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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

February 7, 1973

By the Staff
Board of Governors
of the Federal Reserve System

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DOMESTIC NONFINANCIAL SCENE

SELECTED DOMESTIC NONFINANCIAL DATA
AVAILABLE SINCE PRECEDING GREENBOOK
(Seasonally adjusted)

	Latest Data			Per Cent Change From		
	Period	Release Data	Data	Preceding Period	Three Periods Earlier	Year Earlier
				(At Annual Rates)		
Civilian labor force	Jan.	2/2	86.9	-4.8	-1.4	1.5
Unemployment rate	Jan.	2/2	5.0	5.1 1/	5.5 1/	5.9 1/
Insured unemployment rate	Dec.	1/18	3.2	3.1 1/	3.4 1/	3.8 1/
Nonfarm employment, payroll (mil.)	Jan.	2/2	74.2	3.2	3.4	3.7
Manufacturing	Jan.	2/2	19.4	1.2	4.6	4.8
Nonmanufacturing	Jan.	2/2	54.8	3.9	3.0	3.4
Private nonfarm:						
Average weekly hours (hours)	Jan.	2/2	36.9	37.1 1/	37.3 1/	37.0 1/
Hourly earnings ($)	Jan.	2/2	3.78	9.6	5.4	6.5
Output per manhour (1967=100)	Q IV	1/30	114.3	4.3	--	5.3
Compensation per manhour (1967=100)	Q IV	1/30	143.6	7.4	--	6.8
Unit labor cost (1967=100)	Q IV	1/30	125.7	3.0	--	1.4
Manufacturing:						
Average weekly hours (hours)	Jan.	2/2	40.2	40.7 1/	40.7 1/	40.1 1/
Unit labor cost (1967=100)	Dec.	1/30	119.3	-6.0	-1.0	1.2
Industrial production (1967=100)	Dec.	1/15	119.3	9.1	11.0	10.4
Consumer goods	Dec.	1/15	127.9	11.4	11.3	8.4
Business equipment	Dec.	1/15	110.4	15.4	13.9	12.7
Defense & space equipment	Dec.	1/15	79.4	0.0	8.8	5.0
Materials	Dec.	1/15	121.1	5.0	6.7	11.7
Consumer prices (1967=100)	Dec.	1/23	127.2	2.6	3.2	3.4
Food	Dec.	1/23	126.3	0.0	5.1	4.8
Commodities except food	Dec.	1/23	120.7	-3.0	1.0	2.5
Services 2/	Dec.	1/23	135.4	4.4	3.9	3.6
Personal income ($ bil.) 3/	Dec.	1/18	983.4	9.5	15.5	10.4
				(Not at Annual Rate)		
Mfrs. new orders dur. goods ($ bil.)	Dec.	2/2	37.3	-0.9	1.1	20.2
Capital goods industries:	Dec.	2/2	11.7	-0.2	-0.9	18.3
Nondefense	Dec.	2/2	10.0	2.1	4.7	22.6
Defense	Dec.	2/2	1.7	-11.9	-24.8	-1.9
Inventories to sales ratio:						
Manufacturing and trade, total	Nov.	1/12	1.46	1.47 1/	1.49 1/	1.57 1/
Manufacturing	Dec.	2/2	1.62	1.60 1/	1.65 1/	1.76 1/
Trade	Nov.	1/12	1.32	1.31 1/	1.32 1/	1.40 1/
Ratio: Mfrs.' durable goods inventories to unfilled orders	Dec.	2/2	.867	.870 1/	.877 1/	.942 1/
Auto sales, total (mil. units) 3/	Jan.	2/6	12.23	3.3	7.0	17.6
Domestic models	Jan.	2/6	10.28	4.0	4.5	16.0
Foreign models	Jan.	2/6	1.95	-0.1	22.6	26.9
Housing starts, private (thou.) 3/	Dec.	1/17	239.2	0.2	-0.3	-2.6
Leading indicators (1967=100)	Dec.	1/30	155.6	2.2	5.6	17.3

1/ Actual data. 2/ Not seasonally adjusted. 3/ At annual rate.

DOMESTIC NONFINANCIAL DEVELOPMENTS

Economic activity has continued to expand vigorously in early 1973, although apparently not so rapidly as in the exceptionally strong fourth quarter. The staff is projecting an increase in real GNP at an annual rate of 6-1/2 per cent this quarter following an 8-1/2 per cent rate of increase last quarter.

In January, industrial production and nonfarm payroll employment showed further gains, but for both measures, the increases in December and January were smaller than in most other recent months. The unemployment rate edged down to 5.0 per cent from 5.1 per cent in December, and was at the lowest level since mid-1970.

Consumer and business demands have continued expansive. Retail sales are estimated to have risen appreciably in January, following little change in December. Unit sales of autos increased to new record levels last month, with the total at an annual rate of close to 12.5 million. In the business area, output of business equipment continued to rise strongly in January, and new orders for nondefense capital goods rose substantially further in December. Book value of manufacturers' inventories rose considerably in December, while stock-sales ratios remained close to the low levels reached in recent months.

Wage rates in January increased less than in December, but the rate of advance since August, at an annual rate of 7.3 per cent, was still well above that earlier in the year. Productivity growth slowed somewhat in the fourth quarter, and, with compensation per manhour up sharply, unit labor costs rose appreciably after two quarters of no increase.

The private GNP fixed weight price index increased at an annual rate of 3.3 per cent in the fourth quarter. The consumer price index in December rose at an annual rate of only 2.6 per cent, with food prices unchanged from November. But prices at the farm level were up very sharply in both December and January, suggesting the likelihood of substantial increases in retail food prices in the early months of this year.

Outlook. The staff has made significant changes for 1973 in some of its basic economic assumptions:

(1) Monetary policy is now assumed to be somewhat more restrictive. Growth in the monetary aggregates overtime is now projected to be consistent with expansion in M_1 at an annual rate around 5 per cent. Short-term market rates are expected to rise further from current levels, which are higher than had been anticipated earlier.

(2) Federal expenditures are projected to be consistent with the recently released budget estimates for fiscal years 1973 and 1974. This change has resulted in a somewhat slower growth in total Federal expenditures during calendar 1973 than had been projected before. The composition of these expenditures has also been revised; Federal purchases rose more rapidly than previously projected and other expenditures--such as transfers and grants--increase more slowly.

(3) Phase III controls are incorporated into the projection for the first time. Given recent wage and price developments, increases in both are now expected to be somewhat larger than earlier projected, partly because of the institution of more flexible controls under Phase III.

The over-all effects of these changes in assumptions, as well as of other recent developments, may be seen in the table. Nominal GNP is about unchanged from the projection of four weeks ago. However, a little more of the increase is now represented by price and a little less by real output. This downscaling in real expansion is most evident in the second half of the year when the more restrictive monetary policy now assumed operates, after a lag, to dampen real expansion. In the fourth quarter, real growth is now projected at an annual rate of 4.0 per cent.

STAFF GNP PROJECTIONS

	Change in Nominal GNP $ billion		Per cent increase, annual rate: Real GNP		Per cent increase, annual rate: Private GNP fixed weight price index		Unemployment rate	
Date	1/10/73	Current	1/10/73	Current	1/10/73	Current	1/10/73	Current
1971 1/	74.0	74.0	2.7	2.7	4.5	4.5	5.9	5.9
1972 1/	101.7	101.7	6.5	6.5	3.2	3.2	5.6	5.6
1973	120.3	122.2	6.9	6.6	3.4	3.8	4.9	4.8
1972-I 1/	31.0	31.0	6.5	6.5	4.5	4.5	5.8	5.8
-II 1/	30.3	30.3	9.4	9.4	2.5	2.5	5.7	5.7
-III 1/	24.6	24.6	6.3	6.3	2.9	2.9	5.6	5.6
-IV 1/	32.1	31.8	8.7	8.5	2.7	3.3	5.3	5.3
1973-I	33.3	34.4	6.8	6.5	3.6	4.3	5.1	5.0
-II	30.0	31.3	6.2	6.0	3.8	4.2	4.9	4.9
-III	28.5	27.9	5.4	4.8	3.9	4.1	4.8	4.8
-IV	26.5	26.6	4.4	4.0	4.0	4.3	4.7	4.7

1/ Actual.

The faster rise in prices now projected for 1973 follows from several considerations. A first quarter bulge is now expected because of a sizable increase in retail food prices already in train, the rise in social security taxes effective January 1, and the faster initial price adjustments indicated under Phase III. Over the remainder of 1973 a somewhat faster rise in unit labor costs is expected to exert further upward pressure on prices. The unemployment rate is still projected to decline a little from the January level, to 4.7 per cent in the fourth quarter.

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

	1972	1973	1972		1973			
					Projected			
	Prel.	Proj.	III	IVp	I	II	III	IV
Gross National Product	1152.1	1274.3	1164.0	1195.8	1230.2	1261.5	1289.4	1316.0
Final purchases	1146.2	1260.5	1156.0	1185.9	1218.7	1248.5	1274.9	1300.0
Private	891.3	984.3	900.4	925.6	951.4	975.2	995.9	1014.9
Excluding net exports	895.4	986.4	903.8	928.6	953.8	977.0	997.8	1016.8
Personal consumption expenditures	721.1	794.0	728.6	746.2	766.6	786.6	803.4	819.3
Durable goods	116.3	130.6	118.6	121.5	126.0	130.5	132.5	133.5
Nondurable goods	299.5	331.2	302.0	310.4	319.3	327.6	335.2	342.8
Services	305.4	332.1	308.0	314.3	321.3	328.5	335.7	343.0
Gross private domestic investment	180.2	206.1	183.2	192.4	198.7	203.4	208.9	213.5
Residential construction	53.9	53.9	54.4	56.8	56.7	54.4	53.0	51.3
Business fixed investment	120.4	138.5	120.7	125.6	130.5	136.0	141.4	146.2
Change in business inventories	5.8	13.8	8.0	10.0	11.5	13.0	14.5	16.0
Nonfarm	5.5	13.8	7.9	9.7	11.5	13.0	14.5	16.0
Net exports of goods and services	-4.1	-2.0	-3.4	-3.0	-2.4	-1.8	-1.9	-1.9
Exports	73.7	87.9	74.4	79.7	84.2	86.9	88.9	91.4
Imports	77.8	89.9	77.8	82.7	86.6	88.7	90.8	93.3
Gov't. purchases of goods and services	254.9	276.2	255.6	260.3	267.3	273.3	279.0	285.1
Federal	105.9	107.8	105.4	104.5	106.0	107.0	108.2	109.8
Defense	76.2	74.6	75.1	74.4	74.5	74.4	74.6	74.9
Other	29.7	33.2	30.2	30.1	31.5	32.6	33.6	34.9
State & local	148.9	168.4	150.2	155.8	161.3	166.3	170.8	175.3
Gross national product in constant (1958) dollars	789.7	842.0	796.1	812.4	825.6	838.0	848.0	856.5
GNP implicit deflator (1958 = 100)	145.88	151.31	146.21	147.20	148.75	150.54	152.04	153.64
Personal income	935.8	1026.2	939.9	974.3	994.8	1016.2	1036.8	1056.8
Wage and salary disbursements	627.0	689.9	630.8	648.5	666.2	682.5	698.0	713.0
Disposable income	795.1	879.7	798.8	828.4	857.0	875.5	885.2	901.0
Personal saving	54.8	65.1	50.8	62.4	70.4	68.5	61.0	60.6
Saving rate (per cent)	6.9	7.4	6.4	7.5	8.2	7.8	6.9	6.7
Corporate profits before tax	94.5 1/	110.8	95.7	102.6 1/	105.5	110.0	112.0	115.5
Corp. cash flow, net of div. (domestic)	91.9 1/	104.3	93.1	97.6 1/	100.1	103.4	105.4	108.2
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	228.6 1/	254.7	229.8	238.3 1/	242.3	248.0	261.1	267.5
Expenditures	246.8 1/	268.0	241.6	262.9 1/	269.0	265.1	267.1	270.8
Surplus or deficit (-)	-18.2 1/	-13.3	-11.8	-24.6 1/	-26.7	-17.1	-6.0	-3.3
High employment surplus or deficit (-)	-0.3	-4.9	4.5	-11.7	-14.3	-5.7	-0.4	0.9
State and local government surplus or deficit (-), N.I.A. basis	12.4 1/	9.7	9.4	18.2 1/	16.2	8.6	7.5	6.3
Total labor force (millions)	89.0	90.6	89.2	89.6	90.0	90.4	90.7	91.1
Armed forces "	2.4	2.4	2.4	2.4	2.4	2.4	2.3	2.3
Civilian labor force "	86.5	88.2	86.8	87.2	87.6	88.0	88.4	88.8
Unemployment rate (per cent)	5.6	4.8	5.6	5.3	5.0	4.9	4.8	4.7
Nonfarm payroll employment (millions)	72.8	75.2	73.0	73.8	74.4	75.0	75.5	75.9
Manufacturing	18.9	19.5	18.9	19.3	19.4	19.5	19.6	19.6
Industrial production (1967 = 100)	114.3	123.8	115.0	118.3	120.7	123.0	125.0	126.4
Capacity utilization, manufacturing (per cent)	77.6	81.3	78.1	79.7	80.6	81.3	81.7	81.7
Housing starts, private (millions, A.R.)	2.36	2.04	2.36	2.41	2.25	2.15	1.95	1.80
Sales new autos (millions, A.R.)	10.94	11.61	11.54	11.68	11.85	11.85	11.50	11.25
Domestic models	9.32	9.96	9.90	9.90	10.10	10.10	9.90	9.75
Foreign models	1.62	1.65	1.64	1.78	1.75	1.75	1.60	1.50

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/ F.R. estimate.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1972	1973 Proj.	1972 III	1972 IVp	1973 Projection I	1973 Projection II	1973 Projection III	1973 Projection IV
	-----	-----	-----	Billions of Dollars	-----	-----	-----	-----
Gross National Product	101.7	122.2	24.6	31.8	34.4	31.3	27.9	26.6
Inventory change	2.2	7.9	3.0	2.0	1.5	1.5	1.5	1.5
Final purchases	99.5	114.3	21.6	29.9	32.8	29.8	26.4	25.1
Private	77.4	93.0	20.1	25.2	25.8	23.8	20.7	19.0
Excluding net exports	82.2	90.9	18.3	24.8	25.2	23.2	20.8	19.0
Net exports	-4.8	2.1	1.8	0.4	0.6	-0.6	-0.1	0.0
Government	22.1	21.3	1.5	4.7	7.0	6.0	5.7	6.1
GNP in constant (1958) dollars	48.0	52.3	12.2	16.3	13.2	12.4	10.0	8.5
Final purchases	46.1	46.2	9.8	14.9	11.6	11.9	8.8	7.0
Private	40.8	42.4	11.1	14.5	10.1	10.3	7.5	5.6
	-----	-----	-----	Per Cent Per Year	-----	-----	-----	-----
Gross National Product	9.7	10.6	8.9	11.4	11.5	10.2	8.8	8.2
Final purchases	9.5	10.0	7.6	10.3	11.1	9.8	8.5	7.9
Private	9.0	10.4	9.1	11.2	11.1	10.0	8.5	7.6
Personal consumption expenditures	8.5	10.1	8.5	9.7	10.9	10.4	8.5	7.9
Durable goods	12.4	12.3	16.5	9.8	14.8	14.3	6.1	3.0
Nondurable goods	7.7	10.6	6.5	11.1	11.5	10.4	9.3	9.1
Services	7.8	8.7	7.4	8.2	8.9	9.0	8.8	8.7
Gross private domestic investment	18.6	14.4	14.0	20.1	13.1	9.5	10.8	8.8
Residential construction	26.5	0.0	12.1	17.6	-0.7	-16.2	-10.3	-12.8
Business fixed investment	13.8	15.0	5.0	16.2	15.6	16.9	15.9	13.6
Gov't. purchases of goods & services	9.5	8.4	2.4	7.4	10.8	9.0	8.3	8.7
Federal	8.3	1.4	-10.0	-3.4	5.7	3.8	4.5	5.9
Defense	6.7	-2.1	-17.8	-3.7	0.5	-0.5	1.1	1.6
Other	12.9	11.8	8.1	-1.3	18.6	14.0	12.3	15.5
State & local	10.3	13.1	11.5	14.9	14.1	12.4	10.8	10.5
GNP in constant (1958) dollars	6.5	6.6	6.3	8.5	6.5	6.0	4.8	4.0
Final purchases	6.2	5.9	5.0	7.5	5.8	5.8	4.3	3.3
Private	6.8	6.6	7.0	9.0	6.1	6.1	4.1	3.2
GNP implicit deflator	3.0	3.7	2.4	2.7	4.9 1/	4.1	4.0	4.2
Private GNP fixed weight index 2/	3.2	3.8	2.9	3.3	4.3	4.2	4.1	4.3
Personal income	8.6	9.7	7.5	14.6	8.4	8.6	8.1	7.7
Wage and salary disbursements	9.4	10.0	6.4	11.2	10.9	9.8	9.1	8.6
Disposable income	6.8	10.6	8.2	14.8	13.8	8.6	4.4	7.1
Corporate profits before tax	13.5	17.1	17.9	28.8	11.3	17.1	7.3	12.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.8	11.4	8.7	14.8	6.7	9.4	21.1	9.8
Expenditures	11.8	8.6	-8.0	35.3	9.3	-5.8	3.0	5.5
Nonfarm payroll employment	3.0	3.3	2.5	4.4	3.3	3.2	2.7	2.1
Manufacturing	1.6	3.2	1.4	8.5	2.1	2.1	2.1	0.0
Industrial production	6.8	8.2	6.7	11.5	8.1	7.6	6.5	4.4
Housing starts, private	14.8	-13.5	18.4	7.9	-27.2	-17.8	-37.2	-30.8
Sales new autos	6.8	6.2	41.9	4.7	6.0	0.0	-11.8	-8.7
Domestic models	7.4	6.9	44.4	0.0	8.1	0.0	-7.9	-6.1
Foreign models	3.0	2.0	27.7	33.7	-5.9	0.0	-34.3	-25.0

1/ Excluding Federal pay increase, 4.2 per cent annual rate.

2/ Using expenditures in 1967 as weights.

Industrial production. Industrial production is tentatively estimated to have increased about one-half per cent further in January, following a 10.8 per cent annual rate of increase in the last half of 1972. Gains in output occurred in some industries in January, but auto assemblies were cut.

Production of business equipment and of ordance at privately owned plants apparently rose further in January. Output increases were also indicated in some household appliances, room air conditioners, consumer staples, and some materials--mainly aluminum and paper. Production of raw steel and crude oil changed little continuing at high levels, and production worker manhour data indicate a continued low level of activity in the aircraft industry. Auto assemblies declined 6 per cent from the unusually high December annual rate of 10.3 million units to about a 9.7 million unit rate in January. Production schedules for February indicate little change in auto output from January.

Although both the average workweek and total manhours of manufacturing production workers declined in the January reporting week, available weekly production date indicate some increase in manufacturing output for the month as a whole.

Retail sales. Sales in January, on the basis of weekly data for the four weeks ending January 27, increased about 2 per cent from the December level. All major categories appear to have contributed to the higher volume, with the largest increases in the food, general merchandise, and furniture and appliance groups.

Unit sales of consumer durables. January sales of new domestic-type autos were at a 10.3 million unit rate, 4 per cent above December and 16 per cent above year-earlier levels. Continued strong sales, including a 10.4 million unit annual rate in the last 10-day period, were achieved even without any sales incentive contests. Sales of imported cars in January were also exceptionally strong, at a 2.0 million unit rate, continuing their recent rise.

January factory sales of major home appliances apparently increased sharply from December levels. All appliances in the index showed gains with sales of dishwashers, freezers, refrigerators, and electric ranges particularly strong.

FACTORY UNIT SALES OF MAJOR APPLIANCES
Seasonally adjusted 1967=100

	1972	1972		1973	Per cent change	
	Jan.	Nov.	Dec.	Jan.	Month ago	Year ago
Appliances	137	143	148r	159e	7	16

r/ Revised.
e/ Estimated on the basis of data through January 20.

Consumer surveys. The latest surveys by the Michigan Survey Research Center (SRC), Conference Board, and the Census Bureau suggest that expenditures will remain strong but that there may be some weakening in consumer expectations.

Purchase plans for appliances were strong in both the Census Conference Board surveys. The Census Bureau also found many households planning to purchase furniture and carpets and to make home improvements. Buying plans for houses continued at very high levels in both of these surveys, but they found conflicting outlooks of auto purchases.

The Michigan index of sentiment declined slightly; all questions on present and expected income, business conditions, and market conditions for consumer durable goods, contributed to the decline. The Conference Board also reported a deterioration in expectations of improvement in business conditions and in income and fewer families in the Census Bureau survey expected higher incomes.

There is some evidence in the Michigan survey that consumer response to rising prices may be changing from making some inflationary-induced purchases to a mood of more caution, reflecting concern with rising prices of essentials. Price considerations were mentioned much less frequently as a reason why the present was a good time to buy durables or houses. Fewer respondents thought that the government would be successful in reducing inflation and more families were expecting the rate of inflation to be greater over the next 12 months. Prices were mentioned by 23 per cent of the respondents in November-December as a reason for not being better off financially, as compared to only 15 per cent in August-September.

<u>Construction and real estate</u>. Seasonally adjusted value of new construction activity in January edged up from December to a new high annual rate of over $130 billion. Outlays for private construction tended higher, as residential construction held at about the record pace achieved in December and nonresidential construction outlays moved up somewhat further. Public construction remained just below its improved fourth quarter average.

The Census Bureau's composite index of construction costs in January was unchanged from December at 141 per cent of the 1967 average and was 4.4 per cent above a year earlier. This rise compared with a year-over-year increase of 8 per cent in January of 1972 and of more than 5 per cent in the year 1972 as a whole.

NEW CONSTRUCTION PUT IN PLACE
(Seasonally adjusted annual rates, in billions of dollars)

	1972				1973
	QIII(r)	QIV(p)	November(r)	December(r)	January1/
Total - current dollars	122.5	128.4	126.7	129.6	130.2
Private	93.1	97.4	97.4	98.7	99.3
Residential	54.4	56.9	57.1	57.2	57.3
Nonresidential	39.1	40.6	40.3	41.5	42.0
Public	29.4	31.0	29.3	30.9	30.9
State and local	25.1	26.6	24.9	26.6	26.6
Federal	4.2	4.4	4.4	4.3	4.3
Total - 1967 dollars	88.5	91.2	90.0	91.7	92.0

1/ Data for January 1973 are <u>confidential</u> Census Bureau extrapolations. In no case should public reference be made to them.
r - Revised
p - Preliminary

Seasonally adjusted private housing starts in December were at an advanced annual rate of 2.39 million units--only slightly below the average for the fourth quarter as a whole, which was exceeded only by the record first quarter of 1972. For the year, total starts rounded to 2.4 million units, up 15 per cent from 1971, the first year in which starts had ever exceeded the 2 million mark. Mobile home shipments accounted for an additional 572,000 units, up from 497,000 in 1971.

The December starts pace, which was stronger than expected, was associated with a marked acceleration by builders operating under HUD's multifamily subsidy programs, apparently in response to rumors of the imminence of a freeze on new commitments. Since the freeze did not become effective until after January 5, this type of anticipatory response may also have influenced the rate of starts in that month as well. Even so, given the extraordinary pace of starts already achieved and other factors, some decline in the rate of starts may occur during the present quarter.

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

	QI	QIII(r)	QIV(p)	October(r)	November(r)	December(p)
Starts	2.51	2.37	2.41	2.46	2.38	2.39
1-family	1.35	1.36	1.28	1.31	1.31	1.24
2-or-more-family	1.16	1.01	1.13	1.15	1.08	1.15
Permits	2.09	2.20	2.24	2.22	2.14	2.37
Completions	1.98	1.94	1.93 1/	1.95	1.91	n.a.
MEMO:						
Mobile home shipments	.57	.54	.58 2/	.54	.65	.56 2/

p/ Preliminary. r/ Revised.
n.a. Not available.
1/ October-November average only.
2/ Confidential until February 15.

Vacancy rates on residential rental properties, which had advanced to an average of 5.8 per cent of available stocks in the third quarter of 1972, dipped in the fourth quarter to 5.6 per cent. This was no higher than a year earlier and well below the peak in the fourth quarter of 1965. Vacancy rates on homeowner properties in the fourth quarter also averaged the same as a year earlier. Demands for all types of shelter have increased substantially over the recent period and removals are indicated to have remained very high. However, an important factor in the relatively low vacancy rate pattern at this time has been the lag between completions and starts. This lag has apparently increased as heavy pressure on available resources for residential building continued. Thus, while completions approached a record 2 million units last year, they were still appreciably below the number of starts.

RESIDENTIAL VACANCY RATES
(Per cent)

	Average for the fourth quarter					
	1965	1968	1969	1970	1971	1972
Rental units	8.5	5.4	5.1	5.2	5.6	5.6
Northeast	5.6	3.4	2.6	2.6	3.5	3.9
North Central	7.2	5.1	6.0	5.6	6.0	5.5
South	9.3	6.9	7.0	6.8	7.4	7.0
West	12.5	6.5	4.8	5.7	5.3	6.1
Homeowner units	1.5	1.2	1.0	1.1	1.0	1.0

Manufacturers orders and shipments. New orders for durable goods declined 0.9 per cent (p) in December, following a 2.3 per cent rise in November. Excluding defense, durable goods orders were off 0.3 per cent. However, new orders for nondefense capital goods rose more rapidly, 2.1 per cent, in December than in November. For the fourth quarter as a whole, new orders for durable goods were up 4.3 per cent from the third quarter, a larger gain than in the third quarter. Orders for nondefense capital goods, household durables, and construction materials strengthened noticeably.

Durable goods shipments fell 1.1 per cent in December. Backlogs of unfilled orders rose further with large increases in the motor vehicles and parts industry and in nondefense capital goods, to the highest level since December 1969.

MANUFACTURERS NEW ORDERS FOR DURABLE GOODS: 1972
Per cent changes

	Q III from QII	Q IV from Q III	Dec. from Nov. (p)
Durable goods, total	3.0	4.3	- .9
Excluding defense	4.4	4.6	- .3
Primary metals	9.3	2.2	1.1
Motor vehicles & parts	10.6	3.7	-6.5
Household durables	.6	5.7	-2.0
Capital goods industries	-1.2	4.8	- .2
Nondefense	2.9	5.7	2.1
Defense	-18.2	.0	-11.9
Construction & other durables	1.2	5.0	.4

<u>Inventories.</u> Book value of manufacturers' inventories rose at a $9.7 billion annual rate in December (p). The November rate was revised downward somewhat. For the fourth quarter as a whole, the rate was $7 billion, a little below the third quarter rate.

In the fourth quarter, manufacturers accelerated the buildup of work in process and expanded inventories of materials and supplies at a slightly slower pace than in the third quarter, but sales were increasing rapidly and stocks of finished goods declined. By industry groups, the buildup of both defense and nondefense capital goods inventories accelerated, while growth of inventories held by producers of consumer goods and materials was slower.

Book value of wholesale inventories also increased strongly in December; the fourth quarter increase, at $4.5 billion, was a little higher than the third.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES
Seasonally adjusted annual rate, $ billions

	1972			
	Q III	Q IV (Prel.)	Nov. (Rev.)	Dec. (Prel.)
Manufacturing, total	7.7	7.0	4.4	9.7
Durable	5.6	5.4	3.7	6.6
Nondurable	2.1	1.5	.6	3.1
Wholesale trade	4.1	4.5	3.1	5.9

NOTE: Detail may not add to totals because of rounding.

Manufacturers' shipments declined slightly in December and the inventory/shipments ratio rose, but remained at a low level characteristic of strong cyclical expansion. Unfilled orders for durable goods rose more than inventories, and the ratio of inventories to unfilled orders declined further, but this ratio was still high compared with previous expansions.

Sales increased more than stocks for wholesale trade and the inventory-sales ratio declined to the lowest level in over 3 years.

INVENTORY RATIOS

	1971		1972	
	Nov.	Dec.	Nov. (Rev.)	Dec. (Prel.)
Inventories to sales:				
Manufacturing, total	1.77	1.76	1.60	1.62
Durable	2.14	2.13	1.89	1.93
Nondurable	1.34	1.33	1.23	1.23
Wholesale trade	1.24	1.26	1.19	1.18
Inventories to unfilled orders:				
Durable manufacturing	.944	.942	.870	.867

Cyclical indicators. The Census composite index of leading indicators rose strongly in December--by 2.2 per cent (p). The October and November increases were both revised up about half a per cent, reflecting upward revisions in net business formation, which reached new highs. From September to December, the leading composite index advanced 5.6 per cent, compared with a 3.5 per cent increase over the preceding three months.

The coincident index rose 0.6 per cent in December and the lagging index rose 1 per cent.

Leading series increasing in December were the manufacturing workweek, initial claims for unemployment insurance (inverted), housing permits, industrial materials prices, common stock prices, and the ratio of price to unit labor cost. Series declining were new orders for durable goods and contracts and orders for plant and equipment. Since the December index was compiled, there has been reported some upward revision in new orders and a slight decline in the change in consumer instalment debt.

CHANGES IN COMPOSITE CYCLICAL INDICATORS
(Per cent change from previous month)

	Sept.	Oct.	Nov.	Dec. (p)
12 leading (trend adjusted)	.1	1.1	2.3	2.2
12 leading, prior to trend adjustment	-.3	.7	2.0	1.8
5 Coincident	.9	1.8	1.7	.6
5 Coincident, deflated	.4	2.1	1.6	.6
6 Lagging	2.0	1.3	1.9	1.0

In January, industrial materials prices (13 sensitive) and common stock prices were up from the December average, while the manufacturing workweek declined.

Labor market. The unemployment rate edged down 0.1 percentage point in January to 5.0 per cent, seasonally adjusted. Both total employment (household series) and the labor force declined during the month. (The December unemployment rate was revised to 5.1 per cent from 5.2 per cent as a result of the annual revision of seasonal adjustment factors.)

Labor demand has been quite strong since mid-1972, although growth of nonfarm payroll employment in the last two months has been a little less rapid than earlier. Preliminary estimates indicate that payroll employment increased by 200,000 in January, and the December level was revised up to show a gain of 125,000. Compared to a year ago, payroll employment in January was up 2.7 million with a particularly large gain in manufacturing. Factory employment, however, was still more than 800,000 below its mid-1969 peak. Employment continued growing over the year at a substantial pace in trade, services and State and local government.

CHANGES IN NONFARM PAYROLL EMPLOYMENT
(Seasonally adjusted, in thousands)

	Jan. 1972-July 1972	July 1972-Jan. 1973	Jan. 1972-Jan. 1973	Dec. 1972-Jan. 1973
	Annual rate			
Total	2,218	3,120	2,680	2,364
Government	372	490	436	372
Federal	-104	74	-15	72
State and local	476	416	451	300
Private	1,846	2,630	2,444	1,992
Goods-producing	520	1,202	862	636
Manufacturing	620	1,158	887	228
Service-producing	1,326	1,428	1,382	1,356
Trade	626	502	582	228
Services	544	556	540	684

The factory workweek fell half an hour in January, according to preliminary estimates. Declines were widespread, but were apparently related to unseasonable weather and fuel shortages in some sections of the country during the reporting period. Factory overtime hours also dropped, but were still considerably higher than a year ago.

Unemployment and labor force. Although the over-all unemployment rate was little changed in January, jobless rates for teenagers, Negroes, and part-time workers dropped sharply. The over-all unemployment rate has declined by about one percentage point from a year ago to the lowest level since mid-1970.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1972			1973
	Jan.	June	Dec.	Jan.
Total	5.9	5.5	5.1	5.0
Men 20 years and over	4.2	4.0	3.4	3.0
Women 20 years and over	5.6	5.6	5.1	5.3
Teenagers	17.5	14.9	15.7	14.3
Household heads	3.5	3.5	2.9	2.9
White workers	5.3	5.1	4.6	4.6
Negro workers	10.9	9.2	9.6	8.9
White-collar	3.6	3.2	3.3	3.2
Blue-collar	7.1	6.5	5.6	5.6

After increasing quite rapidly in late 1971 and early 1972, civilian labor force growth has slowed considerably since late summer due to reductions among part-time workers. Since August the full-time labor force has increased by about half a million while the part-time labor force has declined by an equal amount.

<u>Productivity and costs</u>. Reflecting the speed-up in the rate of increase of hourly earnings during the last part of 1972, compensation per manhour rose quite rapidly in the fourth quarter--about 7-1/2 per cent for the private nonfarm economy--considerably faster than in the previous two quarters. At the same time, although productivity in the nonfarm economy continued to rise faster than trend in the fourth quarter--at a 4.3 per cent annual rate--the increase was less rapid than earlier in the year. Consequently, unit labor costs rebounded following two quarters of slight declines.

PRIVATE NONFARM, PRODUCTIVITY, COMPENSATION AND UNIT LABOR COSTS
(Seasonally adjusted, per cent change from previous period, at annual rate)

	Output per manhour	Compensation per manhour	Unit labor costs
1972:I	5.2	9.1	3.8
II	5.1	4.6	- .5
III	6.6	6.1	- .4
IVp	4.3	7.4	3.0
Year p	4.7	6.4	1.6

p - preliminary.

<u>Earnings</u>. Wages increased more moderately in January (6 per cent annual rate) after advancing sharply in December. Compared to a year ago the private nonfarm earnings index was up by 5.9 per cent and the index for manufacturing earnings by 5.7 per cent. Since August, however, there has been an acceleration in the rate of increase, and for the private nonfarm sector as a whole, earnings rose at a 7.3 per cent annual rate. More rapid increases have been widespread, including services and construction.

HOURLY EARNINGS INDEX*
(Per cent change at annual rate based on seasonally adjusted data)

	Jan. 1971-Aug. 1971	Jan. 1972-Jan. 1973	Jan. 1972-Aug. 1972	Aug. 1972-Jan. 1973
Total	6.6	5.9	4.7	7.3
Manufacturing	6.0	5.7	5.0	6.4
Mining	8.3	6.7	4.5	9.6
Construction	8.8	6.9	4.2	10.6
Transportation	8.2	9.2	9.5	8.3
Trade	6.2	4.7	4.1	5.5
Finance	7.1	4.8	3.7	6.5
Services	5.5	5.3	2.3	9.2

* Average hourly earnings adjusted for inter-industry shifts and, in manufacturing only, for overtime hours.

Collective bargaining. Wage increases in major nonfarm collective bargaining settlements in 1972 averaged 6.4 per cent over the life of the contract, with fourth quarter data indicating a further slowing from the 8.1 per cent average increase of 1971. Collective bargaining settlements in both manufacturing and nonmanufacturing industries for the year as a whole were well below increases negotiated a year earlier. The continued decline in wage settlements is in contrast to the recent accelerated increases in average hourly earnings for the private nonfarm sector as a whole. The collective bargaining data cover only firms employing 1,000 or more workers while the earnings data represent firms of all sizes. A clustering of major settlements late in 1972 and wage increases in smaller firms may thus have caused the acceleration in the hourly earnings index.

The recent declines in settlement terms reflect in part substantially smaller first year increases, reflecting less pressure for large catch-up increases with the moderation of the rise in consumer prices. Contracts settled in 1972 had a shorter average duration--about three months less on average than previously negotiated in these situations. This development, which was most evident in the construction industry, reflected union pressure to limit the length of contracts during the stabilization period. Wage and benefit increases in 1972 together averaged 7.3 per cent over-the-life of the contract, compared to 8.8 per cent in 1971.

WAGE INCREASES PROVIDED BY MAJOR CONTRACT SETTLEMENTS*
(Mean per cent, annual rate)

	1970	1971	1972p	1972p			
				Q I	Q II	Q III	Q IV
Average over life of contract							
Total	8.9	8.1	6.4	7.8	6.4	6.1	5.6
Manufacturing	6.0	7.3	5.7	5.5	5.7	5.7	5.9
Nonmanufacturing	11.5	8.9	6.8	9.9	6.6	6.3	5.4
Construction	14.9	10.8	5.9	13.0	6.1	5.5	3.6
First year							
Total	11.9	11.6	7.0	8.4	6.6	6.9	6.2
Manufacturing	8.1	10.9	6.6	7.3	7.0	6.7	6.4
Nonmanufacturing	15.2	12.2	7.2	9.4	6.5	6.9	6.0
Construction	17.6	12.6	6.6	14.6	6.4	6.0	4.7

* Applies to settlements affecting 1,000 or more workers.
p - preliminary.

Major settlements in 1972 covered 2.1 million workers primarily in the aerospace, railroad, construction, and maritime industries--much less than the 4.5 million covered in 1971. In addition, tentative settlements affecting 900,000 workers were reached in 1972 with final settlement pending action by the Cost of Living Council.

Bargaining in 1973 will be heavy again, especially in the second and third quarters when key negotiations will take place in the trucking, rubber, electrical equipment, railroad, construction, and auto industries. Since the end of Phase II, dress workers in the Ladies Garment Union have received an 8 per cent first year wage increase with 6 per cent pay raises to follow in the second and third years of the contract.

Consumer prices. The rise in consumer prices slowed in December to a seasonally adjusted annual rate of 2.6 per cent as food prices leveled off temporarily. Other commodity prices and service costs, however, increased more than in November, at rates of 3 and 4-1/2 per cent respectively. The advance in the total index during 1972, and during Phase II, was 3.4 per cent.

A seasonal decline in beef prices and a much less than seasonal advance for fresh vegetables offset increases for other foods. Egg prices rose sharply and increases were also substantial for dairy and cereal and bakery products for the second month.

Preliminary Department of Agriculture estimates (confidential) based on its chain store sample for early January (the time of month when food also is priced for the CPI) indicate sharply higher retail prices for beef and pork. Wholesale prices for beef, pork, cattle and hogs climbed further through early February; with margins for pork (though not for beef) squeezed for some time, sizable advances in meat prices at retail are also likely for February. The USDA expects substantially larger pork supplies, and consequently lower prices, in the second half of the year.

CONSUMER PRICES
(Percentage changes, seasonally adjusted annual rates)

	Relative Importance Dec. 1971	Pre-stab. period Dec. 1970 to Aug. 1971	1972 Dec. 1971 to June 1972	1972 June Dec.	1972 Nov. Dec.	Phase II Nov. 1971 to Dec. 1972
All items	100.0	3.8	2.9	3.9	2.6	3.4
Food	22.2	5.0	3.5	6.1	.0	5.0
Commodities less food	40.4	2.9	2.6	2.5	3.0	2.5
Services 1/	37.4	4.5	3.7	3.5	4.5	3.6
Addendum:						
All items less mortgage costs 2/	96.3	4.6	3.0	3.9	2.9	3.6
Services less home finance 1/2/3/	31.0	6.7	3.5	3.1	3.7	3.3
Commodities less food, used cars, home purchase 3/	32.2	2.5	2.2	2.0	1.0	2.1

1/ Not seasonally adjusted.
2/ Home financing costs excluded from services reflect property taxes and insurance rates as well as mortgage costs, which in turn move with mortgage interest rates and house prices.
3/ Confidential.

The index for other commodities includes only part of the increase on new cars approved by the Price Commission to cover costs of Government-mandated equipment; most of this advance should be reflected in January. Among service costs, property taxes rose further--to a level over 9 per cent above December 1971--and increases in rents and in home maintenance and repairs were the largest since January 1972 and June 1971, respectively.

Sensitive commodity prices. A marked increase in prices of materials and supplies in January has been reported by purchasing agents. The sensitive BLS index of raw materials, reflecting some of these changes, increased sharply from mid-December to the end of January. Continuation of the upward trend in this index was the result in large part of increases for metals, raw cotton and wool tops, rubber, and cow hides.

Several metals recently have been subject to upward price pressure. Domestic copper prices were increased in January mainly as a result of increased prices on the London Metal Exchange (LME). Continued price increases on the LME combined with increased demand here could bring about another price rise soon. The price of zinc was also raised since mid-December (under Phase III regulations) and the market has been able to support the higher price. The market price of lead also was increased as demand strengthened. Prices of some aluminum products (not included in the BLS raw industrials index) indicated some firming of demand which may presage some further price increases. Prices of steel scrap remained at a high level as strong demands, both foreign and domestic, persisted.

Recent increases in prices of raw cotton were caused in large part by delays in harvesting, and higher prices for wool tops reflected low world supplies and increased demand. Prices of hides have shown renewed upward movement recently after having declined somewhat at the end of last year because of temporarily reduced demand. Foreign demand for U.S. hides, caused in large part by the embargo on hide exports by Argentina, has been a major cause of the recent high price level.

Increased prices of fuel oil and lumber and plywood--commodities not in the BLS raw industrials index--have recently been reported. Higher fuel oil prices were the result, in part, of extremely cold weather, reduced supplies of fuel oil, and higher operating and raw materials costs. The large increases reported for lumber and plywood since the beginning of Phase III were associated with the easing of economic controls, but the basic reasons for the higher prices were tight supplies and strong foreign and domestic demands.

<u>1972 Price changes in the CPI and the WPI</u>. During the twelve months of 1972, the CPI rose 3.4 per cent and the WPI about twice as much, 6.5 per cent. Most of the difference can be attributed to the exceptionally rapid increase of wholesale prices for farm products, as well as for certain industrial materials, which do not enter the CPI.

Farm product prices (excluding processed foods and feeds) rose 19 per cent during the year, intermediate materials, about 4 per cent, and crude materials, 11 per cent. In the case of roughly comparable categories of consumer finished goods, prices of nonfood commodities rose little more than 2 per cent in both indexes but food prices rose more in the WPI--8 per cent as compared to 5 per cent. (Retail food prices usually fluctuate less than those at wholesale because of the influence of other costs; in addition there was a squeeze on margins in 1972, in part because of the competitive price policy of a major supermarket chain).

The 3.6 per cent increase in service costs in the CPI, which have no counterpart in the WPI, exceeded the rise for consumer nonfood commodities but was well below those for foods and materials.

1972 PRICE CHANGE IN WPI AND CPI, SELECTED COMPONENTS, 1972

	Relative importance Dec. 1971	Per cent change from Dec. 1971 to Dec. 1972
CPI - All items	100.0	3.4
Commodities less food, used cars, home purchase 1/	32.2	2.1
Food at home	17.2	5.0
Services	37.4	3.6
WPI - All commodities	100.0	6.5
Consumer fin. goods, excl. foods 2/	20.2	2.2
Consumer fin. foods 2/	13.1	8.0
Intermediate materials 2/3/	41.4	4.1
Crude materials 4/	2.8	10.9
Farm products 2/	10.4	18.7

1/ Confidential.
2/ Some overlap between consumer finished foods and farm products, e.g. fresh fruits and vegetables, eggs, and between other consumer finished goods and industrial materials, e.g. gasoline, detergents.
3/ Excludes intermediate materials for food manufacturing and manufactured animal feed.
4/ Excludes crude foodstuffs and feedstuffs, plant and animal fibers, oilseeds, and leaf tobacco.

Agriculture. Prices received by farmers increased another 5 per cent during the month ended January 15 to a level a fifth above a year ago. Prices of livestock, poultry, eggs, and fresh vegetables contributed to the rise. Prices of corn and cotton declined, the latter due to larger marketings of lower grades. But, by early February, corn prices had reversed their decline and hog and steer prices increased significantly further. Soybean prices also advanced but eggs and wheat had declined.

Limited red meat and poultry supplies--the smallest in three years--contributed to the January livestock price increases. A decline of 4 per cent in this year's winter vegetable production, caused by unseasonably cold weather, affected January prices and should continue to affect fresh vegetable prices through March.

Corn and soybean harvests were also hampered by weather and were still 5 per cent incomplete on February 5; final estimates of yields are 3 per cent smaller and 9 per cent larger, respectively, than 1971 harvests. High prices and revisions in the feed grain and wheat programs (particularly that announced on January 30) are expected to induce 1973 plantings of corn and soybeans about 10 per cent larger than in 1972. Export demand is expected to keep prices high.

DOMESTIC FINANCIAL SITUATION

II-T-1

SELECTED DOMESTIC FINANCIAL DATA
(Dollar amounts in billions)

Indicator	Latest data		Net change from		
	Period	Level	Month ago	Three months ago	Year ago
Monetary and credit aggregates			SAAR (per cent)		
Total reserves	January	32.2p	36.0	19.1	11.5
Reserves available (RPD's)	January	29.4p	22.5	16.5	10.5
Money supply					
M1	January	255.5p	0	6.2	8.2
M2	January	528.2p	7.0	9.1	10.5
M3	January	828.5p	10.1	10.7	12.6
Time and savings deposits (Less CDs)	January	272.7p	14.0	11.9	12.8
CDs (dollar change in billions)	January	44.3p	1.1	4.3	11.1
Savings flows (S&Ls + MSBs)	January	300.2p	14.2	13.4	16.4
Bank credit (end of month)	December	556.8	10.7	14.4	14.0
Market yields and stock prices		Percentage or index points			
Federal funds	wk. endg. 1/31/73	6.35	1.01	1.34	2.92
Treasury bill (90 day)	" 1/31/73	5.70	.57	.96	2.74
Commercial paper (90-119 day)	" 1/31/73	5.93	.30	.65	2.05
New utility issue Aaa	" 2/2/73	7.39p	.00	.12	.17
Municipal bonds (Bond Buyer)	1 day 2/1/73	5.16	.08	.12	-.19
FNMA auction yield	wk. endg. 2/5/73	7.69	.01	.00	-.08
Dividends/price ratio (Common stocks)	" 1/31/73	2.74	.03	-.01	-.25
NYSE index (12/31/65=50)	end of day 2/5/73	61.68	-3.69	-.75	3.42
Credit demands		Net change or gross offerings			
		Current month		Year to date	
		1972	1971	1972	1971
Business loans at commercial banks	December	0.9	-0.7	14.1	5.4
Consumer instalment credit outstanding	December	1.7	0.9	16.0	9.2
Mortgage debt outst. (major holders)	November	5.3	3.8	51.3	37.6
Corporate bonds (public offerings)	November	1.4	2.0	17.3	18.3
Municipal long-term bonds (gross offerings)	November	1.9	2.3	21.9	22.9
		1973	1972	1973	1972
Federally sponsored Agcy. (net borrowing)	January	0.4	0.3	0.4	0.3
U.S. Treasury (net cash borrowing)	February	-0.7e	0.1	1.0e	0.1
Total of above credits		10.9	8.7	122.0	93.8

e - Estimated.
Note: Reserves and deposits revised to reflect new benchmark and seasonal factors.

DOMESTIC FINANCIAL SITUATION

Since the last Committee meeting short-term market interest rates have risen by as much as 50 basis points. Four banks raised their prime loan rate by 1/4 point, but after the CID press release indicated that justification was being requested, three of their institutions rescinded their action and, as of this writing, no other bank had raised its rate. Most recently, pressures on the bill market have lessened as foreign central banks have moved to reinvest much of their recent large dollar acquisitions in Treasury bills.

Financial institutions in January continued to experience relatively rapid fund inflows. Despite the increase in yields on competing assets, nonbank thrift institutions, for example, appear in January to have attracted funds at a rate significantly above the average of the final months of 1972. Similarly, commercial banks, even with private demand balances showing no expansion and growth in passbook savings accounts slowing, benefited from higher Treasury balances and continued to attract a significant volume of time deposits. A substantial share of the latter appear to reflect temporary State and local government investment of both the December and January revenue sharing payments.

Despite the rise in short-term market yields, long rates edged up by only 10 to 15 basis points during the intra-meeting period. Modest corporate offerings in the public bond market and a continued availability of funds to institutional investors have played a significant role in the relative stability of longer-term rates. However, commercial banks in January continued to reduce their net acquisitions of securities, placing almost all of their new funds in loan markets. Business loans rose extremely rapidly, and both real estate and consumer loan expansion at banks was maintained at the very high rates of recent months.

Outlook. Divergent market influences cloud the immediate outlook for short-term interest rates. Reinvestment demand growing out of the Treasury's refunding operation and foreign central bank purchases are likely in the days just ahead to provide some buoyancy to bill markets. Presumably, however, these funds came out of other dollar investments, including short-term instruments and possibly also the stock market. Such instruments would be under upward rate pressure. In addition, rates on some short-term market instruments have not kept pace with the recent advance in the funds rate, and they may be subject to additional upward pressure as they come into closer alignment.

Over the longer run, into spring, short-term credit demands are expected to remain strong, placing further upward pressure on short-term market rates. Treasury financing plans call for sizable new bill issues for cash by mid-April, although any issuance of specials to foreign accounts will reduce this need. Given the high level of economic activity, business credit demands are also likely to be large. And the possible diversion of business credit demands from the commercial paper market may further strengthen total loan growth at banks. In an environment in which growth of consumer-type interest bearing deposits may be slowing, strong credit demands on banks would lead to further reductions in the relatively high-level of bank liquidity and a more aggressive stance of banks in the CD markets.

Even if money market rates only fluctuate in a narrow range, their current level suggests that inflows of consumer-type interest bearing deposits at banks and nonbank thrift institutions can be expected to moderate. However, the degree of moderation is difficult to predict because of the large expected refunds of Federal income taxes and the increasing importance of term accounts in the liability structure of these institutions. It does seem clear, however, that short-term market rates are approaching the zone in which uncertainties regarding deposit inflows could lead to some cutback in new mortgage commitments of thrift institutions, especially given the large backlog of commitments already outstanding.

With a relatively modest calendar of bond offerings and the favorable cash flow position of many institutional investors, long-term rates have adjusted only moderately upward thus far in response to the recent shift in Federal Reserve policy. The staff continues to hear reports, however, of sizable capital market financing planned for March and April. In addition, several large investment bankers are reported to be counseling borrowers to accelerate planned financing in order to avoid higher interest costs later. Some upward rate pressures could occur, therefore, if the corporate calendar for March and April builds up to the extent that now appears possible. In any event, long-term markets are likely to be unusually sensitive to any further tightening in money market rates and conditions.

Monetary aggregates. Preliminary estimates indicate that the money stock showed no further growth on average in January following the exceedingly rapid advance in December. As a result, M_1 expansion for the two months combined was at an annual rate of around 6 1/2 per cent, approximately one percentage point below that for the first 11 months of 1972. Part of the recent volatility in M_1 growth appears to have been associated with the buildup of demand balances of State and local governments out of revenue sharing funds in December, and the shift of these funds into interest earning assets, including CD's and open account time deposits, in January. Taking the two months together, however, the figures suggest a still strong underlying transactions demand for money.

Along with the rising transactions demand, part of the strength in M_1 in recent weeks may reflect additions to compensating balances by businesses. The Demand Deposit Ownership Survey shows that in December almost 80 per cent of the sizable increase in gross IPC demand deposits at Weekly Reporting Banks was in balances of nonfinancial corporate businesses. This rise in business balances was considerably larger than the increase in December of 1971 and also 1970. Similarly, for the fourth quarter as a whole, businesses--which hold approximately 52 per cent of total IPC balances--accounted for over 72 per cent of the large quarterly increase in such deposits at all commercial banks; increases in consumer holdings were largely responsible for the rest.

In January, slower growth of M_1 was partially offset by stronger inflows of time deposits other than negotiable CD's, and M_2 expanded at an annual rate close to 7 per cent. However, this was considerably below

MONETARY AGGREGATES

(Seasonally adjusted changes)

	1972					1973
	QI	QII	QIII	QIV	Dec.	Jan.p
			Per cent at annual rates			
M_1 (Currency plus private demand deposits)	9.2	6.1	8.2	8.6	13.3	.0
M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	12.7	8.5	10.3	10.2	12.2	7.0
M_3 (M_2 plus savings deposits at mutual savings banks and S&L's)	14.9	10.7	12.3	11.4	12.2	10.1
Adjusted bank credit proxy	11.0	11.5	9.8	12.1	13.4	9.0
Time and savings deposits at commercial banks						
a. Total	15.4	14.8	14.0	14.4	17.1	16.5
b. Other than large CD's	16.1	10.8	12.3	11.6	11.2	14.0
			Billions of dollars 1/			
Memorandum:						
a. U.S. Government demand deposits	-.4	.5	-1.1	1.4	-.4	.7
b. Negotiable CD's	.8	3.7	2.4	3.3	2.0	1.1
c. Nondeposit sources of funds	-.3	--	.4	.3	.1	.1

p - Preliminary and partially estimated.
1/ Month-to-month and last-month-in-quarter to last-month-in-quarter changes in averages, not annualized.

the 10 per cent rate of growth that generally prevailed over 1972. Part of the January strength in other time deposits reflected the increase in State and local holdings noted above. On the other hand, inflows of savings deposits, with their lower offering yields, began to slow as interest yields on competing market securities continued to rise. There were continuing strong deposit inflows at nonbank institutions--particularly into higher yielding term accounts--so that M_3 expanded at a 10.1 per cent rate during the month.

Growth in the adjusted bank credit proxy slowed in January relative to December, but it still exceeded that for M_2, as shown in the table. Despite a narrowing spread between CD rates and other short-term yields during January, sales of large CD's remained relatively large, although less than the average monthly increases of the previous quarter. To some extent, this strength also may have reflected the inflow into the CD market of State and local revenue sharing funds. U.S. government deposits also rose moderately in January, while non-deposit sources of funds showed relatively little change.

GROWTH IN IPC DEMAND DEPOSITS BY OWNERSHIP CATEGORY
(Monthly and quarterly changes in billions of dollars,
not seasonally adjusted)

Weekly Reporting Banks	Total	Non-financial business	Financial business	Consumers	Foreign	All other
1970 Dec.	4.5	2.2	- .1	2.2	--	.1
1971 Dec.	4.1	2.8	.7	--	.1	.5
1972 Dec.	5.0	3.9	.2	.5	--	.3
All commercial banks						
1970 QIV	7.3	4.6	.3	2.2	- .1	.3
1971 QIV	9.7	6.9	.6	1.2	.1	1.0
1972 QIV	11.7	7.9	.9	2.1	.1	.8

Source: Demand Deposit Ownership Survey.

Bank credit. Bank credit data for January--although still preliminary and subject to revision--indicated that demands for credit were exceptionally strong, with total loans expanding at an annual rate of close to 25 per cent. While almost all loan categories showed substantial growth, the most rapid increase occurred in business loans which expanded at a record rate of approximately 35 per cent. Moreover, both real estate and consumer loans continued to grow at the high rates of other recent months.

Business loan growth, which had slowed during the first two weeks of December, accelerated during the last part of December and through most of January. The expansion was broadly based geographically and among industries, with almost all major industries increasing their reliance on bank financing. At the larger banks, there has been little evidence of a lengthening in the maturity structure of new loans, suggesting that the rising corporate credit demands were primarily for working capital purposes. Some of the increase may also have reflected a shift to bank financing from the commercial paper market, as commercial paper rates increased relative to the prime rate. In conjunction with expanding credit demands and firmer money market conditions, four banks announced increases in their prime rates from 6 to 6-1/4 per cent effective February 5, but following issuance of a press release by the Committee on Interest and Dividends, indicating that justification was being requested, no further increases have been announced and three of the four banks rescinded their increases.

With no Treasury financings during the month and faced with accelerated loan demand, banks reduced their holdings of U.S. government securities during January. Although there were some net acquisitions of other securities, holdings of these securities increased at a much slower rate than in other recent months. As a result, both New York City banks and banks outside New York experienced a decline in their liquidity ratios--the ratio of liquid assets to total liabilities. However, there is some seasonality associated with this decline, and liquidity ratios in general ramain high by historical standards.

COMMERCIAL BANK CREDIT ADJUSTED FOR LOANS SOLD TO AFFILIATES 1/

(Seasonally adjusted changes at annual percentage rates)

	1972			1973
	QIII	QIV	Dec.	Jan. 3/
Total loans and investments 2/	13.6(13.0) 4/	14.4(15.0) 4/	10.7(11.3) 5/	15
U.S. Treasury securities	-7.6	--	27.7	-5
Other securities	9.8	8.1	5.2	5
Total loans 2/	18.8(17.9) 4/	18.7(19.5) 4/	9.9(10.8) 5/	25
Business loans 2/	12.4	15.2	8.3	35
Real estate loans	17.5	17.6	15.0	15
Consumer loans	18.0	19.0	19.0	15

1/ Last Wednesday of month series.
2/ Includes outstanding amounts of loans reported as sold outright by bank to their own holding companies, affiliates, subsidiaries, and foreign branches.
3/ Changes in January are based on incomplete data and are subject to considerable estimating error. Therefore, January estimates given in the table have been rounded to the nearest 5 per cent.
4/ Adjusted to exclude an $800 million matched sale-purchase transaction by the Federal Reserve on the last Wednesday of September.
5/ Adjusted to exclude a $300 million matched sale-purchase transaction by the Federal Reserve on the last Wednesday of November.

Consumer credit. Total consumer credit outstanding rose at a record seasonally adjusted annual rate of $29.6 billion in December, substantially exceeding the month earlier high of $25.5 billion. The large increases reported in each month of the fourth quarter boosted the full year increase to $19.2 billion, or nearly 14 per cent. In 1971, the growth in consumer credit outstanding had amounted to $11.2 billion (8.8 per cent), while over the 5 preceding years annual gains averaged $7.5 billion.

Noninstalment credit--bolstered by an unusually large increase in charge account credit--expanded by a record amount in December, but the increase in instalment debt outstanding was somewhat smaller than in November, after seasonal adjustment. The rise in seasonally adjusted extensions and repayments of instalment credit both slackened slightly in December, but totals for the full year reached new highs.

The cumulative expansion in total consumer credit outstanding during the 25 months since the general business recession low in November 1970 has totaled nearly $33 billion, or more than 26 per cent. This exceeds the increases in comparable periods of recent business upswings but trails the expansions in the earlier postwar cycles. Since late 1970, extensions of instalment credit have advanced more than two-fifths, while repayments--which generally lag--have risen one-fifth.

CHANGES IN SELECTED COMPONENTS OF
CONSUMER CREDIT FROM RECESSION TROUGHS
(Percentage increase, 25-month period)

	Total credit	Instalment credit		
	Outstanding 1/	Outstanding 1/	Extended (S.A.)	Repaid (S.A.)
Oct. 1949- Nov. 1951	36.3	37.8	32.3	53.6
Aug. 1954- Sept. 1956	32.5	35.3	25.5	22.3
Apr. 1958- May 1960	22.9	23.9	27.8	14.9
Feb. 1961- Mar. 1963	16.2	16.3	32.9	17.6
Nov. 1970- Dec. 1972	26.4	26.9	40.1	20.0

1/ Outstandings are not seasonally adjusted.

Customer finance rates on consumer instalment credit contracts purchased by finance companies during the fourth quarter showed a mixed pattern. Rates for both new and used cars dipped slightly in October, but edged up again during November and December. At year-end, the weighted average rate for all units financed was unchanged from December 1971; a decline of 19 basis points in new car rates was balanced by a rise of about 60 basis points in the less heavily weighted used car component. Finance rates on contracts acquired by finance companies for consumer purchases of mobile homes and other nonautomotive consumer goods declined in the fourth quarter and were considerably below earlier 1972 levels.

Nonbank thrift institutions. Despite recent rises in short-term market rates, savings flows to nonbank thrift institutions were exceptionally strong during January. The estimated combined annual growth rate for the month is 17 per cent, substantially higher than that recorded during the last few months of 1972.

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

	Mutual Savings Banks	Savings and Loan Associations	Both
1972 - QI	13.6	22.5	19.7
QII	10.7	15.9	14.3
QIII	11.7	18.2	16.2
QIVe/	10.2	14.2	13.0
November	9.7	13.3	12.2
December p/	10.2	12.6	11.9
1973 - January e/	12.0	19.0	17.0

p/ Preliminary.
e/ Estimated on the basis of sample data.

Savings and loan associations have used some of their increased inflows to repay FHLB advances, particularly in the Atlanta district where end-of-year borrowing was heavy. Although no commitment data are available for January, both new and outstanding commitments at S&L's remained quite high in December.

Short-term markets. Money market conditions have firmed significantly since the last FOMC meeting, as reflected by a 50 basis point rise in the federal funds rate. In response, rates in the private sector of the short term market have risen about 3/8 of a percentage point on bank CD's and finance company paper and 1/2 percentage point on 90 to 119 day commercial paper. Treasury bill rates also have been subject to substantial upward pressures over this period, essentially keeping pace with the upward movement in the funds rate over most of the period. In recent days, however, bill rates have declined to some extent and are presently about 30 basis points (in the 6-month maturity area) to 40 basis points (in the 3-month maturity area) above their levels at the time of the last meeting. The recent downtrend in rates appears to reflect actual and potential foreign central bank buying as a result of the dollar outflow and expectations of some reinvestment demand from attrition in the current Treasury refunding. Dealer bill positions, which had been relatively high in December and through most of January, recently dropped back to more normal levels, so that a significant proportion of the expected increase in bill demands may have to be met by suppliers outside professional circles.

The Treasury has entered the mid-February financing period with a cash balance significantly higher than had been expected at the time of the last Greenbook, as receipts have been running higher and expenditures lower than was anticipated in early January. Consequently, the Treasury will be able to handle a fairly large attrition in its current financing quite comfortably and will not have to return to the market for new money until late February or early March. Assuming that the Treasury doesn't sell special issues to foreign central banks over this period, they will probably need to raise about $3.5 billion of new money at that time. The Treasury probably will return to the market in early April to raise about $4.0 billion. According to Under Secretary of the Treasury Volcker, this borrowing probably will be focused in the short term area of the market and could include April and June TABS, another quarterly 2-year note of $2 billion, and a $1.8 billion issue which will fill the 13th slot of the 52-week bill cycle.

SELECTED SHORT-TERM INTEREST RATES
(Per cent)

	1973				Change
	Jan. 15	Jan. 22	Jan. 29	Feb. 5	Jan. 15 - Feb. 5
Treasury bills					
3-month	5.27	5.59	5.66	5.69	+.42
6-month	5.56	5.76	5.85	5.86	+.30
1-year	5.51	5.61	5.98	5.96	+.45
Federal agency					
1-year	6.01	6.19	6.31	6.41	+.40
Commercial paper					
90-119 days	5.75	5.88	5.88	6.13	+.38
Large negotiable CD's 1/					
60-89 days	5.50	5.63	5.75	5.88	+.38
90-119 days	5.63	5.75	5.88	6.00	+.37
Bank prime rate-most prevalent	6.00	6.00	6.00	6.00	6.00
	Statement Week Ended				
	Jan. 17	Jan. 24	Jan. 31	Feb. 6 2/	Change--week ending Jan. 17 to week ending Feb. 6
Federal funds (daily average)	5.86	6.03	6.35	6.29	+43

1/ Rate is for closest preceding Wednesday.
2/ Average for first 6 days of the week.

Treasury Coupon Issues

Yields on Treasury coupon issues also have been subject to upward pressure since the last Committee meeting, particularly those with intermediate term maturities. To a considerable extent these advances represent adjustments to the general uptrend in short-term interest rates. In addition, they reflect market adjustment to the terms of the Treasury's mid-February refinancing. In this operation, holders of maturing issues--of which $4.8 billion are publicly held--have been offered an exchange into a new 3-1/2 year, 6-1/2 per cent note priced at a discount to yield 6.60 per cent. The Treasury is also auctioning $1 billion of a 6-3/4 year note with a 6-5/8 per cent coupon for cash. Subscriptions for both issues close February 7 with settlement on February 15.

The market's response to the 3-1/2 year note initially was favorable but a more cautious attitude subsequently developed and the security has most recently traded on a when-issued basis at just its issue price. Thus, there may be substantial attrition in this exchange, which will only be partly offset by the cash raised in the auction of the longer term note. Early ideas on the average yield likely to be set in the auction for the longer note center around 6.70 per cent.

<u>Other long-term security markets</u>. Since the beginning of January long-term interest rates have moved up 7 to 12 basis points, in contrast to the decline that often occurs during this period. The sharp rise in short-term rates and uncertainty about future inflationary trends and the strength of the dollar in world markets seem to have made both underwriters and investors uneasy.

SELECTED LONG-TERM INTEREST RATES
(Per cent)

	New Aaa utility bonds 1/	Long-term State and local bonds 2/	U.S. Gov't. (10-year constant maturity
<u>1971</u>			
Low	7.02 (2/5)	4.97 (10/21)	5.42 (3/26)
High	8.26 (7/30)	6.23 (6/24)	6.89 (7/20)
<u>1972</u>			
Low	6.99 (11/24)	4.96 (12/7)	5.87 (1/14)
High	7.60 (4/21)	5.54 (4/13)	6.61 (9/28)
<u>Week ending</u>:			
Jan. 5	--	5.08	6.43
12	7.29	5.03	6.43
19	7.45	5.00	6.46
26	7.40	5.08	6.50
Feb. 2	7.36p	5.16	6.54p

p/ Preliminary.
1/ FRB series.
2/ Bond Buyer (mixed qualities).

The volume of public corporate bond floatations was only $1 billion during January. Utility offerings were unusually light, and there were just a few industrial and financial firms in the market. Underwriters report a buildup of prospective borrowers for late in the spring, and some of these might accelerate their offerings should expectations of sharp rises in long-term rates develop. However, based on present schedulings the staff estimates that February volume will be about $900 million. Commitment data suggest that takedowns of private placements will continue to remain around the $700 million level, and there is also little prospect of a significant change in new equity issue volume.

CORPORATE AND MUNICIPAL LONG-TERM SECURITY OFFERINGS
(Monthly or monthly averages, in millions of dollars)

	1972 e/	QIV e/	1973 Jan. e/	1973 Feb. f/
Corporate Securities				
Total	3,327	3,238	2,550	2,400
Public bonds	1,523	1,361	1,000	900
Privately Placed	725	819	700	700
Stock	1,081	1,061	850	800
State & local government securities	1,971	1,952	2,000 1/	1,700

1/ Includes $220 million of Washington Metropolitan Transit Authority bonds, which are taxable.
e/ Estimated.
f/ Forecast.

State and local government long-term bond offerings amounted to $2.0 billion in January. (This total includes a $220 million issue of taxable municipal bonds sold by Metro.) The staff still expects February volume to be somewhat lower. Many State and local governments are finding themselves in a comfortable surplus position because of rising tax revenues and Federal revenue-sharing grants, and sales of general obligation bonds have been moderating.

In equity markets, prices have declined considerably since the announcement of Phase III and the increase in the discount rate. With investors concerned about prospective inflation and credit developments, the price decline in NYSE stocks has erased more than one-third of the gains registered in the major rally that began in mid-October and continued on balance during the late-December early-January period despite the temporary dimming of peace prospects in Vietnam. Most recently, the weakening of the dollar in international markets has constituted an additional stock market uncertainty, while the final signing of the Vietnam peace agreement had no discernible favorable market impact. The volume of trading activity has moderated over the past several weeks, but remains high.

The latest evidence suggests that individual investors have continued to find equity investments unattractive. Individual cash account customers have been net sellers of stock through most of 1972 and into 1973, judging from various sources of data. In addition, mutual funds experienced another sizable volume of net share redemptions in December--the 11th consecutive month in which redemptions exceeded sales. Margin investors, principally individuals, increased their net debt by only a small amount in December, following limited increases in the preceding three months.

RECENT CHANGES IN STOCK PRICES
(Per cent change)

	Oct. 16-Dec. 21	Dec. 21-Jan. 11	Jan. 11-Feb. 2
NYSE	+7.7	+3.9	-5.6
D-J	+8.5	+5.2	-6.7
AMEX	+1.9	+1.9	-4.0
NASDAQ	+4.1	+4.4	-7.6

Mortgage market. Interest rates on home mortgages apparently remained relatively stable during January. Field reports and other evidence suggest that contract interest rates in the primary market continued around levels that have prevailed since August. In the secondary market, the average yield on Government underwritten mortgages in the latest FNMA bi-weekly auction (February 5) was up only slightly to 7.69 per cent. The volume of bids remained comparatively low, reflecting both strong private investor demand for mortgages of all types as well as a further decline in HUD(FHA) insurance activity due to field office delays associated with tightening of regulatory standards and increased competition from high-ratio conventional mortgages.1/

On conventional home mortgages in general, average non-rate terms remained relatively liberal through December, according to the FHLBB series. Implied downpayments--an important aspect of effective demand for single-family houses--declined somewhat during 1972, as

1/ Potential support for high-ratio conventional mortgages in the secondary market was strengthened somewhat by liberalized FNMA regulations, effective January 29, relating to its commitment pricing policies on these loans.

FNMA PURCHASE AUCTION
(FHA/VA MORTGAGES)

	Amounts of Total Offers Received	Amounts of Total Offers Accepted	Per cent of offers accepted	4-month commitments: Discount (points)	4-month commitments: Private market yield (per cent)
	(millions of dollars)				
972 - High	365 (5/1)	336 (5/1)	92(5/1,7/24)	5.9(10/16,10/30)	7.72(10/16, 10/30)
Low	61 (11/27)	36 (11/27)	42(3/20)	4.4(3/20)	7.54(3/20)
Nov. 13	79	49	62	5.8	7.71
27	61	36	60	5.6	7.69
Dec. 11	82	42	52	5.5	7.67
26	109	66	61	5.5	7.67
973 - Jan. 8	74	61	82	5.6	7.68
22	107	92	86	5.6	7.68
Feb. 5	129	65	51	5.7	7.69

IOTE: 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 7 per cent Government-underwritten mortgages. Implicit yields shown are gross, before deduction of 38 basis point fee paid by investors to servicers.

average loan size increased by more than average prices of new and existing homes purchased. Monthly carrying charges--another significant influence on housing demand--rose more moderately than loan size, owing mainly to a further lengthening in loan maturity.

SELECTED CHARACTERISTICS OF CONVENTIONAL MORTGAGES
CLOSED ON NEW AND EXISTING HOMES

Characteristics	December 1971	December 1972	Percentage change
Loan size ($1,000)			
New homes	26.5	29.1	9.8
Existing homes	23.9	25.4	6.3
Loan to price ration (per cent)			
New homes	74.5	77.9	4.6
Existing homes	74.6	76.6	2.7
Maturity (years)			
New homes	26.6	27.5	3.4
Existing homes	24.6	26.1	6.1
Implied downpayment ($1,000)			
New homes	9.9	8.9	-10.1
Existing homes	8.6	8.3	- 3.5
Implied monthly payment toward principal and interest (dollars)			
New homes	194	209	7.7
Existing homes	178	184	3.4

NOTE: FHLBB series for conventional first mortgages originated by major lenders, U. S. average.

Federal finance. The new Federal budget for fiscal year 1974 calls for a deficit of $12.7 billion on a unified budget basis and a high employment surplus of $.3 billion. For the current fiscal year, the Administration is predicting a unified budget deficit of $24.8 nillion and a high employment deficit of $2.3 billion. Outlays in fiscal 1974 are set at $268.7 billion, an increase of $18.9 billion over the estimated $249.8 billion for 1973. These aspects of the budget are shown in table 3 at the end of this section. The budget indicates that outlays in these years would be much larger if the Administration had not sought savings through program reductions and terminations.

A shift to tighter controls over program growth in fiscal 1974 is indicated in Table 1 even after adjustments in outlays are made for financial asset sales, oil lease sales and other proprietary receipts. These items are recorded as negative entries in the tabulation of total outlays. Like NIA expenditures, the increase in adjusted budget outlays for fiscal 1974 drops sharply from that in fiscal 1973.

Table 1
OUTLAYS ADJUSTED TO EXCLUDE PROPRIETARY RECEIPTS AND ASSET SALES
(Billions of dollars)

	Fiscal Years				
	1970	1971	1972	1973e	1974e
Total outlays	196.6	211.4	231.9	249.8	268.7
Plus selected negative items	4.7	7.1	7.0	16.4	12.2
Proprietary receipts from the public 1/	3.8	4.9	4.5	10.8	8.2
Net sales of financial assets	.9	2.3	2.5	5.5	4.0
Adjusted outlays	201.3	218.6	238.9	266.2	280.9
Change		17.2	20.3	27.3	14.7
Memorandum					
Change in NIA Federal expenditures*		16.5	20.3	26.7	15.6

* The adjusted budget outlays figure is not precisely the same figure as NIA expenditures because some proprietary receipts affect NIA expenditures and because there are timing differences.

1/ Included in this category are such items as rents and royalties on Outer Continental Shelf lands, military sales to foreigners and sales from the stockpile of strategic and critical materials.

The staff's current estimate of outlays for fiscal 1973 is consistent with the Administration's projected $250 billion ceiling since spending so far this fiscal year appears to be in line with such a spending total. According to the new budget the $250 billion goal will require a spending cutback of $11.2 billion. As shown in Table 2, the spending reduction is to be achieved by timing shifts and additional negative outlays as well as a large number of mostly small program reductions and terminations.

Table 2
BUDGET REDUCTIONS IN FISCAL YEARS 1973
(Billions of dollars)

Timing shifts		2.0
Delay in revenue sharing payment	1.5	
Other deferrals	.5	
Increases in negative outlays		2.7
Stockpile disposals	.4	
Financial asset sales on other shifts to private financing	1.1	
Additional offshore oil receipts	1.0	
Increased user chargers	.2	
Limit of social service grants, enacted by Congress and supported by Administration		2.3
Program reductions and terminations		4.2
Water pollution	.3	
Farm price support programs	.7	
Substitution of regular loan assistance for emergency loans	.4	
Medicare and medicaid cost controls and management	.4	
Other (more than a 100 smaller items)	2.4	

The new budget projects receipts of $225 billion for fiscal 1973 and $256 billion for fiscal 1974, which represent increases of 7.9 per cent and 13.8 per cent, respectively. The increase in fiscal 1974 is largely attributable to the January 1973 rise in the social security wage base and tax rates.

Since the January Greenbook, the staff has raised its fiscal 1973 receipts estimate from $226.5 billion to $228 billion--$3.0 billion above the budget. This is the result of a staff reestimate of the extra refunds (net of final payments) resulting from 1972 overwithholding which are now expected to inject an additional $7 billion into household funds during the spring, rather than the $8 billion we had expected earlier. In general, we are assuming slightly higher effective tax rates than those which underlie the Budget estimates--especially in regard to corporate taxes--and our forecasts are based on slightly higher income assumptions.

The budget document contains no legislative proposals that would require major additional outlays in fiscal 1974 and no major tax proposals. Also, it provides no funds for reconstruction efforts in Southeast Asia, property tax relief, or family welfare reform. Administration spokesmen have indicated that if these programs are introduced, other budget items would be cut to stay within spending ceilings. The main legislative proposals involve economies such as a somewhat larger sharing of costs by medicare patients, and the lumping of a number of categorical grants into special revenue sharing programs in the areas of education and law enforcement. In the latter case the costs of these new programs would approximately equal those of the narrower categorical grants they would replace.

Looking at fiscal year 1974 expenditures on an NIA basis, defense spending rises slightly by $1.3 billion while non-defense purchases show a sharp increase of $4.5 billion, reflecting in part a cessation of reductions in CCC inventories. Transfer payments rise by $10 billion, somewhat less than in fiscal year 1973. The sharpest change of emphasis is in the grants area. Grants have been steadily increasing during the last decade, and the increase is unusually large in fiscal 1973 when revenue sharing was introduced. In fiscal 1974, grants stay unchanged at $41.6 billion. However, Federal takeover of welfare for the aged, blind, and disabled in January 1974 relieves the States of $1.1 billion of public assistance payments that are currently financed from grants.

The budget for fiscal 1974 shows a slower rate of growth (6.0 per cent) for total NIA expenditures than for unified budget outlays (7.6 per cent), reflecting a tapering off in asset sales and a cessation of the economies in unified budget outlays for fiscal 1973 that resulted from the outlay speed-up at the end of fiscal 1972. The Staff's estimates of Federal Sector NIA accounts are in general agreement with those presented in the budget.

As shown in table 3, the staff projections indicate that almost all of the expenditure growth in calendar 1973 will occur in the first half of the year when NIA spending will rise by about $14.8 billion. In the second half, expenditures are projected to rise by only $1.6 billion. The high employment budget shows a similar decrease in fiscal stimulus as the calendar year progresses.

The budget document projects that net borrowing from the public will be $25 billion in fiscal year 1973. The staff's current estimate is for a lower amount--$20 billion. The difference is due to the fact that our receipts estimate is $3.0 billion higher than that given in the budget, and we are projecting a $1.2 billion net drain from other financial sources compared to one of $3.2 predicted by the Administration.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	Jan.	Feb.	March	April
Total net borrowing	1.7	-0.7	3.6	0.8
Weekly and monthly bills	1.0	0.1	0.1	0.1
Tax bills	--	--	--	-3.0
Coupon issues	0.6	3.6	--	--
As yet unspecified new borrowing	--	--	3.5	4.0
Special issues to foreigners	-0.2	--	--	--
Agency transactions, debt repayment, etc.	0.3	-4.4	--	-0.3
Plus: Other net financial sources[a/]	1.3	-0.1	1.6	0.5
Plus: Budget surplus or deficit (-)	-2.7	-3.6	-6.0	1.1
Equals: Change in cash balance	0.3[b/]	-4.4	-0.8	2.4
Memoranda: Level of cash balance, end of period	11.4[b/]	7.0	6.2	8.6
Derivation of budget surplus or deficit:				
Budget receipts	20.1	17.1	15.3	24.8
Budget outlays	22.8	20.7	21.3	23.7
Maturing coupon issues held by public	--	4.6	--	--
Net borrowing by gov't-sponsored agencies	0.4	0.6	1.4	0.6

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

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

	Fiscal 1973 e/		FY 1974 e/	Calendar Years		F.R.B. Staff Estimates				
						Calendar Quarters				
	Jan. Budget	F.R. Board	Jan. Budget	1972 Actual	1973 F.R.B. e/	1972 IV*	1973 I	II	III	IV
Federal Budget						Unadjusted data				
Surplus/deficit	-24.8	-21.8	-12.7	-17.4	-16.4	-10.5	-12.4	3.1	0.4	-7.6
Receipts	225.0	228.0	256.0	221.5	244.1	50.5	52.5	69.5	64.6	57.5
Outlays	249.8	249.8	268.7	239.0	260.5	60.9	64.9	66.4	64.2	65.1
Means of financing:										
Net borrowing from the public	25.0	20.0	16.5	15.2	11.7	12.3	4.6	-2.0	2.0	7.1
Decrease in cash operating balance	3.0	3.0	n.a.	0.2	4.1	-1.3	4.9	-0.9	-0.9	1.0
Other 1/	-3.2	-1.2	n.a.	2.0	0.7	-0.5	2.8	-0.1	-1.5	-0.5
Cash operating balance, end of period	7.1	7.1	n.a.	11.1	7.0	11.1	6.2	7.1	8.0	7.0
Memo: Net agency borrowing 2/	n.a.	6.0	n.a.	1.4	n.e.	0.8	2.4	2.2	n.e.	n.e.
National Income Sector						Seasonally adjusted, annual rates				
Surplus/deficit	-26.6	-24.3	-12.5	-18.2	-13.3	-24.6	-26.7	-17.1	-6.0	-3.3
Receipts	233.3	235.4 3/	263.0	228.6	254.7	238.3	242.3	248.0	261.1	267.5
Expenditures	259.9	259.7	275.5	246.8	268.0	262.9	269.0	265.1	267.1	270.8
High Employment surplus/deficit (NIA basis) 4/	n.a.	-6.8	n.a.	-0.3	-4.9	-11.7	-14.3	-5.7	-0.4	0.9

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

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

2/ 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.

3/ Quarterly average exceeds fiscal year total by $4.2 billion due to spreading of wage base and refund effect over calendar year.

4/ E timated by F.R. Board Staff.

INTERNATIONAL DEVELOPMENTS

III -- T - 1

U.S. Balance of Payments

In millions of dollars; seasonally adjusted

	1 9 7 2 P/				
	Year	1H	3Q	4QP	Dec.P
Goods and services, net 1/		-2,773	-893		
Trade balance 2/	-6,821	-3,619	-1,585	-1 617	-596
Exports 2/	48,838	23,252	12,311	13,275	4,435
Imports 2/	-55,659	-26,871	-13,896	-14,892	-5,031
Service balance		+846	+692		
Remittances and pensions		-772	-383		
Govt. grants & capital, net		-1,574	-819		
U.S. private capital (- = outflow)		-3,302	-2,345		
Direct investment abroad		-1,366	-1,132		
Foreign securities	-631	-747	227	-111	-178
Bank-reported claims -- liquid	-735	-221	-449	-65	-435
" " " other	-2,778	-650	-745	-1,383	-867
Nonbank-reported claims -- liquid		-255	-118		
" " " other		-63	-128		
Foreign capital (excl. reserve trans.)		4,322	1,532		
Direct investment in U.S.		-10	259		
U.S. corporate stocks	2,373	860	379	1,134	351
New U.S. direct investment issues	1,914	1,062	372	480	253
Other U.S. securities (excl. U.S. Govt.)	52	101	-75	26	
Liquid liabilities to:	4,815	1,743	440	2,632	138
Commercial banks abroad	3,905	1,456	316	2,133	36
Of which liab. to branches 3/	(134)	(196)	(34)	(-96)	(336)
Other private foreign	808	334	155	319	202
Intl. & regional institutions	102	-47	-31	180	-100
Other nonliquid liabilities		566	157		
Liab. to foreign official reserve agencies	10,089	3,904	4,661	1,524	307
U.S. monetary reserves (increase, -)	743	554	122	67	157
Gold stock	547	544	3	--	--
Special drawing rights 4/	7	7	--	--	--
IMF gold tranche	154	184	-15	-15	-5
Convertible currencies	35	-181	134	82	162
Errors and omissions		-359	-1,875		
BALANCES (deficit -) 4/					
Official settlements, S.A.	-10,820	-4,456	-4,801	-1,563	
" " , N.S.A.	-10,820	-3,957	-5,544	-1,319	-461
Net liquidity, S.A.		-5,723	-4,630		
" " , N.S.A.		-6,122	-5,274		
Liquidity, S.A. 5/	-15,445	-6,199	-5,197	-4,049	
" , N.S.A.	-15,445	-6,738	-5,765	-2,942	-611

* Monthly, only exports and imports are seasonally adjusted.

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

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

3/ Not seasonally adjusted.

4/ Excludes allocations of SDRs as follows: $710 million on 1/1/72.

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

INTERNATIONAL DEVELOPMENTS

Summary and outlook. The relative calm in foreign exchange markets that had prevailed after the end of the speculative disturbances of last June and July was shattered again in January, and the dollar came under heavy speculative pressure. The first action that stirred the market was the decision of the Italian authorities to protect the lira against large capital outflows by creating a dual market for that currency. Uneasiness was then heightened by the floating of the Swiss franc as the Swiss authorities chose this method of discouraging inflows of capital that were adding to excess liquidity in Switzerland.

After a few days' lull, there was a greatly heightened burst of speculative activity in the closing days of January and early February, this time representing mainly a rush to some other currencies, especially the deutschemark, out of dollars. At this point, the market's behavior seemed to reflect deep-seated concerns with the continuing heavy U.S. deficits, especially as reflected in the December trade data, which disappointed hopes that a strong trend of improvement was finally under way. Moreover, the fourth-quarter trade performances of Germany and Japan were so strong as to suggest to market participants that these countries would have a stronger balance-of-payments position this year than in 1972, despite their revaluations.

In the final quarter of 1972 the U.S. deficit on the official settlements basis was $1.6 billion, seasonally adjusted, bringing the total for the year to $10.8 billion (apart from SDR allocations).

On the (gross) liquidity basis the fourth-quarter and annual deficits were $4.0 billion and $15.5 billion, respectively. Factors tending to raise the deficit in December were the continued large excess of imports over exports (although there will be a small upward revision of exports from the figure initially published), a net increase in bank-reported claims on foreigners of over $1.0 billion, and a somewhat diminished inflow to purchase U.S. corporate stocks. Also, year-end repatriations by direct investors may have been somewhat less than normal.

For the four weeks ended January 31, 1973, weekly data indicate a surplus (not seasonally adjusted) of perhaps $0.5 billion on the official settlements basis. That figure would not yet include the large capital outflows resulting from exchange market transactions on the last two days of January. Very little is known about transactions during the month except for inflows of liquid funds through banks mainly in the first half of the month. There may also have been some reflow of bank credit, for the month as a whole, though outflows were reported in the last week. Inflows of foreign capital to the U.S. stock market probably tapered of

The prospects for the U.S. balance of payments in the period ahead are not encouraging. While the outlook for exports is good, improvement in the trade balance will be slowed by the growing demand in sectors of the U.S. economy that tend to draw heavily on imports. Large increases in interest payments to foreigners will more than offset any likely gain in income receipts. Against that background, recurrent speculative outflows may continue.

Recent Developments in Foreign Exchange Markets. After trading fairly quietly on foreign exchange markets through most of January, the dollar came under heavy selling pressure in recent weeks, culminating in purchases by foreign central banks totaling nearly $4 billion in the past week.

Pressure on the dollar was triggered by the institution in Italy of a two-tier exchange market on January 22, allowing the value of the lira in capital transactions to float while its value in most current transactions is maintained within the official bands. The move was taken to defend Italy's foreign exchange reserves against the heavy capital outflows which had been taking place since mid-1972.

The introduction of a dual market for the lira was immediately followed by a weakening of the dollar against all European currencies. The partial floating of the lira exerted particularly strong upward pressure on the Swiss franc. This was due in part directly to Italian demand for francs but also reflected the general appeal of the Swiss franc to nervous dollar holders. Moreover, interest rates had climbed sharply in Switzerland because of stabilization measures introduced by the Swiss in recent months and these measures in themselves enhanced confidence in the Swiss franc.

The Swiss National Bank purchased nearly $300 million the day the dual lira market was introduced. The following day, in order to counter the threat to its anti-inflation program posed by large-scale capital inflows, the Bank announced that it would temporarily cease intervening to keep the Swiss franc from exceeding its upper limit.

The exchange rate of the franc immediately rose above its ceiling and has continued to float upward to a current level almost 5 per cent above its upper limit -- a level which would seem to effectively rule out a return to the pre-float central rate.

To the general feeling of uncertainty over the stability of the Smithsonian exchange rate structure engendered by the Italian and Swiss actions was added a feeling of pessimism over the fundamental strength of the dollar following the release on Wednesday, January 24 of U.S. trade figures for December showing a worsening of the already large November deficit and a deficit for 1972 as a whole of nearly $6.5 billion (census basis). Under these conditions major European currencies moved towards their ceilings led by the German mark, the only major European currency -- along with the Dutch guilder -- not either floating or traded under a dual market system. This movement was only temporarily halted by favorable market reaction to press reports on Thursday January 25 of market intervention by the FRBNY. (The System's sales in the New York market of German marks and, to the lesser extent, Dutch guilders, have continued on nearly a daily basis up to the present).

By last Thursday, February 1 all major non-floating currencies except the lira had reached or exceeded their ceilings, and on Thursday and Friday foreign central banks took in nearly $1.7 billion. The Bundesbank bought by far the largest amount ($1 billion), but the Bank of Japan ($250 million) and the National Bank of Belgium ($200 million) also intervened substantially. The Bank of Japan purchased an additional $275 million on Saturday following a statement of the Governor of the

Bank that he could not preclude the possibility of another yen revaluation.

On Friday evening the German Cabinet reaffirmed its intention to defend the current mark parity and announced additional capital control measures to deal with the speculative rush into marks. These included the requirement that German non-bank residents must obtain prior Bundesbank approval for foreign borrowing in excess of 50 thousand markes and the extension of the de facto ban applied in June to sales by Germans of German bonds to non-residents to include sales to foreigners of German equities.

The German government's actions halted the rush out of the dollar on Monday, February 5, but amidst a growing feeling that the German measures did not come to grips with the fundamental problem, heavy selling of the dollar on the German exchanges resumed on Tuesday. The Bundesbank purchased over $1.5 billion with other European central banks also taking in smaller amounts of dollars. A further reaffirmation by the German Finance Cabinet at mid-day of its intention to continue to defend the mark's upper limit with Bundesbank intervention halted the inflow, but the mark, Belgian franc, and Dutch guilder all remain poised nervously just below their ceilings.

Sterling, which had traded quietly around $2.35 through most of January was pulled up by the currency turmoil on the Continent, rising above $2.39 on February 6 before easing to a current level of $2.38. The Bank of England purchased nearly $200 million as the pound moved up. The gold price was similarly stimulated by the recent exchange market unrest, rising to nearly $69 after trading around $64.50 through most of January.

Euro-dollar market. Over the past four weeks interest rates in the Euro-dollar market have risen sharply further in some maturities. In recent days the 1-month and 3-month Euro-dollar rates have been higher by 1 to 1-1/4 percentage points than in the week of January 10. The mounting speculation against the dollar evident in the exchange markets since January 22 has undoubtedly taken the form as well of increased demand for Euro-dollar loans for switching into other currencies on a speculative basis, along with a reduced supply of Euro-dollar deposits. Most of the past month's rise in Euro-dollar rates in fact occurred after the speculation against the dollar broke out. Rising short-term interest rates in the United States have been another factor putting upward pressure on Euro-dollar rates. Abroad, there has not been significant additional tightening of Continental European money markets, but British interest rates have continued to climb. In early February the 3-month local authority rate in Britain was up about a percentage point from a month earlier.

Movements of differentials between Euro-dollar rates and U.S. interest rates have been mixed. With Euro-dollar rates in the 1-month and 3-month maturities increasing faster than comparable domestic CD rates, there has been a widening of rate differentials that already favored investments in Euro-dollars and discouraged U.S. banks from borrowing Euro-dollars in those maturities (even if reserve-free). In contrast, the U.S. Federal funds rate has risen considerably relative

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

Average for month or week ending Wednesday	(1) Over-night Euro-$ 1/	(2) Federal Funds 2/	(3) Differ-ential (1)-(2)(*)		(4) 1-month Euro-$ Deposit 1/	(5) 30-59 day CD rate (Adj.) 3/	(6) Differ-ential (4)-(5)(*)	
1972 - Aug.	4.47	4.80	-0.33	(0.79)	5.18	4.73	0.45	(1.75)
Sept.	4.54	4.86	-0.33	(0.79)	5.15	4.96	0.19	(1.48)
Oct.	4.77	5.05	-0.28	(0.91)	5.10	5.10	0.00	(1.28)
Nov.	4.74	5.05	-0.31	(0.88)	5.08	5.01	0.07	(1.34)
Dec.	4.75	5.33	-0.58	(0.61)	6.05	5.25	0.80	(2.31)
1973 - Jan.	5.72	5.94	-0.22	(1.21)	5.97	5.79	0.18	(1.67)
1972 - Dec. 27	5.16	5.34	-0.18	(1.11)	6.11	5.52	0.59	(2.12)
1973 - Jan. 3	5.09	5.63	-0.54	(0.73)	5.60	5.52	0.08	(1.48)
10	5.89	5.66	0.23	(1.70)	5.75	5.66	0.09	(1.53)
17	5.72	5.86	-0.14	(1.29)	5.95	5.79	0.16	(1.65)
24	5.38	6.03	-0.65	(0.70)	6.02	5.93	0.09	(1.60)
31	5.89	6.35	-0.46	(1.01)	6.41	6.05	0.36	(1.96)
Feb. 7p	5.97	6.21	-0.24	(1.25)	6.78	6.05	0.73	(2.43)

1/ All Euro-dollar rates are noon bid rates in the London market; overnight rate adjusted for technical factors to reflect the effective cost of funds to U.S. banks.

2/ Effective rates.

3/ Offer rates (median, as of Wednesday) on large denomination CD's by prime banks in New York City; CD rates adjusted for the cost of required reserves.

*/ Differentials in parentheses are after adjustment of Euro-dollar rates for the 20 percent marginal reserve requirement (relevant to banks with borrowings in excess of their reserve-free bases).

p/ Preliminary.

to the overnight Euro-dollar rate (which shows little net change from a month ago), so that the cost to U.S. banks of reserve-free overnight Euro-dollars has again been below the Federal funds rate, the differential averaging about 1/4 per cent in the past week. Average daily borrowings of U.S. banks from their foreign branches rose from $2.2 billion in the week of January 10 to $2.7 billion in the week ending February 5.

<u>The exchange markets and balance of payments trends in selected countries</u>. The recent unsettled conditions in the foreign exchange markets raise the question whether the recent upward pressure on most major European currencies and the Japanese yen, and the continuing weakness of the Italian lira, seem justified by underlying balance of payments trends.

On the face of it, the prime cause of the downward movement of the dollar against all other major currencies described above appears to have been the mounting loss of confidence in the dollar itself. For the most part, recent balance of payments developments do not appear to indicate pronounced general disequilibria, except vis-à-vis the United States. In Germany, for example, even though the mark has been the currency most heavily in demand since the exchange crisis began two and a half weeks ago, the prospect is for approximate balance of payments equilibrium in 1973.

A notable exception, in addition to the United States, to the apparent absence of major imbalances in individual countries is Japan, which clearly remains in persistent surplus.

Despite the revaluation of the <u>yen</u> in 1971 and the subsequent adoption of direct measures aimed at reducing the trade surplus, the Japanese current account surplus this year is expected to decline by only a relatively small amount, to something over $5 billion from $6.7 billion last year. A decline in the trade surplus of about $1 billion--from $9 billion to about $8 billion--is anticipated, with the dollar value of exports increasing by about 11 per cent, imports by about 22 per cent. And most of this move towards a diminution of the Japanese surplus can be explained by the recovery in economic activity from the 1970-71 recession. The measures taken to reduce the trade surplus--a 20 per cent cut in tariffs, a 30 per cent rise in import quotas, and controls to restrain the growth of exports--are expected to contribute relatively little to a more balanced trade position in 1973.

The basic balance surplus will be somewhat smaller than the current account surplus but, adjusted for reserve gains disguised as capital outflows, will probably total a very substantial $3.5 billion.

The recent surge in demand for marks almost certainly owes something to a changed balance of payments outlook. A huge and unexpected trade surplus in the fourth quarter, primarily reflecting a sharp increase in exports, put the German current account (seasonally adjusted) in the black after a third quarter deficit and virtually a zero balance in the second. An extremely steep jump in export orders in the second half of 1972, moreover, points to the achievement of a very large trade surplus next year.

However, though a large deficit is no longer anticipated in 1973, as it was until fairly recently, the current account is likely to show only a small surplus at most. The deficit on service transactions and transfers shows a strongly rising trend, primarily because of a continuing rise in travel expenditures and a sizable increase in remittances by foreign workers, whose wages and numbers are increasing as the economic upturn gathers steam.

In brief, the German balance of payments may be more or less in equilibrium this year, provided no large capital inflow--other than the purely speculative rush into marks in the last two and a half weeks--occurs. The prospect of equilibrium suggests that the mark, looked at in isolation from other currencies, is not basically undervalued at present. This may help explain the evident determination of the German authorities to maintain the present DM parity and their emphatic rejection of revaluation or floating, at least for the time being, in the absence of similar moves by major competitors, in particular Japan.

The rise in the pound--which was floated in June--during the present foreign exchange crisis has clearly not been a reflection of underlying balance of payments strength. Even the most optimistic current account forecast--made on the assumption of a $2.35 rate which the current value of sterling now exceeds--foresees a 1973 deficit of no less than $750 million.

The strong demand for guilders and Belgian francs is easier to explain in that both the Netherlands and Belgium are expected to run sizable surpluses, at least on current account, this year. However, the anticipated strength of the current accounts in these countries in 1973 is based in part on cyclical factors, with the economies of both the Netherlands and Belgium still operating at levels well below capacity.

For the Netherlands, the long-term outlook for the balance of payments does not appear at all promising because of the exceptionally rapid rate of domestic inflation.

As for Switzerland, there is no evidence that the rise of the Swiss franc above its ceiling following the float initiated on January 23 can be attributed to factors other than those described above--that is, the introduction of the dual market for lire in Italy, the favorable impact on the market's view of the Swiss franc of the vigorous stabilization measures recently adopted in Switzerland, and the weakness of the dollar.

The one major currency, other than the dollar, to exhibit weakness during the recent exchange market disturbances was the Italian lira. The value of the commercial lira vis-á-vis the dollar rose but only because of intervention by EEC central banks to maintain the lira exchange rate within the narrow EEC bands. The weakness of the commercial lira is somewhat surprising, since the current account, on a transactions basis, appears to have recorded a sizable surplus last year and since it appears that even under high employment conditions--not achievable in the near future in any event--the current account might well remain in surplus. The softness of the commercial lira in the wake of the separation of capital from current transactions in the exchange market implies that this action did not dispel fears of a lira devaluation. Such fears are primarily a function of political uncertainties in Italy.

<u>Balance of payments</u>. According to data that are now nearly complete, the seasonally adjusted deficit on the official settlements basis in the fourth quarter of 1972 was $1.6 billion -- about the same as estimated earlier -- while the fourth-quarter deficit on the liquidity basis was about $4.0 billion, considerably larger than indicated by the weekly preliminary data. For the year 1972, the official settlements deficit was $10.8 billion; the (gross) liquidity deficit was $15.4 billion. Comparable figures for 1971 were $30.5 billion and $23.8 billion, respectively.

Preliminary weekly data (not seasonally adjusted) for January show a shift into a surplus of about $1/2 billion on the official settlements basis and a small deficit on the liquidity basis. However, there may again be a larger than usual discrepancy between the weekly data and the final monthly figures, as there was in December. The speculative flow into Swiss francs in January is reflected in the weekly data for the month, but the much larger outflows into DM and other currencies at the end of the month will not show up until settlements are made in the first week of February.

Apart from data on merchandise trade (discussed below) information on other fourth-quarter 1972 developments is limited to securities transactions and bank lending to foreigners. Foreign purchases of U.S. equities in October-December quarter were particularly large, totaling over $1 billion. Market reports indicate, however, that there was a decided weakening in foreign purchases in January. Sales of offshore bond issues by U.S. corporations (to finance their direct investments abroad) were still relatively strong in the fourth quarter. Partly offsetting these larger sales of U.S. securities was the resumption of a more normal outflow for U.S. purchases of Canadian and other IET exempt foreign new issues (about $375 million for the quarter compared with a very small amount in the third quarter).

Bank claims on foreigners rose more than seasonally in December; unadjusted the outflow was about $1-1/4 billion. About half of the increase in bank claims was reported by U.S. agencies and branches of foreign banks. Of the increase in claims reported by other banks, the largest part was in assets not covered by the VFCR. Very preliminary weekly data for January indicate a reverse flow, reducing U.S. bank claims on foreigners, in the first three weeks of the month; toward the end of the month there was another large increase in claims, perhaps reflecting speculative borrowing of dollars by foreigners to sell for other currencies.

U.S. foreign trade. Revised data for December show that the trade deficit was slightly less in that month than in November. The deficits in both November and December were markedly larger than in the immediately preceding months and reversed the gradual decline in the deficits that has occurred from June through October. For the fourth quarter of 1972, the trade deficit was at an annual rate of $6-1/2 billion, up slightly from the third quarter. For the year 1972 the trade deficit was $6.8 billion, $4 billion more than in 1971.

The renewed expansion in imports after mid-year, as domestic economic activity advanced strongly, was mainly responsible for the lack of further improvement in the trade balance. Imports in the fourth quarter were over 7 percent higher than in the third quarter, a decided acceleration from the 4 percent advance from the second to the third quarter. Higher import prices (unit values) accounted for less than one-third of the increase in value of imports in the fourth quarter. Virtually all categories of imports rose from the third to the fourth quarter. Imports of industrial materials -- petroleum, steel and other metals, lumber -- continued to advance strongly, as they have throughout 1972. In addition imports of finished products -- mainly capital equipment but also consumer goods (other than automobiles) -- which had been unchanged from the second to the third quarter, turned up in the last quarter of the year. Imports of such goods were a larger share of total domestic expenditures for similar goods in the fourth quarter than in the third, reflecting the influence of cyclical demand on imports. Although imports of automobiles from Europe and Japan in the fourth quarter did not rise, sales of these cars in the United States increased, not only in terms of units but also as a share of total domestic car sales, reversing the shrinkage in their share that occurred during most of 1972. The increased demand for these foreign cars in the closing months of the year was met by drawing down inventories built up earlier.

Exports advanced strongly in the fourth quarter -- reaching a level 8 percent higher than in the third quarter -- with about two-fifths of the increase in value accounted for by higher prices (unit-values). The expansion in exports from the second to the third quarter had been nearly as great -- 7-1/2 percent -- with virtually all of the increase in real terms as prices rose only marginally. The current strength in exports -- increases of over 30 percent at annual rates in both the third and fourth quarters -- is particularly impressive since exports in the year 1972 as a whole were only 15 percent greater than in 1971. Increased deliveries of agricultural commodities -- not only to the Soviet Union but to other markets -- accounted for about two-fifths of the rise in exports in the fourth quarter. The value of such shipments continued to be buoyed by higher prices for wheat, corn, rice and soybeans. Shipments of these commodities appear to be limited only by the ability of transportation facilities, here and abroad, to handle the heavy volume of cargo. In the current quarter, heavy sales of cotton to Communist China are also expected to help maintain agricultural exports at or above the $11 billion rate of the fourth quarter. (In 1971 total agricultural exports had been less than $8 billion.)

Exports of nonagricultural commodities also showed increasing strength in the fourth quarter. Machinery exports rose further, and foreign orders for U.S. machinery in December were extremely large, continuing the rise in such orders that had begun around mid-1972. Exports of nonagricultural industrial materials -- paper products, chemicals, steel scrap and other metals -- were all up sharply in the fourth quarter. Deliveries of commercial aircraft were also moderately larger than in the third quarter; delivery schedules call for a greater expansion in aircraft exports in 1973.