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Content last modified 6/05/2009.

CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

Prepared for the Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

January 5, 1967

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SUMMARY AND OUTLOOK

Outlook for GNP

GNP for the fourth quarter is now estimated to show a larger increase than was projected four weeks ago because inventory accumulation was much larger than previously indicated. At the same time new evidence now becoming available shows less strength in retail sales than estimated earlier. Estimates of defense spending for both quarters are somewhat lower than those presented in the last Greenbook because of later information for the fourth quarter. Over-all, GNP is projected as rising only $7 billion in the current quarter, as compared with $14 billion in the fourth. In real terms, the rise is estimated to be at an annual rate of about 1.5 per cent in the present quarter.

The fourth quarter inventory bulge -- associated as it was with little, if any, further increase in real consumer takings of goods, another large cut in construction activity, and the slowing in expansion now evident in the equipment sector -- must largely represent involuntary accumulation of stocks which should lead to adjustments of production schedules shortly. Cutbacks in output instituted earlier in construction-related industries and recently in major consumer durable goods industries already have led to reduced output of some materials. More widespread or deeper cutbacks in consumer lines are probably now in order, along with further slowing of expansion in the equipment sector. Under these circumstances, the prospect is for some decline in industrial production in the current quarter.

In a broad sense, inventory accumulation has been excessive since early last spring -- particularly for durable goods -- and stock-sales rations have risen substantially from the low levels prevailing earlier. The rate of accumulation now projected for the first quarter of 1967 for nonfarm business is still as large as in early 1966, and would not likely result in any decline in stock-sales ratios. Consequently, business generally may be expected to continue efforts to curtail inventory additions. Such an adjustment, through its effects on industrial production, can be expected to slow the rise in incomes and to moderate further the rise in consumer spending; in addition, it may weaken further business incentives to expand or maintain investment fixed capital.

Prices and resource use

Crosscurrents in demands and output in recent months have resulted in virtually no net change in the index of industrial production between August and December. Given the excessive level of stocks, near-term prospects in many industries are for output to remain at somewhat reduced levels or to decline. With capacity generally continuing to increase, reductions in output-capacity ratios are in prospect.

While indications of layoffs and cutbacks in the workweek are few and labor markets remain generally tight, there are some signs of softening, such as in the recent more than seasonal rise in unemployment claims.

With output levelling off and manhours continuing upward in recent months, productivity growth has slowed and labor costs per unit of output have risen. But with product markets less strong it will be more difficult to raise prices. As a result, efforts to protect profit margins are likely to focus on holding down cost increases. Thus, even with somewhat larger wage settlements in the months ahead, the average rise in industrial commodity prices may remain limited. The rise over the past year has amounted to 2 per cent, with the largest increases among machinery and equipment.

The outlook for farm and food prices is mixed. For grains, increases in acreage allotments could bring enough expansion in production to weaken prices, but that would have little impact on consumer prices for foods. Prospects are for smaller market supplies of beef this year but for larger supplies of pork, poultry, and eggs. If retail food prices rise at all, apart from seasonal movements, the rate of increase is likely to be far below that in 1965 and most of 1966. However, the recent declines in prices of foodstuffs at both wholesale and retail are believed to be about over and, thus, this offset to higher industrial and service prices can no longer be counted on.

Supply and demand at commercial banks

The supply of deposits at commercial banks increased markedly in December, with both demand and time deposit growing. Total deposits are likely to continue rising, at least by moderate amoungs, in the weeks immediately ahead. At current levels of interest rates, banks may be able to continue adding moderately to outstanding large CD's and to compete relatively successfully for consumer savings. Banks were able to add a very small amount to their outstanding CD's during December, but it is very likely that the maturities on their record sales during the month were generally quite short. Thus, banks will be faced with a continuing problem of rolling over heavy maturities in the weeks ahead.

In the degree that banks continue to have a large burden of maturing CD's and until they are quite certain about their ability to roll them over, they are likely to move slowly in changing their loan policies. Rescission of the September 1 letter may have indicated to banks that funds will be more generally available in the period ahead, but most major banks will probably be awaiting confirming developments as seen in the Federal funds rate and the continued availability of CD money before making any basic loan policy changes.

The inclination of banks to move toward less restrictive lending policies would be encouraged not only by indications of a greater supply of funds but also by any continuation of recent diminished loan demands. The almost negligible business loan expansion of the past two months and bankers' reports in the December 15 lending practices survey suggest some reduction in demand. The December expansion in total bank credit was almost wholly accounted for by additions to U.S. Government security holdings and loans to security dealers.

Still, business loan expansion may pick up in the weeks ahead as compared with the pace of the past two months. Large accelerated payments by corporations of withheld individual income and social security taxes in January will be a factor. Also, it is likely that any gradual relaxation of banks' lending policies will encourage some additional business borrowing from banks, partly because projected capital spending programs imply a continued need for external financing, including term loans from banks. However, the prospect that businesses will be sharply reducing inventory accumulation over the months ahead suggests that there will be no strong sustained resurgence of business loan demand, although there amy be periods of heavy demand associated with tax payments.

Banks are likely to continue rebuilding their U.S. Government securities portfolios in the period ahead. And they should be a positive factor in the municipal market, all assuming CD money continues to be in reasonably good supply and business loans do not expand sharply.

Capital markets

The viability of the reduced levels of bond yields resulting from the sharp decline last month will be tested by the large volume of new securities scheduled for offering in January. Taxable securities offered during that period will total about $1.5 billion, two-fifths of which represents Federal participation certificates; tax-exempt issues will amount to more than $1 billion. And the supply of corporate securities on the horizon after January also appears to be building up.

It is possible that the December yield declines may have overdiscounted the present strength of market forces leading to lower rates. Also, some of the long-term funds that normally come available early in a new year may have already been committed. As a result, the downward tendency of interest rates could be slowed or temporarily halted in the process of marketing forthcoming issues -- barring budget surprises of more than expected fiscal restraint and assuming no intensification of market expectations as to the likely degree of monetary ease.

The Treasury will announce its February refunding toward the end of January. While this refunding is expected to be fairly routine, U.S. Government security dealers do hold a very large inventory of securities in all maturity areas at the moment. This could tend to limit their participation in the new issue(s) and make them less willing holders of existing issues, especially if their borrowing costs remain relatively high and if the Federal budget implies less than expected net debt repayment in the first half of 1967.

The tone of mortgage markets has improved recently, although the latest data (as of November) do not yet show an easing of mortgage rates and other terms. The improved atmosphere is based largely upon expectations that recent increases of savings flows to major types of mortgage lenders will soon be reflected in expanded new loan commitments. But because mortgage lenders have first taken steps to improve their own liquidity, new mortgage loan activity has not yet expanded appreciably.

Balance of payments

In October-November, the advance in merchandise imports slackened while exports continued to increase, and the annual rate of trade surplus was about $3/4 billion larger than in the third quarter. The favorable turn in the trade balance was more than offset, however, by unfavorable developments in other transactions. The over-all deficit on the liquidity basis appears to have approached $1 billion (quarterly rate) in the fourth quarter, despite special receipts of nearly $1/2 billion from Germany at year-end; and the balance on the official reserve transactions basis reverted to deficit, even though inflows of foreign private liquid funds remained large.

Only a small part of the deterioration in non-trade transactions can yet be identified. There was a renewed outflow of bank-reported capital in October-November, even after rough allowanc for seasonality, in contrast to the third-quarter inflow. But there must also have been a substantial worsening on some of the items for which no data are yet available -- other private capital, Government grants and credits, military transactions, and service transations. Some part of the deterioration may prove unexplainable and show up in the residual errors and omissions item; this item showed an unusual plus in the third quarter.

In the months ahead, the trade balance should continue to improve. Weakening of demand in Britain, Germany, and Canada may slow the export advance but seems unlikely to halt it, given the continued strength of demand in Japan, France, Italy, and a large number of non-industrial countries. Meanwhile, imports are likely to level off as domestic inventory accumulation slackens and the boom in capital equipment subsides.

The outlook for capital flows is highly uncertain, but there will probably be four adverse tendencies to reckon with. (1) The inflow of liquid funds through foreign branches of U.S. banks is likely to diminish sharply as domestic credit conditions ease. (2) There is likely to be an outflow of U.S. bank credit. (3) Receipts under military offset arrangements with Germany will probably be significantly smaller than in 1966. (4) It may be difficult to arrange new shifts of funds by foreign official and international institutions from liquid to nonliquid U.S. assets on the massive 1966 scale.

The net result of these adverse tendencies and of the improvement in the trade balance is likely to be a liquidity deficit running above a $2 billion annual rate in the months ahead. And the official settlements deficit, which will be particularly affected by a change in inflows of foreign private liquid funds, may be about as large as the liquidity deficit, in marked contrast to the 1966 experience.

Perhaps only a small portion of the deficit in coming months will have to be settled in gold or in currencies drawn from the IMF. Seasonal factors will be favorable, some reserve gaining countries (e.g. Germany) may be willing to add to their holdings of dollars or Roosa bonds, and Britain will be repaying swaps. But later if Britain gains sufficient reserves to make its scheduled $1 billion repayment to the IMF, it will have to draw upon U.S. reserve assets to do so unless another technique can be found; the Fund cannot accept repayment in U.S. dollars when the United States is a debtor of the Fund.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per cent change: Year Ago*	Per cent change: 2 years Ago*
Civilian labor force (mil.)	Nov'66	77.9	77.1	76.1	2.4	4.6
Unemployment (mil.)	"	2.9	3.0	3.2	-10.8	-21.7
Unemployment (per cent)	"	3.7	3.9	4.2	--	--
Nonfarm employment, payroll (mil.)	"	64.7	64.4	61.9	4.6	9.4
Manufacturing	"	19.4	19.3	18.4	5.5	10.8
Other industrial	"	8.0	8.0	7.9	0.6	3.5
Nonindustrial	"	37.3	37.1	35.5	5.0	10.1
Industrial production (57-59=100)	"	158.3	158.6	146.7	7.9	16.8
Final products	"	158.2	157.9	148.0	6.9	17.2
Materials	"	158.5	159.5	146.1	8.5	16.6
Wholesale prices (57-59=100)1/	"	105.9	106.2	103.5	2.3	5.2
Industrial commodities	"	104.6	104.6	102.7	1.9	3.3
Sensitive materials	"	102.0	102.6	103.4	- 1.4	1.2
Farm products and foods	"	107.1	108.8	104.3	2.7	9.5
Consumer prices (57-59=100)1/	"	114.6	114.5	110.6	3.6	5.4
Commodities except food	"	107.8	107.6	105.6	2.1	2.9
Food	"	114.8	115.6	109.7	4.6	7.5
Services	"	124.7	124.1	119.0	4.8	7.5
Hourly earnings, mfg. ($)	"	2.76	2.76	2.65	4.2	8.2
Weekly earnings, mfg. ($)	"	113.88	113.74	109.60	3.9	9.3
Personal income ($ bil.)2/	"	597.6	594.4	553.2	8.0	17.9
Corporate profits before tax ($ bil.)	QIII'66	81.9	82.8	75.0	9.2	20.8
Retail sales, total ($ bil.)	Nov'66	25.4	25.6	24.6	3.1	17.2
Autos (million units)2/	"	8.4	8.0	9.0	- 6.9	22.0
GAF ($ bil.)	"	6.3	6.1	5.8	8.3	20.6
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,000	841	1,547	-35.4	-33.6
Factory workweek (hours)	"	41.3	41.3	41.4	- 0.2	1.0
New orders, dur. goods ($ bil.)	"	23.1	24.2	22.4	3.4	19.0
New orders, nonel. mach. ($ bil.)	"	3.7	3.6	3.4	8.6	24.1
Common stock prices (1941-43=10)	Dec'66	81.33	80.99	91.73	-11.3	- 3.1
Manufacturers' Inventories, book val. ($ bil.)	Nov'66	76.9	75.8	67.2	14.4	23.2
Gross national product ($ bil.)2/	QIII'66	744.6	732.3	686.5	8.5	16.7
Real GNP ($ bil., 1958 prices)2/	"	649.3	643.5	618.2	5.0	11.0

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Dec. 30	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	5.63	5.40	6.25	3.00
U.S. Treas. bills, 3-mo., yield (per cent)	4.80	4.94	5.59	4.64
Net free reserves 2/ (mil. $)	- 112	- 192	- 94	- 583
Member bank borrowings 2/ (mil. $)	548	529	928	439
Security Markets (N.S.A.)				
Market yeilds 1/ (per cent)				
5-year U.S. Treas. bonds	4.81	4.97	5.89	4.76
20-year U.S. Treas. bonds	4.63	4.74	5.12	4.59
Corporate new bond issues, Aaa	5.74	5.70	5.98	5.61
Corporate seasoned bonds, Aaa	5.43	5.39	5.53	5.12
Municipal seasoned bonds, Aaa	3.74	3.77	4.04	3.72
FHA home mortgages, 30-year 3/	6.81	6.81	6.81	6.45
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	80.58	81.46	87.08	73.20
Dividend yield (per cent)	3.64	3.59	3.89	3.31

	Change in Nov.	Average change last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $) 5/				
Total reserves 6/	- 39	- 91	- 4.6	0.9
Bank loans and investments:				
Total	300	- 800	- 3.1	5.8
Business loans	200	500	7.2	15.8
Other loans	- 200	- 200	- 2.1	6.8
U.S. Government securities	500	-1,100	-22.9	- 8.4
Other securities	- 200	0	0.8	6.1
Money and liquid assets:				
Demand dep. & currency 6/	1,300	0	0	2.0
Time and savings dep. 6/	1,100	300	2.3	8.3
Nonbank liquid assets	700	1,600	7.1	4.9

N.S.A.--not seasonally adjusted. S.A. Seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending December 28.
3/ Latest figure indicated is for month of November. 4/ Data are for weekly closing prices. 5/ Where necessary, comparisons shown below have been adjusted for definitional changes in June and July. 6/ Change in December.

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

	1966 Nov.	1966 Oct.	1966 QIII	1966 QII	1966 QI	1965 QIV	1965 QIII	1965 Year (billions)
	Seasonally adjusted							
Current account balance			908	1.124	1,333	1,290	1,527	6.0
Trade balance 1/	295	345	780	849	1,167	1,271	1,231	4.8
Exports 1/	2,500	2,605	7,439	7,111	7,171	7,027	6,826	26.3
Imports 1/ 2/	-2,205	-2,260	-6,659	-6,262	-6,004	-5,756	-5,595	-21.5
Services, etc., net			128	275	166	19	296	1.2
Capital account balance			-1,244	-1,098	-1,587	-1,542	-1,821	-6.9
Govt. grants & capital 3/			-794	-964	-948	-881	-743	-3.4
U.S. private direct investment			-700	-976	-687	-731	-569	-3.4
U.S. priv. long-term portfolio			-33	-80	-219	-154	-363	-1.1
U.S. priv. short-term			20	-38	-22	-27	105	0.8
Foreign nonliquid			263	960	289	251	-251	0.2
Errors and omissions			118	-167	-297	-80	-240	-0.4
	Balances, with and without seasonal adjustment (- = deficit)							
Liquidity bal., S.A.			-218	-141	-551	-332	-534	-1.3
Seasonal component			-493	-11	503	-3	-472	--
Balance, N.S.A.	-513	-766	-711	-152	-48	-335	-1,006	-1.3
Official settlements bal.,			946	-214	-241	-1,158	232	-1.3
Seasonal component			-519	-166	643	33	-508	--
Balance, N.S.A. 4/	-201	-209	427	-380	402	-1,125	-276	-1.3
Memo items:								
Monetary reserves (decrease -)	-165	4	-82	-68	-424	-271	-41	-1.2
Gold purchases or sales (-)	-49	-45	-173	-209	-68	-119	-124	-1.7

1/ Balance of payments basis which differs a little from Census basis.
2/ Monthly figures tentatively adjusted for changes in carry-over of import documents
3/ Net of loan repayments.
4/ Differs from liquidity balance by counting as receipts (+) increases in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increase in certain nonliquid liabilities to foreign official institutions.

SUMMARY AND OUTLOOK

Gross national product. The pattern of GNP developments now envisaged for the fourth and first quarters differs in some major respects from that presented in the Green Book four weeks ago.

In the fourth quarter, more recent evidence--particularly on retail sales--has resulted in a further lowering of the rise estimated for total final sales (gross national expenditures less outlays to build up inventories). The rise in final sales was reduced in our successive fourth quarter projections beginning in late October, as evidence developed on slackening of expansion in consumer spending and business fixed investment and on deepening of the decline in residential construction; now--with the increase in defense spending also reduced from earlier estimates--the rise in final sales appears to have been considerably smaller than in the third quarter. On the other hand--despite recent production cutbacks instituted in major durable goods lines to halt the rise in stocks--over-all inventory accumulation apparently bulged sharply in the fourth quarter. The result is that GNP is now estimated to have increased $14 billion to a seasonally adjusted annual rate of $758.5 billion ($2 billion higher than the estimate of four weeks ago).

With inventories too high relative to current and prospective sales--chiefly in the durable goods sector--additional production cutbacks are expected to result in a sharp drop in the rate of inventory accumulation in the first quarter. This drop would act as a major offset to a projected further rise in final sales and GNP is projected as rising only $7 billion further, to $765.5 billion. In real terms, growth in the first quarter would be at an annual rate of only 1.5 per cent, as compared with 4 per cent in the second half of 1966, and the unemployment rate is expected to rise moderately. Even with the projected drop in the rate of inventory accumulation, stocks at the end of the first quarter would still be high relative to sales and if sales are not stimulated by, say, a pick-up in defense outlay or in consumer willingness to spend, further inventory liquidation into the spring is likely.

Retail sales, which had been about unchanged from August to October, declined slightly in November. In December, according to weekly data, they may have recovered some or most of the decline of the preceding month--but for the entire fourth quarter they showed only a fractional increase. New domestic auto sales were down moderately for the quarter and sales of some major household durable goods have weakened recently. Altogether, dollar consumption expenditures for goods showed little, if any, more rise than prices of consumer goods. Dollar service outlays continued to expand rapidly, with price increases--now at the fastest pace since 1946--accounting for a major part of this increase.

The rise in consumer income in the fourth quarter exceeded the apparent increase in consumer spending, and the saving rate is indicated to have risen moderately from the low third quarter rate, though still continuing below normal levels. In the first quarter, the rise in consumer income is expected to slow, as expansion in employment and wages and salaries is retarded by slackening industrial activity associated with the inventory adjustment, and as a small further increase in the social security tax takes effect. This slowing in turn is expected to act to limit further the rise in consumer spending.

The recent lag in consumer spending reflects such influences as the sharp and prolonged rise in prices for goods and services, which has served to squeeze funds for the more postponable purchases, the more restricted availability of consumer credit--including mortgage credit used for consumption purposes--the effect of the sharp drop in housing transactions on demand for household durables, and a growing feeling of uncertainty about the future evidenced by the large and progressive decline over the past year in consumer "sentiment" as measured by the Michigan Survey Research Center Index. Moreover, while personal income rose at a fast pace throughout most of 1966, a significant portion of this rise was absorbed in sharply stepped-up personal tax payments.

The moderate rise in business fixed investment now estimated for the fourth and first quarters is based essentially on the findings of the latest Commerce-SEC plant and equipment survey, which was conducted in late October and November. That survey showed the first significant shortfall from preceding survey estimates since 1963 and it projected a very slow rate of expansion in the first half of this year.

Although order backlogs in the machinery and equipment industries were continuing to rise in October and November, new orders were down and the rise in the backlog appeared to be tapering off. Meanwhile, factory shipments of machinery and equipment have been showing little change since midyear, and this may suggest a smaller rise in business equipment outlays than was indicated by the Commerce-SEC survey. Further downward adjustment of business capital investment programs, particularly for capacity expansion, may also develop as the increase in over-all output slows markedly during the course of the large decline in the rate of inventory accumulation now projected as beginning in the current quarter.

Defense purchases of goods and services--according to limited information available--remains a major (perhaps <u>the</u> major) expansive element in the GNP outlook. But the rate of increase, which reached a peak $4.2 billion rate in the third quarter, receded to an estimated $2.8 billion in the fourth quarter and is now projected at $2.5 billion in the first quarter, based on the latest information we can obtain from the Budget Bureau. New orders for defense-type products dropped off sharply in October and November and while the order backlog remained very large, the main expansive impact of defense on production--including the materials and equipment build-up--and employment may already have taken place.

Residential construction now represents a comparatively favorable element in the outlook, in the sense that the sharp curtailment that began last spring probably is about over. Following declines at the rate of about $5 billion in each of the third and fourth quarters, we are now projecting a further decrease of only $0.4 billion in the first quarter. Easing of monetary policy, a resumption of inflows to the savings institutions, and an apparent weakening in business and consumer credit demands appear to be bringing some improvement in the supply of funds available for mortgages. There may well be a considerable lag, however, before any significant pick-up occurs in residential building activity.

The sharp bulge in inventory accumulation--from a rate of $9.9 billion in the third quarter to an estimated $13.5 billion in the fourth quarter--was a compound of a moderate step-up in the book value increase for nonfarm business and a large upward shift in the GNP "inventory valuation adjustment." In the GNP accounts, the inventory item is defined as the change in the physical volume of inventories during the quarter with the change valued at average (inventory) prices for the quarter. During the first three quarters of 1966, the book value increases incorporated large gains in prices and substantial downward adjustments were applied to the book value increases in calculating the GNP inventory change. In the fourth quarter, however, as a result of declines in prices of foodstuffs, fibers and some other materials and the marked slowing of the rise in prices of industrial commodities, the book value increase over the quarter is estimated on net to have included a slight decline in over-all (inventory) prices.

In the first quarter with little change now estimated for the inventory valuation adjustment, inventory accumulation is projected at an \$8.5 billion rate, down \$5 billion from the fourth quarter. This drop is expected to come from a marked slowing of the rate of accumulation in both manufacturing and trade--with possible decumulation taking place for some consumer goods and materials. The rate projected for the first quarter is expected to halt the rise in stock-sales ratios which began last spring.

CONFIDENTIAL -- FR | January 5, 1967

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Expenditures and income figures are billions of dollars
seasonally adjusted annual rates)

	1964	1965	1966	1966				1967
							Projected	
			Proj.	I	II	III	IV	I
Gross National Product	631.7	681.2	739.0	721.2	732.3	744.3*	758.5	765.5
Final sales	627.0	672.1	727.9	712.3	720.0	734.4*	745.0	757.0
Personal consumption expenditures	401.4	431.5	465.6	455.6	460.1	469.9	476.7	483.0
Durable goods	59.4	66.1	69.4	70.3	67.1	70.2	70.2	70.2
Nondurable goods	178.9	190.6	206.7	201.9	205.6	208.1	211.0	213.3
Services	163.1	174.8	189.5	183.4	187.4	191.5	195.5	199.5
Gross private domestic investment	93.0	106.6	116.2	114.5	118.5	114.7*	117.0	112.5
Residential construction	27.6	27.8	25.9	28.6	28.0	25.0	22.2	21.8
Business fixed investment	60.7	69.7	79.1	77.0	78.2	79.8*	81.3	82.2
Change in business inventories	4.7	9.1	11.2	8.9	12.3	9.9	13.5	8.5
Nonfarm	5.3	8.1	11.4	8.5	12.1	10.4	14.4	9.0
Net exports	8.5	7.0	4.9	6.0	4.7	4.2	4.5	4.8
Gov't purchases of goods & services	128.9	136.2	152.4	145.0	149.0	155.5	160.3	165.2
Federal	65.2	66.8	76.3	71.9	74.0	78.3	81.1	84.2
Defense	50.0	50.1	59.2	54.6	57.1	61.3	64.1	66.6
Other	15.2	16.7	17.1	17.4	16.9	17.0	17.0	17.6
State & local	63.7	69.4	76.1	73.1	75.0	77.2	79.2	81.0
Gross National Product in								
constant (1958) dollars	580.0	614.4	647.4	640.5	643.5	648.9	656.7	659.2
GNP Implicit deflator(1958=100)	108.9	110.9	114.2	112.6	113.8	114.7	115.5	116.1
Per cent change, annual rate								
GNP current dollars	7.0	7.8	8.5	9.5	6.2	6.6	7.6	3.7
GNP constant dollars	5.3	5.9	5.4	5.9	1.9	3.4	4.8	1.5
Implicit deflator	1.6	1.8	3.0	3.6	4.3	3.2	2.8	2.2
Personal income	496.0	535.1	580.1	564.6	573.5	585.2	597.0	604.0
Wage and salaries	333.6	358.4	392.1	380.0	387.4	396.7	404.4	408.5
Disposable income	436.6	469.1	505.1	495.1	499.9	507.8	517.5	524.0
Personal saving	24.5	25.7	26.2	26.7	26.6	24.5	26.9	26.8
Saving rate (per cent)	5.6	5.5	5.2	5.4	5.3	4.8	5.2	5.1
Total labor force (millions)	77.0	78.4	80.1	79.4	79.7	80.4	80.9	81.2
Armed forces "	2.7	2.7	3.1	2.9	3.1	3.2	3.3	3.4
Civilian labor force "	74.2	75.6	77.0	76.5	76.7	77.2	77.6	77.8
Unemployment rate (per cent)	5.2	4.6	3.9	3.8	3.9	3.9	3.8	4.0
Nonfarm payroll employment (millions)	58.3	60.8	63.8	62.8	63.6	64.1	64.7	65.1

* Incorporates changes in published figures because of revisions in data underlying GNP estimates.

Industrial production. Industrial production in December is expected to change little from the November level of 158 per cent of the 1957-59 average. Anticipated declines in output of some consumer goods may be offset by a further rise in business and defense equipment. Output of durable goods materials, however, is expected to decline further.

Auto assemblies in December were unchanged from the November annual rate of 8.5 million units but were 8.5 per cent below a year earlier. In early December output of color television sets reached a new high but that of monochrome sets declined further. Truck production, despite trade reports of some softening in demand, continued at high rates in December. Steel ingot production declined further, and there was some easing in output of paperboard. Output of crude petroleum and refined petroleum products, however, were at record levels.

In the first nine months of 1966, industrial production rose at an annual rate of 9 per cent and in August was 158.0 per cent of the 1957-59 average. Since then the total index has changed little, although tending slightly downwards during the last quarter of the year. Curtailments in output in some industries, mainly autos, steel, and construction materials, burdened by large inventories and declining demands, offset continued gains in others. There also have been some selective adjustments in the textile and chemical industries, centering in man-made yarns and fibers, and in some household appliances.

Output of business equipment rose further in the last quarter of the year, and at the end of November unfilled orders for machinery and equipment were at record levels. However, new orders for transportation equipment and all categories of electrical machinery, except transmission and distribution equipment, declined in November.

Autos. Daily average sales of new domestic automobiles during December were 6 per cent below a year ago, and 8 per cent below a month ago. In terms of units, the seasonally adjusted annual rate for the month was 8 million, compared to 8.4 million in November and 8.5 million a year earlier.

Dealer stocks of new cars on December 20 were slightly above the ending November level. For the month as a whole, stocks are expected to show a somewhat more than seasonal rise. At the December selling rate, inventories represent a 52 day supply, considerably above the longer-run relation to sales.

For the calendar year as a whole, sales of domestic new cars totaled 8.4 million units, moderately less than the 8.8 million units sold in calendar year 1965, but substantially ahead of the 7.6 million in 1964. Including imports, total sales of new cars in 1966 reached 9 million units, somewhat less than the record 9.3 million units sold in 1965.

Present industry assembly schedules call for first quarter 1967 output at a seasonally adjusted annual rate of 8.0 million units, approximately 10 per cent below the number of units assembled in the first quarter of 1966. With sales now expected to be a little higher than scheduled production, seasonally adjusted stocks would decline slightly. On an unadjusted basis, however, the number of units in inventory would rise to about 1.7 million at the end of March as compared with 1.4 million in late December.

Consumer credit. Instalment credit expansion increased in November to $444 million, up from a very low $380 million in October, but still less than in any other month in the last two years.

The increase was most noticeable in the auto area and reflected not only increased sales of new cars but also a rise in the proportion of cars bought on credit and in the size of the average instalment contract. The average new car note has risen well over $100 since the introduction of 1967 models, partly because of higher list prices and partly because consumers are continuing to upgrade the models and options purchased.

The increase in consumer instalment debt for the year as a whole is estimated at $6.5 billion, about 15 per cent less than the record $8 billion for 1965. In 1965, both extensions and repayments were in a vigorous uptrend, but in 1966, extensions leveled off while repayments continued to rise.

The slower growth in outstanding auto credit this year accounted for most of the difference in total instalment credit growth. Thus, auto credit increases averaged less than $200 million per month in 1966 as compared to over $300 million a month last year. Expansion in personal loans and repair and modernization loans was also less this year but some offset was provided by greater expansion in credit in the other consumer goods category.

For this expansion period as a whole, the rise in instalment credit extensions has not been as steep as in the upswings of 1954-57 and 1958-60. But credit extensions did move up for a much longer period than in the two earlier expansions. In both of the earlier upswings, new borrowing accelerated sharply at first, and then leveled off, even though the upswing continued in general economic activity. As of now, credit extensions have moved sidewise for almost a year--about the same length of time as preceded the downturn in 1961--but still much less than the 2-1/2 year leveling trend which preceded the 1958 downturn.

Consumer attitudes and buying plans. According to the survey conducted by the Michigan Survey Research Center in November-December 1966, consumer sentiment--as measured by their special index based on consumers' evaluation of their own and general business conditions and prospects--has continued to deteriorate since August. But the recent rate of decline has not been quite so pronounced as it was earlier in the year. As the survey report rather encouragingly puts it, "it would be incorrect to characterize the present state of consumer attitudes as outright pessimisim."

Consumers continued to exhibit concern and uncertainty about the effects of inflation, tight money, and high interest rates on personal-financial, as well as general economic trends, despite the fact that the proportion of family units reporting having made more money than a year ago remained at a record level. As also reported in the Census survey--taken a month or more before the Michigan Survey--buying plans for autos were down significantly from the record year-earlier levels, but, in contrast to the Census survey, the Michigan Survey found no decline in intentions to buy major household durable goods.

Orders for durable goods. New orders for durable goods declined 4-1/2 per cent in November, bringing the total decrease from the September peak to 8-1/2 per cent. The bulk of the decline over this two-month period stemmed from a drop of over 40 per cent in orders for defense-type products; this drop reversed an earlier sharp run-up and brought these orders to the lowest level since December 1965. However, the defense order backlog remained very large at the end of November.

New orders for machinery and equipment and steel also showed sizable declines in October and November, and for steel unfilled orders also decreased. The order backlog for machinery and equipment continued to expand, although at a much slower pace than earlier.

For all durable goods combined the November new order level was the lowest since November 1965 and the backlog of unfilled orders edged off slightly--for the first decline in almost three years.

Inventories. For manufacturing, preliminary October inventory figures have been revised upward appreciably. The rate of accumulation increased substantially further in November, when the factory stock-sales ratio reached 1.73 as compared with a level close to 1.60 prevailing in 1965 and early 1966. For the two months, the average book value increase equalled the high third quarter rate--or an annual rate of nearly $12 billion. Trade inventory accumulation was very large in October (an annual rate of about $6 billion), in large part because of a sharp rise in auto stocks. Since then, however, auto stocks have declined, and trade inventory accumulation for the entire fourth quarter is expected to be well below the October rate.

The high rate of inventory accumulation in manufacturing has been heavily concentrated in durable goods industries and within that sector expansion in stocks--particularly work-in-process--was very pronounced through November in the business and defense equipment sector. In this sector expansion in production has slowed in recent months and given the recent decline in new orders and prospects for much smaller increases in final takings, the earlier rapid inventory accumulation is expected to slow appreciably in coming months. For consumer durable goods, inventory accumulation appears to have been excessive at both the factory and distributive outlets, and output curtailments have already been instituted for autos and some major appliances. Despite these curtailments, inventories were high at the end of the year, and producers and dealers are expected to work them down during coming months.

Construction activity. Seasonally adjusted new construction expenditures dropped 2 per cent further in November, following some downward revision for October. At $69.9 billion, the annual rate was 12 per cent below the peak reached last March and the lowest since early 1965. Residential construction--down for the seventh consecutive month--accounted for all of the further decline in November. Although outlays for both private nonresidential and public construction were estimated to have changed little, these had already dipped further in October and indications were that, on a quarterly basis, the down-trend for these sectors was continuing.

NEW CONSTRUCTION PUT IN PLACE

	Average Oct.-Nov. 1966 ($billions) 1/	Per cent change from	
		1st Q 1966	3rd Q 1966
Total	70.5	-10	-4
Private	46.8	-14	-6
Residential	21.7	-21	-9
Nonresidential	25.1	- 7	-3
Public	23.7	- 3	-1

1/ Seasonally adjusted annual rates; preliminary.

Seasonally adjusted housing starts, which had plummeted more than a fifth further in October to a twenty-year low of 841,000 (annual rate), rose nearly as sharply in November. The November rise was closely in line with earlier expectations and reflected mainly a much less than seasonal decline in the unadjusted series from the unusually low level already reached in October. Even if, as seems probable, seasonally adjusted starts in December continued upward, the average indicated for the fourth quarter as a whole would still be below the reduced third quarter average. Moreover, while some easing now appears to be devleoping in the mortgage markets, current staff projections are for no significant revival in starts from the 1 million unit level until next summer. And because normal seasonal adjustment implies an extremely sharp rise in the unadjusted data during the spring, there is even a possibility of a seasonally adjusted decline during the second quarter of 1967.

Building permits changed little in November from the sharply reduced October rate, as an upturn for 1-family structures was accompanied by a further, though moderate, drop for multi-family structures. Apart from the Northeast, all regions continued to show a further downdrift.

PRIVATE HOUSING STARTS AND PERMITS

	November 1966 (thousands of units) 1/	Per cent change from	
		October 1966	Year earlier
Starts	1,000	+19	-35
Permits	717	--	-44
1-family	449	+ 3	-39
2-or-more family	268	- 4	-51
Northeast	155	+16	-41
North Central	192	- 3	-46
South	233	- 4	-24
West	137	- 2	-37

1/ Seasonally adjusted annual rate; preliminary.

Wages. An acceleration of hourly earnings increases was evident during 1966 in most nonfarm industries for which data are available.

CHANGES IN AVERAGE HOURLY EARNINGS

	Per cent increase November 1966 from a year ago
Hotels and motels	7.2
Laundries and dry cleaning	6.5
Contract construction	5.3
Mining	5.1
Retail trade	4.3
Manufacturing	4.2
Finance, insurance & real estate	3.3

Large wage settlements, especially during the latter part of 1966, were a factor in the higher average rate of increase. First year wage increases in major settlements in 1966 were substantially larger than in 1965--about 5 per cent as compared with 3.9 per cent. The effect on average wages would have been even greater, except that the number of workers who received wage increases in major contract settlements in 1966 was the smallest in many years. A large number (4.1 million) also received deferred wage adjustments under major contracts negotiated in 1965 or earlier but these increases were generally smaller than those obtained under contracts negotiated during 1966.

The accelerated increase in average earnings in 1966 also reflected several other factors: the substantially larger wage rate adjustments which occurred in the nonunionized sectors where employers have been responding to the tightening of the labor market; the receipt of larger wage increases in 1966 by more than 2 million workers covered by cost-of-living escalator clauses; and the continued relative shift of employment into higher paying industries. As a result of the persistent rise in wages, and the trend toward smaller gains in productivity, unit labor costs in manufacturing was upward during 1966; in November they were 2-1/2 per cent above a year earlier.

Some of the factors which have tended to moderate wage increases this past year will operate in the other direction in 1967. A much larger number of workers--more than 3-1/2 million--are covered by major contracts which expire this coming year, and the negotiations will be conducted by stronger unions, namely, trucking, autos, farm equipment, rubber, meat packing and the nonoperating railroad brotherhoods. Also, an increase in the minimum wage early in 1967 will put additional pressure on wages in some nonunionized sectors.

There also will be a large number of deferred wage increases in 1967 but the average size of these wage adjustments will be smaller than in 1966. If, in addition the economic situation and the demand for labor weakens and if consumer price increases moderate in 1967, upward pressure on wages should be reduced somewhat.

Price developments. The comprehensive wholesale price indexes for November confirmed the general pattern of developments outlined in the last Green Book. Industrial commodities edged up slightly while foodstuffs fell about 1.5 per cent. The total index, consequently, declined somewhat further; it was down nearly

1 per cent from the August-September peak, and the increase over a year ago narrowed to about 2.5 per cent.

For industrial commodities, the November increase was very small; as in October--and also through the summer months--declines in sensitive materials roughly offset increases in finished products, chiefly machinery and furniture. The increase of 0.5 per cent in the index for machinery and equipment was about in line with average monthly increases earlier in 1966. Since November, prices of metals and products generally have remained strong, announced increases among chemicals appear to outweigh announced decreases, and the declines among sensitive commodities have tapered off if they have not ended. Price weaknesses among textiles, however, may have continued in December. Altogether it appears likely that the industrial commodity average continued to rise in December.

Wholesale prices of foodstuffs apparently have eased slightly further since mid-November. Livestock and meat prices declined somewhat in contrast with the large increases in December a year ago; in December, livestock prices were down about 15 per cent and meat prices 7 per cent from a year earlier.

The long string of sizable increases in the consumer price index was broken in November when the total rose by only 0.1 per cent. The long-awaited decline in food prices developed, with decreases of 0.9 per cent in food-store prices and 0.7 per cent in the total for food including restaurant meals which, as shown in the table, continued to rise. Commodities less food rose further, with increases in apparel, housefurnishings, and new cars--the last strictly seasonal. On a seasonally adjusted basis, the rise in nonfood commodities remained close to the 2 per cent annual rate of the past year. Services, led by medical care, continued to exert a strong upward push on the total.

One may optimistically speculate that in December the index will again show only a small increase; it could even be stable--which last happened in January--or decline--which it last did in August of 1965. November's decrease in food prices owed something to reductions in meats, but later evidence on market supplies and wholesale meat prices suggests further declines in retail prices from the November levels. These may not be fully offset by seasonal increases in other foods. End-of-season sales of apparel generally begin in December, and discounting on new cars may have begun earlier this year in view of the contraction in demand and the high level of dealers' stocks. Used car prices declined somewhat in November, and market conditions may have caused a further decline since then. Services, of course, continued upward but there is no basis for a guess at the rate.

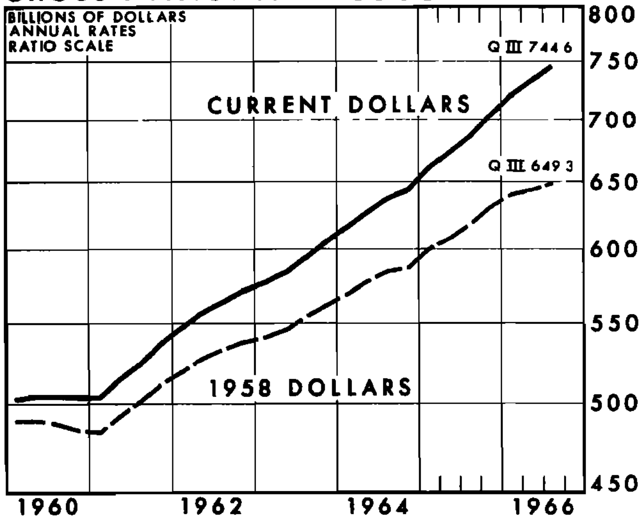
CONSUMER PRICE INDEX

	Per cent change to November 1966 from:	
	October 1966	November 1965
All items	.1	3.6
Food	- .7	4.6
At home	- .9	4.6
Away from home	.4	5.1
Commodities less than food	.2	2.1
Apparel	.5	3.5
Other nondurables	.3	2.4
New cars	.9	.6
Used cars	-1.2	.5
Household durables	.2	1.7
Rent	.2	1.7
Other Services	.5	5.3
Medical	.9	7.9
Transportation	.2	4.2
Household	.6	5.2
Miscellaneous	.2	4.5

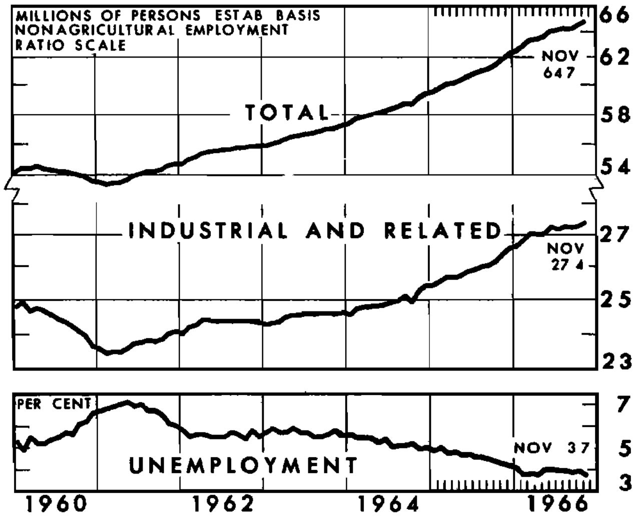
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

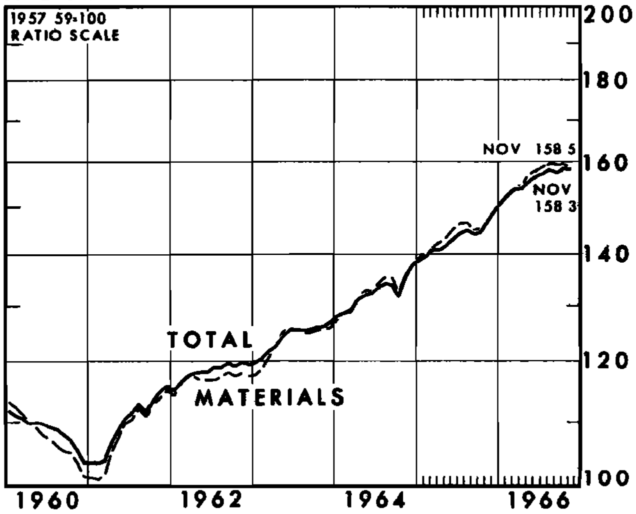
GROSS NATIONAL PRODUCT



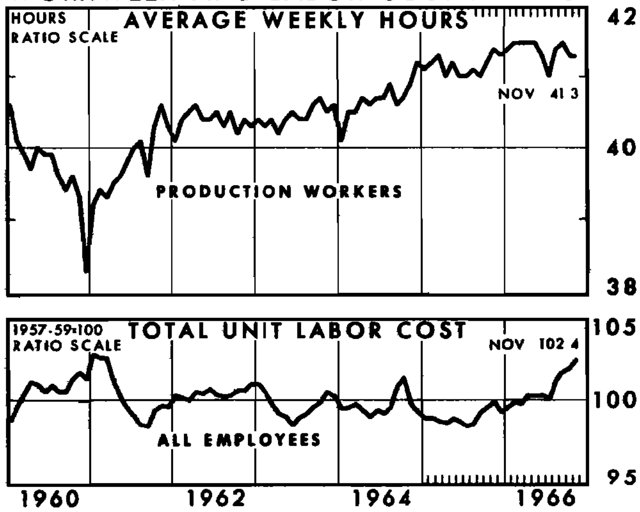
EMPLOYMENT AND UNEMPLOYMENT



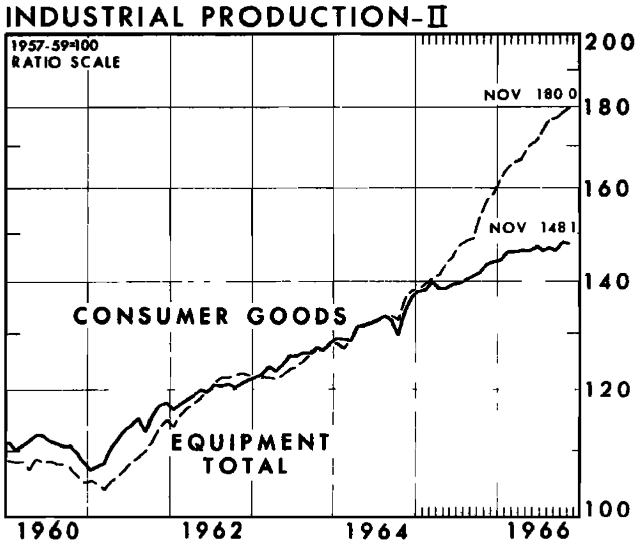
INDUSTRIAL PRODUCTION-I



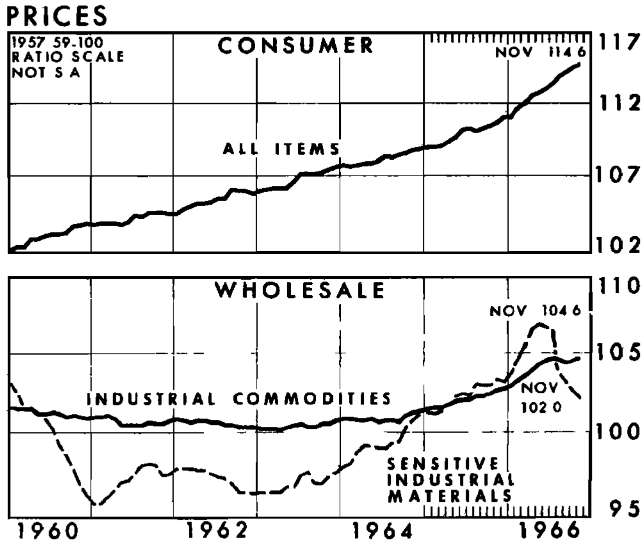
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



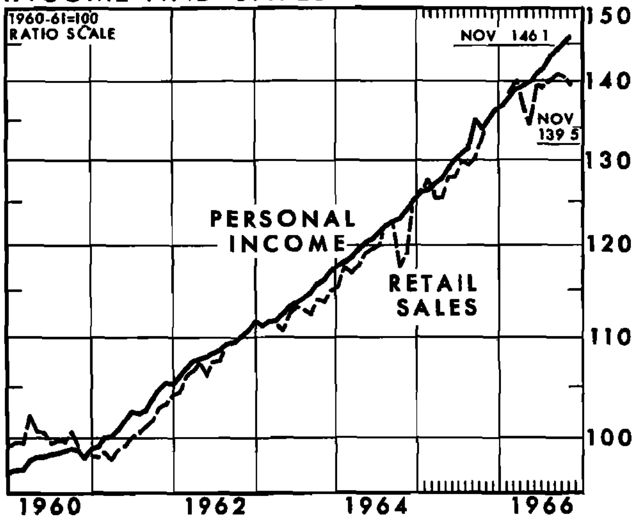
PRICES



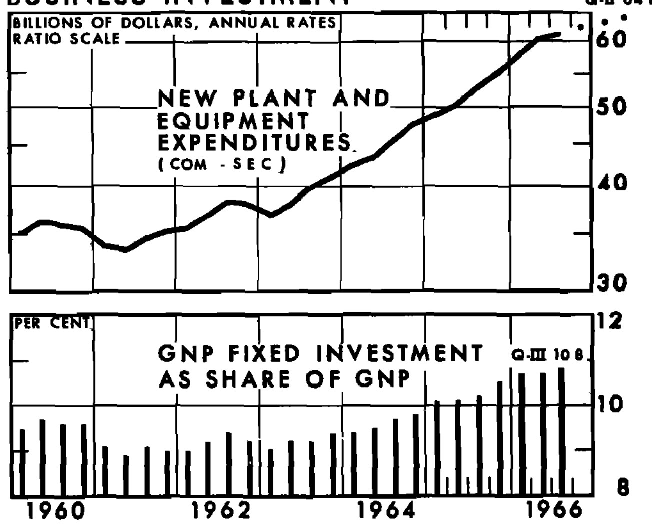
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

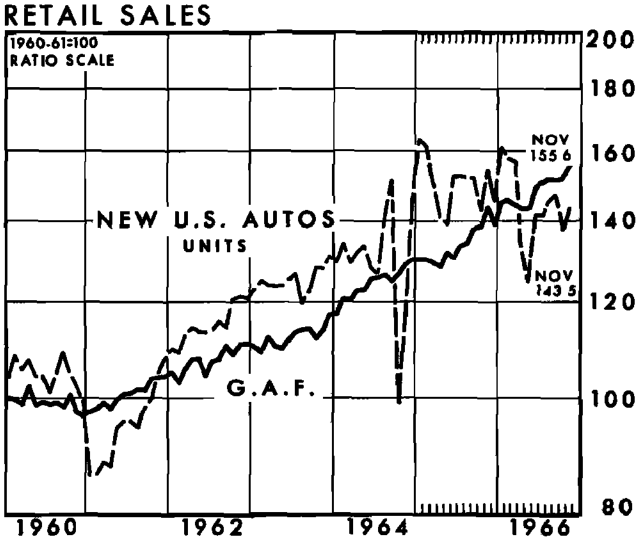
INCOME AND SALES



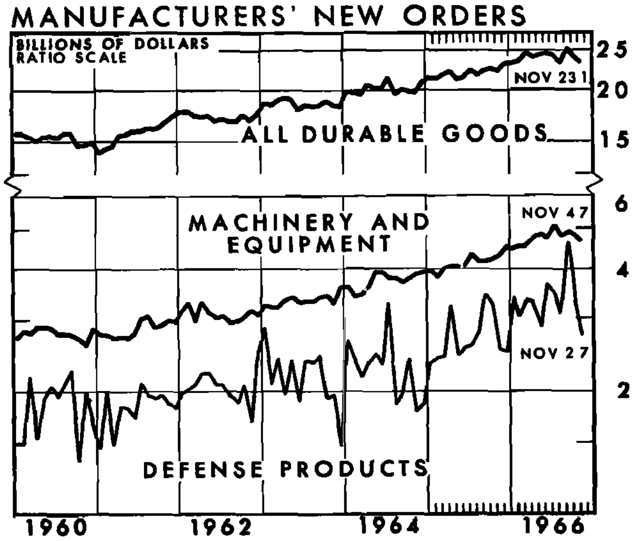
BUSINESS INVESTMENT



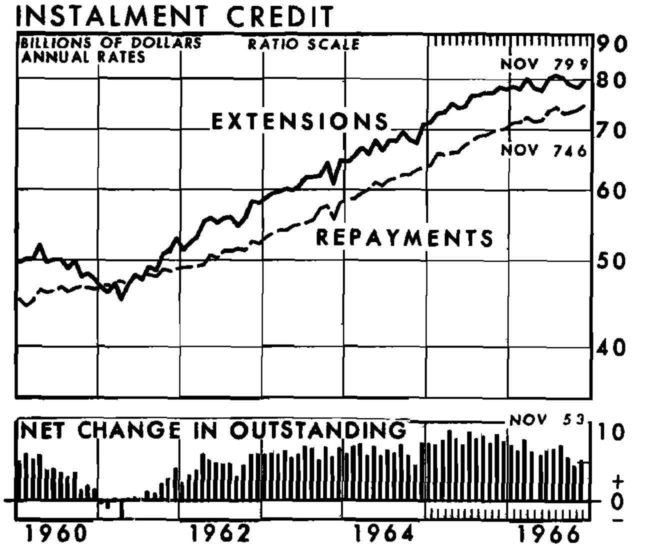
RETAIL SALES



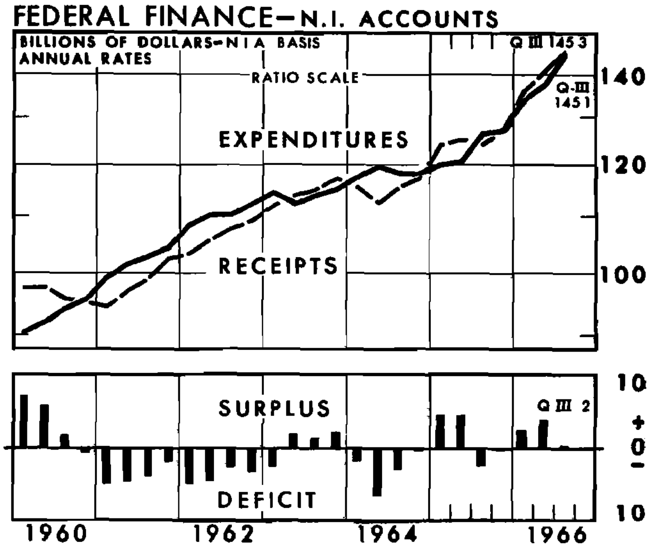
MANUFACTURERS' NEW ORDERS



INSTALMENT CREDIT



FEDERAL FINANCE—N.I. ACCOUNTS



DOMESTIC FINANCIAL SITUATION

Bank credit. Preliminary estimates indicate that commercial bank credit on an end-of-month basis rose substantially in December, perhaps at an annual rate of around 11 per cent. However on a daily average basis bank credit showed less of an increase in December. The bank credit proxy, the daily average of total member bank deposits, increased only at an estimated 3.4 per cent rate during the month. The more rapid rise in total bank assets as measured on an-end-of-month basis primarily reflected the continual growth of bank credit during December from a relatively low end-of-November level. December's rise in credit was far above November's nominal end-of-month increase, and contrasted sharply with the 5.2 per cent annual rate of decline from the end of August to the end of October. Expansion in bank earning assets during December was made possible primarily by the sharp rise in bank time deposits, which followed small average monthly increases since mid-summer.

The increase in total bank credit was accounted for largely by increases in bank holdings of U.S. Government securities and loans other than business credits--especially loans to security brokers and dealers. Business loans showed little further change while bank holdings of municipal and other securities increased only moderately.

CHANGES IN COMMERCIAL BANK CREDIT 1/
(Annual rate - per cent)

	Dec. 2/ projections	Nov.	Sept. - Dec. 2/	Jan. - Aug.	Year 2/
Total loans & investments	11.3	1.2	0.5	8.4	5.8
U.S. Govt. securities	36.4	11.5	-8.6	-4.7	-5.9
Other securities	5.0	-5.0	1.9	6.7	5.1
Loans	6.4	--	2.6	12.7	9.4
Business loans	--	3.0	5.4	18.4	14.3

1/ Annual rates of change have been adjusted for definitional shifts of participation certificates and balances accumulated for payment of personal loans.

2/ December projections may be subject to considerable change as later data are received.

The substantial increase in bank holdings of Treasury issues mainly reflected acquisitions of bills and other short-term issues. These acquisitions partly represented bank efforts to rebuild their liquidity positions after the sharp reductions in recent months and partly window dressing operations for year-end statements. In the four weeks ending December 28 weekly reporting banks, especially those outside of New York, added $1,364 million to their holdings of Treasury issues--an unusually large increase for these four weeks.

The lack of expansion in business loans in December apparently continued to reflect both the cumulative effects of restrictive bank lending policies in recent months and some further lessening in the demand for bank loans. In any event the failure of business loans to expand was especially surprising in that total corporate tax payments are estimated to have been $1.6 billion larger than in December 1965. Based on reports from 71 of the 81 banks in the quarterly interest rate survey, the December 15 survey shows that a significantly greater percentage of banks (about 25 per cent) reported moderately weaker loan demand compared with only 6 per cent three months earlier, although most banks reported over-all demand unchanged. Moreover, about 16 per cent of the banks also anticipated that loan demands would be moderately weaker over the next three months.[1/]

Most industries increased their bank loans less than seasonally in December. However, producers of machinery and transport equipment continued to increase their loans rapidly. Loans to commodity dealers, reflecting in part large CCC sales of quality cotton, rose contraseasonally.

Because of the unusually large increase in dealer inventories of Treasury and Agency issues during the month, dealer financing needs rose substantially. With no business loan expansion, and with bank deposits rising during the month, banks were able to satisfy much of these dealer needs. Through the four weeks ending December 28, bank loans to security dealers and brokers increased by $1,390 million, with more than half of this increase occurring in the week ending December 28. On the other hand, loans to nonbank financial institutions are estimated to have increased by the usual amount in December, even though bank borrowing by finance companies was especially large during the tax period.

1/ A more detailed summary of the results of the survey will be available in the supplement to be distributed Friday January 6.

Bank deposits. On a daily average basis time and savings deposits at commercial banks rose by an estimated $1.1 billion during December, or at an annual rate of 8.4 per cent. While somewhat below the 11 per cent annual rate of increase for the first 8 months of this year, December's estimated growth compares with a less than one per cent rate of gain over the previous three months. As shown in the table reserve city banks outside of New York City and Chicago made substantial gains during the month. Time deposits at New York City and Chicago banks, on a seasonally adjusted daily average basis, declined by 5.4 per cent, substantially less than the losses of other recent months. This reflects some weakness at these banks in late November and early December, followed by large gains over the last three weeks of the month. Country banks increased their outstandings at about a 12 to 13 per cent annual rate, somewhat more than in most recent months.

CHANGES IN TIME AND SAVINGS DEPOSITS
Member Banks
(Annual rate--per cent)

	Dec.		Nov.		Oct.		Sept. - Dec.		Jan. - Aug.	
	1966 1/	1965	1966	1965	1966	1965	1966 1/	1965	1966	1965
All member banks	9.3	10.0	- 2.8	15.2	- 4.6	18.5	0.6	14.7	11.3	15.4
NYC and Chicago banks	-5.4	-15.6	-41.6	5.2	-40.2	26.8	-28.5	5.4	9.6	28.9
Other reserve city banks	9.7	7.9	2.4	18.7	--	19.0	4.0	15.3	11.6	13.1
Country banks	12.5	23.3	8.4	16.5	8.5	14.3	9.9	18.3	17.4	11.8

1/ Estimated.

The increased attractiveness of CD rates relative to rates on other short-term market instruments, particularly Treasury bills, was primarily responsible for this dramatic turnaround. Although facing a record $5.6 billion of December CD maturities and an expectation of large seasonal attrition because of maturities at the tax and dividend dates, banks actually were able to make record sales of new CD's and their outstandings rose by about $170 million over the month. Sales were particularly large for banks outside of New York, but even New York City banks replaced all but $50 million of their $2.3 billion December maturities, their smallest runoff in five months. During the tax weeks the net run-off was only $65 million, compared with $528 million and $338 million for the comparable weeks in 1965 and 1964. Preliminary results of the December 28 survey of the maturity distribution of outstanding negotiable CD's show that banks will have $5.5 billion of CD's maturing in January, about the same as matured in December. These data indicate that banks continued to sell predominately short CD's.

Weekly reporting banks also increased their time deposits other than CD's by $660 million in the four weeks ending December 28. This was the strongest showing for these deposits in three months.

Banks affected by the late September rollback in ceiling rates continue to have time deposit inflows similar to those reported in Appendix A of the last Green Book. That is, from the end of September through the end of November, interest-bearing deposits at small banks in the surveillance program have remained unchanged, while these deposits at small banks not affected by the rollback showed modest growth. In the case of large banks with high negotiable CD-to-deposit ratios, interest-bearing deposits declined as compared with no growth in time deposits for other large banks.

The money stock is now estimated to have risen by about \$1.1 billion in December, an annual rate of less than 8 per cent, following a decline of 2.7 per cent from June through November. Over the last half of the year the money stock declined by about \$800 million, or at an annual rate of less than one per cent. For the year 1966 as a whole it increased 2.0 per cent.

Most of the December increase in money stock was in private demand deposits, reflecting in part the \$700 million decline in U.S. Government deposits. With restrictions on new Treasury borrowing imposed by the legal debt ceiling, the Treasury drew down its balances at commercial banks through the first three weeks of the month.

Large bank borrowing from their foreign branches declined by about \$240 million in the three weeks ending December 28, a decline which was less than had been associated with year-end window dressing in recent years. This may indicate continued strong demand by large banks for Euro-dollars, even though time deposit flows improved in December.

Corporate and municipal bond markets. Yields on new and recently offered corporate bonds have declined about 25 basis points from the recent highs reached at mid-November, and nearly 40 basis points from the 1966 peaks of late last summer. Over the same periods municipal bond yields have dropped as much as 25 and 50 basis points, respectively. At current levels, yields on new corporate bonds have reversed nearly 1/3 of their advance between the discount rate change in December 1965 and their 1966 highs; while municipal bond yields have reversed as much as five-eights of their earlier advance.

Yield declines since mid-November have occurred despite the heavy calendar of new corporate and municipal bonds already marketed in December and the continuing large volume scheduled for January. While the strength of investor demand for bonds has reflected market expectations of declining long-term rates, the quick distribution of December offerings was also aided by the investment of large turn-of-the-year supplies of funds available to pension funds, fire and casualty companies, and trust accounts.

BOND YIELDS
(Per cent per annum)

	Corporate Aaa			State and local Government	
	New		Seasoned		
	With call protection	Without call protection		Moody's Aaa	Bond buyer's (mixed qualities)
1965					
End of July 1/	4.58	--	4.48	3.16	3.25
Early December 2/	4.79	--	4.60	3.37	3.50
1966					
Late summer high	5.98*	--	5.44	4.02	4.24
Weeks ending					
Nov. 18	5.85	--	5.36	3.81	3.93
Dec. 2	5.80	6.10	5.37	3.89	4.02
Dec. 16	5.63	--	5.38	3.74	3.81
Dec. 30	--	--	5.40	3.74	3.77

1/ Week prior to President's announcement of expanded U.S. involvement in Vietnamese War.
2/ Week preceding Federal Reserve discount rate increase.
* The largest of two issues included in this average carried 10-year call protection.

Corporate bond issues scheduled for public offering in January now total $690 million. Allowing for late announcements, the calendar may ultimately total as much as $775 million, which compares with only $460 million in January a year ago. More than half of this total represents the AT&T and Bethlehem Steel issues scheduled for offering next week. It should be noted, however, that if the pattern of over-all corporate financing evident in recent months persists during January, the enlarged calendar of public offerings may not represent any significant year-to-year rise in total corporate demands on capital markets; smaller take-downs of private placements may about offset the relative growth in public offerings.

Other types of debt issues competitive with corporate bonds will also add significantly to the total volume of January security financing. Among these, this week's $600 million offering of FNMA participation certificates is the most important. But, in addition, $100 million of foreign bond issues have been scheduled for January offering. Thus, the January calendar of taxable security offerings looms as a formidable one which may create resistance to further yield declines -- particularly so since other Federal participation certificate offerings are expected as the year progresses and the volume of new corporate issues already planned for February and March is quite large for such an early point in the year.

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

	Bonds					
	Public offerings[2/]		Private placements		Stocks	
	1966	1965	1966	1965	1966	1965
Total 1966	8,045	5,570	7,840	8,151	16,619	14,450
4th Quarter	2,074e	1,226	1,544e	2,264	3,974e	4,030
October	499	287	354	574	989	985
November	550e	613	400e	529	1,075e	1,399
December	*1,025e	326	800e	1,161	1,925e	1,646
	1967	1966	1967	1966	1967	1966
January	775e	460	400e	692	1,300e	1,339

1/ Data are gross proceeds.
2/ Includes refundings.
* Includes $135 million of short-maturity Pennzoil notes.

Tax exempt bond issues already scheduled for January are also large ($875 million), and ultimately the total for the month will probably exceed $1.1 billion. While this would be less than the record January volume a year ago, it would be the largest monthly total since June. Moreover, in the period ahead the forward calendar may be further augmented by several sizable negotiated issues, as well as by reofferings of issues deferred earlier due to market congestion and high rates.

Current yield levels on municipal bonds may not be maintained in January unless commercial banks acquire an increased share of the large net addition to supply. Take downs of bank purchase of municipals normally are reflected in portfolios only after about a month lag behind actual commitments, but reports from dealers suggest that banks have become net buyers recently -- following a period of some net liquidation when CD's were being drawn down.

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

	1966	1965
Total 1966	11,239e	11,329
4th Quarter	2,558e	2,651
October	728	844
November	930e	1,043
December	900e	764
	1967	1966
January	1,100e	1,219

1/ Data are for principal amounts of new issues.

Mortgage market developments. The tone of the mortgage market appears to have improved in recent months, with indications of actual or prospective credit easing and renewed flow of savings to savings and loan associations and other major lender groups. Nevertheless, given the unusual scarcity of funds during most of 1966 and the uncertainties still prevailing, trade and other expectations at the year-end were that it would be some time before improvement in funds-flows would be reflected in a significant upturn in commitments and a decline in mortgage rates.

In November, the latest month for which data are available, yields on mortgages were at a record high. For 6 per cent, 30-year, FHA-insured mortgages, secondary market yields averaged 6.81 per cent.

This compared with 6.63 per cent for 5-3/4 per cent mortgages in September, the last full month when the 5-3/4 per cent regulatory maximum, effective in early October, was associated with some improvement in average prices (and therefore in discounts) offered by investors in such mortgages. But the level of yields were 130 basis points above a year earlier when the regulatory maximum was 5-1/4 per cent.

Contract rates on conventional first mortgages on homes -- FHA series -- held at the advanced October levels in November -- 6.70 per cent for loans on new homes and 6.75 per cent for loans on existing homes. (These data are reported by FHA rounded to the nearest five basis points.) This was only the second time since October 1965, when tightening was already becoming evident, that the series did not show a rise. Even so, although the year-to-year increase in November was much less than for FHA-insured yields, it was still substantial, amounting to 80 basis points for mortgages on both new and existing homes.

Loan/price and maturity terms in November were holding at or very near the restrictive levels reached early last autumn for loans on both new and existing homes, according to the Federal Home Loan Bank Board. Moreover, although prices of homes involved in transactions were still appreciably higher than a year earlier, average loan amounts were staying fairly close to year-earlier levels but somewhat below prior peaks.

AVERAGE TERMS ON CONVENTIONAL FIRST
MORTGAGES FOR HOME PURCHASES

	1966 October	1966 November	Per cent change in November from a year ago
New home loans			
Loan amount ($1,000)	19.2	18.7	1
Loan/price (per cent)	71.0	71.5	-5
Maturity (years)	23.6	23.6	-6
Existing home loans			
Loan amount ($1,000)	14.1	14.1	1
Loan/price (per cent)	69.5	69.5	-3
Maturity (years)	19.2	19.5	-4

Source: Federal Home Loan Bank Board and FDIC.

Nonfarm real estate foreclosures dipped about seasonally from the second to the third quarter of 1966. The year-to-year increase, 1 per cent, was the smallest since late 1959 and the foreclosure rate was the lowest for any third quarter since 1963. Foreclosures reflect, in large part, the result of decisions made some time earlier as well as more recent income and mortgage-market developments. However, given the pattern of more cautious lending that has prevailed in recent years, and particularly in 1966, some further improvement in foreclosure rates seems likely.

NONFARM MORTGAGE FORECLOSES

Third Quarter	Number (In thousands at annual rate)	Number Per cent increase over year earlier	Rate per thousand mortgaged structures
1966	117.2	1	4.8
1965	116.3	4	5.0
1964	112.0	13	5.0
1963	98.8	13	4.5
1962	87.2	18	4.2
1961	74.0	37	3.9
1960	53.8	26	2.8

Source: Federal Home Loan Bank Board.

Flows to depositary-type intermediaries. Net inflows of share capital to savings and loan associations showed a substantial pick-up in November, and savings flows to mutual savings banks continued the relative improvement already evident in preceding months. While some of this improvement was largely offset by the poor November time deposit performance at commercial banks (even after exclusion of large CD's), all three types of institutions apparently experienced relative gains in their savings inflows during December.

SAVINGS FLOWS TO DEPOSITARY-TYPE INTERMEDIARIES
(In millions of dollars)

	Total[1/]	Savings Assn's	Savings Banks	Commercial banks Without CD's	With CD's
November					
1966	678	603	254	-179	-608
1965	1,320	807	276	237	460
1964	1,356	866	318	172	355
1st Eleven months					
1966	14,326	1,877	1,897	10,552	9,917
1965	23,478	6,741	2,982	13,755	17,782
1964	21,645	8,924	3,585	9,136	11,588

1/ Excludes time CD's of $100,000 or more at weekly reporting member banks.

The November increase of share capital at S&L's exceeded $600 million, better than for any other month this year in which there was no crediting of dividends. While no data are yet available on December changes in share capital, S&L deposits with the Home Loan Banks rose in December and their advances declined, both contraseasonally. This strongly suggests that the November pick-up of S&L savings flows has persisted.

November inflows at mutual savings banks fell only 8 per cent short of November 1965. And contrary to October, when improved flows were heavily concentrated among New York State banks, November gains were more widely shared by banks outside New York as well. Data available for the first half of December from the 15 largest savings banks in New York City show that these institutions experienced a net inflow of $45 million, the largest on record for these weeks. And in the first four days of the end of quarter reinvestment period -- in which withdrawals can be made without sacrificing accrued interest -- the volume of net withdrawals was a little less than half as large as in the comparable period a year ago.

Assuming that the fragmentary evidence now available for December correctly indicates the likely course of flows for both S&L's and savings banks, the net gain of share capital for S&L's may total about $2 billion in the fourth quarter, about 30 per cent less than in the like period of 1965. This is the smallest year-to-year short-fall since the January-March quarter of 1966, when the relative decline was also nearly 30 per cent. At savings banks the net inflow in the fourth quarter should total about $900 million, less than 15 per cent below a year ago.

Stock market. Standard and Poor's composite stock price index, after rising during the first half of December, declined on balance during the second half and showed little net change for the month. Price weakness in the closing weeks of the year reflected heavy tax-loss selling in combination with some hesitation on the part of sellers to reinvest the proceeds in stocks. At the start of the new year the index was 80.38, still about 10 per cent above the 1966 low registered in early October, but 2-1/2 per cent below the recent high reached at mid-November and 14-1/2 per cent below the record high of last February.

Trading volume during December was quite brisk, as is typically the case in a period of active tax adjustments and ended the month with an 11 million-share day, third largest for the year. For the month as a whole, activity averaged 7.9 million shares per day, the highest for any month since May, but substantially less than in December a year ago when speculative interest was large.

In November, although stock prices had advanced slightly on balance, the use of stock market credit by margin customers declined $27 million, as measured by the NYSE margin account panel. Thus, on November 30, margin debt had declined $270 million or about 5 per cent from the record total reached in April 1966.

U.S. Government securities market. In recent weeks yields have declined sharply in all maturity sectors of the U.S. Government securities market and in early January were some 50 to 125 basis points below their late summer peaks. Yields on intermediate and long-term bonds have fallen to their lowest levels in nearly a year.

YIELDS ON U.S. GOVERNMENT SECURITIES
(Per Cent)

Date (Closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1965						
Dec. 3	4.12	4.26	4.54	4.52	4.52	4.44
1966-67						
Aug. 29	5.02	5.51	6.22	5.89	5.51	5.12
Sept. 21	5.59	5.96	5.90	5.53	5.21	4.97
Nov. 25	5.27	5.47	5.56	5.39	5.23	4.91
Dec. 13	5.04	5.11	5.32	5.05	4.86	4.78
Dec. 30	4.81	4.92	4.92	4.80	4.64	4.58
Jan. 4	4.81	4.90	4.90	4.79	4.65	4.56
1966-67						
Highs	5.59	5.98	6.22	5.89	5.51	5.12
Lows	4.33	4.46	4.78	4.76	4.56	4.49

The recent declines in Treasury bond yields occurred as continued signs of moderation in the domestic economy and of a less restrictive posture for monetary policy overcame the adverse implications of large current and prospective offerings of new corporate and municipal issues and of FNMA participation certificates. The decline in yields was fueled by dealer efforts to build up their inventories and by a pick-up in investment demand by institutional investors. In this market atmosphere, prices of many intermediate- and long-term issues rose 3 or 4 points from late November to early January and yields on such issues declined 30 to 60 basis points.

Treasury bill rates fell during most of December but turned up somewhat late in the month. The earlier decline was stimulated by sizable dealer and investment demand, with dealers building up their positions substantially through aggressive bidding in the auctions. Late in the month investor demand tapered off, apparently reflecting in part a switch of funds from bills to CD's and other short-term market instruments. As the table below shows, yields on many short-term debt obligations other than bills have held steady or have declined less than bill rates in recent weeks, thereby providing increasingly attractive alternatives to investments in bills.

SELECTED SHORT-TERM INTEREST RATES 1/

	1965	1966		
	Dec. 3	Sept. 23	Dec. 2	Dec. 30
Commercial paper 4-6 months	4.375	5.875	6.00	6.00
Finance company paper 30-89 days	4.375	5.625	5.875	5.875
Bankers' Acceptances 1-90 days	4.25	5.75	5.625	5.50
Certificates of deposit (prime NYC)				
Highest quoted new issue:				
3-months	4.50	5.50	5.50	5.50
6-months	4.50	5.50	5.50	5.50
Seconda y market:				
3-months	4.50	5.90	5.75	5.60
6-months	4.60	6.30	5.80	5.70
Federal Agencies (secondary market):				
3-months	4.34	5.76	5.32	5.07
6-months	4.49	6.04	5.62	5.22
9-months	4.58	5.96	5.84	5.49
Prime Municipals 1-year	2.65	4.25	3.85	3.45

1/ Rates are quoted on the offered side of the market; rates on commercial paper, finance company paper, and bankers' acceptances are quoted on a bank discount basis while rates on the other instruments are on an investment yields basis.

Federal Agency securities. A $1.1 billion offering of FNMA participation certificates was announced on December 19, including $600 million to be sold to the public and $500 million to Treasury investment accounts. The publicly-offered portion is comprised of a $300 million 15-year maturity and $150 million each of 5-year and 10-year maturities. All three maturities were priced to yield 5.20 per cent and early investor interest in the PC's was reported to be strong.

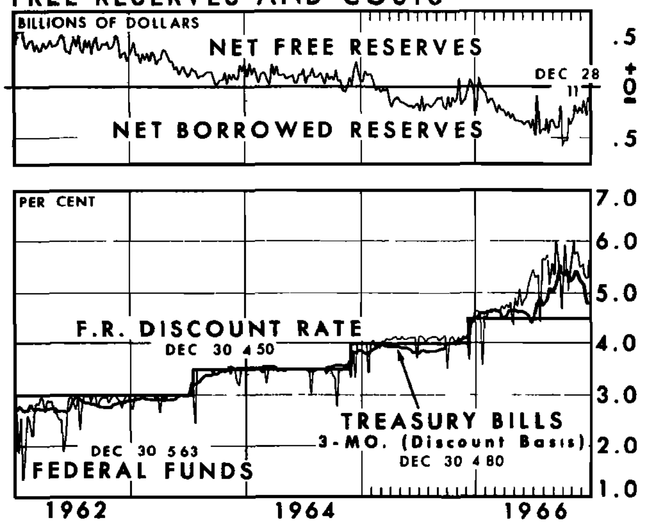
The Export-Import Bank announced in late December that it will sell participation certificates before the end of the current fiscal year. No amount was set, but the January 1966 Budget document had projected $975 million of such sales in the current fiscal year. That document had also projected $3.2 billion of PC sales by FNMA, of which the current issue is the first offering.

Treasury finance. The $600 million of new cash being raised by the public sale of participation certificates should enable the Treasury to get by a mid-January trough in its balances without additional borrowing. Thereafter, the Treasury may not need to return to the market for new money until late February or early March. In any event, an increase in the debt ceiling will be required to permit any significant amount of new borrowing.

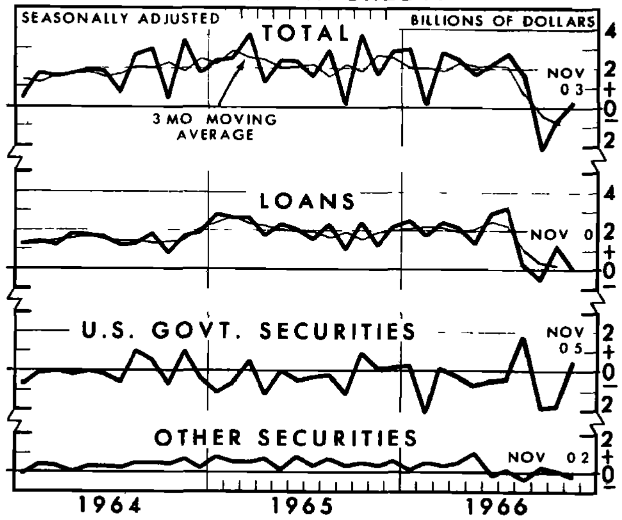
The Treasury is expected to announce the terms of its February refunding late this month. The refunding will involve $7.4 billion of maturing issues, of which a relatively moderate $3.9 billion are held by the public.

FINANCIAL DEVELOPMENTS - UNITED STATES

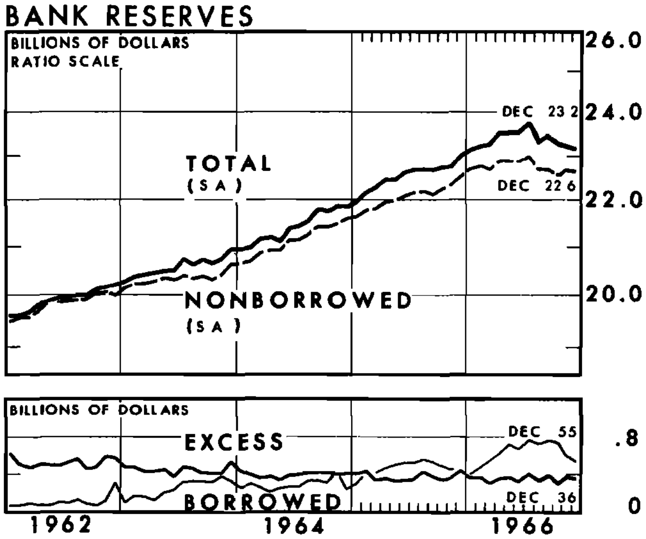
FREE RESERVES AND COSTS



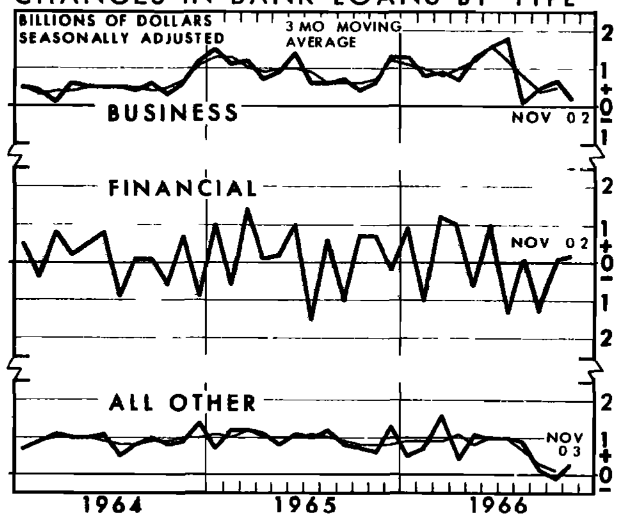
CHANGES IN BANK CREDIT



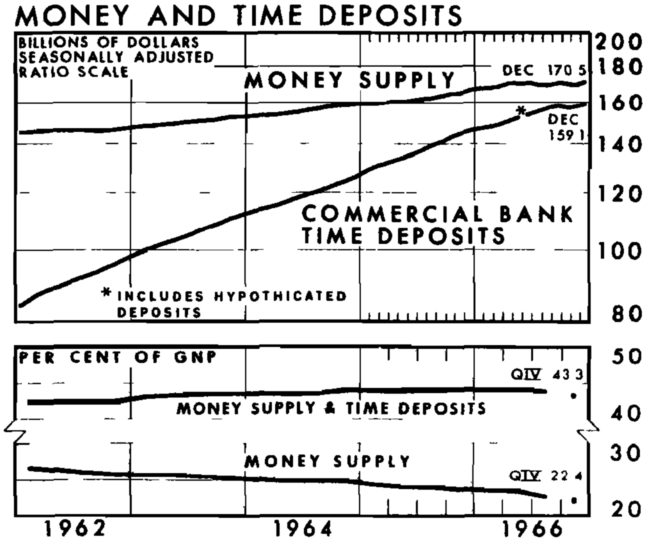
BANK RESERVES



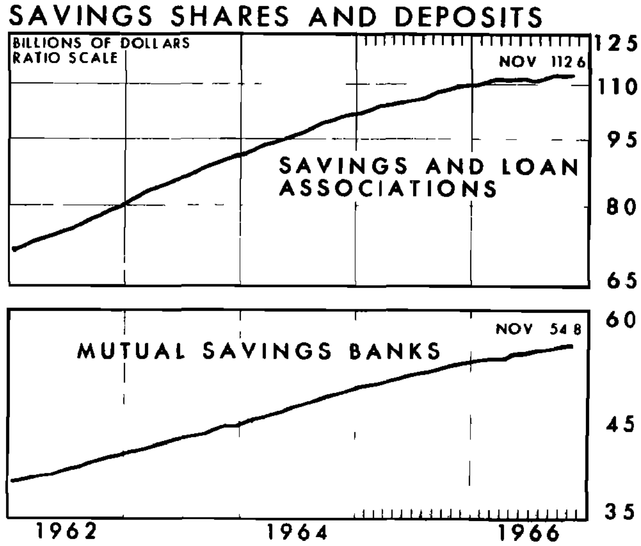
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

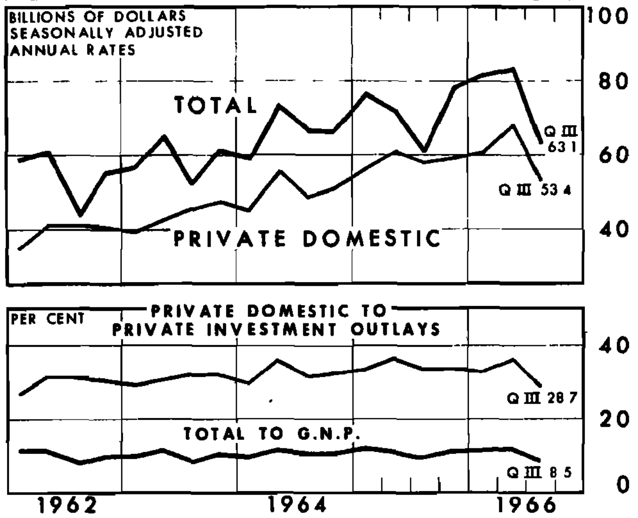


SAVINGS SHARES AND DEPOSITS

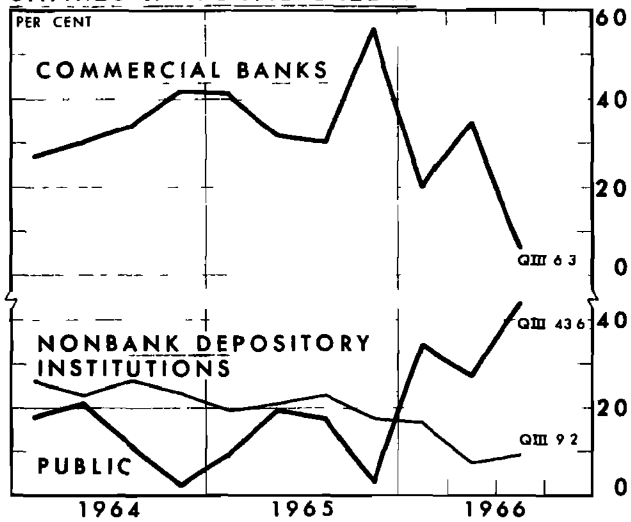


FINANCIAL DEVELOPMENTS - UNITED STATES

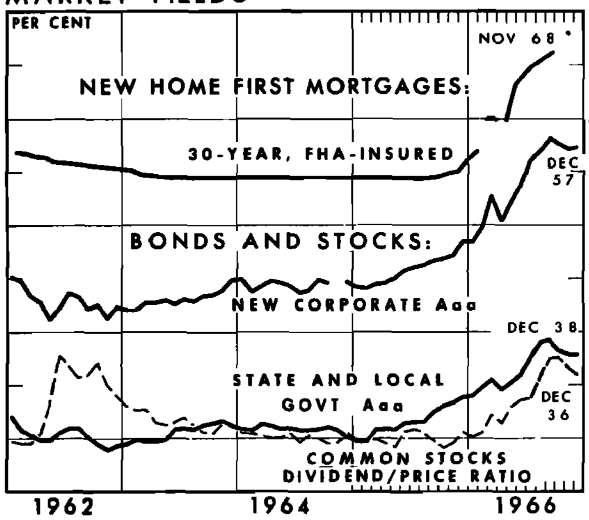
NET FUNDS RAISED-NONFINANCIAL SECTORS



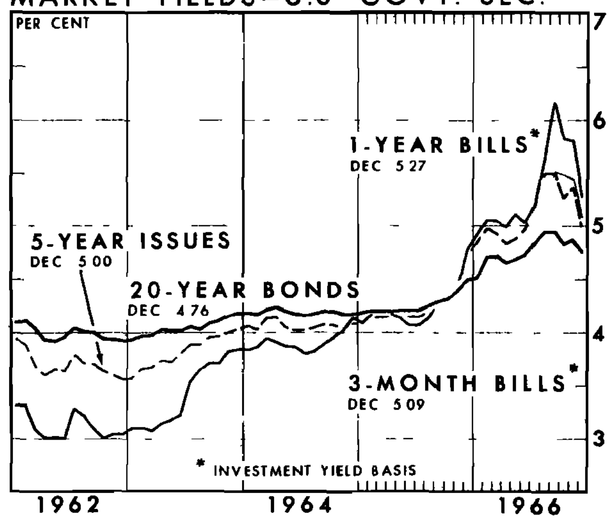
SHARES IN TOTAL CREDIT



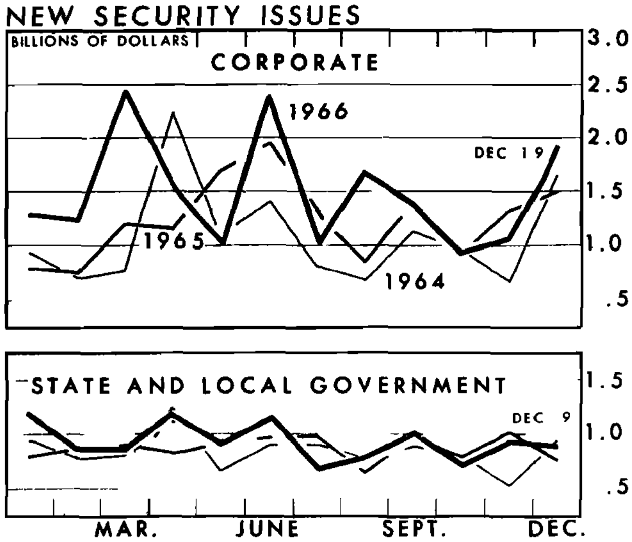
MARKET YIELDS



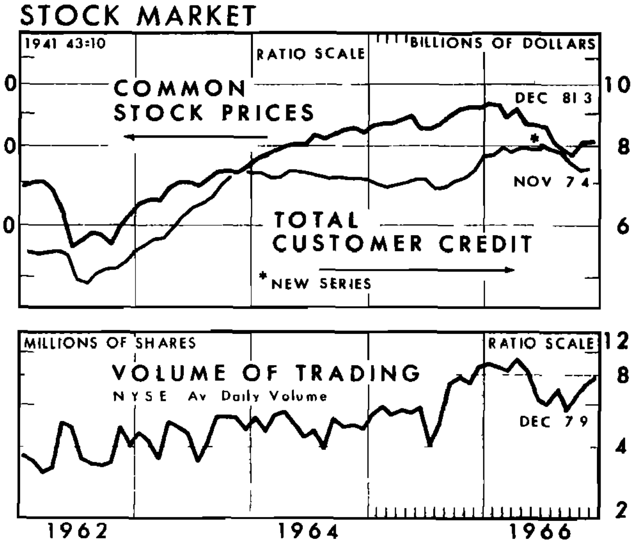
MARKET YIELDS—U.S GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. The payments deficit in November exceeded $500 million on the liquidity basis (not seasonally adjusted). It was substantially higher than had been suggested by weekly indicators, and the deficit for October and November combined totaled $1.3 billion before seasonal adjustment. Weekly indicators showed a further deficit of $350 million in the period December 1-28. There was probably a large surplus in the last few days of the month, primarily because of several large transactions which together produced receipts of $600 million;* but unless the last two days of December produced other large net receipts, the liquidity deficit for the fourth quarter may be estimated at around $1 billion, seasonally adjusted, and the deficit for the year at close to $2 billion, on the liquidity basis.

Information to account for the apparent substantial deterioration in the payments position is not at hand. Data through November show some improvement in the balance on merchandise trade from the third quarter level but, on the other hand, a resumption of outflows of short-term bank credit. The moderate easing of money market stringency in the United States since mid-November, coupled with increased confidence in sterling since September, may have ended or reversed the net inflows on unrecorded transactions that benefited the payments balance in the third quarter.

* A British debt payment of $150 million, a German payment under the military offset agreement of $250 million, and a German debt prepayment of $200 million.

Both exports and imports fell in November but exports had jumped sharply in October and the trade surplus for October and November together came to an annual rate of $3.8 billion, up from the $3.1 billion low reached in the third quarter.

Imports for the two months October and November, though lower than in September, were fractionally above the third quarter average level. From the third quarter to October-November, imports of some manufactured goods, motor vehicles in particular, continued to rise; but these advances were offset by a decline in imports of industrial supplies and some foodstuffs. Most of the sharp rise in imports of autos and parts over the past year reflects a response to the U.S.-Canadian automotive agreement of 1965. Petroleum and sugar, which accounted for a substantial portion of the rise in imports between the second and third quarters, declined significantly in October-November. Steel imports, which also advanced sharply in the third quarter, remained unchanged. During the third quarter, imports equalled 13 per cent of domestic consumption of steel products as contrasted with only 7 per cent in the third quarter of 1964. Imports of other industrial supplies appear to have declined in October-November after having levelled off in the third quarter.

Exports increased at an annual rate of 13 per cent between the third quarter and October-November, a somewhat faster rate of increase than was experienced between the third quarter of 1965 and the third quarter of 1966. The expansion from the third quarter was concentrated in non-agricultural exports; agricultural exports increased only fractionally above the high rate achieved in the third quarter (see Table).

Civilian aircraft exports approached an annual rate of $1 billion in October-November, up from an annual rate of $850 million in the third quarter but about unchanged from the first half. An expansion in aircraft exports is expected; unfilled export orders totalled $2.6 billion at the end of October in contrast with $1.7 billion at the end of 1965.

Exports of autos and parts increased by 25 per cent between July-November 1965 and July-November 1966, most going to Canada as a result of the automotive agreement. Autos and parts also accounted for one-quarter of the growth in all U.S. non-agricultural exports in this period.

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

		1965		1966		
	1964 1/	1st Half 1/	2nd Half	1st Half	3rd Qtr.	Oct.-Nov.
Agricultural	6.4	5.8	6.8	6.8	7.4	7.5
Non-agricultural	19.3	19.1	21.2	22.0	22.6	23.4
Total, Census basis	25.7	24.9	28.0	28.8	30.0	30.8
Total, Balance of payments basis	25.3	24.9	27.7	28.5	29.8	30.6 e/

1/ Distorted by longshoremen's strike early in 1965.
e/ Estimate.

Net reflows of short-term bank credits (loans and acceptances) from Japan, which have been responsible for much of the reduction in outstanding short-term credits to foreigners this year, continued in

October, reflecting high borrowing costs in the U.S. market, but were offset by increases in credits outstanding to other areas. In November, there was no net reflow from Japan, but there were outflows of short-term credits to other areas, and particularly to Continental Europe. In part this outflow to Europe might have represented use of U.S. credit lines by European borrowers resulting from stringent conditions in the Euro-dollar market. In the first 11 months of 1966, outstanding short-term bank credits to Europe rose (net) by more than $100 million, while long-term credits to Europe declined by $400 million.

Total long-term banking claims on foreigners rose $50 million in November, after having declined $270 million in the first 10 months of the year, but the November rise does not necessarily represent increased willingness of U.S. banks to make term loans to foreigners. New long-term loan commitments to foreigners in October and November were no higher than the $70 million per month average which obtained in the first three quarters, and the sizable November net disbursements may well have reflected some bunching of disbursements on commitments.

Liquid liabilities to private foreigners, mainly commercial banks, rose $900 million in October and November together, and by an additional $350 million in the first four weeks of December, reaching a peak at mid-month. This large fourth-quarter increase served to finance the deficit measured on the liquidity basis, so that the outcome measured on official reserve transactions for the quarter was probably not far from balance, even after tkaing into account an increase in non-liquid liabilities to foreign monetary authorities of roughly $300 million (preliminary).

<u>Reserve changes and payments balances of other countries</u>. For other Group of Ten countries not including the United Kingdom the predominant tendency in October and November was for official reserve gains to be smaller than in the third quarter, as may be seen in the first three columns of the table on p. IV- 6. For all Group of Ten countries (plus Switzerland) other than the United States and the United Kingdom, net official reserves increased about $350 million in the third quarter and only about $50 million in October-November. The direction of change was similar to that shown in the U.S. balance of payments on either of our two methods of accounting. (As noted above, the liquidity deficit became much larger in October and November than it had been in the third quarter, even before seasonal adjustment. Inflows of foreign private liquid funds, primarily via U.S. bank branches, were large in both periods.) U.S. official reserve transactions (before seasonal adjustment) shifted from a surplus of about $400 million in the third quarter to a deficit of about $400 million in October-November.

In contrast to these tendencies in the payments positions of most of the major industrial countries, a marked improvement occurred in the British balance of payments. Last summer's speculative attack on sterling ended in September, and in place of the heavy reserve losses (adjusted for assistance received) which the United Kingdom had suffered in the third quarter, reserve gains (adjusted for repayments) were achieved in October-November.

Germany provides a second exception to the recent tendency toward smaller reserve gains. Its official reserve gains were at a somewhat more

THIRD-QUARTER AND OCTOBER-NOVEMBER 1966 CHANGES IN RESERVES
(in millions of dollars)

	Net Official Reserves (including IMF accounts)			Net Official Reserves plus Banks' Net External Assets		
	Q-3	Oct.	Nov.	Q-3	Oct.	Nov.
Germany	+183	+167	+ 29	+300	+193	+188
France	+ 86	- 13	- 71	- 69	- 35	...
Italy	+223	- 86	- 29	+409	- 55	...
Netherlands	+ 69	+ 18	+ 33	+ 51	- 10	...
Belgium	- 24	+ 32	- 2	- 72	+ 24	...
Total EEC 1/	+537	+118	- 40	+619	+117	(+119)
Sweden	+ 8	- 30	+ 10	+ 43	- 32	...
Switzerland	- 61	- 49	+ 41	+ 3	...	...
Canada	- 49	- 19	+ 25	+198	+ 68	...
Japan	- 75	- 28	+ 27	+233	+ 1	...
Total 9 countries 1/ 2/	+360	- 8	+ 63	+1,096	(+105)	(+186)

Source: Confidential tables assembled by B.I.S.
1/ November total lacks changes in banks' net external assets except for Germany.
2/ October total also lacks changes in Swiss banks' net external assets.

rapid rate in October-November than in the third quarter, but were held down in both periods by the additions German commercial banks were making to their net foreign assets. When commercial banks' external assets and liabilities are combined with the official reserve accounts, as is done in the last three columns of the table, the marked enlargement of Germany's surplus on other payments accounts becomes evident.

Apart from Britain and Germany, major shifts were toward smaller reserve gains or reduced payments surpluses. On either basis of computation, the Italian balance of payments moved rapidly from surplus in the third quarter, accentuated by seasonal factors, to deficit in October-November.

JULY-NOVEMBER CHANGES IN RESERVES, 1965 AND 1966
(in millions of dollars)

	Net Official Reserves (including IMF accounts)		Net Official Reserves plus Banks' Net External Assets	
	1965	1966	1965 1/	1966 2/
Germany	+ 94	+379	- 90	+ 681
France	+160	+ 2	+ 217	- 175
Italy	+344	+108	+1,003	+ 325
Netherlands	+144	+120	+ 46	+ 74
Belgium	- 6	+ 6	+ 14	- 50
Total EEC	+736	+615	+1,190	+ 855
Sweden	- 44	- 12	+ 11	+ 21
Switzerland	-212	- 69	(- 212)	- 5
Canada	+245	- 43	+ 383 e.	+ 291
Japan	+108	- 76	+ 319	+ 261
Total 9 countries	+833	+415	+1,691 1/	+1,423 2/
Other developed countries except U.K. and U.S. 3/	- 20	+150e.	...	...
LDC's 3/	+475	-250e.	...	...

1/ Excludes change in bank position for Switzerland.
2/ Excludes November 1966 changes in bank positions except for Germany, and also October 1966 change for Switzerland.
3/ Gross official reserves and IMF accounts.
e. = Partly estimated.

A marked reversal occurred also in French official reserves, which with the help of net inflows of banking funds in the third quarter had continued to grow then, but were drawn down in October and November. No marked trend is evident in the recent Canadian figures. In Japan, the seasonally large third-quarter surplus was followed by near-balance in October on current transactions and long-term capital. However, outflows of banking funds have been occurring from both Canada and Japan, no doubt in response to tightness in the U.S. and Euro-dollar markets, and these outflows caused both Canadian and Japanese net official reserves to decline in the third quarter.

The table on page IV-7 puts recent reserve changes and payments balances in a broader perspective, comparing the whole five-month period July-November 1966 with the corresponding period a year earlier. For the nine G-10 countries other than Britain and the United States, the combined payments surplus in this recent period was somewhat smaller than that of July-November 1965. Within the total, however, the German surplus was nearly $800 million larger (measured by combined official and bank asset changes). On the other hand, the French balance (similarly measured) had gone from surplus to deficit, with a shift of about $400 million; and the Italian surplus had shrunk by nearly $700 million. (On an annual rate basis, these shifts would all be larger. Eleven-month data for 1965 and 1966 do show larger shifts, but just because these data cover longer periods, they understate the pace at which balances have been changing recently.) The Canadian and Japanese payments surpluses (still using the same basis of measurement) were reduced somewhat between July-November 1965 and July-November 1966; and, because of the recent large increase in Canadian commercial bank net assets and decline in Japanese bank liabilities, the official reserves of these countries declined over the recent five-month period.

This table also shows total reserve changes for developed countries outside the Group of Ten, and for LDC's. Comments on these figures are given below, following a brief country-by-country review for the G-10 countries.

Britain's payments deficit on current and long-term capital accounts in the third quarter of 1966 was larger than in preceding quarters though not as large as in the third quarter of 1965. Short-term capital flows greatly enlarged the U.K.'s (adjusted) reserve losses. An improvement in the speculative atmosphere since September and a rise in exports relative to imports have both contributed to the recent reversal of reserve drains.

The shrinkage of the French surplus accelerated last fall, as demand for French exports from such major trading partners as Germany, Britain, and the Netherlands leveled off while expanding domestic activity stimulated French imports. In Italy similar factors have been at work to enlarge the trade deficit. Over-all, the very large surplus of 1965 (nearly $1.6 billion) has gradually and continuously dwindled, and in October-November 1966 the Italian accounts were apparently in deficit. With the restoration of ample liquidity in the Italian economy in 1966, net outflows of long-term and other non-bank capital funds reached about $500 million in the first ten months of the year, compared with a negligible amount the year before.

The turn-around in the German balance of payments began to develop around the end of 1965; it has been due in considerable part to the leveling off in German imports while exports continued to rise strongly. Imports have been influenced by a marked easing of domestic demand pressures, evidenced by the leveling off, and decline since June, in German industrial production; the September-October average index was 3-1/2 per cent below the March-June average. Net inflows to Germany of private capital other than those involving changes in German banks' liabilities or assets continued during 1966 on a somewhat larger scale than in 1965, amounting to about $750 million in the first nine months of 1966. On the other hand, inflows of commercial credit (in "errors and omissions") were smaller while net official capital outflows were larger than in the corresponding period the year before.

As noted earlier, the declines in Canadian and Japanese reserves in recent months reflect sizable net outflows of commercial banking funds. On other accounts, the Canadian current account has shown only seasonal changes over-all since mid-1965, with the trade surplus growing and the deficit on services also increasing. The Japanese trade surplus, seasonally adjusted, has not changed greatly during the past two years. Long-term capital movements have been persistently outward since mid-1965.

Developed countries outside the Group of Ten have, on the whole, improved their reserve positions during the course of 1966. Australia and South Africa, which had lost over $600 million in the first three quarters of 1965, moved into a surplus position in the next nine months as imports fell owing mainly to policies of financial restraint (and also quantitative restrictions in South Africa). More recently, Australian imports have risen sharply, resulting in some loss of reserves. Quantitative restrictions have been relaxed in South Africa, but exports have advanced as well as imports. In Europe, Spain has continued to experience reserve losses, but had seasonal gains during the summer. Among other European countries, reserve gains in 1966 have been running at about the same level as in 1965.

The less-developed countries, which had gained over $1.0 billion of reserves in 1965 and an additional $400 million in the first half of 1966, lost about $250 million in July-November 1966. About $100 million of these reserve losses was by two oil-producing countries, Libya which experienced rapidly rising imports, and Venezuela, from which there was a sharp outflow of private capital in the latter part of the summer. In Latin America, Brazil had built up its reserve position during 1965 by $300 million; a more realistic exchange rate led to an upsurge in non-traditional exports as well as holding down imports. There was also a much larger amount of aid received. In 1966, as imports were allowed to rise, reserves have apparently declined. In Asia, some countries, Thailand in particular, have had their foreign exchange position bolstered by U.S. military expenditures. But India, Ceylon and Pakistan have experienced moderate losses of reserves (including IMF accounts).

Changes in commercial bank external asset positions. Confidential data assembled by the BIS are of some help in visualizing the repercussions in recent months of the heavy bidding for Euro-dollar funds by U.S. banks.

The table on p. IV-12 contains data on commercial banks' net short-term external assets for nine countries. Switzerland, for whose banks the BIS has only recently begun to obtain such monthly data is omitted. Plus signs indicate increases in assets and/or decreases in liabilities; minus signs indicate decreases in assets and/or increases in liabilities. The changes in total net external assets shown in the upper half of the table correspond, for the eight countries other than the United Kingdom, to differences between official net reserve changes shown in the two preceding tables and the combined official and bank net asset changes also shown in those tables.

The second section of the table give the U.S.-dollar component of the changes in banks' net external assets. The totals ought, in principle, to measure changes in the net U.S.-dollar assets of the banks

CHANGES IN COMMERCIAL BANKS' NET SHORT-TERM EXTERNAL ASSETS
(in millions of dollars)

	1950 1st Half	1950 July-Nov.	1950 Dec.	1966 1st Half	1966 July-Oct.
All currencies, including own:					
United Kingdom	- 44	... -190	...	+152	+260
Germany	+526	- 184	-295	+346	+143[1]
France	+104	+ 57	+ 92	+101	-177
Italy	+268	+659	-306	+227	+217
Netherlands	- 9	- 98	+ 30	-104	- 46
Belgium	- 24	+ 20	- 20	- 34	- 56
Sweden	- 50	+ 55	+ 17	- 40	+ 33
Canada	-426	...+ 27	...	+129	+334
Japan	+ 31	+211	+ 40	+ 54	+337
Total, 9 countries	+376	...+115	...	+831	+1,045
U.S. dollars:					
United Kingdom	-188	+221	- 42	+255	+120
Germany	+219	- 83	- 55	+ 90	+182
France	+ 18	...+125	...	+638	n.a.
Italy	+292	+ 70	-327	+285	+125
Netherlands	- 81	...- 83	...	-101	n.a.
Belgium	+112	-110	- 2	+ 80	+ 26[2]
Sweden	- 45	+ 2	+ 30	- 36	+ 27
Canada	-366	...+ 71	...	+114	+336
Japan	+ 54	...+174	...	- 22	+189[2]
A. Total, 9 countries	+ 15	...+505	...	+1,303	(+1,005)[3]
Related data (changes):					
B. Canadian banks' U.S.-$ liabilities to U.S. non-banks	-515	- 34	- 79	-188	- 20
A-B 9 countries banks' U.S.-$ assets, less their liabilities except Canada's to U.S. non-banks	+530	...+618	...	+1,491	(+1,025)
C. U.S. short-term liabilities to commercial banks in Europe, Canada, Japan	- 67	+637	-506	+587	+1,766
A-B-C 9 countries banks' U.S.-$ assets except in U.S., less their liabilities except Canada's to U.S. non-banks	+597	...+487	...	+904	(-741)

1/ Not including Nov. 1966 increase in German Banks' net external assets, +159.
2/ July-Sept.
3/ Incomplete. Omits France, Netherlands; and October for Belgium, Japan.

in the 9 countries vis-a-vis all external debtors or creditors except other banks within the group. As the totals on line A in the last two columns indicate, these banks increased their external U.S.-dollar assets much more than they increased their external U.S.-dollar liabilities during the first ten months of 1966 -- apparently by well over $2 billion more, though the data are incomplete for July-October. (In fact, assets increased by about $3-1/2 billion and liabilities by more than $1 billion, but these figures include inter-bank deposits.) Presumably a good deal of this addition to net external U.S.-dollar assets of these banks taken as a group was acquired through swaps, market purchases covered by market sales of dollars forward, and reversals of previous switches into sterling, covered. A complete analysis would have to take account also of dollar deposits obtained from residents of their own or other countries, and of dollar loans made. In the end it would be found that the increase in <u>net</u> external dollar assets of the group as a whole must have come primarily -- directly or indirectly -- from the reserves of central banks outside the United States (or, at least, have diverted away from central banks dollars that would otherwise have gone to them).

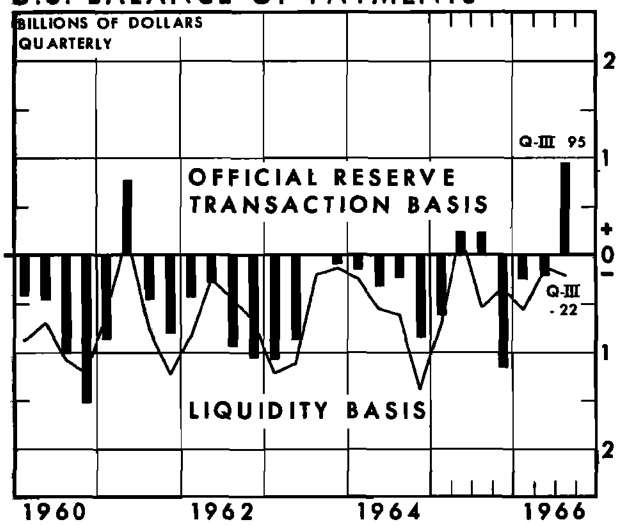
The third section of the table gives data for one important segment of liabilities, <u>U.S.-dollar deposit liabilities of the Canadian banks to U.S. non-banks</u> (line B), and for one important segment of assets, <u>claims on the United States (line C)</u>. The largest single element in line C is the change in balances due from American banks to their branches abroad, and a second (recently much smaller, but in some earlier months quite large) element is the change in balances due to Canadian banks from their agencies in the United States.

The last line of the table is a residual, and is subject of course to the influence of all sorts of statistical discrepancies. The figures here may be interpreted as indicating that in the first half of 1966 the banks in the nine countries were using a considerable part of their net purchases of dollars to make Euro-dollar loans. Since mid-year, with U.S. banks pulling funds out of the Euro-dollar market on a greatly increased scale, it appears that banks operating in the Euro-dollar market may possibly have liquidated some of their Euro-dollar loans and in any case have probably increased substantially their Euro-dollar liabilities to external depositors outside their own circle, i.e. to commercial banks outside the nine countries, to central banks and the BIS, and to businesses and individuals.

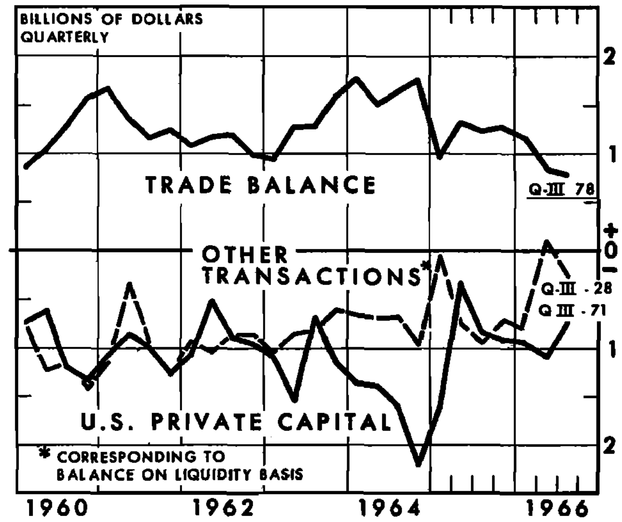
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

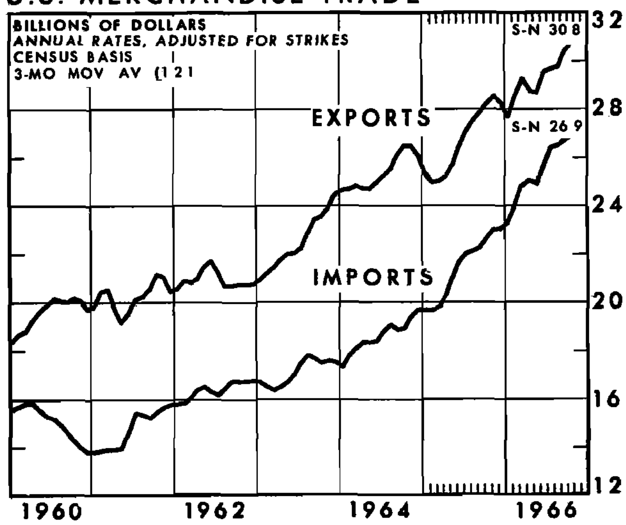
U.S. BALANCE OF PAYMENTS



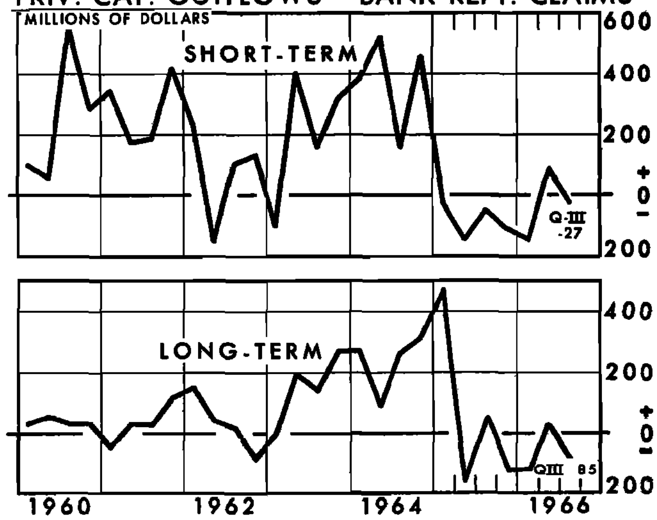
U.S. BALANCE OF PAYMENTS - CONT.



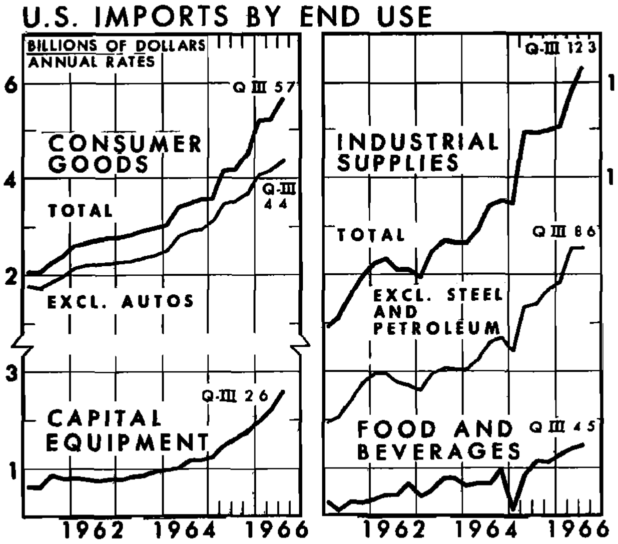
U.S. MERCHANDISE TRADE



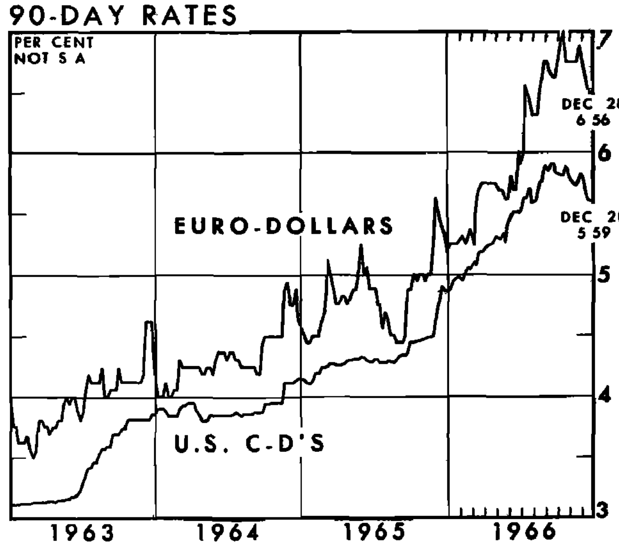
PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



U.S. IMPORTS BY END USE



90-DAY RATES



APPENDIX A: CHANGES IN LABOR FORCE DEFINITIONS IN 1967*

Beginning with January 1967 data, revised definitions will be used in the measurement of employment and unemployment through the monthly household survey. The revisions reflect several years of experimental work by the Bureau of Labor Statistics and the Bureau of the Census focused on implementing the basic recommendations of the President's Committee to Appraise Employment and Unemployment Statistics in 1962. The stated objectives are to clarify the present concepts of unemployment and employment, to make the concepts more consistent with public understanding and to provide additional information on manpower resources and labor force behavior.

The principal revisions in definitions and other changes are as follows: (1) the labor force will include persons 16 years and over rather than 14 years and over; (2) to be counted as unemployed, in addition to "seeking a job," a person must be (a) currently available for work and (b) have engaged in some specific job seeking activity within a 4-week period--no specific time period is currently used; (3) persons with a job and looking for other jobs, such as those on strike, will be classified as employed even though they were not at work -- such persons are now classified as unemployed; (4) new and more detailed questions will be asked on hours of work, duration of unemployment, and for the self-employed; (5) more information will be obtained on persons not in the labor force.

The new definitions are not expected to change the level or rate of unemployment substantially. However, a pretest of the new concepts in the period November 1965-August 1966 resulted in an average over-all unemployment rate 0.2 percentage points lower than estimated by the current concept. It is anticipated that roughly the same difference will hold in the future. In addition, the new age cut-off for labor force activity at 16 rather than 14 years of age will reduce the unemployment rate by about 0.1 percentage point.

Changes in definition of unemployment

The aim of the household survey since its inception in 1940 has been to define unemployment as the overt act of looking for work. When the interviewer asked the question for those not already at work "Was . . . looking for work," a "yes" answer classified the persons as unemployed. The meaning of the answer was often unclear. It could mean that the person unsuccessfully looked for work a month or more ago.

*Prepared by A. Jane Moore, Economist, National Income, Labor and Trade Section, Division of Research and Statistics.

The revised definitions are aimed at making the concept "unemployed" more explicit. To be classified as unemployed under the new definition a person must not be employed during the survey week and must have engaged in specific work-seeking activity within the past four weeks (unless temporarily ill) as determined by questions asked regarding the method used to search for a job. Persons on layoff from a job or waiting to start a new job within 30 days will continue to be classified as unemployed. Persons who did not look for work within the past four weeks because they thought no work was available in their line of work or community -- now counted as unemployed if this reason is volunteered -- will be classified as not in the labor force.

Table A

UNEMPLOYMENT AS MEASURED BY NEW AND OLD DEFINITIONS
(Thousands of persons 14 years and over)

	New	Old	Difference (new less old)	Rates -- per cent New	Rates -- per cent Old	Rates -- per cent Difference (new less old)
Total unemployment	3,006	3,110	-104	3.9	4.1	-0.2
Both sexes, 14-19 years	914	989	- 75	11.5	12.6	-1.1
Men, 20 years & over	1,081	1,196	-115	2.4	2.7	-0.3
20 to 24 years	214	235	- 21	4.5	4.9	-0.4
25 years & over	867	961	- 94	2.2	2.4	-0.2
Women, 20 years & over	1,011	925	86	4.2	3.8	0.4

Note: Data are 10-month averages -- November 1965-August 1966. Excludes the effects of the shift in minimum age from 14 years to 16 years.

A. Changes by age and sex

The effect of making the definition of unemployment more explicit was to lower, on average, the level and rate of over-all unemployment. The impact by sex and broad age groups are presented in Table A for persons 14 years of age and over. Lower average rates of unemployment resulted under the new definition for teenagers and adult men; a higher average rate resulted for adult women.

(1) Adult men: The reduction in unemployment of adult men reflected in part the change in classification to employed from unemployed of persons with a job but not at work (because of strikes, bad weather,

vacation, etc.) who were seeking another job. The lower level also reflected the exclusion from the unemployment count of men who had been without a job more than 4 weeks but had not engaged in specific job seeking activity within the past 4 weeks.

(2) Adult women: The increase in unemployment among adult women under the new definitions probably resulted from the intermittent nature of their job seeking. It is thought that the question on methods used to search for work tends to recall efforts made within the 4-week period to find a job which, under current procedures, were either forgotten or not volunteered.

(3) Teenagers: The reduction in unemployment of teenagers reflected the exclusion from the unemployment count of students seeking summer work in the spring while still attending school, because they were not available to take a job in the survey week -- they do not meet the requirement of current availability. This effect of the new definition will be mainly felt in April, May and June, thus changing the seasonal pattern. Both the total and teenage unemployment rates were reduced substantially in these months.

The 14 and 15 year old population will now be excluded from the data on labor force, employment and unemployment. This age group represents a very marginal group from the standpoint of labor force activity. Nearly all 14 and 15 year olds in the labor force (about 1 million on the average) work very few hours during the school year; while those counted as unemployed in this age group (about 100,000) seek only part-time work. The exclusion of 14 and 15 year olds reduced the unemployment rate by 0.1 percentage points.

Table B

EFFECT OF AGE CUTOFF ON LABOR FORCE COMPONENTS
NEW DEFINITIONS
(Thousands of persons, 10-month averages)

	14 years and over	16 years and over	Difference
Civilian labor force	76,598	75,286	-1,312
Employed	73,592	72,402	-1,190
Nonagriculture	69,370	68,447	- 923
Agriculture	4,223	3,955	- 268
Unemployed	3,006	2,884	- 122
Rate	3.9	3.8	- .1

B. Changes by selected characteristics

The effect of the change in definitions on the number unemployed by duration, color, etc. are related to the points brought out in the discussion of Table A. Thus the increase in the number of persons seeking part-time jobs undoubtedly reflected the increase in unemployment of adult women; while the decline in the number seeking full-time jobs is probably due to the reduction in unemployment of adult men. To some extent the reduction in the "never worked" category reflected the elimination of large numbers of teenagers during the spring months from the unemployment count.

Table C

UNEMPLOYMENT BY COLOR, DURATION AND FULL OR PART-TIME STATUS
(Thousands of persons, 14 years and over)

	New	Old	Difference (New less old)
Total unemployed	3,006	3,110	-104
White	2,329	2,441	-112
Nonwhite	677	669	8
15 weeks & over	522	585	- 63
Less than 5 weeks	1,623	1,673	- 50
Seeking full-time job	2,296	2,471	-175
Seeking part-time job	710	639	71
Never worked 1/	511	594	- 83

Note: Data are based on 10-month averages -- November 1965-August 1966.
1/ Never had a full-time civilian job for two consecutive weeks or more.

The more detailed questions on duration of unemployment significantly reduced the number of persons unemployed for 15 weeks or longer and, in part, reflected the re-classification of persons not actively seeking work from unemployed to outside the labor force. Unemployment among nonwhites was not affected by the change.

Employment

The addition to the new schedule of probing questions on the number of hours worked during the survey week were designed to make it easier for the respondent to recall any time taken off as well as of any overtime or hours worked on a second job. In answering the old question on hours the respondent was likely to report the scheduled workweek and forget longer and shorter hours of work. Thus, the revised questions indicated a sharp increase in part-time work. Similarly there was a largely offsetting increase in the number of persons reporting longer than scheduled hours of work. The average workweek, however, in nonfarm industries was little affected by the new questions.

Table D also shows the effect of the probing questions asked of the self-employed to determine if they are operators of small incorporated businesses. Such operators have tended to report themselves as proprietors but since they are technically employees of a corporation, they will now be classified as nonfarm wage and salary workers. The previous misclassification of this group as self-employed has been a major reason for the lower level of wage and salary employment in the household survey compared with establishment data.

Table D

NONAGRICULTURAL EMPLOYMENT BY CLASS OF WORKER AND HOURS WORKED
(Thousands of persons, 14 years and over)

	New	Old	Difference (New less old)
Wage and salary	63,553	62,649	904
Self-employed	5,296	6,129	- 833
Unpaid family	531	585	- 64
Worked 41 hours or more	22,166	21,245	921
" 35-40 hours	29,644	31,986	-2,342
" 1-34 hours	14,092	12,745	1,347
With a job, not at work	3,183	3,131	52

Note: Data on hours worked are 9-month averages, November 1965-July 1966; on class of worker, 10-month averages, November 1965-August 1966.

Nonworkers

The new household survey schedule also includes a number of questions to be asked of persons who have not actively looked for work within the preceding 4-week period -- when last worked, why left job, nature of last job, why not looking for work, and future intentions regarding job seeking. The BLS hopes that these questions will help to distinguish between persons who are outside the labor force because their past job-seeking activity led them to believe no jobs were available, from those with personal handicaps or who are not seeking work for other reasons.

Effect of revisions on historical comparability

Insofar as possible, monthly and annual estimates for the period 1947-1966 as well as major published and unpublished seasonally adjusted series will be revised to take into account the higher age cutoff.

With this exception, no revision of previously published official estimates will be published and for most major series the new definition data will be treated as continuous with the past. The overlap data showing the differences between the new and old measurement techniques will be confined to annual averages for 1966 and will be published in the February 1967 issue of Employment and Earnings. The usual annual revision of seasonally adjusted monthly series to take into account the addition of 1966 data will also be published in this issue. Special procedures are being developed to obtain 1967 seasonal factors for unemployed teenagers.

Accurate comparisons with the past will be difficult in a number of series. The probing questions with respect to hours of work will introduce a marked discontinuity in employment by hours of work series because of the sharp increase in the number of persons reporting less than 35 hours and 41 hours of work or more. The very large increase in nonfarm wage and salary employment because of the reclassification of operators of incorporated businesses from self-employed to employees will also make comparisons with past periods difficult. The sharp reduction in unemployment of teenagers in the April-June period -- when students seeking summer jobs will no longer be counted as unemployed because they are not currently available to take a job -- will change the seasonal pattern of teenage unemployment significantly in these months. Several years of data will be required to obtain reliable seasonal factors for the new definition series; meanwhile comparison of unadjusted data for previous years will be difficult.