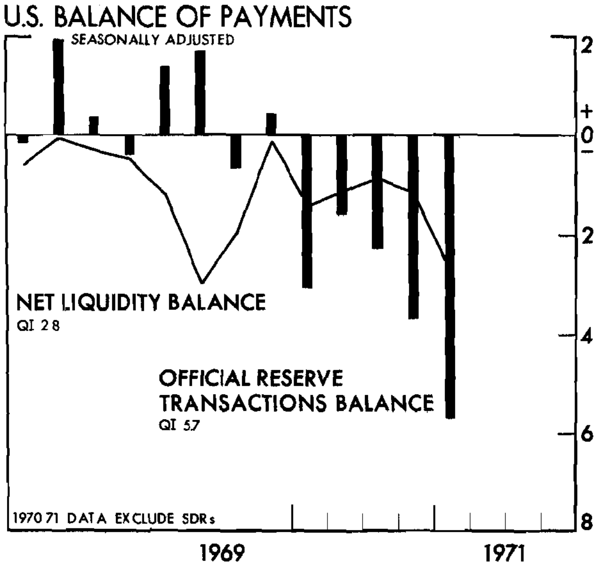
On July 1 Japan liberalized the regulations governing purchase of foreign shares and real estate by Japanese nationals. At the same time, to reduce Japan's bilateral trade surplus with the United States, the government instructed five major industries (autos, color TV sets, desk-type electronic calculators, iron and steel, and cosmetics) to restrain their exports to the United States and to adjust upward the prices charged to foreign buyers of most of these products.

The external position of <u>Canada</u> strengthened further in the early months of this year. The Canadian dollar rose on the exchange markets during the first quarter before levelling off at around 99 U.S. cents in April and May. The Bank of Canada moderated upward pressures on the rate by buying moderate amounts of U.S. dollars, mostly in February and in May. On a seasonally adjusted basis the trade surplus has declined somewhat from late 1970 levels but has remained very large by historical standards. Imports, which declined in the fourth quarter of 1970, picked up quite sharply during the first quarter of this year. The Canadian dollar exchange rate declined in June to around 97-3/4 U.S. cents but in recent days has advanced slightly to about 98 U.S. cents. The rate decline in June can probably be related in part to the presentation of a quite expansionary federal budget for fiscal 1972.

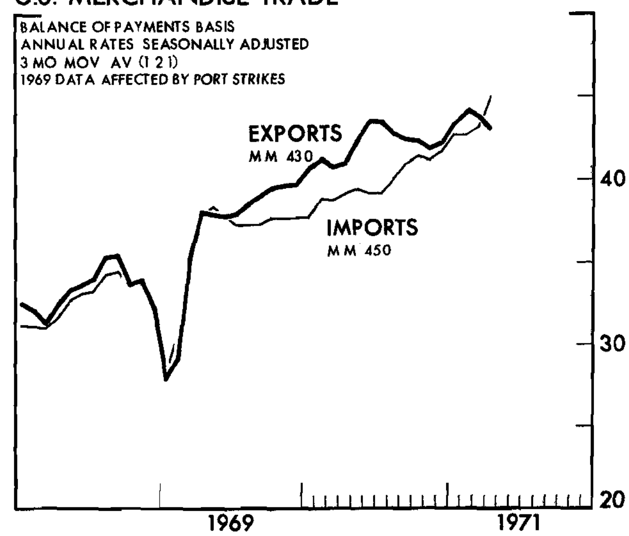
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

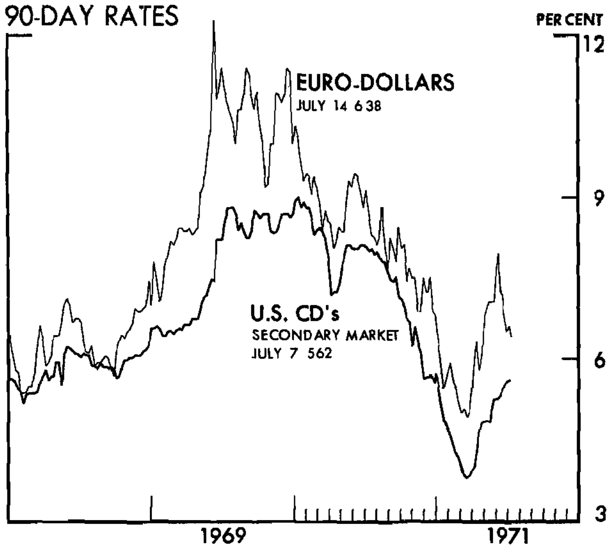
U.S. BALANCE OF PAYMENTS



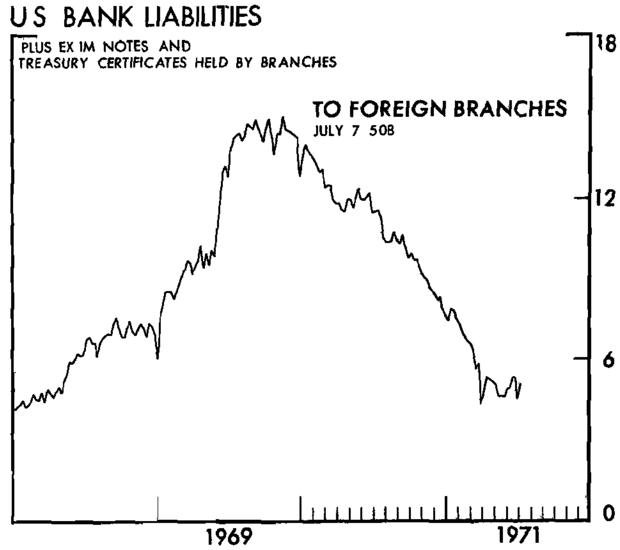
U.S. MERCHANDISE TRADE



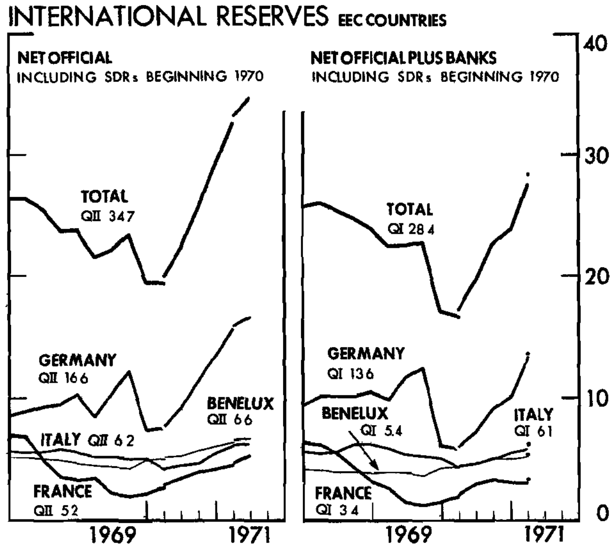
90-DAY RATES



U S BANK LIABILITIES



INTERNATIONAL RESERVES EEC COUNTRIES



INTERNATIONAL RESERVES OTHER COUNTRIES