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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

March 29, 1967

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SUMMARY AND OUTLOOK

Outlook for economic activity

The sharply reduced first quarter growth in GNP has generally been confirmed by the incoming flow of statistics. With retail sales down in February--and probably in March--and other private demands sluggish, we are holding to our earlier estimates of dollar gains of about $5 billion per quarter for the first half. Although price increases have moderated, and are projected to slow further, real GNP growth is still expected to be very small in this and the next quarter.

Selective inventory adjustments apparently did get underway in January, as distributors--and particularly auto dealers--began to liquidate stocks in contrast to their sharp rate of accumulation earlier. Manufacturers continued to add to stocks in January about as rapidly as earlier, but sharp reductions in production in February point to a significant slowdown in inventory building in this sector. Nonfarm inventory accumulation in the first quarter thus may be at a rate about $7 billion less than in the fourth quarter, although declining sales in manufacturing and trade may be slowing the necessary inventory adjustments at both levels.

With further reductions in industrial activity in prospect, we project inventory accumulation in the second quarter to be at a rate $7 billion less than in the first quarter, and to be the major influence underlying declines in hours and employment which began in February to affect aggregate wage and salary income adversely. If, as expected, employment in industrial activities declines further, and over-all employment levels off, wage and salary gains would slow further in the second quarter. Furthermore, first quarter additions to income from increases in minimum wages and veteran's insurance dividend payments will not be present in the second quarter. With retail sales already sluggish, and an increasing number of workers facing reduced earnings, continued weakness in personal consumption expenditures is likely in the second quarter although further declines in purchases of durable goods are not anticipated. With the rise in total consumer outlays projected to be only slightly more rapid than the rise in disposable income, the savings rate would remain high and close to the first quarter rate.

Outlook for resource use and prices

So far, easing in the markets for labor and services has generally been relatively limited, with unemployment in February still at a low 3.7 per cent. But some additional weakness now appears to be developing in demands for labor. Meanwhile, industrial activity and capacity utilization rates are declining and prices of primary commodities continue to fall.

Output curtailments undertaken in an effort to reduce inventories spread from consumer durable goods to nondurable goods in February and March. Also, slower inventory building, reduced orders, and falling backlogs have eased pressures on resources in machinery industries. The rate of capacity utilization in manufacturing fell to 87 per cent in February, from 91 per cent most of last year, and we expect the rate to fall to 85 per cent or below in the second quarter. Most industries are now operating at rates which are about average for them, and well below the rates at which they indicate they would prefer to operate.

Hours of work and employment in manufacturing also dropped sharply in February. Larger than seasonal increases in unemployment claims during March suggest that layoffs have been increasing as employers try to bring their stock-sales ratios down to more reasonable levels. Our projection implies a turn-up in unemployment, with the rate averaging 4.1 per cent for the second quarter.

The downturns here and abroad in basic commodity prices have extended further. Premium copper prices are now off about one-fifth since the beginning of the year and additional weakness has developed from some other metals, hides, rubber, and wool. Also, domestic prices for food and farm products continued to decline moderately in March, and agricultural production is likely to be large enough to continue downward pressures on farm prices. Over-all prices of industrial products, however, rose moderately further in March, and the total index of wholesale prices was unchanged, at a level less than 1 per cent above a year earlier. With industrial capacity use expected to decline further, and the agricultural supply situation generally better than anticipated earlier, prospects are improved for near-term price stability outside the services area.

Outlook for commercial banking system

Accelerations of both corporate income and withheld tax payments will be a major factor influencing demand for bank loans in April. The total of these tax payments, net of the $2.5 billion of maturing tax anticipation bills, will be more than $7 billion, or almost twice last year's payments. This represents one of the largest year-over-year increases for any month since acceleration began. Even with businesses perhaps somewhat more liquid than in recent months--at least as judged by acquisitions of CD's--the need to make tax payments suggests a very substantial, though temporary, growth in business loans in April. To the extent that corporations draw upon liquid assets for meeting tax payments, banks still will be called upon to help finance those payments--mainly by lending to dealers and finance companies and by purchasing bills direct from corporations. In addition, they might need to redeem substantial amounts of maturing CD's.

An offset to such potential loan growth may be forthcoming as some corporations repay bank loans from the proceeds of the recent surge of corporate bond issues, many of which have an April payment date; some market observers have suggested that a larger proportion of recent issues than earlier this year may be used to reduce indebtedness to banks. Another offset may be provided by further reductions in inventory accumulation and, hence, in the need for short-term credit.

The large increases of time and savings deposits over recent months, accompanied by substantial bank purchases of short-term U.S. Government and other securities, suggests that banks have to a degree anticipated these tax period demands. Moreover, the spreading reduction in prime loan rates may indicate growing bank awareness of the weakening outlook for loan demands after the tax period.

As banks have restocked their security holdings, they have provided support to both short- and longer-term credit markets. It is possible that there will be some diminution of this support in the period immediately ahead as a result of some slowing in bank deposit growth and as banks accommodate the expected bulge in short-term loans. However, liberalization of bank lending terms--particularly for term loans--may tend to reduce capital market pressures by encouraging businesses to utilize bank sources rather than bond financings.

We expect some falling off in the pace of time and saving deposit growth in coming months. The rate of growth in these deposits during the first quarter of 1967 was the sharpest quarterly gain since that following the increase in Regulation Q ceilings at the beginning of 1962. Consumer-type deposits (with passbook savings net inflows picking up in recent weeks) have been a major source of time deposit funds to banks. Some of the flow of consumer-type deposits to banks during the first quarter must represent one-time return of funds that had moved into market investments during last year's rise in market rates; the continued sluggishness of consumer purchasing would also help explain consumers' desire for interest-earning depository claims.

Outstanding large denomination CD's may grow relatively little in April, reflecting both corporate redemptions for tax payments and less vigorous sales efforts by banks. And if banks feel that April loan demand is temporary, they may not make strong efforts to obtain CD funds but may prefer to satisfy temporary needs in the Federal funds market or through short-term borrowing abroad or from the System.

The combined total of Government and private demand deposits, after increasing moderately in January and February, rose more sharply in March and is likely to increase further in April. Large expected tax payments, however, are producing sizable shifts between public and private balances.

Outlook for capital markets

While interest rates have declined markedly in short-term markets in recent weeks, they have moved down more sluggishly in markets for corporate and municipal securities. Long-term rates have been held up mainly by the record March volume of publicly offered securities, especially corporate issues but also including sizable amounts of municipal bonds, Federal participation certificates, and foreign and IBRD bonds. In the face of the massive volume of new flotations, one might conclude that even the relatively small rate declines would not have been likely without the effect on money market conditions and bank credit expansion of the recent easing in open market policy and without expectations of further easing.

In April the new issue volume in the corporate and municipal markets is expected to remain at a high level, although noticeably below the March record. Another participation certificate may be in the offing, but it may be of moderate size in April, and foreign and other international issues are not likely to approach their March volume. The

Federal Government will announce the terms on its May refunding toward the end of April; there are almost $3 billion of publicly-held coupon issues maturing in May and another $1.3 billion of such issues maturing in June.

All in all, the moderation of the new issue calendar is likely to be reflected in a tendency for long-term market rates to drift further downwards. However, any reduced bank activity on the buying side in longer-term markets will tend to hold back a tendency for rates to decline. Indeed, shifts in market expectations about the course of monetary policy might even generate some upward rate pressures.

Net inflows of funds to depositary-type lenders have continued to grow sharply, and home mortgage rates have dropped substantially more from their November peak through February than in any other three-month period. The abruptness of the rate decline this time has reflected the extreme shortage of residential mortgages in the pipeline. Lags in the reassembling of builder's resources and in making financing arrangements are, as expected, taking time; seasonal slackness in building activity and in real estate transfers has accentuated the effect of these delays on the availability of mortgages. In the meantime, lenders have used a large part of their increased flows to repay debt and acquire market securities. Given the continuing shortage of mortgages and the size of recent savings inflows, further mortgage rate declines are likely.

International developments

The payments deficit on the liquidity basis has been rather large in the first quarter of 1967, after allowance for favorable seasonal factors. Apart from special transactions, which held the deficit down in late 1966 but thus far this year have been small, the seasonally adjusted liquidity deficit in the first quarter appears to have been over $1 billion, and not very different from a comparable figure for the fourth quarter though well above the average for 1966. There was a sharp improvement in the trade balance in January-February and a continued reflow of U.S. bank credit. But in March U.S. oil companies made tax payments of £100 million ($280) to Libya: similar payments last year came somewhat later in the spring.

Without seasonal adjustment, the liquidity deficit through March 22 came to about $600 million, while the deficit on the official reserve transactions basis--enlarged by repayments of U.S. liabilities to commercial banks abroad--came to about $1.2 billion. But the main foreign reserve gains in this period accrued to the United Kingdom, and U.S. reserve losses were concentrated upon holdings of convertible foreign currencies, sterling and other, which fell by nearly $1 billion.

During the months ahead, the payments deficit before seasonal adjustment is likely to remain substantial on both bases of calculation. Seasonal factors will become progressively less favorable in the next two quarters; in the April-June quarter the liquidity balance will be about the same unadjusted as adjusted. In the absence of unforeseen adverse developments, and with the help of some further decline in U.S.

imports, the liquidity deficit in this quarter apart from special transactions could lie in the half-billion-to-three-quarter-billion range. Whether the official settlements balance is larger than that will probably depend importantly on whether U.S. banks make further repayments to the Euro-dollar market. Incentives to do so might not be strong, especially if European interest rates continue to decline along with U.S. rates. But some further repayments are to be expected, if the liquidity position of U.S. banks improves substantially.

Prospects for U.S. exports are especially difficult to assess. Exports would clearly be favored by an early upturn in general demand conditions in Germany, the expansive repercussions of which in other countries would help offset unfavorable repercussions from the expected easing in U.S. import demand. But the timing of an upturn in Germany is still very uncertain. Adjustments in inventory positions have apparently gone much further than in the United States, but German consumer buying attitudes and business fixed investment intentions are apparently still very cautious.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per cent change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Years Ago*
Civilian labor force (mil.)	Feb'67	77.0	77.1	75.1	2.5	4.2
Unemployment (mil.)	"	2.9	2.8	2.8	3.7	-22.1
Unemployment (per cent)	"	3.7	3.7	3.7	--	--
Nonfarm employment, payroll (mil.)	"	65.5	65.4	62.8	4.3	9.6
Manufacturing	"	19.4	19.5	18.7	3.6	9.5
Other industrial	"	8.2	8.2	8.1	1.9	5.3
Nonindustrial	"	37.9	37.7	36.0	5.1	10.6
Industrial production (57-59=100)	"	155.9	158.0	152.4	2.3	11.7
Final products	"	155.6	157.8	152.1	2.3	12.1
Materials	"	156.1	158.2	152.6	2.3	11.3
Wholesale prices (57-59=100) 1/	"	106.0	106.2	105.4	0.6	4.7
Industrial commodities	"	n.a.	n.a.	n.a.	n.a.	n.a.
Sensitive materials	"	n.a.	n.a.	n.a.	n.a.	n.a.
Farm products and food	"	105.7	107.0	109.8	- 3.7	7.1
Consumer prices (57-59=100) 1/	"	144.8	114.7	111.6	2 9	5.4
Commodities except food	"	107.6	107.3	105.4	2.1	2.8
Food	"	114.2	114.7	113.1	1.0	7.1
Services	"	125.9	125.5	119.7	5.2	7.7
Hourly earnings, mfg. ($)	"	2.78	2.76	2.67	4.1	7.3
Weekly earnings, mfg. ($)	"	112.04	113.36	110.82	1.1	4.9
Personal income ($ bil.) 2/	"	609.9	607.5	564.7	8.0	17.9
Corporate profits before tax ($ bil.) 2/	QIV'66	81.9	81.9	78.7	4.1	21.0
Retail sales, total ($ bil.)	Feb'67	25.3	25.7	25.3	0.1	8.7
Autos (million units) 2/	"	7.0	7.8	9.2	-23.7	-25.5
GAF ($ bil.)	"	6.1	6.2	5.9	3.9	15.3
Selected leading indicators:						
Housing starts, pvt. (thous.) 2/	"	1,089	1,282	1,374	-20.7	-26.5
Factory workweek (hours)	"	40.3	41.0	41.5	- 2.9	- 2.2
New orders, dur. goods ($ bil.)	"	22.2	22.4	23.7	- 6.5	5.0
New orders, nonel. mach. ($ bil.)	"	3.2	3.4	3.3	4.6	3.7
Common stock prices (1941-43=10)	"	87.37	84.45	92.69	- 5.7	0.7
Manufacturers inventories, book value ($ bil.)	Jan'66	78.9	77.9	68.6	15.1	24.8
Gross national product ($ bil.) 2/	QIV'66	759.3	745.3	704.4	7.8	17.9
Real GNP ($ bil., 1958 prices) 2/	"	657.2	649.9	631.2	4.1	11.9

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Mar. 24	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.75	4.63	4.75	3.75
U.S. Treas. bills, 3-mo., yield (per cent)	4.14	4.32	5.48	4.10
Net free reserves 2/ (mil. $)	282	153	282	- 583
Member bank borrowings 2/ (mil. $)	302	211	928	167
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.47	4.58	5.64	4.44
20-year U.S. Treas. bonds	4.54	4.58	4.92	4.44
Corporate new bond issues, Aaa	5.33	5.38	5.99	5.11
Corporate seasoned bonds, Aaa	5.13	5.12	5.53	4.99
Municipal seasoned bonds, Aaa	3.46	3.49	3.83	3.25
FHA home mortgages, 30-year 3/	6.46	6.46	6.81	6.46
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	90.35	88.79	90.94	79.67
Dividend yield (per cent)	3.26	3.30	3.89	3.26

	Change in Feb.	Average change Last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	268	207	10.7	2.9
Bank loans and investments:				
Total	1,700	2,600	10.1	6.7
Business loans	100	500	7.6	13.0
Other loans	- 700	600	5.9	5.8
U.S. Government securities	1,100	700	15.1	- 1.8
Other securities	1,200	800	19.9	9.5
Money and liquid assets:				
Demand dep. & currency	900	400	3.1	13.7
Time and savings dep.	2,600	2,100	16.1	9.8
Nonbank liquid assets	- 500	0	0.1	3.3

N.S.A. -- not seasonally adjusted. S.A. Seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending March 22.
3/ Latest figure indicated is for month of February. 4/ Data are for weekly closing prices.

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

	1967 Feb.	1967 Jan.	1966 QIV	1966 QIII	1966 QII	1966 QI	1966 Year	1965 Year
							(billions)	
			Seasonally adjusted					
Current account balance			882	929	1,147	1,346	4.3	6.0
Trade balance								
As published in B/P			834	787	878	1,174	3.7	4.8
Revised 1/	370	300	(716)	(794)	(959)	(1,204)		
Exports 1/	2,575	2,595	(7,403)	(7,386)	(7,185)	(7,206)	29.2	26.3
Imports 1/	-2,205	-2,295	(-6,687)	(-6,592)	(-6,226)	(-6,002)	-25.5	-21.5
Services, etc., net			48	142	269	172	0.6	1.2
Capital account balance			-1,167	-1,302	-1,074	-1,596	-5.1	-6.9
Govt. grants & capital 2/			-690	-797	-952	-957	-3.4	-3.4
U.S. private direct investment			-963	-737	-976	-687	-3.4	-3.4
U.S. priv. long-term portfolio			100	-14	-80	-219	-0.2	-1.1
U.S. priv. short-term			-278	3	-38	-22	-0.3	0.8
Foreign nonliquid			664	243	972	289	2.2	0.2
Errors and omissions			-273	173	-195	-294	-0.6	-0.4
			Balances, with and without seasonal adjustment (- = deficit)					
Liquidity bal., S.A.			-558	-200	-122	-544	-1.4	-1.3
Seasonal components			30	-499	-27	496	--	--
Balance, N.S.A.	-266	136	-528	-699	-149	-48	-1.4	-1.3
Official settlements bal.			-244	952	-203	-234	0.3	-1.3
Seasonal component			71	-525	-182	636	--	--
Balance, N.S.A. 3/	-304	-469	-173	427	-385	402	0.3	-1.3
Memo items:								
Monetary reserves (decrease -)	-198	-686	6	-82	-68	-424	-0.6	-1.2
Gold purchases or sales (-)	-41	-33	-121	-173	-209	-68	-0.6	-1.7

1/ Based on revised Census seasonal adjustments which will not be incorporated in balance of payments statistics until June, when seasonal adjustment revisions will be made for all components of the balance of payments. January and February figures are on the balance of payments basis which differs a little from the published Census basis.

2/ Net of loan repayments.

3/ 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.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. The staff's current projection of gross national product is essentially the same as that of a month ago, with an average increase of $5 billion per quarter expected for the first half of the year. Despite an apparent moderation in the pace of price increase, the annual rate of growth in real GNP would be small--between 1/2 per cent and 1 per cent--a rate well below current gains in productivity and so low as to be accompanied by further declines in industrial output and employment and a rise in unemployment to about 4.2 per cent by midyear.

Private final demand for goods continued sluggish in the first quarter. Consumer outlays for goods were particularly weak and are expected to show no rise from the fourth quarter. Durable goods expenditures are likely to decline by $2 billion, with unit sales of new domestic automobiles down to an estimated 7-1/4 million from 8.1 million in the fourth quarter. Expenditures for appliances, furniture and other household goods remain soft, while nondurable goods sales continue to be disappointing after allowance for an early Easter.

A major new factor dampening prospective consumer outlays appeared in February when private payrolls decreased because of declines in hours and employment in manufacturing. Payroll advances in government more than offset the decline in the private sector but total wage and salaries increased only $1/2 billion. Almost half of the $2-1/2 billion increase in total personal income in February was accounted for by a speed-up in life insurance dividend payments to veterans. With the marked slowdown in employment gains and payrolls expected to be extended through the second quarter, disposable income is projected to rise by only $5 billion, less than one-half of the $11 billion quarterly increase shown for the fourth and first quarters.

Such a slowdown in income growth provides little basis for anticipating a resurgence in consumer spending for goods. We do, however, expect a leveling off of automobile sales at current reduced rates in contrast to the decline in the first quarter, and this, along with a rise in nondurable goods purchases at about the same rate as in the first quarter, and the continued inexorable rise, in service outlays, would result in a small increase in total personal consumption expenditures. But this rise in consumer expenditure is only a little more than the projected increase in disposable income, so the saving rate would remain high at 6.7 per cent.

The decline in housing starts in February was a reminder that it may take some time to generate a strong expansion in residential construction expenditures, and only a slight increase of $0.5 billion is projected for the second quarter. The latest Commerce-SEC survey suggests that expenditures for plant and equipment investment will decline in the first half of 1967 from the fourth quarter level. These figures reflect a downward revision of business investment plans from the previous survey in November and, broadly speaking, are consistent with the sustained decline in new orders for machinery and equipment and the more recent decline in unfilled orders. The auto component of business fixed investment is also declining in the first quarter. On the other hand, sales of farm equipment still appear to be rising and nonresidential construction, including commercial, has been increasing briskly in recent months. It should be noted that the sales expectations that accompanied the investment survey indicated that manufacturers anticipate sales gains of 8 per cent for the year. Since these sales expectations appear overly optimistic, at least in terms of likely short-run developments, another downward revision in investment plans is possible. On the other hand, the reinstatement of the 7 per cent investment tax credit and accelerated depreciation allowances may encourage some extra fixed investment, but probably not showing up in GNP until later this year. In view of these various considerations we have held the estimate of business fixed investment for the first two quarters at $81.6 billion, the same as in the fourth quarter of 1966. This contrasts with the small increases shown in the preceding projection.

Weakness in private takings of goods have tended to make attempts to curtail inventory expansion more difficult and to delay desired reductions in the stock-sales ratios. But it is the inventory adjustment that is primarily responsible for the projected slowdown in the rate of growth in GNP. Nonfarm inventory accumulation is now recorded in the GNP accounts at an annual rate of $17.6 billion in the fourth quarter of 1966, but this figure is probably low by $1 billion or so since it does not reflect the recent upward revision in the December book value figures. In January the book value of total manufacturing and trade inventories increased at an annual rate of approxi-

The over-all business stock-sales ratio increased further in January and was at the highest level since the spring of 1961. With stocks of autos and other consumer durable goods excessive, with outlays for business fixed capital at best levelling off, and with defense spending rising more slowly than earlier, it seems clear that further marked reductions in inventory accumulation are in prospect. On balance, then, the private sector of the economy contributes little to economic expansion. Business fixed investment is at a standstill, with little likelihood of a major breakout from current levels, at least until much later in the year. Residential construction is recovering--slowly--and is not yet providing much strength to final expenditures, although this should be more in evidence by summer. And business inventory adjustments are more than offsetting the feeble rise in consumer spending for goods.

Government outlays continue to provide an important stimulus to economic activity. A $5-6 billion increase per quarter is expected to come from the public sector as both Federal and State and local purchases continue to rise at a relatively stable rate. Recent information suggests that Federal non-defense and State and local expenditures are rising somewhat faster than previously estimated. While its still too early to re-evaluate our defense expenditure projections based on Budget estimates, there is some evidence that they also may be running slightly higher than originally planned. All told, government purchases are estimated about $1.5 billion higher for the second quarter than in the earlier projection.

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

	1965	1966	1966 I	1966 II	1966 III	1966 IV	1967 Projected I	1967 Projected II
Gross National Product	681.2	739.6	721.2	732.3	745.3	759.3	764.0	769.4
Final sales	672.1	727.7	712.3	720.0	735.4	742.9	753.3	765.4
Private	535.9	574.7	567.3	571.0	579.2	581.8	586.2	593.5
Personal consumption expenditures	431.5	464.9	455.6	460.1	469.9	474.1	478.0	483.8
Durable goods	66.1	69.3	70.3	67.1	70.2	69.6	67.4	67.4
Nondurable goods	190.6	206 2	201.9	205.6	208.1	209.2	211.3	213.3
Services	174.8	189.4	183.4	187.4	191.5	195.3	199.3	203.1
Gross private domestic investment	106.6	117.0	114.5	118.5	115.0	120.0	114.3	108.1
Residential construction	27.8	25.8	28.6	28.0	24.8	21.9	22.0	22.5
Business fixed investment	69.7	79.3	77.0	78.2	80.3	81.6	81.6	81.6
Change in business inventories	9.1	11.9	8.9	12.3	9.9	16.4	10.7	4.0
Nonfarm	8.1	12.2	8.5	12.1	10.4	17.6	11.0	4.0
Net exports	7.0	4.8	6.0	4.7	4.2	4.1	4.6	5.6
Gov't purchases of goods & services	136.2	153.0	145.0	149.0	156.2	161.1	167.1	171.9
Federal	66.8	76.9	71.9	74.0	79.0	81.7	85.5	88.1
Defense	50.1	60.0	54.6	57.1	62.0	65.5	68.3	70.6
Other	16.7	16.9	17.4	16.9	17.0	16.2	17.2	17.5
State & local	69.4	76.2	73.1	75.0	77.2	79.4	81.6	83.8
Gross National Product in constant (1958) dollars	614.4	647.8	640.5	643.5	649.9	657.2	658.0	659.6
GNP Implicit deflator(1958=100)	110.9	114.2	112.6	113.8	114.7	115.5	116.1	116 7
Personal income	535.1	580.4	564.6	573.5	585.2	598.3	610.0	615.5
Wage and salaries	358.4	392.3	380.0	387.4	396.7	405.0	411.3	416.0
Disposable income	469.1	505.3	495.1	499.9	507.8	518.4	529.5	534.5
Personal saving	25.7	27.0	26.7	26.6	24.5	30.4	37.3	36.0
Saving rate (per cent)	5.5	5.3	5.4	5.3	4.8	5.9	7.0	6.7
Total labor force (millions)	77.2	78.9	78.1	78.4	79.1	79.8	80.4	80.6
Armed forces "	2.7	3.1	2.9	3.1	3.2	3.3	3.4	3.5
Civilian labor force "	74.5	75.8	75.2	75.4	76.0	76.5	77.0	77.1
Unemployment rate (per cent)	4.5	3.8	3.8	3.8	3.8	3.7	3.8	4.1
Nonfarm payroll employment (millions)	60.8	63.9	62.8	63.6	64.1	64.8	65.4	65.4
Manufacturing "	18.0	19.1	18.7	19.0	19.2	19.4	19.4	19.0

Note: Labor force revised to exclude persons age 14 and 15. Quarterly data for 1966 also reflect new seasonal factors; projections for 1967 reflect new definitions of unemployment.

PERCENTAGE CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS
(Quarterly changes are at annual rates)

	1965	1966	1966				1967 Projected	
			I	II	III	IV	I	II
Gross National Product	7.8	8.6	9.5	6.2	7.1	7.5	2.5	2.8
Final sales	7.2	8.3	10.5	4.3	8.6	4.1	5.6	6.4
Private	7.6	7.2	10.5	2.6	5.7	1.8	3.0	5.0
Personal consumption expenditures	7.5	7.7	9.3	3.9	8.5	3.6	3.3	4.9
Durable goods	11.3	4.8	13.5	-18.2	18.5	- 3.4	-12.6	0.0
Nondurable goods	6.5	8.2	9.9	7.3	4.9	2.1	4.0	3.8
Services	7.2	8.4	7.1	8.7	8.7	7.9	8.2	7.6
Gross private domestic investment	14.6	9.8	9.3	14.0	-11.8	17.4	-19.0	-21.7
Residential construction	0.7	- 7.2	14.5	- 8.4	-45.7	-46.8	1.8	9.1
Business fixed investment	14.8	13.8	16.8	6.2	10.7	6.5	0.0	0.0
Gov't purchases of goods & services	5.7	12.3	10.8	11.0	19.3	12.5	14.9	11.5
Federal	2.5	15.1	12.0	11.7	27.0	13.7	18.6	12.2
Defense	0.2	19.8	16.0	18.3	34.3	22.6	17.1	13.5
Other	9.9	1.2	2.3	-11.5	2.4	-18.8	24.7	7.0
State & local	8.9	9.8	9.5	10.4	11.7	11.4	11.1	10.8
Gross National Product in constant (1958) dollars	5.9	5.4	5.9	1.9	4.0	4.5	0.5	1.0
GNP Implicit deflator (1958=100)	1.8	3.0	3.6	4.3	3.2	2.8	2.0	2.0
Personal income	7.9	8.5	8.5	6.3	8.2	9.0	7.8	3.6
Wage and salaries	7.4	9.5	9.9	7.8	9.6	8.4	6.2	4.6
Disposable income	7.4	7.7	7.4	3.9	6.3	8.3	8.6	3.8
Nonfarm payroll employment	4.3	5.1	6.5	5.1	3.1	4.4	3.7	0.0
Manufacturing	4.0	6.1	6.5	6.4	4.2	4.2	0.0	- 8.2

Industrial production. The March index of industrial production is difficult to estimate yet. However, some basic elements indicating a further decline are in evidence: new orders for durable goods declined further in February, manufacturer's and retail sales continued sluggish, and inventories continued to rise. However, available production data for March, very scanty at this time, do not indicate any substantial declines but rather a continued softening. Truck assemblies have decreased further and are about 10 per cent below a year earlier. In contrast, auto assemblies have risen 10 per cent from the storm- and strike-affected February low, although still 25 per cent below March 1966. In late March, output of color and monochrome television sets was reduced. Further cutbacks are anticipated, as factory and distributor stocks have continued to rise rapidly. Paperboard production has been at about year ago levels, but new orders have been running 24 per cent below a year earlier. Steel ingot production has declined somewhat further. Freight car loadings of miscellaneous goods, mostly manufactured goods, and intercity truck tonnage have both been below year ago levels.

The January decline in industrial production of 0.6 per cent was largely due to the drops in auto and steel output while the February decline of 1.3 per cent was more general in both final products and materials. The decline in March is expected to be widespread, but--on the basis of fragmentary evidence now available--is not likely to be as large as in February.

Retail sales. Retail sales in the first three weeks of March showed very little change from February, but with a rather large decline occurring in apparel. Sales for the entire first quarter on the basis of the figures now available may be somewhat lower than in the second half of last year, as shown in the table.

RETAIL SALES
Seasonally adjusted annual rates
(Billions of dollars)

	1965	1966	1967
1st Quarter	276.2	303.3	305.5 (est.)
2nd Quarter	278.0	299.3	
3rd Quarter	284.0	306.6	
4th Quarter	294.7	306.1	

According to the advance February estimate, retail sales were off almost 2 per cent from January figures which have been raised--on the basis of the full sample--to a level 1.3 per cent above December and equal to the peak of last September. Final upward revisions in December brought retail sales in the entire fourth quarter almost up to the third quarter level.

The February decline in retail sales was accounted for by a 5 per cent drop in durable goods sales. Dealer deliveries of new U.S.-made cars were down 10 per cent, and total dollar sales of the automotive group of stores declined 6 per cent. Sales were off about 4.5 per cent at furniture and appliance stores. Nondurable goods sales were about the same as in January, with a sizable decline at apparel stores and a more moderate one at department stores offset by small gains at the other types of nondurable goods stores.

Auto markets, Unit sales of new domestic automobiles in March are expected to be at an annual rate of about 7 million cars, unchanged from the preceding month, but down about 15 per cent from the end of 1966 rate. This dropoff was about as much as during a similar period during the 1960-61 readjustment when dealers' stocks had also risen sharply and auto output was reduced by one-fourth.

First quarter sales of new cars were substantially below year-earlier rates, and unless an upturn develops in auto demands this spring, there could be further curtailments in assemblies and in output in auto-supplying industries. In response to lagging sales and mounting dealer inventories, the industry planned output curtailments in the first quarter, and these cutbacks were accentuated by strikes and storms in February. In that month, assemblies fell to a rate of 6 million, which was about one-third below the rate a year earlier and below the rate of dealers' sales. Subsequently in March assemblies rose to a rate of around 7 million--about the same as sales.

On a seasonally adjusted basis, stocks of new cars declined further in February but in March are expected to show little change. Stocks are still high in relation to prevailing sales, representing a 70 days' supply--probably a record high for the industry.

According to trade papers, sales of imported cars in the United States are running ahead of sales in the preceding year, in contrast to the declines for domestically produced cars. In February, sales of imports were at a seasonally adjusted annual rate of 725,000 units, about 3 per cent above the rate in February a year ago and substantially ahead of the 660,000 units sold in calendar year 1966.

Seasonally adjusted prices of used cars rose slightly in February. Prices still remain below the low level reached four years earlier, but are about 10 per cent above the 1960-61 price low.

Consumer credit. Sluggishness in spending for automobile and other consumer durable goods continues to be reflected in reduced demands for instalment credit. New credit extensions have been moving irregularly downward since last summer, and in February they may have reached their lowest point in the past year and a half, judging by early reports from commercial banks.

In the meantime, repayments have continued to increase, although at a slower rate than earlier in the expansion period. With extensions declining and repayments growing slowly, outstandings have been increasing by progressively smaller amounts. Last November, consumer instalment credit was expanding at a seasonally adjusted annual rate of $5.3 billion. The rate slowed to $3.9 billion in December, and to $3.4 billion in January--the smallest increase in more than 4 years--and a further reduction is expected in February. Indeed, for some lenders and some types of credit, there may have been a net decrease in outstandings in February.

CONSUMER INSTALMENT CREDIT

	Extensions	Repayments	Net Increase	Ratio of repayments to disposible income
	(Seas. adjusted annual rate, billions of dollars)			(Per cent)
1965				
Q1	72.5	65.1	7.4	14.4
Q2	74.4	66.4	8.0	14.4
Q3	76.8	68.5	8.3	14.4
Q4	77.8	70.0	7.8	14.4
1966				
Q1	78.9	71.7	7.1	14.5
Q2	78.6	72.3	6.3	14.5
Q3	80.0	73.4	6.6	14.5
Q4	78.4	73.9	4.6	14.2
1967				
Q1 (est.)	77.0-77.5	74.5	2.5-3.0	14.1

For the first quarter as a whole, we are now estimating the slowdown to be somewhat more severe than we had expected a month ago. Much of the slackening in total instalment credit has been accounted for by the slowdown in auto credit. Changes in auto credit extensions, in turn, have tended to parallel those in purchases. But other factors also have been present--notably the size of the auto contract and the proportion of cars bought on credit. During most of the past year, these two factors have provided an upward thrust to auto extensions that has blunted to some extent the effect of reduced auto purchases.

The average instalment contract, for example, has continued to rise along with demand for large cars and more optional equipment, and with the higher list prices on the 1967 models. In January 1967, the typical new-car note was $2,780 as compared with $2,700 a year earlier. Meanwhile the proportion of new cars purchased on credit rose to an average of 66 per cent in 1966, up almost 3 percentage points from 1965. The year-to-year increase widened to 4 percentage points in January, as dealers waged a vigorous campaign to reduce auto stocks.

As shown in the table, the ratio of repayments to disposable personal income has been relatively stable since the first quarter of 1965. For some years prior to that, however, repayments had tended to run ahead of income and the ratio had advanced, on average, about 1 percentage point over each 5-year interval. The ratio edged down in the final quarter of 1966, the first such decline since mid-1961. A further small decline is estimated to have taken place in the first quarter of this year.

New orders for durable goods. New orders for durable goods declined further in February and were 12.2 per cent below the September 1966 peak. The decline in February was less than 1 per cent in contrast to the very sharp 6.7 per cent drop which occurred in January. But substantial declines were experienced in machinery, which fell nearly 4 per cent, and in transportation equipment, where the decline was 2.3 per cent. Defense orders--which had declined sharply in January--rose in February.

Although shipments declined substantially in both January and February, the backlog of orders also fell in both months. At the end of February, unfilled orders for durable goods were down $1.4 billion or nearly 2 per cent from the year-end level. While defense order backlogs have risen slightly since December, unfilled orders have declined in all other major sectors. The machinery backlog fell 1.2 per cent in this period, thus indicating a potential weakening in the fixed investment sector.

Business inventories. The January increase in book value of inventories held by manufacturing and trade concerns totaled $970 million, an annual rate of $11.7 billion. This represents a sharp fall off from the $18.8 billion rate of accumulation now reported for the fourth quarter. The shift occurred at distributors, where inventories showed virtually no change in January after rising at an annual rate of $6.8 billion during the fourth quarter. For manufacturers, the January rise in stocks was close to the $12 billion annual rate of the fourth quarter.

At wholesalers, stocks showed no change in January, following a large run-up in late 1966. At retail outlets, the book value of inventories declined slightly in January, owing mainly to an appreciable decrease in auto stocks; stocks of other durable goods increased further while nondurable goods inventories were about unchanged. The stock-sales ratio for distributors declined somewhat although it remained well above the lows of early 1966.

While the January increase in total manufacturers' stocks remained at the high fourth quarter rate, accumulation slackened in the durable goods sector--particularly in basic materials industries. In nondurable goods industries, on the other hand, the rate of accumulation picked up. For both durable and nondurable goods, shipments declined and stock-sales ratios rose--for all manufacturing industries combined the ratio was about the highest of this expansion period.

Despite the sustained high rate of accumulation in January, manufacturers apparently hope to reduce sharply the rate at which their stocks increase in subsequent months. According to the Commerce survey of manufacturers' inventory and sales anticipations conducted in February, manufacturers anticipate inventory accumulation at an annual rate of $7.2 billion for the first quarter as a whole and at a rate of $5.2 billion in the second quarter--as compared with $12 billion in the fourth quarter. Along with these inventory anticipations, manufacturers are anticipating a moderate gain in sales--most of it in the second quarter.

Business fixed investment. Planned expenditures for new plant and equipment in 1967 totaled $63.0 billion according to the Commerce-SEC survey taken in February. This is $2.4 billion, or 3.9 per cent, more than last year and is substantially smaller than the increases of over 15 per cent in each of the last three years.

The survey of 1967 expenditures was made before the proposal was announced to restore the investment tax credit and the special accelerated depreciation allowances. Thus, the February plans could be modified to take account of the restoration of these investment incentives. However, with available capacity increasing sharply and manufacturing capacity utilization and order backlogs declining, it seems unlikely that total outlays this year should be adjusted upward by the full $2.3 billion they were reportedly reduced when the investment stimuli were suspended. (See Greenbook of March 1, 1967.)

Although increases planned for this year were generally smaller, relatively large additions to plant and equipment were again indicated by producers of electrical machinery and equipment, nonelectrical machinery, and rubber. More moderate gains were indicated by producers of primary metals and food and by the mining and electric utility industries. In contrast, February plans of railroads showed a 25 per cent cutback from last year and motor vehicles and textiles showed reductions of more than 10 per cent. The large reduction planned by the railroads apparently reflected the effects of the temporary suspension of investment incentives. These plans could well be revised sharply upward when the investment incentives are reinstated.

BUSINESS PLANT AND EQUIPMENT EXPENDITURES

	Billions of dollars		Per cent increase from year earlier	
	1966	1967*	1966	1967*
ALL BUSINESS	60.63	63.00	16.7	3.9
Manufacturing industries	26.99	27.94	20.2	3.5
Durable goods industries	13.99	14.64	22.7	4.6
Iron and steel	2.17	2.31	12.4	6.5
Nonferrous metal	.86	.92	26.5	7.0
Electrical machinery and equipment	1.19	1.47	40.0	23.5
Nonelectrical machinery	2.86	3.51	29.4	22.7
Motor vehicles and parts	1.93	1.69	- 2.5	-12.4
Other transportation	1.09	1.06	87.9	- 2.8
Nondurable goods industries	13.00	13.30	17.6	2.3
Food and beverage	1.39	1.49	12.1	7.2
Textiles	1.13	1.00	15.3	-11.5
Paper	1.50	1.55	33.9	3.3
Chemicals	2.99	3.04	15.4	1.7
Petroleum	4.42	4.59	15.7	3.8
Rubber	.42	.52	23.5	23.8
Nonmanufacturing industries	33.64	35.06	14.0	4.2
Mining	1.47	1.58	13.1	7.5
Railroad	1.98	1.48	14.5	-25.3
Other transportation	3.44	3.94	22.4	14.5
Public utilities	8.41	9.15	21.2	8.8
Communication	5.62	18.91	13.8	3.0
Commercial and other	12.74		8.1	

* February 1967 plans.

Manufacturing industries planning large increases in plant and equipment outlays this year were generally producing above their preferred operating rates last December; those planning large declines were generally operating below preferred rates and in at least two of the past three years had increased investment outlays by exceptionally large amounts.

The survey shows that plant and equipment expenditures are expected to fall off in the first two quarters and then rise moderately in the last half of the year. The new first half estimates are considerably lower than indicated in the preceding Commerce-SEC survey. In part this may reflect a more considered evaluation of the impact of the suspension of the investment credit but easing in economic activity was probably also an important factor. It is not at all clear why businessmen in February anticipated renewed upturn in expenditures after midyear.

BUSINESS PLANT AND EQUIPMENT EXPENDITURES
(Annual rates)

	November survey				February survey		
	1966	1967		1966	1967		
	IV	I	II	IV	I	II	2nd Half*
	(Per cent change quarter-to quarter)						
ALL BUSINESS	8.8	5.4	3.8	10.1	-1.3	-2.2	3.9
Manufacturing	3.6	.7	8.6	2.9	-2.2	1.4	4.0
Durable goods	8.4	1.4	10.9	4.2	-1.4	-5.5	7.7
Nondurable goods	-1.5	0.0	6.1	1.5	-3.0	9.1	0.0
Nonmanufacturing	12.5	9.8	0.0	16.0	- .6	-5.1	3.9

* From first half average to second half, annual rates.

The 3.9 per cent rise in business plant and equipment expenditures this year shown by the February Commerce-SEC survey is not necessarily out of line with the 6.3 per cent increase reported by a McGraw-Hill re-check survey taken only a month earlier. Although the McGraw-Hill survey is designed to provide comparable results, the sample is concentrated more heavily in the larger companies and has weak coverage in the commercial sector. The effects of the suspensions of the tax credit and accelerated depreciation allowances were especially sharp for commercial enterprises and smaller companies. A further deterioration in the economic climate from January to February may also have led to some reductions in investment plans in the time between the surveys.

Construction activity. Outlays for new construction, which were revised upward by 2 per cent for January, edged higher in February to a seasonally adjusted annual rate of nearly $72 billion. Although this rate was still appreciably under the peak reached in March of last year, it was up moderately from the late 1966 low reached before the mortgage market began to ease.

Residential construction expenditures--benefiting from an irregular but improved flow of starts since October--rose for the second successive month in February. Private nonresidential construction apparently held its advanced level in February. Within this category, outlays for industrial plants have declined irregularly since last summer, but outlays for public utilities have tended higher and outlays for most other types of properties have recovered appreciably. Public construction, which shared in the February rise, also continued fairly near its early 1966 peak.

NEW CONSTRUCTION PUT IN PLACE

	February 1967 ($ billions)1/	Per cent change from	
		January 1967	March 1966
Total	71.7	+1	-10
Private	48.2	+1	-12
Residential	21.2	+2	-22
Nonresidential	27.1	--	- 2
Public	23.4	+1	- 4

1/ Seasonally adjusted annual rates; preliminary.

Supplementing the broad movement toward general credit ease in money and capital markets, several steps taken by the Administration in early March promise further stimulus to nonresidential as well as residential construction activity over the period ahead. These included a request that the Congress restore the investment tax incentives and the most accelerated forms of property depreciation allowances, plus a restoration of part of an $800 million reduction in amounts originally appropriated for road building in this fiscal year, with the possibility that additional sums may be restored later this spring.

Seasonally adjusted private housing starts--revised upward 3 per cent further for January--dropped in February to an annual rate just under 1.1 million units. This decline, which was in line with staff expectations, raised the possibility of a further drop in March and also April. In these months, such momentum as builders have achieved in the abruptly altered and now fluid mortgage market will be tested against the steeply rising seasonal allowances that are normal for spring.

Reflecting in part the unexpectedly advanced rate reached in January, indications now are that both the first and second quarters will moderately exceed a seasonally adjusted annual rate of 1.1 million, as compared with a low of less than a million in the fourth quarter. If achieved, this would result in a first-half average about a tenth higher than seemed tenable as recently as last December. A starts rate of 1.1 million for the first half would be consistent with some further expansion in the rate of residential outlays in the second quarter.

Regionally, seasonally adjusted starts in February dropped substantially in the Northeast--where most of the over-all advance in January occurred--and in the North Central states. In the West, which showed the only month-to-month rise, the advance amounted to a fifth, but still left the level well below the already reduced rate a year earlier.

Seasonally adjusted building permits, which had turned up sharply further in January, turned down in February and were substantially under a year earlier when the level was still relatively high. All of the February drop was accounted for by structures of 5-or-more units. Such units--which usually require a longer lead time for planning and financing arrangements than other types--had shown an unexpectedly large advance in January.

PRIVATE HOUSING STARTS AND PERMITS

	February (thousands of units)1/	Per cent change from	
		January 1967	Year earlier
Starts	1,089	-15	-21
Permits	847	-10	-29
1-family	551	--	-15
2-or-more family	296	-25	-46
Northeast	153	-45	-33
North Central	217	- 3	-37
South	311	+ 4	-22
West	166	+18	-27

1/ Seasonally adjusted annual rate; preliminary.

Personal income. A $2-1/2 billion increase (at annual rates) in personal income in February was the smallest monthly increase since April, 1966, and less than half as large as the $5-3/4 billion rise which occurred in January. Moreover, a large one-time rise in transfer payments--primarily the acceleration in life insurance dividend payments to veterans--accounted for almost half of the small February increase in personal income.

Total wages and salaries increased by only $1/2 billion in February, as private payrolls actually decreased for the first time since April, 1965. Most of the private payroll decline was centered in the manufacturing sector where a billion-dollar decline was reported. This reduction in manufacturing payrolls was attributable to the sharp decrease in average hours worked and substantial reduction in employment. Other private industries and the government sector recorded payroll advances which overcame the decline in manufacturing, thus providing the $1/2 billion rise in total wages and salaries.

Labor market. The labor market in February showed some significant signs of weakness. While nonfarm payroll employment as a whole continued to increase--125,000 over the month--the rise was less than half the growth of other recent months. More important, manufacturing employment and hours showed widespread declines, particularly in durable goods industries. Reductions in employment were not yet reflected in the unemployment figures in February, however, and the unemployment rate remained unchanged at 3.7 per cent. However, an upward trend in unemployment insurance claims in recent weeks suggests a rise in total unemployment is likely in March.

The reduction of 65,000 in February was the first substantial decline in manufacturing employment in more than four years. This cutback was preceded--as is typical--by a reduction in the workweek. After drifting down gradually from extremely high levels early in 1966, average weekly hours dropped by four tenths of an hour in December, and even more sharply--by seven tenths of an hour--in February to average 40.3 hours, 1.2 hours below a year ago. In durable goods, the workweek in February was cut by one full hour, reflecting sharply curtailed work schedules in primary and fabricated metals, machinery and electrical equipment industries. The workweek in durable goods, at 40.9 hours, was 1-1/2 hours below February a year ago. The workweek was also down sharply in a number of nondurable goods industries. In apparel, hours as well as employment were sharply reduced, while in textiles and leather, employment declines were small relative to reductions in hours of work.

AVERAGE WEEKLY HOURS IN MANUFACTURING INDUSTRIES
(Seasonally adjusted)

1966	Total	Durable Goods industries	Nondurable Goods industries
QI	41.5	42.4	40.4
QII	41.4	42.2	40.3
QIII	41.3	42.1	40.2
QIV	41.2	42.0	40.1
1967			
January	41.0	41.9	40.1
February	40.3	40.9	39.5

The reduction in the manufacturing workweek in February was one of the sharpest for a single month in the postwar period and may have reflected storms and strikes as well as reductions in demand. The extent of the cutback also reflected in part the very high level of overtime prevailing earlier. Hours of work during most of 1966 were higher than at any time since World War II, and despite the sharp drop in February, overtime--at 3.4 hours--still remained higher than at the cyclical peaks of 1957 and 1960. Employers still appear to have a considerable margin to adjust labor input by further cutting hours.

In the nonmanufacturing sectors, employment continued strong in government and private services. In contract construction, employment increased by 50,000 in February and has shown substantial recovery in recent months after its sharp decline in the spring and summer. Construction employment has risen by 150,000 since November, and in February was only 60,000 below the March 1966 peak.

In addition to cutbacks in both hours and employment in manufacturing, there has been other confirming evidence of an easing in the labor market. The number of nonfarm workers on part time for economic reasons has shown a steady rise in recent months, and increased by over 150,000 in February to 2.1 million. In addition, unemployment insurance claims toward the end of February began to show the first year-over-year increases in more than 3 years. Initial claims in late March were running 35 to 40 per cent above the same week a year ago. Although possibly still affected to some extent by the G.M. strike of mid-February, the figures undoubtedly reflect increasing layoffs in autos, appliances, and other industries where production cutbacks have followed reduced sales and excessive inventory accumulation.

Outlook for employment and unemployment. The virtual leveling off in real GNP projected for the first half of 1967 suggests a rise of possibly half a percentage point in the unemployment rate by midyear. Most of the increase can be expected to occur in the second quarter, reflecting a lag in the adjustment of employment to changes in output. Typically, the biggest declines in both production and employment occur in manufacturing, particularly in durable goods industries. Because the factory labor force consists largely of full-time workers with a relatively permanent attachment to the labor market, much of the employment reduction tends to become translated into rising unemployment.

An additional upward pressure on unemployment could also come from the rising number of young men in the population now reaching 20 years of age and looking for permanent jobs. Inasmuch as they are relatively inexperienced their job opportunities would be curtailed in a weak labor market. On the other hand, the expected leveling off in real output could cause some slow-up in labor force growth, thus tending to limit increases in unemployment. Women and teenagers typically withdraw from or postpone entrance into the labor force as it becomes apparent that job opportunities are becoming less available.

Earnings in manufacturing. Average hourly earnings in manufacturing industries rose in February to $2.78, and were 4.1 per cent above a year earlier. In many low-paying industries the year-over-year rise accelerated following the increase in the minimum wage to $1.40 from $1.25 an hour in early February. A particularly noticeable increase occurred in leather. Food industry workers also benefited from the increased minimum, as to a smaller degree did workers in the lumber and furniture industries. In most of these industries the over-the-year rise in hourly earnings is now at or close to 5 per cent.

Unit Labor Costs. The rise of hourly earnings in manufacturing and the levelling off and decline in production have continued to put pressure on unit labor costs. There has been relatively little increase in manufacturing productivity and unit labor costs are reflecting most of the increase in wages and fringe costs. In the fourth quarter of 1966, unit labor costs were about 2-1/2 per cent higher than a year earlier; in the first quarter of this year they appear to be running over 4 per cent higher than a year earlier.

Prices. The wholesale price index was unchanged in March at 106.0 per cent of the 1957-59 average, according to the preliminary BLS estimate. Prices of farm products and foods continued to decline, while industrial commodities rose moderately further--continuing the pattern of recent months except for January, when farm products temporarily reversed the declining trend that began last fall. From last September's peak, prices of farm and food products have declined about 6 per cent--and the total wholesale price index has declined 0.8 per cent. Over that 6-month period, prices of other commodities (now labeled "industrial" by the BLS, instead of "other than farm and foods") have increased 1 per cent, or an annual rate of 2 per cent as compared with about 2.5 per cent over the preceding year.

Prices of industrial commodities increased 0.2 per cent in February--instead of showing no change as estimated originally by the BLS--and another 0.2 per cent in March, according to the BLS advance estimate. Major advances in February were reported for refined petroleum and lumber and wood products. In March, gasoline prices continued to rise and price increases were reported for a heterogeneous collection of items, including toys, fertilizers, rubber products, paper boxes and containers, floor tiles, household furniture, and photographic equipment. On the other hand, the February increase for the lumber and wood products group was reversed, as prices of plywood declined; and there were significant declines for some fiber products, leather and leather products, and copper scrap and some copper products. Moreover, prices of machinery and equipment apparently remained virtually stable for the second month, following steady and sizable gains up to the turn of the year. Altogether--in view of the current easing in the over-all demand and supply situation--it seems likely that the price rise for industrial commodities will slow in coming months.

Price declines for farm products and foods have largely reflected expanded supplies--particularly of livestock and products. Production of foods is likely to be large enough to continue the downward pressure on farm prices during 1967. Commodities expected to be in larger supply this year than last include beef, port, poultry meat, eggs, and citrus fruits. Dairy products will be slightly smaller. Planned acreages indicate that food crops will be in ample supply.

The consumer price index edged up 0.1 per cent in February, to 114.8, bringing the increase since last October to 0.3 per cent or an annual rate of 1 per cent as compared with 4 per cent earlier in 1966. Food prices decreased further (and contraseasonally) in February, with reductions fairly widespread. Prices of commodities other than food, which had been relatively stable during the preceding three months, rose moderately in February, with apparel, household textiles, used cars and gasoline up. Prices of new cars declined somewhat further. Service prices continued to rise--although at a somewhat slower pace than in most months of 1966. A slight decline in mortgage interest rates has contributed to some slackening of the pace of advance in over-all costs of consumer services.

Farm and food developments. With favorable weather, farm production of foods is likely to be large enough to continue the downward pressure on farm prices during 1967 but this does not preclude some further edging upward in retail prices because of nonfarm costs. The index of per capita consumption of food in 1967 may exceed last years' index of 102.5 (1957-59) and may equal the record high index of 103.5 reached in 1946. Commodities expected to be in larger supply in 1967 than last year include beef, pork, poultry meat, eggs, and citrus fruits. Dairy products will be in slightly smaller supply. Planned acreages indicate that food crops will be in ample supply. Within the year there may be some temporary shortages or gluts with accompanying fluctuations in prices. The March survey of planting intentions shows that farmers plan substantial increases in acreage of the major field crops but not enough to rebuild stocks of feed grains to levels considered desirable. The March report on pig crops planned for the next six months shows that producers are scaling down production plans a little.

Hog producers are apparently cutting down production in response to current low profit margins and probably because of the changed cattle price outlook. According to the March Pig Crop Report, producers in the 10 Corn Belt states have revised their plans and intend to raise 3 per cent fewer hogs than a year earlier for sale in the seasonally high fourth quarter instead of the same number which they had reported earlier. Furthermore, they indicated intentions to cut production to 5 per cent below a year earlier for hogs to be marketed in the first quarter of 1968. This move by hog farmers will probably add strength to end-of-year markets which had been expected to sag and thus justify reinstatement of earlier predictions of meat animal prices equal to those in late 1966.

The current unrest among farmers should not go without comment. This discontent is widespread and is being expressed in many ways. Immediate causes of discontent are the steadily falling farm prices since last August, Administration requests for boosts in acreage without additional incentives, and finally, the 4 per cent upward revision in beef cow numbers to a new Census checkpoint. The significance of this revision in cattle numbers is that it shows us still to be at the crest of the cattle numbers cycle rather than on the downswing as had been thought earlier. Instead of 2 or 3 years of relatively strong cattle prices in prospect to lend strength to hog prices, the prospect is now for relatively stable prices close to current levels.

Farmer discontent may be a factor in the lagging response to government measures to expand acreages as revealed in the March Survey of Planting Intentions although it is true that farmers find it difficult to change planting plans drastically in a years' time. Of the 17 principal field crops covered in the March survey, increases in 1967 planted acreage of only 2.7 per cent are planned. With winter wheat and other fall-planted crops included, the increase amounts to 6 per cent over 1966.

PLANTED ACREAGE
(Thousands of acres)

Selected crops and total plantings	1961-65 average	1966	Planned 1967	Per cent change 1966-67
Feed grains	123.2	117.0	120.3	2.8
Corn	66.1	66.3	70.6	6.6
Sorghum	16.1	16.3	18.3	12.2
Oats	27.9	23.2	21.2	-8.7
Barley	13.0	11.2	10.2	-8.9
Soybeans	30.5	37.4	40.6	8.6
Cotton	15.3	10.4	10.0	-3.7
Spring wheat	11.6	11.6	13.9	19.7
Other survey crops	77.2	73.8	72.0	-2.4
Total (17 spring-planted crops)	257.9	250.1	256.8	2.7
Winter wheat	44.3	42.9	54.1	26.2
Other crops	5.6	5.0	5.2	4.2
Total (59 crops)	305.9	298.0	316.2	6.1

<u>Population</u>. The birth rate continued on its downward course in 1966 but the decline was not as pronounced as a year earlier. The downtrend, which began in 1957, has now brought the birth rate very close to the low rates experienced in the mid-30's. Because of the small number of births last year, net addition to the population and the rate of increase were the smallest in two decades. Moreover, the marriage rate, which has been rising moderately since 1962, increased by only 2 per cent in 1966, despite the larger number of young persons reaching marriage age.

With the number of births reduced again in 1966 the net addition to the population was 2,150,000, nearly one-third less than in 1956. The increase of only 1.1 per cent in 1966 was the lowest since 1945, and was far below the 1.8 per cent growth rate of 1956. Even under the most optimistic series of population projections by the Census Bureau, population growth does not return to a rate of 1.8 per cent until 1974; under all but the gloomiest projections, however, some small rise is predicted in the years to come.

<u>Marriages</u>. The marriage rate for 1966 again showed only modest response to the more favorable age composition of the population and the continued rapid growth in economic activity. Some evidence of an acceleration in the marriage rate occurred in the last half of 1966. This probably reflected in part the concentration of the increase in population at age 20, close to the median age at first marriage of young women which was 20.5 years in 1966.

A continuation of this acceleration in 1967 would seem to hinge largely on the impact of population change. More young persons will reach age 21, and many of them will thus be graduating from college, permanently entering the labor market and becoming financially able to marry and set up households. These expectations are, however, tempered by the uncertainty of the economic outlook, the continuing sizable, if smaller than in 1966, number of unmarried young men entering the armed services and the fact that most of these young men will still be below the median age of 22.8 years for first marriage of men.

MARRIAGES AND BIRTHS
(Seasonally Adjusted)

	Number 2/ (000 omitted)					Rate 3/			
	Marriages		Births			Marriages		Births	
	1965	1966	1965	1966		1965	1966	1965	1966
Q I	1,748	1,756	3,868	3,676		9.2	9.1	20.0	18.9
Q II	1,708	1,796	3,764	3,660		8.8	9.2	19.5	18.8
Q III 1/	1,880	1,920	3,744	3,544	1/	9.7	9.8	19.2	18.1
Q IV	1,820	1,916	3,692	3,628		9.3	9.6	19.0	18.4
Year	1,789	1,844	3,767	3,629		9.2	9.4	19.4	18.5

1/ Reflects the change in draft status of married men without children effective August 29.
2/ Annual rate.
3/ Per 1,000 total population.

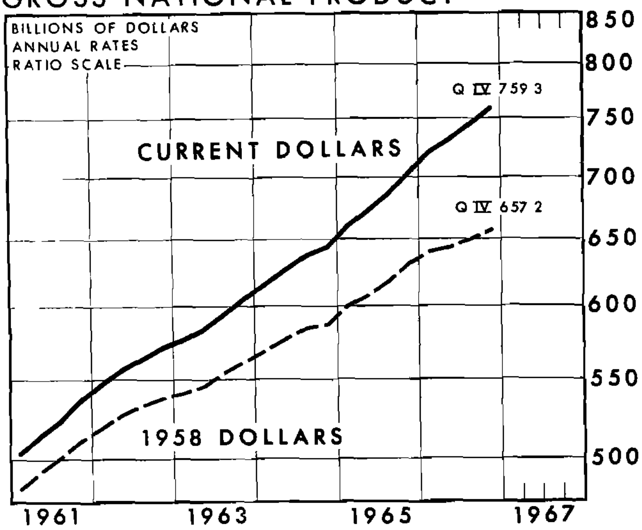
Births. Births in 1966 declined by 140,000 to 3.6 million, the smallest number since 1950. The birth rate dropped further by close to 5 per cent in 1966 to a rate of 18.5 per thousand, bringing it to the lowest levels of the 1935-39 depression years. However, the fertility rate (which measures the number of births per 1,000 women 15 to 44 years) has remained substantially higher than in the mid-1930's. At 93 in 1966 compared with 76 in the mid-1930's, 1966 fertility rate, however, is far below the 1957 postwar peak of 123.

Birth statistics for 1966 do not provide any firm evidence of a change in the birth rate trend. The rate was still very low in the final quarter of the year, although it had rebounded somewhat after a precipitous decline in the preceding quarter. There is evidence, however, that the fertility rate was bottoming out at year-end at a level about one per cent below the 1966 average. The substantially larger rise in the number of women in the 20 to 24 age group this year than in 1966, and the further rise in marriages portend some abatement if not reversal in the downtrend in number of births in the near future.

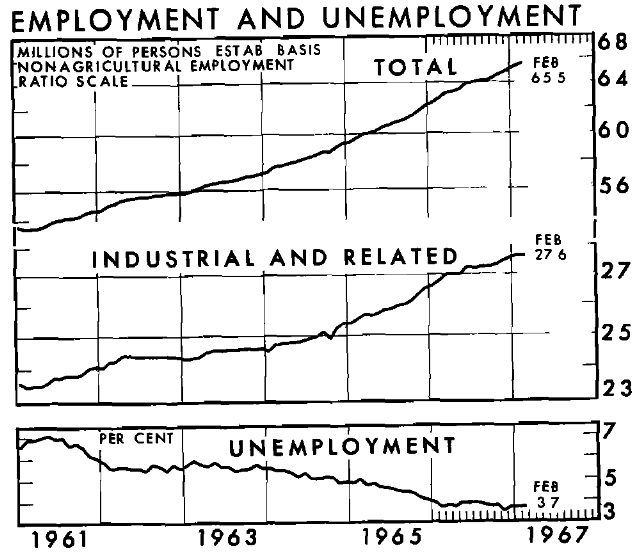
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

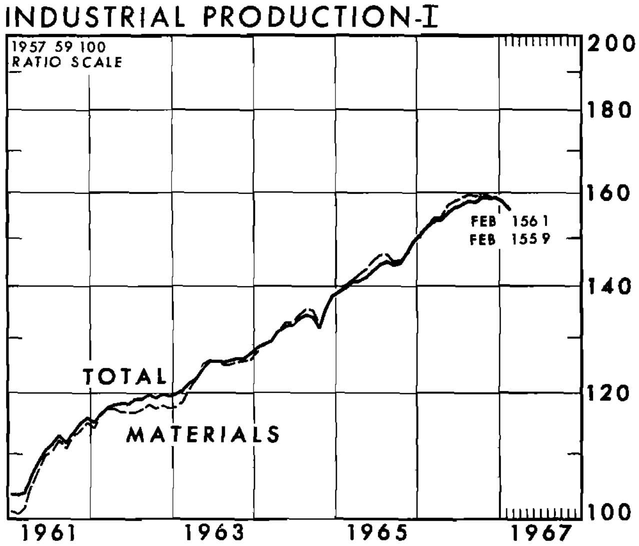
GROSS NATIONAL PRODUCT



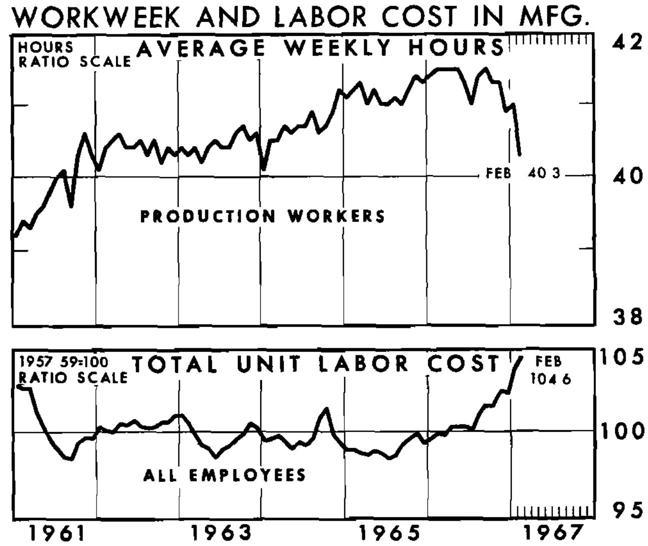
EMPLOYMENT AND UNEMPLOYMENT



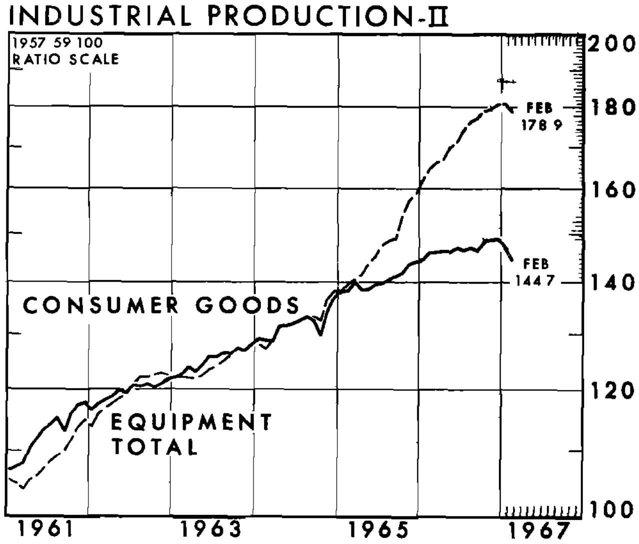
INDUSTRIAL PRODUCTION-I



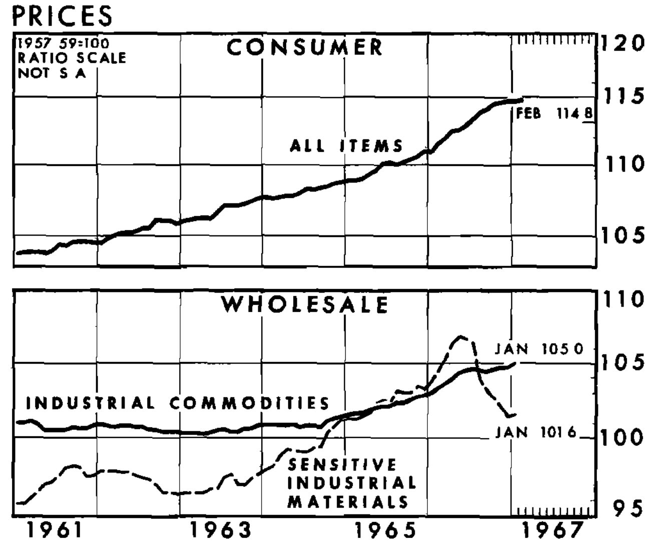
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



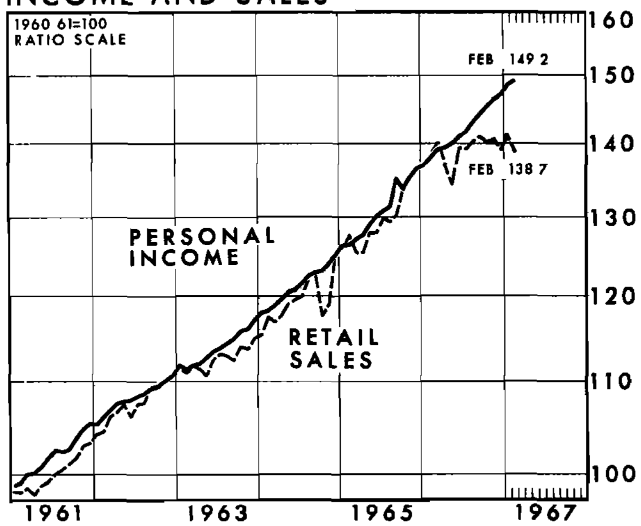
PRICES



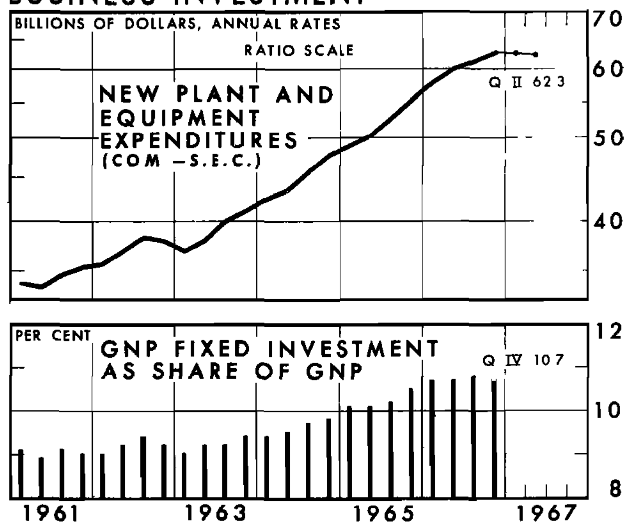
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

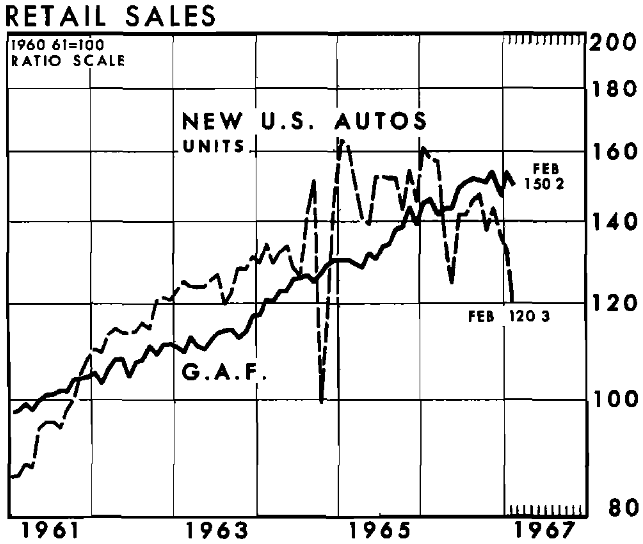
INCOME AND SALES



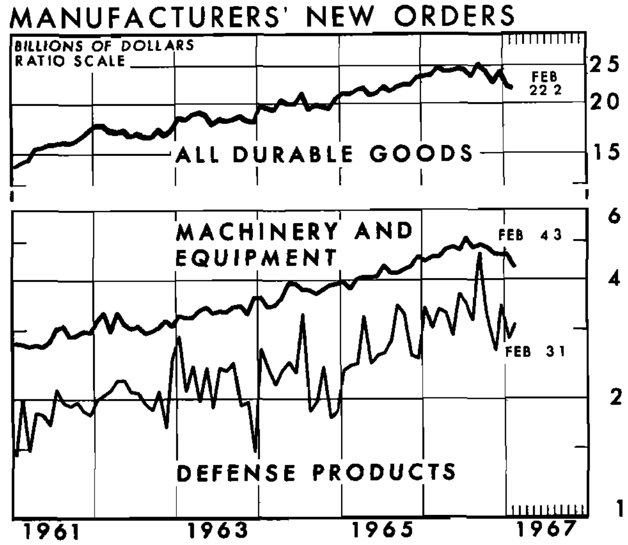
BUSINESS INVESTMENT



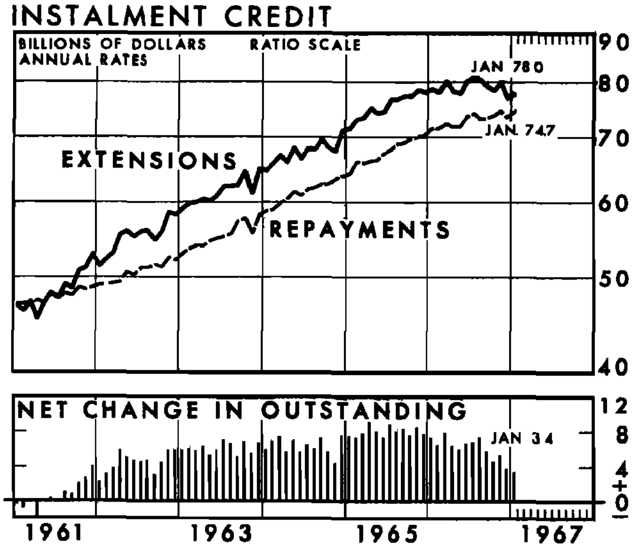
RETAIL SALES



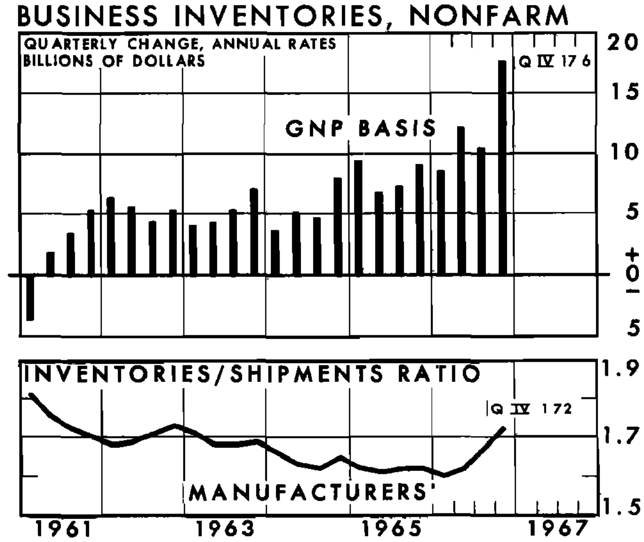
MANUFACTURERS' NEW ORDERS



INSTALMENT CREDIT



BUSINESS INVENTORIES, NONFARM



DOMESTIC FINANCIAL SITUATION

Flow of funds. Preliminary estimates of fourth-quarter flows of funds present two contrasting pictures of financial markets, with the data on borrowing showing characteristics of severely restricted credit conditions while supply data are typical of periods of ease. The total of credit flows in the fourth quarter was roughly equal to the low level of the third quarter, after seasonal adjustment, bringing the total for the year below that of 1965, the highest year on record.

SUMMARY OF CREDIT MARKET BORROWING
(Billions of dollars, seasonally adjusted annual rates)

	1965	1966	1966 First half	1966 III	1966 IV
Total borrowing	72.1	70.1	81.0	60.8	57.6
U.S. Government	3.5	6.8	9.0	2.8	6.4
Foreign	2.6	1.1	2.3	.2	- .3
Private domestic nonfinancial sectors	66.0	62.2	69.8	57.8	51.5
State and local obligations	7.4	5.9	6.3	4.8	6.1
Corporate securities	5.4	11.1	13.6	11.7	5.7
Mortgages	25.5	21.6	25.7	19.7	18.1
Bank loans n.e.c.	13.6	9.8	11.5	9.5	6.8
Other	14.1	13.8	14.1	12.2	14.8

The year 1966 thus divides essentially into two halves, with credit flows in the first half at slightly over an $80 billion annual rate and in the second half at less than a $60 billion rate. While this division appears in all major forms of credit flows, it is seen most clearly in private domestic borrowing, where corporate security issues, mortgage lending, bank loans, and consumer credit all fell off sharply in the latter part of the year. Federal borrowing was also somewhat less in the second half of the year. The Federal Government shifted from surplus to deficit over the course of the year in income-and-product transactions, but this was largely offset by a sharp reduction in loan outflows, particularly FHLB loans to the savings and loan industry, which were at a $2.5 billion annual rate in the first quarter and at a $2.5 billion repayment rate in the fourth.

The fourth quarter drop in private borrowing contrasted sharply with movements in private capital outlays, particularly the surge in inventory accumulation. Part of the decrease in credit flows was in mortgage lending on single-family houses, both construction loans to builders and permanent financing for households. This decrease closely paralleled the decline in home construction activity; both expenditures and home-mortgage lending were about $4 billion less (at annual rates) in the fourth quarter than in the first quarter. With homebuilding set aside, the table below indicates the extent to which plant and equipment and inventories were financed from sources other than credit and capital consumption allowances.

NONFINANCIAL BUSINESS
Capital Expenditures and Credit Market Borrowing
(Billions of dollars, seasonally adjusted annual rates)

		1965	1966 Total	1966 First half	1966 III	1966 IV
(1)	Total capital outlays 1/	81.3	92.9	91.2	91.8	97.6
	Sources of finance--					
(2)	Capital consumption	50.2	53.2	52.4	53.7	54.5
(3)	Credit market borrowing 2/	29.5	34.1	39.4	30.3	27.2
(4)	Other sources	1.6	5.6	- .2	7.8	15.9
(5)	Net investment ((1)-(2))	31.1	39.7	38.8	38.1	43.1
	Percent borrowing of net investment	96.5	86.0	101.6	79.6	63.0

1/ Excludes net investment in 1- to 4-family residential construction.
2/ Excludes 1- to 4-family residential mortgages.

These other sources (line 4), which are the sum of retained income, reduction of liquid assets, and miscellaneous other financial transactions, had worked out on a net basis to virtually zero during 1961-65 and continued so in the first six months of 1966, when borrowing was heavy partly to meet accelerated payment schedules on corporate taxes. In the second half of the year, however, they rose to an unprecedented rate of almost $12 billion. Part of the increase was in retained income, which on an income-and-product basis was $1.5 billion higher than the first half, despite the downward tendency in book profits. This increase in internal funds reflects no more than the $3 billion rise in inventory valuation adjustment during the fourth quarter, which constitutes virtually all of the $3 billion increase in corporate inventory investment in the quarter. Leaving aside the IVA, both retained earnings and inventory change are almost constant over most of 1966. A more important internal source, however, was liquid assets, which seem to have been reduced heavily by business to pay for capital outlays during the latter half of the year. Although there was a clear tendency toward more internal financing of investment as the year progressed, tax borrowing in the first half made the shift more abrupt than it would otherwise have been. Taking the two halves of the year together, however, the total of $6 billion in internal sources was large in comparison with earlier years and represented a sharp departure in trend.

The supply of funds to credit markets showed clear signs of easing market conditions during the fourth quarter, despite the low volume of total credit flow. Inflows to savings institutions were up sharply from spring and summer rates and were used to a considerable extent for repayment of FHLB debt. Allowing for such repayments, credit flows through nonbank financial institutions rose from 35 per cent of total borrowing in the third quarter to over 50 per cent in the fourth. Bank credit at the same time increased at about double the rate of the summer, and rose from 7 per cent of total credit flows in the summer to over 30 per cent in the fourth quarter. The third-quarter figure was depressed by the large runoff in Federal cash, but the bank-credit increase was substantial even after allowance for the drop in Treasury balances. Another evidence of reduced credit market pressure was the reduction in volume of securities bought directly by

FORM OF FUNDS SUPPLIED TO CREDIT MARKETS
(Billions of dollars, seasonally adjusted annual rates)

	1965	1966	1966 III	1966 IV
Total borrowing	72.1	70.7	60.8	57.6
Funds supplied by--				
Private nonfinancial sectors	49.3	42.5	36.9	29.2
Demand deposits and currency	7.9	2.6	-4.6	5.7
Time and savings deposits at banks	20.2	13.2	11.0	8.0
Savings accounts at savings institutions	13.1	17.4	5.1	11.0
Direct lending	8.3	19.3	25.3	4.5
Federal loan programs	4.7	7.5	6.3	2.3
Federal cash balances	-1.0	- .1	-7.3	1.1
Other sources	19.0	20.8	24.9	25.0

nonfinancial investors from the $20-25 billion rate of the first three quarters to about a $5 billion rate in the fourth. This shift brought the volume of such direct investment back to the moderate levels that prevailed during much of 1961-65.

To some extent the drop in direct lending by nonfinancial sectors in the fourth quarter was exaggerated by special developments. About $12 billion of the decline was in Government securities, and roughly half of that reflected transient circumstances such as the large buildup in positions of Government security dealers at year end. Direct investment also included an exceptionally large liquidation of corporate stock holdings by households, roughly $8 billion at annual rates. Part of this sell-off of stocks reflected the retirement of Consolidated Coal shares (about $2 billion at annual rates) in October.[1/] The rest of the stock sell-off arose mainly from a shift by investment companies into security buying. During preceding quarters investment companies had been accumulating sizable balances of cash and Governments with proceeds of share sales, but from the third to the fourth quarter a net shift of such flows into stocks occurred that ranged around $4 billion at annual rates. This was reflected in household transactions as a corresponding shift into net sales of stocks.

Professional portfolio management was thus the source of much of the drop in direct lending during the fourth quarter. A rebound by households from this position can be expected in the current quarter, and it is likely that security sales to individuals can increase somewhat from recent levels without pressures on interest rates.

<u>Flows to Non-bank financial intermediaries</u>. Net flows to savings and loan associations and mutual savings banks showed a marked seasonally adjusted expansion in the closing months of 1966. The change was particularly pronounced at the S&L's, which until November had not shared in the improved flow already evident at savings banks since July.

1/ The Consolidation Coal transaction affected several comparisons between the third and fourth quarters, because it was financed by a bank loan in the third quarter, the proceeds of which were carried into the fourth quarter as a time deposit. If the entire transaction had occurred in the third quarter, both total borrowing and time-deposit flows into banks would have been more closely equal in the two quarters.

As in the market for publicly-offered corporate bonds, bond offerings of State and local government also set an all-time high in the first quarter--25 per cent larger than in the like period of 1966. In each month of the quarter volume was in excess of $1 billion, with March registering an estimated $1.2 billion. The March volume was digested with some difficulty and several recent offerings still have substantial unsold balances. As a result, the Blue List of dealer's advertised inventories has risen to $700 million, the highest level since October 1965. The April municipal calendar, however, now estimated at about $850 million, would represent the smallest monthly volume of offerings since October.

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

	1966	1965
Total	11,362	11,329
	1967	1966
January	1,350e	1,219
February	1,160e	867
March	1,200e	879
1st Quarter	3,710e	2,965
April	850e	1,211

Mortgage market developments. Mortgage markets eased further in March as demands for new credit and the ready supply of existing laons apparently continued to expand less than inflows of savings to mortgage lenders. As evidence of additional easing, seasonally adjusted weekly applications to FHA for insurance on home mortgages increased again through late March, and market observers noted further declines in mortgage yields. Secondary-market offerings of FHA-insured and VA-guaranteed home mortgages to FNMA, however, turned up somewhat, reflecting the increase in FNMA's buying price on March 6--the second 1/8 of 1 per cent increase made within a month.

Additional direct Government steps toward stimulating the marekt included another 1/4 of 1 per cent reduction in rates charged on Federal Home Loan Bank advances, effective March 1, bringing the level down to 5-1/2 per cent. Also, FNMA on March 6 released an additional $380 million to buy mortgages under its various special assistance functions, mainly for low and medium priced homes with Government-underwritten loans; on April 1, $250 million more will be made available. If all this additional $630 million is actually used, it could ultimately finance more than 40,000 new dwellings. Of the $250 million originally made available late last November under FNMA's special $1 billion support program authorized for new homes, about four-fifths had been committed by early March on more than 12,000 mortgages, but only a few loans had actually been taken down.

Data for Feburary indicate that easing of interest rates and yields on home mortgages was even more marked than in January.

In the primary marekt, a 10 basis point decline in conventional mortgage rates (FHA series) reduced the average to 6.50 per cent for loans on new homes. But the rate was still 45 basis points above the rising level a year earlier and 70 basis points above the 1963-65 low. Reflecting the abruptness of easing in the secondary market, where loans available for immediate delivery continue in particularly short supply, discounts on certain FHA-insured new-home loans eased furhter to 4.0 points from 5.3 points. As a result, the secondary market yield on these 6 per cent FHA mortgages declined by a record 16 basis points.

Overall, the decline from the November peak in interest rates and yields for these two mortgage series has ranged from 20 to 35 basis points. As the table shows, their reported decline has been substantially greater than during the first three months after turning points in earlier cyclical downturns in mortgage rates that followed less dramatic periods of tightness.

CYCLICAL DECLINES IN YIELDS ON NEW-HOME MORTGAGES

Date of cyclical peak in rate	Interest Rate or Yield: At peak (per cent)		Interest Rate or Yield: Decline in first 3 months after peak (basis points)	
	Conventional loans	FHA loans	Conventional loans	FHA loans
November 1966	6.70	6.81	20	35
January 1960	6.30	6.25	5	4
October 1957	6.00	5.63	5	4
September 1953	n.a.	4.86	n.a.	8

NOTE: FHA series, for interest rates on conventional first mortgages in primary market (excluding additional fees and charges, and rounded to nearest 5 basis points), and yields on FHA-insured Sec. 203 loans in secondary market.

Nonfarm real estate foreclosures were down further in the fourth quarter of last year, registering one of the few year-over-year decreases of the postwar period. With some additional rise in outstanding mortgages, the foreclosure rate dipped to the lowest level in 3 years.

NONFARM MORTGAGE FORECLOSURES

Fourth Quarter	Number (In thousands at annual rate)	Number: Per cent increase over year earlier	Rate per thousand mortgaged structures
1966	114	-4	4.6
1965	119	10	5.0
1964	108	11	4.8
1963	97	10	4.5
1962	88	16	4.3
1961	76	34	3.9
1960	57	33	3.0

SOURCE: Federal Home Loan Bank Board. Data not adjusted for seasonal variation.

Flows to depositary-type intermediaries. Savings flows to depositary-type intermediaries continued to show dramatic improvement during February, and preliminary evidence for commercial and mutual savings banks indicates that growth has persisted in March as well. For all depositary type institutions combined, February inflows of consumer-type savings were a record. Flows to both commercial and mutual savings banks exceeded any previous February, and the growth in share capital at S&L's was only 7 per cent less than the previous high for the month, reached in 1963. On a seasonally adjusted basis, the annual growth rate in February was 10 per cent for savings banks, 9.5 per cent for S&L's, and a little less than 9 per cent for commercial banks (on consumer-type accounts).

NET FLOWS TO DEPOSITARY-TYPE FINANCIAL INTERMEDIARIES
(Millions of dollars)

February	Total[1/]	S&L's	MSB's	Commercial Banks Without CD's[1/]	Commercial Banks With CD's
1967	2,754	790	300	1,664	2,360
1966	1,499	528	203	768	821
1965	2,356	579	203	1,574	1,807
1964	1,806	760	244	802	1,124

1/ Excludes CD's in excess of $100,000 at weekly reporting banks.

Further acceleration of inflows in February was not significantly reflected in expanded mortgage acquisitions by either savings banks or S&L's. Final February reports for mutual savings banks (not yet available) are expected to show a pattern similar to January's when these institutions purchased nearly as many securities as they did mortgages, an unusual distribution of available funds even for this time of year.

Thus far in 1967, savings and loan associations have repaid nearly $1.7 billion of their outstanding indebtedness to the Federal Home Loan Bank System, raising to $2.1 billion the overall reduction in such debt from the peak reached late last July following the heavy summer withdrawals of share capital. Reflecting these large net repayments, outstanding S&L advances dropped recently to a level $360 million below that prevailing a year ago. Taking advantage of the large repayments, the Federal Home Loan Bank System has retired more than $1 billion of its own debt within the past month and a half, and even so still holds unusually large reserves.

FHL BANK ADVANCES AND MEMBER DEPOSITS
(Millions of dollars)

	Advances:		Member Deposits at FHL Banks:	
	Change from Jan 1.-March 23	Outstanding as of March 23	Change from Jan. 1-March 23	Level of Deposits March 23
1967	-1,677	5,258	+389	1,425
1966	- 538	5,618	-240	803
1965	- 700	4,623	-169	1,030
1964	- 927	4,055	-200	952

<u>Stock market</u>. As measured by Standard & Poor's index of 500 stocks, stock prices have advanced another 3-1/2 per cent in March, extending the total advance to 12 per cent since the end of last year and to 23 per cent from the 1966 low of last October. Thus, roughly four-fifths of last year's February-to-October decline has been recovered. Further price advances in the past month have been broadly based including blue chip issues as well as low priced stocks.

Trading volume on the New York Stock Exchange in the first half of March was extremely high, averaging 11.1 million shares a day; and on March 10 alone it totaled nearly 15 million shares, close to the all time daily record of 16.4 million shares recorded in 1929. In the most recent week, ending March 24, however, volume receded somewhat to an average of 9.3 million shares per day and has since remained at or below that level. On the American Stock Exchange volume also rose during the first half of March, averaging about 4.6 million shares per day, compared with an average of 3.7 million shares in February, but there too volume has receded somewhat most recently.

Customer's net debit balances at New York Stock Exchange firms carrying margin accounts rose about $60 million in February. Over the longer period of generally rising prices since last October, customer's net debit balances have risen $180 million. But to some extent both the February rise and the longer-range increase reflect increases of changing balances in cash accounts arising from higher levels of trading activity since last fall. Purpose loans at banks which showed little change in February are nearly $90 million below their outstanding level at the beginning of October last year.

In view of the continuing evidence of slowing economic activity, further advances in stock prices seem somewhat paradoxical. But this divergence between current economic facts and stock price movements apparently reflects an investor consensus that any weakening in economic activity will be short lived. Additional support for this view has been provided recently by the recommended restoration of the investment tax credit, and by the further easing in monetary policy.

Some slowing of economic activity and squeezing of corporate profit margins this year had been widely anticipated and discounted in last year's general stock price decline. But, the sharpness of the 1966 decline was accentuated by the special impact of tight money on competitive yields provided by fixed income investments, as well as on the cost and availability of stock market credit. Thus, with corporate profit positions not yet so deeply eroded as had been feared, and with money easing again, stock prices have risen. Institutions which had established large positions in high yielding short-term securities during last year's stock market break have provided a strong upward stimulus to prices by switching aggressively back into stocks as yields on market securities have declined.

Price-earnings ratios on many good quality stocks are still well below levels that have typically prevailed in recent years, but the ratio of recent prices to estimated fourth quarter profits for issues included in Standard and Poor's composite index has risen to 16.7, which compares with the 17.3 level reached in February a year ago, just before prices turned down. Thus, any serious further deterioration in business activity might lead to a reappraisal of recent stock market tendencies. The fact that short-positions on the New York Stock Exchange rose to a record volume at mid-March suggests that an increasing number of investors already expect at least some near-term price decline, although any decline that did occur would tend to be cushioned in the first instance by the potential demand represented in these positions.

<u>Bank credit</u>. Total loans and investments at all commercial banks, on an end-of-month basis, are tentatively projected to rise at an annual rate of around 16 per cent in March. With this increase, bank credit will have expanded at approximately a 12 per cent annual rate since the end of November, compared with a less than one per cent annual rate over the July through November period last year and 9.8 per cent for the first half of 1966.

Continued large inflows of time and savings deposits in March, together with the marked easing in reserve positions, enabled banks not only to expand loans substantially, but also to make large further additions to their security holdings. For all commercial banks, it now appears that holdings of Governments may increase at better than the 25 per cent annual rate of February while holdings of other securities may rise at close to the February rate of 29 per cent.

The increase in investments during March was heavily concentrated in short maturities, suggesting continued bank desire to rebuild liquidity positions, though banks also showed interest in longer-term securities. City banks apparently acquired a considerable amount of Treasury bills in March, with the $2.7 billion of tax anticipation bills paid for on March 13--50 per cent payable through tax and loan credit--undoubtedly helping to enlarge this total. In addition, nearly two-fifths of city bank acquisitions of municipal and other securities over the four weeks ending March 22 was in tax warrants and other short-term issues, although the proportion was much higher at banks in New York City than at outside banks.

Business loans are estimated to show a rise of about $1 billion in March, about twice the average increase over the previous three months and slightly more than the monthly increase of a year earlier. The substantial growth in business loans in March, as in the periods of rapid business loan expansion in 1966, was associated in part with large payments of income and withheld taxes. These payments were estimated at $12.8 billion in March--slightly more than a year earlier and well above the $8.5 billion in February.

Businesses also have been satisfying a substantial part of their financing needs outside the banking system, as indicated by the record volume of capital market financings by corporations in March and in the first quarter. Apparent reluctance by some banks to make term loans because of a desire to rebuild liquidity--as well as the continued cost advantage of borrowing in capital markets--probably contributed to this surge of market financings by corporations seeking to rebuild liquidity.

An analysis of the changes in loans by industry suggests that loan demand has remained strong in the heavy goods industries, where order backlogs still remain large, but in other sectors it has been weaker. Over the three weeks ending March 15, about half of the increase in business loans at weekly reporting banks was accounted for by borrowings of machinery and transportation equipment producers. Over one-tenth was in bankers' acceptances. Loans in other major business loan categories either expanded only moderately or declined more than seasonally. Loans to food processors, trade firms, textile manufacturers and other manufacturers--industries where borrowing is generally associated with inventory demand--have been especially weak. The recent reduction in the prime rate to 5-1/2 per cent by many large banks which had maintained a 5-3/4 per cent rate also possibly may indicate some weakening in the longer-run demand for bank loans.

Increases in real estate and consumer loans appear to have remained relatively moderate in March. However, bank loans to security dealers increased sharply during the month--following a marked decline in February--reflecting changes in dealer inventory positions and in their expectations for near-term interest rate movements.

Bank deposits. Time and savings deposit inflows at commercial banks, which had slackened briefly in late February, resumed their rapid growth in March. On a seasonally adjusted basis total time and savings deposits are estimated to have increased at an annual rate of 16 per cent for the month. Over the first quarter, these deposits rose at about an 18 per cent annual rate--the highest rate for any calendar quarter since the first quarter of 1962.

A major part of the recent growth has been in passbook savings, which have staged a dramatic turn-around beginning about mid-February after a year of almost continuous decline. The recent expansion has been about as large at reserve city as at country banks. It is estimated that these deposits accounted for over one-third of the March increase in total time and savings deposits at all commercial banks. Despite the noncompetitiveness of the 4 per cent ceiling, this growth probably reflects in part the sluggishness of retail sales, particularly for large-ticket durable goods.

With the rate of personal saving high and interest rates on short-term market instruments declining further in March, inflows of consumer-type time deposits continued at a rapid pace at both country and reserve city banks. Thus, total time and savings deposits at country banks accelerated to an annual rate of about 15.5 per cent, well above the 13 per cent average rate of increase in the preceding two months. At reserve city banks, however, reflecting mainly the reduced growth on a monthly average basis of large CD's, the rate of growth in total time and savings deposits slackened considerably from the very rapid pace of the preceding two months.

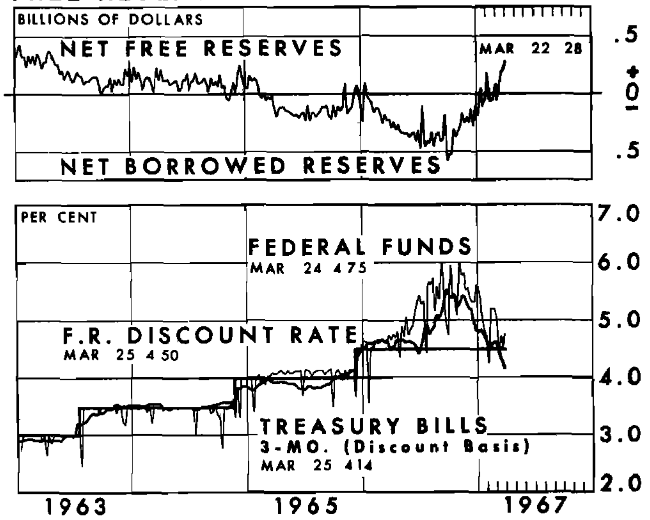
Even though offering rates on large CD's declined during the month, their yields remained attractive relative to those on Treasury bills; however, they continued to be lower than yields on commercial paper. Nevertheless, large banks were able to add $560 million to their outstanding CD's over the first four weeks of March in spite of the nearly $1 billion of maturities over the tax and dividend dates. During the tax week, the loss was only $82 million as compared with nearly $400 million in the comparable week last year. Banks outside of New York City continued to account for most of the growth in CD's.

The money stock rose sharply in March--at about a 16 per cent annual rate--with growth in private demand deposits accounting for the major portion of the increase. Since November, the money stock has increased at an annual rate of about 6 per cent, as compared with a decline of nearly 3 per cent from the end of June through November of 1966.

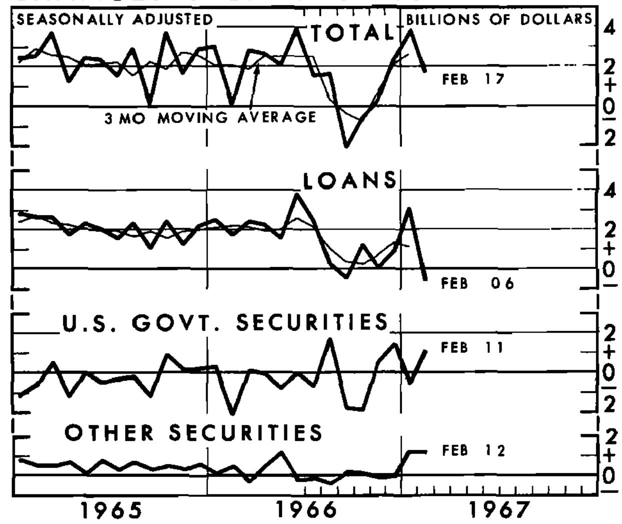
Reflecting the increase in demand deposits--as well as the slowing in the economy's rate of growth--the seasonally adjusted rate of turnover of demand deposits at 232 Standard Metropolitan Statistical Areas (excluding New York City) declined to an average rate of 39.4 for the first two months of 1967 from an average rate of 39.7 for the fourth quarter of last year. Turnover was still about 6 per cent higher than a year earlier, however.

FINANCIAL DEVELOPMENTS - UNITED STATES

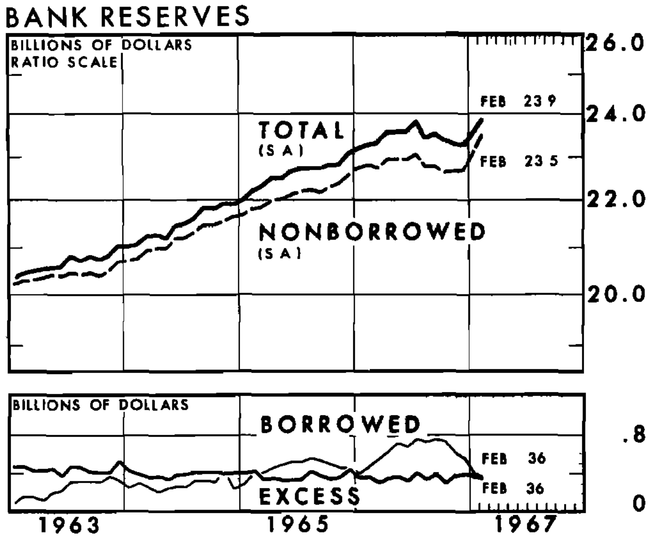
FREE RESERVES AND COSTS



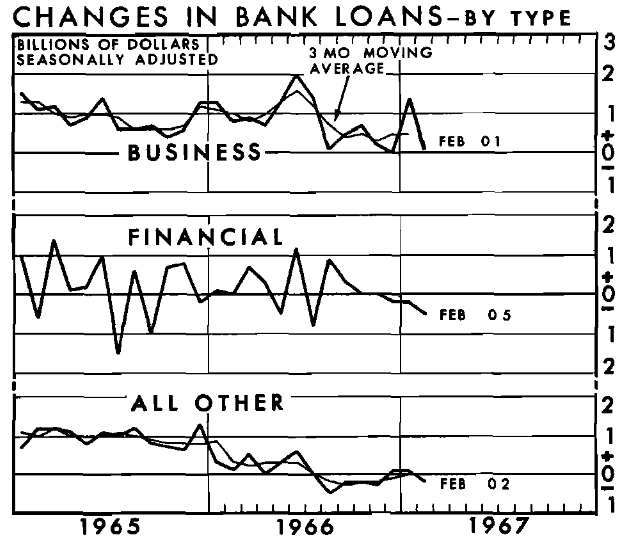
CHANGES IN BANK CREDIT



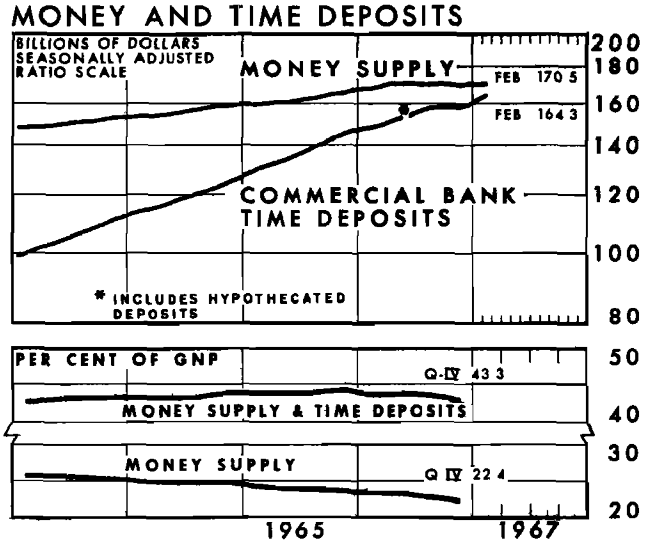
BANK RESERVES



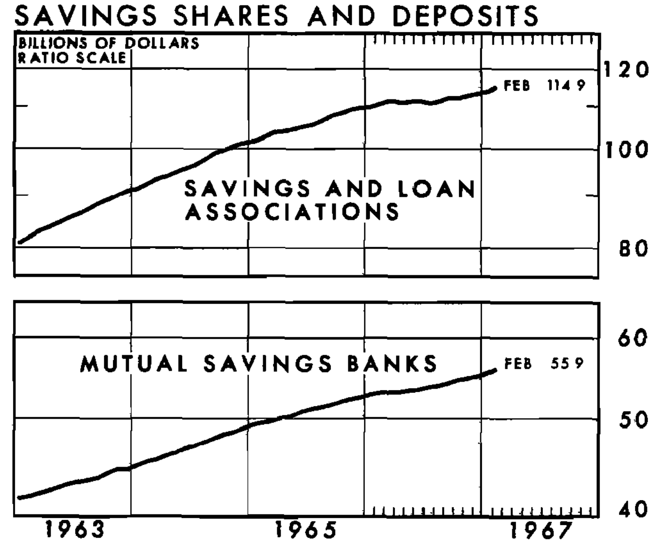
CHANGES IN BANK LOANS–BY TYPE



MONEY AND TIME DEPOSITS

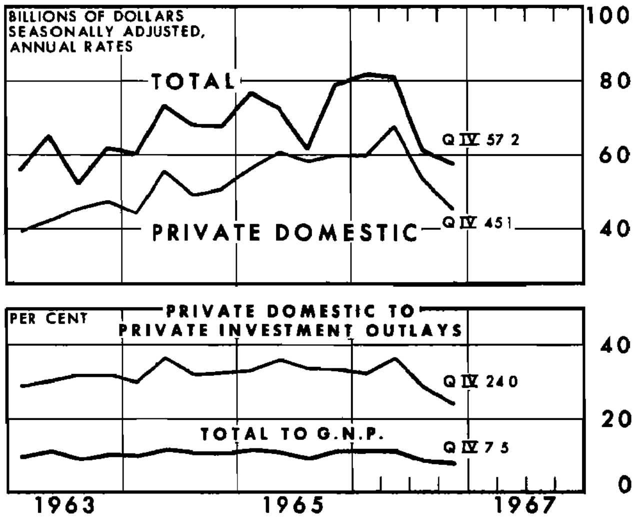


SAVINGS SHARES AND DEPOSITS

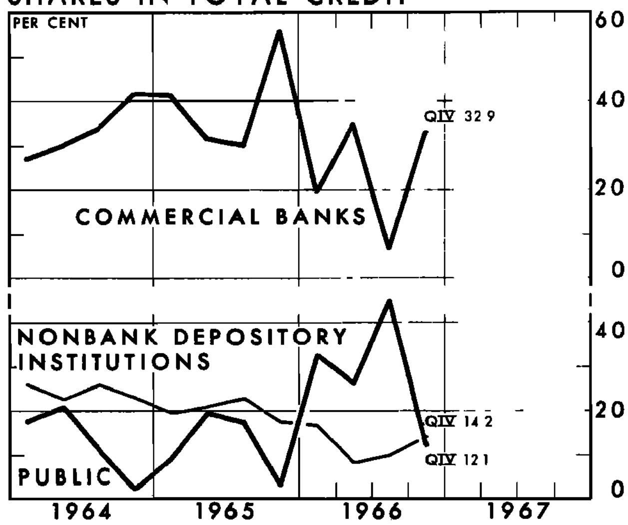


FINANCIAL DEVELOPMENTS - UNITED STATES

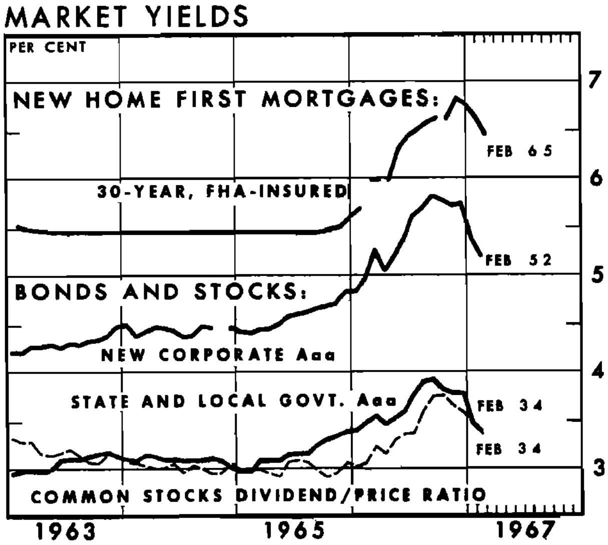
NET FUNDS RAISED-NONFINANCIAL SECTORS



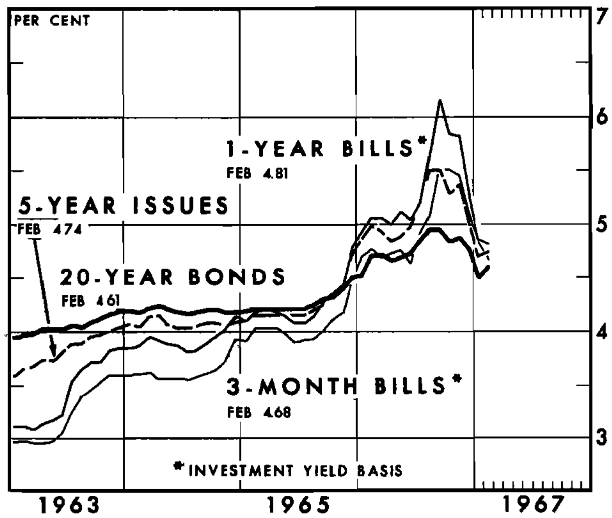
SHARES IN TOTAL CREDIT



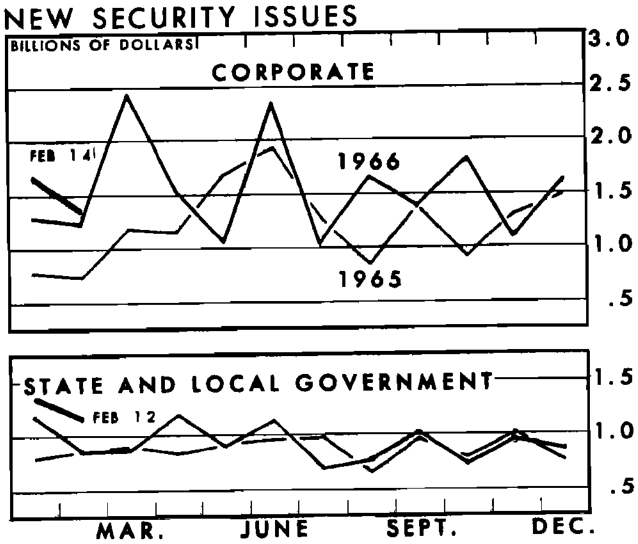
MARKET YIELDS



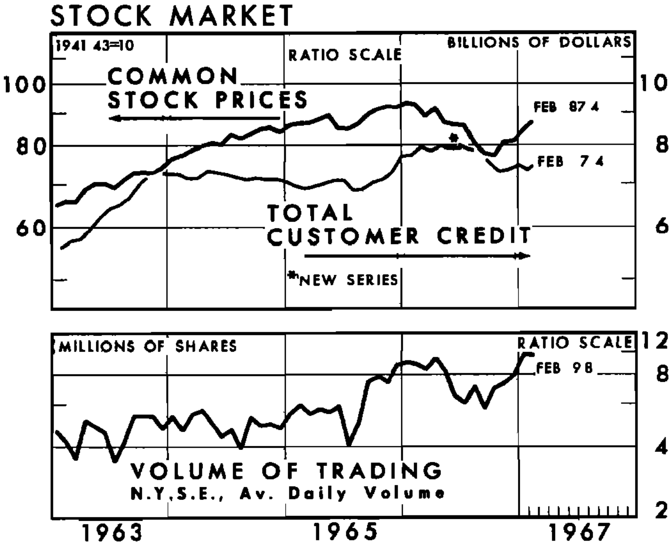
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. The balance of payments measured on the liquidity basis appears to have deteriorated in March, unless month-end transactions and official operations effect a sharp reversal. In January and February combined the deficit was $130 million, before seasonal adjustment, but in the first three weeks of March a deficit of $460 million has been reported. The seasonal adjustment now in use raises the reported first quarter deficit by about $500 million. However, the figures for the quarter are greatly influenced by special factors that must be taken into account in assessing the underlying condition of U.S. international payments.

Tax payments to Libya by U.S. petroleum companies amounting to £100 million ($280 million) were advanced in timing to March this year. Last year the payments were somewhat smaller and were made in April. Also, the first-quarter liquidity balance has not, through March 22, benefited from official transactions nearly as large as those arranged in the fourth quarter of last year. In that quarter the seasonally adjusted deficit was $550 million, but special receipts included additions to foreign official holdings of long-term U.S. assets amounting to $300 million, and advance debt repayments of about $190 million. Taking into account the special factors affecting the balance in the past two quarters, the basic situation still seems to be one of very substantial liquidity deficits.

Measured on the official settlements basis, the first quarter deficit was extraordinarily large. In January and February this deficit totalled $770 million, before seasonal adjustment, and there was a further $400 million deficit in the first three weeks of March. The seasonal adjustment will increase this quarterly deficit by a further substantial amount. The difference between the two measurements reflects principally changes in U.S. liabilities to commercial banks abroad. From mid-December to early February U.S. banks returned about $1.0 billion of borrowed funds to their foreign branches. Since then net flows have been small and the two measures of balance have been less divergent.

U.S. reserve assets were reduced very little in March. The gold stock rose by about $25 million through the 22nd, but this was offset by a reduction of $110 million in convertible currencies, almost entirely sterling. In the first quarter through March 22 the gold stock and IMF gold tranche position changed very little, while holdings of sterling and other convertible currencies were reduced by nearly $1.0 billion.

The available information on merchandise trade and capital flows does not suggest any weakening in basic trends. The merchandise trade surplus in January-February was at an annual rate of $4.0 billion. This represented a major improvement over the fourth quarter cyclical low of $2.9 billion. Exports moved up about 5 per cent over the fourth quarter rate, to an annual rate of $31.0 billion on the balance of payments basis. Country and commodity detail are lacking as yet, but the following table indicates that non-agricultural commodities accounted for this increase. Export orders for manufactures were relatively high at year end.

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

	1965	1966 1st Qtr.	1966 2nd Qtr.	1966 3rd Qtr.	1966 4th Qtr.	1967 Jan.-Feb.
Agricultural	6.3	6.8	6.9	7.4	7.0	6.7p/
Non-agricultural	20.4	22.0	22.1	22.4	22.9	24.6p/
Total, Census basis	26.7	28.8	29.0	29.8	29.9	31.3
Total, Balance of payments basis	26.3	28.8	28.7	29.5	29.6	31.0e/

p/ Preliminary
e/ Estimate

U.S. imports in January-February were at an annual rate of about $27.0 billion, a little over 1 per cent higher than in the fourth quarter. Earlier rapid advances at rates around 20 per cent a year ceased after October.

There is no indication yet of any noteworthy outflow of U.S. private capital, apart from the amounts required to make the March tax payments mentioned above. On balance, banks reduced their claims on foreigners by $56 million in February, following a seasonally high reduction of $263 million in January. Bank commitments for long-term loans in the first quarter were quite low, and disbursements may well continue to be exceeded by maturing loans. Now that long-term dollar loans by foreign branches of U.S. banks are exempt from the IET there may well be a tendency to use the branches for financing foreign affiliates of U.S. firms as well as other foreign customers, if deposit funds of suitable maturities are obtained.

Foreign new security issues sold in the U.S. in the first quarter were about average for the past few years, at about $300 million. Most of the sales came relatively early in the year, and were for Canadian or international organization borrowers.

Economic activity abroad. The widespread slowdown in economic activity in Europe which began in mid-1966 apparently continued into the first two or three months of 1967. However, there have been indications that the decline in Britain may have been leveling out. In Japan, expansion has continued vigorously.

Declines during the latter half of 1966 in British and German demands for goods had repercussions elsewhere in Europe, contributing, for example, to the moderation of demand pressures in France and in the Netherlands. Even in Italy, where supply conditions and Government policies both favor further rapid expansion of output this year, there was some slowing in growth of production of finished consumer and capital goods toward the end of 1966. Weakness of demand for textiles was particularly widespread in Europe from September onwards. The mainspring of the European slowdown, however, continues to be slackness in British and German private capital outlays.

In January 1967, manufacturing production rose in Britain for the second month in succession. In Germany there was a further decline in industrial production, and French industrial output stayed at its November-December level.

INDUSTRIAL PRODUCTION
(1st quarter 1966 = 100)

	U.K.	EEC	Germany	France	Italy	Nether-lands	Canada	Japan	U.S.
1966									
Q-1	100	100	100	100	100	100	100	100	100
Q-2	99	102	101	103	104	101	101	104	102
Q-3	100	101	99	104	107	101	101	110	103.5
Q-4	96	101	98	105	109	102	103	114	104
July	101	102	101	104	105	95	101	108	103
Aug.	100	101	96	104	107	103	101	109	104
Sept.	98	102	99	104	108	102	102	112	104
Oct.	97-	101	99	103	107	99	103	112	104
Nov.	95	101	97	105	109	103	103	115	104
Dec.	97-	102	96	105	110	104	103	117	104
1967									
Jan.	.97	...	95	105	...	...	...	120	104

Central bank discount rates have been reduced twice (by 1/2 per cent steps) since the beginning of the year in Germany, Britain, Sweden, and (by 1/4 per cent each time) in Belgium, and there have been single cuts in the Netherlands and (by 1/4 per cent) in Canada. Evidence is still lacking that these and other measures to stimulate renewed expansion have begun to exert their desired effects.

In Britain, the recession that started in the spring of 1966 and was sharply accelerated by the July measures of restraint appears to have been checked by factors closely related to those involved in the previous decline. First, consumer expenditure on goods picked up somewhat around the end of the year, after dropping sharply in the third quarter. Second, according to the U.K. Treasury, inventory accumulation was cut back sharply in the fourth quarter, possibly even to the extent of an absolute reduction in volume of stocks; with inventory adjustment thus proceeding in line with intentions, there was little pressure on manufacturers to reduce output still further. Other factors contributing to stopping the recession were the continuing increase in central and local government spending and the rise in U.K. exports. On the other hand, private fixed investment outlays, which fell off slightly in real terms in the third quarter, are thought to have declined further.

Retail sales (excluding autos) were 2-1/2 per cent lower in terms of volume at constant prices in September-October than in March-May of last year. Part of the loss was then recovered, and in the three months through January the volume of sales was only 1 per cent below the peak. New car registrations fell sharply in the summer and early autumn, reaching a fourth-quarter level about 25 per cent below a year earlier. In January, however, car registrations showed an exceptionally big rise, and in February, though they fell back somewhat, they remained better than in the fourth quarter.

Consumer behavior reflected the stand-still in incomes and prices during the second half of 1966. Hourly earnings rose only 1 per cent from April to October, apparently all in the first part of that period. Weekly earnings declined slightly from July through the rest of the year, because of less overtime and more short-time working. Retail prices rose by 1-1/2 per cent from July to December, mostly as the result of higher indirect taxes and the selective employment tax. A White Paper published on March 22 states the Government's intention of allowing its powers to prevent or nullify price and wage increases to lapse in August, in place of which it will reactivate powers to delay increases.

Slackening in private fixed capital expenditure last year occurred mainly in residential construction and the distributive and service industries; manufacturing capital expenditures were well maintained. However, the outlook for 1967 according to the Board of Trade's quarterly survey taken in late November and December was for 10 per cent declines in real volume of outlays by both manufacturers and the distributive and service industries. A Confederation of British Industry survey in January seemed to suggest a larger drop, but at the same time it evidenced less pessimism than had a CBI survey last September. The Board of Trade survey was too early to reflect reactions to the Government's announcement on December 1 of its decision to raise investment grants by five percentage points, and both surveys were of course too early to indicate responses to the decision, announced last week, to start payments of the grants in April rather than in July.

U.K. exports in the three months through February were 1-1/2 per cent higher than in the preceding three months, and up 8 per cent from the corresponding months a year earlier. Imports, which had been low in anticipation of the removal of the surcharge at the end of November, have been substantially higher since then. In the six-month period September-February as a whole they were 2 per cent lower than a year earlier.

Unemployment rose again in March after two months of little or no change, but this may have little significance since unusually good weather had helped to hold down unemployment in the winter.

By January, German industrial production (as seasonally adjusted by OECD) was down 7 per cent from the peak reached in March-April 1966. Unemployment rose further in January, and, for the first time in years, the number of job vacancies fell below the number of unemployed.

New orders also fell further in January. Since last May orders have been consistently below current deliveries, with a consequent running down of order backlogs. This development has been especially marked for the nondurable goods industries, including textiles, and also for steel. According to press reports, steel inventories have fallen lower than they did in 1958. It is adjustments such as these, together with the Government's public works expenditure plans, that give support to views occasionally heard that an upturn may occur sooner rather than later this year. On the other hand, bearish views emphasize the profit squeeze and the decline that has been occurring in business outlays and orders for machinery and equipment.

In late 1966, survey results exhibited an extraordinary degree of pessimism on the part of businessmen, according to the January Monthly Report of the Deutsche Bundesbank. As compared with earlier times when capacity utilization ratios and ratios of unfilled orders to current production were comparable to those of last December, many more businesses than before considered their orders on hand to be smaller than they wanted. Reportedly business sentiment has brightened somewhat in the past few weeks.

Through the end of 1966 major factors working to sustain economic activity were the rise in German exports and the advance in wage rates, which helped to support consumption. Wage rate increases were the principal factor in the 5.5 per cent year-over-year advance, to the fourth quarter of 1966, in gross wages and salaries. The year-over-year rise of about 4 per cent in private consumption expenditures, when contrasted with the 9 per cent rise from first half of 1965 to first half of 1966, suggests, however, that seasonally adjusted there was very little further advance in consumption expenditures during the second half of 1966. Since the cost of living index rose about 1/2 per cent further from mid-year to year-end (with food down, services up substantially, and industrial products up slightly), the real volume of consumption may even have declined a little. Automobile and motorcycle purchases were 10 per cent lower in the fourth quarter than a year earlier.

Apart from the marked easing of monetary policy in recent months, major actions to foster economic revival have included liberalization of depreciation allowances to stimulate private investment and central bank financing of a government investment program involving projects that can be started with minimum delay.

In France the pace of advance in economic activity slackened in the latter half of 1966, with industrial production showing less than a 1 per cent rise from July to January 1967. The slowdown is attributable to easing in both consumer and investment demand, as well as to leveling off in exports. Department store sales, in value terms, were virtually level from mid-year to year-end. So also was production of automobiles after a rapid rise during 1965.

Unemployment increased noticeably in January and February. However, the rate of unemployment is still very low -- less than one per cent in February.

Private industry had been planning a moderately larger increase in capital expenditures this year than occurred in 1966, with an especially large increase in the steel industry, according to an INSEE survey taken in November. Public sector industries plan a substantial increase, and there is also to be an increase in public housing construction. Private housing starts will be aided by releases of funds under the housing savings program initiated at the end of 1965.

In Italy GNP rose about 5-1/2 per cent in real terms last year. The fourth-quarter-to-fourth-quarter rise in industrial production was 12 per cent, despite a slowing of advance in output of finished consumer and capital goods after midyear.

Italy is still in a period of recovery and advance following the severe recession of 1964. With no shortage of labor or capital facilities having yet materialized, the Italian authorities have refrained from any action that might damp the current expansion.

In the Netherlands the excessive demand pressures which troubled the economy for the preceding three years abated in mid-1966. The easing was evident both in a slowing of increase in Dutch exports and in internal demand, with weakening clearest in the private investment sector.

With the rate of growth in production slowing and order backlogs dwindling, the Netherlands Bank reduced the discount rate on March 15 from 5 to 4-1/2 per cent and also took steps which in effect raised the limits on credit expansion imposed on Dutch commercial banks.

In Canada, seasonally adjusted gross national product in constant prices may have increased again in the fourth quarter after declining in the third. Industrial production advanced again, and unemployment dropped a little. However, housing starts declined further, retail sales leveled off, and there were indications of marked slowing in the investment boom. Unemployment was again increasing slightly in January and February.

Japan has been experiencing a vigorous expansion in economic activity, supported by a strong capital investment trend. The Government, in a special session of the Diet in mid-March, warned businessmen to exercise caution in their plant and equipment investments to avoid overheating.

In January, industrial production reached a level 20 per cent higher than a year earlier. New orders for machinery have been brisk, and in January of 1967 were 44 per cent higher than a year earlier. Unfilled orders for machinery have also been rising since mid-1965, and in December were up 17 per cent from a year earlier.

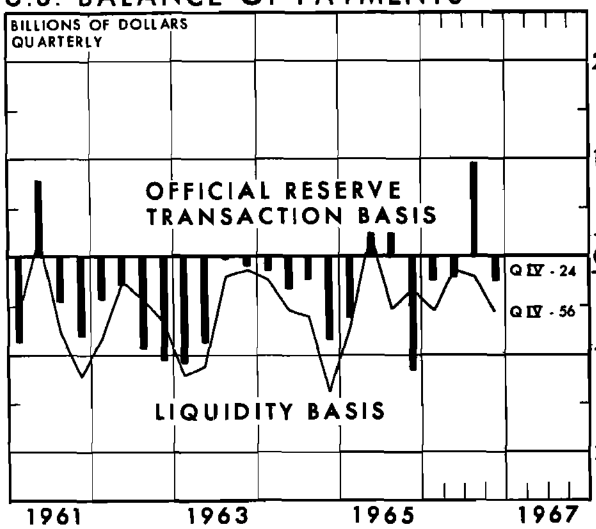
Producers' inventories of finished goods have risen only 1 per cent from a low in mid-1966. In January, they were still 4 per cent below the previous high in September of 1965. But raw materials inventories have been rising faster since early 1966, and in December were 10 per cent above their level a year earlier.

Business profits have been improving and a survey of smaller firms indicates that profits in the 6 months ending March 1967 are expected to be up 17 per cent over the previous six months.

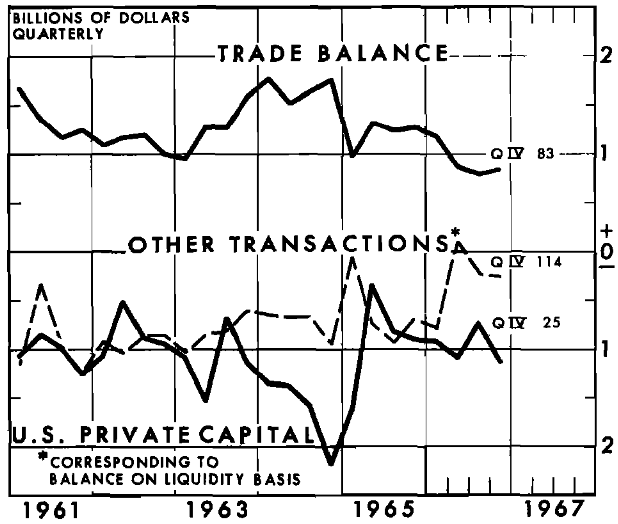
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

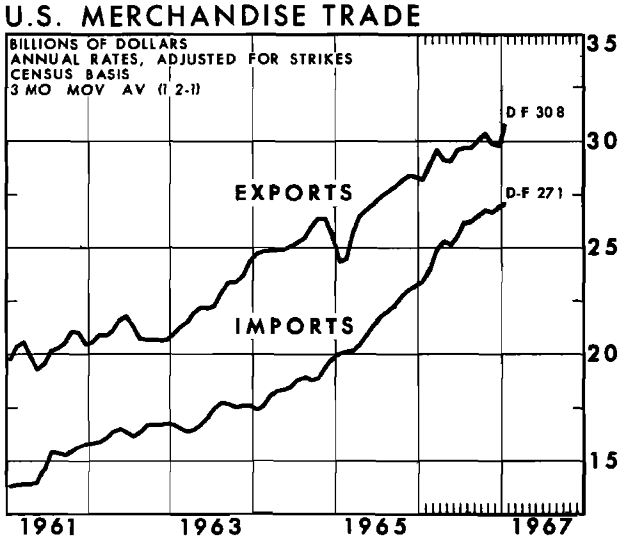
U.S. BALANCE OF PAYMENTS



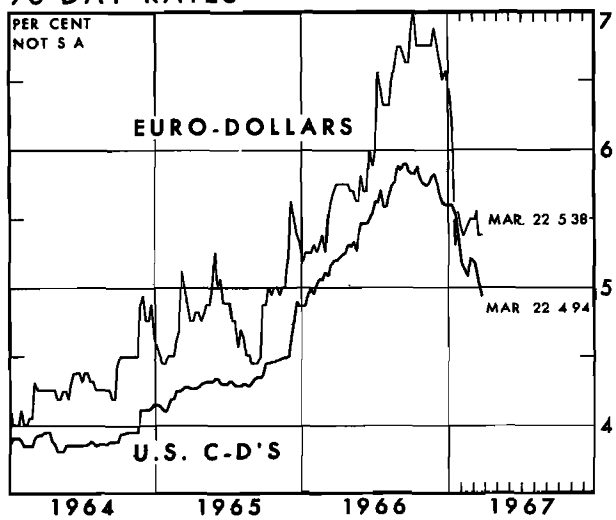
U.S. BALANCE OF PAYMENTS - CONT.



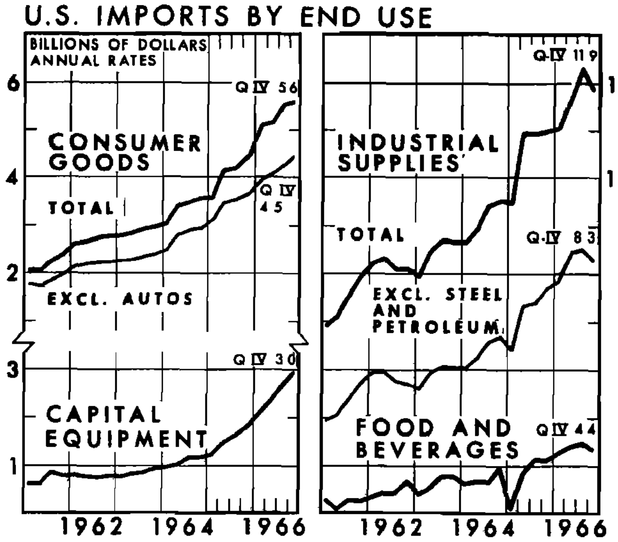
U.S. MERCHANDISE TRADE



90-DAY RATES



U.S. IMPORTS BY END USE



U.S. EXPORTS BY AREA