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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**

November 8, 1967

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SUMMARY AND OUTLOOK

Outlook for economic activity

Although we expect the pace of economic expansion to increase considerably further this quarter, the rate of growth is being retarded somewhat by work stoppages, which now seem likely to be more extensive than anticipated earlier. Our current estimates still put growth in real GNP at a rate significantly faster than in the third quarter, and the rise in prices (as measured by the GNP deflator) at as rapid a pace as during the summer.

Despite the dampening influences of strikes and strike-induced layoffs on private wage and salary gains, personal income increases are expected to be larger this quarter than last. Current and anticipated wage increases, including the Federal pay raise, largely account for the faster rise in personal income. Wages and fringe benefits involved in the Ford settlement are expected to average more than 6 per cent a year for three years. The settlement involves an unusually large money increase in the first year, and is expected to set a target for other settlements.

Consumer outlays are also apparently rising more rapidly this quarter, judging from fragmentary data on new auto and other retail sales in October. But the rise in consumer spending is likely to be held down by the limited supply of new model autos. With disposable incomes expected to advance somewhat faster than consumption, the rate of saving may rise slightly further this quarter.

Residential construction outlays are expected to increase sharply further this quarter, reflecting both increasing costs and a considerably higher rate of starts in the third quarter than we had previously anticipated. Business fixed investment is also expected to rise moderately; the McGraw-Hill Survey, to be released later this week, confirms the anticipated increase in plant and equipment expenditures of 5 per cent in 1968 suggested by other recent private surveys. The accumulation of business inventories this quarter is expected to be small. Automobile stocks are likely to decline to minimum levels, partly offsetting some possible further build-up in stocks of defense products and machinery and equipment.

Federal defense spending, aside from the expected pay increase for the military is expected to increase this quarter at about the reduced third quarter rate. There will be a further boost in Federal outlays for farm price supports, and a continued strong growth in State-local outlays arising from increased employment, wage rate advances, and expansion of public works.

Outlook for resource use and prices

Although there have been relatively few announcements of price increases in recent weeks, upward price pressures on the industrial sector are likely to continue in coming months. The combined effects of earlier price and cost advances, large current and prospective wage rate increases, and supply limitations resulting from work stoppages are providing an upward momentum. However, a

restraining influence on the over-all upward price trend has been the generally weaker tone this autumn in prices of farm and food products. Most livestock and crop products, except cotton, have now declined to the lowest levels in two years. In September retail food prices showed some decline for the first time since April.

The recent decreases in manufacturing plant capacity utilization have been largely due to strikes while the increases in the unemployment rate reflect unusual growth in the labor force. At the same time, there is some evidence of a leveling off in the earlier sharp increases in expenditures and employment in defense related industries. The resumption of full auto production and sales, the increase in Federal pay and in social security benefits, the rise in minimum wages, and other forces likely to boost incomes in the months ahead should result in resumed pressure on the labor force and in higher rates of capacity utilization.

Outlook for banking

Bank credit demands are expected to remain comparatively moderate over the balance of the year. Modest increases in inventory and capital outlays are likely to hold down the rate of business loan expansion. Offsetting this, however, is the growing attractiveness of the prime loan rate relative to the cost of open market financing, which could lead to some switching to bank financing by businesses and to continued strong use of bank loans by finance companies.

With no further Treasury financings involving direct debt scheduled until next year, bank acquisitions of Treasury securities will probably moderate, although banks are likely to remain interested in bills and other liquid assets in anticipation of renewed loan demands next year and of a concurrent monetary restraint. Banks, especially smaller ones, are also still likely to seek relatively long-term investments in view of the very attractive yields available, particularly on municipal securities but also on the offerings of FNMA and Export-Import Bank PC's expected in the weeks ahead.

While the recent higher levels of interest rates have increased the attractiveness of investments to banks, these levels are also tending to reduce somewhat the banks' ability to attract deposit funds. At offering rates of 5-1/2 per cent, CD's maturing in 6 months or more now cannot compete effectively on a rate basis with market instruments. Although some longer-term CD's are likely to be sold in coming weeks, an increasing proportion of sales will be made in the shorter maturity ranges where effective offering rates remain below the Regulation Q ceiling. While November CD inflows may benefit from temporary investment of the proceeds of a few large capital market issues, December tax and dividend maturities are quite large and sizable attrition could develop. Under the circumstances, banks are likely to remain active in the Euro-dollar market. Inflows of consumer-type deposits may be retarded slightly as a result of the recent Treasury financing, but current rate relationships are unlikely to produce any sharp drop-off in inflows of such deposits.

Growth in total demand deposits is also likely to moderate in coming weeks as loan demands remain modest. Sizable offsetting variations between private and Government demand deposits may be expected as Treasury balances are reduced to relatively low levels in the latter weeks of the year.

Capital markets outlook

The near-term course for bond yields seems to be further upwards, as market hopes for effective fiscal action this year have faded and been replaced by a growing conviction that monetary policy will have to tighten. Both underwriters and institutional lenders are generally assuming that the recent pattern of anticipatory borrowing in long-term markets will continue in the months immediately ahead, even in the face of rising interest costs. Moreover, the market is expecting a sizable FNMA PC offering, which will compete actively for available capital market funds.

The calendar of new corporate and municipal offerings next week is exceptionally heavy. On next Tuesday (November 14) alone, issues totaling more than \$900 million are scheduled for offering--headed, in the corporate market, by \$225 million of U. S. Steel debentures and, in the municipal market, by \$130 million of Mississippi industrial revenue bonds and \$100 million of State of California bonds.

In mortgage markets, fragmentary reports suggest that while interest rates have been rising, they have continued to lag

behind changes in bond yields, as is typically the case in such circumstances. With spreads between bond yields and mortgage rates at one of the narrowest margins in history, significant further increases in mortgage rates seem likely during the weeks ahead even if the uptrend in bond yields should moderate. At the same time, while no dramatic shrinkage of net savings flows to thrift institutions is expected over the rest of 1967, additional evidence for October indicates some further moderation in the pace of net inflows, after seasonal adjustment.

Balance of payments

Further information and new adjustments of the third quarter data indicate that the deficit in that period on the liquidity basis was larger than previously estimated, and reached about \$3 billion at an annual rate, compared with a rate of about \$2 billion during the first half of the year. Nevertheless, as net acquisitions of over-one-year time deposits and nonconvertible Roosa bonds by foreign official institutions were small in the third quarter, the rate of deficit before reduction by such transactions diminished--from about \$4 billion to about \$3 billion.

The near-term outlook is for continuation of large deficits in the U.S. balance of payments on the liquidity basis. Among the various influences that held down receipts or raised U.S. out-payments in the third quarter some are probably persisting in the current quarter. The upward movement in long-term interest rates in this country has been encouraging anticipatory borrowing by Canadian issuers of securities. The advance in GNP has kept imports of finished goods at a high level, while the decline in imports of materials has moderated.

Other factors in the situation have mixed implications. On the one hand, for example, the closing of Expo-67 brings to an end a season of unusually large tourist expenditures. Also, difficulties of seasonal adjustment may have made the third quarter bank credit outflow look larger than would be fairly representative of current movements. On the other hand, sterling's persistent

troubles, which in the third quarter may have produced unrecorded private receipts for the U.S. balance of payments, are now having an unfavorable impact on our balance of payments through operations to liquefy part of the U.K. official investment portfolio. The temporary decrease in U.S. petroleum imports last summer, which followed the Mid-East crisis, is beginning to be reversed, and some strike-anticipating imports of steel are likely before long.

On the official reserve transactions basis, large quarter-to-quarter fluctuations in the balance have occurred. A surplus of nearly \$400 million is presently estimated for the third quarter. The fourth-quarter balance on this basis as well as on the liquidity basis will be adversely affected by the U.K. operations mentioned above. Tending to hold down the deficit, however, there has been a further rise in the liabilities of U.S. banks to their foreign branches since the end of September.

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.)	Oct '67	78.0	77.8	76.1	2.5	4.4
Unemployment (mil.)	"	3.4	3.2	2.9	16.8	5.3
Unemployment (per cent)	"	4.3	4.1	3.8	--	--
Nonfarm employment, payroll (mil.)	"	66.2	66.0	64.7	2.3	7.5
Manufacturing	"	19.2	19.2	19.4	- 1.3	4.7
Other industrial	"	8.1	8.1	8.1	0.3	2.1
Nonindustrial	"	38.9	38.8	37.2	4.6	10.2
Industrial production (57-59=100)	Sept '67	156.3	157.8	157.7	- 0.9	8.5
Final products	"	156.6	158.1	156.3	0.2	9.0
Materials	"	155.7	157.1	159.2	- 2.2	7.5
Wholesale prices (57-59=100) ^{1/}	"	106.2	106.1	106.8	- 0.6	3.1
Industrial commodities (FR)	"	105.6	105.4	104.4	1.1	3.2
Sensitive materials (FR)	"	101.1	100.2	103.1	- 1.9	- 1.8
Farm products, foods & feeds	"	105.3	105.2	111.5	- 5.6	1.7
Consumer prices (57-59=100) ^{1/}	"	117.1	116.9	114.1	2.6	6.3
Commodities except food	"	110.0	109.4	107.0	2.8	4.9
Food	"	115.9	116.6	115.6	0.3	5.7
Services	"	128.7	128.2	123.5	4.2	8.6
Hourly earnings, mfg. (\$)	Oct '67	2.86	2.85	2.76	3.6	7.9
Weekly earnings, mfg. (\$)	"	116.40	116.69	113.96	2.1	6.4
Personal income (\$ bil.) ^{2/}	Sept '67	633.5	631.5	594.1	6.6	14.1
Corporate profits before tax (\$ bil.) ^{2/}	QII '67	78.9	79.0	83.6	- 5.6	4.4
Retail sales, total (\$ bil.)	Sept '67	26.8	26.4	25.7	4.1	12.6
Autos (million units) ^{2/}	Oct '67	7.0	8.1	8.0	-12.5	-15.8
GAF (\$ bil.)	Sept '67	6.5	6.4	6.1	6.0	16.2
Selected leading indicators:						
Housing starts, pvt. (thous.) ^{2/}	Sept '67	1,457	1,403	1,048	39.0	- 1.0
Factory workweek (hours)	Oct '67	40.7	40.8	41.3	- 1.5	- 1.2
New orders, dur. goods (\$ bil.)	Sept '67	23.2	23.7	25.3	- 8.3	4.6
New orders, nonel. mach. (\$ bil.)	"	3.7	3.9	3.7	- 1.2	10.7
Common stock prices (1941-43=10)	Oct '67	95.66	95.81	77.13	24.0	4.7
Manufacturers' Inventories, book val. (\$ bil.)	Sept '67	81.4	81.4	74.9	8.7	22.8
Gross national product (\$ bil.) ^{2/}	QIII '67	790.1	775.1	748.8	5.5	14.5
Real GNP (\$ bil., 1958 prices) ^{2/}	"	671.6	664.7	654.8	2.6	8.2

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended	4-week	Last 6 months	
	Nov. 3, 1967	average	High	Low
Money Market <u>1/</u> (N.S.A.)				
Federal funds rate (per cent)	4.05	3.85	4.70	3.45
U.S. Treas. bills, 3-mo., yield (per cent)	4.57	4.57	4.57	3.41
U.S. Treas. bills, 1-yr., yield (per cent)	5.31	5.25	5.31	3.84
Net free reserves <u>2/</u> (\$ millions)	295	226	574	109
Member bank borrowings <u>2/</u> (\$ millions)	80	125	353	43
Capital Market (N.S.A.)				
Market yields (per cent)	5.74	5.63	5.74	4.44
5-year U.S. Treas. bonds <u>1/</u>	5.54	5.44	5.54	4.57
20-year U.S. Treas. bonds <u>1/</u>				
Corporate new bond issues, Aaa <u>1/</u>	6.12	6.11	6.34	5.72
Corporate seasoned bonds, Aaa <u>1/</u>	5.95	5.86	5.95	5.38
Municipal seasoned bonds, Aaa <u>1/</u>	3.92	3.90	3.92	3.75
FHA home mortgages, 30-year <u>3/</u>	--	6.63	6.63	6.29
Common stocks, S&P composite series <u>4/</u>				
Prices, closing (1941-43=10)	91.78	94.53	97.26	89.79
Dividend yield (per cent)	3.20	3.11	3.25	3.01

	Latest month	Amount	3-month average	Change from year earlier	
				Latest 3-month month average	
New Security Issues (N.S.A., \$ millions)					
Corporate public offerings <u>5/</u>	Nov. '67 <u>e/</u>	2,200	2,091	1,115	993
State & local govt. public offerings	Nov. '67 <u>e/</u>	1,300	1,158	331	244
Comm. & fin. co. paper (net change in outstandings)	Sept. '67 <u>e/</u>	- 596	+ 23	+ 461	-313

	Latest month	Out-standings Latest month	Change Latest month	3-month average	Annual rate of change from		
					Pre-ceding month	3 months ago	12 months ago
					(\$ billions)		
					(per cent)		
Banking (S.A.)							
Total reserves <u>1/</u>	Oct. '67	24.66	0.33	0.26	16.2	13.2	9.5
Credit proxy <u>1/</u>	"	271.9	2.6	2.9	11.7	13.1	10.8
Bank credit, total <u>6/</u>	"	342.5	3.2	3.4	11.3	12.4	10.9
Business loans	"	83.4	0.2	0.2	2.9	2.4	6.1
Other loans	"	137.9	1.4	1.4	12.3	12.9	7.2
U.S. Govt. sec.	"	62.4	0.7	1.2	13.6	23.8	16.9
Other securities	"	58.8	0.9	0.7	18.6	14.8	21.5
Total liquid assets <u>1/</u> <u>6/</u>	Sept. 67	639.4	4.3	5.5	8.1	10.5	6.7
Demand dep. & currency <u>1/</u>	"	179.2	0.1	1.0	0.7	6.8	5.1
Time & sav. dep., comm. banks <u>1/</u>	"	178.9	1.7	2.2	11.4	15.1	13.7
Savings, other thrift instit. <u>6/</u>	"	181.4	1.7	1.6	11.4	10.6	8.9
Other <u>6/</u> <u>7/</u>	"	99.9	0.8	0.7	9.7	2.0	-4.9

N.S.A. -- not seasonally adjusted.

S.A. -- seasonally adjusted.

e. Estimated by F.R.B. 1/ Average of daily figures. 2/ Average for statement week ending Nov. 1. 3/ Latest figure is for Sept. 4/ End of week closing prices; yields are for Friday. 5/ Corporate security offerings include both public and private bonds and stocks. 6/ Month-end data. 7/ U.S. savings bonds and U.S. Government securities maturing within year.

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

	1966		1 9 6 7				
	QIII	QIV	QI	QII	QIII	Aug.	Sept.
	Seasonally adjusted						
Goods and services, net <u>1/</u>	1,151	1,084	1,349	1,300			
Trade balance <u>2/</u>	802	722	999	1,136	1,135	470	340
Exports <u>2/</u>	7,382	7,402	7,691	7,723	7,715	2,590*	2,560*
Imports <u>2/</u>	-6,580	-6,680	-6,692	-6,587	-6,580	-2,120	-2,220
Services balance	349	362	350	164			
Remittances and pensions	-278	-246	-264	-390			
Govt. grants & capital <u>3/</u>	-759	-724	-1,205	-931			
U.S. private capital	-932	-1,165	-958	-1,130			
Direct investments	-900	-1,003	-622	-684			
Foreign securities	-50	-83	-263	-171			
Banking claims	89	44	62	-176			
Other	-71	-123	-135	-99			
Foreign capital, nonliquid	376	780	824	1,215			
Official foreign accts.	172	425	397	759			
Long-term deposits	88	373	309	605			
U.S. Govt. liab.	84	52	88	154			
Int'l. institutions <u>4/</u>	38	15	64	95			
Other <u>5/</u>	166	340	363	361			
Errors and omissions	277	-148	-284	-576			
	Balances, with and without seasonal adjustment (- deficit)						
Liquidity balance, S.A.	-165	-419	-538	-512	-738		
Seasonal component	-530	-47	303	319	-470		
Balance, N.S.A.	-695	-466	-235	-193	-1,208	-364	-338
Official settlements bal.	861	-18	-1,827	-814	382		
Seasonal component	-456	-180	545	132	-380		
Balance, N.S.A. <u>6/</u>	405	-198	-1,282	-682	2	449	-239
	Reserve changes, N.S.A. (decrease -)						
Total monetary reserves	-82	6	-1,027	419	375	381	44
Gold stock	-173	-121	-51	-15	-92	-61	2
Convertible currencies	426	173	-1,007	424	462	443	38
IMF gold tranche	-335	-46	31	10	5	-1	4

1/ Equals "net exports" in the GNP.

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

3/ Net of scheduled and non-scheduled repayments.

4/ Long-term deposits and Agency securities.

5/ Includes some foreign official transactions in securities.

6/ 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 (+) increases in certain nonliquid liabilities to foreign official institutions.

*/ Data have been adjusted by \$50 million, raising August and lowering September.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. The fourth quarter increases in GNP in both current and constant dollars now appear likely to be somewhat smaller than projected in the preceding Greenbook, mainly because of altered assumptions regarding strikes in the automobile industry rather than because of any major change in underlying demands. We now expect a rise in current dollar GNP of \$18 billion, annual rate, in this quarter compared to a rise of \$15 billion in the third quarter. Real GNP is projected to increase at an annual rate of slightly over 5 per cent compared to a little over 4 per cent in the third quarter.

The increases in dollar GNP continue to reflect rather large advances in prices. The GNP deflator is projected to rise at an annual rate of 3.7 per cent in the fourth quarter, about the same as in the third quarter. However, 0.6 points of the 3.7 per cent is attributable to the anticipated Federal pay raise, which is treated as a straight price increase in the calculation of the deflator. Consumer prices, with autos up 2 per cent, and apparel prices sharply higher, are likely to rise as fast in the fourth as in the third quarter. Construction costs should advance further but are unlikely to equal the sharp step-up reported for the third quarter.

Work stoppages at Ford persisted longer than we had anticipated and the likelihood of strikes at General Motors--and possibly at Chrysler--now appears much greater than it did earlier.

Even if agreements on a national basis are reached fairly promptly, production may be hampered by work stoppages at individual plants over local issues.

In consequence of the greater-than-anticipated strike effects, our estimate of unit sales of new domestic cars in the fourth quarter has now been reduced to 8 million, annual rate, from the 8-1/4 million we projected earlier; total consumer outlays for durable goods consequently have also been lowered somewhat. Moreover, it now appears that dealer stocks of autos will be sharply curtailed this quarter, after allowance for the usual seasonal increase. The longer work stoppages in autos should result in sharp step-ups in production, purchases, and inventories in the first half of next year, reinforcing the effects on incomes in that period of likely Federal and private pay raises, the wage increase already provided by existing legislation, and the anticipated large increase in social security benefits. In addition, both producers and consumers of steel may be adding to their stocks in anticipation of a possible strike when the present contract expires at the end of July.

Total consumer expenditures for goods are still expected to rise at a faster pace in the current quarter than in the preceding period, although shortages of some new model autos may shift some spending to nondurables and other durable goods. Weekly retail trade data for October suggest more strength in nondurable goods sales and some improvement in furniture and appliances following a relatively weak third quarter. Color TV sales appear to be chalking up significant gains.

Underlying the projected increase in consumer spending is the expected further sizable expansion in incomes. Personal income is expected to rise almost \$14 billion, annual rate, in the fourth quarter, compared to \$11.6 billion in the third quarter, despite the effect of work stoppages in slowing the increase in wage income. Farm income is now rising again, interest income is expanding rapidly and other components of income, including transfer payments, are continuing to increase.

Although the increase in consumer disposable income in the fourth quarter is now expected to be somewhat below earlier estimates, the saving rate is likely to increase slightly to over 7 per cent of income as the auto strike and the expected bunching of a retroactive Federal pay increase in December may limit the rise in consumer outlays.

Residential construction expenditures continue to be a strong upward force in the economy and are now projected to rise about \$2.3 billion, to \$27.7 billion in the present quarter. This increase is considerably larger than shown in our previous projection. Starts in the third quarter were unexpectedly large as a result of upward revisions in the July and August figures and a strong September performance.^{1/} Fourth quarter starts are projected to be somewhat higher than in the third quarter because of the momentum already achieved, the relatively high level of current mortgage commitments,

^{1/} These third quarter starts figures were shown in the last Greenbook but became available too late to be incorporated in the table of GNP expenditures estimates shown in that Greenbook.

and possibly because some builders may accelerate their rate of starts in view of growing uncertainties about the continuing availability of mortgage funds around current rates.

Scattered information on the outlook for fixed investment in plant and equipment continues to suggest only modest improvement. The McGraw-Hill survey, which will be available later this week, is expected to be consistent with the results of other recent private surveys showing an increase in plant and equipment outlays next year of about 5 per cent in current dollars. Commercial and industrial construction are still declining, especially in real terms.

Government outlays for goods and services, which are projected to rise about \$6 billion, annual rate, in the current quarter, are expected to account for about one-third of the increase in GNP. The odds still favor a pay increase before year-end for Federal civilian and military employees amounting to about \$1.7 billion or 5 per cent, annual rate, retroactive to October 1, although pay checks are not likely to incorporate these increases before December.

Defense spending in the current quarter, except for added employee and military compensation, is expected to rise at about the third quarter rate of \$1.5 billion. This slower rise in defense outlays after the large increases in the first half of the year appears in line with the slower recent rise in prime contracts, leveling in orders for defense products, and the more nearly stable size of the armed forces. The \$1.4 billion rate of rise in Federal nondefense outlays in the current quarter reflects both an assumed

pay raise of over \$1 billion and a further increase in outlays for farm price supports.

Accumulation of nonfarm inventories in this quarter is expected to be quite modest and less than projected earlier, since a decline in auto stocks, because of strike disruptions, is expected largely to offset a net increase in other areas.

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)

	1966	1967 Proj.	1966		1967			Proj. IV
			III	IV	I	II	IIIp	
Gross National Product	743.3	784.9	748.8	762.1	766.3	775.1	790.1	808.1
Final sales	729.9	782.4	737.4	743.6	759.2	774.6	788.6	807.1
Private	575.6	605.0	579.7	581.9	588.8	599.6	609.7	622.0
Personal consumption expenditures	465.9	492.6	470.1	473.8	480.2	489.7	495.8	504.5
Durable goods	70.3	72.4	70.9	70.6	69.4	72.5	73.0	74.5
Nondurable goods	207.5	218.2	209.5	210.3	214.2	217.2	219.0	222.5
Services	188.1	202.0	189.8	192.9	196.6	200.0	203.8	207.5
Gross private domestic investment	118.0	109.4	116.4	122.2	110.4	105.1	109.8	112.2
Residential construction	24.4	24.4	23.7	20.9	21.4	23.1	25.4	27.7
Business fixed investment	80.2	82.5	81.2	82.8	81.9	81.5	82.9	83.5
Change in business inventories	13.4	2.5	11.4	18.5	7.1	.5	1.5	1.0
Nonfarm	13.7	2.4	12.0	19.0	7.3	.6	1.1	.5
Net Exports	5.1	5.6	4.6	4.3	5.3	5.3	5.6	6.3
Gov't. purchases of goods & services	154.3	177.4	157.7	161.7	170.4	175.0	178.9	185.1
Federal	77.0	90.8	79.5	81.5	87.1	89.5	91.4	95.3
Defense	60.5	73.3	63.0	65.6	70.2	72.5	73.9	76.4
Other	16.5	17.6	16.6	15.9	16.8	17.0	17.5	18.9
State & local	77.2	86.5	78.1	80.2	83.3	85.4	87.6	89.8
Gross National Product in constant (1958) dollars	652.6	669.3	654.8	661.1	660.7	664.7	671.6	680.2
GNP Implicit deflator (1958=100)	113.9	117.3	114.4	115.3	116.0	116.6	117.7	118.8
Personal income	584.0	626.8	589.3	601.6	612.9	619.1	630.7	644.5
Wage and salaries	394.6	423.9	399.6	407.4	414.7	418.3	425.9	436.5
Disposable income	508.8	544.8	512.4	522.0	532.7	540.0	547.9	558.6
Personal saving	29.8	38.1	29.2	34.6	38.8	36.0	37.8	39.7
Saving rate (per cent)	5.9	7.0	5.7	6.6	7.3	6.7	6.9	7.1
Corporate profits before tax	83.8	80.2	84.0	83.9	79.0	78.9	80.5*	82.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	143.2	151.8	145.6	148.6	149.1	148.1	152.9*	157.1
Expenditures	142.9	165.1	146.3	151.9	160.9	162.8	166.4	170.2
Surplus or deficit (-)	.3	-13.3	-.7	-3.3	-11.9	-14.7	-13.5*	-13.1
Total labor force (millions)	78.9	80.8	79.1	79.8	80.3	80.2	81.1	81.6
Armed forces "	3.1	3.5	3.2	3.3	3.4	3.5	3.5	3.5
Civilian labor force "	75.8	77.3	76.0	76.5	76.9	76.7	77.7	78.1
Unemployment rate (per cent)	3.8	3.9	3.8	3.7	3.7	3.8	3.9	4.0
Nonfarm payroll employment (millions)	64.0	66.0	64.3	65.0	65.7	65.7	66.1	66.4
Manufacturing	19.2	19.3	19.3	19.5	19.5	19.3	19.2	19.3
Industrial production (1957-59=100)	156.3	156.8	157.6	158.8	157.0	155.8	156.9	157.4
Capacity utilization, manufacturing (per cent)	90.5	84.6	90.6	89.8	87.0	84.8	83.8	82.8
Housing starts, private (millions A. R.)	1.17	1.30	1.08	.92	1.12	1.21	1.41	1.45
Sales new U.S.-made autos (millions, A. R.)	8.38	7.79	8.47	8.13	7.33	7.83	8.01	8.00

* Projected.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1966	1967 Proj.	1966		1967			Proj. IV
			III	IV	I	II	IIIp	
----- In Billions of Dollars -----								
Gross National Product	59.4	41.6	12.1	13.3	4.2	8.8	15.0	18.0
Final sales	55.4	52.5	14.7	6.2	15.6	15.4	14.0	18.5
Private	37.5	29.4	8.2	2.2	6.9	10.8	10.1	12.3
GNP in constant (1958) dollars	35.9	16.7	5.5	6.3	-4	4.0	6.9	8.6
Final sales	32.1	28.8	8.3	-0.3	10.1	10.3	5.9	9.0
Private	21.9	12.0	4.4	-2.8	3.7	7.1	4.1	6.3
----- In Per Cent; Quarterly Changes are at Annual Rates -----								
Gross National Product	8.7	5.6	6.6	7.1	2.2	4.6	7.7	9.1
Final sales	8.2	7.2	8.1	3.4	8.4	8.1	7.2	9.4
Private	7.0	5.1	5.7	1.5	4.7	7.3	6.7	8.1
Personal consumption expenditures	7.6	5.7	7.4	3.1	5.4	7.9	5.0	7.0
Durable goods	6.5	3.0	15.8	-1.7	-6.8	17.9	2.8	8.2
Nondurable goods	8.5	5.2	4.6	1.5	7.4	5.6	3.3	6.4
Services	6.9	7.4	7.5	6.5	7.7	6.9	7.6	7.3
Gross private domestic investment	9.9	-7.3	-7.1	19.9	-38.6	-19.2	17.9	8.7
Residential construction	-9.6	0.0	-32.6	-47.3	9.6	31.8	39.8	36.2
Business fixed investment	12.8	2.9	12.7	7.9	-4.3	-2.0	6.9	2.9
Gov't purchases of goods & services	13.1	15.0	17.2	10.1	21.5	10.8	8.9	13.9
Federal	15.3	17.9	24.6	10.1	27.5	11.0	8.5	17.1
Defense	20.8	21.2	31.5	16.5	28.0	13.1	7.7	13.5
Other	-1.2	6.7	0.0	-16.9	22.6	4.8	11.8	32.0
State & local	10.9	12.0	10.0	10.8	15.5	10.1	10.3	10.0
GNP in constant (1958) dollars	5.8	2.6	3.4	3.8	-2	2.4	4.2	5.1
Final sales	5.3	4.2	5.2	-0.2	6.3	6.3	3.6	5.4
Private	4.4	2.3	3.4	-2.2	2.9	5.5	3.1	4.8
GNP Implicit deflator	2.7	3.0	3.2	3.1	2.4	2.1	3.8	3.7
Personal income	8.6	7.3	8.3	8.3	7.5	4.0	7.5	8.8
Wage and salaries	9.9	7.4	9.6	7.8	7.2	3.5	7.3	10.0
Disposable income	7.8	7.1	7.2	7.5	8.2	5.5	5.8	7.8
Corporate profits before tax	9.5	-4.3	1.9	-5	-23.4	-0.5	8.1*	9.9
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.7	6.0	11.3	8.2	1.3	2.7	13.0*	11.0
Expenditures	15.8	15.5	22.8	15.3	23.7	4.7	8.8	9.1
Nonfarm payroll employment	5.3	3.1	3.8	4.4	4.3	0.0	2.4	1.8
Manufacturing	6.1	.5	4.2	4.1	0.0	-4.1	-2.1	2.1
Industrial production	9.0	.3	6.2	3.0	-4.5	-3.1	2.8	1.3
Housing starts, private	-20.4	11.1	-62.5	-59.3	87.0	32.1	66.1	11.3
Sales new U.S.-made autos	-4.4	-7.0	33.6	-15.8	-39.6	27.3	9.2	.0

* Projected.

Industrial production. Available production and employment data for October indicate a slight further decline in industrial production from the preliminary September level of 156.3 per cent. "Special" situations again seem to account for most of the decline.

Auto assemblies in October remained at the sharply reduced September level as the Ford strike continued into early November. Production of television sets, furniture, and apparel apparently changed little in October. Output of industrial equipment declined further, mainly because of a strike (now settled) at Caterpillar Tractor Corporation, and was one-tenth below last December's peak. Production of commercial equipment was maintained at levels prevailing earlier this year while output of trucks remained at the strike-reduced September level. Output of aircraft and defense equipment generally, however, continued to advance.

Steel ingot production changed little in October but crude oil production declined 6 per cent further as allowables were reduced further by state regulatory agencies. Among other materials, employment data indicate a rise in output of some chemical and stone, clay, and glass products, little change in textiles and paper, and further declines in some auto supplying industries.

The underlying trend of production in the manufacturing sector does not appear strong even after allowances for strikes and other special situations. Average hours worked in manufacturing, which had been rising in the third quarter, declined in October with

declines widespread in both durable and nondurable industries. Manufacturers' inventories of finished goods and work in process continued to rise through August and then leveled off in September. At months' end, they were up 6 per cent further from the high December 1966 level. Also, in recent months, the physical volume of retail sales, excluding autos, has shown little significant change.

Manufacturing capacity utilization. The estimated operating rate for manufacturing fell one point to 83.2 per cent in September, slightly below the previous low for the year of 84.0 recorded in July. Much of the decline was a result of the work stoppage in the automobile industry; the operating rate would have been about 84 per cent if automobile output had been maintained.

Because of continuing growth in capacity the estimated utilization rate would fall 0.4 points in October, even if manufacturing output were unchanged. Since output is expected to be down a little the decline in the utilization rate is likely to be somewhat larger.

Unused capacity currently exists in most manufacturing industries. Only the aircraft, rubber, and petroleum industries seem to be operating at high rates relative to historical experience.

UTILIZATION RATES

Industry	July	August	September
Manufacturing	84.0	84.4	83.2
Primary products	81.8	82.3	81.8
Advanced products	85.6	85.6	84.2

Manufacturers' shipments and inventories. Shipments of all manufactured goods decreased 2.7 per cent in September, owing largely to the auto strike. Excluding automobiles, other manufacturing shipments were down only 1.3 per cent. Shipments of durable goods other than autos declined 0.3 per cent, but remained higher than in any month except August this year. Shipments of non-durable goods were down 1.6 per cent, the second consecutive month of moderate decline.

Manufacturers inventories were virtually unchanged in September, after rising sharply in each of the previous two months. Inventories of finished goods and of materials increased slightly while work in process showed a small decline.

Orders for durable goods. New orders for durable goods declined 2.3 per cent in September according to Census Bureau preliminary figures. Totals for both August and September were revised upward, however, from those given in previous releases. Motor vehicle orders declined because of the Ford strike. The volatile aircraft series was up 30 per cent from an unusually low August figure. If motor vehicles are excluded from the total, durable goods orders are up slightly in September. If both autos and aircraft are excluded, the total decline is 2.5 per cent.

Orders for durable goods increased about 10 per cent between January and June, but for the last three months have remained in a range a little below the June high. The lag between orders

and production in the aircraft industry is long; if this highly irregular series is excluded, the rise in new orders continued through August, but declined in September.

Unfilled orders for durable goods were up 0.6 per cent in September marking the fifth consecutive monthly increase. About two-thirds of the increase over the five month period has been in defense products. The other third is about evenly split between the iron and steel and machinery and equipment industries.

Auto sales and stocks. Dealer deliveries of new domestic autos in October were 16 per cent smaller than a year earlier; if Ford cards are excluded, however, sales were 5 per cent larger. In the final ten days of October it appeared that the long strike was stimulating sales of the other auto manufacturers as their deliveries were up 16 per cent from a year earlier, after no change in the first twenty days.

The seasonally adjusted annual rate of total domestic auto sales in October was 7.0 million units as compared with 8.1 in September. Dealers' stocks of new cards on October 31 were slightly below ten days earlier and one-fifth below last year.

Nearly all of Ford's 160,000 production workers are expected to be back on the job by the end of this week but it will be considerably longer before inventories reach normal levels. These work stoppages and reduced sales have not lowered the auto industry's sales expectations of 9.0 to 9.2 million units (including imports) in the new model year.

Sales of imported cards in October increased 15 per cent from a year earlier; such sales are expected to total a record 750,000 units this calendar year.

Consumer credit. Consumer credit has continued to climb during the summer and early fall, but the rate of expansion has continued at the reduced rate of earlier this year and far below 1966. For example, in September consumer instalment debt outstanding increased at an annual rate of \$3.4 billion, while a year earlier the increase was \$5.7 billion. Two years ago, the annual rate of expansion was \$8.2 billion

The slowdown in credit expansion continues to be centered in the auto area. The volume of auto extensions has been running below year-earlier levels throughout 1967. At the same time, repayments on old debt have been larger than in comparable 1966 months. The net result has been a sharp slowing in the expansion of outstanding consumer auto debt. On average, auto debt during the first nine months of 1967 increased only \$21 million a month, sharply below the \$175 million monthly average for 1966. Indeed, in two months--February and April--auto repayments actually exceeded extensions and outstanding auto debt declined.

Meanwhile, terms on which consumers have been obtaining auto credit continue relatively easy. Sales finance companies have been writing more new-car contracts at 36-months than ever before. In September, 82 per cent of all their new-car contracts provided for

this maturity, as compared with 80 per cent a year earlier. Downpayment requirements also have eased on new cars, following a periods of stiffening last year. The finance companies also have moved toward slightly longer average maturities on used-car contracts. The "over 30-months" category now accounts for 38 per cent of the total, up about two percentage points from last spring.

The principal exception to this easing trend in auto terms has been in downpayment requirements for used cards. In the first few months following the turnaround in monetary policy late last year, downpayments became less restrictive. But there has been a noticeable tightening again this past spring and summer. By September, only 9 per cent of all used-car contracts written by sales finance companies were in excess of 120 per cent of dealer cost, down from 15 per cent or more early this year.

PROPORTION OF USED CAR CONTRACTS
IN EXCESS OF 120 PER CENT OF DEALER COST

Date	Per cent
1966 July	14.9
Aug.	14.8
Sept.	13.3
Oct.	13.3
Nov.	12.7
Dec.	12.9
1967 Jan.	14.9
Feb.	15.4
Mar.	15.9
Apr.	14.8
May	13.7
June	12.2
July	10.5
Aug.	10.8
Sept.	9.2

Note: Sales finance company data, seasonally adjusted. In general, a decline in the proportion implies a larger average downpayment.

This recent stiffening in used-car downpayments may be in response to an increase in delinquency and repossession rates, but it may have broader implications arising out of the searching look which some finance companies appear to be giving their consumer loan portfolios. The large independent finance companies in particular are attempting to upgrade their auto paper, and at the same time they are moving more aggressively into nonauto goods and personal loan areas, as well as into business financing activity.

Construction activity and real estate. New construction put in place, which was revised upward significantly in August and September, rose further in October to a new record high. The major upward impetus has come from the accelerated recovery in residential construction over the past ten months. Private nonresidential construction expenditures have changed little since April, at a level a tenth below their peak last January. Public construction expenditures, however, apparently continued to edge upward in October, to another high.

NEW CONSTRUCTION PUT IN PLACE

	October 1967 (\$ billions) ^{1/}	Per cent change from	
		September 1967	October 1967
Total	78.7	+1	+ 9
Private	51.5	+1	+ 8
Residential	25.9	+2	+20
Nonresidential	25.6	--	- 3
Public	27.2	+1	+12

^{1/} Seasonally adjusted annual rates; preliminary. Data for the most recent month (October) are available under a confidential arrangement with the Census Bureau. Under no circumstances should public reference be made to them.

While the uptrend in residential construction has been pronounced this year, it has been limited in the case of single family homes by the relative inability or unwillingness of speculative builders to build ahead of the market under prevailing financial market and other conditions. As a result, speculative builders' stocks of new homes either completed or under way have remained at the already reduced August level; in August the latest month for which data are available, they amounted to only 3.7 months supply. Although data on vacancies for the third quarter are not yet available, the limited volume of completions so far this year and the steady accumulation of basic demands probably has continued to drive vacancy rates down further. Nationally, vacancy rates on rental units during the second quarter were already at an 8-year low.

The further recovery in housing starts in the third quarter was stronger than generally expected, but even the more optimistic trade projections tend toward a level for 1968 as a whole not much higher than the 1.46 million annual rate (including farm starts) reached in September.

Labor market. Employment and unemployment figures for October indicate a pause in employment expansion, appearing to reflect largely temporary factors. Job growth has been curtailed in manufacturing and transportation--which are showing the direct and indirect effects of several major strikes--and in the public services, which have been affected by the curb on Federal government hiring.

With the settlement of the Ford, agricultural machinery and steel haulers strikes, however, a significant rise in nonfarm employment should be apparent in the November figures.

Nonfarm employment rose only modestly in October, while at the same time, the labor force continued to grow at a brisk rate. As a result, the unemployment rate rose by two-tenths--the second consecutive month of increase--to 4.3 per cent in October. Although the unemployment rate for adult males was also up in October--by two-tenths of a point. The rate at 2.5 per cent was still extremely low and virtually unchanged from a year earlier.

The factors making for some easing in the labor market seen likely to be of short duration; the settlement of the Ford and other major strikes alone should result in increased employment in autos, metals and machinery, barring a protracted strike at G.M. Moreover, the current rapid rate of expansion of the labor force--which is now tending to raise the unemployment rate--augurs well for meeting the sharply increased demand for workers that is suggested by our projections for the near future. The total labor force in October was over 2 million above a year earlier--some half a million greater than normal--including for the first time in many years a large number of additional male workers who are now reaching adult working age.

Nonfarm payroll employment rose by 113,000 to 66.2 million in October, with increases concentrated in State and local government and trade. The number of workers who were still on strike in October

was large (over 200,000) including the strikes in autos, agricultural machinery, copper, and independent steel haulers. In addition, there were some secondary layoffs--unemployment claims suggest about 20,000--as a result of strikes.

Manufacturing employment appeared to show firmness in the face of the direct and indirect impact of the strikes. Employment increased by 13,000 in October, and this gain would have been closer to 30,000 if employment in durable goods had not been reduced by new strikes in the agricultural machinery industry. Employment in the primary and fabricated metals industries held firm at the September level. Modest increases in employment occurred in the stone, clay and glass, and lumber industries.

In contrast to the durable goods sector, employment in the nondurable goods industries showed a recovery of 25,000. Increases were generally small, with the apparel and chemical industries contributing the largest gains.

The workweek in manufacturing, at 40.7 hours in October, was off by one-tenth of an hour over the month, and remained over a half hour below the level a year earlier. There were widespread but small dips among durable goods industries. The largest declines occurred in transportation equipment and nonelectrical machinery, as a result of the Ford strike. The picture was somewhat erratic in nondurable goods, where the workweek was off by three-tenths of an hour.

The lack of the usual employment strength in the non-industrial sectors was a significant factor in slowing the overall employment gain. Federal civilian employment is now showing a definite downward trend, perhaps in part due to delays in approving funds for government agencies. Federal employment declined by 11,000 in October and is now down by 55,000 from the July high. Private services did not show their usual employment rise and the increase in State and local government mainly reflected the return of school teachers on strike in September. Construction employment continued relatively unchanged in October as has been the case since July. However, trade employment continued to show significant gains in October.

Earnings. Average hourly earnings of production workers in the total private nonfarm economy rose one cent in October to \$2.72, and are now 12 cents or 4.6 per cent above a year ago. Manufacturing hourly earnings, at \$2.85, showed no change in October. The relatively small increase from a year earlier, (3.6 per cent), reflects largely the decline of six-tenths in overtime hours at premium pay, and the reduced levels of employment in some high wage industries. The effect was apparent mainly in durables, up by 3.1 per cent over the year; in nondurables, hourly earnings were up by 5.2 per cent.

The recovery of hours of work and employment in the high-wage auto, metals and agricultural machinery industries and the direct and indirect impact of the effect of raising earnings in the

manufacturing sector significantly. The Ford wage settlement of 5.3 to 6.6 per cent (see Appendix A) can be expected to set a pattern for the industry, and should also affect upcoming negotiations in the steel, can, and other industries. Hourly earnings in nonmanufacturing industries continue to exhibit annual rates of growth of more than 5 per cent, with construction and finance showing increases of 6.3 and 6.0 per cent, respectively.

Minimum wage increase, 1968. In addition to the sharp increase in prospective earnings resulting from negotiated wage rate adjustments, increases in the minimum wage will become effective on February 1, 1968 and should increase aggregate wages substantially. The minimum wage will go up by 20 cents to \$1.60 per hour for workers who had been covered under the Fair Labor Standards Act prior to the 1966 Amendments. The \$1.60 minimum should have a direct impact on the wages of about 6 million workers, resulting in an estimated increase of almost \$2.0 billion in the annual wage bill. In addition, the minimum wage will be increased 15 cents, to \$1.15, for workers first covered by the 1966 Amendments. About 3 million workers were first brought under coverage in early 1967 under these Amendments, mainly farm workers and workers in trade and service activities. The direct impact of the increase in their minimum wage has not as yet been estimated, but will be smaller than the impact of the rise in the minimum to \$1.60 for workers already covered. However, in addition to the direct effects of the minimum

wage increase, the tendency to maintain wage rate differentials is likely to result indirectly in further upward adjustment of wage rates for higher-rated workers.

Wholesale prices. The final BLS report on industrial commodity prices confirms the increase of 0.2 per cent estimated for September, and the preliminary October estimate showed another 0.2 per cent rise. This brings the rise from mid-July, just before the recent upturn began, to mid-October to an annual rate of 2.8 per cent, the largest increase since the first half of 1966. Whether the industrial price rise has continued since the BLS October pricing date (October 10) is more uncertain than had been the case in the three preceding months, when a rise in the index could be anticipated on the basis of frequent and widespread announcements of price increases. In recent weeks, there have been very few such announcements, with the main advances apparent in copper and brass products where a strike affecting most domestic copper output is now in its 17th week.

In September, as in August, there was a relatively wide diffusion of price increases among the various components of the industrial commodity average--in each month, two-fifths of the 225 product classes showed increases (double the number of decreases). Petroleum and products, rubber products, and building materials had dominated the August increase; about two-thirds of the September rise was accounted for by lumber, plywood, steel scrap and steel

mill products, and copper products. Price increases were effected in September for some additional rubber products (mainly for industrial use), and cotton textile prices also increased.

Lumber and plywood prices had been rising steadily through the spring and early summer, with the strengthening in residential building activity. In late August and early September, logging operations were curtailed in the Northwest by a temporary closing of forests, and the BLS price index for lumber in mid-September rose 3 per cent (as much as over the preceding 6 months) and for plywood, about 5 per cent. These sharp increases, coupled with sizable gains for steel scrap and copper mill products, led to a pronounced spurt in the Board's index of sensitive industrial materials. Prices of sluggish materials edged up slightly further--mainly because of the rise in steel mill products; and average prices of industrial products showed a much smaller increase in September than in August, when rubber and petroleum products were boosted substantially.

By October 10, with improved logging supplies in the Northwest and with the seasonal decline in shipments for homebuilding underway, prices of lumber and plywood were declining and despite further increases for copper products the index of sensitive items probably declined. The October increase in the total industrial price average thus apparently reflected some further upcreep in sluggish materials (some additional steel mill products, a few basic

chemicals, and building materials other than lumber and plywood) and a step-up in product prices--reflecting particularly higher prices for 1963 model autos and trucks.

Wholesale prices of foods and foodstuffs declined about 1 per cent from mid-September to mid-October, according to the BLS estimate (and because of this decline, the total wholesale price index edged down 0.1 per cent). The mid-October level was down about 3 per cent from July and only 1 per cent above the April low; since mid-October these prices may have declined further.

Hog prices have declined steadily and sharply since mid-year as marketings have persisted at unexpectedly high levels. On the basis of earlier pig crop surveys it had appeared that hog slaughter would be down to year-earlier levels by October, but instead it remained well above a year ago. Moreover, pork storage stocks are up sharply. Beef production has been running at about year earlier levels since late July--after being well above earlier in the year--and prices tended upward through early September. However, since then (and particularly in late October), cattle prices have declined, owing in part to the unexpectedly large supplies of pork. Record crops have continued to exert downward pressure on prices of corn and soybeans. However, prices of wheat have tended to stabilize following the earlier sharp decline, and cotton prices have risen in the face of a short crop.

Consumer prices. The consumer price index increased only 0.2 per cent in September as food prices declined somewhat more than

seasonally while prices of other commodities and of services increased sharply further. From April to August, when food prices were rising, the increase in the CPI averaged 0.35 per cent a month--or an annual rate of over 4 per cent.

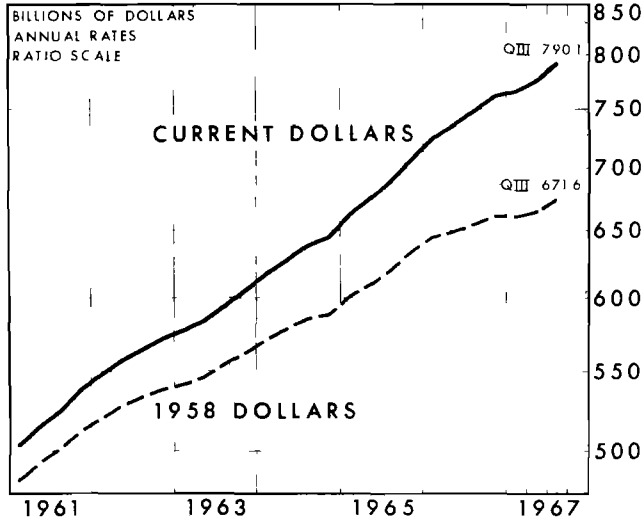
The decline in average retail food prices in September reflected decreases for fresh vegetables and eggs. Meat prices were unchanged, where as they usually rise seasonally. Recent declines in livestock and meat prices at wholesale may be reflected in lower retail prices for red meat after September. Chickens and turkeys are also plentiful and prices have been declining at wholesale.

Average retail prices of commodities other than food, which were rising sharply in the spring and summer, showed another spurt in September. Apparel prices showed twice the usual large seasonal rise with the introduction of new fall and winter lines, and used car prices rose further (and contraseasonally), owing in part to the spill-over to used car markets of limited supplies of new cars.. Prices of most other consumer items continued to rise--though less rapidly than for apparel and used cars. Altogether, average retail prices of non-food commodities increased at an annual rate of 4 per cent from March through September, and another sizable gain seems probable for October with the introduction in the index of higher prices for 1968 model autos and perhaps a further contra-seasonal rise in used car prices.

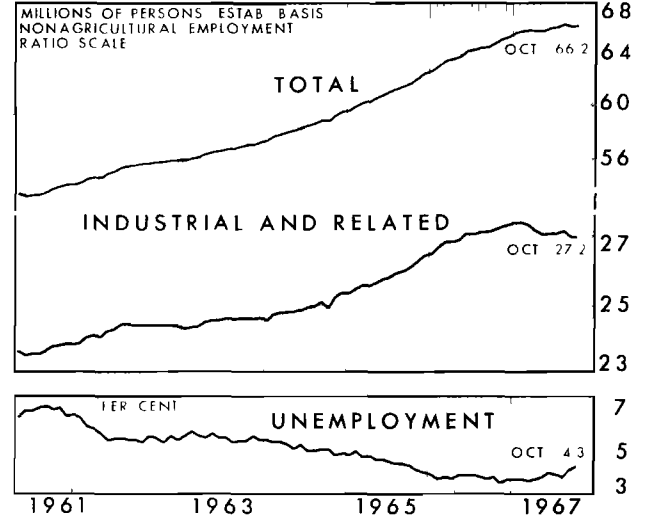
ECONOMIC DEVELOPMENTS - UNITED STATES

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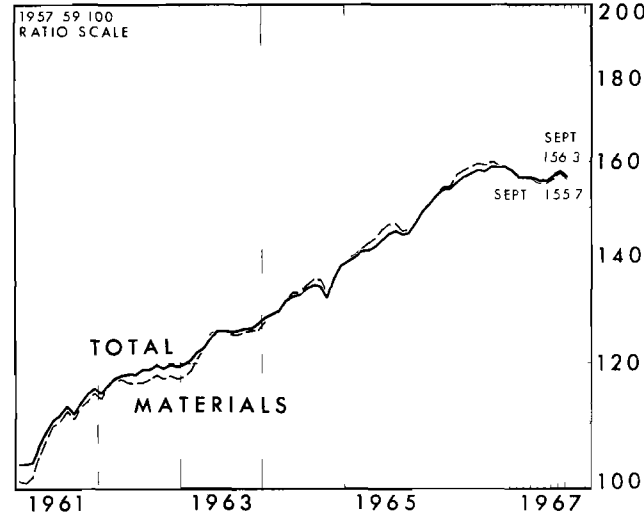
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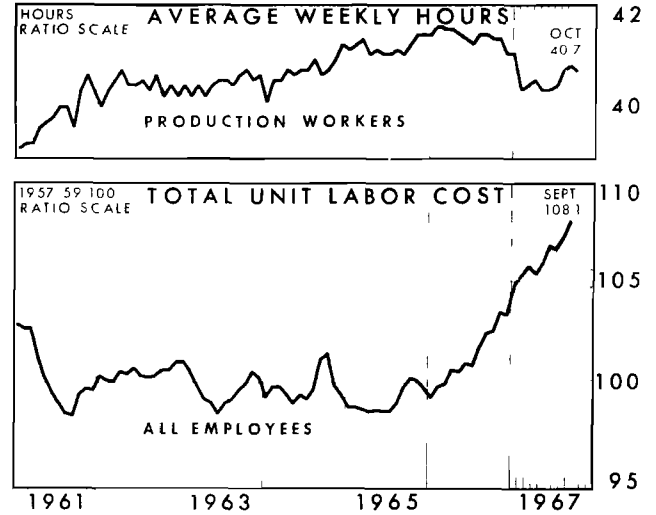
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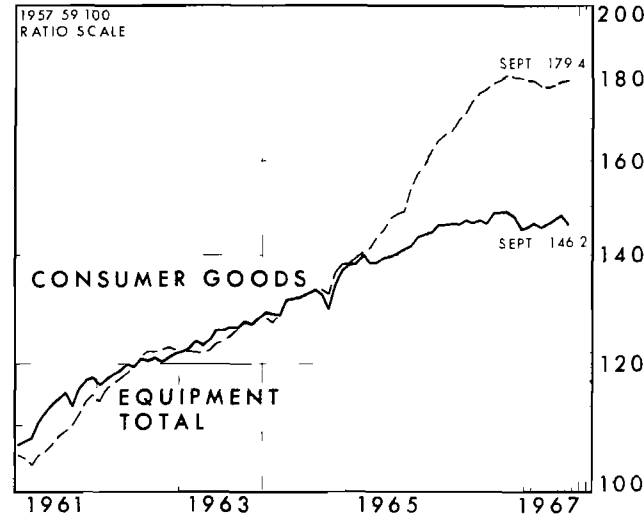
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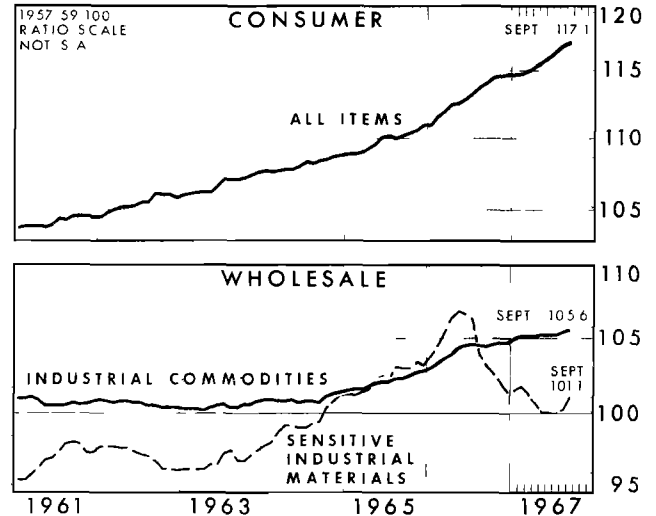
WORKWEEK AND LABOR COST IN MFG



INDUSTRIAL PRODUCTION-II



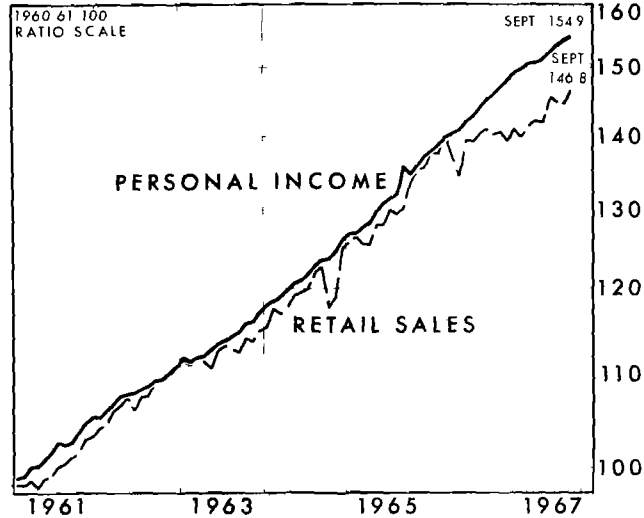
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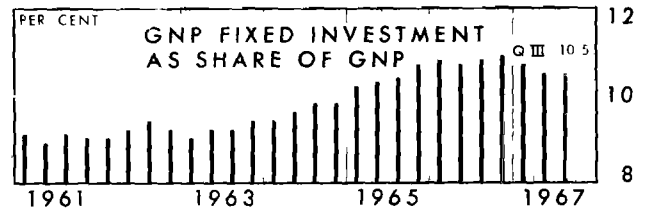
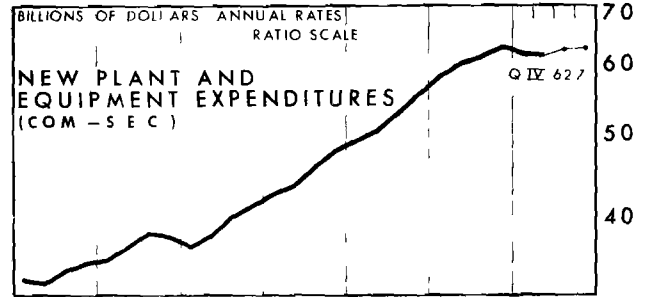
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

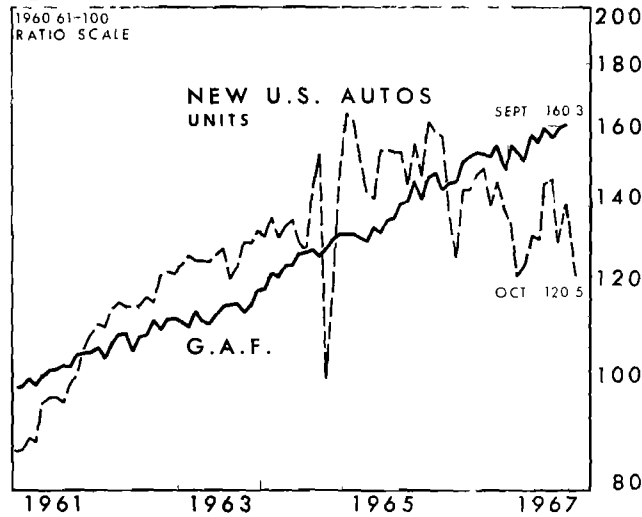
INCOME AND SALES



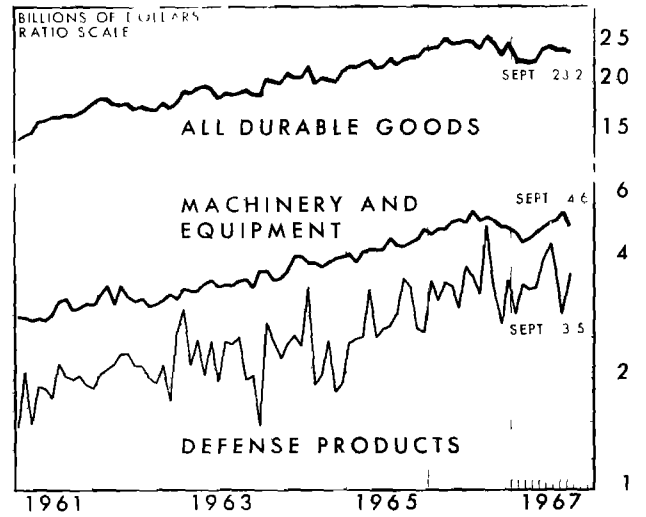
BUSINESS INVESTMENT



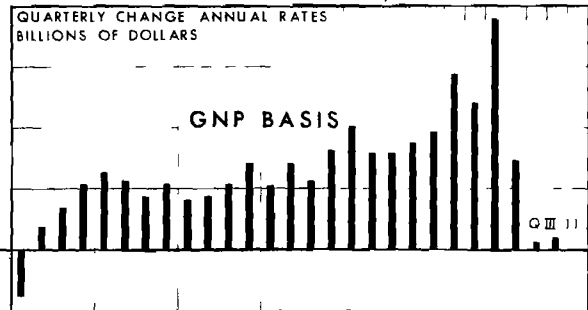
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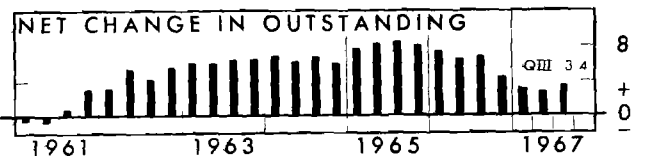
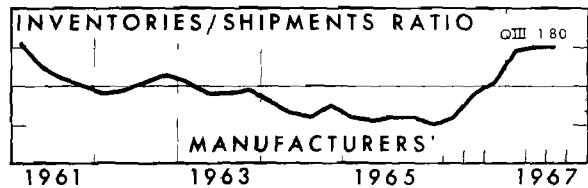
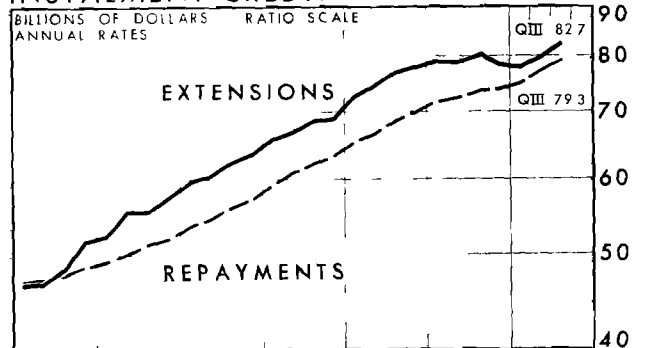
MANUFACTURERS NEW ORDERS



BUSINESS INVENTORIES, NONFARM



INSTALMENT CREDIT



 DOMESTIC FINANCIAL SITUATION

Bank credit. Bank credit expanded at an estimated 11 per cent annual rate in October, compared with 8 per cent in September when there was no new Treasury issue to underwrite. The expansion in bank loans and investments net of acquisitions of Treasury securities has shown considerably less variation, with most of the remaining greater growth in July and August reflecting sizable loans to Government security dealers associated with Treasury financings.

CHANGES IN BANK CREDIT IN 1967
ALL COMMERCIAL BANKS
(Seasonally adjusted annual rate, per cent; end-of-month series)

	1st Half	July- August	September	October	1st 10 months
Total loans & investments	<u>9.5</u>	<u>22.5</u>	<u>7.8</u>	<u>11.3</u>	<u>12.5</u>
U.S. Gov't. securities	8.2	64.6	-3.9	13.6	19.4
Other securities	29.2	18.3	8.3	18.6	24.9
Loans	5.2	12.7	11.0	8.7	7.8
MEMO: Total less U.S. Gov't. securities	9.7	13.8	10.5	10.8	11.0

Although total loans continued to expand somewhat more rapidly in October than in the first half of the year, business loans increased at a very modest pace for the third straight month. Moreover, as in September, a sizable share of the business loan expansion reflected large acquisitions of bankers' acceptances. These increases

are associated in part with Japanese trade financing, but probably also reflect continued bank interest in portfolio liquidity. No industry category of business loans showed any real strength and the machinery, other durable goods, trade, and public utility groups displayed weakness.

COMPOSITION OF LOAN GROWTH IN 1967
ALL COMMERCIAL BANKS
(Seasonally adjusted annual rate, per cent; end-of-month series)

	1st Half	July- August	September	October	1st 10 months
Total loans	<u>5.2</u>	<u>12.7</u>	<u>11.0</u>	<u>8.7</u>	<u>7.8</u>
Business	9.2	5.8	2.9	2.9	7.3
Real estate	5.9	7.6	6.4	8.5	6.7
Consumer	4.1	6.1	9.0	8.9	5.6
Security	-22.8	171.4	53.3	38.3	27.3
Nonbank financial	-6.6	-15.4	31.6	41.0	0.0

As in September, both security and nonbank financial loans increased relatively rapidly last month and accounted for more than one-third of the increase in total loans. The strength in loans to Government security dealers reflected in large part distribution of the new tax bills, but miscellaneous security loans also continued to increase sharply. The further growth of finance company loans apparently resulted from the narrowing gap between the cost of market and bank financing. Other loan categories expanded at about the moderate pace of other recent months.

As has been the case since late summer, relatively modest loan demands led banks to continue to add to their portfolio of liquid assets in October. Banks took essentially all of the \$4.5 billion issue of tax anticipation bills early in the month, but reportedly quickly sold off a sizable portion of these bills. However, at weekly reporting banks, total holdings of bills did not decline particularly rapidly after the financing, as the attractive yields on shorter bills and the continued bank demand for liquidity led banks to add further to their short-bill holdings. With loan demands light relative to deposit inflows, acquisition of other securities also accelerated from the low September pace to about a 19 per cent rate in October. Purchases of both municipals and participation certificates were particularly large at weekly reporting banks outside of New York.

Bank deposits. Total time and savings deposit inflows in October were maintained at the reduced 12.0 per cent annual rate of September, compared to the over 17 per cent rate in the first 8 months of the year. Most of the slower growth in total time and savings deposits in the last two months has been accounted for by negotiable CD's. In September, banks lost over \$800 million of CD's, in large part due to tax and dividend payments. In October, they replaced only about \$200 million of this run-off--considerably less than previous monthly increases; essentially all of the October growth occurred in New York City. The attrition and slow subsequent growth in outstandings occurred despite upward movements in CD rates of 10 to 40 basis

points since late August. Moreover, although banks are generally offering 5.50 per cent for over 6 months CD's, the slow October expansion may reflect the growing lack of competitiveness of certificates in this maturity range. For example, the more liquid June tax bills were yielding about 5.50 per cent, on an investment basis, in late October. In the 3 to 6 month maturity range, CD's still remain relatively attractive; but with loan demands expected to be less than exuberant in the near-term, banks are evidently not aggressively seeking funds in this maturity range, even though sales of longer CD's are becoming more difficult. Despite the higher costs of Euro-dollars, banks borrowed, on average, about \$325 million from their foreign branches in October to supplement their resources. No information is available on the maturity of such borrowing.

As far as can be determined, inflows of IPC time and savings deposits other than CD's continue relatively strong. While inflows at weekly reporting banks in the last couple of months are somewhat below the pace earlier in the year, the degree of deceleration appears modest.

AVERAGE WEEKLY CHANGE IN TIME AND SAVINGS DEPOSITS
WEEKLY REPORTING BANKS, 1967
(Not seasonally adjusted, millions of dollars)

	End of Feb.- end of May	End of May- end of Aug.	End of Aug.- end of Oct.
Total IPC, excluding CD's	181	182	159
Savings	51	52	59
IPC time, excluding CD's	130	130	100
All other time (including CD's)	93	126	-115
Total time and savings	274	308	44

The money stock--after virtually no growth in September--increased at about a 5.5 per cent annual rate in October. However, a large part of this expansion reflected a run-off of Treasury balances in the second half of September and early October prior to payment for the new tax bills. Over the first 10 months of the year the money stock has grown at a 6.8 per cent rate, but during the September-October period the rate of growth has slowed to a 3.0 per cent rate. This slow down probably reflects the pull of higher short-term yields, as well as the slower pace of loan demand.

U.S. Government securities market. Yields on Treasury notes and bonds have risen considerably further in recent weeks, although the advance was interrupted briefly following the Treasury refunding announcement in late October and the refunding was well received. Currently, yields on long-term Treasury bonds are well above their highest levels of 1966 and have approached their 1966 highs in the 5-year area. Treasury bill rates have also risen in recent weeks, as the table shows.

MARKET YIELDS ON U. S. GOVERNMENT SECURITIES
(Per cent)

	1966 Highs	1967 Lows	October 23	November 6
Bills				
3-months	5.59 (9/21)	3.33 (6/23)	4.58	4.64
6-months	5.98 (9/19)	3.71 (5/22)	5.09	5.13
1-year	5.94 (9/21)	3.80 (4/24)	5.24	5.38
Coupon issues				
3-years	6.22 (8/29)	4.27 (4/10)	5.56	5.83
5-years	5.89 (8/29)	4.38 (4/10)	5.61	5.82
10-years	5.51 (8/29)	4.45 (3/20)	5.56	5.79
20-years	5.12 (8/29)	4.44 (1/16)	5.47	5.64

N.B. Latest dates on which high or low rates occurred are indicated in parentheses.

The continued advance in Treasury bond yields has occurred against a background of decreasing hopes for tax increase legislation this year and attendant expectations of a shift by the System to a firmer monetary policy. Market psychology has also been weakened by several large new additions to the corporate bond calendar and by official indications that \$1.0 to \$1.5 billion of participation certificates will be brought to market before year-end.

The Treasury's November refunding has added to market supplies in the short and intermediate-term coupon areas. The Treasury sold to private investors about \$3.2 billion of new 15-month, 5-5/8 per cent notes and \$1.6 billion of new 7-year, 5-3/4 per cent notes. This cash refinancing served to pay off about \$2.6 billion of publicly-held

maturing issues and to raise some \$2.2 billion of new money. A strong interest developed in the 7-year notes which attracted about \$14 billion of subscriptions from the public and which were subjected to an unusually low allotment ratio of 7-1/2 per cent on subscriptions over \$100,000. The new 15-month notes drew subscriptions totaling about \$8 billion from private investors and the Treasury set an allotment ratio of 36 per cent on this issue.

While the terms of the refunding initially proved attractive to investors, market enthusiasm for the new notes faded with the closing of subscription books and considerable selling pressure developed from temporary holders, especially holders of the new 7-year notes. This selling contributed to the rapidly deteriorating market atmosphere in the first part of November. Dealers were able to uncover some offsetting market demand, albeit at declining prices and partly on switches out of outstanding issues. The market was also relieved of a sizable amount of the new 7-year notes by Treasury Investment Account purchases. The most recent data indicate that dealers held about \$115 million of the new 7-year notes on November 6, down from original allotments estimated at about \$280 million. Dealer holdings of the new 15-month notes were a more sizable \$430 million.

The recent rise in Treasury bill rates has been influenced to a major extent by the deterioration in longer-term debt markets. Despite generally good market demand for bills, supplemented by System purchases in the market totaling nearly \$500 million in late October

and early November, dealers have been willing sellers of bills at rising yields. Most of the upward pressure on bill rates has been in the longest maturities which were most affected by bond market developments and by the anchor issue in the Treasury refunding. Yields on bills maturing this year have actually declined somewhat in recent trading sessions. The bearishness on future yield trends no doubt has led many investors to place a premium on the most liquid money market instruments.

In other short-term debt markets, some additional yield increases have occurred since the third week of October, as the table shows.

SELECTED SHORT-TERM INTEREST RATES

	1967		
	Oct. 2	Oct. 23	Nov. 6
Commercial paper 4-6 months	5.00	5.13	5.13
Finance company paper 90 days	4.75	5.00	5.13
Bankers' Acceptances 90 days	4.88	4.88	4.88
Certificates of deposit (prime NYC)			
Most often quoted new issue:			
3-months	5.00	5.25	5.25
6-months	5.25	5.38	5.38
1-year	5.38	5.50	5.50
Secondary market:			
3-months	5.10	5.25	5.30
6-months	5.45	5.55	5.60
Federal Agencies (Secondary Market):			
3-months	4.45	4.90	5.10
6-months	5.40	5.40	5.50
1-year	5.45	5.50	5.70
Prime 1-year Municipals	3.25	3.50	3.45

Treasury finance. The completion of the November refunding in which the Treasury raised about \$2 billion of net new money will probably mark the last major Treasury financing utilizing direct debt this year. Additional cash will continue to be raised through \$100 million additions to weekly and monthly bill auctions and, as noted, through the sale of \$1.0 to \$1.5 billion of participation certificates. Total cash raised over the second half of 1967 (including sales of participation certificates) is expected to approximate \$17 to \$17-1/2 billion, some \$5 billion more than the previous postwar record set in the second half of 1959.

The Treasury's next major financing operation is expected to be in January. The market expects additional sales of June tax bills at that time.

Social Security bill. The Senate Finance Committee is expected to complete action on a new Social Security bill by November 8. The bill was changed a number of times during the Committee's deliberations. At one point the bill provided for a substantial increase in employment tax rates, but on November 6 the Committee voted to retain the present 8.8 per cent tax rate until 1969. Tax liabilities are expected to increase, however, during 1968 through an expansion in the tax base. The larger tax base will increase tax collections in the latter part of 1968, while larger benefit payments are scheduled to begin in February.

At this juncture it is too early to predict what the final outcome will be in regard to the Social Security bill.

The various proposed bills are compared in the following table:

PROPOSED SOCIAL SECURITY TAXES AND BENEFITS
Calendar year 1968, in billions of dollars

	No legislation	Allowing for full year of operation		
		January 1967 Budget proposal	Senate bill	House bill
Tax liabilities	29.5	31.5	31.7	31.2
Benefits	<u>25.0</u>	<u>29.2</u>	<u>30.5</u>	<u>28.3</u>
Net receipts	4.5	2.3	1.2	2.9

Over-all Federal budget data are summarized in an accompanying table. The Summer Budget review data shown in that table allow for an increase in social security benefits of \$2.0 billion during the half-year from January to June 1968. Thus the fiscal year receipts and payments impact of the contemplated Social Security legislation is roughly similar to the Summer Review figures.

VARIOUS FEDERAL BUDGETS
(In billions of dollars)

	1966		1967				Fiscal Year		
	III	IV	I	II	III	IV ^e	1967	1968	
							Actual	Jan. Budget Document	Summer Review ^{3/}
<u>Quarterly data, unadjusted</u>									
Cash surplus/deficit (-)	-6.7	-7.7	1.4	11.3	- 9.2	-10.3	-1.8	-4.3	-11.5
Cash receipts	34.6	31.1	38.0	49.8	35.9	32.3	153.5	168.1	164.0
Cash payments	41.3	38.8	36.7	38.6	45.1	42.6	155.3	172.4	175.5
Change in total cash balance	-4.1	-2.5	.7	1.2	.3	- 2.4	-4.7	--	--
Net Cash borrowing (+)	2.4	5.1	- .9	-10.3	9.3	7.9	-3.8	3.8	11.0
(Pool sales to public) <u>1/</u>	- .5	--	1.1	1.8	--	1.5	2.9	5.0	5.0
<u>Seasonally adjusted annual rate</u>									
Federal surplus/deficit (-) in national income accounts	- .7	-3.3	-11.9	-14.7	-13.5	-13.1	-7.7	-2.1	- 6.4
Receipts	145.6	148.6	149.1	148.1	152.9	157.1	147.9	167.1	164.0
Expenditures	146.3	151.9	160.9	162.8	166.4	170.2	155.5	169.2	170.4
High employment surplus/ deficit (-) <u>2/</u>	- .4	-3.3	-10.5	-13.0	-12.6	-12.5	-6.8		

e - Staff projections. Based on existing tax rates.

1/ Not included in net cash borrowing.

2/ Uses 1966 IVQ as a high employment base.

3/ Figures derived from President's statement of August 3. The figures assume a 10 per cent surcharge effective July 1, 1967, for corporations, and October 1, 1967, for individuals, as well as the lowest expenditure totals considered possible by the Administration. The President's tax increase proposals were projected to produce \$7.4 billion of additional revenues in fiscal 1968.

Corporate and municipal bond markets. After a brief late October respite in which yields generally declined slightly, bond markets have most recently weakened again and yields on new corporate and municipal issues have resumed their advance. At current levels, new issue yields in both markets are at, or close to, the highs reached in mid-October, and some utility issues carrying 5-year call protection have exceeded the previous peak yields for comparable offerings. The corporate new issue series in the yield table overstates the magnitude of the yield decline due to the heavy weight given to industrial offerings with 10-year call protection. Also, the lagging seasoned municipal yield series do not yet reflect the recent upward yield tendency in the market for new municipal issues during the two most recent weeks.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa		State and local Government	
	New With call protection	Seasoned	Moody's Aaa	Bond Buyer's (mixed qualities)
<u>1965</u>				
End of July ^{1/}	4.58	4.48	3.16	3.25
Early December ^{2/}	4.79	4.60	3.37	3.50
<u>1966</u>				
Late summer high	5.98*	5.44	4.04	4.24
<u>1967</u>				
Weeks ending:				
February 3 ^{3/}	--	5.02	3.25	3.50
September 22	5.82	5.64	3.82	4.14
October 20	6.29	5.83	3.92	4.33
October 27	6.05*	5.90	3.92	4.27
November 3	6.11*	5.93	3.92	4.27

^{1/} Week prior to President's announcement of increased U.S. involvement in Vietnam.

^{2/} Week preceding Federal Reserve discount rate increase.

^{3/} 1967 lows. * - Some issues included carry 10-year call protection.

The short-lived yield decline in late October was apparently chiefly a reaction to the sharp run-up of yields earlier in the month. Investor demand was whetted by the historically high yields offered on several key issues, such as the Standard Oil Company of New Jersey and the New York City bonds. In addition, the initially favorable reception of the new 7-year, 5-3/4 per cent Treasury note apparently contributed to a developing view that longer-term yields might be stabilizing. This market optimism was quickly dissipated in early November, however, when press reports virtually wrote-off the prospects for any increase in Federal income tax rates this year and downgraded chances for an increase even in 1968. At the same time, a continuing build-up in the calendar of forthcoming corporate bond issues, and the Treasury's announcement of a prospective offering of longer-term participation certificates heightened the near-term outlook for renewed general upward pressures on bond yields.

In the corporate bond market, U.S. Steel's announcement of plans to sell \$225 million of debentures in mid-November also had a significant impact on market expectations, since it seemed to imply that the pattern of anticipatory corporate bond financing evident earlier in October would continue. This issue raised the volume of corporate debt definitely scheduled for public offering in November to more than \$1.1 billion. And in the final analysis, November volume may match October's \$1.35 billion figure. A reduced volume of stock offerings expected in November may result, however, in aggregate public and private bond and stock offerings about \$150 million less than the \$2.35 billion floated in October.

The mix between straight debt and convertible bonds has not been altered perceptibly since the Board's announced proposal to extend margin requirements to convertible bonds. Only one small, scheduled convertible bond has been indefinitely postponed since the announcement whereas several new issues have been added to the calendar. Two already scheduled issues (one the large Tenneco offering) have been changed from rights to regular offerings, however, reportedly to achieve a broader market among institutional investors. Also, on the new convertible issues that have been sold since October 20, borrowing costs have increased--by roughly 1/4 of a percentage point--and some other terms--such as the conversion price--have had to be liberalized in order to elicit a favorable investor response. In the first 10 months of 1967, gross offerings of convertible bonds totaled \$3.4 billion including \$1.6 billion in the third quarter alone. This compares with gross offerings of only \$1.9 billion for all of 1966.

CORPORATE SECURITY OFFERINGS^{1/}
(Millions of dollars)

	Bonds				Total bonds and stocks	
	Public Offerings ^{2/}		Private Placements			
	<u>1966</u>	<u>1967</u>	<u>1966</u>	<u>1967</u>	<u>1966</u>	<u>1967</u>
1st Quarter	1,774	3,263	2,586	1,811	5,094	5,464
2nd Quarter	1,941	4,017	2,083	1,465	5,115	6,208
3rd Quarter	2,256	4,600e	1,627	1,775e	4,197	7,075e
September	676	875e	657	825e	1,400	1,900e
October	499	1,350e	256	650e	892	2,350e
November	569	1,350e	435	650e	1,115	2,200e

^{1/} Data are gross proceeds.

^{2/} Includes refundings.

Recent municipal bond offerings have generally been well received by investors since mid-October. Dealers' advertised inventories presently aggregate about \$330 million which reflects, in part, the increased sales of new issues and in part price cutting on older issues. A temporary lull in the calendar during the past two weeks has undoubtedly been a factor in this market as well as strong localized interest in particular issues (such as the New York City offering).

State and local government bond issues offered during October aggregated about \$925 million, more than \$300 million below September but more than \$150 million above October 1966. The monthly volume would have been substantially larger were it not for more than \$250 million of issues known to have been postponed or cut back in size. Municipal volume in November is currently estimated at \$1.3 billion, well above October and the highest monthly volume since June. Included in this estimate are \$350 million of tentatively scheduled industrial revenue bonds, which may go even higher in view of additional plans known to be under discussion. Through October, industrial revenue bond offerings amounted to \$825 million, up from \$500 million for all of 1966. The exceptionally high volume in recent months is reported to reflect in part anticipatory borrowing as a hedge against the possibility that restrictive legislation will be passed in 1968.

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

	1966	1967
1st Quarter	2,964	4,171
2nd Quarter	3,256	3,872
3rd Quarter	2,510	3,050e
September	1,032	1,250e
October	759	925e
November	976	1,300e

1/ Data are for principal amounts of new issues.

Corporate profits. Earnings reports now available for large companies confirm the earlier staff projection of a small increase in corporate profits (seasonally adjusted) from the second to the third quarter. In manufacturing, data are presently available only on a seasonally unadjusted basis and the movement in seasonally adjusted earnings has to be estimated by relating year-to-year changes to the level of seasonally adjusted profits in 1966. Third quarter 1967 profits continued to run below a year earlier in almost all manufacturing industries but, despite strikes in the auto and copper industries and a continued rise in unit labor costs, the over-all year-to-year decline was slightly narrower in the third quarter than in the second, as the table below shows. With seasonally adjusted manufacturing profits practically unchanged between the second and third quarters of last year, a narrowing of the 1966 to 1967 decline in the third quarter implies a small rise in seasonally adjusted profits.

PROFITS OF MANUFACTURING CORPORATIONS^{1/}

	1966 to 1967 percentage change			Level (\$ billion) 1967 QIII
	QI	QII	QIII ^{2/}	
All mfg. industries	- 7	- 9	- 8	6.8
Durable goods	-11	-12	-13	3.2
Nondurable goods	- 1	- 6	- 3	3.6
Motor vehicles	-36	-12	-31	.2
Machinery	- 2	- 5	- 2	1.3
Iron and steel	- 9	-33	-28	.3
Nonferrous metals	+11	-11	-31	.2
All other durables	- 6	-13	-13	1.2
Food	- 4	- 4	- 3	.6
Chemicals	- 7	-10	- 6	.8
Petroleum	+12	+ 9	+ 8	1.4
All other nondurables	-12	-20	-15	.8

^{1/} Profits after taxes, FTC-SEC series.

^{2/} Estimates based on data for 520 companies that account for about 55 per cent of all manufacturing corporate profits.

In nonmanufacturing, seasonally adjusted profits are estimated to have remained at about the second quarter level except for a moderate further rise in the earnings of trade companies. All in all, a rise in the seasonally adjusted annual rate of profits before tax, from \$78.9 billion in the second quarter to \$80.5 billion in the third, continues to seem reasonable.

Mortgage market developments. With the sharp rise in bond yields last month, price markdowns in the secondary market for Government-underwritten home mortgages were considerably larger than in September, according to unofficial FNMA field reports, with some individual lenders

said to have cut back sharply on their new commitments within the past few weeks. It thus seems probable that in October, the sensitive secondary market yield series on FHA-insured new-home mortgages approached still closer to the record level reached toward the end of last year. Official data on mortgage rates, however, are not yet available for last month.

While real estate brokers anticipate somewhat higher yields on home mortgages in coming months, they look for funds for such mortgages to continue in adequate supply for qualified borrowers, according to a mid-September mortgage survey of the National Association of Real Estate Boards. The NAREB findings concerning the future availability of mortgage funds were similar to the results of the Federal Reserve Bank survey that was made at about the same time. Both surveys were taken before the sharp further advance of bond yields of recent weeks, and comprehensive information is not yet available to judge the full impact of this development on the pace at which new mortgage commitments were being made in October.

By the end of September, private lenders had at last virtually fully regained their mortgage commitment positions held in January 1966, when the combined volume of outstanding commitments of the three major reporting institutions reached a postwar peak and when cash flows at least to thrift institutions were smaller than they are now. Forward mortgage commitments outstanding were sharply above their December 1966 low, especially for savings and loan associations, and also above their April 1967 level, when mortgage yields generally

reached a low for this year. Judging from available data that cover both residential and nonresidential mortgages, lenders continued to be cautious in committing immediately ahead, with a third of all outstanding savings bank mortgage commitments scheduled to mature more than 9 months later. At life insurance companies, three-fifths of total commitments expected to be taken down within 7 months or more, a somewhat larger share than early in 1966.

INDEX OF MORTGAGE COMMITMENTS OUTSTANDING
(January 1966 = 100)

	Volume at end of		
	December 1966	April 1967	September 1967
Savings and loan associations	56	72	99
Savings banks in New York State	76	81	100
Reporting life insurance companies	89	88	96
All three lenders	74	81	98

Note: Based on seasonally adjusted data which are confidential for life insurance companies.

As the availability of mortgage funds has recovered through September of this year, savings and loan associations--traditionally conventional mortgage lenders--have been placing a growing share of their funds in Government-underwritten loans which carry more liberal nonrate terms to borrowers. Since June, yields on FHA and VA mortgages which may be traded in the nationwide secondary market have equaled or exceeded average returns on conventional home mortgages which tend to

reflect local market conditions to a much larger degree. Accelerated net takings by S&L's of FHA and VA loans during the third quarter, plus sharply higher net acquisitions by FNMA, more than offset any lessening of interest by life insurance companies or other types of lenders in this relatively minor sector of the market.

Market support for Government-underwritten loans from S&L's and FNMA--which limited the rise in yields on FHA and VA mortgages during the third quarter--seems likely to continue during the current quarter. Net savings inflows to S&L's tend to be stronger than new loan demands at this time of year under normal market conditions, so that some excess S&L funds may remain available for FHA and VA mortgages if usual seasonal influences prevail. Also, FNMA purchases of Government-underwritten mortgages appear certain to remain substantial for some time. Although offerings to FNMA of FHA and VA loans for purchase under its secondary market operations declined in September, following a reduction in FNMA's buying prices, they revived in October as upward pressures on home mortgage yields intensified. By the week ended November 2, offerings to FNMA had risen to around \$77 million--the largest weekly volume since the spring of 1966--raising some questions about how long FNMA could hold to its current schedule of purchase prices. FNMA's continued substantial purchases under its secondary market operations, which are ultimately financed by open-market borrowing, will undoubtedly more than offset any decline in loan acquisitions resulting from the agency's mid-October cut-off of new commitments to

buy mortgages under certain of its special assistance programs--a step designed to reduce FNMA's use of Treasury funds for this purpose.

Savings flows to financial intermediaries. The only new evidence available on savings flows to thrift institutions during October is for all savings banks in New York State. For the first time this year these banks experienced a year-to-year drop in their net inflows, from \$114 million last year to \$99 million this year. In October a year ago, however, net inflows were at a record for the month, slightly above the previous October peak of \$112 million reached in 1964 following retirement of the famous Treasury Magig 5's.

This year's October experience is, thus, the third best October on record for New York State savings banks. Nevertheless, the year-to-year short fall confirms the impression gained from savings bank and S&L data already reported for the October reinvestment period, that the rate of growth in net flows to thrift institutions has moderated somewhat since summer.

Spreads of yields on some types of market securities over the maximum rates generally available on passbook accounts at savings and loan associations are presently nearly as large as the peak spreads reached in 1966. But so far this is true only for long-term securities and short-term Federal Agency debt. Spreads between other short-term rates and maximum S&L passbook rates are still substantially less than during the 1966 periods of peak pressure on thrift institutions, as the table shows. While industry spokesmen generally expect some further

slowing of growth in gross savings inflows over the remaining weeks of 1966, they do not contemplate any major redirection of net flows prior to the January reinvestment period, even if short-term interest rates rise further.

Industry observations point to a few longer-run factors which may help to moderate the general impact of any further increases in short-term rates on thrift institutions. These include the less aggressive competition of commercial banks at given ceiling rates on consumer-type savings accounts, and the fact that much of the interest sensitive money which left these institutions during 1966 apparently did not return, although yield spreads favored claims of thrift institutions earlier this year.

Moreover, even if a larger near-term slowdown in savings flows than is now anticipated should occur, there are several reasons for believing that the squeeze on thrift institutions and home mortgage markets would be less extreme than in 1966. In the first place, seasonally adjusted loan commitments outstanding at S&L's were only 1.9 times larger than seasonally adjusted net inflows in the third quarter, whereas the backlog of similar commitments outstanding in March 1966 was 3.8 times the like inflows for that quarter. S&L's in particular are paying much stricter attention to current money market developments than during the spring of 1966 and consequently have held their commitments for new loans in a more nearly sustainable relation to inflows of funds.

S&L's have also substantially improved their liquidity during the past year so that the ratio of their liquid assets (Government securities plus cash) less all borrowing, to their share capital had risen to 6.4 per cent at the end of September. This is the highest level reached by this ratio since mid-1963 and compares with 2.2 per cent at the end of September 1966. In addition, the Federal Home Loan Bank System has expanded its own liquid assets substantially, which are available to meet the borrowing demands of its member S&L's. At the end of October, the System held liquid assets of more than \$1.8 billion, or more than twice the average volume during most of 1966.

SPREAD BETWEEN SELECTED MARKET RATES^{1/}
AND MAXIMUM S&L PASSBOOK RATE ^{2/}
(In basis points)

	6-month Bills	4-6 month commercial Paper	6-month Agencies	1-year Bills	3-year Governments
<u>1966</u>					
March	- 02	53	25	06	18
June	- 10	65	68	03	29
September	67	70	65	65	66
October	01	75	-03	02	21
<u>1967</u>					
March	- 78	13	-50	-80	-63
June	-108	-52	-45	-62	-19
September	05	00	41	15	40
November	07	13 p	50	31	66

^{1/} Yields on market rates represent the highest weekly average for the indicated months. For November, the data refer to the week of November 6.

^{2/} The maximum S&L passbook rate generally available during the entire period is from California S&L's. The rates were: 4.85 per cent for March and June 1966; 5.25 per cent from September 1966 through June 1967; and 5.00 per cent since July 1, 1967. S&L certificate accounts paying 5.25 per cent for \$1,000 six-month minimums have been generally available throughout the country since October 1966. Mutual savings banks, which generally do not offer certificate accounts, paid 4.50 per cent on passbook accounts prior to July 1966 and have been paying 5.00 per cent since.

Stock market. Since early October, stock prices have retreated on a broad front. As a result, the sharp earlier gains realized in September have now been wholly eliminated and the average of Dow-Jones industrials, down over 9 per cent from its high, is back to its early June level. Standard & Poor's composite index of 500 stock prices has declined 6 per cent from its all-time high of 97.59, reached on September 25, and the American Exchange index has declined almost as much from a similar high reached on October 9. During the decline, trading volume has been exceptionally heavy, averaging 10.2 million shares a day on the New York Exchange and a record breaking 6.1 million shares a day on the American Exchange.

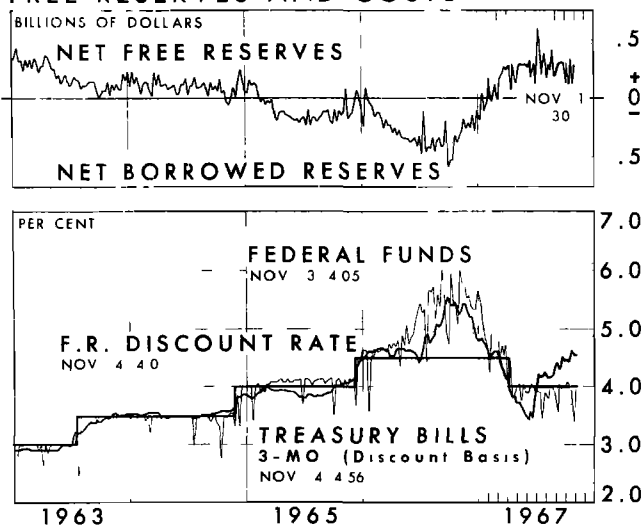
A breakdown of stock price movements by industry groupings shows that less than 20 per cent have advanced since early October. Among these, the only notable advances were made by the glamour-industries--electronics, office equipment and color TV--which were boosted by the advance of certain component issues reporting very favorable earnings records.

Factors contributing to the recent general weakness of stock prices have included further widening of the gap between yields on stocks and bonds, an associated heightening of market concern about the prospects for tight money if no tax increase is enacted, and general disappointment over third quarter earnings reports in a number of key industries. While Federal Reserve announcement of the proposed new margin regulations has had a pronounced initial impact on convertible bond prices as expected, the influence on stock prices seems to have been relatively minor in comparison with the other forces recently contributing to declines.

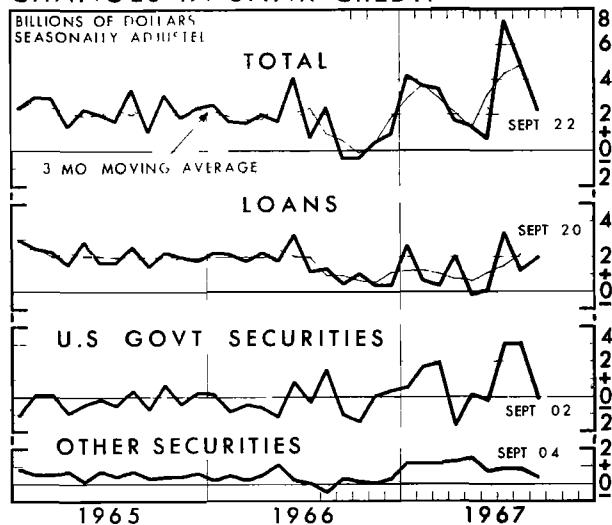
The extension of margin requirements under Regulation U to all bonds convertible into registered stock has forced price reductions extending to as much as 15 points in some outstanding issues, indicating the substantial volume of narrowly margined credit that was being used to support positions in such issues. As a result, a sizable number of margin calls have been made particularly on the substantial volume of loans that were made initially through money brokers. Immediately after the Board's announcement, trading in some convertibles stopped completely since few buyers could be found to pick up the large overhang of sell-orders triggered by the action. At the same time, dealers showed a strong reluctance to take positions because they feared credit to support such positions would now have to be margined at 70 per cent. As prices have dropped, some institutional investors have begun to show an interest in picking up bargains. But while trading in virtually all convertibles has now resumed, the convertible market remains generally weak--due partly to the further decline of stock prices, and to the continuing uncertainty of dealers concerning their financing.

FINANCIAL DEVELOPMENTS - UNITED STATES

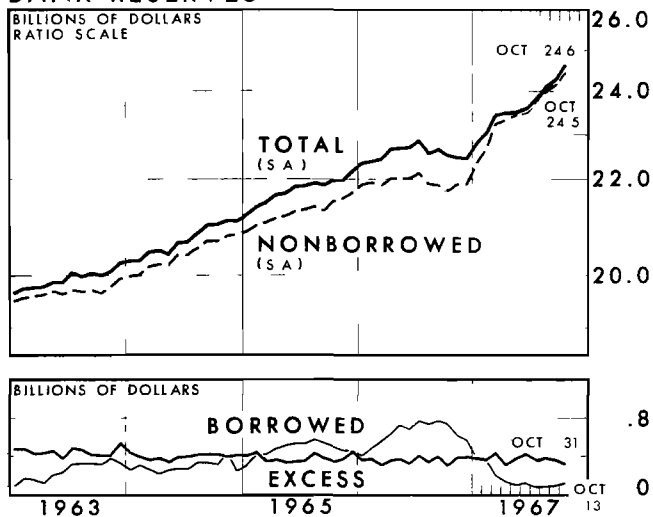
FREE RESERVES AND COSTS



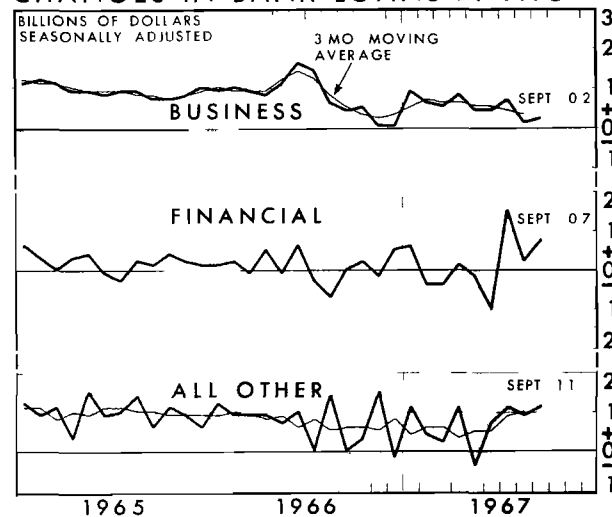
CHANGES IN BANK CREDIT



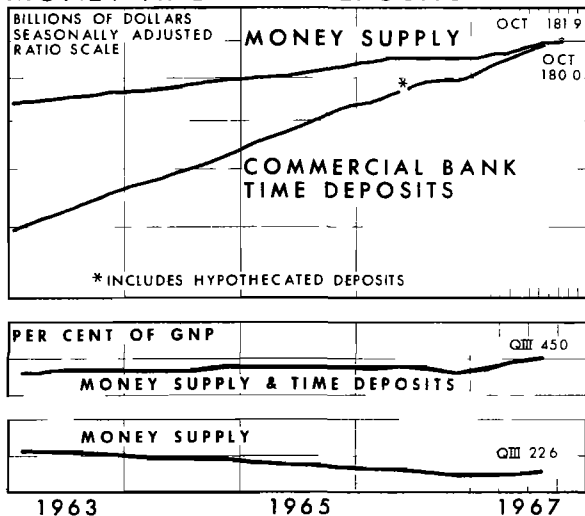
BANK RESERVES



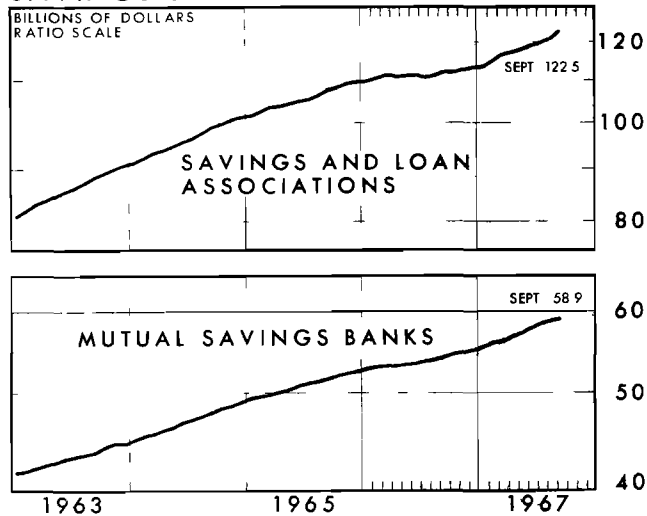
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

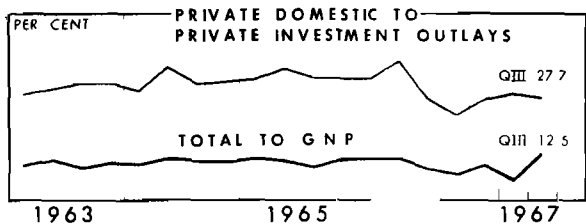
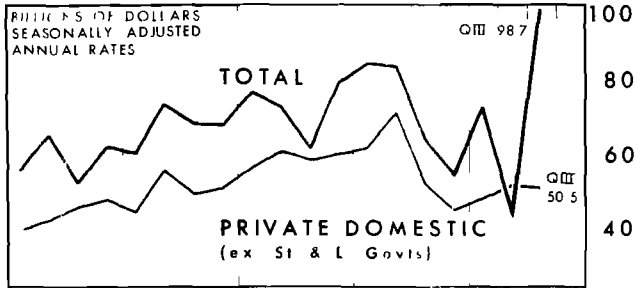


SAVINGS SHARES AND DEPOSITS

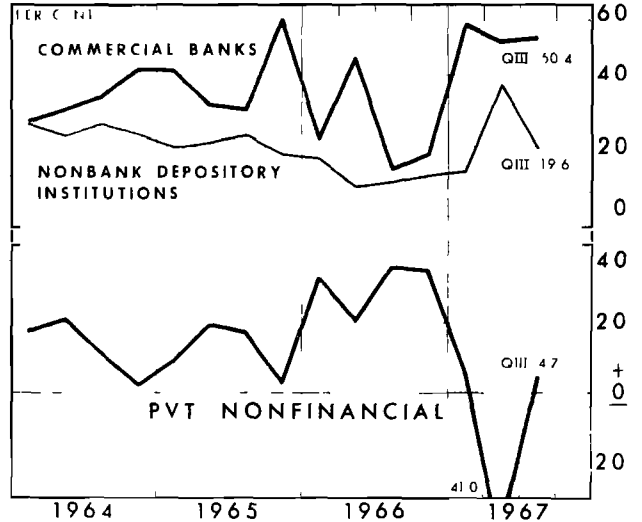


FINANCIAL DEVELOPMENTS - UNITED STATES

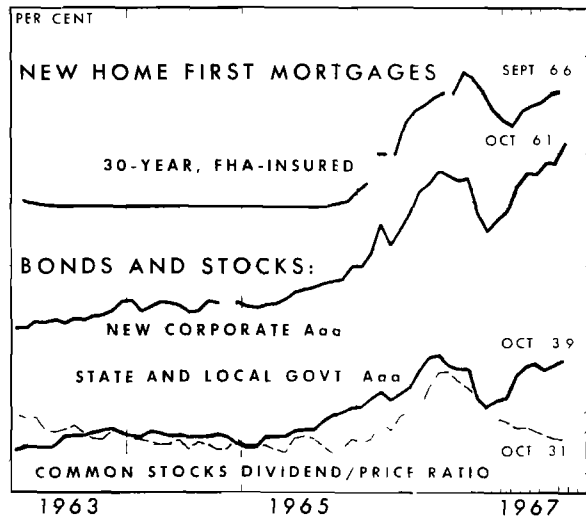
NET FUNDS RAISED-NONFINANCIAL SECTORS



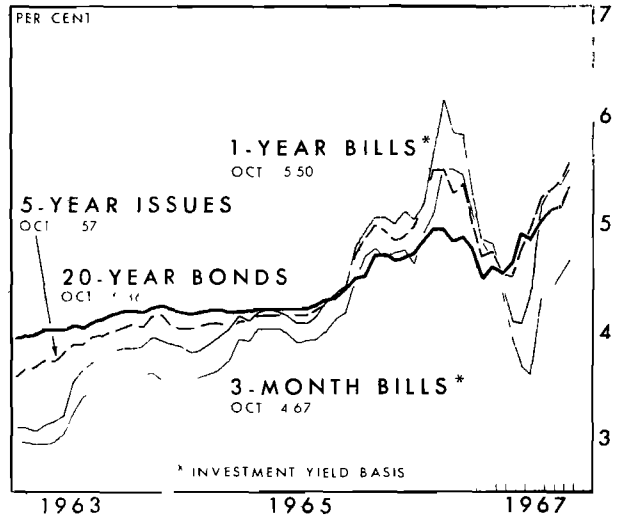
SHARES IN FUNDS SUPPLIED



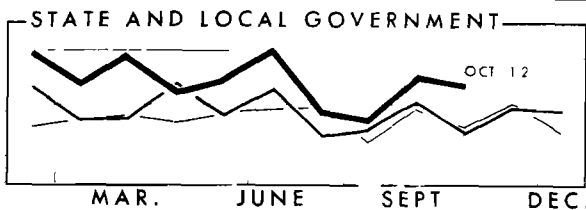
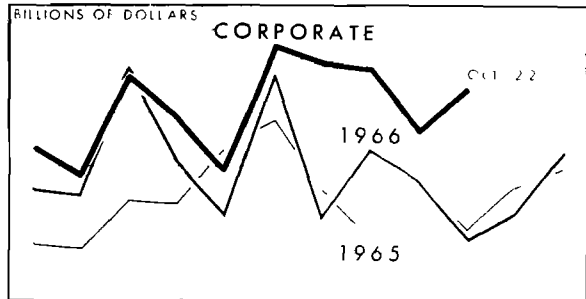
MARKET YIELDS



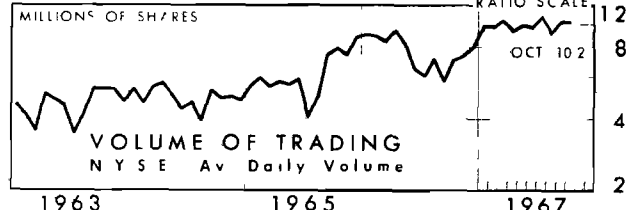
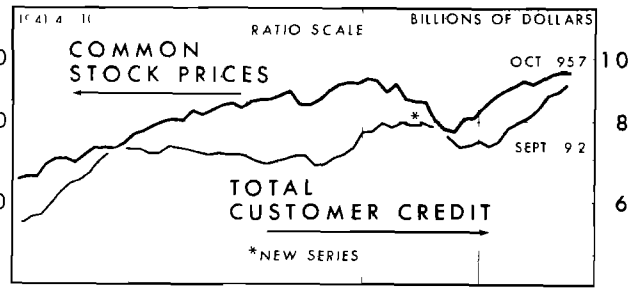
MARKET YIELDS-U S GOVT SEC



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. The liquidity deficit in the third quarter was somewhat larger than previously estimated, partly because of a revision of the seasonal adjustment that added over \$75 million to the adjusted total. Before seasonal adjustment the deficit for the three months totaled \$1.2 billion, and after the new adjustment for seasonal factors the deficit, as published, will be nearly \$750 million. The substantial deterioration in the published liquidity deficit from the \$2.1 billion annual rate of the first half to a rate of nearly \$3.0 billion in the third quarter may well stir considerable public concern.

Since the published liquidity deficits for the first two quarters were greatly reduced by official "special" transactions, and such transactions were relatively small in the third quarter, the balance adjusted for these transactions actually showed some improvement in the third quarter.

Weekly reports covering the month of October (though subject to the usual reservations about accuracy and month-end overlaps) show an extraordinarily large liquidity deficit-on the order of \$900 million. October deficits have averaged about \$600 million over the past five years, and most of the excess over that rate this year can be accounted for by a reduction of about \$260 million in U.K. holdings of U.S. Government agency securities. These agency securities had been acquired when the U.K. Treasury switched out of investments in U.S. corporate stocks, and at that time were counted for balance of

payments purposes as nonliquid, nonofficial holdings so as to avoid any impact on the measures of the deficit. Now as they are converted into liquid dollar holdings there will be a worsening of the deficit on both measures.

Other October transactions, some conjectural, that would tend to keep the deficit large are (1) the last spate of travel expenditures for Expo 67, (2) a continued large flow to Israel, (3) a larger than usual volume of new Canadian bonds sold in this market, (4) temporarily swollen outflows of capital from banks and industrial concerns anticipating the announcement of possible changes in the voluntary programs, and (5) perhaps some borrowing by Canadian banks at the end of their fiscal year to enlarge their balance sheet totals.

Using the October total derived from weekly figures, it appears that the deficit for the first ten months of the year not counting the reductions by means of special transactions (but without seasonal adjustment) was about \$2-1/2 billion. The special transactions for the year through October totaled about \$1.0 billion.

The alternative official reserve transactions balance has exhibited wide fluctuations this year, and was in surplus by about \$400 million (seasonally adjusted) in the third quarter. The increase in liabilities to commercial banks abroad and other private foreign accounts, which serves to reduce the deficit on this basis, amounted to \$1.3 billion in the quarter, coming primarily in July and August. Nearly \$900 million of the increase was in liabilities of U.S. banks to their foreign branches.

In October there was a continued substantial increase in privately-held short-term assets in the U.S., including an increase of perhaps \$100 million in amounts due to foreign branches of U.S. banks, and an increase of about \$200 million in holdings of Canadian banks. Nevertheless the official settlements balance registered a deficit (not seasonally adjusted) of approximately \$300 million in October. The German purchase of a second \$125 million nonliquid Treasury note improved the liquidity balance but had no effect on the official settlements balance. The shift of U.K. official holdings out of Agency bonds enlarged the deficit on both measures as noted above.

Bank lending. From January through September bank-reported short-term claims on foreigners increased by a net amount of \$488 million (not seasonally adjusted) whereas in the same period last year there was a net reduction of \$315 million. This net shift in flows of \$800 million has been a large factor in the worsening of the deficit this year. Nearly \$700 million of the shift was in claims on Japan, and there has also been a considerable outflow this year to Mexico and the Philippines.

Using the seasonal adjustments employed in the balance of payments accounts -- which may now be questionable because of the disturbances caused by the voluntary programs and variations in borrowing practices by Japanese banks -- the contraseasonal unadjusted outflow of \$76 million in the third quarter is greatly amplified to a seasonally adjusted outflow of about \$290 million.

Again, this reflects a moderate draw down on U.S. bank financing by Japan, whereas for some years past Japanese borrowers have tended to make large repayments in the third quarter.

Outstanding term loans to foreigners by U.S. banks were reduced by about \$250 million in the first three quarters of the year, slightly more than in the same period of 1966. Though there was a resumption of net outflows in the third quarter, it was concentrated in loans to a few Latin American countries while inflows continued from other areas. In the fourth quarters of the past two years there have been net repayments of these credits of over-one-year maturity. The net increase in bank-reported claims of all maturities this year through September, amounting to \$220 million, exceeded the amount reported under the VFCR largely because of increases in claims of U.S. agencies of foreign banks and of bank customers.

Under the revised VFCR, banks have only a few hundred million of leeway for foreign lending available for use in the current quarter. This limitation, joined with the already large drawdowns on Japanese credit lines, and with the likelihood that U.S. banks will use their foreign branches increasingly to take care of foreign business, suggests that total U.S. bank credit outflow this quarter may be relatively small.

International transactions in securities. Net U.S. purchases of foreign securities in the first nine months of this year were about \$1/2 billion higher than in the same period of 1966, thus adding further to the pressures on the overall balance.

In the third quarter alone the net outflow this year was some \$400 million (unadjusted), whereas in the third quarter last year there was very little net outflow. Much of the year-to-year increase was in purchases of new issues of foreign bonds; this year through September such purchases totaled \$1.2 billion, about \$200 million more than last year, and the fourth quarter total this year will considerably exceed the \$200 million of last year. For the year there will be substantial increases in bond sales in the U.S. by the World Bank and by Israel, and the Canadian total will probably exceed last year's record of over \$900 million.

U.S. purchases of foreign equity securities have also increased this year. Whereas in the first nine months of 1966 there was a net liquidation producing a net inflow of \$150 million, this year there has been a small net outflow on this account.

On the other hand, foreign purchases of U.S. corporate stocks (excluding transactions for U.K. account) have resulted in large receipts this year, especially in the third quarter when they amounted to nearly \$300 million.

U.S. foreign trade. The U.S. foreign trade surplus in September dropped substantially from the high August rate as imports increased while exports fell. For the entire third quarter, the trade surplus on a balance of payments basis was at an annual rate of \$4.4 billion, slightly below the second quarter rate. As mentioned in the last Green Book, the Arab-Israeli war and the copper strike affected both the second and third quarter trade figures. With

adjustment for these special events, the trade surplus would have declined more from the second to the third quarter.

Exports in the third quarter showed only minor variations from the pattern of the preceeding quarter. Agricultural exports fell sharply in the first quarter of this year and have remained relatively low. Nonagricultural exports expanded rapidly in the early part of the year and have stabilized at this high plateau. Shipments to Canada continued to drift downward; deliveries of automotive vehicles there may have been slowed by the Ford strike. The pronounced, but temporary, decline in exports to the Arab countries was, of course, a direct effect of the Arab-Israeli war.

U.S. EXPORTS AND IMPORTS
(billions of dollars)

	1 9 6 6				1 9 6 7		
	I	II	III	IV	I	II	III
	(seasonally adjusted annual rates)						
Agricultural exports	6.7	7.0	7.4	7.0	6.5	6.6	6.5
Non-agricultural exports	22.1	22.0	22.4	22.9	24.7	24.5	24.6
Total exports							
Census basis	28.8	29.0	29.8	29.9	31.2	31.1	31.1
Balance of payments basis	<u>28.8</u>	<u>28.7</u>	<u>29.5</u>	<u>29.6</u>	<u>30.8</u>	<u>30.9</u>	<u>30.8</u>
Total imports							
Balance of payments basis	<u>24.1</u>	<u>24.9</u>	<u>26.3</u>	<u>26.7</u>	<u>26.8</u>	<u>26.4</u>	<u>26.3</u>
Trade balance	<u>4.7</u>	<u>3.8</u>	<u>3.2</u>	<u>2.9</u>	<u>4.0</u>	<u>4.5</u>	<u>4.4</u>

The entire increase in sales to Western Europe in the third quarter is attributable to emergency deliveries of crude oil following

the closing of the Suez Canal. Shipments of other nonagricultural products to these countries are still higher than a year earlier. Deliveries of civilian aircraft were particularly heavy in the past six months. In addition, exports of machinery in the first three quarters of this year were considerably higher than in the corresponding periods of a year ago. Agricultural exports to Europe through September, however, were far below those in January-September 1966, reflecting improved crops in Europe and other supplying countries and some tightness in domestic supplies. Shipments to Japan continued to expand in third quarter but at much slower pace than in the previous quarter.

Imports in the third quarter were at an annual rate of \$26.3 billion, only slightly lower than in the second quarter. With the advance in GNP, imports of finished products remained high while the decline in industrial materials has moderated. Imports of petroleum were below normal by about \$0.3 billion as world petroleum supplies were rearranged to compensate for the loss of Mid-East oil. Total imports, after adjustment for this shortfall, were about 3.4 per cent of total GNP in the third quarter, only marginally below the peak rate of 3.5 per cent in the last half of 1966 when domestic economic activity was stronger, business inventories were expanding sharply and the utilization of manufacturing capacity was 90 per cent, compared with less than 84 per cent in the third quarter of this year. Imports of finished consumer and capital goods have remained high.

U. S. MERCHANDISE IMPORTS BY PRINCIPAL COMMODITY CATEGORIES
(millions of dollars, seasonally adjusted)

	1 9 6 6				1 9 6 7		
	I	II	III	IV	I	II	III ^{1/}
Total ^{2/}	6,020	6,307	6,618	6,685	6,684	6,571	6,564
Foods, feeds, and beverages	1,125	1,129	1,132	1,142	1,181	1,116	1,136
Ind. supplies	2,862	3,043	3,142	3,061	3,011	2,898	2,791
Fuel, lubricants	560	543	585	567	572	572	508
Iron and steel	250	323	390	349	313	356	387
Other metals	660	705	742	800	769	697	605
Textile supplies	325	325	312	282	266	239	250
Building materials	201	211	194	184	184	181	190
Other	866	936	919	879	907	853	850
Capital goods ^{3/}	462	503	576	621	609	571	623
Autos, trucks, and parts	400	415	516	586	571	640	647
Consumer goods	941	965	993	1,008	1,052	1,038	1,044
All other	230	252	259	267	260	308	323

^{1/} Preliminary. ^{2/} Census basis. ^{3/} Mainly machinery.

Imports of iron and steel-mill products advanced further in the third quarter, approaching the record rate of last fall. Imports of other metals, though sustained by heavy arrivals of refined copper, declined further in total. Other industrial materials, particularly textile supplies and building materials, which had been sluggish or declining since the middle of last year, turned up moderately in the third quarter, reflecting the expansion in domestic textile output and residential construction. Imports of machinery in the third quarter recovered sharply from the unusually low value of the preceding quarter, possibly reacting to restoration of the investment tax credit last spring and to further gains in domestic outlays for producers' equipment.

Reserve changes in other industrial countries. Further strains on Britain's net reserve position and a large increase in Italian official foreign exchange reserves were two major developments in the third quarter.

Partly for seasonal reasons and partly in consequence of sterling's renewed weakness during the summer, the pattern of total European Economic Community official reserve gains this year has resembled last year's, with large gains in the third quarter after much smaller accretions in the first half year.

The combined changes in reserves and in net assets of commercial banks in EEC countries amounted to somewhat over \$700 million in the third quarter, nearly twice the quarterly average in the first half of 1967. This alternative measure of reserve and liability changes, given in the second table, is the counterpart of the EEC's surplus of international receipts on current and nonbank-capital accounts. Both this summer and in the summer of 1966 this balance may have been swollen by movements out of sterling into EEC currencies on the part of businesses and investors. As the commercial banks of the area did not, in the aggregate and on balance, increase their net external assets during the third quarter, the entire surplus accrued to official reserves.

The increase in U.S. banks' liabilities to their foreign branches amounted to nearly \$900 million in the third quarter, reflecting large borrowings by the branches in the Euro-dollar market. As the German and other continental European commercial banks were on balance no longer switching large sums out of domestic into foreign assets, as they had earlier in the year, it is clear that funds moving out of sterling

OFFICIAL NET RESERVE CHANGES ^{1/}
(in millions of U.S. dollars)

	Year	Jan. -Sept.		1st Half		Q-3	
	1966	1966	1967	1966	1967	1966	1967
Germany	351	56	15	127	-115	183	130
France	386	542	95	447	8	95	87
Italy	170	253	556	30	49	223	507
Netherlands	42	- 6	39	- 75	33	69	6
Belgium	<u>36</u>	<u>- 18</u>	<u>110</u>	<u>6</u>	<u>96</u>	<u>- 24</u>	<u>14</u>
Total EEC	985	827	815	281	71	546	744
Switzerland	- 15	-393	-221	-332	-163	- 61	- 58
Sweden	56	81	- 12	73	- 17	8	5
Canada	-280	-287	- 23	-238	- 91	- 49	68
Japan	- 63	- 92	- 50	- 17	- 3	- 75	- 47

^{1/} Changes in net gold and foreign assets and IMF position.
Source: Confidential BIS data.

RESERVE AND LIABILITY CHANGES: COMBINED OFFICIAL AND COMMERCIAL BANKS ^{1/}
(in millions of U.S. dollars)

	Year	Jan. -Sept.		1st Half		Q-3	
	1966	1966	1967	1966	1967	1966	1967
Germany	448	519	1,115	219	949	300	166
France	343	434	188p.	548	176	-114	12P.
Italy	558	666	374	257	-203	409	577
Netherlands	- 37	-128	- 81p.	-179	-129	51	48p.
Belgium	<u>-110</u>	<u>-100</u>	<u>- 6P.</u>	<u>- 28</u>	<u>76</u>	<u>-72</u>	<u>-82P.</u>
Total EEC	1,202	1,391	1,590	817	869	574	721
Switzerland	n.a.	n.a.	n.a.	n.a.	76	3	n.a.
Sweden	95	76	120	33	57	43	63
Canada	147	89	20P.	-109	-258	198	278P.
Japan	322	270	-473	37	-489	233	16

^{1/} Data of preceding table plus changes in net external short-term assets of commercial banks. Swiss commercial bank data are available at present only from 1966 Q-2 through 1967 Q-2.

Source: Confidential BIS data

p.: Lacks September change in banks' net assets.

into dollars contributed heavily to supplies in the Euro-dollar market. Such movements reflected both the low state of confidence in sterling and the emergence of covered interest rate differentials unfavorable to sterling as a result initially, of the advance in Euro-dollar rates in May and June. With the discount on forward sterling widening since then, from about 1/2 per cent per annum at midyear and 0.7 per cent at the end of September, to more than 1 per cent recently, the unfavorable covered differentials have not been eliminated by the October 19 rise in Bank Rate from 5-1/2 to 6 per cent.

The overall development of Common Market payments this year was influenced by the shift in Italy from deficit in the first half to surplus in the third quarter. The seasonally high inflow of tourist receipts was a major factor in this shift, but the change was much more than seasonal. Among nonseasonal elements, changes in capital flows were important. Shifts of funds from sterling to lira assets have been reported, and Italian exporters have been borrowing abroad, especially in Switzerland, because of favorable interest rate differentials. Also, a very favorable shift in leads and lags in trade payments seems to have occurred in August and September, particularly as regards repatriation of export receipts. In addition, there have been reports of inflows of funds from abroad into Italian shares. Expansion of activity in the Italian economy has been continuing.

Net gold and foreign assets of the Bank of Italy rose by about \$500 million in the third quarter, and appear to have increased further by more than \$100 million in October. To limit the size of its uncovered dollar holdings, the Bank of Italy has recently twice asked the System to

purchase dollars from it. For this purpose, the System drew \$100 million equivalent of lire under the swap line with the Bank of Italy on October 17, and a further \$100 million on November 2, bringing the outstanding lira drawings to \$300 million.

Germany's surplus on current and nonbank-capital account was smaller in the third quarter than in preceding quarters or than in the corresponding period a year ago. While Germany's trade surplus continued to run at the record annual rate of over \$4 billion through July-August, net outpayments on services, grants, and official capital accounts were large. Moreover, there has been a shift from large inflows of private non-bank capital last year to outflows this year -- already reaching substantial magnitude in the second quarter. This shift reflects the change in the German credit situation, with German borrowers now repaying foreign loans taken up during the preceding period of credit stringency. Also transactions in fixed-interest securities are again producing net outflows.

German commercial banks during the first half of the year placed large amounts of funds in short-term foreign investments, and the Bundesbank's net gold and foreign exchange reserves actually fell somewhat in that period. In the third quarter, however, the outflow of commercial bank funds slowed. The Bundesbank's net gold and foreign exchange position increased by about \$200 million in the four months July-October.

The outlook for the German balance of payments is for continued surplus. Although imports were up strongly in June-August, responding to the upturn in industrial activity, new export orders have also picked up and exports have begun to rise again. As advancing economic activity in

Germany leads to increasing domestic credit demands it is to be expected that private capital outflows will shrink again. However, German industrial production in September was about unchanged from August, and so remained well below the high July level. The third-quarter average was up 1-1/2 per cent from the second quarter's.

France this year avoided a balance-of-payments deficit in the third quarter, often an unfavorable season for the French accounts. The trade deficit, which was fairly large in the latter part of 1966 and early 1967, has been reduced by a decline in imports. The overall surplus has reflected continued net capital inflow, aided by flotations of bond issues of nationalized and private French industries on the Euro-bond market. In the first ten months of 1967 such issues amounted to \$130 million. In the face of the domestic economic slowdown, French interest rates have been kept relatively high.

Of the smaller European countries, Sweden and the Netherlands both have had better payments positions this year than last. In both countries, slowdowns in economic growth resulting from stabilization programs have led to a leveling off in imports; export growth, although not strong, has been somewhat better maintained. The result in each case has been a significant improvement in the trade balance which, in turn, accounts in large part for the improvement in the overall balance.

Outside Europe, Canada's international accounts shifted sharply from deficit in the first half of the year to a large surplus in the third quarter which, however, is not expected to persist. The third-quarter surplus appears to have arisen primarily from heavy tourist receipts --the

Canadian government now estimates a net payments gain for the full year of about \$400 million from Expo-67 -- and from increased capital inflows. Wheat exports in the third and fourth quarters are running smaller than in the first half of 1967.

As Canadian interest rates have risen strongly since last spring, the flow of long-term capital to Canada has increased. During the third quarter, Canada offered about \$325 million in bonds in the United States. Rising long-term rates in this country, far from discouraging the flow, have encouraged anticipatory borrowings. A further \$325 million of Canadian bond flotations is expected in the New York market in October-November alone -- but payments on these issues may carry forward into 1968.

Official Canadian reserves rose a little in the third quarter. In October, despite attempts to keep them down through the use of market swaps and purchases of Canadian and IBRD bonds in the United States, they rose further by about \$80 million. This put total reserves slightly over the limit of \$2,544 million agreed upon with the United States in exchange for Canada's IET exemption.

The Bank of Canada has recently persuaded the large chartered banks to lower deposit rates by about two-thirds of one per cent. The aim is to lower business borrowing costs in the Canadian economy, currently suffering rising unemployment with substantial price inflation. The government is expected shortly to announce a tax increase and to introduce some form of incomes policy.

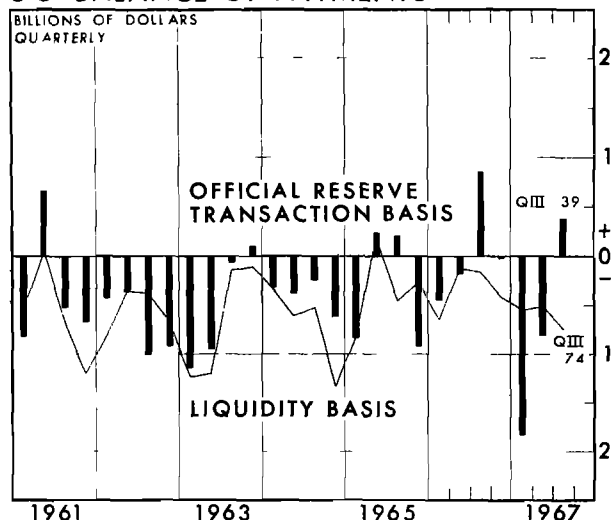
In Japan, the continued expansion of demand has led to steady import growth. Exports stayed flat during the first half year, and a very sizable import surplus consequently developed. Nevertheless, reserve

losses were largely avoided in that period, as the commercial banks borrowed heavily in the Euro-dollar market and elsewhere. In the third quarter official reserves experienced an appreciable decline. Imports continued to exceed exports, but an upturn in exports appeared to be emerging. Japanese exports to the United States showed considerable strength in September.

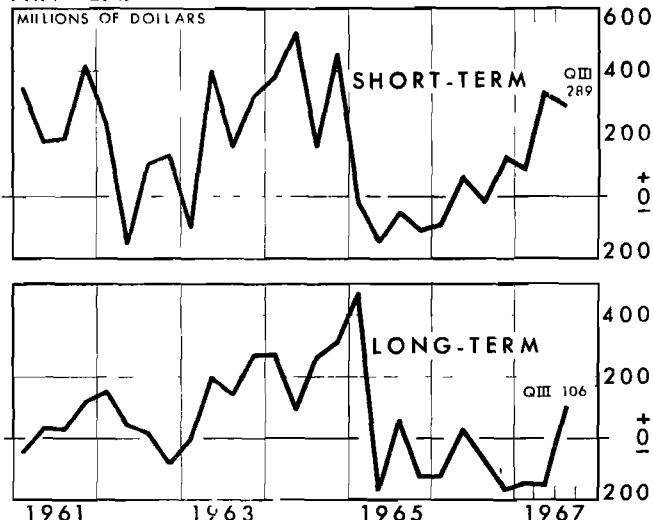
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

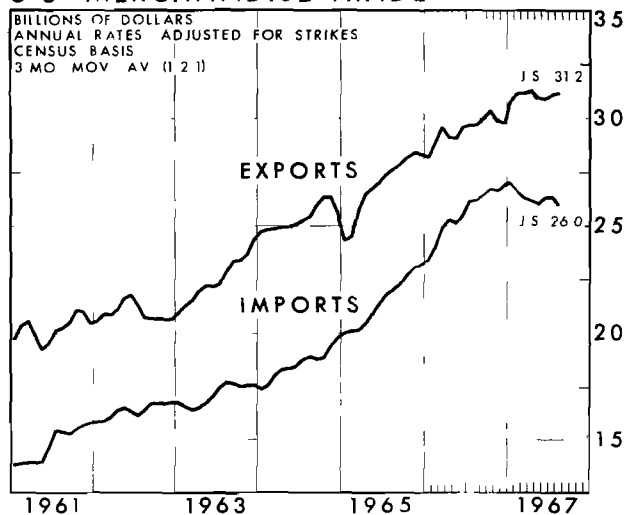
U S BALANCE OF PAYMENTS



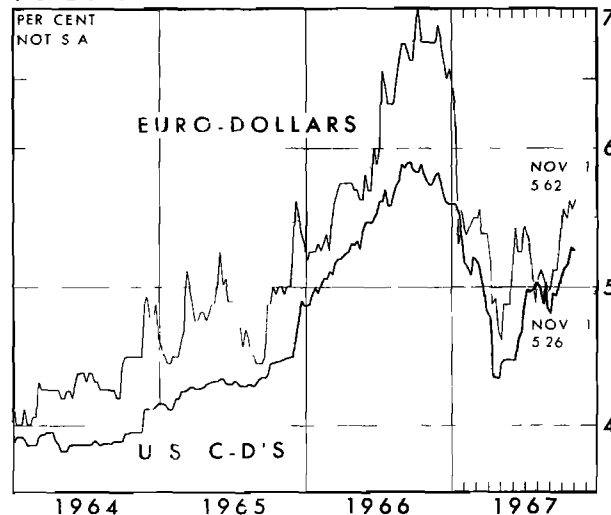
PRIV CAP FLOWS - BANK REPT CLAIMS



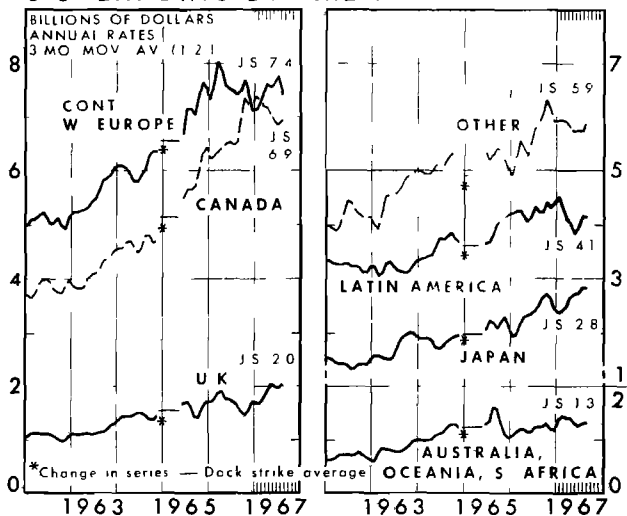
U S MERCHANDISE TRADE



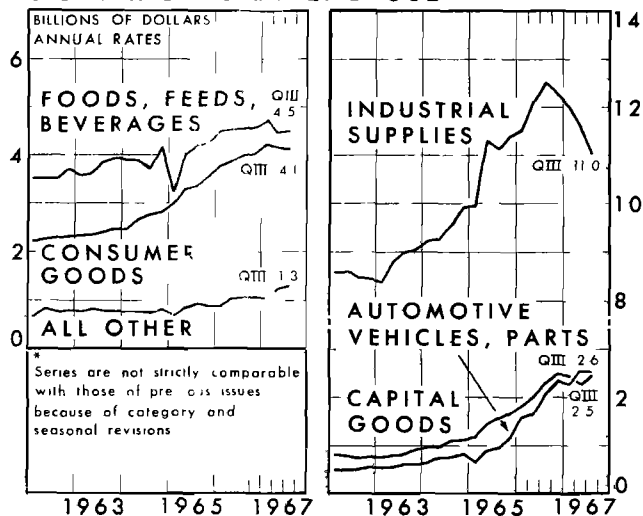
90-DAY RATES



U S EXPORTS BY AREA



U S IMPORTS BY END USE*



*Series are not strictly comparable with those of previous issues because of category and seasonal revisions

APPENDIX A: THE FORD-UAW SETTLEMENT*

The Ford Motor Company and the United Automobile Workers signed a three year contract on October 22, 1967. A return to large-scale operations, however, was delayed until the week of November 6 by unresolved issues at the local level. The total cost of the contract for the three years is estimated at between 88 cents and \$1.01 an hour, depending on the amount of cost-of-living adjustment and on the cost of certain fringe benefits over the life of the contract. This works out to an average annual rate of increase (compounded) of 5.8 - 6.6 per cent, using as a base the pre-strike average hourly compensation figure of \$4.80 for wages and fringes.

Wages. The largest proportion of the contract costs is for direct and indirect wage increases. A general wage rise of 20 cents an hour was provided in the first year; an additional 3 per cent deferred increase (averaging 11 cents a year) was granted in each of the next two years. In addition, a "roll-up" estimated at 10 cents an hour reflects the secondary effects on overtime and on shift differentials of the rise in base pay. Skilled workers were granted an extra and immediate increase of 30 cents an hour. These workers comprise an estimated one-sixth of the work force, and the differential is thus equivalent to about 5 cents an hour in wages for all workers.

Cost-of-living allowance. An important feature of the new contract was the ceiling put on cost-of-living adjustments. No cost-of-living adjustment was granted in the initial year of the contract. Annual adjustments will be given for the next two years with a minimum allowance of 3 cents and a maximum of 8 cents an hour each year. Workers will receive one cent for each rise of 0.4 points in the consumer price index. Thus, an eight cent maximum adjustment corresponds to a rise in the CPI of 3.2 points (somewhat less than 3 per cent, given the present level of the index). The union has the option of permanently waiving a penny of any cost-of-living adjustment in excess of 6 cents in return for an additional holiday to begin in 1970.

Nonwage benefits. The total cost of nonwage benefits is not certain, but has been estimated at about 25-28 cents an hour. This may overstate the actual cost since in the past funded pension and other nonwage costs frequently have been overestimated because growth in the fund assets has usually been substantially greater than anticipated. The most important of the nonwage benefits is an increase in the basic pension rate from \$4.25 to \$5.25 per month per year of service. After January 1, 1969, the pension rate will rise to \$5.50, \$5.75

* Prepared by Ruth Fabricant and Jane Moore, National Income, Labor Force, and Trade Section, Division of Research and Statistics.

or \$6.00 depending on the worker's pay level. Many assembly line workers will also receive an extra twelve minutes of relief time a day, making a total of 48 minutes. An additional paid holiday will be given at Christmas to provide a long weekend. The contract agreement also provides higher life insurance (\$13,000 maximum instead of \$11,500), company paid "Medicare" fees (\$3.00 a month), improved medical and surgical benefits, and a company paid drug plan.

The improved guaranteed annual wage protection provided in the new contract is essentially an expansion of the existing supplementary unemployment benefit program. However, the new provisions will not require an increased contribution by the company which will continue to pay 5 cents an hour into the fund, as in the prior contract. Contributions are halted when the fund reaches a specified maximum. The guaranteed annual wage provides laid-off workers with seven years seniority a full year of benefits at 95 per cent of after-tax pay, less a \$7.50 weekly deduction. For short workweeks, 80 per cent of regular gross weekly pay is guaranteed for both scheduled and unscheduled short workweeks.

Some implications. While the new Ford contract tends to confirm a growing trend in industry toward wage and fringe benefit increases in the neighborhood of 6 per cent per year, its distinctive feature is the emphasis of an immediate, substantial money wage increase with a considerable impact on production costs and current consumption expenditures. This is in sharp contrast to the previous auto contract in 1964. In that contract, no direct money wage increase was granted in the first year and a high proportion of the total package was in pension and other fringe benefits.

The new contract terms will set the pattern for the G.M. and Chrysler farm equipment and auto parts contracts (still to be negotiated this year) and is also likely to have an important influence on other major contract negotiations, in such industries as cans, steel, aluminum, and aerospace, bituminous coal mining, shipping and railroads.

The first year cash increase of 25-30 cents (including roll-up costs and higher wages for skilled workers) amounts to over 7 per cent of money wages, probably higher than the rate of productivity gain in the industry and well above first year increases received by workers in other major manufacturing contracts negotiated earlier this year. However, in nonmanufacturing activities, particularly in railroads and in construction, first-year wage increases of 6 per cent or more have been negotiated.

COST OF FORM - UAW SETTLEMENT

	Estimated Cost Per Hour (Cents)
	<hr/>
1. Wages	<u>\$.57</u>
20 cent increase in first year and 3 per cent increase in each of next two years (averaging 11 cents each year) for all workers.	.42
30 cent additional increase in first year for skilled workers. (Skilled workers are estimated to be 1/6 of total.)	.05
Roll-up costs	.10
2. Cost-of-living allowance	.06-.16
Two annual adjustments: December, 1968 and December, 1969. 3 cent minimum and 8 cent maximum on each adjustment depending on the amount of increases in the CPI.	
3. Nonwage benefits	<u>.25-.28</u>
Immediate increase of \$1.00 in pensions to \$5.25 per month per year of service, with additional increases on January 1, 1969 to \$5.50-\$6.00 the exact amount depending on worker's wage.	
Relief time increased 12 minutes to 48 minutes a day for assembly line workers.	
Improved insurance, medical and surgical benefits.	
Improved supplemental unemployment benefits.	
	<hr/>
Total cost	\$.88-1.01
Average annual cost	\$.29-.34
Average annual per cent increase (compounded)	5.8-6.6