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Content last modified 6/05/2009.

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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

July 10, 1968

SUMMARY AND OUTLOOK

Outlook for economic activity

Third quarter GNP seems certain to show sharply slower growth, reflecting in large part a slowing in inventory accumulation as the buildup in steel is terminated and as businesses trim purchases in line with the recently slower growth in consumption. Adding to this short-term influence will be the combined impact of the tax surcharge, a tapering off of Federal expenditures, and a slide-off in residential construction activity. In real terms, output is expected to show little increase, even in the absence of a steel strike. The easing in the economy should be evident in a more moderate rate of industrial price increases--although the GNP deflator is likely to rise somewhat faster in the third quarter as a result of the Federal pay raise, which is counted as a price increase in the income and product accounts.

With demands for manpower increasing only modestly, unemployment is expected to rise somewhat, and personal income to grow at a slower rate. Increased tax withholdings are expected to keep disposable personal income from rising much. The rise in personal consumption expenditures in the third quarter seems likely to be slightly under the second quarter increase--and that increase can occur only with a decline in the rate of savings from the very high second quarter rate.

The slow growth in retail sales, except for autos, last quarter suggests the accumulation of excess consumer stocks. In addition, auto inventories were raised to near-record levels, and additional steel stocks accumulated in anticipation of a possible strike. As a result of this large inventory investment and heavy overhang and the beginning of liquidation of steel inventories whether or not there is a strike, a smaller rate of inventory accumulation is expected in the third quarter. A steel strike could result in an even greater run-off of inventories and further retardation of over-all economic activity.

Most major sectors of activity appear likely to either show less strength or actually decline in the current quarter. Federal expenditures are expected to expand less rapidly, with most of the rise reflecting the pay raise, and private construction activity and expenditures are expected to dip as a result of reduced availability of mortgage funds and tight monetary policy. Only plant and equipment expenditures are projected to rise somewhat--based upon the results of the Commerce-SEC survey of business anticipations. Even here, actual second quarter expenditures appear to have fallen short of the survey expectations, casting some doubt on the full realization of the earlier projections in an atmosphere of curtailed growth and profit margins.

Outlook for prices and resource use

Industrial production, which has moved up at a moderate pace (at about a 5 per cent annual rate for the second quarter as a whole--about in line with real GNP as revised), may decline somewhat after July as excessive inventories--of steel and probably also autos and some other consumer durables--are worked down. Hours of work and employment in manufacturing are also likely to edge off, and the rate of manufacturing capacity utilization is expected to fall below the 84 per cent plateau maintained since last summer. With growth in real output slowing, employment expansion is likely to taper off further and the unemployment rate to rise somewhat.

The upward movement in consumer prices--at a 4 per cent rate over the past year--has shown no sign of slackening yet, nor have the efforts of workers to achieve wage increases now that will recoup past cost-of-living increases and assure ample growth in real wages in the future. Contracts covering 1.3 million workers are up for negotiation in this quarter and are expected to continue the pattern of high first-year wage increases (7-1/2 to 10 per cent). In the fourth quarter, however, the number of workers involved in new contract negotiations will decline sharply.

Industrial prices resumed their upward course in June after a 1-month decline. The current rise, however, lacks the vigor evident last winter--with the number of products currently showing increases at the lowest level since last September. With upward wage pressures persisting when production--and presumably gains in productivity--is declining, another spurt in unit labor costs may be in store for industrial producers as business and consumer demands diminish. Under these opposing pressures, the industrial price rise is likely to persist, although at a more moderate pace. The sharp upward movement in food prices this year may be approaching its zenith, and lagging consumer demands may help to slow the rise in retail prices of other goods and services in coming months.

Outlook for credit demands

Loan demand at banks may be expected to moderate over the course of the summer, apart from any temporary bulge in reflection of business payments of additional taxes due in mid-July stemming from the surtax legislation. A reduced rate of inventory accumulation--once needs in anticipation of a steel strike are satisfied--and a slower growth in economic activity are likely to reduce business demands for bank financing, given existing loan terms and conditions. Corporate demands in the bond market, too, may moderate later this summer from the relatively large volume of offerings in June and on the docket for July.

On the other hand, State and local government offerings may increase further from their already large volume, buoyed by industrial revenue bonds offered to beat the yearend deadline removing tax exemption. And mortgage credit demands have shown little sign of abating despite the record cost of mortgage finance, as basic housing requirements, pent-up after more than two years of under-building, have continued to increase.

Further Federal Government borrowing will be added to private capital market demands later this summer. The Treasury will have to roll over $3.7 billion of maturing securities held by the public in mid-August, and will also have to raise a substantial amount of new cash (perhaps about $3 billion) during the month. While the timing and form of Treasury offerings will depend on market conditions, it appears likely that longer-term Treasury notes and possibly a PC could be included.

Thus, from the demand side of markets alone, the prospect for significant declines in interest rates during the summer depends in large part on a possible curtailment of corporate security market financing demands once the current spurt of new issues is marketed. An actual easing of supply conditions, or a greater conviction of market participants that credit will become more available, would tend to bring interest rates down over a broad spectrum of credit instruments.

Outlook for supply of funds

The experience of thrift institutions with savings flows during the current reinvestment period appears to be somewhat stronger than might have been expected on the basis of existing interest rate relationships, at least insofar as can be judged from fragmentary data for the early part of the reinvestment period. And if short-term interest rates ease further, these institutions may be expected to accelerate their mortgage commitment activity in anticipation of a further improvement of inflows.

Consumer-type time and savings deposits at banks have also held up moderately well, and outstanding CD's have recently begun to rise as Treasury bill rates have dropped and remained below Regulation Q ceiling rates. It is likely that growth in time and savings deposits this summer will be more rapid than the 3 per cent annual rate of the second quarter. But under current market conditions, it is more conjectural whether time and savings deposits will recover to the 7 per cent pace of the first quarter of 1968, a pace which was already reflecting the constraints of developing monetary tightness.

Meanwhile, private demand deposits are not likely to be as substantial a source of funds to banks over the summer, as transactions needs moderate. Nor are Euro-dollars likely to be as readily available if confidence in the franc and the pound is re-established.

On balance, it appears that the projected continued sizable total demands on credit markets will be accompanied by only a modest increase in over-all credit availability under existing monetary conditions.

Balance of payments

Although the dollar strengthened in foreign exchange markets in May and June as a result of new doubts about the French franc and the British pound and of enactment of the U.S. fiscal restraint program, the underlying U.S. payments position has remained unsatisfactory.

The published balance of payments deficit on the liquidity basis in the second quarter may be less than $1 billion at a seasonally adjusted annual rate, down from $2-1/2 billion in the first quarter and the smallest for any quarter since 1966. All of the second quarter reduction, however, reflected special official transactions, including a large shift of Canadian reserves from short-term to over-one-year securities, and sales of nonmarketable U.S. notes to the German central bank and to German commercial banks. Before special transactions, the liquidity deficit remained near $4 billion at an annual rate, as in the first quarter. The net export surplus on goods and services remained very small, and an increase in net outflows of U.S. capital from their abnormally low first quarter level was apparently matched by an increase to record levels of foreign purchases of U.S. corporate stocks and Euro-bonds.

Since foreign private liquid funds also poured in in record volume during the second quarter, the official settlements balance swung into substantial surplus.

Inflows of foreign capital, both liquid and nonliquid, are unlikely to continue at recent record rates for long, even at present interest rate relationships. France and Britain could not long sustain reserve drains on the scale experienced in May and June, and U.S. corporate equities may lose some of their recent attraction for foreigners as the U.S. economic expansion slows down. Hence, even though the U.S. trade balance is expected to recover fairly rapidly during the second half year, the liquidity deficit before special transactions may continue at about a $4 billion annual rate, and the official settlements balance is likely to revert to deficit.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per Cent Cha	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Yrs Ago*
Civilian labor force (mil.)	Jun'68	79.0	78.6	77.2	2.3	4.4
Unemployment (mil.)	"	3.0	2.8	3.0	-2.5	2.3
Unemployment (per cent)	"	3.8	3.5	3.9	--	--
Nonfarm employment, payroll (mil.)	"	67.9	67.8	65.8	3.1	5.8
Manufacturing	"	19.7	19.7	19.4	1.9	2.4
Other industrial	"	8.1	8.2	8.0	1.1	0.3
Nonindustrial	"	40.0	39.9	38.4	4.1	8.8
Industrial production (57-59=100)	May'68	163.7	162.5	155.6	5.2	5.3
Final products	"	162.6	161.4	156.3	4.0	5.6
Materials	"	164.7	163.5	154.6	6.5	4.9
Wholesale prices (57-59=100) 1/	"	108.5	108.3	105.8	2.6	2.7
Industrial commodities (FR)	"	107.8	107.9	105.2	2.5	3.4
Sensitive materials (FR)	"	106.0	107.8	100.1	5.9	-0.8
Farm products, foods & feeds	"	107.9	106.8	105.0	2.8	0.0
Consumer prices (57-59=100) 1/	"	120.3	119.9	115.6	4.1	6.8
Commodities except food	"	112.5	112.2	108.7	3.5	5.8
Food	"	118.8	118.3	113.9	4.3	4.7
Services	"	133.0	132.5	127.0	4.7	9.5
Hourly earnings, mfg. ($)	Jun'68	3.00	2.98	2.82	6.4	10.7
Weekly earnings, mfg. ($)	"	122.81	121.92	113.99	7.7	9.5
Personal income ($ bil.) 2/	May'68	674.0	669.8	618.2	9.0	17.0
Corporate profits before tax ($ bil.) 2/	Q I'68	88.7	85.1	79.0	12.3	6.0
Retail sales, total ($ bil.)	May'68	28.0	27.6	25.9	8.0	14.3
Autos (million units) 2/	Jun'68	8.8	8.7	8.5	4.0	7.9
GAF ($ bil.)	May'68	6.8	6.7	6.3	8.4	17.0
Selected leading indicators:						
Housing starts, pvt. (thous.) 2/	May'68	1,331	1,586	1,274	4.5	5.5
Factory workweek (hours)	Jun'68	40.9	40.9	40.4	1.2	-1.2
New orders, dur. goods ($ bil.)	May'68	25.6	25.2	23.9	7.2	5.4
New orders, nonel. mach. ($ bil.)	"	3.8	3.8	3.5	9.8	8.1
Common stock prices (1941-43=10)	Jun'68	100.53	97.87	91.43	10.0	16.8
Manufacturers' Inventories, book val. ($ bil.)	May'68	84.3	84.0	80.3	4.9	18.9
Gross national product ($ bil.) 2/	Q I'68	826.7	807.3	766.3	7.9	13.9
Real GNP ($ bil., 1958 prices) 2/	"	689.7	679.6	660.7	4.4	6.9

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended July 5, 1968	4-week average	Last 6 months High	Last 6 months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	5.78	6.06	6.42	4.5
U.S. Treas. bills, 3-mo., yield (per cent)	5.35	5.45	5.82	4.8
U.S. Treas. bills, 1-yr., yield (per cent)	5.56	5.64	5.99	5.1
Net free reserves 2/ ($ millions)	-405	-351	384	-54
Member bank borrowings 2/ ($ millions)	493	661	823	18
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds 1/	5.74	5.80	6.15	5.4
20-year U.S. Treas. bonds 1/	5.34	5.38	5.68	5.3
Corporate new bond issues, Aaa adj. 8/	9/	10/ 6.69	6.83	6.1
Corporate seasoned bonds, Aaa 1/	6.27	6.28	6.29	6.0
Municipal seasoned bonds, Aaa 1/	4.18	4.19	4.42	3.9
FHA home mortgages, 30-year 3/	--	6.94	6.94	6.7
Common stocks, S&P composite series 4/				
Prices, closing (1941-43=10)	100.91	100.57	101.27	88.4
Dividend yield (per cent)	3.03	3.00	3.38	2.9

	Latest month	Amount	3-month average	Change from year earlier: Latest month	Change from year earlier: 3-mont[h] averag[e]
New Security Issues (N.S.A., $ millions)					
Corporate public offerings 5/	July '68 e/	2,050	2,150	-404	- 2[illegible]
State & local govt. public offerings	July '68 e/	1,300	1,266	357	4[illegible]
Comm. & fin. co. paper (net change in outstandings) 6/	May '68	+ 908	+ 201	+ 90	-42[illegible]

	Latest month	Out-standings Latest month	Change Latest month	Change 3-month average	Annual rate of change from Pre-ceding month	Annual rate of change from 3 months ago	Annual rate of change from 12 month[s] ago
		($ billions)			(per cent)		
Banking (S.A.)							
Total reserves 1/	June '68	25.80	0.09	--	4.3	-0.2	7.1
Credit proxy 1/	" "	278.7	1.4	0.2	6.0	1.0	7.4
Bank credit, total 6/	" "	356.6	0.3	1.6	1.0	5.5	9.[illegible]
Business loans	" "	90.5	0.9	0.9	12.0	12.3	9.[illegible]
Other loans	" "	142.7	0.3	0.7	2.5	5.7	8.9
U.S. Govt. sec.	" "	60.0	-0.7	--	-13.8	0.7	8.[illegible]
Other securities	" "	63.4	-0.1	--	-1.9	-0.6	12.6
Total liquid assets 1/ 6/	May '68	669.5	2.1	2.9	3.8	5.3	7.9
Demand dep. & currency 1/	June '68	187.3	1.2	1.3	7.7	8.5	6.4
Time & sav. dep., comm. banks 1/	" "	188.1	0.5	0.5	3.2	3.0	9.0
Savings, other thrift instit. 6/	May '68	188.4	0.7	0.9	4.5	5.8	7.4
Other 6/ 7/	" "	107.4	-0.9	0.1	-10.0	0.7	6.8

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 July 3 . 3/ Latest figure is for Apr.. 4/ End of week closing prices; yields are for Friday. 5/ Corporate security offerings include both bonds and stocks. 6/ Month-end data. 7/ U.S. Savings bonds and U.S. Government securities maturing within 1 year. 8/ Adjust to Aaa basis. 9/ No new issues during week. 10/ Four-week average - June 7, 14, 21, and 28.

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

	1967 I	1967 II	1967 III	1967 IV	1968 I	1968 Apr.	1968 May
	Seasonally adjusted						
Goods and services, net 1/	1,293	1,269	1,359	848	374		
Trade balance 2/	975	1,098	1,085	319	84	230	-60
Exports 2/	7,661	7,703	7,626	7,478	7,924	2,870	2,690
Imports 2/	-6,686	-6,605	-6,541	-7,159	-7,840	-2,640	-2,750
Services balance	318	171	274	529	290		
Remittances and pensions	-262	-392	-358	-263	-269		
Govt. grants & capital 3/	-1,176	-1,039	-988	-1,008	-1,163		
U.S. private capital	-975	-1,104	-1,788	-1,638	-711		
Direct investments	-653	-651	-902	-815	-468		
Foreign securities	-259	-199	-476	-332	-406		
Banking claims	79	-198	-435	95	365		
Other	-142	-56	25	-586	-202		
Foreign capital, nonliquid	865	1,202	766	353	1,311		
Official foreign accts.	382	724	18	150	336		
Long-term deposits	304	584	-215	147	117		
U.S. Govt. liab.	78	140	233	3	219		
Int'l. institutions 4/	64	95	121	13	-96		
Other 5/	419	383	627	190	1,071		
Errors and omissions	-250	-458	207	-34	-148		
Balances, with and without seasonal adjustment (- deficit)							
Liquidity balance, S.A.	-505	-522	-802	-1,742	-606		
Seasonal component	267	302	-410	-159	382		
Balance, N.S.A.	-238	-220	-1,212	-1,901	-224	-596	+208
Official settlements bal.,S.A.	-1,764	-806	247	-1,082	-510		
Seasonal component	485	101	-272	-314	600		
Balance, N.S.A. 6/	-1,279	-705	-25	-1,396	90	-356	+933
Reserve changes, N.S.A. (decrease -)							
Total monetary reserves	-1,027	419	375	181	-904	-86	508
Gold stock	-51	-15	-92	-1,012	-1,362	-156	-79
Convertible currencies	-1,007	424	462	1,145	401	58	582
IMF gold tranche	31	10	5	48	57	12	5

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 (+) increase 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.

THE ECONOMIC PICTURE IN DETAIL

Gross national product. Recent data on retail sales and employment have caused us to revise down sharply our estimate of the rise in GNP in the second quarter. Currently, we estimate the increase at a rate of $18.5 billion, about $3-1/2 billion less than indicated in the last Greenbook, with the annual rate of growth in real GNP slowing from 6 per cent in the first quarter to 5 per cent. Further marked slowing in activity is projected in the summer months as the surtax offsets the growth in incomes. In the third quarter the rise in GNP is estimated at only $9 billion, with little growth in real output.

With demand weakening, price increases are expected to moderate somewhat in the private economy, but the wage increase for Federal government workers--which is treated as a price increase in the national income accounts--is expected to raise the GNP deflator from 3.7 per cent in the second quarter to 4 per cent in the third.

The deceleration in second quarter activity resulted largely from a sluggish rise in consumer buying despite a continued large rise in disposable income. Little change was recorded in sales for most categories of nondurable and durable goods, except for an increase in auto marketings. Weak detail sales in April were at first largely attributed to civil disturbances, but the May recovery was modest and retail sales in June, according to the weekly data, changed little from the May level. (Preliminary data for the month of June are not yet available). Personal consumption expenditures rose by an estimated $7 billion in the second quarter as compared to $17 billion in the first, while the savings rate returned to the high fourth quarter rate of 7.6 per cent.

No satisfactory explanation for the abrupt slow-down in sales between the first and second quarters is readily available in view of a rise in income which was only moderately below the record first quarter. Price increases may have limited sales, and the surtax may have cast its shadow, but, according to a recent survey of consumer sentiment, continued apprehension over the international situation--and not the upcoming tax increase--was a major cause of buyer hesitancy. But basically, consumers' behavior remains as puzzling in the spring of 1968 as it was all through 1967, when consumers maintained an exceptionally high savings rate despite a steady growth in real as well as money income.

The second quarter estimate of business investment in plant and equipment has also been revised down, since recent data suggest an even more severe drop than was indicated in the May Commerce-SEC plant and equipment survey. Net exports last quarter also fell considerably below expectations, contributing to weaker growth in total GNP.

Inventories apparently rose at a sharply increased rate, on the other hand, partly because of slack sales in many consumer durable and nondurable goods lines. Auto inventories rose to near-record levels and steel stocks continued to mount in anticipation of the strike deadline August 1st. At this point, inventory data for all business sectors are available only for April, but production and sales estimates suggest that the physical volume of nonfarm inventories may have climbed at a rate of about $8 billion last quarter.

The imposition of the tax surcharge, in conjunction with a likely reduction in the growth of Federal expenditues, a decline in residential construction outlays, and a smaller rate of inventory accumulation will probably result in a virtual halt in the rate of growth in real GNP in the third quarter.

The rise in personal income will reflect a general slowing in the economy. Although wages are continuing to rise briskly and the Federal pay raise will add $1.9 billion to before-tax income this month, easing in economic activity is likely to result in slower employment growth, curtailed workweek schedules, and a smaller gain in wage and salary payments.

Most of the $10 billion rise in personal income anticipated in this quarter will be offset by the increased withholdings of 10 per cent on all families now subject to the income tax. Social security taxes, which normally fall sharply in the third quarter as the taxable wage-ceiling is attained, will continue to absorb about 4.4 per cent of workers' pay this year, owing to the statutory increase in the amount of annual wage and salary earnings subject to tax. (This is not reflected in the national income accounts for technical reasons, but it will nonetheless deter spending.)

We are projecting a rise in consumption of about $6.5 billion this quarter, despite the leveling in spendable income. This estimate is consistent with a dip in the rate of savings to about 6.5 per cent from the 7.6 per cent of last quarter as consumers attempt to maintain living standards. This saving rate is still relatively high compared to most recent years. Although the rise in spending is comparable to that of the previous quarter, the durables component is somewhat weaker. Over a period of time, sales of nondurable tend to follow the upward trend in population, prices, and income, notwithstanding sharp variations from quarter to quarter. Service outlays show a fairly regular pattern of increase regardless of short-term variation in income or in other expenditures. These two categories may thus be relatively immune to the sharp break in the upward trend in income. Durable goods sales, on the other hand, should be adversely affected, even though auto dealers will be making exceptional efforts to dispose of heavy stocks before fall.

Nonfarm inventory accumulation is expected to dip from an estimated $8.0 billion in the second quarter to $5.0 billion in the third. The disappointing retail sales picture probably resulted in some overhang of stocks of many consumer goods, which should eventuate in a lower rate of accumulation this quarter. In addition, steel stocks accumulated in anticipation of a strike, will be run down for the remainder of the year even if, as we have assumed, a strike is avoided and there is a steel settlement by August 1.

(If there should be an industry-wide steel strike, which remains a distinct possibility, the depressing effect on inventories and on output would be more severe. If a strike lasted 6 weeks, nonfarm inventory investment would be reduced by about $2 billion below the $5.0 billion now projected. Some 450,000 workers would be directly affected and wage and salary payments would be lowered by over $2 billion /annual rate/ in the third quarter).

Restrictive conditions in the mortgage market are likely to reduce housing starts in the third quarter to a rate of 1.33 million units--down from 1.41 million in the second quarter--and expenditures for residential construction may dip by $1-1/2 billion to $27.9 billion. Business investment in plant and equipment however, should rise this quarter if business intentions as disclosed in the Commerce-SEC survey are realized. However, the drop in these expenditures in the second quarter appears to have been sharper than the survey anticipated, indicating that fixed investment may not rise as much as previously planned in the last half of this year. The full impact of the rise in taxes in reducing profit margins may not have been anticipated in May.

Although the tax increase should act as the major source of fiscal restraint in the third quarter, the effort to reduce Federal expenditures is also likely to begin to affect both Federal and State-local purchases of goods and services. After rising by an estimated $2.5 billion last quarter, defense spending--excluding the impact of the pay raise--is expected to increase by less than $0.5 billion this quarter. The small increase projected in nondefense expenditures mainly reflects the pay increase.

With the tax take rising sharply, the Federal deficit, NIA basis, is likely to be cut from an annual rate of $10.7 billion in the second quarter to about $6.0 billion, if Federal spending is restrained as indicated above. This compares with a peak rate for recent years of almost $15 billion, reached in the second quarter of last year.

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	1967			1968	Projected	
			II	III	IV	I	II	III
Gross National Product	743.3	785.0	775.1	791.2	807.3	826.7	845.2	854.2
Final sales	729.9	779.8	774.6	787.4	798.1	824.0	836.7	848.9
Private purchases	575.6	603.5	599.6	609.2	616.4	635.7	643.3	651.1
Personal consumption expenditures	465.9	491.7	489.7	495.3	501.8	518.7	525.8	532.2
Durable goods	70.3	72.1	72.5	72.7	73.8	78.4	78.8	78.5
Nondurable goods	207.5	217.5	217.2	218.5	220.3	228.1	230.6	233.5
Services	188.1	202.1	200.0	204.1	207.7	212.1	216.4	220.2
Gross private domestic investment	118.0	112.1	105.1	112.2	120.8	118.0	123.8	120.5
Residential construction	24.4	24.4	23.1	25.6	27.6	28.2	29.4	27.9
Business fixed investment	80.2	82.6	81.5	82.8	84.0	87.2	85.9	87.3
Change in business inventories	13.4	5.2	.5	3.8	9.2	2.7	8.5	5.3
Nonfarm	13.7	4.8	.6	3.4	7.7	1.8	8.0	5.0
Net Exports	5.1	4.8	5.3	5.4	3.0	1.7	2.2	3.7
Gov't purchases of goods & services	154.3	176.3	175.0	178.2	181.7	188.3	193.4	197.8
Federal	77.0	89.9	89.5	90.9	92.2	96.2	98.9	101.2
Defense	60.5	72.5	72.5	73.3	74.2	76.7	79.1	80.9
Other	16.5	17.4	17.0	17.6	18.0	19.5	19.8	20.3
State and local	77.2	86.4	85.4	87.4	89.5	92.1	94.5	96.6
Gross National Product in constant (1958) dollars	652.6	669.3	664.7	672.0	679.6	689.7	698.4	698.9
GNP Implicit deflator (1958=100)	113.9	117.3	116.6	117.7	118.8	119.9	121.0	122.2
Personal income	584.0	626.4	619.1	631.0	642.5	659.0	674.5	684.8
Wages and salaries	394.6	423.8	418.3	426.2	435.9	447.6	456.3	463.4
Disposable income	508.8	544.7	540.0	548.2	557.9	571.5	585.2	586.2
Personal saving	29.8	38.7	36.0	38.5	41.6	38.0	44.3	38.6
Saving rate (per cent)	5.9	7.1	6.7	7.0	7.5	6.6	7.6	6.6
Corporate profits before tax	83.8	80.8	78.9	80.0	85.1	88.7	92.5	90.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	143.2	151.8	148.1	152.7	157.3	167.9*	171.9	180.0
Expenditures	142.9	164.3	162.8	165.9	167.9	175.6	182.6	185.9
Surplus or deficit (-)	.3	-12.5	-14.7	-13.2	-10.7	-7.7*	-10.7	-5.9
Total labor force (millions)	78.9	80.8	80.3	81.1	81.6	81.9	82.2	82.7
Armed forces "	3.1	3.4	3.5	3.5	3.5	3.5	3.5	3.6
Civilian labor force"	75.8	77.3	76.8	77.6	78.2	78.4	78.7	79.1
Unemployment rate (per cent)	3.8	3.8	3.8	3.9	3.9	3.6	3.6	3.8
Nonfarm payroll employment (millions)	64.0	66.0	65.7	66.1	66.7	67.4	67.8	68.0
Manufacturing	19.2	19.4	19.4	19.3	19.5	19.6	19.7	19.6
Industrial production (1957-59=100)	156.3	157.8	155.9	157.2	159.5	162.1	164.0	163.5
Capacity utilization, manufacturing (per cent)	90.5	85.1	84.9	84.1	84.4	84.4	84.1	83.0
Housing starts, private (millions A.R.)	1.17	1.29	1.21	1.41	1.44	1.50	1.41	1.33
Sales new U.S.-made autos (millions, A.R.)	8.38	7.57	8.11	7.57	7.44	8.19	8.44	8.25

* Includes retroactive 10 per cent surcharge on corporate profits tax liability.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1966	1967	1967 II	1967 III	1967 IV	1968 I	1968 Projected II	1968 Projected III
	------------ In Billions of Dollars------------------							
Gross National Product	59.4	41.7	8.8	16.1	16.1	19.4	18.5	9.0
Final sales	55.4	49.9	15.4	12.8	10.7	25.9	12.7	12.2
Private purchases	37.5	27.9	10.8	9.6	7.2	19.3	7.6	7.8
GNP in constant (1958) dollars	35.9	16.7	4.0	7.3	7.6	10.1	8.7	0.5
Final sales	32.1	24.6	10.3	4.2	2.5	16.2	3.2	3.2
Private purchases	21.9	10.4	7.1	3.0	1.7	11.9	0.6	1.9
	--- In Per Cent; Quarterly Changes are at Annual Rates							
Gross National Product	8.7	5.6	4.6	8.3	8.1	9.6	8.9	4.3
Final sales	8.2	6.8	8.1	6.6	5.4	13.0	6.2	5.8
Private purchases	7.0	4.8	7.3	6.4	4.7	12.5	4.8	4.8
Personal consumption expenditures	7.6	5.5	7.9	4.6	5.2	13.5	5.5	4.9
Durable goods	6.5	2.6	17.9	1.1	6.1	24.9	2.0	- 1.5
Nondurable goods	8.5	4.8	5.6	2.4	3.3	14.2	4.4	5.0
Services	6.9	7.4	6.9	8.2	7.1	8.5	8.1	7.0
Gross private domestic investment	9.9	- 5.0	-19.2	27.0	30.7	- 9.3	19.7	-10.7
Residential construction	- 9.6	0.0	31.8	43.3	31.2	8.7	17.0	-20.4
Business fixed investment	12.8	3.0	- 2.0	6.4	5.8	15.2	- 6.0	6.5
Gov't purchases of goods & services	13.1	14.3	10.8	7.3	7.9	14.5	10.8	9.1
Federal	15.3	16.8	11.0	6.3	5.7	17.4	11.2	9.3
Defense	20.8	19.8	13.1	4.4	4.9	13.5	12.5	9.1
Other	- 1.2	5.5	4.8	14.1	9.1	33.3	6.2	10.1
State & local	10.9	11.9	10.1	9.4	9.6	11.6	10.4	8.9
GNP in constant (1958) dollars	5.8	2.6	2.4	4.4	4.5	5.9	5.0	0.3
Final sales	5.3	3.8	6.3	2.5	1.5	9.7	1.9	1.9
Private purchases	4.4	2.0	5.5	2.3	1.3	9.0	0.4	1.4
GNP Implicit deflator	2.7	3.0	2.1	3.9	3.6	3.7	3.7	4.0*
Personal income	8.6	7.3	4.0	7.7	7.3	10.3	9.4	6.1
Wages and salaries	9.9	7.4	3.5	7.6	9.1	10.7	7.8	6.2
Disposable income	7.8	7.1	5.5	6.1	7.1	9.7	9.6	0.7
Corporate profits before tax	9.5	- 3.6	- 0.5	5.6	25.5	16.9	17.1	- 8.6
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.7	6.0	- 2.7	12.4	12.0	27.0	9.5	18.8
Expenditures	15.8	15.0	4.7	7.6	4.8	18.3	15.9	7.2
Nonfarm payroll employment	5.3	3.1	0.6	2.4	3.6	4.2	2.4	1.2
Manufacturing	6.1	1.0	- 4.1	- 2.1	4.1	2.0	2.0	- 2.0
Industrial production	9.0	1.0	- 3.1	3.3	5.9	6.5	4.7	- 1.2
Housing starts, private	-20.4	10.3	32.1	66.1	8.5	16.7	-24.0	-22.7
Sales new U.S.-made autos	- 4.4	- 9.7	53.1	-26.6	- 6.9	39.2	12.2	- 9.0

* Excluding the pay increase of Federal government military and civilian employees the annual rate increase is 3.4 per cent.

Industrial production. Industrial production in June is presently estimated to have increased somewhat from an upward revised May level. Total production worker manhours in manufacturing have been revised up 1 per cent in May and the preliminary June data are up 0.5 of one per cent. (Upward revision of the May production index now published at 163.7, however, probably will be only about half as large as the manhours revision.) Other available data indicate a continuing high level of output, except for the aluminum strike which will amount to about -.3 of one point in the total index. Auto assemblies were unchanged from the May seasonally adjusted annual rate of 9.4 million units and truck production remained at record levels. Other indicators of economic activity--output of raw steel, paperboard, electric power generation, and miscellaneous freight car loadings--continued at high levels.

One measure of the ability of manufacturing to expand production is the capacity utilization rate, which in May was estimated at 84.0 per cent. While ample plant capacity is clearly at hand, it has been suggested that current tightness in the labor market may serve to restrict further output expansion. While both production worker employment and average hours worked in manufacturing have risen from their 1967 lows, in June they were still well below the record levels reached in late 1966, as shown in the table. Manufacturing output, however, reflecting gains in productivity, was up around 2.5 per cent in June from the December 1966 high and could be increased further by lengthening the workweek, and, in the durable goods industries by increasing employment to the levels reached in 1966.

MANUFACTURING
Per cent Change from late 1966 Highs to June 1968

	Output	Production Workers		
		Employment	Manhours	Average Weekly Hrs.
Total	2.5	- .5	- 2.0	-1.4
Durables	0.5	-1.8	- 4.0	-1.4
Nondurables	4.0	1.4	- .0	- .7

e Estimated roughly.

While declines in the workweek have occurred in all durable and nondurable manufacturing industries, the decline in the number of production workers has centered in the durable goods industries with large declines, 5 per cent or more, in primary metals (before the aluminum strike), electrical and nonelectrical machinery, and lumber. The only manufacturing industries showing a rise in the number of production workers from their 1966 highs are transportation equipment, paper, printing, chemicals, and rubber. In these industries, however, the increase in the number of workers has been accompanied by declines in the workweek ranging from .3 to .8 hours.

Capacity utilization. The May rate of manufacturing capacity utilization is now estimated at 84.2 per cent, up from 83.8 per cent the previous month. If manufacturing output increased slightly in June, as indicated above, the operating rate will probable show little change. At the 84 per cent level, current utilization rates are about equal to their long-run average and similar to levels prevailing at the beginning of 1964.

Recent operating rates have been high in the production of iron and steel, motor vehicles, aircraft, petroleum and rubber. Other manufacturing industries have substantial amounts of unused capacity.

UTILIZATION RATES
(per cent)

	1967		1968			
	QIII	QIV	QI	April	May (e)	June (e)
Manufacturing	84.1	84.4	84.5	83.8	84.2	84.2
Primary processing Industries	82.5	84.6	84.6	84.8	--	--
Advanced processing Industries	85.2	84.3	84.4	83.0	--	--

Unit auto sales and stocks. Dealer deliveries of new domestic autos in the final 10 days of June were up sharply, and for the month seasonally adjusted sales were at an annual rate of 8.8 million units, slightly above the 8.7 million rate in May and sharply higher than April's 7.9 million. June sales were 4 per cent larger than a year earlier.

For the second quarter, new car sales were at an annual rate of almost 8.5 million units, up from 8.2 million in the first quarter and 8.1 million a year earlier. Trade sources indicate continued optimism for the current quarter although there is some concern that the recent unusually extensive sales contests may have shifted some deliveries from the summer months. The trade does not expect the 10 per cent tax surcharge to have much effect on new car sales.

Seasonally adjusted dealer stocks of new cars stabilized during the month of June and the supply (unadjusted) totaled about 1.7 million units by the end of the month, one fifth higher than a year earlier. The days' supply of new cars based on the seasonally adjusted stock-sales ratio reached about 50 days, down slightly from May. The stock build-up which has taken place in recent months apparently has been intentional because of anticipated strong sales in the summer months and the possibility of a steel strike.

Sales of imported cars continued high in June and were almost one-fifth above a year earlier. Seasonally adjusted, the annual rate of sales of imported cars in the first half of this year has been about 910,000 units, an increase of almost 30 per cent from last year.

Consumer credit. Expansion in consumer credit picked up noticeably in May. Instalment credit outstanding increased at a seasonably adjusted annual rate of $7.3 billion, up from $6.5 billion a month ago and $2.3 billion a year ago. It was the largest increase since March of 1966 and confirmed the broad advance in consumer credit that began early this year. For the second quarter as a whole the annual rate of expansion may approximate $7 billion, up $1 billion from the first quarter and more than $4 billion from a year- earlier when credit growth was unusually slow.

Demand for auto credit rose in May along with the rebound in auto sales. A slightly larger average new-car note contributed to the increased use of credit but it was the rise in unit sales of autos that provided the major upward thrust. So far in 1968, net increases in consumer auto debt have been at a $2.5 billion annual rate, sharply higher than at any time last year and similar to the rise in the first half of 1966.

INCREASE IN AUTO DEBT
(Seasonally adjusted annual rates)

Period	Billions of Dollars
1966 - Q1	2.8
Q2	2.0
Q3	2.1
Q4	1.6
1967 - Q1	.0
Q2	.2
Q3	.5
Q4	.6
1968 - Q1	2.3
Q2 (e)	2.6

e -- estimated.

Consumer demand for personal cash loans also was stronger in May. Loan volume jumped to an annual rate of $28.7 billion, after fluctuating in a narrow range around $27.5 billion since last summer. In general, personal loans have not kept pace with rising expenditures for consumer services during the past two years. There are a number of reasons for this, but the increased use of credit cards to finance travel and vacations is probably one of the more important. On balance, this has resulted in a shift away from the personal loan category to "other consumer goods" credit, where most credit card activity is now classified.

Acceleration of growth in outstanding consumer instalment credit reflects more rapid new credit extensions and a slower and more typical rate of growth in repayments on existing debt, following the exceptionally fast pace of last summer and fall. Growth in outstandings is still not back to the record $8 billion increase recorded for 1965, but it may have approached that annual rate in June.

Retail sales. The dollar value of retail sales in June was unchanged from May and totaled 5.7 per cent more than a year earlier, with over half the year-to-year gain reflecting higher prices.

Durable goods sales rose nearly 1 per cent in June while nondurables were off slightly. Except for autos and lumber, sales at other stores were unchanged or down. Furniture sales were off 2 per cent.

For the entire second quarter, total retail sales were up 1.3 per cent from the first quarter, with durable goods up 2.3 per cent and nondurable goods 0.8 per cent. The moderate second quarter rise followed a sharp increase in the first quarter; from the fourth to the first quarter, total retail sales increased 4.6 per cent, with durables rising 6.3 per cent and nondurables 3.8 per cent.

Consumer buying sentiment. The May University of Michigan Index of Consumer Sentiment indicates that consumers continue cautious. In May 1968, the index declined to 92.6 from 95.3 in February. Generally, the Survey Research Center suggests that the index should move in the same direction for two quarters before a change in current buying habits is signaled. Since the middle of 1967, little trend has been evident--an increase in one quarter has been followed by a decrease in the next. The May survey was completed before the assassination of Senator Kennedy.

Over a longer period, there has been a significant drop in the percentage of families with optimistic views about economic prospects during the next 5 years. From 1963-1966, the proportion of respondents saying there would be good times far outnumbered the proportion saying that there would be bad times. Over the last two years the spread between these views has narrowed and in the last three months has almost disappeared.

Supplemental questions in May which are not included in the index, but which are added to the survey because of their topical nature, suggest that worries and uncertainties related to Viet Nam are mainly responsible for the relatively low state of consumers' willingness to buy. In the May survey, a special cross tabulation of expectations was made, reflecting the respondents' evaluation of the course of the war and their opinions about short and longer range business developments and expectations about their personal financial situations. It was found that those who expected an improvement in the war situation were much more optimistic than the others. But, since 63 per cent of families thought that fighting would continue at the present level or increase--despite the Paris talks--there was no basis on the grounds of the peace negotiations to have expected a change in purchases plan .

The latest surveys also continue to suggest that most people react to price increases by delaying major expenditures so that they will have more funds on hand to pay for necessities. But an increasing percentage is saying that now is a good time to buy a car because prices are going up. In May 1968, 31 per cent indicated rising prices as a reason for buying a car now as compared with only 14 per cent the year before. The Survey Research Center believes this desire to buy before prices for autos increase further explains why buying plans for autos are less depressed than attitudes toward business conditions and personal financial expectations alone would indicate.

CONSUMER ATTITUDES

	November 1966	May 1967	February 1967	May 1968
	(In per cent of family units)			
Cars				
Good time to buy because				
Prices low	8	17	9	8
Prices are going up	8	14	22	31
Bad time to buy because				
Prices high	19	16	17	11

A supplemental question in the survey on the Federal surtax suggests that anticipation of ill effects on business from the tax increase has diminished during the last 6 months; in November 1967, among those who expected a tax increase only 6 per cent thought it would have good effects on business compared to 20 per cent in May 1968.

Business inventories. The book value of manufacturers' stocks (preliminary) increased $300 million in May, down sharply from the $737 million rise in April and back close to the relatively low average monthly increase during the first quarter. At auto dealers unit stocks of autos continued to expand, and a rise in total manufacturers' shipments considerably in excess of the increase in retail sales suggests another sizable expansion in total distributors' inventories in May. Whether the latter increase could have equaled the large $600 million increase in distributors' stocks now reported for April--when retail sales slowed an unexpected sharp drop--is open to question. For April and May together, the rate of total business inventory accumulation clearly remained well above the low first quarter rate.

At manufacturers, the book value of inventories in business and defense equipment industries showed no change in May--as they had for the first quarter as a whole--following a sharp spurt in April. For other durable goods (including consumer durables), May accumulation totaled nearly as much as in April and remained above the first quarter rate. In nondurable goods industries, the book value increase in May was down substantially from April and close to the first quarter average.

With manufacturers' inventory accumulation moderating again and with shipments up nearly 3-1/2 per cent from April and 2-1/2 per cent from the previous high in March, the over-all factory stock-sales ratio declined to 1.71 in May from 1.76 in April and 1.73 in March. The May rate was about mid-way between the low 1965 average of 1.61 and the 1967 highs of over 1.80.

Orders for durable goods. New orders for durable goods increased moderately in May, despite a sharp further decline in orders received by the aerospace industry. New orders for machinery and equipment rose 4 per cent to the highest level since their peak of last August. New orders for both steel and nonferrous metals also increased substantially.

The May durable new order level, though up nearly 2 per cent from April, remained about 3 per cent below both March, when aerospace orders spurted to an unprecendented high because of large commercial "aerobus" orders, and December 1967, when orders bulged for autos and parts after the strike and steel ordering reached a peak.

Unfilled orders were about unchanged in May at a level 8 per cent above a year earlier. Of the increase in unfilled orders over the year, the bulk was in the aerospace industry and most of the remainder at steel mills. The machinery and equipment order backlog was down moderately, with the decline concentrated in the first five months of 1968. The unfilled orders - shipments ratio in May was moderately below April and also May a year ago.

ORDERS FOR DURABLE GOODS
(Billions of dollars; seasonally adjusted)

	New Orders			Unfilled Orders		
	May 1967	Dec. 1967	May 1968	May 1967	Dec. 1967	May 1968
Total Durables	23.9	26.5	25.6	75.0	79.6	80.9
Iron & steel	2.0	2.4	2.4	2.7	3.5	4.3
Aerospace Industry	2.8	2.9	2.7	27.7	29.7	32.5
Machinery & equipment	4.6	4.8	4.9	18.9	19.2	18.3
Other durables	14.5	16.4	15.6	25.7	27.2	25.8

<u>Construction and real estate</u>. Seasonally adjusted construction put in place--revised 3 per cent for the December-May period as a result of a sharp upward revision for public construction--changed little in June at a rate just below the new peak of $84.1 billion now reported for February. As much as two-fifths of the year-to-year increase in total construction outlays in June was attributable to higher costs.

Reflecting the sharp decline in housing starts after April, private residential expenditures dipped in June for the first month in a year and a half. Nonresidential construction expenditures--which had tended downward earlier this spring--apparently changed little, at a level 8 per cent below the early 1967 peak. Public construction edged higher.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	June 1968 ($ billions)1/	Per cent change from May 1968	Per cent change from June 1967
Total	83.5	--	+15
Private	54.5	-1	+13
Residential	28.4	-1	+24
Nonresidential	26.1	--	+ 4
Public	28.9	+1	+19

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

Seasonally adjusted private housing starts, which even after an expected downward revision were at an unsustainably high annual rate of 1.59 million units in April, dropped sharply in May to a rate of 1.33 million, the lowest since last December. The May decline was probably accentuated by unseasonally heavy rains. The decline was widespread and actually carried starts below year-earlier rates in the Northeast and North Central states. Multifamily units, which had soared highest earlier this year, accounted for the greatest drop.

Building permits in permit-issuing areas also dropped in May for the second consecutive month. However, with both permits and mortgage-commitments still relatively high, the rate of starts probably did not decline significantly further in June. If so, the annual rate of starts in the second quarter as a whole most likely averaged just above 1.4 million, down from the first quarter average of 1.50 million and about the same as in the third quarter of 1967.

PRIVATE HOUSING STARTS AND PERMITS

	May 1968 (Thousands of units) 1/	Per cent change from April 1968	Per cent change from May 1967
Starts	1,331	- 16	+ 4
1 - family	821	- 11	- 2
2 - or-more-family	510	- 23	+ 17
Northeast	201	- 13	- 1
North Central	309	- 22	- 13
South	551	- 14	+ 12
West	270	- 16	+ 22
Permits	1,254	- 7	+ 18
1 - family	648	- 4	- 2
2 - or-more-family	606	- 9	+ 25

1/ Seasonally adjusted annual rates; preliminary.

Passage of the fiscal package in late June greatly improves prospects for relief for lenders, builders, and buyers over the period ahead. However, a sustained revival in the rate of starts is not expected until next winter; this is because of the lag between changes in financial market conditions--which are still somewhat uncertain--and changes in housing starts. On the other hand, any further reductions in housing starts this year will be limited in part by demand pressures which have continued to build up over the past 2-1/2 years. In that period, the seasonally adjusted annual rate of starts has approximated basic market requirements in only one quarter--the first quarter of this year. As a result, vacancy rates this year have not only remained abnormally low but have continued to drop. In the first quarter of 1968, for example, rental vacancy rates--at 5.5 per cent of all rental units available and fit for use--were the lowest for any first quarter since 1957, when the initial post-World War II shortages were still a market factor. Moreover, homeowner vacancy rates, which are less sensitive than those for rental units, averaged only 1.0 per cent in the first quarter of this year. This rate compares with 1.2 per cent in the fourth quarter of last year as well as for the year as a whole.

RENTAL VACANCY RATES
(per cent

	Average for first quarter of:					
	1957	1964	1965	1966	1967	1968
All regions	4.8	7.3	7.7	7.5	6.6	5.5
Northeast	3.0	4.6	5.5	4.9	5.0	3.4
North Central	4.6	8.3	7.2	6.4	5.3	5.0
South	5.7	8.2	8.2	8.7	6.9	6.8
West	6.6	8.7	10.6	10.7	10.0	7.3

Labor market. The labor market continued generally firm in June, although there were some signs of easing. Nonfarm payroll employment again increased only modestly and the unemployment rate rose to 3.8 per cent from 3.5 per cent in May. The increase in unemployment was concentrated among 16 to 24 year-olds, who entered the labor focce in greater-than-usual numbers at the end of the school year. While the demand for new workers may have eased somewhat in June, the unemployment rate for adult men (aged 25 and over) and the level of insured unemployment remained extremely low.

Nonfarm payroll employment rose only 82,000 from May to June and averaged 67.8 million for the quarter. Employment was up 360,000 from the first quarter, or by about half as much as the first quarter rise. In part, the slower pace of employment growth in recent months can be attributed to growing weakness in construction activity and a falloff in expansion in retail sales. Bad weather and strikes account for some of the weakness in construction, where employment was down by over 200,000 from its February high. The civil disturbances played a significant role in holding down both retail sales and trade employment in April, but there has been little indication of strength since then and employment has been rising less rapidly than last year.

Manufacturing employment, which averaged 19.7 million in June, has risen by 115,000 from the turn of the year. Practically all of the increase occurred in the nondurable goods sector, where apparel has shown a good gain since January. Employment has not risen appreciably in the durable goods sector, despite very high rates of steel and auto production. Although the average workweek, at nearly 41 hours in June, was still somewhat below the record levels of 1966, employers have apparently met some of their recent labor needs by small increases in the amount of overtime worked rather than by hiring.

Unemployment. After remaining steady in the first five months of 1968, the unemployment rate jumped three-tenths of a point to 3.8 per cent in June. The rise probably reflected a larger-than-seasonal summer influx of younger workers into the labor market and may be a temporary phenomenon. Because the survey week came soon after schools were dismissed, fewer than usual of the 2.3 million teenage entrants had found jobs. Their unemployment rate rose a full point to 13.6 per cent. Reflecting the same adjustment problem, the unemployment rate for 20 to 24 year-olds rose from 5.3 per cent in May to 6.5 per cent in June. Usually most youngsters find jobs by July, but slack in the over-all market this summer could result in continued higher unemployment rates for young workers.

Earnings. Reflecting the continued upward pressure on wage rates, hourly earnings of rank-and-file workers on private payrolls rose to a record $2.82 in the second quarter. The increase from a year earlier amounted to 6 per cent, continuing to exceed the average increases of recent years by a wide margin. The rise in hourly earnings has been broadly distributed, with large increases in all major industry groups. Despite persistent increases in the growth rate of money earnings, "real" gains have remained small as consumer price increases eroded dollar gains. In turn, the rapid rise in prices has contributed to the demands for higher wages.

PER CENT INCREASES IN THE HOURLY EARNINGS OF PRODUCTION AND NONSUPERVISORY WORKERS ON PRIVATE NONFARM PAYROLLS

	1964-1965	1965-1966	1966-1967	IQ 67-IQ 68	IIQ 67-IIQ 68
Total private	3.8	4.5	4.7	5.7	6.0
Contract construction	4.2	5.1	5.7	7.0	6.7
Manufacturing:					
Durable goods	3.0	3.9	3.4	5.7	6.4
Nondurable goods	3.1	3.8	4.9	5.9	6.7
Wholesale and retail trade	3.6	4.9	5.6	6.3	7.2
Finance, insurance and real estate	3.9	3.3	4.5	5.5	6.2
Consumer price index	1.7	2.9	2.8	3.7	4.1*

* Preliminary estimate.

But several forces pushing up the general wage level--a tight labor market, higher minimum wages, and a large number of important contract negotiations in durable goods manufacturing-- will diminish somewhat in importance this fall and winter and should allow some moderation in earning increases by early 1969. Wage pressures will not ease immediately because rising unemployment typically does not loosen the labor market quickly enough to ease entry-level wage pressure for several quarters, and sizable built-in annual wage increases and escalator-clause raises will continue in many industries, although they will be somewhat smaller than in 1968 because of the recent tendency to provide smaller increases in later years of contracts. A further rise in minimum wages in some industries will occur next February, but it will be much more limited than those that became effective in 1967 and 1968.

Although wage increases should moderate as fiscal restraint takes hold later this year, the rise in unit labor costs will probably continue, reflecting the difficulty of adapting labor input--especially overhead labor--to a slower pace in output growth, particularly when the slowdown is expected to be temporary. Coupled with the tax increase, this rising cost pressure suggests a corporate profit squeeze and additional strong efforts to cut costs and boost productivity.

Consumer prices. In May, the consumer price index rose 0.3 per cent to 120.3 per cent of the 1957-59 average, as prices of nondurable goods and consumer services moved higher. The increase over the year was 4.1 per cent.

Grocery prices continued upward at a rapid pace. Fruits and vegetables increased more than usual as a result of late harvests, weather damage to crops, and smaller carry-over stocks. The earlier increase in the support price for milk pushed up retail prices of dairy products sharply, and meats rose contraseasonally. During the first 5 months of the year prices of food for home use increased at an annual rate of 6 per cent (nearly 8 per cent after allowance for seasonal changes). Prices of restaurant meals increased 0.5 per cent in May and at an annual rate of 5 per cent from last December to May.

Apparel prices continued their strong upward trend in May, with a rise of 0.9 per cent, 3 times the usual seasonal increase for the month; summer wear for women and girls led the advance. The year-over-year rise in apparel prices continued much larger at retail (5.3 per cent) than at wholesale (3.4 per cent). Retail prices of women's and girl's clothing were up 6 per cent from a year earlier; this rise is half as large as the net increase over the preceding 20 years.

Prices of fuel oil showed an unusual increase for this time of year especially on the East coast, as seasonal discounts were skipped by distributors. Retail prices of gasoline declined slightly and were about the same as a year earlier. At wholesale, prices of gasoline in May were nearly 6 per cent below May 1967 but a sharp increase in June has apparently largely eliminated this gap.

In contrast to nondurable goods, average prices of durable goods were unchanged for the month. New car prices were maintained although some seasonal decline is expected. Used car prices increased less than seasonally despite a firm market for good later model cars. Furniture prices continued to rise.

The rise for consumer services, which had slowed appreciably in April, picked up somewhat in May, to 0.4 per cent, or about the average monthly increase over the past year. Medical care services rose another 0.5 per cent in May as doctors' and dentists' fees increased 0.3 per cent and hospital service charges nearly 1 per cent. The April and May increases for medicare, however, were somewhat smaller than in earlier months. Personal care services, largely barber and beauty shop services, were up substantially--by 0.7 per cent--continuing the acceleration evident over the past year.

Wholesale prices. Industrial prices resumed their upward trend in June. The sharp drop for sensitive materials--notably copper--which slowed the rise in the BLS industrial average in April and then precipitated an 0.2 per cent decline in May, slackened appreciably in June. With average prices of other industrial commodities continuing upward, the BLS estimates an 0.2 per cent rise in their industrial price index last month.

Along with the especially large decline in copper and copper and brass mill prices in May (about 12 per cent), the total number of price increases reported represented only 40 per cent of all industrial product classes, and preliminary estimates for June indicate an even lower proportion for increases and an excess of the number showing no change over increases for the first time since last September. The current relatively small proportion of increases represents a considerable let-down from January and February, when increases were being reported for 57 per cent and when the industrial price average was rising by 0.4 per cent per month.

Sensitive industrial materials declined only an estimated 0.2 per cent further in June, following a 2 per cent decline from their March peak to May. Prices of brass and wire mill products were reduced sharply further in early June, steel scrap continued to recede, and hide prices declined. But prices of aluminum ingot and most mill products were boosted 4 per cent, following the large wage settlement, and lumber and plywood prices continued to rise although at a much slower pace than last winter. The reduction in basic copper prices--and perhaps also steel scrap--appears to be largely over (although price cuts for some copper end-products have been announced in recent weeks.) Average prices of sensitive industrial materials may tend to show little change for a few months unless the lumber price rise is reversed with the expected cuts in residential construction activity; in that event sensitive material prices are likely to resume a decline.

The estimated June rise for industrial commodities other than sensitive materials was 0.2 per cent--larger than in May and close to the average monthly increase prevailing since last summer. However, nearly half the June rise for this broad category reflected a sharp spurt in gasoline prices (partly seasonal and partly in response to earlier strength in retail demand--and prices.) In addition to gasoline, price increases were reported last month for apparel, man-made textile fiber products, and various building materials other than lumber. Lower prices were posted for paper and paperboard products, household appliances, and television sets.

CHANGES IN WHOLESALE PRICES OF INDUSTRIAL COMMODITIES
(In per cent, Special FR Groupings)

	Monthly average		March	April	May
	July 1967 to October 1967	October 1967 to March 1968	to April	to May	to June[e]
				(1968)	
All items	0.2	0.4	0.1[r]	-0.1	0.2
Sensitive materials	0.4	1.4	-0.4[r]	-1.7	-0.2
All other industrial commodities	0.2	0.2	0.3	0.1	0.2
Sluggish materials	0.1	0.2	0.3	0.1	n.a.
Cons. nonfood products	0.3	-0.2	0.2	0	n.a.
Producers' equipment	0.4	0.3	-0.4	0.1	n.a.

n.a. -- not available.

The May rise for farm product prices was somewhat sharper than had been estimated earlier, and, despite the industrial price decline, the total BLS wholesale price index increased 0.2 per cent. In June, prices of foods and foodstuffs were about unchanged and the WPI rose an estimated 0.2 per cent further--to 108.7 per cent of the 1957-59 average. This level is 2.3 per cent above a year earlier, with farm products and processed foods and feeds up 1.1 per cent and industrial commodities up 2.6 per cent.

Farm prices. Prices received in the first half of 1968 averaged nearly 3 per cent above a year earlier. Prices of livestock and products were up 2 per cent, bolstered by stronger prices for cattle and broilers and a boost of 7 per cent in dairy price supports effective April 1. Crop prices were up 3 per cent. Crop prices are not likely to stray far from price-support loan rates if the excellent yield prospects at home and in many countries abroad are realized. Prices of livestock products are likely to stay well above year earlier levels, reflecting strong consumer demands and per capita supplies of meats only a little larger than a year earlier in the summer and a little smaller in the fall.

PRICES RECEIVED AND PAID BY FARMERS IN 1968

June and the First Half Indexes Compared with a Year Earlier
1957-59 = 100

	1968		Percentage change from year ago	
	1st half	June	1st half	June
Prices received, total	107	107	2.6	1.9
Livestock	109	111	2.1	2.7
Crops	103	103	3.3	1.0
Prices paid	120	121	3.4	3.4
Family living	116	117	3.6	4.5
Production items	111	112	1.8	1.8
Interest per acre	273	273	8.3	8.3
Taxes per acre	193	193	6.6	6.6
Wage rates	154	157	8.5	7.5
Parity ratio 1/	74	73	-1.4	-2.7
Parity ratio, adjusted 1/2/	80	79	-0.3	-1.3

1/ Ratio of the Index of Prices Received to Index of Prices Paid--both indexes on the 1910-14 base set by Statute.

2/ Adjusted to reflect Government payments in Index of Prices Received.

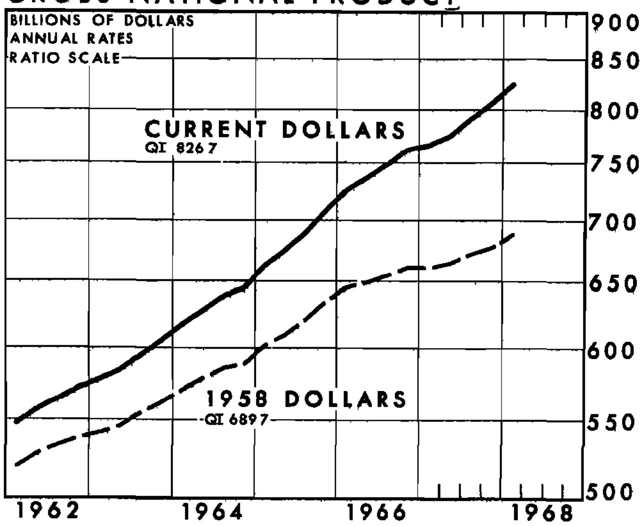
Prices paid. Prices paid by farmers so far in 1968 have averaged more than 3 per cent above a year earlier. Items used in production rose least; while interest, taxes, and wage rates increased the most from a year ago, showing the biggest rise since 1957-59. Interest on mortgage debt per acre increased 8 per cent from the first half of 1967 and was 173 per cent above the 1957-59 average; real estate taxes per acre were up 7 per cent and nearly double the 1957-59 average. The family living component averaged 4 per cent above last year.

Parity ratio. With prices paid advancing at a little more rapid rate than prices received, the parity ratio (1910-14 = 100) has averaged lower so far in 1968 than at any time since the upswing in farm prices in mid-1965.

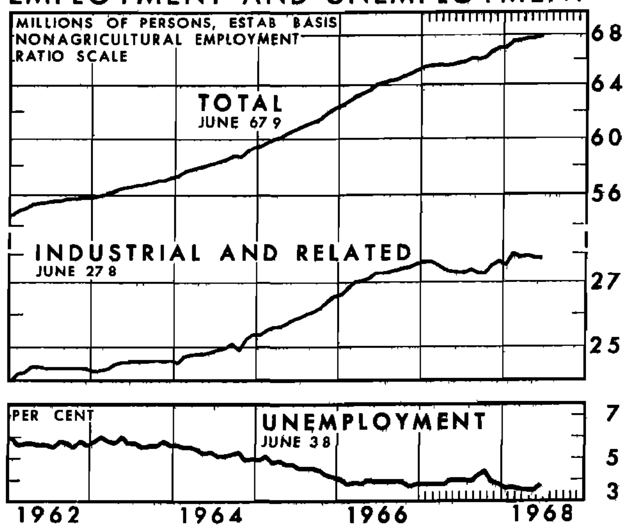
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

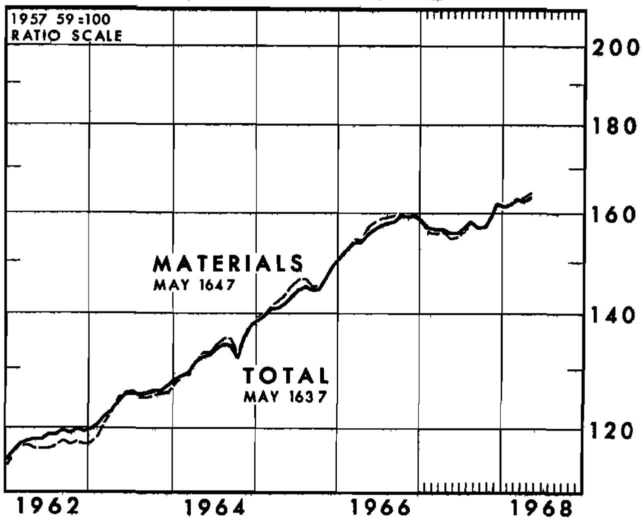
GROSS NATIONAL PRODUCT



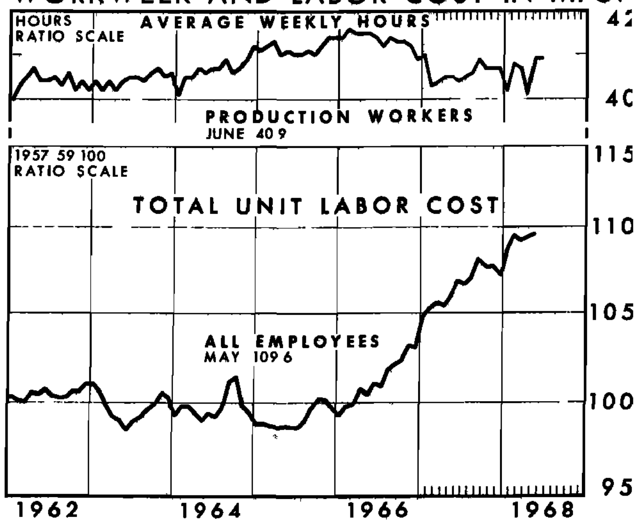
EMPLOYMENT AND UNEMPLOYMENT



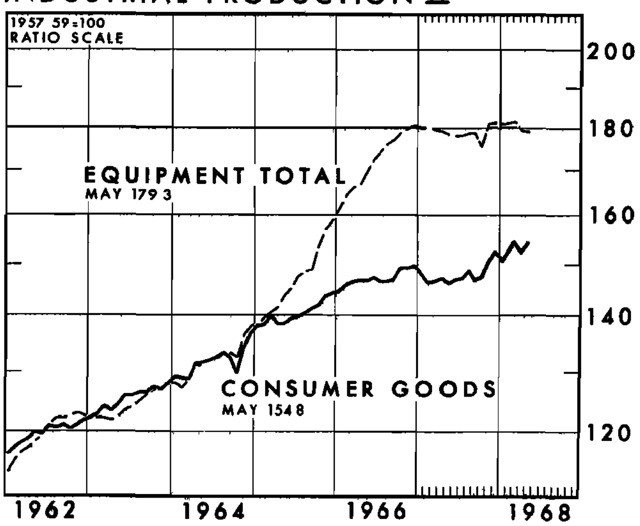
INDUSTRIAL PRODUCTION-I



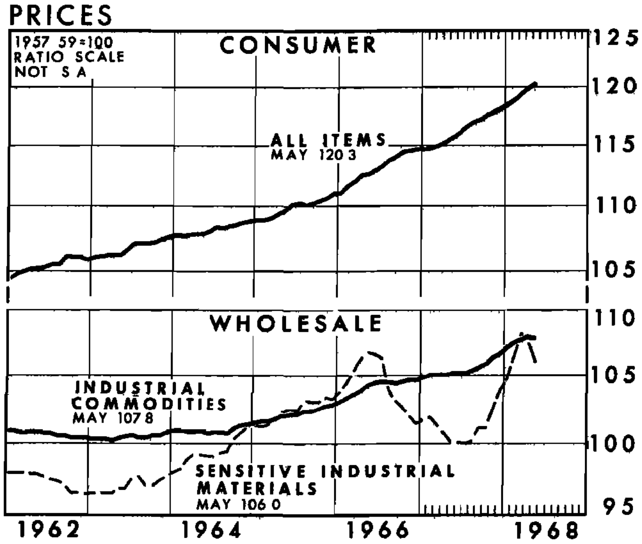
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



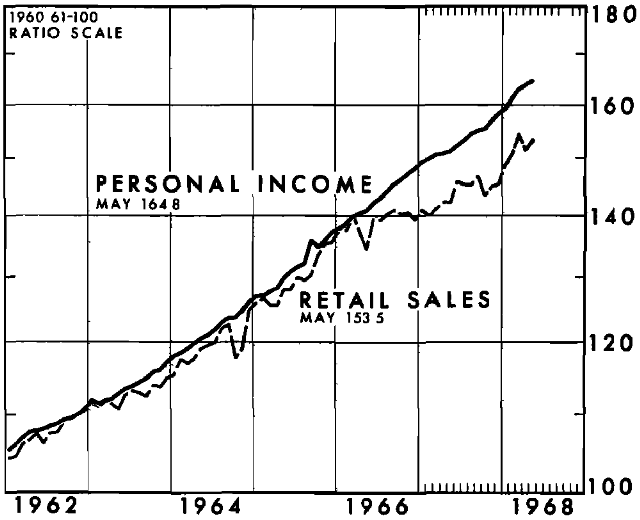
PRICES



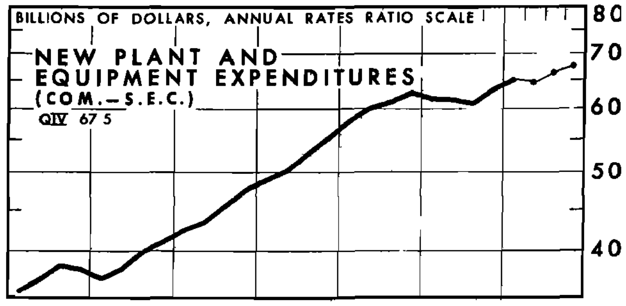
ECONOMIC DEVELOPMENTS - UNITED STATES

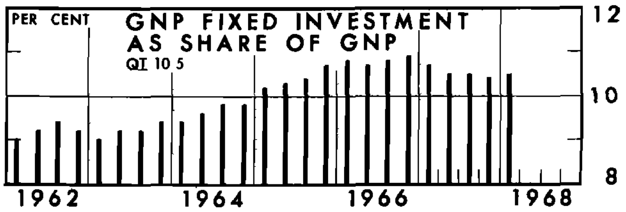
SEASONALLY ADJUSTED

INCOME AND SALES

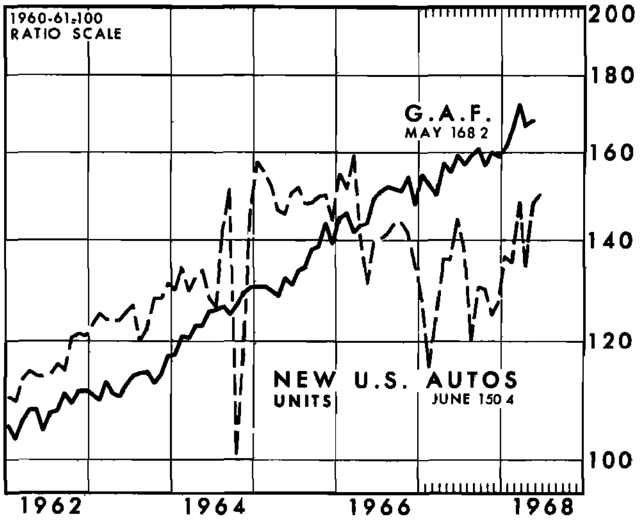


BUSINESS INVESTMENT

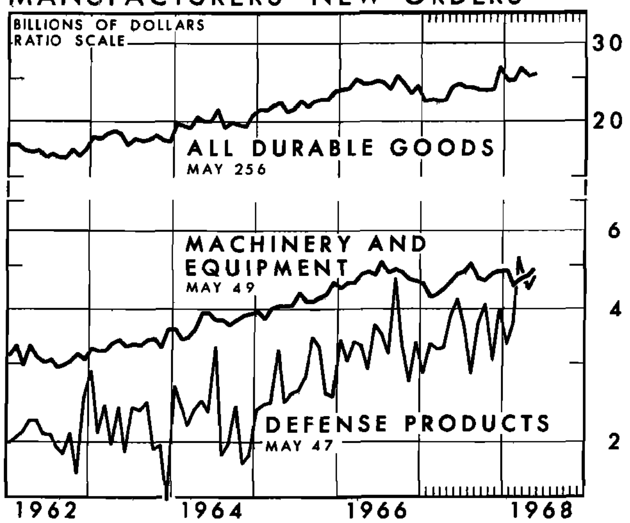




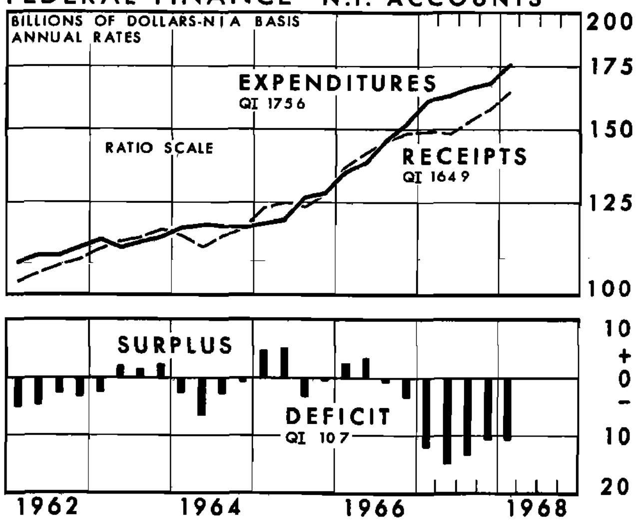
RETAIL SALES



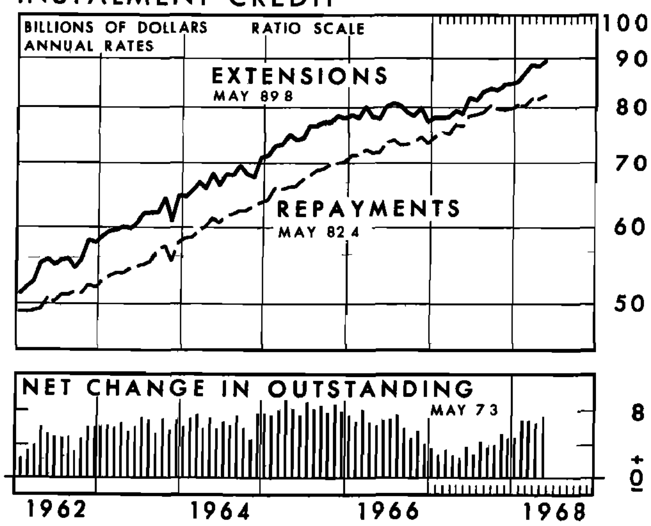
MANUFACTURERS' NEW ORDERS



FEDERAL FINANCE—N.I. ACCOUNTS



INSTALMENT CREDIT



DOMESTIC FINANCIAL SITUATION

Bank credit. Total loans and investments at all commercial banks (month-end series) expanded at a very low 1.0 per cent annual rate in June, less than one-sixth the rate of growth over the first five months of the year. This slowdown reflects principally a reduction of security holdings at banks, as business loans increased at more than twice the pace of last month. (Measured on a daily average basis by the proxy, outstanding bank credit in June was 8.5 per cent, at an annual rate, above its average level in May, after including the sharp increase in Euro-dollar borrowing during recent weeks.)

NET CHANGE IN BANK CREDIT
All Commercial Banks, End-of-Month Series
(Seasonally adjusted annual rates in per cent)

	1967	1968			
		H1	Q1	Q2	June 1/
Total loans & investments	11.5	6.2	6.8	5.5	1.0
U.S. Gov't. securities	11.0	1.3	2.0	0.7	-13.8
Other securities	26.1	6.5	13.7	-0.6	- 0.9
Total loans	8.2	7.4	6.4	8.2	6.2
Business loans	9.8	9.7	7.0	12.3	12.0

1/ All June rates are preliminary estimates based on incomplete data and are subject to revision.

Holdings of Government securities fell approximately $700 million at all commercial banks during June, representing in large part liquidation of Treasury bills as well as some continued selling of the

15-month notes acquired in the May financing. With tight reserve positions and constrained deposit inflows, banks have reduced substantially their bill holdings in recent months in order to meet loan demands. Since the first of the year large banks have liquidated about $3.7 billion of Treasury bills.

For the same reasons, banks have reduced their holdings of other securities recently, particularly short-term municipals. With the $100 million liquidation in June, banks holdings of these securities showed a small decline over the second quarter, compared with almost a 14 per cent annual rate of increase in the first quarter.

After a temporary slowdown in May, business loans resumed expansion at near the higher rate of growth that began in mid-March. The June increase was fairly widespread among industry categories, although borrowing by durable goods manufacturers remained heavy and could reflect financing for inventory accumulation by steel-using industries in light of a possible steel strike this summer. Direct corporate borrowing to meet tax and dividend payments also appears to have accounted for some of the June increase in business loans. While below June of last year, the growth of business loans around the tax date was above comparable periods in other recent years. The following table summarizes changes in business loans and related items at large banks during the June tax and dividend period for the past several years.

CHANGES IN SELECTED BALANCE SHEET ITEMS AT LARGE COMMERCIAL BANKS OVER THE JUNE TAX AND DIVIDEND PERIOD 1/
(Millions of dollars)

Item	1965	1966	1967	1968
Business loans	1,216	1,253	2,382	1,580
Government security dealer loans	259	150	-168	-285
Finance company loans	699	716	643	475
Treasury bill holdings of banks	32	244	-169	-2
Negotiable CD's outstanding 2/	-326	-631	-335	-439
Total banks financing 2/	2,532	2,994	3,023	2,207
Corporate income tax payments (1968 estimated)	6,597	8,251	9,328	7,300
Ratio of business loans to tax payments (per cent)	18.4	15.2	25.5	21.6
Ratio of total bank financing to tax payments (per cent)	38.4	36.3	32.4	30.6
Memo:				
Tax bills outstanding	3,263	4,523	5,515	5,534
Tax bills turned in for taxes	2,118	2,525	2,061	2,100
Ratio of bills turned in for taxes to tax payments (per cent)	64.9	55.8	37.4	37.9

1/ Reporting week or weeks including June 10 and 15.
2/ Reductions in outstanding CD's are considered a source of bank financing to the public for the purpose of making tax and dividend payments.

Real estate loans at all commercial banks in June expanded at the somewhat slower pace of the previous month, probably reflecting the unwillingness of banks to make long-term commitments in view of their reduced deposit inflows. The June increase in consumer loans, however, matched the more rapid rate of growth in May as automobile sales remained strong.

<u>Bank deposits</u>. Time and savings deposits at all commercial banks are estimated to have expanded at about a 3.2 per cent annual rate in June, on a daily average basis, approximately the same increase as in May. The low rate of growth in June partly reflects a much more than usual reduction in time deposits held by State and local governments and by foreign institutions. State and local governments are reported to be drawing down liquid assets, including time deposits, in response to heavy expenditures and the high costs of market financing.

NET CHANGE IN TIME AND SAVINGS DEPOSITS
Weekly Reporting Banks
(Millions of dollars, not seasonally adjusted)

	1965 May 26-June 23	1966 May 25-June 22	1967 May 31-June 28	1968 May 29-June 26
Total time & savings deposits	562	-129	1,020	-404
Consumer-type deposits	n.a.	n.a.	1,037	365
Savings deposits	330	-145	454	128
Time deposits, IPC (Other than CD's, IPC)	n.a.	n.a.	583	237
CD's	138	-447	77	-279
All other time deposits	n.a.	n.a.	-94	-490
Memo:				
Time deposits held by State and local governments	-95	-209	-255	-401
Foreign held time deposits	-94	- 85	327	-215
Total time & savings deposits, excluding those held by State and local governments and foreign institutions	751	165	948	212

n.a. - Not available.

Although outstanding CD's at large banks declined about $280 million in June, pressure on CD's seems to have eased somewhat recently and banks were able to attract a large quantity of these funds in late June and early July. With Treasury bill rates well below Regulation Q ceilings on all maturities by the end of the month, some large New York banks reduced their offering rates to 6.00 per cent on longer-term CD's. Moreover, offering rates on all maturities in the secondary market fell from 15 to 25 basis points during June. Consequently, in the last week in June, large banks were able to recover over one-half of the about-normal $440 million decline in CD's that occurred during the mid-month tax and dividend period, and banks in New York and Chicago added another $223 million to their outstandings in the first week of July.

Consumer-type time and savings deposits continued to expand in June at approximately the moderate pace of last month, but the composition and location of the recent increase was very different from that in May. Savings deposits accounted for a larger share of the growth in these deposits during June, increasing at about three times the rate in May. In addition, much more of the increase in total consumer-type time and savings deposits took place at banks in the large financial centers. These deposits continued to expand--by $29 million at banks in New York and Chicago during the week ending July 3, in sharp contrast to declines in recent past years during this first week following the midyear interest crediting period. However, all of the increase last week reflects a gain of $65 million in time certificates and open accounts which more than offset a reduction in outstanding savings deposits at these banks.

With moderate deposit inflows and the recent expansion in loan demand, banks continued to rely heavily on the Euro-dollar market as a source of funds in June. Bank liabilities to foreign branches, although below the record May expansion, increased approximately $600 million on a monthly average basis.

The money stock, on a daily average basis, is estimated to have expanded at a 7.7 per cent rate in June, down from the rapid 11.7 per cent increase of last month. This reduced rate of expansion reflects a slower growth in private demand deposits--at about one-half the May pace--as U.S. Government deposits at banks showed a slight increase for the first time since February. Over the entire first half, the money stock expanded at a 6.6 per cent annual rate, with nearly one-half of this growth occurring during April and May when reductions in U.S. Government deposits were the heaviest.

Nonbank depositary institutions. Based on available data for the early days of the reinvestment period, outflows from savings and loan associations were only somewhat larger than during the similar period of 1967, while the largest New York City mutual savings banks had "adjusted" outflows about twice as large as the comparable period of last year.

At the savings and loans, the relatively favorable experience during the 3-day grace period was rather uniform by region; on the West Coast, outflows were only marginally greater than last year.[1/] For the

1/ Data for the last 3 days of June 1966 are not available. However, since outflows reached a record in the first 10 days of July of that year, it can be assumed that during the June grace period of 1966 outflows were much larger than in 1967 or 1968.

first 5 days of the reinvestment period,[2/] New York City savings banks had sizable net withdrawals, a large part of which was predictable from the unprecedented passbook loan activity throughout the second quarter. Adjusting net withdrawals for depositors' repayment of passbook loans--which were, in effect, withdrawals of funds at the time the passbook loans were made--provides a better measure of the recent experience of the savings banks. As comparison of these "adjusted" outflows, shown in the table, suggests, the savings banks have not done as well as the savings and loans so far during the reinvestment period, although their outflows have not been as heavy as in 1966.

15 LARGEST MUTUAL SAVINGS BANKS IN NEW YORK CITY
FIRST 5 DAYS OF JUNE-JULY REINVESTMENT PERIOD*
(Millions of dollars)

	1965	1966	1967	1968
Deposits	109.8	166.5	167.3	153.1
Withdrawals	265.1	441.2	333.4	434.1
Net	-155.3	-274.9	-166.1	-281.0
"Adjusted" net**	- 79.1	-169.1	- 67.7	-121.4

* - June 26 through July 2, 1968.
** - Net inflow adjusted for the repayment of passbook loans made earlier to avoid loss of interest income.

2/ At writing, a longer time period is available for the savings banks than for the associations.

SAVINGS AND LOAN ASSOCIATIONS*
THREE GRACE DAYS IN JUNE
(Millions of dollars)

	1967	1968
All	-568	-602
Districts:		
Boston	-29	-28
New York	-65	-59
Pittsburgh	-36	-17
Greensboro	-102	-107
Cincinnati	-34	-71
Indianapolis	-29	-30
Chicago	-58	-53
Des Moines	-54	-62
Little Rock	-47	-52
Topeka	-30	-30
San Francisco	-61	-73
Spokane	-23	-21

* - Based upon a sample of 480 savings and loan associations evenly distributed among the districts.
Note: Above data exclude dividends and interest credited. This survey was first taken for the first 5 days in July 1966.

Mutual savings bank trade sources indicate no special concern about their outflows, and it can be assumed that the savings and loans now are likely to act with some assurance toward their loan demands. However, it remains possible that developments over the balance of the reinvestment period may--as in the previous two quarters--tend to aggravate the final savings and loan results for this dividend crediting period. Thus, it would be premature to derive results for the entire month of July from the data now available.

Consistent with the evidence available so far for the reinvestment period, preliminary indications are that inflows for the month of June moderated at mutual savings banks and accelerated at savings and loans. (The mutual savings bank June data are preliminary, and confidential until July 11.) The moderation of inflows at mutuals in June is probably related to the heavy month-end withdrawals, part of which reflected repayment of passbook loans.

SAVINGS FLOWS AT NONBANK DEPOSITARY INTERMEDIARIES
(Seasonally adjusted annual rates)

	Mutual Savings Banks	Savings and Loan Associations	Both
		(In per cent)	
1966 - I	4.9	5.2	5.1
II	2.1	2.0	2.0
III	5.9	1.0	2.5
IV	6.5	4.9	5.4
1967 - I	9.8	9.4	9.5
II	11.0	11.4	11.3
III	8.6	9.8	9.4
IV	6.7	5.8	6.1
1968 - I r/	7.5	5.7	6.2
II p/	6.7	5.6	5.9
April r/	4.7	3.9	4.2
May p/	8.9	5.8	6.9
June p/	6.3*	6.9	6.7

r/ - Revised.
p/ - Preliminary.
* - Confidential until July 11.

Mortgage market developments. The residential mortgage market tended to stabilize during the second half of June and into early July, according to fragmentary information, after tightening further through mid-June. Investor interest in mortgages improved after passage of the fiscal package was assured and as savings experience, at least during the initial days of the reinvestment period, proved less unfavorable than the thrift industry had been prepared to meet.

In FNMA's weekly auctions--an indicator of expectations in the FHA-VA sector of the market--yields on Government underwritten home loans for future delivery to FNMA turned down after the middle of last month, although they were higher at the end of June than at the end of May. By July 8, implicit yields on FNMA's 6-month forward purchase commitments, while still close to earlier postwar highs, had declined further to the lowest level in 8 weeks, as the table shows.

FNMA WEEKLY AUCTIONS
(6-month forward commitments)

Auction date	Accepted bids ($ millions)	Implicit private market yield (per cent)
May 6	18.3	7.15
13	27.4	7.39
20	28.3	7.48
27	35.5	7.55
June 3	40.0	7.66
10	44.8	7.72
17	49.8	7.70
24	50.4	7.61
July 1	60.5	7.49
8	65.9	7.41

Note: Average secondary market yield after allowance for commitment fee and required FNMA stock purchase, assuming prepayment period of 15 years for 30-year mortgages. Yields shown are gross, before deduction of 50 basis point servicing fee.

Demands for residential mortgage credit--especially in the dominant conventional loan sector--have continued to press against supply in spite of the sharp increases in mortgage rates earlier this year. Moreover, average yield spreads between home mortgages and new issues of high-grade corporate bonds improved appreciably through May from the March low, as the table shows, with some further improvement likely during June as a whole. While the wider yield spreads have particularly enhanced the attractiveness of FHA and VA home mortgages, a quick return to large discounts on these loans has continued to inhibit some builders and sellers from entering into transactions financed with this type of credit. As a result, indications are that home buyers during June were resorting even more than before to assumptions of existing mortgages and purchases under installment sales contracts.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary Market: Conventional loans		Secondary Market: FHA-insured loans		
	Level (per cent)	Yield spread (basis points)	Level (per cent)	Yield spread (basis points)	Discount (points)
1967					
May	6.45	79	6.44	78	3.8
June	6.50	71	6.51	72	4.4
July	6.50	72	6.53	75	4.6
August	6.55	66	6.60	71	5.2
September	6.55	67	6.63	75	5.4
October	6.55	43	6.65	53	5.6
November	6.65	12	6.77	24	6.5
December	6.70	19	6.81	30	6.8
1968					
January	6.75	51	6.81	57	6.8
February	6.75	46	6.78	49	6.6
March	6.80	24	6.83	27	7.0
April	6.90	38	6.94	45	7.9
May	7.15	49	7.50e	84e	6.1e

Note: FHA series; interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points; secondary market yields and discounts are for certain 6 per cent, FHA-insured Sec. 203 loans through April with data for May estimated by Federal Reserve based on the new 6-3/4 per cent regulatory rate. Gross yield spread is average mortgage return, before deducting servicing fees, minus average yield on new issues of high grade corporate bonds.

With yields to lenders on home mortgages again above the 7 per cent level during June, usury ceilings were raised administratively to 7-1/4 per cent in New York State and to 7-1/2 per cent in New Jersey, both effective July 1. In some other States, 7 per cent usury ceilings now have become a barrier to new mortgage commitment activity, particularly as lender uncertainty has arisen about what types of loan charges are legal under legislation which has not yet been tested in the courts.

During May, there was a decline in total outstanding residential mortgage commitments reported by lenders, as shown in the table, following an upturn earlier in the spring. The backlog of mortgage commitments to be taken down in coming months remained quite high relative to the recent average cash flow position of the thrift institutions.

RESIDENTIAL MORTGAGE COMMITMENTS OUTSTANDING
(Per cent increase)

	Thrift Institutions			Reporting life insurance companies	All reporting lenders
	All S&Ls	New York State savings banks	Total		
1967					
June	11.4	7.7	10.1	1.5	8.0
July	7.4	0.8	5.1	-1.2	3.7
August	6.2	-1.5	3.6	0.7	3.0
September	2.4	5.9	3.5	0.2	2.8
October	3.2	-0.5	2.0	-0.7	1.4
November	2.3	0.1	1.6	1.8	1.6
December	--	-3.2	-1.0	1.8	-0.5
1968					
January	0.4	-2.5	-0.5	5.3	0.7
February	0.9	-2.3	-0.1	5.2	1.0
March	3.8	0.8	2.9	-0.1	2.3
April	1.4	0.8	1.2	3.6	1.8
May p/	-1.9	1.3	-1.0	1.2	-0.5

Note: Based on seasonally adjusted data which are confidential for life insurance companies. Reporting savings banks and life insurance companies account for about 70 per cent of total mortgage lending in the industry. Data for savings banks and S&Ls include a minor amount of nonresidential commitments.

Life insurance companies--policy loans. Policy loan activity at life insurance companies has increased so far in 1968, as shown in the table below. In fact, the sharp increase during May was exceeded only in the late summer and fall of 1966. To some extent, an upward trend in these loans can be expected as policyholder cash values increase, but the sharp further increase during May is explainable mainly by the high relative cost of borrowing elsewhere and the attractive yields available on alternative investments.

POLICY LOANS OF 15 LIFE INSURANCE COMPANIES*
($ millions: not seasonally adjusted)

	Net change in holdings			
	1965	1966	1967	1968
January	20	36	70	57
February	25	33	56	57
March	35	57	64	67
April	37	69	60	73
May	31	68	51	85
June	34	73	51	
July	28	70	38	
August	30	108	49	
September	31	156	43	
October	25	129	38	
November	24	92	41	
December	33	90	55	

* - These 15 companies account for two-thirds of industry policy loans held and made in a month.

Corporate and municipal bond markets. Since passage of the tax bill on June 20, corporate yields have edged up slightly. While the lack of appropriate corporate issues produced a break in our new issue series for the week ended July 5, bonds released from synidcate did show an upward adjustment in free market yields that week. For example, the release of the Ohio Bell Telephone Aaa-rated bonds to free market trading on July 2--when 75 per cent of the issue remained unsold after two weeks--resulted in an immediate upward yield adjustment to a level about 5 basis points above that prevailing on similar issues in mid-May. Municipal yields early in July were about 5 basis points below their mid-May level reached immediately preceding the market's reaction to the May delay in deliberations of the tax bill. Although municipal yields recently have evidenced relative stability, some upward rate pressure appears to be building up in this market.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa		State and local Government	
	New	Seasoned		
	With call protection		S&P High Grade	Bond Buyer's (mixed qualities)
1968				
Low	6.12 (2/2)	6.07 (3/8)	4.23 (2/2)	3.16 (2/2)
High	6.83 (5/24)	6.30 (6/7)	4.68 (5/24)	4.71 (5/24)
Week ending:				
May 3	6.44	6.25	4.50	4.44
10	6.64	6.25	4.43	4.37
17	6.63	6.27	4.55	4.52
24	6.83	6.28	4.68	4.71
31	6.65	6.29	4.65	4.63
June 7	6.66*	6.29	4.59	4.51
14	6.61	6.28	4.61	4.56
21	6.67	6.29	4.52	4.42
28	6.70	6.27	4.50	4.48
July 5	--	6.27	4.50	4.48

* - Some issues included carry 10-year call protection.

While uncertainty over the future course of monetary policy and a probable underestimate by market participants of the degree of economic restraint incorporated in the fiscal package have played a role in recent yield developments, most market attention seems to be devoted to the large near-term volume of bond financing. In both corporate and municipal markets the sizable June pace of offerings will likely be maintained at least through July. During the last week of June alone, more than $500 million of corporate offerings scheduled for July were announced. New municipal issues also continue to be announced in volume and industrial revenue bonds again began to enter the market. The maintenance of new issue volume apparently reflects the announcement of issues in the planning stage for some time.

The volume of corporate public bond offerings in June is estimated to have aggregated $1.35 billion, the largest since October 1967. In addition, new stock offerings are estimated at about $450 million, also the largest total since October. Privately placed bond issues, however, are expected to have been about $700 million, somewhat less than estimated earlier. The downward revision in estimated private placements for June (and earlier months) is attributable to continued slow year-to-year growth in takedowns of commitments, the reasons for which are not completely clear. The slow growth does not appear to be primarily related to life insurance company activity, but rather may reflect both the relative pull of attractively priced public bonds and increased purchases of equities by pension funds. Nevertheless, the aggregate volume of corporate security financing in June is estimated at $2.5 billion, the largest since the record financing volume during the summer of 1967.

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

	Bonds				Total bonds and stocks	
	Public Offerings[2/]		Private Placements			
	1967	1968	1967	1968	1967	1968
QI monthly average	1,088	822	604	575	1,821	1,726
QII monthly average	1,339	1,036e	489	588e	2,069	1,968e
May	965	1,040e	396	600e	1,518	1,950e
June	1,684	1,350e	659	700e	2,674	2,500e
July	1,889	1,300e	486	600e	2,589	2,100e

e/ Estimated.
1/ Data are gross proceeds.
2/ Includes refundings.

It was noted in the last Greenbook that the void in the July calendar evident at that time might be quickly filled if a sizable volume of rumored industrial issues materialized. This has, in fact, occurred and the staff now estimates an ultimate July volume of public corporate offerings of about $1.3 billion, or just slightly below June. An estimated decline in stock offerings as well as a seasonal drop in private placements will likely hold aggregate security offerings to about $2.1 billion, significantly below June.

In the municipal market, the volume of new issues continues large. During June more than $1.3 billion of bonds were marketed--including about $150 million of industrial revenue issues--and a similar volume is estimated for July. However, a sizable portion of the municipal bonds that were offered at reduced yields late in June remained in syndicate early in July. These undistributed issues, continued limited bank participation, and a large forward calendar have contributed to the upward yield pressures noted above.

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

	1967	1968
QI monthly average	1,391	1,238
QII monthly average	1,294	1,258e
May	1,253	1,175e
June	1,497	1,325e
July	950	1,300e

1/ Data are for principal amounts of new issues.

Stock market. Common stock prices drifted lower during the latter half of June and early July, while trading volume showed some moderation. Nonetheless, early in the second week of July, price indices--having then rebounded--were above their historic highs of June 11, and volume since mid-June had been heavy by any but the most recent standards. Indeed with back office problems still not resolved, four-day trading weeks, originally scheduled to end the first week in July, will now continue through the end of the month.

STOCK PRICE INDICES

	Dow Jones Industrial Average	New York Stock Exchange Index	American Exchange Index
1968			
January high	908.92	54.17	25.67
March 29	840.67	50.05	22.42
June 11	917.95	57.32	29.80
July 3	903.51	56.88	29.42
July 9	920.42	57.61	29.99

AVERAGE DAILY TRADING VOLUME

	New York Stock Exchange	American Stock Exchange
1968		
March	9.2	3.6
April	14.8	6.6
May	13.3	8.1
Week ending:		
June 7	16.4	9.1
14	16.6	8.7
21	14.2	6.2
28	13.6	5.5
July 3	13.0	5.3

Despite the recent price advances, the market as a whole has shown no great enthusiasm in response to the passage of the tax bill. This lack of enthusiasm may reflect continued uncertainty about monetary policy and the effect of fiscal restraint on the economic outlook in general, and corporate profits in particular. Moreover, the recent increase in margin requirements--especially by increasing the number of restricted accounts--may have dampened speculative enthusiasm. However, even OTC stocks--not subject to margin requirements--also appear to have been affected by the slowing of the advance of equity prices.

Data now available for May indicate that open-end investment companies made a record commitment of $564 million to the stock market in that month. In addition, borrowed funds continued to flow into the market in May at a rapid rate. Brokers' margin customers increased their debt by $180 million (preliminary) to a record level of $6.6 billion in May. (Revised figures indicate a record margin debt increase in April of $250 million.) Purpose loans by large weekly reporting banks rose by only $10 million during the month, and total stock market credit stood at roughly $9 billion at the end of May. "Paper profits" available in special miscellaneous accounts at brokerages also rose sharply during the month to a new high of $6,350 million (preliminary). Under the 80 per cent margin requirements now in effect, these balances were available to purchase roughly $8 billion in stocks without the deposit of additional cash.

Incomplete data suggest that brokers' margin customers increased their debt at a somewhat slower rate in June. Some of this slowdown undoubtedly reflected the higher level of margin requirements announced in early June. These higher requirements also shifted about $2.8 billion of accounts into "restricted" status. Such accounts cannot generate "paper profits" eligible to be reserved in special miscellaneous accounts until collateral values have risen sufficiently to make the account once again unrestricted.[1/]

1/ When adjusted debt is 20 per cent or less of collateral values, the account is "unrestricted"; it is, otherwise, "restricted."

U.S. Government securities market. Yields on most U.S. Government securities have moved erratically since the last FOMC meeting but on balance have declined moderately. Yields are generally now 50 to 75 basis points below the levels reached in the third week of May, when they reached a peak in reflection of pessimistic expectations of enactment of fiscal restraint.

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

	1966 Highs	1967 Highs	1968 Highs	1968 May 21	1968 June 17	1968 July 9
Bills						
1-month	5.60 (9/19)	4.75 (1/4)	5.70 (5/21)	5.70	5.45	5.30
3-month	5.59 (9/21)	5.07 (12/15)	5.92 (5/21)	5.92	5.58	5.38
6-month	5.08 (9/19)	5.60 (12/1)	6.08 (5/21)	6.08	5.64	5.44
1-year	5.94 (8/21)	5.71 (12/29)	6.03 (5/21)	6.03	5.65	5.42
Coupons						
3-years	6.22 (8/29)	5.87 (11/13)	6.36 (5/21)	6.36	5.78	5.53
5-years	5.89 (8/29)	5.91 (11/13)	6.21 (5/21)	6.22	5.81	5.62
10-years	5.51 (8/29)	5.87 (11/13)	6.02 (5/21)	6.01	5.71	5.51
20 years	5.12 (8/29)	5.81 (11/20)	5.77 (3/14)	5.66	5.39	5.32

Just prior to and immediately after passage of the fiscal program, a fairly firm tone developed in the Government securities market. This tone was short-lived, however; and dealers soon expressed disappointment over the lack of expected demand, especially in the note and bond sector, and there was a moderate increase in yields throughout the list.

Demand in the coupon area of the Government market has picked up somewhat in the last 10 days. This has resulted from increased bank swapping into longer maturities and decreased dealer profit-taking, which had caused some professional pressure on prices earlier. Both of these developments suggest that the market may be beginning to react to prospects of easier monetary conditions. In addition, there was fair-sized demand from the System which bought coupon issues outright on a couple of days, in amounts totaling around $200 million.

A large part of the demand for bills in the latter half of June stemmed from seasonal factors, such as reinvestment of June tax bills not turned in for taxes, bank buying for mid-year statement purposes and System reserve-supplying operations in connection with the currency drains associated with the July 4 holiday. During the period the System also purchased a sizable amount of bills to offset the effects of the British IMF drawing and other official international transactions.

Most bill demand was concentrated in shorter-term bills with the result that dealer trading positions in that category were sharply reduced. Thus yields on bills due in 3 months or less fell sharply, with the 3-month bill going as low as 5.20 per cent--30 basis points below the discount rate--in the third week of June.

Bill yields have backed up moderately on balance in the last two weeks with reversal of bank demands for year-end statement purposes and a larger over-all supply of new bills.

The Treasury auctioned $4 billion of tax-anticipation bills on July 2, with $2 billion each of March and April 1969 maturities; commercial banks were allowed to pay for the bills by 100 per cent crediting of tax and loan accounts. Bidding for the tax bills was somewhat more aggressive than expected. Bank interest in the bills has continued, and to date they apparently have been less anxious than usual to sell their awards into the secondary market.

Other short-term rates have also shown some indications of moving lower since the last Committee meeting. Nonetheless, the changes are scattered, and most of these yields have not declined to the same extent as Treasury bills.

SELECTED SHORT-TERM RATES

	1966 Highs	1967 Highs	1968 Highs	1968 May 21	1968 June 17	1968 July 9
1-month						
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/31)	5.50 (12/29)	5.50 (7/5)	5.50	5.50	5.50
Secondary market	5.75 (9/28)	5.50 (12/29)	6.20 (5/20)	6.10	6.00	6.00
3-month						
Bankers' acceptances	5.75 (10/25)	5.63 (12/29)	6.13 (5/24)	6.13	6.00	6.00
Federal agencies	5.76 (9/21)	5.30 (12/29)	6.11 (5/17)	6.11	5.91	5.64
Finance paper	5.88 (12/31)	5.88 (1/6)	6.13 (6/25)	6.00	6.00	6.00
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/31)	5.50 (12/29)	6.00 (7/5)	6.00	6.00	6.00
Secondary market	5.90 (9/21)	5.70 (12/29)	6.20 (5/31)	6.15	6.10	6.10
6-month						
Bankers' acceptances	6.00 (9/23)	5.75 (12/29)	6.25 (5/24)	6.25	6.13	6.00
Commercial paper	6.00 (12/31)	6.00 (1/16)	6.25 (7/5)	6.13	6.25	6.25
Federal agencies	6.04 (9/21)	5.55 (12/29)	6.25 (5/24)	6.26	6.08	5.98
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/31)	5.50 (12/29)	6.25 (7/5)	6.25	6.25	6.25
Secondary market	6.30 (9/28)	6.00 (12/29)	6.40 (5/31)	6.30	6.25	6.25
1-Year						
Federal agencies	6.13 (9/23)	5.95 (12/29)	6.01 (5/31)	5.97	6.00	5.92
Prime municipals	4.25 (9/21)	4.00 (12/29)	3.90 (5/31)	3.80	3.70	3.50

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

Federal finance. While final data on the fiscal year 1968 Budget will not be available until the end of July, preliminary estimates by the Board's staff indicate that the Budget deficit exceeded $24 billion (see table). Budget receipts are estimated at close to $153.5 billion, only slightly larger than the Budget Document forecast, after the latter is adjusted for the delay in surtax legislation. Individual income tax collections, however, were greater than estimated and corporate taxes less. Personal tax refunds, after being unusually large in the first five months of calendar year 1968, declined sharply in June, indicating faster processing of tax returns than in previous years.

NEW BUDGET: FISCAL YEARS 1967-1969
(In billions of dollars)

	Actual 1967	FRB[e] 1968	Budget Document Adjusted 1968[1/]	Budget Document Adjusted 1969 [2/]
Deficit (-)	- 8.8	-24.3	-25.0	- 2.1
Receipts	149.6	153.4	153.1	180.6
Indiv. income taxes	61.5	68.6	66.8	81.8
Corporate income taxes	34.0	28.6	29.5	35.9
All other	54.1	56.2	56.8	62.9
Outlays	158.4	177.7	178.1	182.7
Unallocated spending cut	--	--	--	- 6.0
Defense	70.1	79.1	79.0	83.5
All other	88.3	98.6	99.1	105.2

1/ Original Budget Document figures have been adjusted by eliminating FY 1968 surtax and acceleration receipts and by adding $2.5 billion to Vietnam defense spending as announced by the President.
2/ Original Budget Document receipts have been adjusted to shift surtax and acceleration collections from FY 1968 to FY 1969 (except a $0.2 billion decrease in corporate acceleration due to changed legislation). Original Budget Document outlays have been adjusted (1) to incorporate the legislated $6.0 billion spending cut, (2) to add $2.6 billion to Vietnam defense spending as announced by President, (3) to allocate contingency funds for July 1968 Federal pay raise as between defense and all other outlays.
e - estimated on basis of preliminary data.

Budget outlays for FY 1968 are estimated at close to $178 billion, roughly in line with the Budget forecast after adjusting the latter for $2.5 billion additional Vietnam spending as announced by the President at the end of March.

A rough picture of the fiscal year 1969 outlook can be obtained by making specific adjustments to the original Budget Document. Relative to the original forecast, (1) receipts will increase because the delay in the passage of the surtax increases retroactive tax collections during fiscal year 1969, (2) outlays will be reduced due to the legislated $6.0 billion spending cut, and (3) outlays for exempted Vietnam spending will be increased by $2.6 billion as was also announced by the President at the end of March. When these adjustments are incorporated into the 1969 Budget, a deficit of $2.1 billion is obtained. It may be noted that these adjusted forecasts are based on an assumed GNP of $846 million in calendar year 1968.

During the current month, the issue of $4.0 billion of tax bills on July 11, and weekly increases of $100 million in 6-month bill issues, should provide for financing of the large--partly seasonal--cash deficit and, in addition, should lift the Treasury cash balance by an estimated $0.9 billion. Accordingly, the end of July cash operating balance is estimated at $6.2 billion. These estimates incorporate receipts of $1.1 billion for a special retroactive tax payment by corporations on July 15--a result of the surtax law.

In August, the Treasury will need to refinance maturing coupon issues and, also to raise about $3.0 billion of additional funds.

MONTHLY TREASURY CASH OUTLOOK
(In billions of dollars)

	July	August	Sept.
Net cash flow, receipts less outlays	-3.5	-3.5	2.5
Net borrowing from public	4.4	3.0	.4
Change in cash balance	.9	- .5	2.9
Level of cash balance	6.2	5.7	8.6

Weekly additions to 6-month bill issues will provide $0.5 billion of this financing need, but the form of the remaining financing is still unspecified. No further borrowing operations--other than the scheduled weekly additions to 6-month bill issues--will be required in September, and an excess of tax receipts over expenditures during that month should allow the Treasury to enter the fourth quarter of seasonal deficits with a substantially enlarged balance.

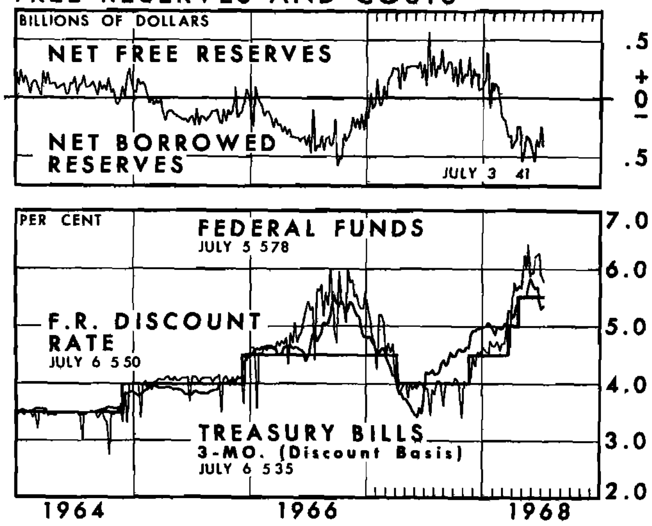
NEW BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS
(In billions of dollars)

	Fiscal Years		Calendar Quarters				
	1967	1968	1967		1968		
	Actual	FRB[e]	III	IV	I	II[e]	III[e]
Quarterly data, unadjusted							
New Budget:							
Surplus/deficit	- 8.8	-24.3	- 8.5	-11.0	- 8.6	3.8	- 5.1
Receipts	149.6	153.4	35.4	31.9	36.3	49.8	43.1
Total expenditures and net lending	158.4	177.7	43.9	42.9	44.8	46.0	48.2
Means of financing:							
Total borrowing from the public	3.6	22.9	9.0	10.1	6.7	- 2.9	7.8
Decrease in cash operating balance	5.2	.3	- 1.0	1.1	.1	.1	- 3.3
Other 1/	--	1.1	.5	- .2	1.8	- 1.0	.6
Cash operating balance, end of period	5.7	5.3	6.7	5.6	5.4	5.3	8.6
Seasonally adjusted annual rate							
Federal surplus/deficit in national income accounts	- 7.5	-11.4	-13.2	-10.7	- 7.7	-10.7	- 5.9
Receipts 2/	147.6	161.6	152.7	157.3	167.9	171.9	180.0
Expenditures	155.1	173.0	165.9	167.9	175.6	182.6	185.9

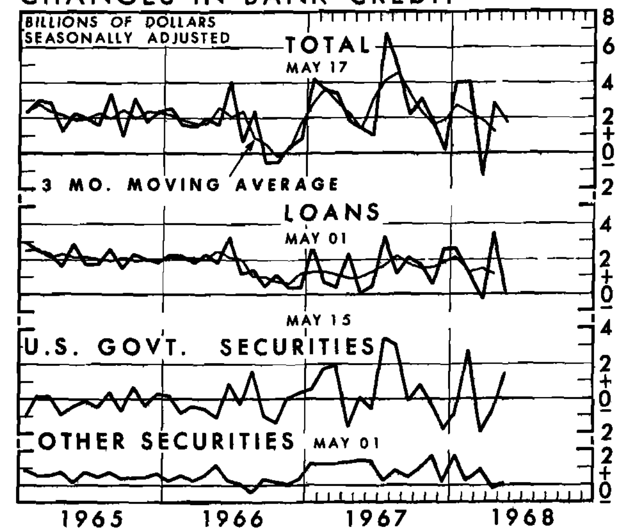
e - Projected or estimated on basis of preliminary data.
1/ Includes various accrual items, such as deposit fund accounts and clearing accounts.
2/ Retroactive corporate surtax liability is included beginning first quarter 1968. Quarterly receipts do not add to fiscal year totals due to seasonal adjustment of social security taxes.

FINANCIAL DEVELOPMENTS - UNITED STATES

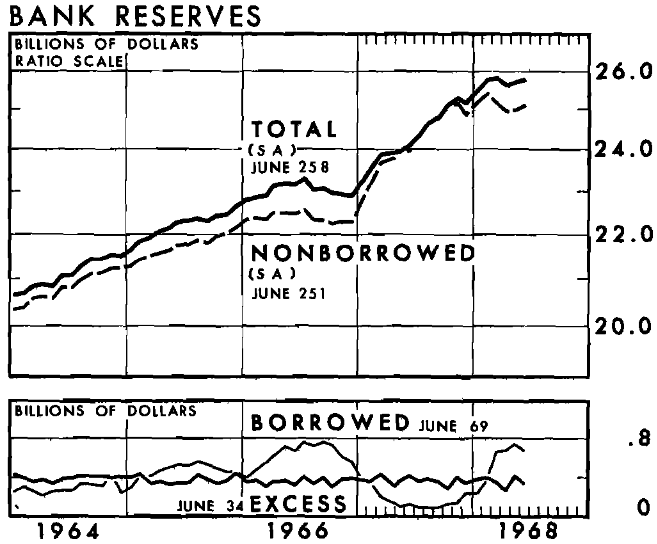
FREE RESERVES AND COSTS



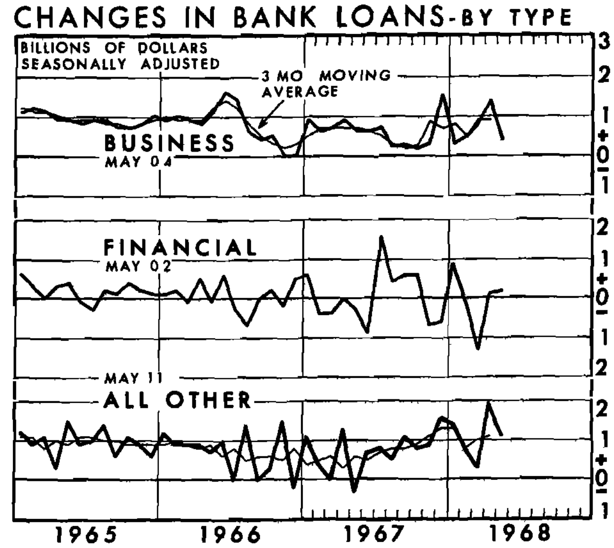
CHANGES IN BANK CREDIT



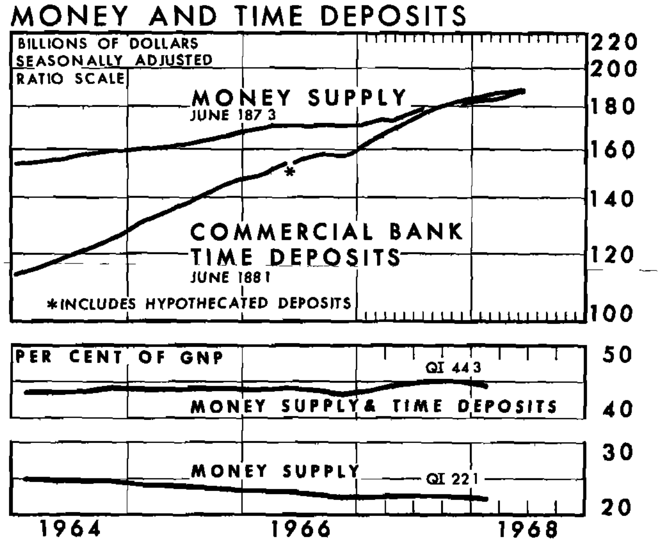
BANK RESERVES



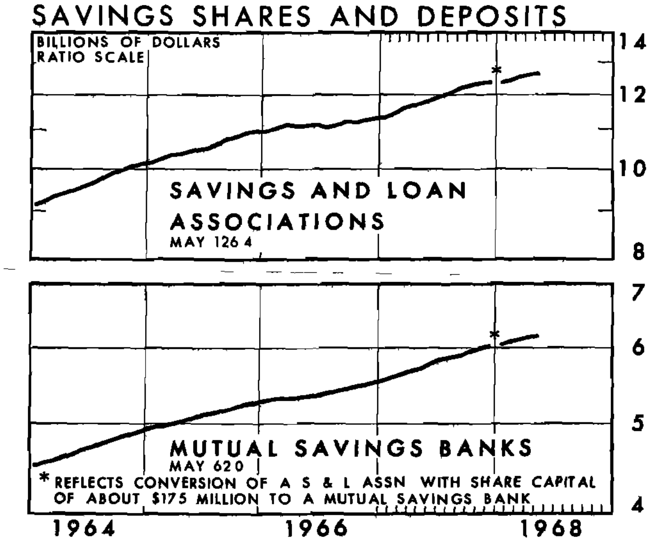
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

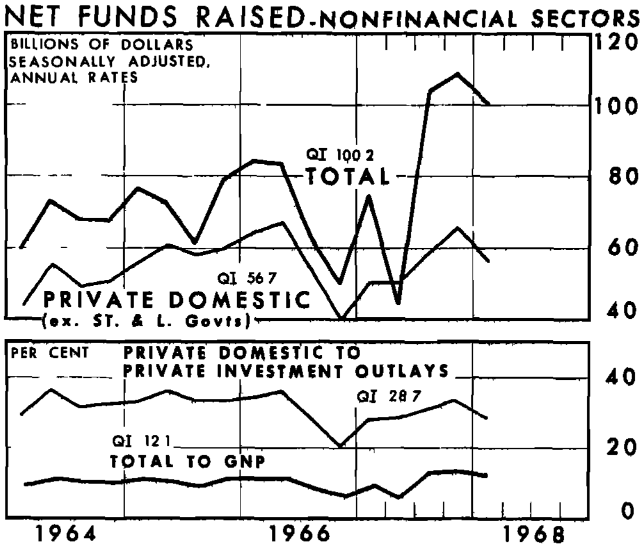


SAVINGS SHARES AND DEPOSITS

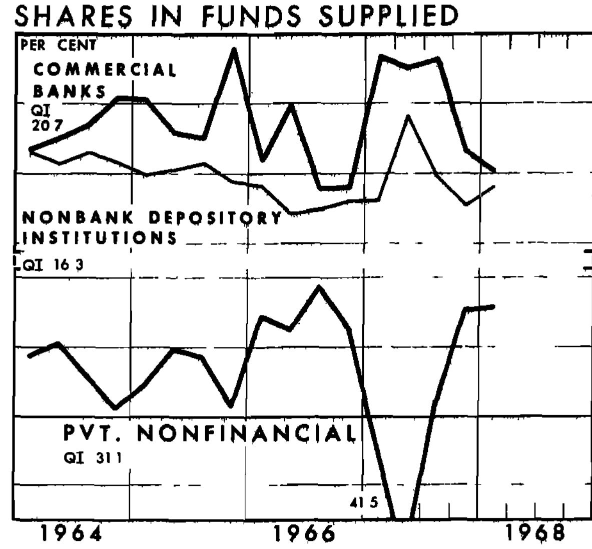


FINANCIAL DEVELOPMENTS - UNITED STATES

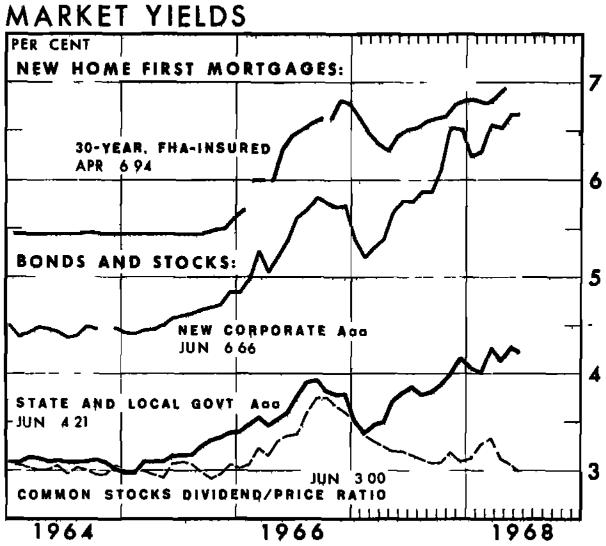
NET FUNDS RAISED-NONFINANCIAL SECTORS



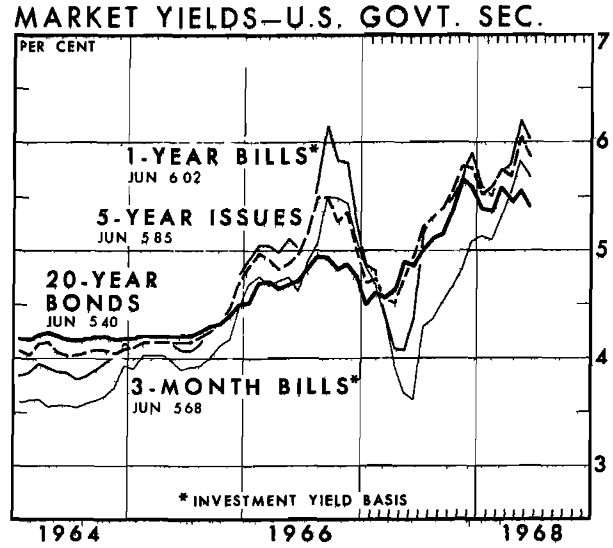
SHARES IN FUNDS SUPPLIED



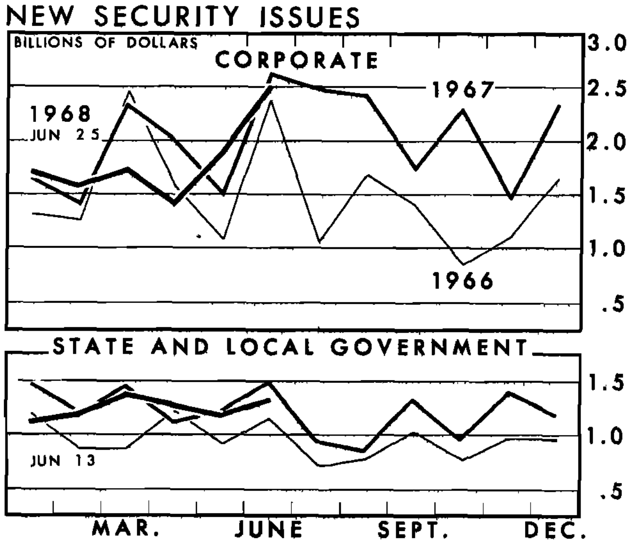
MARKET YIELDS



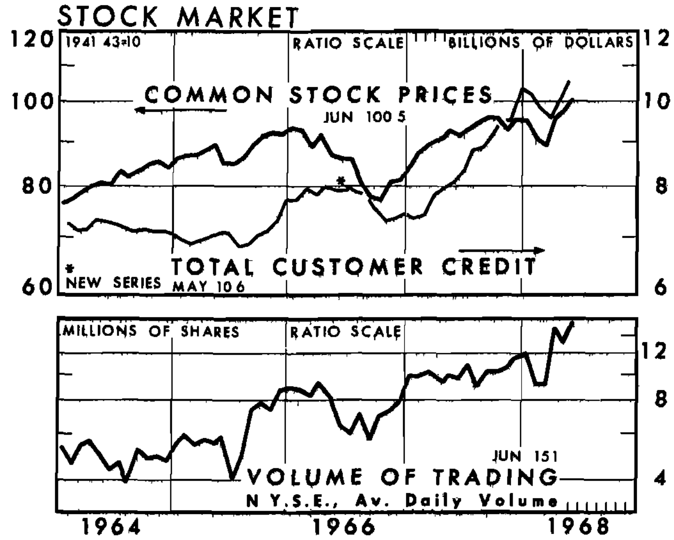
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

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Recent exchange market developments. Both France and Britain experienced large reserve losses in late June and early July, and their currencies touched new lows in foreign exchange markets. There were rumors that the French franc would be devalued, despite Gaullist election victories and the announcement of temporary import restrictions and export subsidies to defend the present parity. Sterling was affected by these rumors and by pessimism over recent U.K. trade and reserve figures and labor difficulties.

Apparently most of the funds transferred out of sterling and French franc assets during this period were invested in U.S. dollar assets -- Euro-dollar deposits, Euro-bonds, U.S. corporate stocks, and other claims on the United States. While the Swiss franc exchange rate was very strong, Swiss reserve gains were modest. The German mark fluctuated close to par against the dollar.

Early this week, sterling showed a considerable recovery, on news that 12 countries including the United States had committed themselves at a B.I.S. meeting to provide up to $2 billion of medium-term financing for Britain to cover declines in the sterling holdings of sterling area countries. Settlement of a British railway labor dispute with only a minor breach of the Government's wage guidelines also contributed to sterling's recovery. By Wednesday, July 10, the sterling rate had rebounded to about $2.3880, its highest level since mid-May, and the forward discount on 3-month sterling had narrowed to about 4 per cent per annum, lowest since mid-June.

However, the market has been very thin. Whether this week's sterling recovery will hold, and perhaps mark the long-awaited turning point, will depend importantly on the U.K. foreign trade figures for June, scheduled to be released on July 11.

The French franc has been under less severe selling pressure in recent days, thanks to further Gaullist victories in the second round of the national elections, and to the announcement of new policies to contain domestic inflation. These actions included an increase in the Bank of France discount rate from 3-1/2 to 5 per cent, effective July 3 (with exceptions, however, for export paper and small business), and an announcement that new taxes of some sort will be imposed in September. However, France has continued to lose reserves, bringing total losses to date to about $2 billion, and while the authorities hope to stop the outward flight of capital soon and have announced that they are strengthening the temporary exchange controls imposed at the end of May, no significant reflow should be expected until the French economy has demonstrated a capacity to absorb the recent large wage increases without lasting damage to its international competitive position.

Gold. The free market price of gold in London and Zurich remained remarkably steady near $41 an ounce during late June and early July as traders awaited a resolution of problems connected with the marketing of South African gold. Upon rumors that a compromise was being reached under which South Africa would sell most of its new production in free markets but with assurance of central bank or IMF purchases if the free market price should drop to $35 an ounce, the price declined to $39.80 on Tuesday, July 9, but rose above $40 on Wednesday.

The monetary authorities of sterling area countries continued to buy small amounts of gold from the United States through early July. So far this year, through July 9, nine countries that hold their foreign exchange reserves mainly in sterling had purchased a total of about $220 million (apart from purchases for payment to the IMF). A number of non-sterling countries have also made gold purchases recently, or signified their intention to do so. But thanks to substantial sales by France, the total U.S. gold stock increased by $213 million in June (CONFIDENTIAL until publication of *Treasury Bulletin* for July), and will probably show a further increase in July.

U.S. balance of payments. Preliminary data indicate that the seasonally adjusted liquidity deficit in the second quarter before special transactions was somewhat larger than the $900 million deficit in the first quarter. However, special financial transactions were very large, over $900 million; so the liquidity deficit on the published basis was small -- probably less than $200 million, compared with $600 million in the first quarter.

Special transactions during the second quarter consisted mainly of Canadian and German purchases of nonconvertible Treasury notes, including $125 million of such notes sold to German commercial banks under the new agreement to offset U.S. foreign exchange outlays related to maintaining U.S. troops in Germany. This agreement also calls for the Bundesbank to purchase, in fiscal 1969, $500 million of U.S. Treasury notes in quarterly instalments, as in fiscal 1968, and for the German Government again to buy $100 million of U.S. military equipment.

The balance in the second quarter benefited from two unusual transactions (not included in special transactions) as mentioned in the last Green Book: (1) redemption of $150 million of maturing IBRD securities held by U.S. residents, and (2) a direct investment inflow of $50 million from a group of European banks.

The balance on the official reserve transactions basis in the second quarter will show a very large surplus -- perhaps as much as $1-1/2 billion, seasonally adjusted -- compared with a deficit of about $500 million in the first quarter. The surplus in the second quarter reflected a record inflow of funds from foreign branches of U.S. banks of nearly $2 billion, about double the inflow in the first quarter. Shifts of funds out of French francs and sterling probably contributed importantly to this inflow, and these shifts cannot be expected to continue long at recent rates.

The U.S. export surplus on goods and services seems to have recovered very little in the second quarter from the low first quarter annual rate of $1.5 billion. There was probably some increase in net outflows of U.S. private capital, which had fallen to an unusually low level in the first quarter under the influence of the new restraint programs. On the other hand, outflows of U.S. Government grants and loans are thought to have diminished, and inflows of foreign private capital into U.S. corporate stocks and Euro-bond issues rose to new highs. Some of these developments are discussed in detail below.

U.S. foreign trade. For the second time in three months, merchandise imports exceeded exports in May. While the import balance in March was attributable to the New York port strike, the trade deficit in May does not appear to have reflected any such unusual event but rather stems from a renewed advance in imports while exports receded from the strike-inflated shipments in April. For the three months of March-May combined (which eliminates the effect of the strike on March-April trade), the export surplus (balance of payments basis) was virtually nil, and was far below even the low rates of the first two months of the year and the closing quarter of last year.

Exports in March-May were at an annual rate of $32.0 billion (balance of payments basis), about 3 per cent below the rate in the first two months of the year. Shipments of both agricultural and non-agricultural products fell during the past three months; the rate of decline in agricultural commodities, however, was twice that for nonagricultural goods. The drop in agricultural exports stemmed from lower commercial sales of wheat. A slackening in the rate of deliveries in aircraft accounted for most of the dip in shipments of nonagricultural products.

Exports to all major regions except the EEC countries of Europe fell or showed little change in the March-May period. The heaviest declines were in shipments to Canada and to Asian countries other than Japan. Exports to EEC countries increased slightly but it is still too soon to determine whether this is the beginning of the long-awaited improvement in sales of these countries.

It is expected that U.S. exports in the second half of the year will receive some stimulus from implementation on July 1, by the United Kingdom, the EEC countries and Japan, of 40 per cent of the tariff reductions negotiated in the Kennedy Round. On that same date, the common external tariff of the Common Market countries became effective. Consequently, the average rate of duty on imports of industrial products dropped substantially in France and Italy, with a much more moderate decline in German and the Benelux countries. The recent imposition of quotas on some imports for six months by France may tend to offset some of the reduction in its duty rates; but the quotas permit imports of 7-15 per cent larger quantities than a year earlier; and U.S. exports to France of the items affected by these quotas -- steel, automobiles, textiles, household appliances -- are relatively small, less than 5 per cent of total shipments to that country in 1967.

Imports in May increased, after remaining fairly stable during the first four months of the year. (Imports in March and April did not appear to be much affected by the port strike in March). For April-May combined, imports were about 3 per cent greater than the very high rate of the first quarter, and 22 per cent larger than a year earlier. Purchases of cars from Europe and Japan, steel, heavy electrical machinery, coffee, sugar and apparel were all up sharply in April-May. Imports of cars from Canada were little change from the high rate of the first quarter.

Arrivals of cars, other than from Canada, were particularly heavy in April-May, increasing by more than 25 per cent over the first quarter rate. Sales of such cars in the United States are near an annual rate of one million units and stocks are being increased to meet this heavy demand. Purchases of foreign apparel also expanded further and imports of gem diamonds increased.

The continuing rise in coffee and sugar imports since the beginning of the year largely reflects the need to replenish inventories. The removal of the quarterly allocation for sugar imports in early April resulted in heavy arrivals of sugar which ordinarily would not have been imported until later in the year.

Imports of industrial materials in total showed little change in April-May from the first quarter rate. Copper imports in May finally turned down sharply as U.S. refineries expanded their output following the ending of the strike last March. Arrivals of aluminum in April-May also fell as the threat of a strike receded when agreement was reached on a new labor contract. On the other hand, a further increase in the value of iron and steel imports in April-May -- to a rate nearly 60 per cent above a year earlier -- just about offset the drop in the value of aluminum and copper imports.

Bank-reported claims. Claims on foreigners reported by banks in the United States declined little further in April-May after dropping sharply in the first quarter by $416 million ($360 million, seasonally adjusted). Claims subject to the Federal Reserve restraint program, which represent a somewhat more narrowly defined category, were down by more -- $525 million for the 5 months through May. Probably little further reflow is to be expected during the remainder of the year.

The decline in bank-reported claims through May was geographically widespread. There were declines of $149 million in claims on Europe, $128 million in claims on Latin America, $119 million in claims on Canada, and $76 million in claims on Japan.

CHANGE IN BANK-REPORTED CLAIMS ON FOREIGNERS, 1968
(In millions of dollars, unadjusted for seasonality)

	Jan.-March	April-May(p)	Jan.-May(p)	Outstanding, May 31 (p)
All areas	-416	-19	-435	12,071
Europe	-227	+78	-149	1,863
Canada	-96	-23	-119	905
Japan	+51	-127	-76	3,258
Latin America	-125	-3	-128	4,137
All other	-19	+56	+37	1,908

(p) Preliminary.

Securities transactions. U.S. purchases of newly issued foreign securities, mainly Canadian, increased to nearly $500 million in the second quarter, seasonally adjusted, compared with less than $400 million in the first. Redemptions in the second quarter, however, were unusually large, reflecting the maturing of $150 million of IBRD bonds mentioned above; and net purchases of outstanding foreign securities apparently diminished. Hence the net outflow of U.S. funds into foreign securities was probably somewhat smaller than in the first quarter.

Foreign purchases of U.S. corporate securities reached record proportions in the second quarter. Net purchases of equities came to $260 million in April and $80 million in May; they probably exceeded $400 million in the second quarter as a whole. For the first half year, such foreign purchases approached the previous record total for a full year -- $800 million in 1967.

In addition, U.S. corporations sold a record amount -- more than $600 million -- of convertible Euro-bonds in the second quarter to finance direct investments abroad. They had sold $500 million in the first quarter, compared with only $450 million in the full year 1967. An additional $100 million of offerings have already been announced for July, but it is expected that total offerings in the second half year will be much smaller than in the first half. Only a small portion -- perhaps one-fourth -- of the proceeds of Euro-bond issues during the first half year have yet been transferred to foreign affiliates. Most of the remainder is being held as Euro-dollar deposits for future use.

Direct investments. The new mandatory control program for U.S. direct investments had a marked effect in the first quarter. There was a sharp drop in capital outflows for direct investment abroad, to $470 million, seasonally adjusted, compared with a quarterly average of $750 million in 1967. The $470 million figure includes about $90 million of funds that had been borrowed abroad through security issues. In addition, as described above, U.S. corporations borrowed very large sums abroad for future use in financing direct investments.

There had been some expectation, even before imposition of the new controls, that outflows of U.S. direct investment capital this year would be no higher than last year, in view of the projected slackening in the rate of increase in plant and equipment expenditures by foreign affiliates of U.S. firms. A survey taken in December 1967 indicated that such outlays might increase 6 per cent this year, following increases of 9 per cent in 1967, 16 per cent in 1966, and 21 per cent in 1965.

With the new program in effect, it is now anticipated that outflows of direct investment capital will be smaller than last year, perhaps $2-1/2 billion instead of $3 billion, and of the $2-1/2 billion, roughly $1 billion may be financed by the use of funds borrowed through security issues abroad, as compared with less than $300 million so financed in 1967. Thus, outflows net of such foreign financing may be cut by more than $1 billion. They will not, however, remain as low as during the first quarter; the unusually small outflows in that quarter reflected the initial confusion and delays right after the controls were first announced.

Price and wage developments in major industrial countries. Outside the United States, the most important price and wage developments have been those connected with the recent upheaval in France and with the struggle in the United Kingdom between the Government and trade unions over incomes policy. Elsewhere, German wages have resumed a more rapid advance after the 1967 pause, and the Canadian and Japanese price and wage advances slowed down in the early months of the year.

The United Kingdom Government, striving to achieve a 2 per cent reduction in real consumption expenditures from the second half of 1967 to the second half of 1968, is attempting to carry out a tough incomes policy, limiting wage increases to an annual rate of 3-1/2 per cent. The aim is to allow consumer prices to increase more rapidly than wage rates, and if possible to prevent wages from increasing faster than productivity.

From last November, when sterling was devalued, through March of this year, wage advances just about equaled price increases. In April, however, indirect taxes imposed in the budget resulted in a very sharp rise in the consumer price index; following a further increase in May that index stood at 1.9 per cent above the March level. During the same period, wage rates increased very little, by only about a quarter of one per cent. The continuation of these favorable developments will depend on the Government's determination to resist demands from the labor unions.

An important test of the incomes policy came in the latter half of June, when the unions of railway workers commenced widespread delaying tactics, working-to-rule, and complete rail stoppages at weekends. The unions insisted on an across-the-board pay raise and refused pay advances geared to productivity increases offered by the Transport Commission. Contrary to its previous practice, the Government refused to interfere in the dispute. Early in July, a settlement was reached directly between the unions and the Transport Commission. An across-the-board wage increase of about 3 per cent was granted immediately with the lowest-paid workers getting 4-1/2 per cent. The unions and the Commission will now enter into productivity agreement discussions which must be concluded by September 2. Any further pay advances granted as a result of these talks must absorb the pay raise already granted. The agreement is a technical breach of the incomes policy but if meaningful productivity agreements are negotiated and the additional pay increases do not outstrip productivity gains, the settlement may be considered a modest triumph for the Government's incomes policy.

A second major test of the toughness of the incomes policy is the current deadlock in wage negotiations involving Britain's 2.5 million engineering workers. In this case, also, the unions insist on a centrally negotiated across-the-board wage increase and refuse to accept management's proposals that pay raises be negotiated locally and geared to productivity agreements.

These labor disputes are very important tests of the Wilson Government's determination to enforce its incomes policy and their final outcome will strongly influence developments in the British economy during the next 12 months. Lax enforcement of incomes policy would accelerate inflation and dissipate some of the price advantages of the devaluation; overly rigid enforcement might lead to costly and disruptive strikes. The recent labor disputes have contributed to the weakness of the pound in foreign exchange markets.

Consumer prices in Britain rose 3 per cent during the first 5 months of 1968, and the Government's forecast that they will increase by around 7 per cent during the full year 1968 seems reasonable. It is doubtful whether wage increases can be kept rigidly within the 3-1/2 per cent target, but in view of actual and foreseen price increases, wage rises in the range of 5 to 5-1/2 per cent might still be compatible with the Government's stabilization and balance of payments goals.

A more distinct pattern in France is now emerging as the result of the settlement of the general strike. French wholesale prices in the first quarter of this year actually declined quite sharply, largely as the result of the introduction of the value-added tax system. Perversely, the introduction of this system at retail level caused consumer prices to advance sharply in January following an equally sharp increase in the last quarter of 1967, reflecting predominantly increased social security taxes and medical costs. In the meantime, French wage rate increases continued to lag behind those of France's EEC partners and unemployment reached about 2-1/2 per cent of the labor force in March.

The combination of these influences, coupled with strong resentment of the Government's highhandedness in dealing with the labor sector--from June to December last year the Government ruled by decree and the Parliament was recessed--goes a long way to explain the nearly catastrophic events of May and June in France. The Government and the Employer's Association, obviously taken aback by the scope and violence of events, agreed to grant very substantial wage and benefit increases to all segments of the French labor force. The Government also agreed to rescind, in some degree, medical benefit cuts passed by decree in 1967. Following the unexpectedly overwhelming Gaullist victory on June 23 and 30, the French authorities are now faced with the conflicting problems of absorbing much higher wage costs and avoiding accelerating inflation unduly while retaining the competitiveness of French export products.

The June wage increases, exclusive of minor fringe benefits, range between 10 and 15 per cent and appear to average about double the rate that had been expected this year, before the unrest. The upward push on costs and prices is going to be severe and the French Government is attempting to limit price increases in several ways. First, the Government budget deficit will absorb the higher deficits of nationalized enterprises (mainly utilities and transportation) and no increase in prices to consumers is expected for this year. Second, the Government expects to monitor closely price developments outside the public sector and, in general, is determined to limit both wholesale and retail price increases to 3 per cent during the second half of 1968; it is not clear if this means a substantial tightening of the very moderate system of price controls in force during the first half of this year. Third, the Government has decided temporarily to assume part of the wage increases in the export industries through a system of export subsidies, based on labor content of exported goods. These rebates are estimated to equal about 2-1/2 per cent of the total export price for the period July-October and 1-1/2 per cent for the period November-January 1969, when the rebates are scheduled to be terminated.

Our estimates, based on the data currently available, indicate that unless very strict price controls are exercised, French consumer prices may rise during this year by as much as 7-1/2 per cent. Such a rate of price advances is apparently unacceptable to the French authorities. However, too rigid price controls would cut sharply into the already thin profit margin of most French enterprises and thus further aggravate the unemployment situation.

Following a distinct pause in wage and price increases in 1967, prices in Germany rose sharply in January 1968. The rise in wholesale prices was almost solely due to the introduction of the value-added tax system and, in some cases, double taxation of year-end inventories. From February to April, however, wholesale prices of industrial products declined by 0.6 per cent as a result of seasonal reductions in the price of heating oil and price declines for non-ferrous metals after the end of the U.S. copper strike. Consumer prices also rose sharply in January, when services were subjected to the value-added tax for the first time and rent controls were relaxed in a number of areas. From February to April, consumer price increases slowed down very markedly.

German wage rates advanced quite slowly during the first quarter of this year, but the tempo picked up recently in response to continuing economic recovery and declining unemployment. In April, contracts were negotiated for 4.5 million workers resulting in wage increases of 5 per cent; this may be contrasted with average increases of 3-1/2 per cent negotiated during the first quarter of the year.

In Italy, wages and prices are expected to continue along the recent trends of 2 per cent per annum for prices and 3.7 per cent annually for wages. No major wage negotiations are scheduled to take place in Italy this year. Continuation of the present trends are dependent upon industrial tranquility; reports from our Embassy in Rome indicate that any unrest of the recent French type is unlikely.

There are signs that problems of wage and price inflation, which troubled Canada since 1965, may now be easing. The unemployment rate has recently increased to 4.9 per cent from 4.7 per cent at the beginning of the year and the Government is pursuing a restrictive fiscal policy. As is the case in the current labor disputes in the U.K., the Canadian Government is not interfering in labor disputes; in the past the authorities intervened in strikes of national importance and allowed excessive wage settlements. Moreover, the Government is contemplating introduction of a "forceful" incomes policy. At the moment no details have been announced beyond the decision to establish a Wages and Income Board in the near future.

The Canadian wholesale price index has been relatively steady in recent months, although preliminary figures for May indicate an increase of 0.6 per cent over the April level. There was no increase in the consumer price index in May, following a gain of 3.5 per cent between December and April. Canadian wage rates increased by 8.3 per cent in 1967, but the rate of increase appears to have slowed down in 1968. Our tentative estimates indicate that consumer prices may increase by about 3.5 per cent this year and that wage increases may be held down to slightly over 5 per cent.

Developments in Japan indicate an acceleration in wage increases in manufacturing this year, and we expect wages to increase by between 14 to 15 per cent this year. Consumer prices, following a decline early in 1967, have been rising ever since and preliminary data for May show that the index was 7.1 per cent above the level a year earlier. Later this year, in response to seasonal factors, consumer prices should weaken. For the year as a whole, consumer prices should not increase by more than 5 or 6 per cent.

WHOLESALE AND CONSUMER PRICE INDICES IN MAJOR INDUSTRIAL COUNTRIES: 1967-68
(1963=100)

	1966 Average	Per Cent Change From Previous Period 1967 Q I	1967 Q II	1967 Q III	1967 Q IV	1968 Q I	April 1968	Per Cent Change From April 1967
A. Wholesale price indexes								
Canada[a/]	105.8	+0.5	+0.6	+0.7	+0.4	+0.5	109.4	+2.1
Japan[a/]	103.8	+0.2	0.0	0.0	+1.4	+3.2	106.9	+2.3
France[b/]	106.9	-0.3	-1.0	+0.6	+1.0	-3.1	100.7	-4.0
Germany[c/]	109.5	0.0	-0.3	-0.4	-0.1	+3.8	111.0	+3.4
Italy[c/]	102.9	+0.2	-0.4	+0.4	+0.5	+1.2	104.6	+3.9
United Kingdom[a/]	109.5	0.0	0.0	+0.8	+0.9	+2.5	115.9	+5.4
United States[a/]	105.4	-0.2	+0.2	+0.8	+0.3	+1.1	109.1	+3.4
B. Consumer price indexes-- all goods and services								
Canada	108.2	+0.4	+1.5	+1.5	+0.4	+1.1	115.9	+4.3
Japan	116.4	+1.9	-0.1	+0.4	+3.2	+1.7	126.8	+5.2
France	108.9	+0.9	+0.4	+0.6	+1.4	+1.4	115.5	+4.0
Germany	109.5	+0.7	+0.5	-0.3	-0.4	+1.4	112.3	+1.0
Italy	113.3	+1.5	+0.6	+0.8	+0.3	+0.3	118.5	+1.9
United Kingdom	112.4	+0.5	+0.9	-0.5	+1.2	+1.4	120.4	+4.4
United States	106.0	+0.2	+0.7	+1.0	+0.8	+1.1	112.4	+4.0

a/ Manufactured goods.
b/ Intermediate goods.
c/ Investment goods.
Source: OECD, Main Economic Indicators, June 1968.

MANUFACTURING WAGES IN MAJOR INDUSTRIAL COUNTRIES: 1967-68
(1963=100 except for Italy)

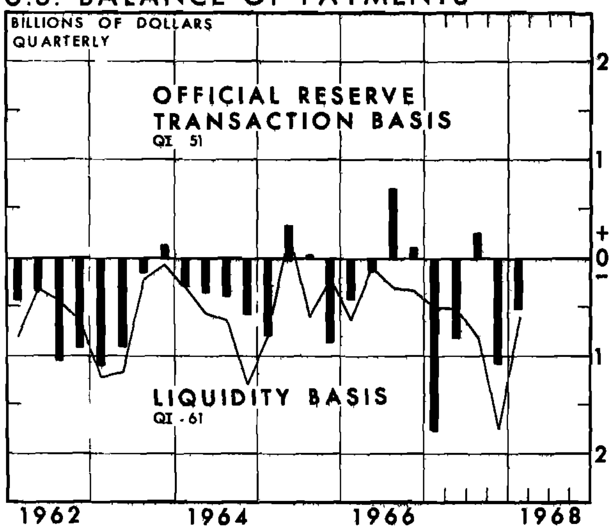
	1966 Average	Per Cent Change From Previous Period 1967 Q I	1967 Q II	1967 Q III	1967 Q IV	1968 Q I	1968 Latest	Per Cent Change From a Year Earlier
Canada, hourly earnings, s.a.	115.0	+1.6	+1.7	+2.5	+1.6	0.0*/	127.0 (Feb.)	+ 5.8
Japan, monthly earnings, s.a.	134.1	+2.9	+4.3	+2.5	+3.5	+3.2	167.2 (Mar.)	+15.0
France, hourly rates, n.s.a.	119.8	+1.3	+1.6	+1.7	+1.2	n.a.	130.8 (Jan.)	+ 6.3
Germany, hourly rates, n.s.a.	122.9	+2.9	+0.5	+0.2	+0.5	+0.6	130.9 (Jan.)	+ 1.9
Italy, hourly rates, n.s.a., 1966=100	100.0	n.a.	+0.9	+1.1	+0.7	+1.2	108.4 (Apr.)	+ 8.4
United Kingdom, ave. rates, mfg., n.s.a.	117.8	+1.3	+0.2	+3.2	+0.7	+4.6	131.7 (Apr.)	+ 9.0
United States, hourly earnings, n.s.a.	111.0	+0.9	+0.9	+0.9	+1.7	+2.6	120.0 (Apr.)	+ 5.3

*/ January-February only.
Source: OECD, Main Economic Indicators, June 1968.

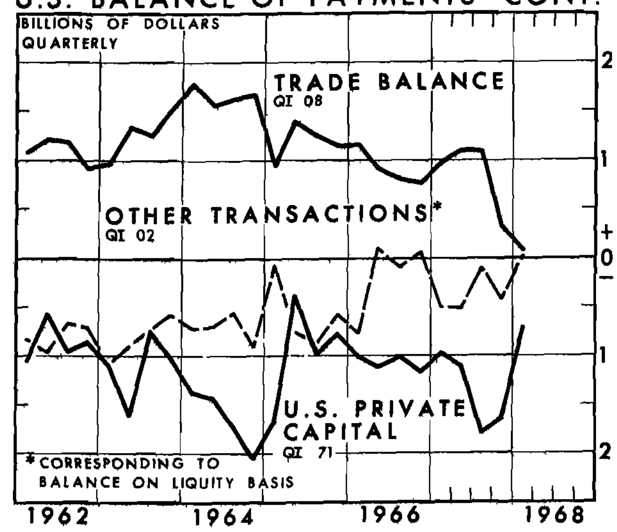
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

U.S. BALANCE OF PAYMENTS

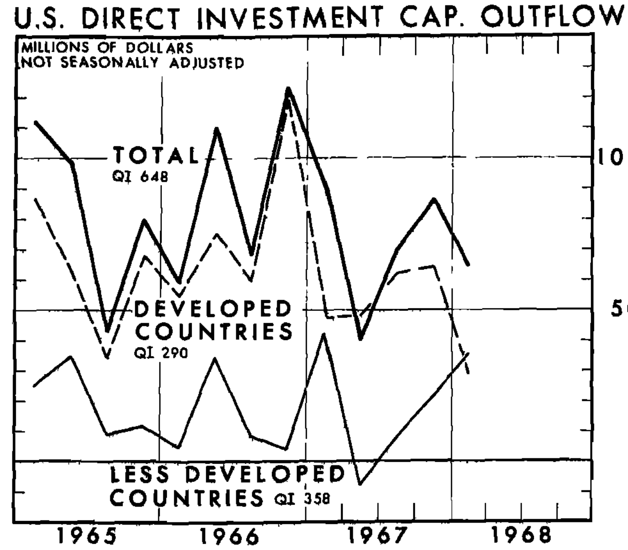


U.S. BALANCE OF PAYMENTS—CONT.

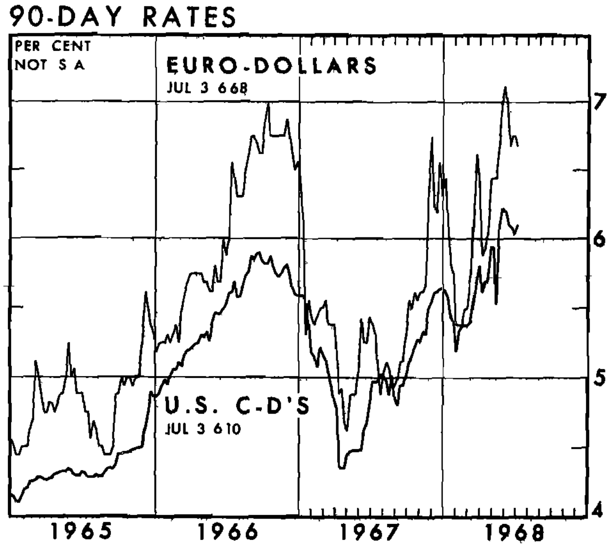


U.S. MERCHANDISE TRADE

U.S. DIRECT INVESTMENT CAP. OUTFLOW



90-DAY RATES



LIAB. OF U.S. BANKS TO FOR. BRANCHES