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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

July 12, 1968

The Domestic Economy

Industrial production in June was 164.4 per cent of the 1957-59 average as compared to the upward revised May figure of 164.1 and to 155.6 a year earlier. In June, output of consumer goods and defense equipment increased, while production of business equipment and materials was unchanged. (STRICTLY CONFIDENTIAL until July 17.)

Auto assemblies were at an annual rate of 9.4 million units, up slightly from May. Output of some household goods and consumer staples rose moderately. Production of industrial and commercial equipment was about unchanged in June but output of trucks increased further. Among materials, a rise in steel production was offset by the aluminum strike and small declines in output of some nondurable materials.

The Domestic Financial Situation

Data that have become available since the Greenbook, suggest that the thrift institutions have weathered the reinvestment period with relatively modest outflows considering the level of market yields. While large mutual savings banks in New York City during the entire reinvestment period had "adjusted" outflows equal to about two-thirds of the 1966 experience, they are reported to consider these flows as normal.

15 LARGEST MUTUAL SAVINGS BANKS IN NEW YORK CITY
June-July Reinvestment Period
(Millions of dollars)

	1965	1966	1967	1968
Deposits	204.2	332.6	321.9	294.5
Withdrawals	350.1	591.5	430.8	544.4
Net	-145.8	-285.5	-108.9	-249.8
"Adjusted" net*	- 70.5	-153.1	- 10.5	-105.0

* - Net inflow adjusted to reflect repayment of passbook loans made earlier to save interest.

Unfortunately, savings and loan data for early July are not comparable with previous years because of the timing of the survey. However, while outflows accelerated during these first four business days of July from their pace during the June grace period, this pattern has been typical of recent experience. Staff of the Federal Home Loan Bank Board suggests that inflows have appeared later in the reinvestment period and report that results appear to be more favorable than the associations had expected.

Corporate and municipal bond yields declined significantly this week and investor interest in new issues picked up. In both markets, very good receptions of the dominant issues this week appeared to buoy sentiments of market participants, with the effect spilling over to other issues. It would seem that late in the week a general shift in expectations began to develop that suggested bond yields may have reached an upper turning point. This expectational shift stemmed, in part, from the view that monetary restraint was in the process of being relaxed--no doubt related to the cut in the RP rate and the financial press coverage of this development. In addition, favorable international monetary developments and a more realistic appraisal of the extent of fiscal restraint also affected expectations.

Corrections

Page II - 30, table. Consumer nonfood products for October 1967 to March 1968 and producers equipment for March to April should both be plus, not minus as shown.

KEY INTEREST RATES

	1967	1968		
	High	High	June 18	July 11
Short-Term Rates				
Federal funds (weekly average)	5.25 (1/11)	6.38 (5/15)	6.20 (6/12)	6.03 (7/10)
3-months				
Treasury bills (bid)	5.07 (12/5)	5.92 (5/21)	5.60	5.39
Bankers' acceptances	5.63 (12/29)	6.13 (5/24)	6.00	5.88
Euro-dollars	6.88 (11/28)	7.19 (6/4)	6.94	6.44
Federal agencies	5.30 (12/29)	6.11 (5/17)	5.91	5.65
Finance paper	5.88 (1/6)	6.13 (6/25)	6.13	
CD's (prime NYC)				
Highest quoted new issue	5.50 (12/29)	6.00 (7/11)	6.00	6.00
Secondary market	5.70 (12/29)	6.20 (5/31)	6.10	6.05
6-months				
Treasury bills (bid)	5.60 (12/1)	6.08 (5/21)	5.66	5.47
Bankers' acceptances	5.88 (12/29)	6.25 (5/24)	6.13	6.00
Commercial paper	6.00 (1/16)	6.25 (7/11)	6.25	6.25
Federal agencies	5.55 (12/29)	6.25 (5/24)	6.08	5.80
CD's (prime NYC)				
Highest quoted new issue	5.50 (12/29)	6.25 (7/11)	6.25	6.25
Secondary market	6.00 (12/29)	6.40 (5/31)	6.27	6.18
1-year				
Treasury bills (bid)	5.71 (12/29)	6.03 (5/21)	5.67	5.45
Federal agencies	5.95 (12/29)	6.01 (5/31)	6.00	5.88
Prime municipals	4.00 (12/29)	3.90 (5/31)	3.70	3.30
Intermediate and Long-Term				
Treasury coupon issues				
5-years	5.91 (11/13)	6.21 (5/21)	5.82	5.67
20-years	5.81 (11/20)	5.77 (3/14)	5.40	5.31
Corporate				
Seasoned Aaa	6.25 (12/28)	6.29 (6/6)	6.29	6.27
Baa	6.98 (12/28)	7.10 (6/3)	7.07	7.03
New Issue Aaa				
With call protection	6.55 (12/7)	6.83 (5/24)	6.61	6.56
Without call protection	6.70 (12/1)	6.99 (6/3)	--	--
Municipal				
Bond Buyer Index	4.45 (12/7)	4.71 (5/24)	4.56	4.36
Moody's Aaa	4.15 (12/28)	4.42 (5/31)	4.25	4.18
Mortgage--Implicit Yield In FNMA Weekly Auction 1/	-- --	7.72 (6/10)	7.70 (6/17)	7.41 (7/8)

1/ Yield on 6-month forward commitment after allowance for commitment fee and required FNMA stock purchase. Assumes discount on 30-year loan amortized over 15 years.

International Developments

British trade balance improves. The British trade deficit improved markedly in June, declining (on a balance of payments basis -- i.e., with both imports and exports measured f.o.b.) to £50 million from £86 million in May. Most of the improvement came from a drop in imports, which fell -- on a c.i.f. basis -- from £648 million in May to £609 million in June, the lowest monthly total this year. Exports increased from £498 million to £508 million (see table on next page).

The decline in imports is particularly heartening because the persistence of a large U.K. payments deficit has been due in large measure to the unexpected rise in British purchases from abroad after devaluation. Few details for June are available, but it appears that imports are responding to the sharp cutback in consumer spending that has taken place since March. It may be hoped that the reduction in imports also indicates an acceleration of the import substitution process, which was evidently slow to get under way.

To some extent, the June decline was influenced by special factors. Anticipation of Kennedy Round tariff cuts effective July 1 may have caused some deferral of purchases in June. Furthermore, June imports from France were reportedly £10 million below the monthly average for the first 5 months of the year, reflecting delays in shipments because of the civil disturbances there.

United Kingdom: Foreign Trade
(Monthly averages, seasonally adjusted)

	Exports[1/] f.o.b.	Imports[2/] c.i.f.	Trade balance with c.i.f. imports	Trade balance with f.o.b. imports 3/
£ million				
1967-I	467	-525	-58	-8
II	443	-525	-82	-38
III	436	-515	-79	-27
IV	391	-566	-175	-111
(Year)	(434)	(-533)	(-99)	(-46)
1968-I	513	-642	-129	-66
II	504	-634	-130	-74
April	506	-645	-139	-86
May	498	-648	-150	-86
June	508	-609	-101	-50
$ million[4/]				
1967-I	1,308	-1,470	-162	-22
II	1,240	-1,470	-230	-106
III	1,221	-1,442	-221	-76
IV	1,017	-1,472	-455	-289
(Year)	(1,197)	(-1,464)	(-267)	(-123)
1968-I	1,231	-1,541	-310	-158
II	1,210	-1,522	-312	-178
April	1,214	-1,548	-334	-206
May	1,195	-1,555	-360	-206
June	1,219	-1,462	-243	-120

1/ Includes re-exports.
2/ Excludes imports of U.S. military aircraft.
3/ Balance-of-payments basis.
4/ Converted from pounds sterling at $2.80 in 1967-I to III, $2.60 in 1967-IV, and $2.40 in 1968.

On the other hand, imports in June may have been inflated by scare buying stimulated by conjecture and rumor that import controls might soon be imposed. Presumably the improvement in the trade balance will quiet fears on this score and thus slow the pace of import buying.

Exports continue to do well. The second quarter total was slightly below that of the first quarter, but this was attributable to the inflation of first quarter exports because of shipments delayed by the dock strikes last fall. The trend has been upward, and prospects remain bright. Exporters continue to express the optimism that has characterized their outlook throughout the year, and new export orders continue to rise in a large number of industries.

The possibility of some interruption of the trade improvement in coming months cannot yet be ruled out, however, although a new widening of the deficit seems unlikely. On the import side, inventory accumulation and imports are closely correlated in the United Kingdom, and it appears that, after more than a year of inventory run-off, stocks are only now beginning to be rebuilt. Inventory accumulation is likely to continue for the balance of 1968. Furthermore, although the consumer buying spree has ended, export growth and increased investment in fixed capital are expected to take up the slack; statistical studies suggest that the marginal propensity to import in Britain is about as high for the export sector as for consumption, and may also be high for fixed investment. Thus imports may turn up again for a time. Meanwhile, export growth may be slowed by the restrictive fiscal measures recently enacted in the United States. Strong U.S. demand for British goods has contributed heavily to the strength of U.K. exports in recent months.

Gold and foreign exchange markets. Release of the favorable U.K. trade figures imparted further strength to sterling in foreign exchange markets. Having risen sharply early in the week on news of progress toward a funding of sterling balances, the sterling rate increased sharply further to $2.3907 on Friday morning, July 12, and the discount on 3-month forward sterling narrowed somewhat further to 3.7 per cent per annum. Although the market was thin, the Bank of England was able to add modestly to its reserves.

The London gold price declined sharply further to $39.10 on Thursday and Friday, its lowest level since early May.

The French franc has remained near its lower support level except for a brief recovery Wednesday afternoon, July 10, when it was announced that the Bank of France had arranged $1.3 billion of new credit facilities with 5 central banks and the B.I.S. Included in these arrangements was a $600 million increase in the reciprocal currency arrangement with the Federal Reserve from $100 million to $700 million.

Euro-dollar market. In early June, interest rates on Euro-dollar deposits declined from their peak levels for the year recorded late in May. For several weeks thereafter rates were stable, as a wide variety of changing influences on both the supply and demand sides of the market balanced out. This week, rates have been marked down further for all maturities, to levels 50 basis points or more below late-May peaks, and the lowest since April.

BROKERS' BID-RATES FOR EURO-DOLLAR DEPOSITS IN LONDON
(Wednesday, except as noted)

	Call		1-month		3-month		6-month		12-month	
	Rate	Change	Rate	Change	Rate	Change	Rate	Change	Rate	Change
May 1	6.13		6.06		6.44		6.63		6.88	
15	6.44	+.31	6.25	+.19	6.69	+.25	6.81	+.18	6.94	+.06
29	6.50	+.06	6.75	+.50	7.13	+.44	7.19	+.38	7.31	+.37
June 12	6.25	-.25	6.44	-.31	6.69	-.44	6.75	-.44	6.88	-.43
26	6.63	+.38	6.56	+.12	6.75	+.06	6.81	+.06	7.00	+.12
July 10	6.00	-.63	6.00	-.56	6.31	-.44	6.69	-.12	6.88	-.12
Friday, July 12	5.75	-.25	6.25	+.25	6.31	.00	6.69	.00	6.81	-.07

Rate movements have, as usual, roughly paralleled the movements of corresponding interest rates in the United States. But flows have been influenced not only by the changing demands of U.S. banks for funds but also by changing supplies. The fact that the U.S. banks were able to attract Euro-dollar funds in very large volume throughout May and June resulted in large measure from tne fact that funds were being shifted out of French francs and sterling. In recent days, the flows out of francs and sterling have slackened. But this change has apparently been partly offset on the supply side by the replacement in Euro-dollar deposits by commercial banks in Germany of funds withdrawn over mid-year. Also, the demand for Euro-dollar funds on the part of U.S. banks is apparently slackening, now that U.S. interest rates have eased so that funds can more readily be obtained from sales of domestic CD's.