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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

May 17, 1967

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SUMMARY AND OUTLOOK

Outlook for economic activity

The outlook continues to be for a small gain in real GNP this quarter followed by a stronger third quarter. Sharp downward revision of retail sales figures for March and other recent indications of sluggishness have cooled some of the earlier exuberance in business and financial expectations. However, despite the recent unfavorable turn of the news, we believe the progressively slower rate of inventory accumulation since the beginning of the year has begun to lay the groundwork for a resumption of more rapid economic growth later on.

Substantial increases in final demand are estimated for the second quarter, partly offset by a continuation of the inventory adjustment. Some decumulation of stocks is now anticipated for the second quarter. Inventory liquidation is likely to continue in the third quarter, particularly if auto sales pick up in anticipation of a strike, but such liquidation should exert much less of a downward drag on economic activity than in the two preceding quarters. Gains in government and private final demands over the summer are expected to be at the same fast pace as in the second quarter. We project a rise in real GNP of 4 to 5 per cent, annual rate, which would be sufficient to end downward pressures on industrial output and employment.

Outlays by consumers in the second and third quarters are expected to show somewhat larger increases than earlier, partly because of greater strength in auto purchases. Even with an expected resumption of rapid advance in personal income over the summer, the strength projected in consumer buying would result in a drift off in the savings rate from the exceptionally high level reached in the first quarter.

In addition, developments in Vietnam are resulting in larger defense outlays than previously expected. And our expectations continue to be for some further expansion in residential construction, for little change in fixed capital investment, and for sharply rising State and local spending.

Outlook for resource use and prices

The pause in over-all economic expansion in recent months has continued to exert downward pressure on industrial production. Outside the auto and defense sectors, cutbacks in output were widespread among final products and materials in April, resulting in a half-point decline in total industrial production and a full-point decline--from 87 to 86 per cent--in the rate of manufacturing capacity utilization. Further moderate declines in industrial production and capacity utilization are still in prospect for the next few months, while the inventory adjustment is being completed. Moreover, the unemployment rate is likely to rise moderately further. The civilian labor force, which declined from December to March, began rising again in April and is expected to continue expanding at a substantial rate, while industrial employment is tending lower.

Cutbacks in employment and working-time per employee have brought manufacturing manhours down along with production, and productivity has shown little net change since December, while wage rates and hourly earnings have continued on up at a sizable pace. As a result, unit labor costs have risen substantially. These trends are likely to hold in the near future. Upward pressures on unit labor costs are likely to continue until production turns up vigorously, with the usual concomitant increase in productivity.

Despite these upward cost pressures, wholesale prices of industrial commodities were stable in March and April. Stability in the over-all total resulted in part from declines in sensitive industrial materials, while prices of some other materials and products continued to rise. With domestic and world supplies of metals and other basic materials generally much more ample than a year ago, and with--as yet--little prospect for renewal of expansion in business equipment demands, industrial price increases are likely to be moderate.

Sharp declines in prices of farm products through April resulted in a decline in the over-all wholesale price index and acted to slow appreciably the rise in the consumer price index. But this moderating influence may be waning. The earlier marked expansion in output of livestock and products has tapered off as producers have begun to react to the sharp fall-off in prices received and sustained relatively high costs of feed. Supplies of many livestock products are expected to work down to around year earlier levels by summer or autumn, and while crop prospects now appear favorable, wholesale prices of farm products and foods may generally stabilize or increase. At retail, average food prices are now expected to rise more than seasonally this summer, and the consumer price index may then rise faster than during the period from last October through March.

Outlook for banking

Bank credit in May is expected to be essentially unchanged or only slightly higher. Corporate tax payments in May are projected about $2 billion less than last year, reducing the amount of tax-related loan demands. This, along with continued business inventory adjustments and the high level of capital market financings, might even lead to some net business loan repayments this month. Demands for other types of loans are also likely to remain relatively weak, but bank security portfolios will probably rise further, although at a reduced rate.

In June, corporate tax payments are expected to amount to over $15 billion--about the same as last year--which should tend to lead to a repetition of last year's temporary bulge in loan demand. Banks may be under some temporary pressure in meeting these customer loan demands with their large CD maturities and with their Treasury balances expected to continue to decline because of rising Government expenditures. This pressure might induce some increased bank efforts to expand CD sales, to obtain other short-term borrowings and to liquidate some securities. Over the somewhat longer run, bank competition for CD funds is likely to be moderate so long as loan demand remains weak and inflows from passbook savings and time deposits other than large CD's continue strong.

Capital markets outlook

New uncertainties have developed in capital markets in the wake of the Treasury's request for statutory leeway to breach the 4-1/4 per cent interest rate ceiling on U.S. Government bonds and to extend the maturity of notes (which are not subject to the ceiling) to 10 years. Prior to the Secretary's testimony, bond yields had shown some signs of leveling off, following a substantial advance extending over more than a month. But with the May and June calendars in both corporate and municipal markets still very heavy and with the FNMA expected to announce a $900 million offering of participation certificates later this month, even this earlier tendency toward stability in bond yields might have been short-lived.

The initial reaction of corporate underwriters to the Treasury's request has been to defer offering of a few negotiated issues scheduled for the current week. These postponements are likely to be strictly temporary, however. Thus in the short-run, the supply pressures on bond yields seem likely to persist.

In the secondary mortgage market, scattered yield advances have been reported recently for FHA and VA home mortgages. These changes seem to have been made more in anticipation of tightening credit markets later in the year than to any current shortage of mortgage credit. At life insurance companies, most commitments now being made are for delivery either in late 1967 or beyond; for the limited volume of uncommitted funds that are available for investment currently, corporate obligations have been more attractive than mortgages.

Among depositary-type lenders, recent data show no slackening in the net growth of consumer-type savings accounts. The below normal share of these inflows being allocated to mortgages at savings and loan associations and savings banks through April was apparently attributable more to the relative shortage of immediately available mortgages than to the preemption of funds by other types of borrowers. However, the high corporate bond yields, which have attracted savings bank funds in record volume recently, suggests that as mortgages do become more readily available they will have to provide liberal returns in order to attract a normal share of such funds.

International developments

Preliminary U.S. payments results for the first quarter of 1967, announced today, show a seasonally adjusted deficit of $540 million on the liquidity basis. The figure was held down by special transactions in the absence of which it would have been about $1 billion. The deficit on the official reserve transactions basis was a record $1,830 million. In April, the liquidity deficit apparently increased, owing mainly to the absence of favorable special transactions. The official settlements deficit remained very large last month, as U.S. banks further reduced their liabilities to their foreign branches.

Compared with the fourth quarter, the first-quarter liquidity deficit before special transactions was little changed. Capital outflows increased, while net exports of goods and services rose from an annual rate of $4.5 billion to about $5.4 billion.

Some adverse influences that were present in the first quarter--unusually large outflows of U.S. private capital into foreign securities, and high food imports--may now be waning. On the other hand, the first quarter included some temporarily favorable elements, including large foreign official placements in nonliquid U.S. assets and further reflows of U.S. bank credit in January-February which gave way to a renewed outflow in March. Also, military expenditures in Asia are doubtless continuing to increase.

In the months ahead, a substantial further increase in net exports will be required to hold the rates of deficit for the full year 1967 down--as earlier projected--to about $2 billion on the liquidity basis and $3-1/2 billion on the official reserve transactions basis.

Recent business developments abroad still leave the U.S. export outlook uncertain. Prospects for a gradual pickup of demand in European economies are brightened by the further discount rate reductions in Germany and Britain this month, as well as by some indications that the recessions in these countries may have begun to bottom out earlier this year. The OECD staff now estimates that real GNP may rise from the first half of 1967 to the second half almost as much in OECD Europe (4 per cent annual rate) as in the United States (4-1/2 per cent). For OECD Europe as a whole this would constitute a marked acceleration, after growth in the current half year at a rate of only 1-1/2 per cent; for Germany alone it would represent a sharp turnaround from decline to advance.

But it is still uncertain whether the monetary and fiscal actions Germany has taken up to now are sufficient to get this result. Also, recovery in Britain thus far has been slow, and a recent deterioration in the U.K., trade balance, coupled with the need to make further large repayments this year to the IMF, seem to insure that Britain's economic policies will remain cautious. Thus in general we may expect the recent weakening tendencies in world markets to be arrested, but no early renewal of boom conditions in Europe should be looked for.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per cent change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Yrs. Ago*
Civilian labor force (mil.)	Apr'67	76.7	76.5	75.3	1.9	3.5
Unemployment (mil.)	"	2.8	2.8	2.8	1.1	-20.6
Unemployment (per cent)	"	3.7	3.6	3.7	-	-
Nonfarm employment, payroll (mil.)	"	65.6	65.5	63.4	3.6	9.1
Manufacturing	"	19.2	19.4	18.9	1.6	7.8
Other industrial	"	8.1	8.2	8.0	0.7	4.3
Nonindustrial	"	38.3	38.0	36.4	5.2	10.8
Industrial production (57-59=100)	"	155.9	156.4	153.9	1.3	10.6
Final products	"	156.5	156.5	152.9	2.4	12.2
Materials	"	155.9	156.4	154.5	0.9	9.4
Wholesale prices (57-59=100)1/	Mar'67	105.7	106.0	105.4	0.3	4.3
Industrial commodities	"	105.1	105.1	103.6	1.4	3.4
Sensitive materials	"	101.3	101.9	105.4	-3.9	-0.1
Farm products, foods and feeds	"	104.6	105.7	109.4	-4.4	5.7
Consumer prices (57-59=100)1/	"	115.0	114.8	112.0	2.7	5.5
Commodities except food	"	107.8	107.6	105.6	2.1	2.9
Food	"	114.2	114.2	113.9	0.3	6.8
Services	"	126.3	125.9	120.1	5.2	7.9
Hourly earnings, mfg. ($)	Apr'67	2.80	2.79	2.70	3.7	8.1
Weekly earnings, mfg. ($)	"	112.90	112.44	111.57	1.2	6.4
Personal income ($ bil.)2/	Mar'67	613.1	609.7	569.0	7.8	17.9
Corporate profits before tax($bil.)2/	QIV'66	81.8	81.9	78.7	3.9	20.8
Retail sales, total ($ bil.)	Apr'67	25.7	25.8	24.9	2.9	12.3
Autos (million units)2/	"	7.6	7.2	7.9	-3.6	-7.8
GAF ($ bil.)	"	6.3	6.1	5.8	9.4	22.0
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	Mar'67	1,171	1,151	1,569	-25.4	-21.4
Factory workweek (hours)	Apr'67	40.5	40.4	41.5	-2.4	-1.2
New orders, dur. goods ($ bil.)	Mar'67	22.1	22.3	24.9	-11.1	1.9
New orders, nonel. mach. ($ bil.)	"	3.4	3.3	3.5	-4.0	9.3
Common stock prices (1941-43=10)	Apr'67	90.96	89.42	91.60	-0.7	3.4
Inventories, book val. ($ bil.)	Mar'67	136.9	136.8	123.6	10.8	20.5
Gross national product ($ bil.)2/	QI '67	764.3	759.3	721.2	6.0	15.7
Real GNP ($ bil., 1958 prices)2/	"	657.2	657.2	640.5	2.6	9.5

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended May 12	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	3.65	3.92	6.25	2.50
U.S. Treas. bills, 3-mo., yield (per cent)	3.65	3.73	5.45	3.71
Net free reserves 2/ (mil. $)	260	240	292	-268
Member bank borrowings 2/ (mil. $)	63	118	711	63
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.73	4.65	5.42	4.38
20-year U.S. Treas. bonds	4.90	4.78	4.92	4.44
Corporate new bond issues, Aaa	5.62	5.52	5.85	5.11
Corporate seasoned bonds, Aaa	5.19	5.14	5.39	5.03
Municipal seasoned bonds, Aaa	3.65	3.59	3.79	3.38
FHA home mortgages, 30-year 3/	6.35	6.35	6.81	6.35
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	93.75	93.24	94.44	80.09
Dividend yield (per cent)	3.14	3.16	3.12	3.70

N.S.A.--not seasonally adjusted. S.A. Seasonally adjusted.
1/Average of daily figures. 2/Averages for statement week ending May 10, 1967
3/Latest figure indicated is for month of March. 4/Data are for weekly closing prices.

	Latest month	Billions of Dollars: Outst. Latest month	Billions of Dollars: Change Latest month	Billions of Dollars: Change Average-Latest 3 months	Annual rate (per cent) Change: Latest month	Annual rate (per cent) Change: Latest 3 months	Annual rate (per cent) Change: 12 months
Banking (S.A.)							
Total reserves 1/	April 1967	24.34	0.04	0.25	2.1	12.8	3.6
Credit Proxy 1/	April 1967	256.9	2.9	3.1	13.7	14.9	6.1
Bank Credit 2/							
Total	April 1967	323.8	2.3	3.1	8.6	11.8	7.3
Business loans	April 1967	82.8	1.4	0.8	20.6	11.4	13.6
Other loans	April 1967	131.3	0.6	0.2	5.5	15.3	4.3
U.S. Gov't. sec.	April 1967	56.4	-1.2	0.9	-25.0	19.3	0.9
Other securities	April 1967	53.3	1.4	1.3	32.4	30.7	13.2
Money and other liquid assets							
Total 1/ 2/	April 1967	615.8	1.4	3.8	2.7	7.5	4.4
Demand deposits & currency 1/	April 1967	172.1	-0.7	0.8	-4.9	5.9	0.7
Time and savings, comm. banks 1/	April 1967	167.3	2.0	2.3	15.1	16.9	11.2
Savings accounts, other institutions 2/	April 1967	173.9	1.5	1.6	10.4	11.4	6.0
Other 2/ 3/	April 1967	102.5	-1.4	-0.9	-16.2	-10.3	-1.2

1/ Averages of daily figures.
2/ Month-end data.
3/ U.S. Savings bonds and U.S. Government securities maturing within 1 year.

NOTE: Where necessary, changes have been adjusted to take account of conceptual and definitional changes in data.

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

	1967 Apr.	1967 Mar.	1967 Feb.	1967 QI	1966 QIV	1966 QIII	1966 QII	1966 Year (billions)
				Seasonally adjusted				
Current account balance					882	929	1,147	4.3
Trade balance								
As published in B/P 1/					834	787	878	3.7
Revised 2/		360	370	1,029	(722)	(802)	(956)	
Exports 2/		2,550	2,580	7,732	(7,402)	(7,382)	(7,181)	29.2
Imports 2/		-2,190	-2,210	-6,703	(-6,680)	(-6,580)	(-6,225)	-25.5
Services, etc., net 1/					48	142	269	0.6
Capital account balance 1/					-1,167	-1,302	-1,074	-5.1
Govt. grants & capital 3/					-690	-797	-952	-3.4
U.S. private direct investment					-963	-737	-976	-3.4
U.S. priv. long-term portfolio					100	-14	-80	-0.2
U.S. priv. short-term					-278	3	-38	-0.3
Foreign nonliquid					664	243	972	2.2
Errors and omissions 1/					-273	173	-195	-0.6
Balances, with and without seasonal adjustment (- = deficit)								
Liquidity bal., S.A.				-539	-451	-164	-112	-1.4
Seasonal component				308	-20	-535	-37	--
Balance, N.S.A.	-354	-219	-144	-231	-471	-699	-149	-1.4
Official settlements bal. S.A.,				-1,832	-29	870	-165	0.2
Seasonal component				550	-153	-461	-220	--
Balance, N.S.A. 4/		-540	-278	-1,282	-182	409	-385	0.2
Memo items:								
Monetary reserves (decrease -)	51	-143	-198	-1,027	6	-82	-68	-0.6
Gold purchases or sales (-)	50	23	-41	-51	-121	-173	-209	-0.6

1/ As published in March 1967.
2/ Based on revised seasonal adjustments, as published in May 17, 1967 press release. Figures for February and March are on the balance of payments basis which differs a little from the published Census basis.
3/ Net of loan repayments.
4/ Differs from liquidity balance by counting as receipts (+) increases in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increase in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. Gains of $8 billion and $14 billion in GNP now projected for the second and third quarters are about the same as our previous estimates. After a first quarter which showed a slight decline in real GNP, aggregate real output is projected to rise at about a 1-1/2 per cent annual rate in the second quarter and a 4-1/2 per cent rate in the third quarter. The trend of prices as reflected in the GNP deflator is assumed to continue upward at around the first quarter rate.

Revised first quarter estimates of GNP (to be released by the Department of Commerce May 18) incorporate a number of changes which are largely offsetting. The first quarter figures now show an increase of $4.4 billion in current dollar GNP, and a slight decline after adjusting for price changes. The major revisions are as follows: Consumer expenditures for nondurables have been lowered by about $2 billion, reflecting downward revisions in retail sales for February and March; this results in an upward revision in the saving rate to 6.5 per cent, up from the 5.9 per cent rate in the fourth quarter. Defense expanditures, which previously had been estimated as increasing by $3.3 billion, now show a rise of $4.2 billion. And net exports have been increased up from $4.9 billion to $5.4 billion, with exports up sharply and imports up only moderately.

Our expectation is that any continued sluggishness in consumer spending for nondurables will be compensated for by greater strength in auto sales in this and next quarter. Prospects for somewhat higher Federal defense expenditures also tend to support expectations of acceleration of the expansion. All in all, there does not appear to be sufficient new evidence to support any major modification in the profile of our previous projections.

If this outlook proves correct, the economy will have adjusted to the massive shift in inventory investment from a peak rate of accumulation in the fourth quarter to slight liquidation indicated for the current quarter with only a minor interruption in economic growth and with relatively mild adverse secondary effects on the economy. By the third quarter the economic advance will have resumed a pace which should halt, and probably reverse, current downward pressures on industrial output and employment.

The drop in the rate of accumulation in the book value of business inventories has been very steep--from a rate of $19 billion in the fourth quarter to about $2 billion in March. With this sharp drop in stock building, the inventory-sales ratio declined slightly in March, reversing the sharp uptrend which had been underway since mid-1966.

The principal inventory problem remaining is in the area of manufacturer's durable goods, where stocks for both defense and nondefense categories are still high relative to sales. The nondurable goods inventory-sales ratio for manufacturers in March, although higher than a year ago, was in line with that of March 1965 and below that of March 1964. Stock-sales ratios for manufacturer's finished durable goods were moderately higher than in March 1964 and 1965, but the really large increase over the past year was in work in process (much of which probably reflected long leadtime defense and business equipment items). The durable goods inventory overhang thus remains very large, foreshadowing further cuts in output in these lines.

Distributors' inventories were reduced in both February and March, in large part because of reductions in auto stocks. Rising auto sales in April and May cut the stock-sales ratio to a more satisfactory level, and in view of recent better sales and the possibility of a strike this fall, auto production should remain relatively strong and any further buildup in stocks would likely be intentional. The moderate increases in demand projected for non-durable goods, along with reduced production levels, are expected to result in further stock adjustments in this sector.

It seems likely, therefore, that total business inventories will be liquidated, possibly at an annual rate of around $.5 billion, in the second quarter in contrast to the $5.6 billion rate of accumulation in the first quarter. In the third quarter, the retarding influence of production cutbacks should be about over, and with some final sales rising faster than output, some small further liquidation is likely, perhaps at an annual rate of about $2 billion.

In real terms, the rise in disposable income in the first quarter was larger than in any quarter of the past year. Although the second quarter flow of income will be somewhat smaller, the increase in spending power will still be substantial. Gains in total employment--although not in industrial employment--and wage rates are continuing, while the small increase in the personal tax-take in the first half of this year is leaving an unusually high proportion of income gains in consumer's hands. These high levels of real income have been reflected in an exceptionally high and rising saving rate over the last six months, and consumers are therefore in a position to step up spending. However, total retail sales are still sluggish, and since extended periods of high rates of consumer savings have occurred before, we are projecting only a moderate growth in consumer expenditures in the second and third quarters. Spending for nondurable goods is projected as increasing only at about the modest (revised) first quarter rate; domestic auto sales, however, are projected to rise to an $8 million annual rate in the third quarter, from a $7.6 million rate in the second quarter.

Although the outlook for consumer expenditures thus continues to have major elements of uncertainty, there is more widespread agreement that defense expenditure will be significantly higher than the January Budget estimate. For fiscal 1967, the defense Budget will be exceeded by over $1.5 billion, with rates of expenditures for the January-March quarter already nearly $2 billion over January expectations.

In the April-June quarter, the annual rate of defense spending may be nearly \$3-1/2 billion higher than projected in January. Current guesses suggest 1968 fiscal year defense outlays of \$5-6 billion over the Budget. These levels are reflected in our projection, which now shows a \$3 billion rise in the second quarter and \$2.5 billion in the third quarter.

Expenditures for transfer payments and interest are also outstripping Budget estimates, with the result that the Federal deficit (NIA basis) will run at a rate in excess of around \$10 billion annually in the first half of this calendar year, compared with \$2 billion in the second half of last year. The \$8 billion increase in the deficit provides a rough measure of the role of the Federal government in sustaining activity in the first half year when total GNP is expected to rise only \$16 billion. After midyear, the deficit is expected to continue to increase to very high levels, even if revenues should rise more rapidly as the economy returns to a higher rate of expansion.

The role of State and local governments must also be considered stimulative, even though they normally do not run large deficits on current account. Continued large municipal flotations in the capital market and rising State-local revenues suggest a continued rise in public works and related services.

Residential construction appears to be regaining its momentum slowly. The staff projections embody increases in these outlays in the second and third quarters, in line with the recent pattern of housing starts. High bond yields so far do not appear to have curbed the flow of savings to mortgage lending institutions--in fact the supply of mortgage money at the moment remains somewhat in excess of demand on current lending terms. Potential demand for new homes is being strengthened by rising resales of existing structures, decreasing vacancies, and new family formation, but even vigorous response on the part of the housing industry cannot greatly shorten the lag between the low winter rate of starts and a more normal rate of completions.

In the area of fixed business investment, the unfavorable impact on capital expenditures of the gradual decline in manufacturing capacity utilization rates to 86 per cent or lower, and the decline in profits, should be counterbalanced to some extent by the expected reinstatement of the investment tax credit. Expenditures for farm equipment were a little stronger in the first quarter and spending for plant construction a little higher than estimated earlier. Meanwhile, the Commerce Department reported the profits decline in the first quarter at $4.5 billion. Selling prices of finished industrial commodities have risen somewhat and may moderate the effect of rising unit labor costs on margins. If labor costs continue to rise, profits margin may dip further in the second and third quarters, but corporate liquidity should rise. It seems likely that outlays for business fixed investment will remain fairly constant in this and the next quarters. The next Commerce-SEC quarterly survey of business intentions to invest in plant and equipment, to become available in early June, should help to clarify the picture.

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

	1965	1966	1966 II	1966 III	1966 IV	1967 I	1967 Projected II	1967 Projected III
Gross National Product	681.2	739.6	732.3	745.3	759.3	763.7	771.7	786.0
Final sales	672.1	727.7	720.0	735.4	742.9	758.1	772.2	788.0
Private	535.9	574.7	571.0	579.2	581.8	589.0	597.8	608.5
Personal consumption expenditures	431.5	464.9	460.1	469.9	474.1	479.9	487.0	495.0
Durable goods	66.1	69.3	67.1	70.2	69.6	68.4	69.4	60.9
Nondurable goods	190.6	206.2	205.6	208.1	209.2	212.5	214.7	217.5
Services	174.8	189.4	187.4	191.5	195.3	199.1	202.9	206.6
Gross private domestic investment	106.6	117.0	118.5	115.0	120.0	109.3	104.3	105.0
Residential construction	27.8	25.8	28.0	24.8	21.9	22.1	23.2	25.0
Business fixed investment	69.7	79.3	78.2	80.3	81.6	81.6	81.6	82.0
Change in business inventories	9.1	11.9	12.3	9.9	16.4	5.6	- .5	- 2.0
Nonfarm	8.1	12.2	12.1	10.4	17.6	6.0	- .5	- 2.0
Net Exports	7.0	4.8	4.7	4.2	4.1	5.4	6.0	6.5
Gov't purchases of goods & services	136.2	153.0	149.0	156.2	161.1	169.1	174.4	179.5
Federal	66.8	76.9	74.0	79.0	81.7	87.0	90.1	93.0
Defense	50.1	60.0	57.1	62.0	65.5	69.7	72.7	75.2
Other	16.7	16.9	16.9	17.0	16.2	17.2	17.4	17.8
State & local	69.4	76.2	75.0	77.2	79.4	82.1	84.3	86.5
Gross National Product in constant (1958) dollars	614.4	647.8	643.5	649.9	657.2	656.7	659.0	666.7
GNP Implicit deflator (1958=100)	110.9	114.2	113.8	114.7	115.5	116.3	117.1	117.9
Personal income	535.1	580.4	573.5	585.2	598.3	609.7	617.0	629.0
Wage and salaries	358.4	392.3	387.4	396.7	405.0	411.8	418.0	427.0
Disposable income	469.1	505.3	499.9	507.8	518.4	528.5	535.0	544.5
Personal saving	25.7	27.0	26.6	24.5	30.4	34.4	33.4	34.5
Saving rate (per cent)	5.5	5.3	5.3	4.8	5.9	6.5	6.2	6.3
Total labor force (millions)	77.2	78.9	78.4	79.1	79.8	80.3	80.5	80.9
Armed forces "	2.7	3.1	3.1	3.2	3.3	3.4	3.5	3.5
Civilian labor force "	74.5	75.8	75.4	76.0	76.5	76.9	77.0	77.4
Unemployment rate (per cent)	4.5	3.8	3.8	3.8	3.7	3.7	3.9	4.0
Nonfarm payroll employment (millions)	60.8	63.9	63.6	64.1	64.8	65.4	65.6	65.9
Manufacturing	18.0	19.1	19.0	19.2	19.4	19.4	19.2	19.2
Industrial production (1957-59=100)	143.4	156.3	155.2	157.6	158.8	157.0	155	157
Capacity utilization, manufacturing (per cent)	89	91	91	91	90	87	85	85
Housing starts, private (millions, A.R.)	1.5	1.2	1.4	1.1	1.0	1.2	1.2	1.3
Sales new U.S.-made autos (millions), A.R.)	8.8	8.4	7.8	8.5	8.1	7.3	7.6	8.0

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

	1965	1966	1966			1967	Projected	
			II	III	IV	I	II	III
			(Billions of Dollars)					
Gross National Product	49.5	58.4	11.1	13.0	14.0	4.4	8.0	14.3
Final sales	45.1	55.6	7.7	15.4	7.5	15.2	14.1	15.8
Private	37.8	38.8	3.7	8.2	2.6	7.2	8.8	10.7
GNP in constant (1958) dollars	34.4	33.4	3.0	6.4	7.3	-0.5	2.3	7.7
Final sales	30.2	31.1	-0.1	8.9	1.2	9.5	8.2	9.0
Private	27.4	22.0	-2.2	4.4	-2.2	4.2	4.9	6.0
			(per cent)					
Gross National Product	7.8	8.6	6.2	7.1	7.5	2.3	4.2	7.4
Final sales	7.2	8.3	4.3	8.6	4.1	8.2	7.4	8.2
Private	7.6	7.2	2.6	5.7	1.8	4.9	6.0	7.2
Personal consumption expenditures	7.5	7.7	3.9	8.5	3.6	4.9	5.9	6.6
Durable goods	11.3	4.8	-18.2	18.5	-3.4	-6.9	5.8	-49.0
Nondurable goods	6.5	8.2	7.3	4.9	2.1	6.3	4.1	5.2
Services	7.2	8.4	8.7	8.7	7.9	7.8	7.6	7.3
Gross private domestic investment	14.6	9.8	14.0	-11.8	17.4	-35.7	-18.3	2.7
Residential construction	0.7	-7.2	-8.4	-45.7	-46.8	3.7	19.9	31.0
Business fixed investment	14.8	13.8	6.2	10.7	6.5	0.0	0.0	0.0
Gov't purchases of goods & services	5.7	12.3	11.0	19.3	12.5	19.9	12.5	11.7
Federal	2.5	15.1	11.7	27.0	13.7	25.9	14.3	12.9
Defense	0.2	19.8	18.3	34.3	22.6	25.6	17.2	13.8
Other	9.9	1.2	-11.5	2.4	-18.8	24.7	4.6	9.2
State & local	8.9	9.8	10.4	11.7	11.4	13.6	10.7	10.4
GNP in constant (1958) dollars	5.9	5.4	1.9	4.0	4.5	-0.3	1.4	4.7
Final sales	5.2	5.1	-0.1	5.6	0.7	5.9	5.0	5.5
Private	5.9	4.5	-1.7	3.4	-1.7	3.3	3.8	4.6
GNP Implicit deflator	1.8	3.0	4.3	3.2	2.8	2.8	2.7	2.7
Personal income	7.9	8.5	6.3	8.2	9.0	7.6	4.8	7.8
Wage and salaries	7.4	9.5	7.8	9.6	8.4	6.7	6.0	8.6
Disposable income	7.4	7.7	3.9	6.3	8.3	7.8	4.9	7.1
Nonfarm payroll employment	4.2	5.1	4.9	3.3	4.0	3.7	1.2	1.8
Manufacturing	4.4	5.8	6.9	3.5	4.0	0.0	-4.1	0.0
Industrial production	8.4	9.0	7.9	6.2	3.0	-4.5	-5.1	5.2
Housing starts, private	-3.4	-18.9	-39.5	-81.3	-39.3	80.0	0.0	33.3
Sales new U.S.-made autos	15.0	-4.4	-62.8	33.6	-15.8	-39.5	16.4	21.1

<u>Industrial production</u>. In April, industrial production declined one-half point, or 0.3 per cent, to 155.9 per cent of the 1957-59 average from 156.4 in March. The decline in the total index was moderated by a further rise in output in the automotive industry amounting to one-half point in the total index. Cutbacks in output were widespread among other final products and materials.

Auto assemblies rose 10 per cent in April--to an annual rate of 7.6 million units (equal to sales)--but remained 16 per cent below a year earlier; in May and June, output is scheduled at about the April rate. Production of television sets dropped 20 per cent in April, to a level 30 per cent below last December's high, but despite the sharp cutback in production since December, manufacturers' total stocks of TV sets increased 40 per cent as color TV inventories rose three-fold, according to confidential trade reports. Output of furniture continued to decline in April while production of appliances apparently stabilized at a level about 15 per cent below last October's peak. Manufacturers' inventories of some appliances, however, have continued to rise in this period. Among consumer nondurable goods, output of apparel was below previous highs, but production of staples edged up further.

Output of equipment continued to decline, except aircraft and defense equipment which rose further. In April, production of business equipment was 3 per cent below the high reached at the end of 1966. Output of most nondurable and durable materials, including iron and steel, also declined.

The moderate decline in the total index and decreases in its components in the four months since December have been in some respects similar to developments in the early stages of the mild 1960-61 recession, whereas in the first four months of the 1953-54 and 1957-58 recessions declines were much more pronounced. In those earlier downturns, output in most industries was generally reduced simultaneously. In the recent period, however, production in some groups started to decline before the end of 1966 and in some industries--autos, appliances, lumber, and to a lesser extent steel--the readjustment in output appears to be about over.

INDUSTRIAL PRODUCTION[1/]
(Per cent changes)

	Dec. 1966 to Apr. 1967	May 1960 to Sept. 1960	Aug. 1957 to Dec. 1957	July 1953 to Nov. 1953
Total index	- 2.0	- 1.9	- 7.1	- 6.6
Consumer goods	- 2.0	- 1.6	- 2.8	- 4.6
Autos	-10.6	- 0.5	-17.5	-20.0
Appliances	- 3.7	- 8.4	- 5.6	-13.0
Apparel and staples	- 0.2	- 0.5	- 0.8	- 1.4
Business equipment	- 3.1	- 0.6	- 8.0	- 7.4
Defense equipment	+ 6.8	- 2.0	-11.2	- 8.5
Durable materials	- 3.1	- 5.9	-13.1	- 9.6
Steel	- 4.7	-21.0	-21.8	-15.0
Nondurable materials	- 1.3	- 1.0	- 4.1	- 5.0

1/ Changes for earlier periods are for the first four months of cyclical decline.

Retail sales. Retail sales in April were indicated to be about unchanged from the revised March total, according to the Census advance[1/] estimate, and were not much changed from the level reached last September. March sales, however, according to the preliminary[1/] estimate were revised sharply down from the level indicated previously and were only 1.2 per cent above February sales, which have also been lowered. The figures now indicate a rise in first quarter sales of only .5 per cent from those in the final quarter of last year, in contrast to a 1.7 per cent increase reported a month earlier. April sales at both nondurable goods stores and durable goods outlets, as well as total sales, were about 3 per cent above a year earlier.

Over the period since last September, total sales of durable goods stores have declined nearly 3 per cent (with auto dealers off about 7 per cent and other durables up 3 per cent) while nondurable goods sales have increased 1 per cent. These changes have been about offsetting and total retail sales have shown little change.

Auto markets. Domestic deliveries of new cars in the month of April were at a seasonally adjusted annual rate of 7.6 million units, 5 per cent above the rate in the preceding month, but 4 per cent below a year earlier. Trade papers reported that the April sales increase represented a market strengthening and that the industry views second quarter sales with considerable optimism.

1/ See Appendix A for explanation of these designations.

Daily average sales in the first 10 days of May rose more than seasonally to a rate 9 per cent above a month ago and 17 per cent above a year earlier. Taken literally, this implies that May has started off with a much higher annual rate of sales than in April, but the figures should not be taken as too suggestive of the entire month's results because they were so strongly influenced by special sales contests. Thus almost all of the increase was attributable to a very sharp increase in GM sales which were influenced by sales incentive programs in the Pontiac and Chevrolet Divisions. Ford daily average sales were virtually unchanged from the corresponding period in the preceding month, and were 10 per cent below last year. On the other hand, Chrysler daily average sales were down slightly from early April but 8 per cent above a year ago.

Output of new cars in April reached 657,000 units, or an annual rate of 7.6 million units, up 10 per cent from March, but 16 per cent below the rate a year ago. On a seasonally adjusted basis, the stock of new cars on April 30 was virtually unchanged from the end of March level. At the April daily average sales rate, the unadjusted inventory, at 1.43 million units, represented a 50 days' supply, down substantially from the record levels reached early in the year. Trade papers indicate the industry expects new cars stocks to remain at 50-55 days' supply through the end of June and then to decline sharply in July and August during the model change.

<u>Consumer credit</u>. In recent months, sluggishness in spending for autos and other durable goods has been translated into reduced demands for consumer credit. By February, the instalment credit expansion

had dropped to the lowest rate in 5 years. Consumers stepped up their borrowing a little in March and the expansion rate accelerated for the first time since last November, but it is still too early to tell whether this signals a turn-around in the instalment credit situation. Perhaps the most important development in March was that auto credit outstanding was once again increasing. In February, repayments on old auto debt actually were larger than new extensions, and as a result auto credit declined $40 million, the first decline since September 1961.

RECENT CHANGES IN CONSUMER INSTALMENT CREDIT
(Millions of dollars, seasonally adjusted)

Period	Monthly increases
1966--October	380
November	444
December	321
1967--January	280
February	216
March	264

Reports presently available for April are too sketchy to permit much more than a guess. However, with April new car sales up further, and fairly good sales increases reported by apparel and department stores, it is likely that the rate of consumer borrowing at least kept pace with March.

There are some signs of further easing in consumer lending standards, although the picture is mixed. The clearest evidence is provided by reports on auto contracts written by sales finance companies.

These show that the proportion of new-car contracts written for 36 months has begun to rise again, after flattening out and turning down a little in 1966. The ratio has now moved up for 5 successive months, from 80.1 per cent in October to 82.8 per cent in March, on a seasonally adjusted basis. There are also signs of some easing in downpayment requirements on new-car contracts. Interest charges on consumer loans continue to react sluggishly, as they typically do, to changes in the general level of market rates of interest. Right now, consumer rates appear to be holding firm. Meanwhile, there are reports that some banks are easing their policies on loans to new customers and to borrowers outside their immediate service area and are again actively promoting instalment loans.

Business inventories. The rate of inventory accumulation by manufacturing and trade concerns (combined) in March declined slightly further from the sharply reduced February rate. Preliminary March data show a book value increase of $165 million (an annual rate of $2 billion), as compared with $190 million in February (an annual rate of $2.3 billion). In both months, declines in trade inventories offset a substantial portion of the continuing--but reduced--accumulation by manufacturers. The first quarter book value increase now works out to an annual rate of $5.6 billion--down over two-thirds from the extraordinary $18.8 billion rate in the fourth quarter.

Inventory liquidation continued in the trade sector in March, with the decline again mainly accounted for by a large decrease in auto dealer stocks, and for the entire quarter, trade inventories declined at an annual rate of $1.7 billion. In the fourth quarter, trade stocks had increased at a rate of almost $7 billion.

Inventory accumulation by manufacturers dropped sharply in February and March and for the first quarter was at an annual rate of $7.2 billion versus $12 billion in the fourth.

Last year's high and rising rate of inventory accumulation--culminating in the record fourth quarter burst--generally far outpaced the rise in sales, particularly in the durable goods sector, and stock-sales ratios, which had been tending downward in 1964 and 1965, rose substantially over the year, as shown in the table below.

CHANGES IN INVENTORY POSITIONS

	Per cent change in sales		Per cent change in inventories (book value)		Stock-sales ratios		
	Dec. 1965 to Dec. 1966	Dec. 1966 to Mar. 1967	Dec. 1965 to Dec. 1966	Dec. 1966 to Mar. 1967	Dec. 1965	Dec. 1966	Mar. 1967
Manufacturing trade, total	5.3	- .6	12.1	1.0	1.45	1.54	1.57
Durable goods, total	4.4	-2.0	15.6	.9	1.80	2.00	2.06
Manufacturing	6.3	-2.8	18.2	2.2	1.94	2.11	2.22
Defense products	15.0	7.0	36.7	7.6	2.53	3.00	3.02
Machinery and equipment	9.6	0.8	17.7	1.6	2.56	2.74	2.77
Consumer durables	- .7	-6.5	17.0	1.1	1.15	1.35	1.46
Other durables	6.7	-5.1	12.6	0.8	1.89	2.00	2.12
Trade	1.8	-2.4	11.2	-1.6	1.67	1.82	1.82
Auto dealers	-4.2	-2.8	11.9	-7.3	1.46	1.71	1.63
Other durables	4.6	- .5	10.8	0.7	1.77	1.88	1.90
Nondurable goods, total	6.0	0.7	7.7	1.3	1.15	1.17	1.18
Manufacturing	7.3	- .3	8.4	2.5	1.27	1.28	1.31
Trade	4.9	1.5	7.0	0.2	1.07	1.09	1.07

While the rate of business inventory accumulation slowed drastically in the first quarter of 1967, sales also slackened and the over-all stock-sales ratio rose further between December and March, reflecting primarily developments in durable goods manufacturing industries.

At trade concerns dealing in durable goods, which had contributed significantly to the sharp run-up in the total business stock-sales ratio in 1966, the ratio stabilized during the first quarter. At auto dealers sharp output curtailments brought stocks down considerably more than sales. For other durable goods, the stock-sales ratio showed only a small further rise, although it appeared clearly excessive in March and a substantial adjustment in their inventory position was in order, either through a sales pickup or further output curtailments, or both. A pickup in auto sales in April and early May further improved dealers' inventory position in that area.

In durable goods manufacturing, stocks of defense products, which had shown by far the largest rise and had accounted for 30 per cent of the total inventory increase in 1966, took another sharp spurt between December and March and accounted for 60 per cent of the total increase over that period. The December to March rise was about in line with the increase in sales and the stock-sales ratio showed only a slight further rise. In machinery and equipment industries, the stock-sales ratio also showed little further increase, but as a result of a marked slowing of the rate of stock build-up to the accompaniment of little further increase in sales. For other durable goods, inventory positions continued to deteriorate despite a pronounced slowdown in inventory accumulation, as sales dropped sharply.

<u>Construction activity</u>. New construction activity in April apparently continued to fluctuate near the moderately improved February rate, at a level 7 per cent below the high in the first quarter of 1966. While a month-to-month increase of 1 per cent is indicated by confidential projections now available to us for April, this was associated with a 1 per cent downward revision for March.

Residential construction expenditures, which, as expected, were revised upward for March, continued to expand in April for the fourth consecutive month. Private nonresidential construction activity, however, has apparently dwindled in recent months, particularly in the case of commercial construction, which along with industrial activity, had shown unexpected strength last winter. Public construction expenditures, as projected, have tended higher.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FR)

	April 1967 ($ billions) 1/	Per cent change from March 1967	Per cent change from April 1966
Total	73.4	+1	- 7
Private	48.5	+1	-11
Residential	22.2	+2	-19
Nonresidential	26.3	--	- 2
Public	24.9	+1	+ 3

1/ Seasonally adjusted annual rates; preliminary. Data for April and the most recent month hereafter are being made available under a new confidential arrangement with the Census Bureau. Under no circumstances should any public reference be made to them.

Seasonally adjusted private housing starts in April edged slightly above the revised (1 per cent downward) rate for March. While the March rate was moderately below the average for the first quarter as a whole, it exceeded earlier projections and suggested that builders have already moved into position to meet the difficult test of at least a normal spring seasonal rise.

Moreover, seasonally adjusted building permits also expanded further in April and much more sharply than starts. All regions and all types of residential structures shared in the advance, which tended to be most pronounced for multifamily units and in the Northeast which had declined in March.

PRIVATE HOUSING STARTS AND PERMITS

	April 1967 (Thousands of units) 1/	Per cent change from	
		March 1967	April 1966
Starts	1,171	+ 1	-22
Permits	1,003	+ 8	-15
1-family	589	+ 6	-11
2- or more-family	414	+12	-21
Northeast	189	+21	-25
North Central	266	+ 5	-12
South	345	+ 4	-13
West	203	+10	-13

1/ Seasonally adjusted annual rates; preliminary.

Whether the unusually heavy pressures from other capital market sectors will seriously inhibit recently reviving commitment activity for residential construction still remains to be determined.

Even if commitments are inhibited, sufficient momentum already has now been generated by builders to maintain the course of starts and related expenditures through the third quarter, within the range of our earlier moderately optimistic projections. Moreover, transactions in existing homes, which were also a casualty of last year's developments and which are an important factor in new home demands, have picked up considerably in recent months. Also, with completions still extremely low, vacancy rates on rental properties have moved down further and rates for home-owner units remained below earlier peaks.

In the first quarter as a whole, rental vacancy rates were the lowest since early 1959. Among regions, a build-up of potential demand based on this factor alone, seems clearest in the North Central states and the South, as shown in the table. In both regions, the rate in early 1967 was the lowest since early 1958. In the West, the average was still relatively high, reflecting, in part, lingering elements of overbuilding from earlier years in some localities; and in the Northeast states, where rates tend to be lowest, there was little change.

RENTAL VACANCY RATES
(Per cent)

	Average for first quarter of:				
	1967	1966	1965	1964	1961
All regions	6.6	7.5	7.7	7.3	8.0
Northeast	5.0	4.9	5.5	4.6	4.6
North Central	5.3	6.4	7.2	8.3	8.5
South	6.9	8.7	8.2	8.2	8.9
West	10.0	10.7	10.6	8.7	11.0

Labor market. The latest labor market figures reflect some further easing in demands for manpower. Unemployment insurance claims continued into May at levels considerably above last year, suggesting further layoffs in the industrial sectors. Manufacturing employment in April was down for the third successive month, and both transportation and construction suffered employment cuts. But the labor market on the whole remained relatively strong, with the unemployment rate in April edging up only one tenth to 3.7 per cent.

CHANGES IN NONAGRICULTURAL EMPLOYMENT
(In thousands, seasonally adjusted)

	March to April	January to April
Nonagricultural employment	98	230
Industrial employment	-188	-297
Manufacturing	-117	-234
Construction	- 41	- 22
Other industries 1/	- 30	- 41
Nonindustrial employment	286	527
Government	64	194
Finance and services	34	171
Trade	188	162

1/ Mining, transportation and public utilities.

Nonfarm payroll employment rose 98,000 over the month, but the increases occurred entirely in trade, government and private services--sectors with strong growth trends. Manufacturing employment was cut 117,000 in April, and after three months of decline, was down 234,000 from its January peak. This was the sharpest dip in manufacturing employment since the 1961 recession, although the April figure may have been affected somewhat by the teamsters strike. In contrast to the previous month, the cutbacks in April were concentrated almost entirely in durable goods industries; employment reductions of 20,000 or more occurred in primary metals, electrical and transportation equipment.

Although average weekly hours of all factory production workers were up by one tenth to 40.5 hours in April, there were widespread further reductions in the workweek of durable goods industries. Primary and fabricated metals, machinery, and electrical equipment industries all had their workweeks cut by at least four tenths of an hour in April, and all were down an hour or more from January. The only significant increase in hours among durable goods industries was in transportation equipment, reflecting the moderate rebound in auto production. In contrast to the further shortening of the workweek in durable goods industries, hours in nondurable goods industries increased two tenths of an hour, with the largest gains in apparel and tobacco.

Employment gains totaling 286,000 in trade, finance, services and government more than offset declines in the industrial sectors. Expansion in these non-industrial activities reflects a general tendency for them to grow both in periods of expansion and contraction. They have increased steadily as a proportion of total employment in recent decades, and now provide so much built-in employment growth that total nonfarm employment is unlikely to decline very much short of a major economic contraction.

The large employment increase in trade (188,000) following a decline in March, probably reflected little more than the difficulty of making an accurate seasonal adjustment at this time of year because of the shifting date of Easter. The net rise from January to April is more in line with the longer term trend of growth of the industry.

Unemployment. Stability of the total unemployment rate at current low levels in the face of three months of continued layoffs in manufacturing and slower growth in other industrial sectors has been an impressive aspect of the labor market scene. The unemployment rate in April was 3.7 per cent, virtually unchanged from the level of the past four months, and about the same as a year earlier. As suggested above, part of the reason for stability is the continued strong growth of employment in government and the private services; in the past three months, these industries increased their employment by over half a million, apparently absorbing some of the laid-off industrial workers.

Another reason for the stability of overall unemployment, however, is the fact that along with the decline in overall employment there has been a compensating decline in the labor force. With an easing of employment demand, some workers left the labor force--mainly adult women--while others put off their entrance, which has reduced the pressure on unemployment temporarily. The normal growth in the labor force from December to March would call for a rise of about 350,000; actually, the labor force contracted during those months.

However, unemployment insurance claims, which are particularly sensitive to industrial layoffs, have been rising relative to last year.

The seasonally adjusted rate of State insured unemployment rose from 2.5 to 2.7 per cent over the month, and in April was half a point above a year earlier. Weekly unemployment insurance claims continued well above last year's levels; in the week ending May 6th, claims were running 340,000, or 35 per cent, higher than the same week last year.

It is unlikely that the total unemployment rate could continue for long its recent remarkable stability if industrial employment declines persist. With modest additional growth of real output likely in the second quarter, some increase in unemployment may be anticipated. But if a more rapid expansion of output is generated in the third quarter the increase in the unemployment rate should be relatively small.

Hours and earnings in nonagricultural industries. A new statistical series was released in April by the Bureau of Labor Statistics which makes available monthly estimates of average weekly hours and average hourly and weekly earnings for the private nonagricultural economy. These new estimates, covering some 44 million production or nonsupervisory workers--about two-thirds of all nonfarm employees--provide a much more comprehensive measure of changes in hours and earnings than has heretofore been available. The data are currently available only back to 1964, and are not seasonally adjusted.

Weekly earnings have increased more in the nonmanufacturing sector than in manufacturing in the past year. The workweek in private nonagricultural establishments was down by six tenths over the year, while in comparison, the workweek of production workers in the more cyclically-sensitive manufacturing sector, at 40.2 hours (not seasonally adjusted), was down by an hour; in addition, hourly earnings have been rising faster in most nonmanufacturing industries.

HOURS AND EARNINGS IN PRIVATE NONFARM INDUSTRIES

	Average weekly hours		Average hourly earnings		Average weekly earnings	
	April 1967	Per cent change from a year ago	April 1967	Per cent change from a year ago	April 1967	Per cent change from a year ago
Private non-farm	37.9	-1.6	$2.63	4.0	$ 99.68	2.3
Manufacturing	40.2	-2.4	2.80	3.7	112.56	1.2
Construction	37.0	0.3	3.98	4.5	147.26	4.7
Trade	36.3	-1.6	2.23	5.2	80.95	3.5
Finance, insurance and real estate	37.1	-0.5	2.58	4.0	95.72	3.5

Note: Data exclude hours and earnings of salaried workers.

But despite their more rapid rise, average weekly earnings of production workers in the private nonagricultural sector as a whole have also lagged increases in consumer prices over the past year. As a result, their real weekly earnings have declined slightly between the first quarters of 1966 and 1967.

Agricultural developments. Farmland prices advanced 2 per cent further from November to March when they were 7 per cent above a year earlier, according to preliminary USDA data. This year-to-year rise compares with an increase of 8 per cent in the preceding year. Advances during the past year ranged from 9 per cent in the Corn Belt to less than 5 per cent in Mountain States and the West Coast.

FARM REAL ESTATE VALUES BY FARM PRODUCTION REGIONS 1/

	March 1, 1967 Index (1957-59)	Percentage change		
		Nov. 1, 1966 to March 1, 1967	March 1, 1966 to March 1, 1967	March 1, 1965 to March 1, 1966
U. S. Total	160*	1.9*	6.7*	7.9
Northeast	157	1.4	6.9	6.5
Lake states	140	2.9	8.4	5.7
Corn Belt	152	4.6	9.1	11.2
Northern Plains	155	2.5	7.4	7.5
Appalachian	162	1.9	6.6	6.3
Southeast	191*	1.9*	7.7*	6.0
Delta states	192	2.5	7.1	14.7
Southern Plains	174	2.0	5.1	5.1
Mountain	153	0	4.7	7.4
Pacific	162*	-2.0*	1.1*	6.7

1/ March 1 figures are preliminary and are to be kept confidential until released by the Department of Agriculture.
* Data for the Southeast and Pacific regions are incomplete.

The somewhat slower rate of increase in the national average in the latest 4-month period was largely confined to the regions along the Atlantic Seaboard and the West Coast. Values rose at a quickened pace in the Corn Belt and the Southern Plains. In the other central regions, values advanced at a fairly even pace throughout the year.

USDA analysts suggest that whatever dampening effect higher interest rates and reduced availability of credit may have had on land prices in the past year was offset at least in part, by increased incomes received in calendar 1966, and expanded plantings planned for 1967 crops.

Net realized farm income in the year 1966 was 15 per cent above a year earlier and nearly one-third higher than the 1960-64 average. On a per farm basis the increase was even more impressive with average net realized income of $5,024 up 19 per cent from a year earlier. However, farm income was declining after the first quarter of 1966.

Increases in incomes from a year earlier were centered in livestock regions which benefited from a 12 per cent average rise in prices received for livestock and products in 1966. The smallest increases were in regions largely dependent on crops. Increases of a fifth or more in realized net income per farm were reported in the central and western regions in 1966. The eastern third of the nation fared less well. The Appalachian and Southeast regions had increases of 7 per cent and 4 per cent, respectively, reflecting their dependence on cash sales of tobacco, peanuts, potatoes, sugarcane, which brought about the same cash receipts as the year before. Cotton receipts were down 45 per cent from 1965 but compensating government payments were made.

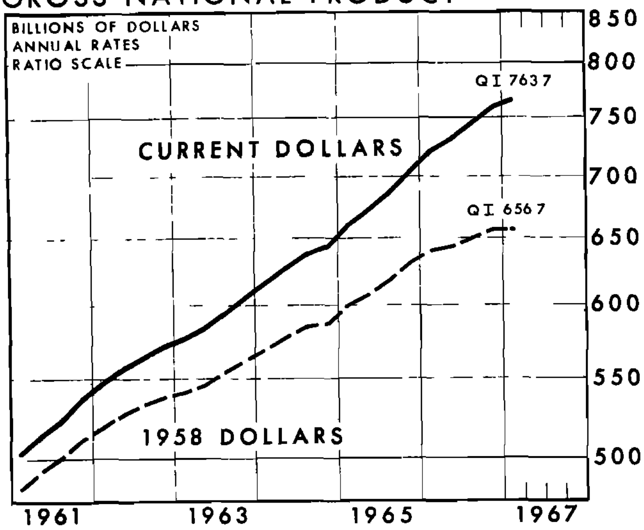
Voluntary transfers of farmland are off slightly in most regions except the Corn Belt and Lake states, preliminary data show. Both Federal land bank and insurance company representatives attenting the May 1 meeting of the National Agricultural Credit Committee in Chicago reported relatively low demand for farm real estate loans. This undoubtedly reflects resistance to high land values but it may reflect resistance to high interest rates as well. The rate is now 6 per cent at Federal land banks and according to a weighted fourth quarter 1966 average, 6.6 per cent at insurance companies. The Federal land banks, the only lender to publish such data, report that new money advanced in the first quarter this year is 17 per cent less than a year earlier. Perhaps many prospective borrowers have been discouraged by the very tight lending policies last year.

Non-real estate loans are larger than a year ago but the rate of expansion may be tapering off. At the end of December 1966 member banks had 10 per cent more credit outstanding to farmers than a year earlier, the same rate of expansion as in the preceding year, and operating loans of the Farmers Home Administration were unchanged from a year earlier. Production Credit Association loans outstanding in March were up 17 per cent from a year earlier, a margin unchanged since November. First quarter cash advances of the PCA's were 7 per cent above a year earlier.

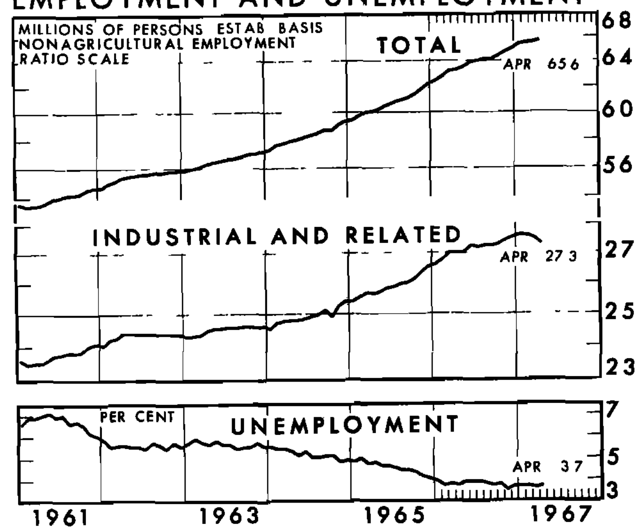
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

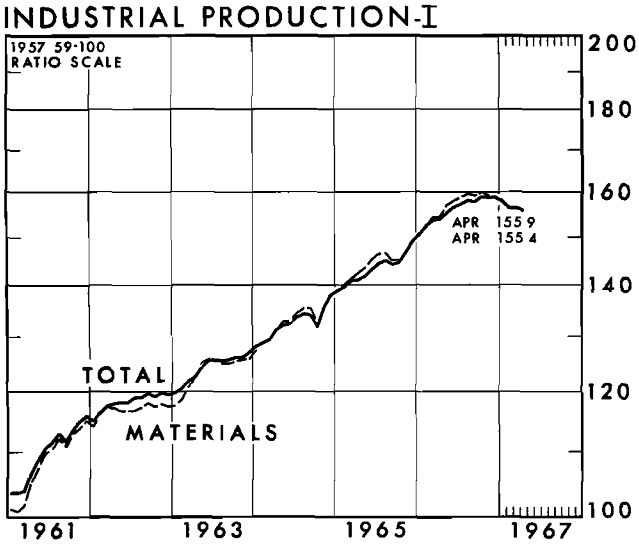
GROSS NATIONAL PRODUCT



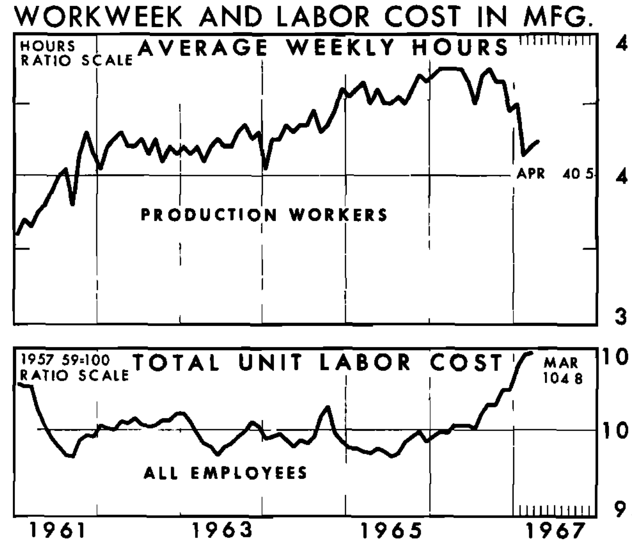
EMPLOYMENT AND UNEMPLOYMENT



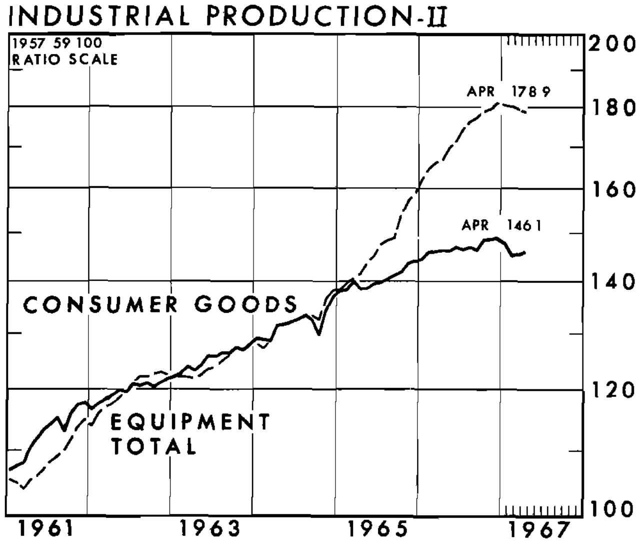
INDUSTRIAL PRODUCTION-I



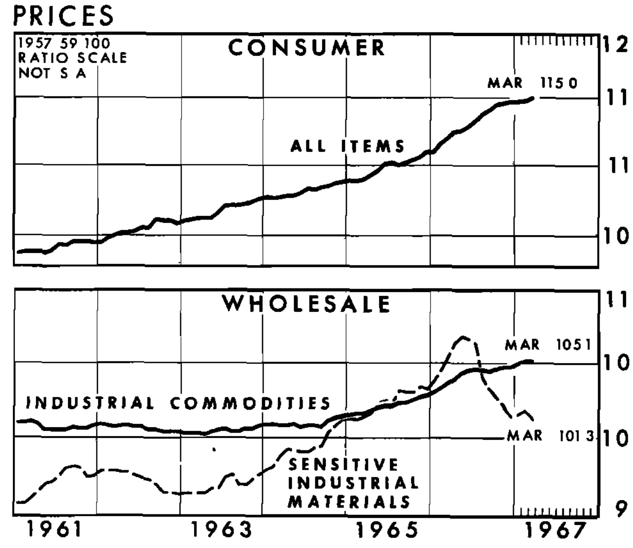
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



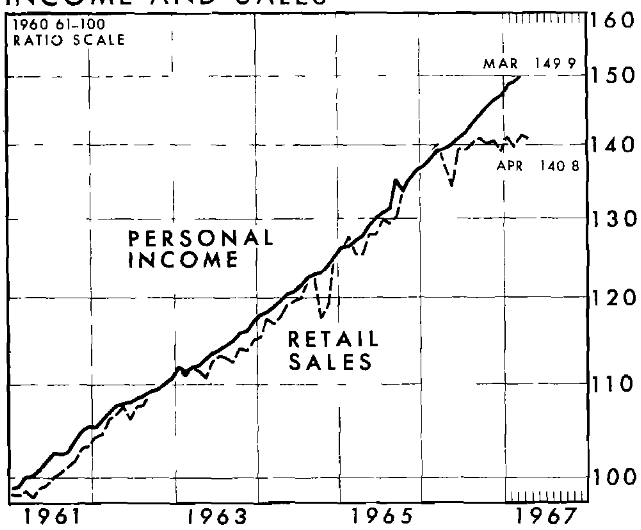
PRICES



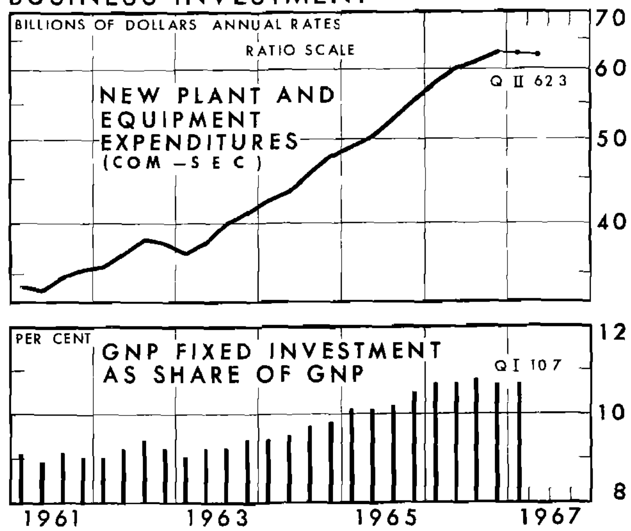
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

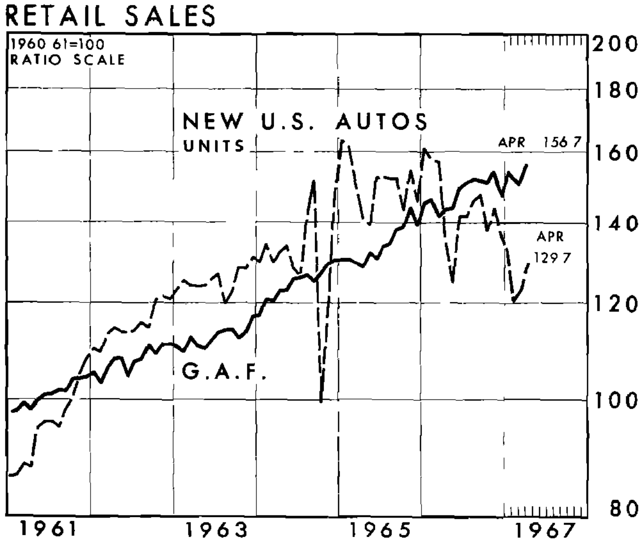
INCOME AND SALES



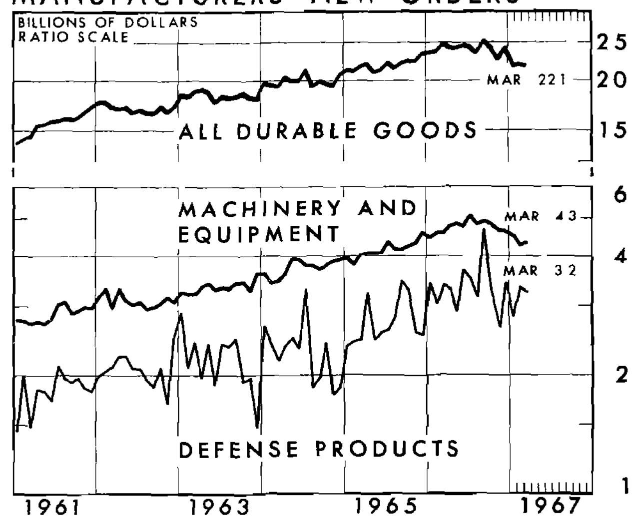
BUSINESS INVESTMENT



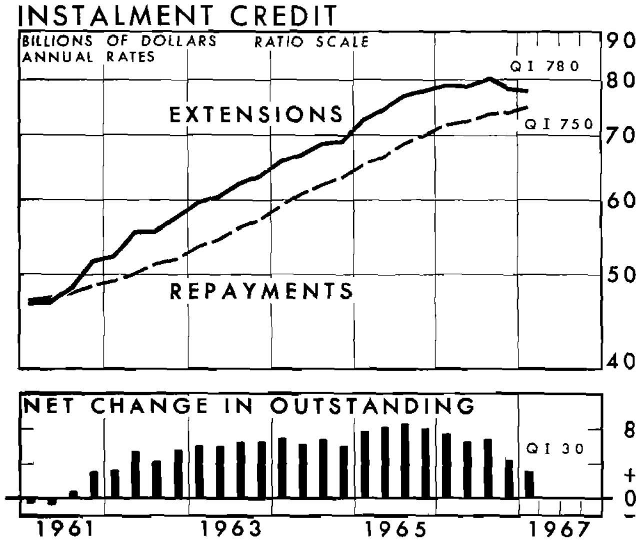
RETAIL SALES



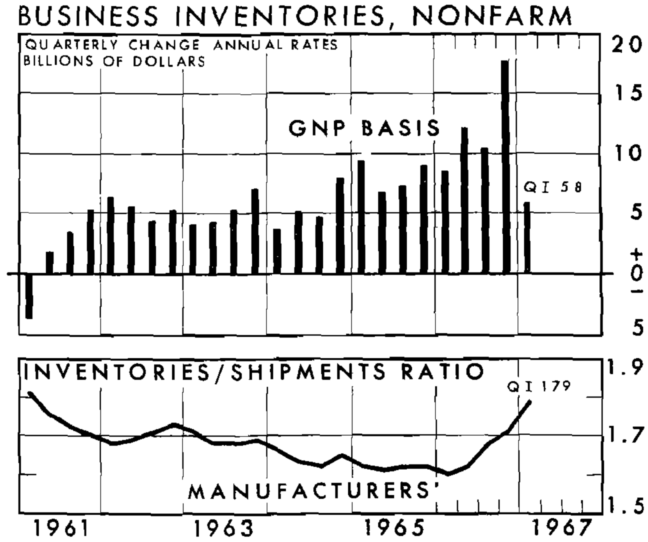
MANUFACTURERS' NEW ORDERS



INSTALMENT CREDIT



BUSINESS INVENTORIES, NONFARM



DOMESTIC FINANCIAL SITUATION

First Quarter Flow of Funds. Preliminary estimates of the flow of funds for the first quarter indicate a sharp increase in the rate of credit expansion. Total borrowing, at a $70 billion seasonally adjusted annual rate, was $16 billion above the fourth quarter of 1966. The bulk of this increase was in Federal borrowing, business security issues, and state and local borrowing. Mortgage flows were up slightly and consumer credit flows were little changed.

Commercial banks supplied directly about half of the total credit flow, a high proportion by any historical standard and a sharp change from late 1966 when they supplied less than a fifth. Banks were a major source of funds to the Government and municipal securities markets during the first quarter, with net purchases larger than the total of net issues in the two markets combined. The large supply of corporate bonds was absorbed partly by nonbank financial institutions, but funds were also attracted into the market from nonfinancial investors.

Table I

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

	1965	1966	1966 I	1966 IV	1967 I
Total borrowing	72.1	71.1	84.1	53.7	70.1
U. S. Government	3.5	6.7	14.9	2.2	10.6
Foreign	2.6	1.4	2.3	.9	-.8
Private domestic nonfinancial sectors	66.0	62.9	66.9	50.5	60.4
State and local obligations	7.4	5.9	5.4	6.2	9.8
Corporate securities	5.4	11.4	11.9	6.9	14.5
Mortgages	25.5	21.0	26.2	15.5	16.8
Bank loans n.e.c.	13.6	10.8	9.0	8.8	6.3
Other	14.1	13.8	15.4	13.2	12.9

Federal finance. The major influence on the fiscal and financial position of the Federal Government was the widening NIA deficit which is estimated at about $10 billion during the quarter, $6 billion deeper than the fourth quarter. The Home Loan Bank System provided a substantial offset to this deficit with funds received from savings and loan associations both as deposits and as loan repayments. The burden of financing the deficit nevertheless was primarily on the credit markets, where government borrowing rose to a $10.6 billion rate, about three quarters of it in direct U. S. securities. Sales of loan participation certificates were at a $6.3 billion rate, about as high as the second quarter of 1966 and mainly in FNMA and Export-Import Bank issues. This was offset in part by the retirement of Home Loan Bank debt at a $4.8 billion annual rate during the quarter.

Business borrowing in credit markets. The first-quarter rise in private borrowing was concentrated in security markets and contrasted with the leveling of plant and equipment outlays and the decrease in inventory investment. In part, the security issues were a funding of capital outlays of late 1966 that had been paid for to a large extent out of cash assets and other sources. In the fourth quarter of 1966, over $20 billion (annual rate) of business investment had been covered by sources other than borrowing and capital consumption (Table II, line 4), and to some extent there was a need to restore liquid assets after the drains of that period. Corporate holdings of liquid assets appear to have risen sharply during the first quarter, at a $10 billion annual rate.

Table II

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

		1965	1966	1966 I	1966 IV	1967 I
(1)	Total capital outlays	75.7	86.3	82.4	91.4	83.2
	Sources of finance:					
(2)	Capital consumption	45.2	47.9	46.8	49.1	49.7
(3)	Credit market borrowing	26.3	29.4	32.3	21.4	30.3
(4)	Other sources	4.2	9.0	3.3	20.4	3.2
(5)	Net investment ((1) - (2))	30.5	38.4	35.6	42.3	33.4
	Borrowing as a percentage of net investment	86.3	76.6	90.7	50.6	90.7

The borrowing may also have been partly in anticipation of second-quarter tax payments, however. The corporate profit tax payment schedule was accelerated another notch in April this year, with payments that at annual rates will be $20 billion higher than accruals of taxes during the quarter. This compares with a $7 billion rate of excess payment over accruals in the second quarter of last yaar. The tax payment schedule is a predominant influence on first-half corporate finance this year, and uncertainties are mainly about the extent to which payments will come from borrowing as against liquid assets.

Sources of credit supply. The pattern of credit supply continued the trend toward easing that had begun in the fourth quarter. Inflows both to savings institutions and to commercial-bank time deposits rose to the extraordinary annual rate of $50 billion, $15 billion above any previous quarter and $35 billion above the fourth quarter. About $7 billion of the increase from the fourth quarter was to savings institutions, but much of this flow was channeled to Federal Home Loan Banks, and lending by these institutions in credit markets was only $2.5 billion higher than the fourth quarter.

Table III

DIRECT LENDING IN CREDIT MARKETS
(Billions of dollars, seasonally adjusted annual rates)

	1966	1966 I	1966 IV	1967 I	Change IV to I
Total funds raised	71.1	84.1	53.7	70.1	+16.4
Federal Reserve System	3.5	2.1	3.7	4.5	+ .8
Commercial banks a/	18.2	18.2	9.5	34.2	+24.7
Nonbank finance a/	21.7	26.6	22.4	25.8	+ 3.4
U. S. Government	7.5	11.3	1.9	.9	- 1.0
Foreign	-1.4	-1.6	-2.7	.5	+ 3.2
Private domestic nonfinancial	21.7	27.7	19.0	4.3	-14.7
Households	11.1	12.2	6.5	-3.9	-10.7
Business	3.3	6.1	2.4	.7	- 1.5
State and local govts.	7.0	8.0	7.7	6.0	- 1.7
Less security credit	- .3	-1.3	-2.3	-1.3	+ 1.0

a/ Net of credit market borrowing.

The rise in time-deposit flows to banks was reflected in loans and investments, however, and brought bank credit up to 50 per cent of total borrowing during the quarter, as against 18 per cent in the fourth quarter and an average of 36 per cent for the years 1961-65. The rise in bank lending was predominantly in direct Treasury issues, loan participation certificates, and municipals and was a major factor in each of these markets. Thus, while State and local government borrowing rose to exceptionally high levels during the quarter, bank buying of municipals was up over twice as much (relative to the fourth quarter) and left only minor amounts of the net new supply of municipals to be distributed among other investors. The impact was still greater in Treasuries, where banks bought over twice as much as the net total issued to the public (after seasonal adjustment) and left nonbank investors as net sellers of $14 billion of these securities at annual rates.

In the corporate bond market, the high rate of offerings was facilitated to some extent by demand from mutual savings banks and insurance companies. The mutuals, with a $2 billion increase over the fourth quarter in rate of deposit inflow, invested the entire increment in bonds and maintained their mortgage flows at the rate of the last half of 1966. Insurance companies had a smaller drain from policy loans than in 1966 and an offsetting rise in flows into corporate bonds, much of it in the form of takedowns on commitments. Even with the institutional demand, new issues were high enough to require investment by the household sector at over a $2 billion annual rate, and the market was under pressure during the quarter.

SOURCES OF CREDIT TO TOTAL BORROWING
(Billions of dollars at seasonally adjusted annual rates)

	1966	1966 I	1966 IV	1967 I
Total borrowing	71.1	84.1	53.5	70.1
Sources of credit:				
Private domestic	44.2	55.3	40.5	60.6
nonfinancial sectors	2.9	2.8	7.5	7.6
Demand deposits and currency	12.3	15.1	4.6	32.4
Time and savings deposits at banks	7.3	9.7	9.4	16.4
Savings accounts at savings institutions	8.1	13.0	7.5	-14.0
U.S. Gov. securities	13.6	14.6	11.5	18.3
Other securities				
Federal loan programs	7.5	11.3	1.9	.9
Federal cash balances	- 0.5	- 5.1	- 4.0	- 2.4
Other sources	19.9	22.6	15.1	11.0

The rise from the fourth quarter in household buying of corporates was almost equal to the decline in their flow into municipals. Within the household totals, this shift was less important than the $11 billion drop in buying of Governments and the rise in savings-deposit flows from a $17 billion rate in the fourth quarter to a $33 billion rate. Corporations also sold Governments and invested in time deposits, but in addition they appear to have bought large amounts of commercial paper. Net issues of commercial paper continued in the first quarter at the very high rate of the fourth quarter after seasonal adjustment, although the first-quarter borrowing was mainly by nonfinancial corporations rather than finance companies. For both groups, however, it was an important substitute for bank credit, and the funds were evidently supplied largely by other corporations investing for liquidity purposes.

<u>Bank deposits</u>. Since late April, total deposits of member banks have shown almost no expansion, and current projections suggest that a modest reduction in deposits is expected over the remaining weeks of May. As indicated in the table showing average weekly changes in the components of member bank deposits, the recent slower growth is the result of a sharp contraction in Treasury balances, not completely offset by a more rapid rate of growth of private deposits.

AVERAGE WEEKLY CHANGE IN MEMBER BANK DEPOSITS, 1967
(Seasonally adjusted daily averages in millions of dollars)

	April 26 to May 10 (3 weeks)	February 15 to April 26 (9 weeks)
Total deposits	+ 16	+697
Private demand	+531	+ 45
U. S. Gov't demand	-937	+274
Time and savings	+422	+378

The rather sharp decline in Treasury balances since late April reflects factors influencing both receipts and payments. Scheduled tax receipts in May will be considerably smaller than April and payments from Treasury balances were expanded by the increased pace of Government expenditures. Payments were also increased by the large official purchases of intermediate-term Treasury issues, designed to reduce dealer inventories during the recent refunding. As a result, Government balances are expected to decline, on a seasonally adjusted monthly average basis, by $2 billion this month following their sharp rise in April.

Time and savings deposit inflows at weekly reporting banks have been well maintained since the tax date. However, as indicated in the table below, essentially all of the expansion at weekly reporting banks has occurred in deposits other than negotiable CD's. From mid-December of 1966 to mid-February of 1967 outstanding CD's had risen rapidly as banks took advantage of declining market yields to replace their previous deposit losses. After mid-February, CD inflows slowed to a pace below that in 1966, and over the April tax period sizable CD run-offs occurred. Since then, banks in New York and elsewhere have not replaced all of their April run-offs.

TIME AND SAVINGS DEPOSIT INFLOWS, WEEKLY REPORTING BANKS
(Millions of dollars, not seasonally adjusted)

	Late April to Early May 1/		April tax period 2/		Mid-February to early April 3/	
	1967	1966	1967	1966	1967	1966
Total Time and savings	+435	+378	- 79	+307	+2,569	+1,994
Negotiable CD's	+ 8	+ 27	-591	+141	+ 719	878
Other time 4/	+311	+582	+757	+985	+1,266	+1,826
Savings	+116	-231	-245	-819	+ 584	- 710
MEMO: Other time 4/ plus savings	+427	+351	+512	+166	+1,850	+1,116

1/ Two weeks ending May 3, 1967, and May 4, 1966.
2/ Two weeks ending April 19, 1967, and April 20, 1966.
3/ Seven weeks ending April 5, 1967, and April 6, 1166.
4/ Other than large negotiable CD's.

Since mid-Feburary, offering rates on negotiable CD's have not been high enough to attract sizable inflows. Banks tended to pull back from the CD market in part because large deposit inflows were available from other sources--especially consumer interest-bearing deposits. Indeed, the enlarged inflow of consumer deposits has led some banks to take actions to moderate their inflows.

Since late April, there have been some indications that a few banks may be attempting to attract more large CD funds. While other short-term rates have declined, offering rates on CD's have edged up 12 to 25 basis points since the tax date. In addition, there have been reports that a few banks--expecting heavier loan demands later this year--are now seeking longer-term CD's by offering over one year certificates at rates above posted levels, apparently as high as 4-3/4 to 4-7/8 per cent. It is too early to determine the success of these banks in attracting longer-term money, or whether this tendency will spread.

While the increase in posted rates on CD's and the decline in yields on other short-term investment has somewhat reduced the yield advantage of competing money market paper, yields on CD's is still historically low relative to finance company and commercial paper. Offering rates are also still 20 to 25 basis points below secondary market yields on CD's. CD yields appear favorable only relative to Treasury bills, whose yields have been under particular downward pressure due in large part to official purchases and tax bill run-offs.

Bank credit. One reason why banks may lose interest in replacing recent CD attrition quickly is that tax-related and other credit demands in coming weeks are not expected to be particularly large. The fluctuating and higher level of total corporate tax payments this year has been an important factor determining both the pattern and relatively high level of loan demands at banks. But in both May and in June, tax payments are expected to be smaller than in the same months of 1966, and this month the level of payments is relatively modest. These payment schedules suggest the prospect of--perhaps substantial--easing of business loan demand. This view tends to be reinforced by the continued high level of market financing by businesses, their apparent build-up of liquid assets since late last year, and the sharply reduced rate of inventory investment.

Since the tax date, business loan expansion has been small at weekly reporting banks outside of New York, and at New York City banks--for which we have one more week of data--such loans declined contraseasonally. With security financing remaining large and tax payments lower, some of the May loan repayments in New York apparently reflected the use of capital market proceeds. We have been advised that most of the $100 million decline in loans to the machinery industry at New York City banks during the second week of May represented repayment of bank debt by a single large firm out of the proceeds of its recent large capital market issue.

While business loan expansion has been generally dominated by the pattern of tax payments so far this year, three industrial categories of loans have remained strong. Loans to machinery and "other fabricated metals" manufacturers--industries which are heavily affected by defense outlays--have risen more than seasonally, and loans to the chemical industry have also increased sharply. On balance, so far this year, most other industrial classifications have shown seasonal or less than seasonal changes. Declines in retail trade borrowing since year-end apparently has been dominated by the reduction of automobile dealer inventories.

Most other loan categories have continued to show relative weakness. Growth in real estate and consumer loans has apparently remained modest since mid-April, and loans to finance companies--which had increased in April for the first time since last fall--declined somewhat after the tax date as finance companies shifted back to cheaper financing in the commercial paper market.

Weekly reporting bank holdings of Treasury issues--mainly bills--continued to decline after the tax date, as they had in early April, due perhaps to some continued liquidation of securities underwritten in March as Treasury deposits declined, but probably more the result of the sharp decline in bill yields that have reduced their relative attractiveness. New York City banks also liquidated sizable amounts of State and local tax warrants, but these declines reflect the seasonal tax inflows of political subdivisions. Weekly reporting banks outside of New York City continued to be relatively large buyers of municipals--mainly short-term issues.

U.S. Government securities market. In the first half of May yields on Treasury notes and bonds rose further while Treasury bill rates continued to decline. Thus, the spread between short- and long-term yields continued to widen, with bill rates moving to new 1967 lows and Treasury bond yields reaching new 1967 highs.

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

Date (Closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1965						
Dec. 3	4.12	4.26	4.54	4.52	4.52	4.44
1966						
Aug. 29	5.04	5.51	6.22	5.89	5.51	5.12
Sept.21	5.59	5.96	5.90	5.53	5.21	4.97
Nov. 25	5.27	5.47	5.56	5.39	5.23	4.91
Dec. 30	4.81	4.92	4.94	4.80	4.64	4.58
1967						
Jan. 16	4.72	4.69	4.63	4.60	4.49	4.44
Apr. 4	4.00	4.03	4.31	4.42	4.49	4.55
May 2	3.74	3.87	4.51	4.68	4.75	4.81
16	3.63	3.82	4.63	4.75	4.86	4.93

The further weakness in longer-term Treasury bonds since early May has reflected continued concern over the size of new issue flotations in capital markets, increasing investor awareness of the prospects for large Treasury financing needs in the second half of 1967, and widespread expectations of more vigorous economic expansion later this year. Most recently, Treasury proposals before the House Ways and Means Committee to modify the 4 1/4 per cent interest rate ceiling and permit some borrowing through longer-term issues at higher yields served to half a minor rally which developed late last week.

Issues in the 5-year maturity area performed somewhat better than longer-term bonds in the first half of May, reflecting in part sizable Treasury trust fund purchases in the 1971-74 maturity range. These purchases helped to absorb loosely-held blocks of securities that had been weighing on the market during the period of the Treasury refunding.

Preliminary results of the refunding indicate public subscriptions of \$2.0 billion for the new 15-month note and \$2.7 billion for the new 5-year note. Attrition from holders of securities maturing in May and June was somehwat larger than anticipated and totaled \$0.8 billion or around 18.5 per cent, but private holders of \$1.3 billion of issues maturing in August exercised their option to exchange into the new 5-year note, a better turn-in than had been generally expected.

Treasury bill rates continued to decline in the first half of May, as bills remained in generally strong demand from a wide range of investors, including the Federal Home Loan Banks. Some funds from sellers of rights in the May refunding and from holders of maturing securities redeemed at mid-month may also have been re-invested in Treasury bills.

Short-term rates on market instruments other than bills showed mixed changes in the first part of May, after declining earlier. While rates on commercial and finance company paper and on bankers' acceptances fell, rates on CD's edged up, especially on the longest maturities.

SELECTED SHORT-TERM INTEREST RATES

	1967		
	Mar. 31	April 28	May 12
Commercial paper 4-6 months	5.00	4.75	4.63
Finance company paper 30-89 days	4.88	4.38	4.25
Bankers' Acceptances 1-90 days	4.38	4.25	4.25
Certificates of deposit (prime NYC)			
Typical new issue:			
3-months	4.63	4.25	4.38
6-months	4.75	4.38	4.50
1-year	4.75	4.38	4.75
Secondary market:			
3-months	4.85	4.35	4.50
6-months	4.85	4.40	4.60
Federal Agencies (Secondary Market):			
3-months	4.30	3.89	3.95
6-months	4.31	4.19	4.15
1-year	4.31	4.33	4.25
Prime Municipals 1-year	2.60	2.50	2.75

Treasury finance. Treasury borrowing needs are expected to be very large over the second half of 1967, as a large budgetary deficit is projected to augment the usual seasonal cash drain. Although estimates at this point must be highly tentative, our current "best guess" points to overall borrowing needs on the order of $18 billion for the July-December period (Table A line 2) and this figure does not allow for an additional $2.5 billion in participation certificate sales implied by the Budget message.

Major assumptions underlying these projections include continued expansion in defense expenditures, legislation raising social security benefits (retroactive to July 1), and no surtax legislation effective in calendar 1967.[1/] For the present, we are assuming that the Federal Home Loan Banks will not be significant net borrowers in the second half of 1967. It might be noted that Treasury borrowing needs in the second half are higher than otherwise, because the Treasury is not expected to have a large end-of-June cash balance on which to draw as in other recent years. This will also mean that the Treasury must come to the market for cash relatively early in the second half. Table A compares borrowing needs projected for the second half with those of comparable periods in other recent years.

1/ The second half projection carries defense expenditures at an annual rate that would be about $5 billion above the January 1967 Budget message figure for fiscal 1968. The projection also assumes increased social security benefits at an annual rate of $2 billion, which is about half the amount recommended by the President. If a surtax of 6 per cent is passed, effective October 1, it should reduce the second half cash deficit by around $1 billion.

Table A

TREASURY CASH DEFICIT AND ITS FINANCING
July - December Periods
(In billions of dollars)

	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967 p
1. Treasury cash deficit	12.6	7.5	4.7	9.2	9.1	9.7	10.2	12.0	14.4	16.6
2. Gross cash borrowing 1/	11.8	9.5	5.8	8.8	7.5	4.7	6.4	6.4	9.7	17.9
3. Less: Attrition & debt retirement 1/	-3.7	- .6	-1.5	-1.2	-1.1	- .7	- .5	-.9	-1.0	-1.3
4. Misc. debt transactions 2/	- .4	-1.3	-1.2	+1.6	- .3	+ .8	+ .8	- .2	-1.2	- .7
5. Net cash borrowing	7.7	7.6	3.1	9.2	6.1	4.8	6.7	5.3	7.5	15.9
6. Other sources of funds										
7. Decrease in cash operating balance (+)	+4.8	- .4	+1.3	+ .2	+2.7	+4.6	+ 3.9	+6.1	+6.3	+ .2
8. Seigniorage & other 3/	+ .1	+ .3	+ .3	- .2	+ .2	+ .3	- .5	+ .6	+ .7	+ .5
N. B. Participation certificates sold to public 4/	--	--	--	--	--	--	.8	.9	--	2.5

1/ Direct marketable debt only.

2/ Includes net issues of nonmarketable debt and net security transactions of Federal Agencies and trust funds.

3/ Includes mainly changes in cash held outside the Treasury (e.g. by disbursing agents), checks in process of collection, and statistical discrepancy items.

4/ These sales, carried as "negative expenditures," reduce the Treasury cash deficit. Although they are not in line 2, they also represent Federal Government borrowing.

Table B

VARIOUS FEDERAL BUDGETS
(In billions of dollars)

	Calendar 1966				Calendar 1967			Fiscal Year		Jan. Budget Document	
	I	II	III	IV	I	IIp	IIIp	1966	1967p	Fy 1967	Fy 1968
Quarterly data, unadjusted											
Cash surplus/deficit (-)	- 1.3	10.0	-6.7	-7.7	1.4	7.0	-5.5	-3.3	-6.1	- 6.2	- 4.3
Cash receipts	33.3	46.2	34.6	31.1	38.0	50.8	36.2	134.5	154.5	154.7	168.1
Cash payments	34.6	36.2	41.3	38.8	36.7	43.9	41.7	137.8	160.6	160.9	172.4
Change in cash balance	- .3	+5.8	-3.6	-2.7	+ .7	- .2	+ .9	- .1	-5.8	- 3.4	--
Net cash borrowing (+)	+ 1.0	-3.7	+2.4	+5.1	- .9	-8.6	6.2	+2.6	-2.0	+ 1.7	+ 3.8
(Pool sales to public) 1/	.4	1.8	--	--	1.1	2.0	1.2	3.1	3.2	3.1	5.0
Seasonally adjusted annual rate											
Federal surplus/deficit (-) in national income accounts	2.3	3.8	-.5	-3.6	-10.3	-12.5	-13.0	+0.3	-6.7	- 3.8	-2.1
Receipts	136.0	141.0	145.3	147.9	149.2	149.4	152.7	132.6	148.0	149.8	167.1
Expenditures	133.7	137.1	145.8	151.5	159.5	161.9	165.7	132.3	154.7	153.6	169.2
High employment surplus/deficit (-) 2/	1.5	4.1	-.2	- .6	-8.3	- 9.2	-10.2	2.1	-5.3	n.a.	n.a.

P - Staff projections.

1/ Not included in net cash borrowing.

2/ Uses 1966 IVQ as a high employment base.

Corporate and municipal bond markets. Yields on new corporate and municipal bonds rose again last week to new highs for the year. At these more liberal yield levels, some signs of expanded investor demand appeared. But most recently, Treasury's request for statutory leeway to sell longer-term Treasury debt has created new market uncertainties. With the immediate calendar of new issues still heavy, the likely near-term course of long-term rates thus remains in doubt.

Precise quantification of the extent of the yield advance since the early weeks of April is difficult because the available yield series on new and recently offered bonds have lacked homogeneity. But last week's new Aa-rated electric utility issue with five-year call protection carried a yield of 5.78 per cent, 40 basis points above that on a similar issue offered at the end of March. Over the same period, yields on seasoned municipal bonds have advanced as much as 34 basis points.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa New			State and local Gov't.	
	With call protection	Without call protection	Seasoned	Moody's Aaa	Bond Buyer's (mixed qualities)
1965					
End of July 1/	4.58	--	4.48	3.16	3.25
Early December 2/	4.79	--	4.60	3.37	3.50
1966					
Late summer high	5.98*	--	5.44	4.04	4.24
Weeks ending:					
February 3 3/	--	5.21	5.02	3.25	3.40
March 3 4/	5.45*	--	5.11	3.53	3.60
March 31	5.21*	--	5.12	3.46	3.54
May 5	5.58	--	5.16	3.65	3.79
May 12	5.58*	5.79	5.19	3.65	3.88

1/ Week prior to President's announcement of increased U.S. involvement in Vietnam.
2/ Week preceding Federal Reserve discount rate increase.
3/ 1967 low.
4/ Late February - early March high.
* Some issues included carry 10-year call protection.

The sharpness of the yield advance since early April has of course, reflected the general strengthening of market convictions about the course of economic activity in the second half. But the most immediate and pressing cause of recent yield increases has been the continued and mounting pressure of new issue volume. In addition to the heavy supply of corporate and municipal bonds expected through June, a large Federal participation certificate offering (of as much as $900 million), and a number of foreign bonds will add to aggregate security volume in markets for public offerings. Altogether, and in the absence of postponements, the June volume of public financings may amount to as much as $3.8 billion, about the same as in March.

In the corporate bond market, the estimated volume of public offerings for May has swelled nearly to the $1.4 billion total marketed in April, and in June volume may exceed $1.4 billion. While June always shows a seasonal increase in corporate public offerings, this year's estimated total could exceed last year's by $600 million. This would make aggregate public offerings for the second quarter total a little over $4 billion--$800 million larger than in the first quarter and more than twice the second quarter volume last year. Prior to the Secretary of Treasury's debt statement, corporate utility companies had already postponed scheduled issues totaling about $150 million, and since then two negotiated industrial offerings have been deferred temporarily. However, these latter issues are expected back in the market shortly, and other industrial corporations also have indicated tentative plans for large debt issues. Thus, any lifting of yield pressures as a result of postponements could encourage new additions to the corporate calendar

CORPORATE SECURITY OFFERINGS[1/]
(Millions of dollars)

	Bonds					
	Public Offerings 2/		Private Placements		Total Bonds and Stocks	
	1966	1965	1966	1965	1966	1965
Total	8,018	5,570	7,542	8,150	18,074	15,992
	1967	1966	1967	1966	1967	1966
1st Quarter	3,263	1,774	1,811	2,586	5,464	5,094
2nd Quarter	4,100e	1,941	1,800e	2,083	6,350e	5,115
April	1,350e	628	600e	743	2,100e	1,582
May	1,350e	481	600e	556	2,050e	1,106
June	1,400e	832	600e	784	2,200e	2,427

1/ Data are gross proceeds.

2/ Includes refundings.

Among other things, the record volume of corporate borrowing in the public market this year has reflected the substitution of publicly-offered bonds for other forms of borrowing. In addition to the substitution of market borrowing for expansion of bank debt, growth of public offerings has occurred partly because of a shrinkage in the volume of private placements--due chiefly to the constraints exerted by tight money on the advance commitment activity of life insurance companies in 1966.

Data just released by the SEC indicate that corporate private placements in the first quarter this year dropped $750 million or 30 per cent behind private placement volume in the like period of 1966. As a result, first quarter private placements accounted for only 41 per cent of total corporate borrowing this year, whereas they had amounted to nearly 60 per cent of the total in the like period of 1966.

Manufacturing corporations--the major users of private placements--have accounted for much of this year's increase in public bond offerings. From the end of December through April, roughly three-fifths of all public bond offerings were made by such corporations, one-fifth more than in the like period of 1966. Public utility financing, although considerably larger than a year ago in absolute dollar volume continued to amount to about one-fifth of the total, while financing attributable to financial corporations, dropped sharply, both absolutely and relatively. Most recently, financing by both industrial corporations and public utilities has continued heavy, but offerings by financial corporations have also expanded.

In the municipal bond market estimate of May, offerings have been revised upward to more than $1 billion, following the scheduling of several large new issues. And the number or large offerings already scheduled for June suggests that the total may exceed $1 billion in that month as well. A special influence currently adding to pressures on municipal yields in the fact that volume in the weeks immediately ahead includes an unusually large proportion of long-term maturities, the part of the term structure that has attracted the least investor interest in recent weeks.

While the blue list of dealers' advertised inventories has dropped about $150 million since late April, the total overhang of unsold issues held by market professionals is estimated to be substantially larger than the advertised figure. One small municipality scheduled to borrow last week announced that it was postponing long-term financing and would finance its interim needs with short-term loans. This action had little effect on the volume of expected long-term financing, but it may presage other postponements if the present market congestion continues.

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

	1965	1966
Total, year	11,329	11,362
	1966	1967
1st Quarter	2,965	3,995
2nd Quarter	3,260	3,400e
April	1,211	1,050e
May	906	1,100e
June	1,143	1,250e

1/ Data are for principal amounts of new issues.

<u>Mortgage market developments</u>. With credit demands in capital markets strong, the decline in yields on home mortgages slowed in April, despite the large continuing net inflows of savings to nonbank thrift institutions. In fact, during the first two weeks of May, there were scattered reports of a slight rise in yields on Federally-underwritten home loans in a number of Eastern cities, adding to uncertainty about future mortgage market conditions. The change apparently surprised some mortgage companies that had been warehousing uncommitted FHA and VA loans in the belief that the recent improvement in prices paid for these mortgages by savings banks and life insurance companies would continue for some time longer. Official data are not yet available to assess how much the tone of the market has changed or how widespread the change may have been.

The over-all decline in yields on new-home mortgages from the turning point last November to April amounted to 30 basis points in the conventional series and to 52 basis points in the FHA series. Despite these unusually large reductions, April yields on conventional loans were still 60 basis points above the yield plateau which prevailed from the spring of 1963 through the summer of 1965. Yields on FHA loans, which have been more volatile, were still about 85 basis points above their 1963-65 low.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	PRIMARY MARKET: Conventional loans		SECONDARY MARKET: FHA-insured loans	
	Level (Per cent)	Change (Basis points)	Level (Per cent)	Change (Basis points)
1966				
November	6.70	0	6.81	n.a.
December	6.65	5	6.77	4
1967				
January	6.60	5	6.62	15
February	6.50	10	6.46	16
March	6.45	5	6.35	11
April	6.40	5	6.29	6

NOTE: FHA series; interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points; secondary market yields are for certain 6 per cent FHA-insured Sec. 203 loans.

Continued underlying strength in the availability of mortgage credit during April is suggested by the reduced volume of mortgages offered to FNMA for purchase under its secondary market operations as well as by scattered FNMA mortgage sales. But with yields on corporate bonds tending upward while those on home mortgages were declining, yield spreads in favor of home mortgages narrowed sharply after February. By April, the spread had declined nearly to the unusually narrow margins that prevailed during much of 1966.

Flows to financial intermediaries. Preliminary estimates indicate that all three depositary-type financial intermediaries continued to receive savings in record volume during April.

As the table shows, aggregate April flows are estimated to have been nearly three times the previous April high reached in 1964, (the first year for which separate data on large CD's are available). On a seasonally adjusted annual rate basis, the 17 per cent April increase for S&L's and the 19 per cent increase for savings banks were the highest growth rates reached since savings flows began improving last year.

FLOWS TO DEPOSITARY-TYPE INTERMEDIARIES
(Millions of dollars)

	Total 1/	S&L's	Savings Banks	Commercial Banks Without CD's	Commercial Banks With CD's
April					
1967	2,704	600 p/	175 p/	1,929	1,213
1966	147	-773	-341	1,261	1,570
1965	397	-93	-22	512	1,291
1964	1,027	329	87	611	1,258
Jan - April					
1967	11,451	2,962 p/	1,654 p/	6,835	9,785
1966	5,684	516	445	4,723	6,128
1965	8,369	1,795	1,060	5,514	7,672
1964	7,449	2,665	1,186	3,598	4,682

1/ Excludes negotiable CD's at weekly reporting banks.
p/ Preliminary.

While data are not yet available on the uses to which April flows were put, industry observers report that neither S&L's nor savings banks have been acquiring mortgages in a volume in keeping with savings inflows of this magnitude. Savings banks are apparently continuing to place an unusually large share of their funds in corporate bonds and S&L's are continuing to reduce their indebtedness at the Home Loan Banks and to a lesser extent to build up holdings of liquid assets. At both types of institutions, however, the allocation of funds was apparently dictated in large part by the continuing relative scarcity of immediately available mortgages.

During the first quarter, S&L repayments to the Home Loan Banks, while consistent in direction with the normal seasonal pattern were unusually large. The $450 million of further repayments since March, however, is distinctly contra-seasonal and compares with net increases in April borrowing of $829 million in 1966 and $472 million in 1965. Over the longer period since last August, S&L's have repaid $2.6 billion of their outstanding advances. As a result, their total indebtedness to the Home Loan Banks has dropped to the lowest level in two years.

While both savings banks and S&L's have rebuilt liquidity ratios (cash and governments to savings) from last year's low points, these increases have not been as sharp as the recovery in savings flows. S&L's, by reducing their relatively expensive Home Loan Bank debt, are now in a position to borrow heavily again, if this should become necessary. Savings banks, on the other hand, in purchasing record amounts of corporate bonds have not sacrificed significantly on their earning potential (once allowance is made for servicing costs on mortgages), and at the same time they have acquired assets with more potential marketability than mortgages.

<u>Stock market</u>. After reaching new high levels early in May, stock prices declined moderately on balance through May 16. The decline--which amounted to about 1-1/2 per cent in Standard and Poor's composite index--was partly a reaction to the sustained rise from mid-April to early May. But it also apparently reflected some weakening in investor optimism regarding business and profit prospects later this year and in 1968.

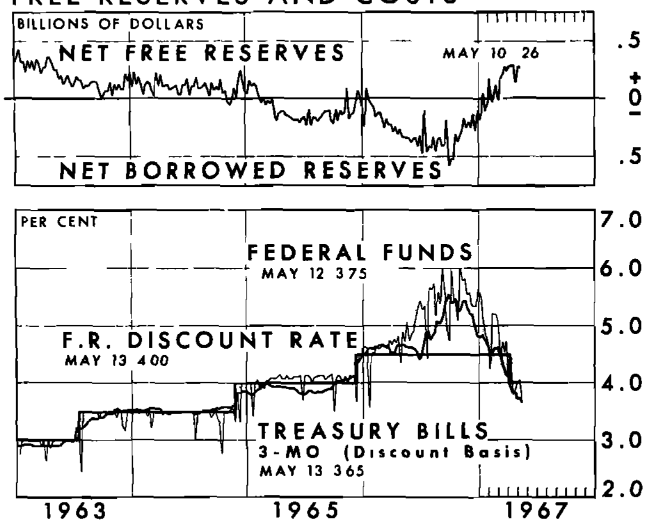
Trading volume remained high--during both the period of price advances and the subsequent period of decline. In the first two weeks of May, daily volume averaged about 10.7 million shares--well above the 9.4 million share average for all of April.

Based on seasonally adjusted fourth quarter 1966 earnings, the price-earnings ratio for Standard and Poor's composite index at the early May high was 17.2, compared with 13.0 in October 1966. However, the early May ratio was below the 17.9 level of February 1966--the previous high for stock prices--and well below the 20-22 range which prevailed in 1961. Since mid-April, dividend yields have fallen further to 3.14 per cent, and the spread in favor of newly issued corporate bonds has widened by an additional 15 basis points.

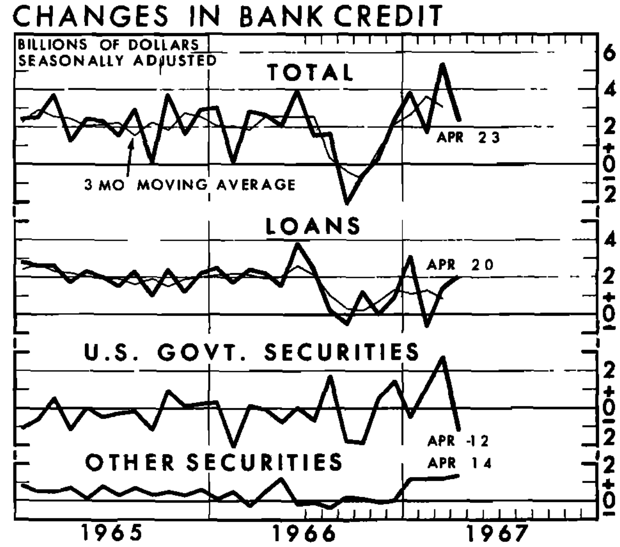
In April, net debit balances, as measured by the New York Stock Exchange's margin panel series, increased by $60 million. This rise follows the revised increase in March of $90 million and a February increase of $120 million. The smaller increase in April apparently reflected some customer withdrawals of funds to pay personal income taxes. Purpose loans at banks, which increased by about $60 million in April, were back to levels which prevailed in early October 1966.

FINANCIAL DEVELOPMENTS - UNITED STATES

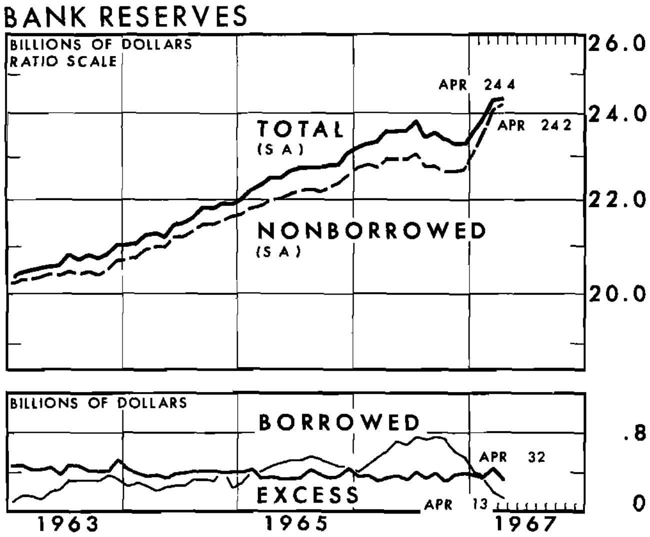
FREE RESERVES AND COSTS



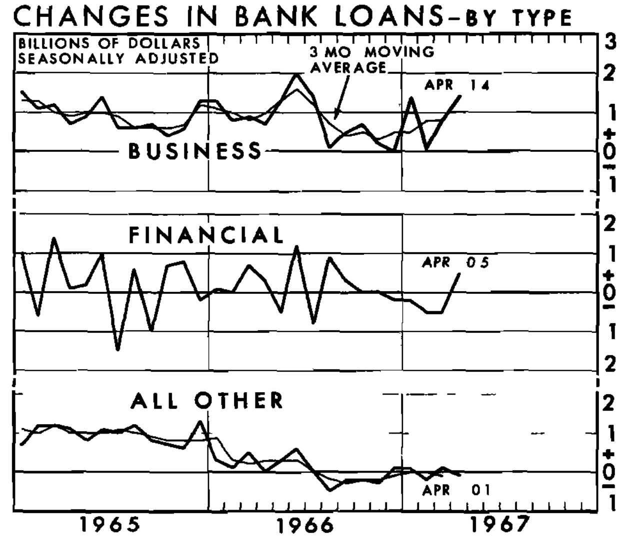
CHANGES IN BANK CREDIT



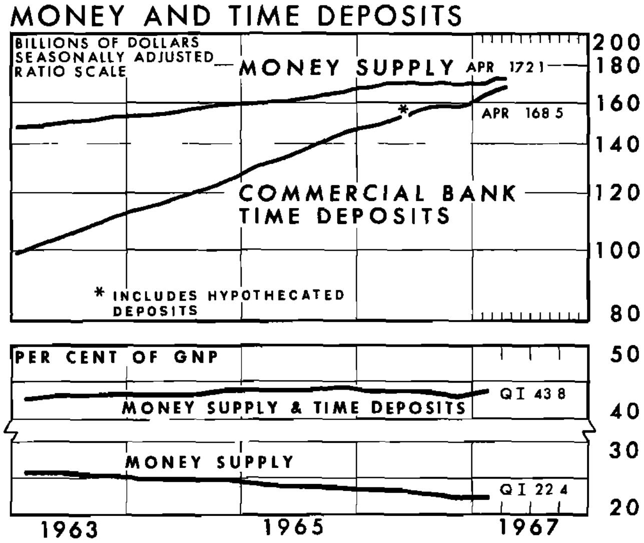
BANK RESERVES



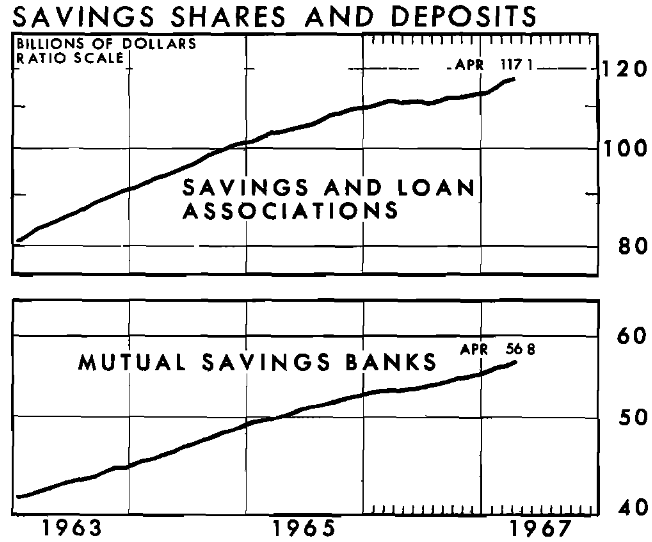
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

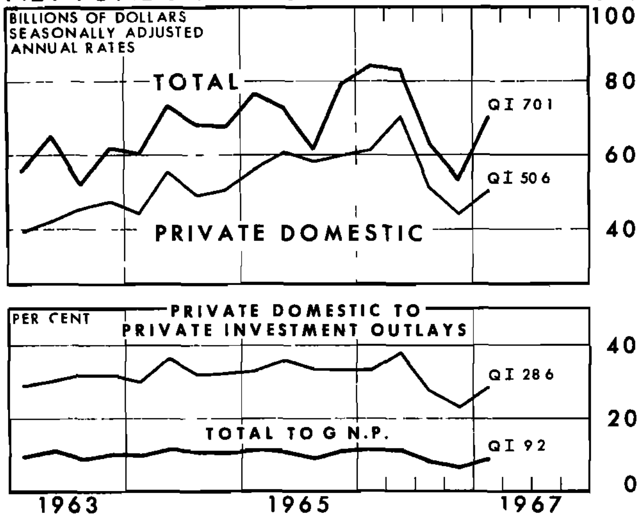


SAVINGS SHARES AND DEPOSITS

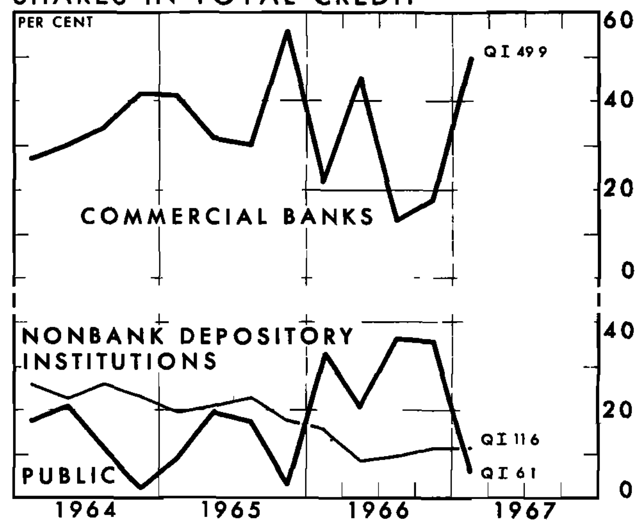


FINANCIAL DEVELOPMENTS - UNITED STATES

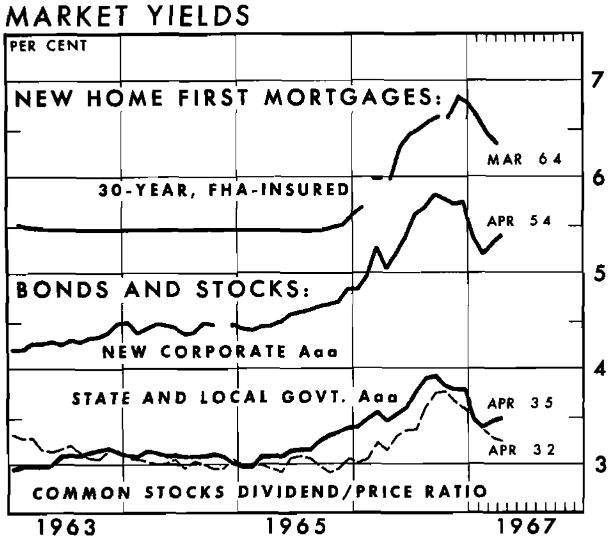
NET FUNDS RAISED-NONFINANCIAL SECTORS



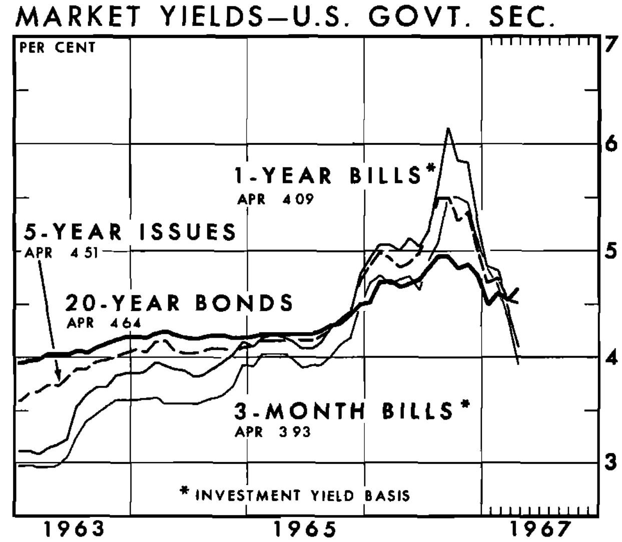
SHARES IN TOTAL CREDIT



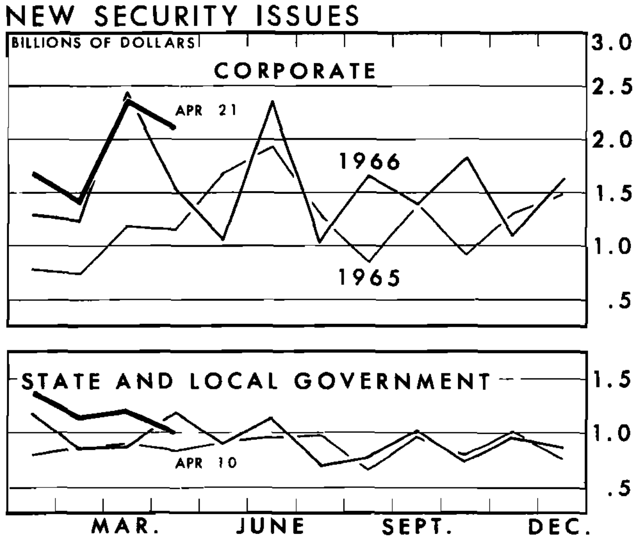
MARKET YIELDS



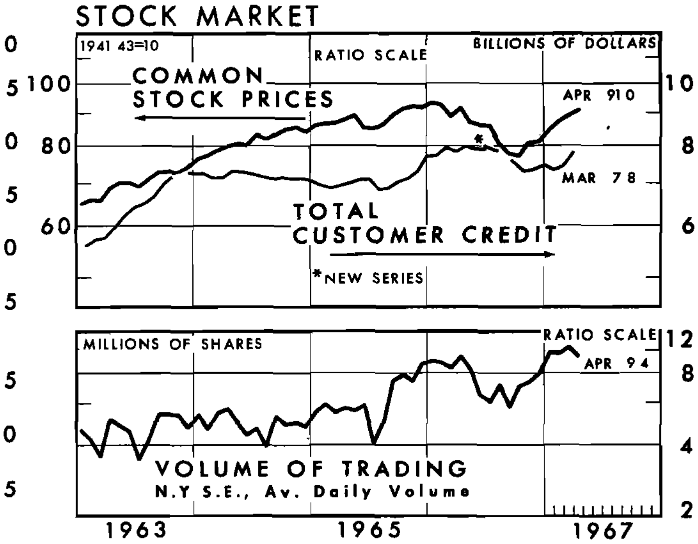
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. The payments deficit in the first quarter on the liquidity basis was $540 million, seasonally adjusted, after reduction by about $500 million of special transactions. The "flash" report for April -- based on reports from a sample of 40 large banks -- shows an unadjusted deficit on the liquidity basis of $350 million. Apparently there were no sizable special transaction receipts during the month. In past years, April has accounted for much more than one-third of deficits in the second quarter, so that substantial downward seasonal adjustments of April deficits were appropriate. This year, with oil company payments to Libya shifted from April to March, this may no longer be the case. It therefore appears that the April result represents, broadly speaking, a continuation of the past two quarters' large underlying liquidity deficits, not counting special transactions, which have run about $1 billion per quarter.

Data presently available show that there was a substantial improvement ($300 million) in the merchandise trade balance between the fourth and first quarters and (based on new seasonal adjustments) no change in the rate of reduction in claims reported by U.S. banks. The trade improvement was more than offset by an increase ($200 million) in outflows of U.S. private capital into foreign securities and by the absence of debt prepayments receipts, which had amounted to about $200 million in the fourth quarter. The balance on all other transactions that affect the liquidity deficit was about unchanged. Within that residual, military expenditures in Asia probably continued to increase. It is not yet known whether outflows of direct investment capital and net unrecorded payments continued unusually large, as in the fourth quarter, nor are data yet available on investment income, other services, or Government grants and loans.

Additional information regarding the large first-quarter improvement in the merchandise trade balance is sketchy. The balance of automotive trade with Canada appears to have been somewhat less favorable than in the fourth quarter. Total imports, at an annual rate of $26.8 billion, were essentially unchanged from the fourth quarter. Imports of foods, notably sugar and cocoa, increased, while imports of materials such as lumber and wool declined. On the export side, the unusually sharp increase of about 7 per cent in nonagricultural exports, while agricultural exports declined, included large shipments of many types of machinery and aircraft.

The net outflow on new security issues in the first quarter -- mainly to Canada -- was higher than indicated earlier; at $350 million, seasonally adjusted, it was substantially above the depressed level of the fourth quarter. Well over half of the issues sold in the first quarter were offered in January and the beginning of February, although not all were taken down then. Offerings of foreign issues subsequently have been in much reduced volume, apart from the $250 million IBRD issue in March, of which $90 million was paid for in April. The firming of long-term rates in this country since February, together with the availability of funds in the Euro-dollar bond market, reduces the incentives for foreigners -- especially others than

Canadian borrowers and international organizations -- to sell issues in the U.S. market. The narrow margin that presently obtains between U.S. and Euro-dollar bond rates is illustrated by two issues by the Government of Mexico: an April offering in the U.S. (not subject to IET) was quoted in early May to yield 7.3 per cent; a Mexican Euro-bond issue has been scheduled to be offered at a yield of about 7.5 per cent.

In the first quarter there was a net reduction of $65 million in claims on foreigns reported by banks in the United States, following a similar reflow in the fourth quarter (based on revised seasonal adjustments.) The first-quarter reflow reflected continued large net repayments on long-term loans; there were also net repayments of short-term bank loans and acceptance credits, but these were more than offset by increased collection claims on foreigners. The total reflow of bank loans plus acceptances, before seasonal adjustment, was close to the $215 million reflow reported for the quarter under the VFCR.

Within the first quarter, there were net reflows of bank credits in January and February and net outflows in March. The March outflows consisted mainly of net extensions of credits to Japan and Latin America, which offset earlier reflows from these countries. Most of the net reflow for the quarter represented reductions in outstanding credits (long- and short-term) to Europe.

Reports by banks and non-banks (still incomplete for the quarter) reveal no significant movements of liquid funds in the first quarter. There was a small increase in sterling assets, and a rise in dollar deposits abroad that may have been associated with temporary investment of proceeds of external bond issues by domestic affiliates of U.S. companies making direct investments abroad.

On the basis of official reserve transactions, the U.S. payments deficit in the first quarter was $1.3 billion before seasonal adjustment and $1.8 billion after adjustment. Preliminary indicators show that large deficits have continued in April and early May. For the 6 weeks March 30 - May 10 (which overlaps the first quarter by two days) the unadjusted deficit totaled $1.1 billion; during this most recent period U.S. banks reduced their liabilities to foreign branches by $620 million, and this decline appears to account for the difference between the balance on the liquidity basis and on official settlements, as shown by the weekly indicators. (By contrast, the $1 billion difference between these two measures of the balance in the first quarter greatly exceeded the reduction in liabilities to branches, primarily because special transactions which benefited the liquidity balance did not equally affect the balance on the basis of official reserve transactions.)

Industrial production abroad. Over-all industrial activity in Europe was virtually level during the last quarter of 1966 and the first two months of this year, and slightly below the plateau of the two preceding quarters. This interruption of growth was due mainly to policy actions the two largest countries took to curb excess demand. British industrial production declined from last summer through November, and German output from last summer through February. The weakness of German demand in particular exerted a depressing or restraining influence on the economies of neighboring countries, including not only such smaller countries as the Netherlands, Belgium, and Austria, but also France, where industrial activity was virtually unchanged from July 1966 through February of this year. In Italy output rose strongly, but less rapidly after midyear than before.

Major restraining roles were played in Britain in 1966 by a wage freeze, instalment credit controls, new taxes, and general monetary measures -- with marked effects in reducing consumer expenditures and inventory investment in the latter part of last year. In Germany, tight monetary conditions until late in the year hit State and local governments particularly hard, and consumer outlays for goods also fell off in the fourth quarter. Easing of monetary policies in both countries this year has removed one block to recovery, while expansion of government expenditures -- together, perhaps, with autonomous strengthening of consumer demand -- seems to be providing the chief immediate stimulus. Business fixed capital expenditure plans in both countries remain weak.

INDUSTRIAL PRODUCTION
(1960 = 100)

	1966				Latest		Change (%) from year earlier	
	Q-1	Q-2	Q-3	Q-4	Dec. Jan.	Jan.-Feb.	2nd half 1966	Latest 2 months
OECD	(132)	(133)	(133)	(132)	(132.5)	(132)	(+ 3)	(+ 1)
United Kingdom	118	117	118	115	115.5	115.5	0	- 2
EEC								
Germany	135	136	133	131	129	127 a/	0	- 6 a/
Netherlands	140	141	141	145	146	147	+ 6	+ 6
Belgium	136	134	134	134	137	137.5	0	+ 1
France	134	136	139	140	140	139.5	+ 6	+ 5
Italy	149	155	159	160	161.5	163.5	+12	+10
Sweden	147	148	151	149	146.5	148	+ 2	+ 1
Austria	128	130	129	132	131	128	+ 4	0
Switzerland	133	133	131	135	...	...	+ 3	...
Canada	151	152	152	155	155	155	+ 6	+ 3
Japan	181	189	200	208	215	217 a/	+17	+20 a/
United States	140	143	145	146	146	146 a/	+ 9	+ 3 a/

a/ January-March

German industrial production was unchanged from February to March (OECD seasonal adjustment) at a level 7 per cent below the high plateau of March-June 1966. After falling rapidly since October, output of "capital goods" (including autos, TV's, and other eleectrical goods) declined only a little further in March, and output of consumer nondurables (excluding food) moved up slightly. These developments followed a pickup in February of manufacturers' new orders. We will need at least another month's production data to judge whether a turning point was being reached in German industrial activity. New orders in March rose slightly further according to the Bundesbank's seasonal adjustment, but the OECD adjustment (not yet available) may show a new dip.

Through most of 1966 new orders for both durables and nondurables were falling faster than current deliveries, and consequently there were large reductions in outstanding unfilled orders. The leveling out of new orders in the early months of 1966 may have been related to the improvement registered in retail sales: after dropping by 10 per cent from September to December, retail sales picked up sharply, and in the first quarter were again at their third-quarter-of-1966 level (OECD seasonal adjustment). As there was very little change in average retail prices, a corresponding recovery occurred in the real volume of retail trade.

In contrast to the developments described above, industrial output of materials (including chemicals, steel, and building materials, but excluding intermediate products of the textile industry which are classed with consumer nondurables) has been relatively stable in total over the past year. Excess order books for steel built up in 1963 and 1964 were largely run off in 1965. Apparently of late there has been no large overhang of materials inventories to work off -- apart from chronic trouble with coal.

Despite these signs suggesting a possible bottoming out of the German recession, business confidence has continued at a low ebb. This is understandable in view of the emergence of a considerable margin of unused capacity and of the further rise in unemployment, which reached a new high of 2.2 per cent of the labor force at the end of March, over three times its level a year earlier. Moreover, though exports in the first quarter were at a very high level, new export orders in February and March averaged no higher than in the preceding three months November-January. Thus foreign demand, the principal support for German economic activity during most of 1966, could no longer be counted on for immediate stimulus.

In mid-April the Parliament's Budget Committee approved release of the final one-third tranche of the DM 2.5 billion contingency budget. The Bundesbank (as previously reported) announced on April 27 a reduction in reserve requirements effective May 1. On May 11 the discount rate was lowered for the fourth time this year and is now 3 per cent, as low as during cyclical troughs in 1954 and 1961.

In Britain industrial production has shown signs of recovery since the sharp drop of last summer and fall. From the 1966 high in July-August output had fallen steadily to November, dropping 4 per cent. Manufacturing production had declined 6 per cent. In December and January, manufacturing output moved up more than 2 per cent, and the January level was maintained in February.

The cyclical movement was most marked in the textile, leather, and apparel sector and in metals. In these two sectors recovery continued in February. Output of textiles, leather, and apparel had fallen 10 per cent from March 1966 to December, and then regained two-fifths of the lost ground in the next two months. Metals production had been declining from quarter to quarter since the spring of 1965, and fell off most rapidly toward the end of 1966; the fourth-quarter average was down 12 per cent from the second quarter of 1965. Monthly, output of metals was lowest in November, and it rose in each of the next three months.

In the important "engineering and allied industries" (machinery and equipment, including vehicles) the fourth-quarter level of production, which was 3 per cent lower than in the first quarter of 1966, was maintained in January and February. Partial recovery in automobile production offset declines for capital equipment.

Construction activity in the last quarter of 1966 stayed at the high level reached in the third quarter. However, the value of new construction orders fell considerably; for both residential and nonresidential construction, orders were one-tenth lower in the fourth quarter than in the second.

As we noted three weeks ago, stimulus to expansion in Britain is being provided by a rising trend in publis investment expenditures -- mainly those of nationalized industries and local authorities -- and no further reflationary measures were taken in the April Budget. On May 4, Bank rate was reduced to 5-1/2 per cent; this was the third reduction this year.

British imports rose in April, apparently confirming the pickup in domestic demand, but the increase was far sharper than had been expected. Though exports also rose, regaining their February-March average level, the trade balance worsened.

In <u>France</u> industrial production was unchanged in January and declined one point in February. The February INSEE survey indicates continuing cautiousness on the part of businessmen, reflecting weakness in domestic consumer demand and the unsatisfactory export situation.

The government still expects real GNP to rise by 4.7 per cent in 1967 over 1966, but French business opinion appears more nearly in line with the OECD staff estimate of a 4 per cent gain. Both estimates assume an upturn in German demand before long.

<u>Italy</u> was the only major European country where economic activity was still rising vigorously when the year came to a close. For the full year 1966, industrial production was 11.4 per cent higher than in 1965, while the rise in real GNP was 5.5 per cent. The OECD staff looks for continuation of this rate of GNP growth in 1967, but with a somewhat less rapid rise in industrial production.

The generally rising trend of Italian exports was interrupted last summer by the fall in German demand, but has since resumed. There may also have been some moderation of inventory investment in the second half of 1966, especially for cars and trucks. But such restraining influences have been outweighed by rising domestic consumption and fixed investment.

The decline in Italian residential construction that started in 1964 has been reversed. Housing starts rose, and the decline in completions appeared to be leveling out as the year progressed.

In <u>the Netherlands</u>, industrial production continued to rise through February (OECD seasonal adjustment), but order backlogs have been declining and demand pressures have diminished enough to have led the central bank in February to moderate its restraints on credit expansion.

Belgian industrial output, after remaining generally stable through most of 1966, stepped up in December-February, apparently reflecting increased output of consumer nondurables such as textiles and of materials. Output of capital equipment was unchanged. The production increase was accompanied by a rise in exports, and both may have been related to the removal of the British import surcharge. That is known to have been a factor in the temporary bulge in Austrian industrial production in December and Austrian exports in December and January.

In Sweden, where fiscal policy has been directed toward reducing the pressures of domestic demand on resources, industrial production declined after last September to a low in January. Output rose in February. From the fourth quarter of 1966 to the first quarter of this year production in consumer goods industries increased, but there were declines for metal products, wood products, and iron mining.

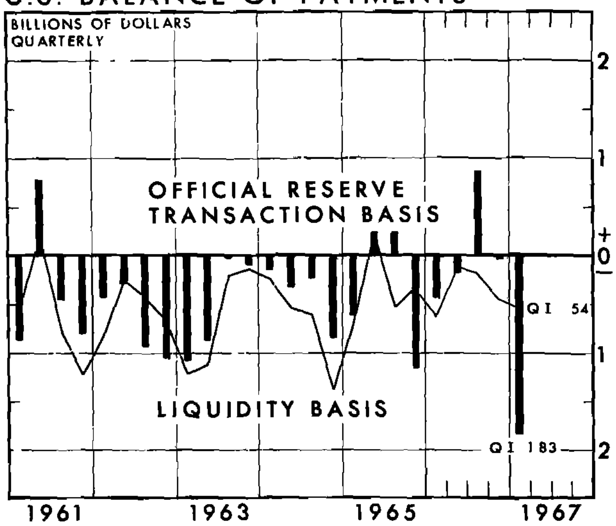
Canadian industrial production, after an earlier dip, moved up from July to November last year. In the next three months it changed little, dipping slightly in January and rising in February (latest). Fixed investment was fairly stable in real terms throughout 1966. Despite some reduction in the rate of inventory investment, manufacturers' stock-sales ratios remained higher after mid-1966 than they had been for some time past.

The first significant interruption to the rise in Japanese industrial production since late 1965 occurred in February, followed, however, by a rise to a new high in March. Some fall-off in the months February and March taken together is evident in output of consumer goods, both durable and nondurable; this may be related in part to the leveling off in Japanese exports since late last year. Output of capital goods has continued to advance.

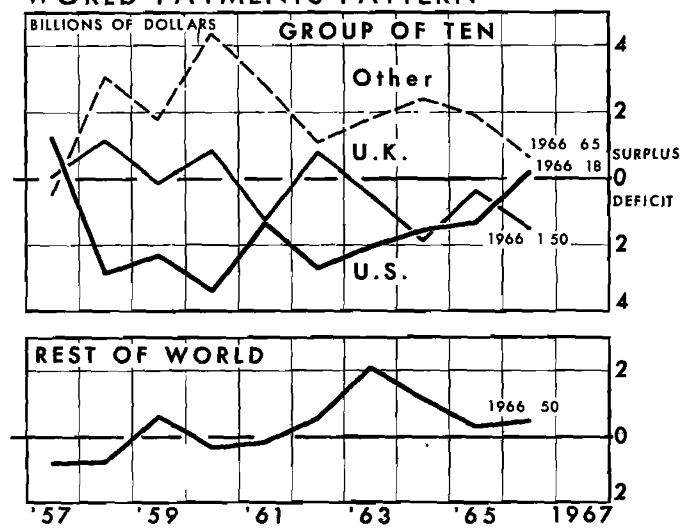
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

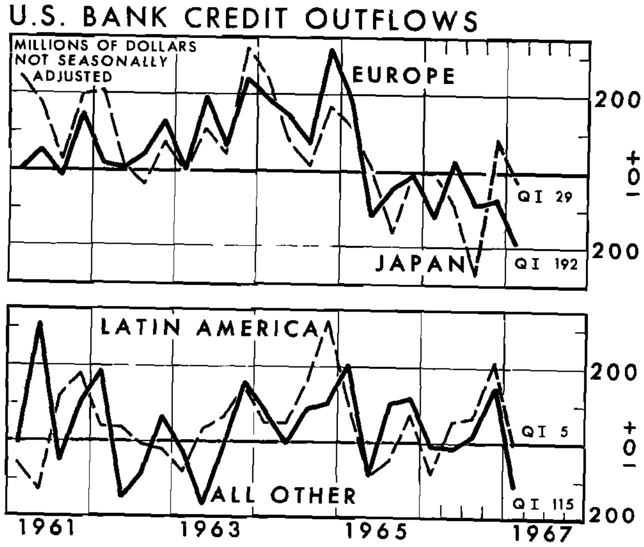
U.S. BALANCE OF PAYMENTS



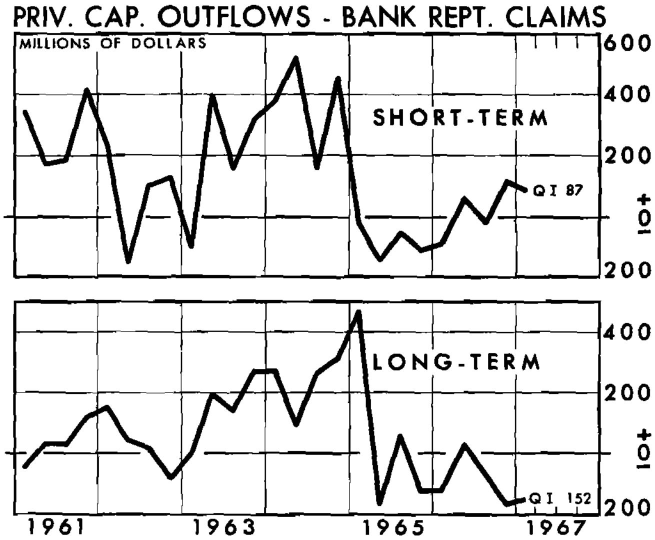
WORLD PAYMENTS PATTERN



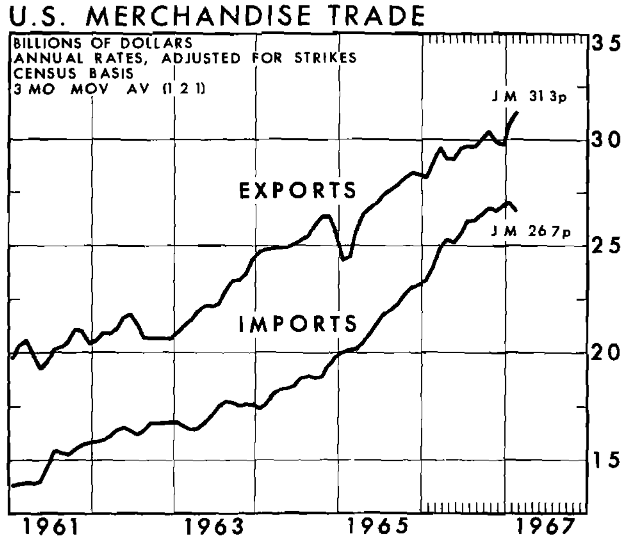
U.S. BANK CREDIT OUTFLOWS



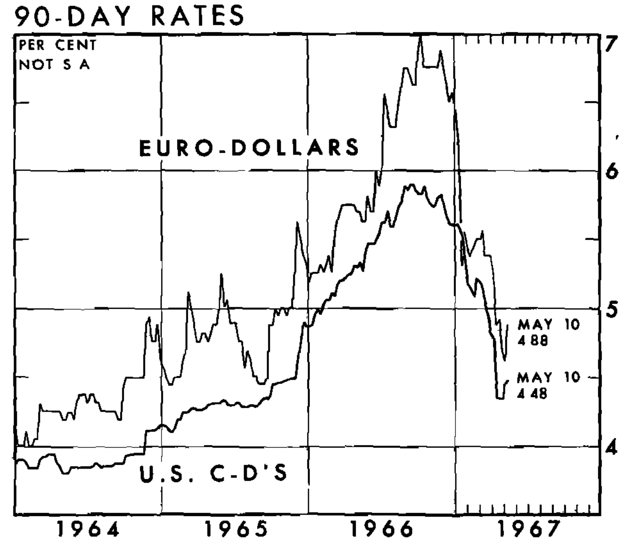
PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



U.S. MERCHANDISE TRADE



90-DAY RATES



APPENDIX A: RECENT CHANGES IN RETAIL SALES ESTIMATES*

The recent revision in the retail sales estimate for the month of March has raised questions concerning the reporting sequence and interpretation of the Census Bureau's retail sales series. For any given month, a succession of estimates of the level and change in retail sales becomes available over a period of several months, beginning with the weekly retail sales figures (not adjusted for seasonal variation) which are based on sample data collected from 2,500 firms covering approximately 48,000 retail stores. The weekly figures are released on Thursday afternoon of the following week, and as the month progresses the weekly figures provide some basis for a very rough estimate for the month as a whole.

The first actual seasonally adjusted monthly estimate, however, is the Census Bureau's "advance" estimate which is published about 10 days following the close of the month. This is based on monthly information collected from the same subsample that reports weekly sales. A month later a "preliminary" estimate of monthly retail sales becomes available which is based on the Census Bureau's full reporting sample of retail stores, a sample about three times greater than the weekly sample. This preliminary estimate is then subject to further revision (usually moderate)--and becomes the "final" estimate--about two months after the "advance" estimate is released.

The advance estimate of retail sales in March, released on April 10, optimistically specified a strong 3.2 per cent increase above February. This estimate led many to conclude immediately that a moderate to strong revival of consumer demand was underway. Probably, the concensus of informed opinion was that the advance estimate properly signaled a spring upturn. Retail sales had remained virtually unchanged over the preceding six months while personal income had risen sharply further, making for a strong presumption that sales would turn up soon. However, final retail sales have rarely increased so sharply in any one month, except in months in which sales were strongly affected by exogenous economic circumstances such as a nationwide strike.

Once preliminary returns from the full reporting panel were completed, a downward revision was required in sales for March. The preliminary March estimate released on May 10, revised downward by about $0.7 billion (or nearly 3 per cent) the advance March estimate of a month earlier, understandably dampening the previous optimistic view that a spring sales revival was underway. Based on the more complete data, March retail sales at $25,771 million, seasonally adjusted, were 1.2 per cent above February (which in the meantime had been revised downward), and 1 per cent above a year earlier.

*Prepared by James M. Howell and the Business Conditions Section

The table below shows the indicated month-to-month percentage change in total retail sales over the past year, as revealed, successively, by the advance, preliminary, and final estimates. As the table indicates, even for the short period covered, some sizable revisions have been made between the advance and final estimates.

PER CENT CHANGE IN SEASONALLY ADJUSTED TOTAL RETAIL SALES
BASED ON SUCCESSIVE MONTHLY ESTIMATES:

ADVANCE (A); PRELIMINARY (P); AND FINAL (F)

Available at time of release of "Advance"-- about the 10th of:	1966								1967			
	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
June	A -2.4											
July	P -1.6	1.2										
August	F -1.9	3.6	0.6									
Sept.		3.8	0.4	1.5								
Oct.			-0.1	1.2	-0.4							
Nov.				0.8	0.3	0						
Dec.					0.5	-0.3	-0.9					
Jan.						-0.6	0.6	-1.3				
Feb.							0.2	-1.1	-0.1			
March								-0.9	1.3	-1.7		
April									1.3	-0.2	3.2	
May										-0.8	1.2	-0.4

Note: The "final" monthly percentage changes shown here are still subject to revision, on the basis of annual benchmark adjustments and review of current seasonal factors.