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CONFIDENTIAL (FR)

CURRENT ECONOMIC
and
FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

May 21, 1969

CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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of the Federal Reserve System

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SUMMARY AND OUTLOOK

Outlook for economic activity

Recent data suggest that economic expansion is continuing to moderate but price pressures remain extremely strong. We have revised our projected second quarter increase in GNP downward by about $1.5 billion to $14 billion and real GNP growth is now expected to grow a little more slowly than projected earlier, rising at an annual rate of 2.2 per cent this quarter compared with 2.8 per cent in the first quarter.

Signs of some easing have appeared in growth of employment, output, and incomes in April. The rise in construction activity has slowed and housing starts have declined considerably in recent months. Retail sales through mid-May continued to lack buoyancy; there has been little gain in real takings since last fall. In addition, revised estimates are for a much smaller post-strike rebound in net exports this quarter than previously expected.

With expansion in real output moderating, credit quite tight, and growth in total profits slowing, businessmen's attitudes toward new investment may be in process of changing somewhat. At recent meetings of business economists, forecasts of new plant and equipment spending in 1969 have been typically in the 10-11 per cent range, rather than the 14 per cent indicated in the February Commerce-SEC survey. There also had been a leveling in domestic new orders for machinery and equipment, prior to the probably temporary April upsurge related to prior rumors of imminent repeal of the investment tax credit. Consequently, discounting this April surge, we are continuing to project relatively little further increase in capital spending for the remainder of this year from the sharply advanced first quarter rate.

In the second half of the year, reduced rates of expansion in employment and personal income are expected to hold growth in consumption to moderate rates, even though the ending of retroactive tax payments and the scheduled Federal pay increase will tend to increase growth in disposable income in the third quarter. It appears likely that Federal spending (aside from the pay raise) will continue under substantial restraint; construction activity will turn downward; and, as indicated above, business fixed investment outlays will show a sharply reduced rate of growth. On balance, the probabilities are that real economic expansion will slow further, perhaps to about a 1-1/2 per cent rate in the second half of the year. It seems unlikely, however, that the rise in the GNP deflator can be reduced to less than a 3-1/2 per cent annual rate before year end, compared to 4.3 per cent in the first quarter.

Outlook for resource use and prices

If our GNP projections are realized, the rate of increase in industrial production in this and remaining quarters of this year is likely to slow significantly from the pace of the past two quarters. Growth in industrial output already slackened in April to an annual rate of 3.5 per cent, from about 6 per cent in the first quarter.

After the extraordinary rise in employment in recent months, the small gain in April was not unexpected. Furthermore, prospective slackening in growth of aggregate demand suggests only moderate gains from now on. With reduced availability of new jobs, the labor force may also expand less rapidly than it has recently, so that unemployment is likely to rise only gradually from the April rate of 3.5 per cent.

The increase in compensation per manhour slowed to an annual rate of about 6-1/2 per cent in the first quarter with fewer new settlements; however, little further trimming in the rise in wages is likely this year. Unit labor costs in manufacturing may have risen at about a 4 per cent annual rate in the first quarter, but manufacturing corporations were able to raise prices sufficiently to raise slightly their profit margins. Further rapid increases in unit labor costs are likely to persist in the months ahead, but in the less ebullient markets projected, it should prove increasingly difficult for businesses to pass on rising costs in the form of higher prices.

Consumer prices in April rose nearly as sharply as in March. The rise in service prices may taper off in May, if, as expected, the climb in mortgage rates peaks out. But meat prices seem likely to continue to rise, possibly until midyear, when improved supplies of pork and poultry are in prospect.

Wholesale prices of industrial commodities rose much less rapidly in April than in the first quarter, due mainly to sharp declines in prices of lumber and plywood. For other commodities, the picture of widespread and rapid price increases was nearly the same as in other recent months. Strong foreign demand and high levels of domestic business investment and residential construction have contributed significantly to rising material and machinery prices but slackening demand pressures in these domestic sectors are in train.

Outlook for credit demands

Credit demands are likely to remain relatively strong in late spring and early summer, although current high yield levels are leading to some postponements in bond markets, particularly municipal issues. Such postponements, as they continue, may take some of the edge off of upward interest rate pressures, which are being generated in part by expectations of a prime loan rate rise, by continuing very tight money market conditions, and by a dampening of near-term peace hopes in Vietnam.

It appears likely that long-term interest rates may rise further over the near-term. Corporate need for external funds is expected to remain large, and municipal and mortgage markets are strongly constrained by continuing limitations on the supply of funds. But while bond markets are going through a short-run upward interest rate adjustment, it is not clear that longer-run expectations of a tapering off in interest rate pressures as the year progresses have altered significantly. So long as such expectations are maintained--and this depends in part on the continued prospect for some slowing in economic expansion--the current upward interest rate adjustment may be limited.

Corporate borrowing in the bond market may remain close to its recent pace, on the assumption that businesses do not anticipate a significant further tightening of monetary policy and thus are not disposed to push ahead on long-term financing needs at current interest rate levels. In light of the rise in market rates realtive to bank loan rates, and expectations of lower long-term rates later in the year, corporations are expected to continue drawing heavily on bank lines and from other short-term sources over the period ahead. Business needs for credit in June will be dominated by the $9-1/2 billion or so of income taxes that corporations are expected to pay at that time--a much larger total than in any previous year except 1967.

The municipal market is currently under considerable pressure and yields have reached new record levels. These pressures have reflected continued small bank demand and the overhang of dealers' positions built up earlier when expectations of declining interest rates were more prevalent. The forthcoming volume of offerings is likely to remain moderate as the pace of cancellations and postponements increases in face of limited bank interest and dealer caution. Bond market yields may also be under upward pressure over the short-run if Government security dealers continue to make efforts to dispose of the remaining overhang of the new 7 year Treasury note offered in the mid-May refunding.

<u>Outlook for bank deposits and other sources of funds</u>

Barring a sizable decline in short-term yields, particularly on Treasury bills, total time and savings deposits at commercial banks are expected to show relatively little net growth over the next few weeks. CD maturities and expected attrition will be seasonally large in June in light of corporate needs for funds for tax payments. Moreover, net inflows of consumer-type time and savings deposits may be a relatively limited source of funds to banks. The decline in such deposits in April undoubtedly was associated with large retroactive payments of individual income taxes at midmonth, and the turn-around after the tax date has been moderate. With respect to demand deposits, maintenance of high interest rates and the restricted availability of funds should keep growth rates of cash balances to modest proportions in the months ahead.

With deposits constrained, while credit demands continue relatively strong, other financing arrangements of banks could expand sharply over the next couple of months. A major avenue for such financing that appears likely to surge is the issuance of commercial paper by bank holding companies and their affiliates. An increase in such borrowings in the order of $1/2 to $1 billion over the next few months could well develop. This may enable some banks to postpone adjustments in their portfolio of longer-term securities while at the same time exerting upward rate pressures in short-term markets.

Following the April reinvestment and tax period, inflows to nonbank savings institutions are likely to return to around the first quarter pace, at least until the July reinvestment period. But with outstanding commitments high and the prospects for July reinvestment experience uncertain, new commitment volume is likely to moderate. With mortgage demands continuing strong, mortgage rates particularly for conventional loans, are likely to rise into the summer.

Balance of payments outlook

A massive outflow of corporate and other U.S. private capital during the recent period of intense speculation on a revaluation of the German mark has added a strange new patch to the craxy-quilt pattern of the U.S. balance of payments this year. In the first quarter, U.S. merchandise trade showed a deficit, and the December corporate capital inflow reversed itself, but foreign purchases of U.S. equities were at a record level and the inflow of liquid funds to the United States through banks abroad exceeded $3 billion. The overall balance was in heavy deficit on the liquidity basis, but on the official settlements basis there was an unprecedentedly large surplus.

During the first half of May, the outflow of nonbank capital into marks greatly enlarged the U.S. balance of payments deficit (under any definition). The official settlements balance was adversely affected also by a run down of short-term U.S. bank liabilities to branches abroad, as Euro-dollar depositors and borrowers withdrew funds to purchase marks. Liabilities of U.S. banks to their foreign branches dropped by more than $1 billion in 20 days after April 23.

After May 13, however, these liabilities to branches started to rise again. Prediction would be rash, but it would not be surprising to see the inflow continue, so long as U.S. banks prefer to pay high short-term interest rates rather than take large losses in liquidating investments--at least until the next rush to marks squeezes the Euro-dollar market again.

Recent interagency group projections of the U.S. balance of payments foresee no improvement this year as compared with 1968 in the goods and services account and some worsening in the long-term capital account. However, until recovery from the port strike is farther advanced useful evidence on the trade position will remain scanty, and, of course, projections of the capital accounts--both short- and long-term--are more than ever suspect under the present conditions of uncertainty in exchange markets.

May 20, 1969

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per Cent Change: Year Ago*	Per Cent Change: 2 Yrs. Ago*
Civilian labor force (mil.)	Apr'69	80.5	80.5	78.4	2.6	4.6
Unemployment (mil.)	"	2.8	2.7	2.8	2.6	-2.8
Unemployment (per cent)	"	3.5	3.4	3.5	--	--
Nonfarm employment, payroll (mil.)	"	70.2	70.2	67.8	3.6	7.0
Manufacturing	"	20.1	20.1	19.7	2.4	3.6
Other industrial	"	8.5	8.5	8.3	3.2	6.1
Nonindustrial	"	41.5	41.5	39.8	4.3	8.9
Industrial production (57-59=100)	"	171.5	171.0	162.5	5.5	9.4
Final products	"	170.9	170.5	161.7	5.7	8.4
Materials	"	172.6	171.7	163.1	5.8	10.7
Wholesale prices (57-59=100) 1/	"	111.9	111.7	108.3	3.3	6.3
Industrial commodities (FR)	"	111.1	111.0	107.9	3.0	5.7
Sensitive materials (FR)	"	114.8	115.7	107.8	6.5	14.0
Farm products, foods & feeds	"	110.9	110.7	106.8	3.8	7.3
Consumer prices (57-59=100) 1/	Mar'69	125.6	124.6	119.5	5.1	9.2
Commodities except food	"	116.8	115.7	111.9	4.4	8.3
Food	"	122.4	121.9	117.9	3.8	7.2
Services	"	140.9	139.7	132.1	6.7	11.6
Hourly earnings, mfg. ($)	Apr'69	3.13	3.13	2.96	5.7	11.8
Weekly earnings, mfg. ($)	"	127.37	127.77	118.68	7.3	12.7
Personal income ($ bil.) 2/	"	730.5	727.7	672.6	8.6	18.1
Corporate profits before tax ($ bil.) 2/	QI '69	96.0	95.7	88.9	8.0	20.2
Retail sales, total ($ bil.)	Apr'69	29.4	29.0	27.8	5.9	13.4
Autos (million units) 2/	"	8.2	8.2	7.9	4.2	3.1
GAF ($ bil.)	"	8.0	7.7	7.3	8.7	17.0
Selected leading indicators:						
Housing starts, pvt. (thous.) 2/	"	1,543	1,580	1,591	-3.0	38.3
Factory workweek (hours)	"	40.7	40.8	40.1	1.5	0.5
New orders, dur. goods ($ bil.)	"	30.9	29.7	27.4	12.7	28.3
New orders, nonel. mach. ($ bil.)	"	5.6	5.5	4.7	20.4	34.5
Common stock prices (1941-43=10)	"	101.26	99.30	95.67	5.8	11.3
Manufacturers' inventories, book val. ($ bil.)	Mar'69	90.3	89.6	83.8	7.8	12.7
Gross national product ($ bil.) 2/	QI '69	903.3	887.4	831.2	8.7	17.0
Real GNP ($ bil., 1958 prices) 2/	"	723.5	718.4	692.7	4.4	8.7

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended May 17, 1969	4-week average	Last 6 months High	Last 6 months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent) 9/	8.43	8.13	8.43	5.27
U.S. Treas. bills, 3-mo., yield (per cent)	6.07	6.03	6.20	5.42
U.S. Treas. bills, 1-yr., yield (per cent)	6.13	6.03	6.38	5.45
Net free reserves 2/ ($ millions)	-965	-1,039	- 52	-1,159
Member bank borrowings 2/ ($ millions)	1,170	1,256	1,603	434
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds 1/	6.50	6.41	6.50	5.58
20-year U.S. Treas. bonds 1/	6.01	5.97	6.17	5.46
Corporate new bond issues, Aaa adj. 8/	7.08	7.11	7.57	6.43
Corporate seasoned bonds, Aaa 1/	6.75	6.79	6.99	6.13
Municipal seasoned bonds, Aaa 1/	5.10	4.99	5.10	4.21
FHA home mortgages, 30-year 3/	--	8.06	8.06	7.36
Common stocks, S&P composite series 4/				
Prices, closing (1941-43=10)	105.94	104.18	108.37	98.00
Dividend yield (per cent)	2.99	3.04	3.21	2.86

	Latest month	Amount	3-month average	Change from year earlier Latest month	Change from year earlier 3-month average
New Security Issues (N.S.A., $ millions)					
Corporate public offerings 5/	May '69e	1,550	1,667	204	485
State & local govt. offerings	"	975	1,042	-168	-246
Comm. & fin. co. paper (net change in outstandings) 6/	March '69	+816	+1,061	+142	+816

	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 months ago
Banking (S.A.)		($ billions)			(per cent)		
Total reserves 1/	April '69	26.85	-0.23	-0.12	-10.4	- 5.1	4.8
Credit proxy 1/ 10/	"	293.6	1.3	-0.5	5.3	- 2.0	6.2
Bank credit, total 6/	"	389.9	3.1	1.3	9.6	4.1	9.8
Business loans	"	101.2	1.4	1.2	16.8	14.3	14.0
Other loans	"	159.4	1.7	1.1	12.9	8.7	11.8
U.S. Govt. sec.	"	57.6	0.2	-1.1	0.8	-21.1	-4.5
Other securities	"	71.7	-0.2	0.1	10.7	1.7	13.1
Total liquid assets 1/ 6/ 11/	"	716.0	2.2	2.7	3.7	4.6	7.0
Demand dep. & currency 1/	"	195.8	1.8	0.7	11.1	4.5	6.2
Time & sav. dep., comm. banks 1/	"	200.8	-0.2	-0.6	-1.2	-3.4	7.3
Savings, other thrift instit. 6/	"	199.1	0.2	1.1	1.2	6.7	6.1
Other 6/ 7/ 11/	"	120.3	0.4	1.5	4.0	15.2	9.4

N.S.A.--Not seasonally adjusted. S.A.--Seasonally adjusted e--Estimated.
1/ Average of daily figures. 2/ Average for statement week ending May 14. 3/ Latest figure is monthly average for April. 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/ Adjusted to Aaa basis. 9/ Federal funds data are 7-day averages for week ending Sunday: latest figure is for week ending May 18. 10/ Reflects $400 million reduction in member bank deposits resulting from withdrawal of a large country bank from System membership in January 1969. Percentage annual rates are adjusted to eliminate this break in series. 11/ Reflects $1.7 billion increase beginning January 1969 in U.S. Government securities maturing within 1 year to conform to the new Budget concept. Percentage annual rates are adjusted where necessary.

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

	1968[r]					1969	
	Year[p]	I	II	III	IV	I[p]	Apr.
	Seasonally adjusted						
Goods and services, net 1/	1,965	308	720	785	152		
Trade balance 2/	100	-1	128	187	-214	-303	
Exports 2/	33,373	7,881	8,335	8,824	8,333	7,376	
Imports 2/	-33,273	-7,882	-8,207	-8,637	-8,547	-7,679	
Service balance	1,865	309	592	598	366		
Remittances and pensions	-1,159	-269	-281	-315	-295		
Govt. grants & capital, net	-3,975	-1,089	-1,065	-970	-852		
U.S. private capital	-4,860	-795	-1,349	-1,755	-962		
Direct investment	-2,743	-433	-881	-1,213	-217		
Foreign securities	-1,288	-340	-183	-314	-451	-141	
Banking claims	254	236	243	-90	-135	80	
Other	-1,083	-258	-528	-138	-159		
Foreign Capital	9,128	768	2,567	2,845	2,948		
Official foreign, nonliquid	2,458	334	934	444	746		
Official foreign, liquid	-3,099	-1,182	-2,282	215	150		
Int'l and reg., liq. & nonliq. 3/	241	-19	-99	77	282		
Foreign private non-bank, liq.	368	4	97	45	222		
Foreign commercial banks, liq.	3,392	457	2,340	723	-128		
New direct invest. issues 4/	2,190	581	585	588	436		
Other	3,578	593	992	753	1,240		
Errors and omissions	-221	-178	-581	391	147		
	Balances, with and without seasonal adjustment (defict -)						
Liquidity balance, S.A.		-602	-71	-23	852	-1,778	
Seasonal component		340	133	-410	-63	413	
Balance, N.S.A.	156	-262	62	-433	789	-1,365	-782
Official settlements balance, S.A.		-423	1,518	239	305	1,126	
Seasonal component		513	34	-166	-381	585	
Balance, N S.A. 5/	1,639	90	1,552	73	-76	1,711	n.a.
Adjusted over-all balance, S.A. 6/		-888	-829	-492	456	-1,941	
Seasonal component		340	133	-410	-63	413	
Balance, N.S.A.	-1,753	-548	-696	-902	393	-1,528	n.a.
Financed by: Liab. to comm. banks abroad, N.S.A. (decrease -)	3,392	638	2,248	975	-469	3,239	n.a.
Official settlements, N.S.A. 7/	-1,639	-90	-1,552	-73	+76	-1,711	n.a.
	Reserve changes, N.S.A. (decrease -)						
Total monetary reserves	880	-904	137	571	1,076	48	190
Gold stock	-1,173	-1,362	-22	74	137	-56	100
Convertible currencies	1,183	401	-267	474	575	73	23
IMF gold tranche	870	57	426	23	364	31	67

1/ Equals "net exports" in the GNP, except for latest revisions.
2/ Balance of payments basis which differs a little from Census basis.
3/ Long-term deposits and Agency securities.
4/ New issues sold abroad by U.S. direct investors
5/ 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.
6/ Represents the net result of all international transactions of the U.S. other than changes in reserve assets, in all liabilities to foreign monetary authorities and in liabilities to commercial banks abroad (including U.S. bank branches) reported by banks in the U.S.
7/ Minus sign indicates decrease in net liabilities.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. Recent data appear to confirm the trend toward slowing real growth in the economy. Employment and income gains were distinctly smaller in April than during the winter, and recent estimates of retail sales have shown erratic monthly movements with little growth since last fall in real takings. Housing starts have declined for the third successive month, and construction activity has begun to grow more slowly. New orders for machinery and equipment had leveled off prior to a sharp but probably temporary upsurge in April, apparently in anticipation of suspension or repeal of the investment tax credit; on the whole, however, the recent course of such orders supports forecasts of slower growth in plant and equipment spending. Even the post-strike surge in exports, which is expected to bolster GNP growth this quarter, now seems likely to be much smaller than earlier anticipated. We are therefore projecting a reduced rate of growth of GNP this quarter, $14 billion, down from a revised estimate of $15.9 billion in the first quarter. With price increases continuing strong, real GNP growth is expected to dip further, to an annual rate of 2.2 per cent from 2.8 per cent last quarter.

A further slowing in growth appears increasingly likely during the second half of the year. Tight monetary and credit policy should soon begin to curtail construction activity; budgetary restrictions will probably halt growth of Federal expenditures before year end;

and only a modest growth in personal income is likely to restrain increases in consumption expenditures. With costs still rising substantially and with external financing increasingly costly and hard to get, businessmen's anticipations should begin to be dampened, leading to curtailment in the growth of business spending and greater resistance to wage increases. But strong cost pressures are expected to perist and only a modest easing in the rate of inflation seems likely in the remainder of this year.

Although consumption expenditures rebounded in the first quarter from the weak fourth quarter rate, the recovery in retail sales so far in 1969 has been uneven, with the level of sales in April only slightly above that of late last summer despite substantial price increases. In real terms, retail sales as a whole in March and April were apparently little or no higher than a year earlier. Domestic auto sales have declined from the 9 million average rate of last fall, averaging 8.2 million in both March and April; in early May, however, sales advanced above this level.

With much slower growth in disposable income, the first quarter increase in consumer expenditures was associated with a sharp dip in the saving rate to 6.1 per cent, which is low by recent standards but about in line with the 1965-66 experience. Except for a prospective temporary bulge in the third quarter resulting from the Federal government pay raise, gains in disposable income are expected to continue moderate for the remainder of the year. Wage rate increases are likely to continue relatively large, but average hours are expected to fall and employment growth to moderate. With the saving rate already reduced, consumer spending seems unlikely to show notably stronger growth than disposable income.

Business spending for plant and equipment has provided the major underpinning for recent expansion in overall output. The first quarter showed an unusually large $5.3 billion rise in these expenditures--almost equal to the anticipated increase reported in the February Commerce-SEC survey. This survey indicated a dip in expenditures in the second quarter followed by moderate increases in the last half of the year. However, the momentum of recent increases plus a rise in manufacturers' unfilled orders for machinery and equipment in the first quarter suggest that a dip is unlikely and we continue to project a small increase in the current quarter.

With even a small further rise this quarter, the level of capital spending would already be some 11 per cent above 1968, and only modest further gains would be needed in the second half to attain the 14 per cent increase projected in the survey for 1969. Recent meetings of business economists suggested that a 1969 average increase in spending of 10-11 per cent is now considered a more reasonable projection, which would imply no increase in capital spending after this quarter. We agree that the survey projection for the year may not be realized, but are continuing to project a small gain of about $1 billion quarterly in the second half. This would bring the average increase for the year 1969 to about 12 per cent.

Private housing starts in April were down to an annual rate of 1.5 million units, compared with a peak rate of 1.9 million in January. As a result, residential construction expenditures are expected to dip by about $1 billion in the current quarter, with rising costs partly offsetting the expected dip in starts. High interest rates and an increasing shortage of mortgage funds should work to reduce new housing activity further in the second half of the year, but the decline should be relatively moderate. Exceptionally strong underlying shelter demands, the marked shift in starts toward multi-family units, and the surprisingly high level of commitments reported by the thrift institutions so far this spring suggest that housing starts in the second half of the year may not drop below 1.4 million units.

The shift from larger to smaller rates of inventory accumulation between the fourth and first quarters was a major factor restraining GNP growth in the latter period. In the second quarter, we anticipate stock building will continue at about the same rate as in the first quarter. Some liquidation of auto stocks and of inventories for export should serve to moderate possible rapid inventory accumulation in other sectors. If, as we expect, consumption expenditures continue to show only modest real growth and orders for business equipment tend to level off, a more rapid inventory buildup may well develop later on in the year.

The anticipated rebound in net exports following the longshoremen's strike now appears likely to be much smaller than anticipated earlier, and this is a major factor lowering our projection of the second quarter rise in GNP. Revised estimates--based on projections of an interagency balance of payments group--now indicate a lower level of exports (including the possible permanent loss of some $400 million in exports during the strike), and further increases in imports for the current quarter. As a result, the net export balance for the second quarter is now projected to be $2.7 billion instead of the $6.0 we had been projecting earlier. In addition, the estimated net export balance for the third and fourth quarters has been cut back to $1.7 billion from the previous estimate of over $3 billion a quarter, largely reflecting growing pessimism on the outlook for exports.

Our projections of Federal spending continue to be consistent with the downward revised budget outlays of $192.9 billion for fiscal 1970 proposed in the new administration's April budget review (and repeated in testimony of the Director of the Budget on May 20.) Except for the pay increase scheduled for July 1, little further rise is anticipated this year in purchases of goods and services. In fact, as now budgeted, defense purchases will decline in real terms in the last three quarters. Recent Congressional determination to fix a ceiling for 1970 expenditures would also seem to assure a relatively tight Budget in the coming fiscal year.

The large first quarter Budget surplus probably has played an important role in slowing the growth in economic activity. The sharp increase in tax receipts--reflecting mainly higher social security taxes and retroactive surtax payments--in conjunction with slower growth in spending produced an estimated surplus in the first quarter at an annual rate in excess of $7 billion (NIA basis). This compares with a virtual balance of receipts and expenditures in the fourth quarter, and had its counterpart in a reduced rate of expansion in private incomes--especially in personal disposable income. The first quarter rate of surplus is expected to be repeated in the current quarter, but subsequently growth of tax receipts will slow, reflecting completion of retroactive payments and some easing in activity. Nevertheless, the surplus is projected to average about $4 billion in the second half, so that a moderate Federal restrictive impact can be expected to persist for the balance of the 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)

	1967	1968	1969 Proj.	1968 III	1968 IV	1969 - Projected I	II	III	IV
Gross National Product	789.7	860.6	923.9	871.0	887.4	903.3	917.3	931.5	943.5
Final Sales	783.6	852.9	916.6	863.5	876.8	896.3	910.4	924.5	935.0
Private excluding net exports	600.4	653.7	702.7	660.6	672.8	689.4	697.5	707.1	716.6
Net exports	4.8	2.0	1.5	3.3	1.0	.0	2.7	1.7	1.7
Personal consumption expenditures	492.2	533.8	570.6	541.1	546.8	557.4	565.7	575.1	584.1
Durable goods	72.6	82.5	87.4	85.1	85.1	86.8	87.0	87.5	88.2
Nondurable goods	215.8	230.3	244.4	232.7	233.7	238.1	242.0	246.8	250.8
Services	203.8	221.0	238.8	223.4	228.0	232.5	236.7	240.8	245.1
Gross private domestic investment	114.3	127.7	139.4	127.1	136.6	139.0	138.7	139.0	141.0
Residential construction	24.6	29.9	31.1	29.5	31.6	32.5	31.5	30.5	30.0
Business fixed investment	83.6	90.0	101.0	90.1	94.3	99.6	100.3	101.5	102.5
Change in business inventories	6.1	7.7	7.3	7.5	10.6	6.9	6.9	7.0	8.5
Nonfarm	5.6	7.3	7.1	7.3	9.7	6.2	6.5	7.0	8.5
Net exports of goods and services	4.8	2.0	1.5	3.3	1.0	.0	2.7	1.7	1.7
Gov't. purchases of goods & services	178.4	197.2	212.4	199.6	203.0	206.9	210.2	215.7	216.7
Federal	90.6	100.0	103.8	101.2	101.7	102.4	102.7	105.4	104.7
Defense	72.4	78.9	81.0	79.6	80.0	80.2	80.0	82.2	81.5
Other	18.2	21.1	22.8	21.5	21.7	22.2	22.7	23.2	23.2
State & local	87.8	97.2	108.6	98.4	101.2	104.5	107.5	110.3	112.0
Gross national product in constant (1958) dollars	673.1	706.7	728.5	712.3	718.4	723.5	727.4	730.0	733.0
GNP implicit deflator (1958=100)	117.3	121.8	126.8	122.3	123.5	124.9	126.1	127.6	128.7
Personal income	628.8	685.8	739.7	694.3	708.2	721.7	734.0	746.5	756.5
Wages and salaries	423.4	463.5	504.6	469.0	479.0	490.8	500.0	510.0	517.5
Disposable income	546.3	589.0	624.1	592.7	602.4	609.2	618.0	630.8	638.2
Personal saving	40.2	40.7	38.4	37.1	40.9	36.9	37.2	40.4	39.1
Saving rate (per cent)	7.4	6.9	6.2	6.3	6.8	6.1	6.0	6.4	6.1
Corporate profits before tax	81.6	92.3	94.4	92.7	95.7	96.0	95.0	94.0	92.5
Federal government receipts and expenditures (N.I.A. basis)									
Receipts	151.2	176.9	199.3	182.1	187.0	196.9	200.1	199.2	201.0
Expenditures	163.6	182.2	193.5	184.9	186.9	189.7	192.7	195.9	195.7
Surplus or deficit (-)	-12.4	-5.4	5.8	-2.8	0.2	7.2	7.4	3.3	5.3
Total labor force (millions)	80.8	82.3	84.1	82.4	82.6	83.7	84.0	84.2	84.4
Armed forces "	3.4	3.5	3.5	3.6	3.5	3.5	3.5	3.5	3.5
Civilian labor force "	77.3	78.7	80.6	78.8	79.1	80.2	80.5	80.7	80.9
Unemployment rate (per cent)	3.8	3.6	3.6	3.6	3.4	3.3	3.5	3.6	3.8
Nonfarm payroll employment (millions)	66.0	68.1	70.3	68.3	69.0	69.9	70.2	70.4	70.6
Manufacturing	19.4	19.7	20.0	19.8	19.9	20.1	20.1	20.0	19.9
Industrial production (1957-59=100)	158.1	164.7	172.3	165.2	167.4	170.0	171.8	173.0	174.5
Capacity utilization, manufacturing (per cent)	85.3	84.5	84.0	84.0	84.2	84.4	84.0	83.5	83.2
Housing starts, private (millions A.R.)	1.29	1.51	1.51	1.55	1.60	1.71	1.51	1.40	1.40
Sales new domestic autos (millions, A.R.)	7.57	8.62	8.55	9.01	8.82	8.37	8.50	8.60	8.75

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1967	1968	1969 Proj.	1968 III	1968 IV	1969 I	1969 Projected II	1969 Projected III	1969 Projected IV
	In Billions of Dollars								
Gross National Product	42.1	70.9	63.3	18.1	16.4	15.9	14.0	14.2	12.0
Inventory change	-8.6	1.6	-.4	-3.2	3.1	-3.6	.0	.1	1.5
Final sales	50.8	69.3	63.7	21.4	13.3	19.5	14.1	14.1	10.5
Private excluding net exports	28.8	53.3	49.0	16.2	12.2	16.6	8.1	9.6	9.5
Net exports	-.3	-2.8	-.5	1.3	-2.3	-1.0	2.7	-1.0	.0
Government	22.2	18.8	15.2	3.9	3.4	3.9	3.3	5.5	1.0
GNP in constant (1958) dollars	16.0	33.6	21.8	8.9	6.1	5.1	3.9	2.6	3.0
Final sales	24.0	32.4	22.3	12.0	3.2	8.6	3.9	2.8	1.1
Private	9.8	23.9	18.1	11.1	2.1	7.3	2.7	2.3	1.9
	In Per Cent Per Year								
Gross National Product	5.6	9.0	7.4	8.5	7.5	7.1	6.2	6.2	5.2
Final sales	6.9	8.8	7.5	10.2	6.2	8.9	6.3	6.2	4.5
Private	5.0	8.3	7.4	10.8	6.0	9.3	6.3	4.9	5.4
Personal consumption expenditures	5.7	8.5	6.9	10.0	4.2	7.8	6.0	6.6	6.3
Durable goods	3.0	13.6	5.9	20.2	0.0	8.0	0.9	2.3	3.2
Nondurable goods	4.4	6.7	6.1	7.9	1.7	7.5	6.5	7.9	6.5
Services	8.2	8.4	8.1	8.6	8.2	7.9	7.2	6.9	7.1
Gross private domestic investment	-5.4	11.7	9.2	-0.6	29.9	7.0	-0.9	0.9	5.8
Residential construction	-0.8	21.5	4.0	0.0	28.5	11.4	-12.3	-12.7	-6.6
Business fixed investment	2.8	7.7	12.2	14.3	18.6	22.5	2.8	4.8	3.9
Gov't. purchases of goods & services	14.2	10.5	7.7	8.0	6.8	7.7	6.4	10.5	1.9
Federal	17.1	10.4	3.8	4.8	2.0	2.8	1.2	10.5	-2.7
Defense	19.5	9.0	2.7	3.0	2.0	1.0	-1.0	11.0	-3.4
Other	8.3	15.9	8.1	9.5	3.7	9.2	9.0	8.8	0.0
State & local	11.4	10.7	11.7	11.7	11.4	13.0	11.5	10.4	6.2
GNP in constant (1958) dollars	2.4	5.0	3.1	5.0	3.4	2.8	2.2	1.4	1.6
Final sales	3.7	4.9	3.2	6.9	1.8	4.9	2.2	1.6	0.6
Private	1.9	4.5	3.3	8.2	1.5	5.2	1.9	1.6	1.3
GNP implicit deflator	3.1	3.8	4.2	3.4 1/	4.1	4.3	4.0	4.8 2/	3.5
Personal income	7.2	9.1	7.9	9.6	8.0	7.6	6.8	6.8	5.4
Wages and salaries	7.3	9.5	8.9	10.0	8.5	9.9	7.5	8.0	5.9
Disposable income	6.8	7.8	6.0	4.4	6.5	4.5	5.8	8.3	4.7
Corporate profits before tax	-4.7	13.1	2.3	1.7	12.9	1.3	-4.2	-4.2	-6.4
Federal government receipts and expenditures (N.I.A. basis)									
Receipts	5.7	17.0	12.7	23.5	10.8	21.2	6.5	-1.8	3.6
Expenditures	14.9	11.4	6.2	6.6	4.3	6.0	6.3	6.6	-0.4
Nonfarm payroll employment	3.1	3.2	3.2	2.9	4.1	5.2	1.7	1.1	1.1
Manufacturing	1.0	1.5	1.5	2.0	2.0	4.0	0.0	-2.0	-2.0
Industrial production	1.2	4.2	4.6	2.4	5.3	6.2	4.2	3.2	3.5
Housing starts, private	10.9	16.7	0.0	29.7	14.5	27.8	-46.7	-30.2	0.0
Sales new domestic autos	-9.7	14.0	-0.8	27.1	-8.5	-20.4	6.3	4.7	7.0

1/ Excluding Federal pay increase, 2.8 per cent per year.
2/ Excluding Federal pay increase, 3.7 per cent per year.

Industrial production. Industrial production in April was 171.5 per cent of the 1957-59 average--up 0.3 per cent from March and 5.5 per cent from a year earlier. Output of business equipment and some industrial materials rose further, but production of consumer goods declined.

The February and March levels of the index were each revised upwards by 0.3 per cent and the revised first quarter average, 170.0 per cent, is 1.5 per cent above the fourth quarter of 1968--a 6.2 per cent annual rate of increase. If the preliminary April gain is matched in May and June, the second quarter average would be about 172.0 per cent and the rate of growth would slow to an annual rate of 4.7 per cent. The following table indicates the month to month per cent changes in the total index and its major components from December 1968 to April 1969.

INDUSTRIAL PRODUCTION
Per cent changes from previous month

	1969			
	January	February	March	April
Total index	.2	.5	.6	.3
Consumer goods	.6	.6	.2	-.4
Autos	-2.2	-3.3	0	-9.1
Home goods	2.4	-1.9	2.1	.1
Nondurables	.4	1.1	-.3	.3
Business equipment	.7	.6	.3	.9
Defense equipment	-8.0	4.5	3.7	3.0
Durable materials	.9	.7	1.2	.8
Steel	1.8	5.0	3.3	2.2
Nondurable materials n.e.c.*	-1.9	-.1	.3	-1.0

* Textiles, paper, chemicals

Auto assemblies were at an annual rate of 7.7 million units in April, down almost one-tenth from March mainly because of strikes at Chrysler and General Motors. The strike at Chrysler has been settled but that at General Motors has continued thus far in May, and auto production this month will most probably not return to the February-March level of 8.4 million units.

Sales of new domestic autos rose in the first ten days of May and were about 7 per cent above the 8.2 million unit annual rate of March-April and 2 per cent above a year earlier. Dealers' stocks declined somewhat further, but were still 8 per cent above a year earlier.

Among other consumer goods, output of television sets declined in April and preliminary data for household appliances indicate little change in production levels since January. Output of furniture, however, continued to expand. Production of apparel and footwear has been relatively stable since March 1968 at a level around 140 per cent of the 1957-59 average. While the value of retail sales of apparel has increased about 7 per cent over the past year, the BLS consumer price index for apparel also rose by the same amount. Output of consumer staples--which includes foods, drugs, medicine, residential electricity, and some other products--has continued to rise at its long-term growth rate of about 4 per cent a year.

Production of industrial and commercial equipment increased further in April and so far in 1969 output has risen at an annual rate of over 10 per cent. Output of freight and passenger equipment leveled off in April as a decline in truck assumblies, because of strikes, was offset mainly by increased production of commercial aircraft. Output of farm equipment, which had declined about 25 per cent since December 1966, has been about unchanged since January of this year. Defense equipment production has recovered from the strike-reduced low in January, but in April was still 3 per cent below the third quarter 1968 high.

Output of iron and steel increased further in April to within 5 per cent of the pre-labor contract settlement high in 1968. In early May, production of raw steel was about unchanged. Output of construction materials and parts for consumer durable goods declined in April. Production of textiles and industrial chemicals has changed little since January and output of paper was apparently unchanged in April.

Capacity utilization. The April rate of manufacturing capacity utilization is estimated at 84.4 per cent, unchanged from the first quarter average. While the overall operating rate remains at moderate levels, there has been some tightening in the materials producing industries in recent months. Operating rates are high in the paper, nonferrous metals and rubber products industries, and above normal in the production of aircraft. Appreciable amounts of unused capacity are available for most other manufacturing products.

UTILIZATION RATES
(Per cent)

Industry	1968 QI	1968 QII	1968 QIII	1968 QIV	1969 QI	1969 Feb.	1969 March	1969 April
Manufacturing	84.9	84.8	84.0	84.2	84.4	84.4	84.5	84.4
Primary processing industries	85.5	86.5	84.6	85.6	86.7	86.9	87.1	86.9
Advanced processing industries	84.4	83.6	83.5	83.2	82.6	82.6	82.7	82.5

Consumer credit. Consumer instalment credit outstanding rose at a seasonally adjusted annual rate of $7.8 billion in March, a marked slowing from the February increase of $9.6 billion. Extensions declined slightly in March as a reduction in personal loans more than offset small increases in automobile and other consumer goods credit; repayments were at a record high.

For the first quarter as a whole, the net increase in instalment credit amounted to $8.3 billion, seasonally adjusted annual rate, as compared with increases of about $10 billion in each of the two preceding quarters. Smaller gains were reported in most major classifications of consumer credit.

NET CHANGE IN CONSUMER INSTALMENT CREDIT OUTSTANDING
(Billions of dollars, seasonally adjusted annual rates)

	Total	Automobile	Other consumer goods	Personal loans	Home repair and modernization
1968 - QI	$ 7.0	$2.8	$1.9	$2.4	$ 0
QII	8.4	3.0	2.8	2.4	.1
QIII	10.0	3.9	2.6	3.3	.2
QIV	10.2	3.8	2.7	3.5	.2
1969 - QI	8.3	2.7	2.5	3.0	.2

The increase in auto credit during the first quarter was the smallest since the fourth quarter of 1967 when new car sales were curtailed by strikes at some of the major producers. The recent slowing reflects a decline in unit sales of new and used cars during early 1969--in part because of the dockworkers' strike that curtailed sales of imports--that was tempered by larger average size of notes and a higher proportion of credit sales.

Retail sales. Following the decline in retail sales in the fourth quarter, the erratic recovery so far in 1969 has brought sales levels only modestly above those of late last summer. Actually, the figures for March show almost no change from September 1968, and the rise in retail sales in April was not very large considering the March decline. The advance March retail sales estimate was reduced by an unusually large preliminary revision in the data, changing an increase in retail sales from February of close to 1 per cent to a decline of about the same amount.

Retail sales in April increased 1.5 per cent from March, according to the advance report, as almost all major groups except automotive recovered all or part of their March declines. The April recovery brought total sales to a new high, but durable goods sales remained slightly below the first quarter average. This was entirely accounted for by the automotive group, with other durable goods sales in April holding even with the first quarter. Nondurable goods sales in April were relatively stronger and this category was 1.7 per cent above the average of the first three months of this year.

RETAIL SALES
Percentage changes

	From previous quarter:			
	1968		1969	
	III	IV	I	April 1/
Total	2.5	-0.6	1.7	1.1
Total, excl. automotive	1.8	0.0	1.8	1.6
Durable goods	3.9	-1.7	2.0	-0.2
Automotive	5.3	-2.7	1.1	-0.9
Nondurable goods	1.7	0.0	1.5	1.7
Department stores	4.4	1.7	-0.3	6.6
Total retail sales, real*	1.5	-1.6	0.9	n.a.

1/ From first quarter monthly average.
* Deflated by all commodities CPI.

In real terms, retail sales have been showing progressively less strength in year-to-year increases for some months. In March, total sales deflated by the all commodities CPI were 0.6 per cent lower than in March 1968. It is unlikely that there was any significant gain in real takings in April, since the dollar amount of sales was only 5.9 per cent above a year earlier, with the bulk of the rise likely to represent price increases.

Leading indicators. The preliminary Census composite leading indicator decreased about 1 per cent in March--the first decline that large since January 1968. In addition, the coincident and lagging composites barely increased, after more than a year of sustained strength.

COMPOSITE CYCLICAL INDICATORS
1963 = 100

	12 Leading Indicators	5 Coincident Indicators	6 Lagging Indicators
1968 - December	144.6	163.3	174.3
1969 - January	144.3	164.7	177.7
February	146.4	166.4	181.2
March	145.0p	166.9p	181.8p

Since the preliminary March composites were compiled, a number of the leading components have had some upward revision, including the manufacturing workweek, housing permits, durable new orders, and plant and equipment contracts and orders. On the other hand, March declines are now reported for other components such as net business formation, changes in consumer instalment debt, and inventory book value change. Of the components available so far for April, the workweek is down fractionally and housing permits, stock prices, and the ratio of price to unit labor costs are up.

Manufacturers orders. New orders for durable goods rose 3.9 per cent in April according to advance figures, following a 2.6 per cent decline in March. Shipments were little changed and unfilled orders rose 1.5 per cent. The largest gains in unfilled orders were for iron and steel and for machinery and equipment.

A huge surge in new orders for railroad equipment resulted in a rise of 78.5 per cent in orders for transportation equipment excluding motor vehicles and aircraft. Apart from the transportation equipment group, durable goods orders were up 2.4 per cent from March and about at the February level. April new orders for machinery and equipment--which includes railroad equipment--rose 9.7 per cent and for iron and steel, 9.0 per cent. New orders for defense products (new series) were down 3.2 per cent and for nonferrous metals were down .6 per cent.

The preliminary March new order figures for durables have been revised down slightly, but the present figures for the first three months of this year still average nearly 1 per cent (annual rate of 4 per cent) above the fourth quarter of 1968. On the other hand, non-durable orders averaged 1 per cent (annual rate of 4 per cent) less than in the fourth quarter. Wholesale price indexes were rising, particularly for durable manufactures; after allowing for price change, the new orders data for the first quarter imply declines in real terms at annual rates of about 3-1/2 per cent for durables and 7-1/2 per cent for nondurables. As the table indicates, new orders were exceptionally strong in the fourth quarter, when steel orders were recovering, capital goods orders were rising sharply, and consumer staples were showing substantial increases.

MANUFACTURERS' NEW ORDERS
Per cent changes at annual rates

	1968				1969
	QI	QII	QIII	QIV	QI*
Manufacturing, total	8.2	6.5	9.5	20.7	0.3
Durable	10.4	-2.0	6.3	31.3	4.1
Nondurable	5.4	17.1	12.6	8.7	-4.3
Home goods and apparel	17.9	24.6	-12.2	-8.7	24.7
Consumer staples	-0.3	11.4	22.3	13.1	-11.4
Equipment and defense (excluding auto)	6.4	-1.9	12.7	33.0	9.2
Automotive equipment	44.6	6.7	26.1	3.8	-3.9
Construction materials	-22.5	28.6	13.6	30.1	-6.4
Other materials	9.8	-1.1	2.6	28.5	-0.6
Per cent change in wholesale prices, annual rate:					
Durable manufactures	5.9	2.2	1.8	5.4	7.4
Nondurable manufactures	3.0	2.3	2.2	-1.1	3.4

* Changes based on preliminary March figures.

Inventories. According to the revised official GNP estimate, inventories accumulated at a $6.9 billion annual rate in the first quarter, slightly larger than the preliminary estimate but still well below the fourth quarter of 1968. Total book values of manufacturing and trade inventories increased at a somewhat lower rate than in the fourth quarter while the valuation adjustment for price increase was particularly large, cutting book value further in its translation to the GNP concept.

INVENTORY CHANGE (BOOK VALUE)
(Seasonally adjusted monthly, millions of dollars)

	1968	1969	
	QIV Average	QI Average	March
Manufacturing & trade, total	1,045	852	986
Durable goods	731	606	856
Manufacturing	321	507	661
Wholesale	130	72	140
Retail	280	27	55
Nondurable goods	314	246	130
Manufacturing	169	54	45
Wholesale	14	103	150
Retail	131	89	-65

Book value increases were substantial in February and March, especially at wholesale and at durable manufacturers. But wholesale sales also jumped in March, and the wholesale inventory-sales ratio dropped back to the lowest point since last September. These recent changes in wholesale sales and inventories may, however, reflect mainly the ending of the dock strike.

Retail inventory accumulation was small in the first quarter; there was no accumulation in March, but retail sales were down and the inventory-sales ratio rose, particularly at G.A.F. stores. In April, retail sales recovered, and stocks of U.S.-made autos declined again as strikes limited production. For these reasons, continued slow retail inventory growth and declines in stock-sales ratios seem likely for the current period.

The first quarter inventory accumulation was concentrated in durable goods manufacturing, where book values were rising rapidly and were creeping up relative to sales and unfilled orders. This build-up is probably largely "voluntary"; manufacturers of business and defense equipment, which to a large extent produce to order rather than to stock, accounted for more than half of the first-quarter increase in durable manufacturers' inventories. The value of new orders in these industries has been tending to level off, apart from the April advance, and may decline in coming months if the proposed suspension of the investment tax credit and other restraining forces take effect.

SELECTED RATIOS, MANUFACTURING

	December 1966	March 1969
Manufacturing, total:		
Inventories/shipments	1.72	1.71
Durable manufacturing:		
Inventories/shipments	2.00	2.00
Unfilled orders/shipments	3.13	2.89
Inventories/unfilled orders	.64	.69
Machinery and equipment:		
Inventories/shipments	2.50	2.39
Unfilled orders/shipments	4.28	3.67
Inventories/unfilled orders	.58	.65
Defense products industries:		
Inventories/shipments	2.87	2.94
Unfilled orders/shipments	9.72	8.35
Inventories/unfilled orders	.30	.35

The inventory position of the equipment industries appears to be more extended than in 1966, just before the 1967 inventory readjustment. Although inventory-shipments ratios are not much different from December 1966 levels, ratios of unfilled orders to shipments are lower. Inventories are also higher relative to order backlogs, and it seems possible that declines in backlogs in the equipment industries would be followed by inventory liquidation, rather than continued build-up as in 1967, and also by greater production declines than in 1967.

Construction and real estate. The seasonally adjusted value of new construction put in place edged upward further to a new current-dollar peak of $92.1 billion in April, according to preliminary estimates by the Census Bureau. While the year-to-year increase amounted to 8 per cent, all of it reflected higher costs.

Although some slowing in outlays for residential construction is indicated during the second quarter, in line with the overall downtrend in starts which began last February, such outlays apparently rose further in April. However, nonresidential construction activity continued below the high reached last January, reflecting a leveling off in outlays for stores, offices and other commercial structures since then and some reduction in activity on industrial plants. Public construction moved higher, but also remained under its earlier peak.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	April 1969 ($ billions) 1/	Per cent change from	
		March 1969	April 1968
Total	92.1	+1	+ 8
Private	62.7	+1	+ 9
Residential	32.2	+2	+10
Nonresidential	30.5	--	+ 9
Public	29.4	+1	+ 5

1/ Seasonally adjusted annual rates; preliminary. Data for the most recent month (April) are confidential Census Bureau extrapolations. In no case should public reference be made to them.

Seasonally adjusted private housing starts continued downward in April for the third consecutive month. However, the decline was associated with a 3 per cent upward revision for March and was to a still relatively high annual rate of 1.54 million units.

While--as in March--all of the decline in April was concentrated in single-family starts, the rise in multifamily starts was minimal and the rate remained appreciably short of earlier peaks. Within the individual regions, total starts moved counter to the prevailing downtrend mainly in the West, reflecting further recovery from a sharp curtailment induced by unusually heavy rains in California last winter.

PRIVATE HOUSING STARTS AND PERMITS

	April 1969 (Thousands of units)1/	Per cent change from	
		March 1969	April 1968
Starts	1,543	- 2	- 3
1 family	785	- 5	- 6
2-or-more family	758	+ 1	+13
Northeast	253	- 5	+ 9
North Central	352	-18	-11
South	577	+ 5	-10
West	361	+ 8	+11
Permits	1,449	+ 2	+ 8
1 family	646	- 4	- 4
2-or-more family	803	+ 7	+21

1/ Seasonally adjusted annual rates; preliminary.

Seasonally adjusted building permits, which have fluctuated within a narrow range so far this year, turned upward again in April, but the overall rise was comparatively slight as an increase for multi-family structures was largely offset by a further decline for single-family structures to the lowest rate since last June. Consequently, staff projections of starts for the remainder of the spring quarter remain essentially unchanged, with some further easing expected from the exceptionally high first quarter annual rate which averaged in excess of 1.7 million units. Even so, with both mortgage commitments outstanding at thrift institutions and the rate of building permits still quite high, housing starts for the spring quarter as a whole should hold close to the advanced 1.5 million rate averaged in the year 1968.

Apart from the accelerated first quarter pace of starts and continued tightness in financial markets as a whole, disruptions caused by competitively low usury ceilings in some states have also been a factor in the recent downtrend in starts. These difficulties have been particularly marked in the North Central states which led the rise in housing starts earlier this year. In addition, high construction costs and labor and materials shortages appear to have contributed to the less than seasonal increase this spring. At the same time, however, consumer interest in available new and existing houses has apparently continued quite strong. Based on the FRB-FHLBB survey of lenders, demands for funds to support such purchases were generally running in excess of available funds in May, as discussed in the special supplement distributed with the Greenbook.

Census Survey of Consumer Buying Expectations. The April survey suggests that there has been no change from a year earlier in the number of new cars consumers expect to purchase, or in the amount of money which they plan to spend on household durables and houses. The maintenance of buying plans is somewhat surprising in view of the sharp drop in the proportion of families reporting actual year-over-year increases in incomes, and the deterioration in their expectations for family money income over the next 12-month period.

The index of expected new car purchases in April was unchanged from the second quarter of 1968 and up about 2 percentage points from the January 1969 value (not seasonally adjusted). According to the

Census forecasting equation--which was recently revised--this level of the index implies household car purchases of domestic and foreign cars at an annual rate of 7.9 million equal to about 9.3 million for total sales, including business and government purchases, in the second and third quarters of this year. (The total sales rate in the first quarter was 9.3 million.) The index of plans to purchase used cars is down significantly from a year ago, although--as with the index for new cars--it is up from the first quarter figure.

The April index of expected expenditures for houses was almost unchanged from last year. However, there was a rather large decline in the likelihood that a specific household would buy a house, and the index of expenditures was sustained by a substantial increase in the average price expected to be paid for a house.

The index of expected expenditures for household durables was up from a year earlier and also from January. However, the number of major items reported likely to be purchased per household within 12 months was down slightly from a year ago and the increase in the index was mainly attributable to the larger average dollar expenditures anticipated.

The proportion of families reporting income increases in the last 12 months dropped to 35.9 per cent--the fourth successive quarterly decline from the 40.9 per cent peak reported in April 1968. The likelihood that a family was expecting an income increase in the next 12 months was also slightly lower--and the probability of an expected decrease slightly larger--than a year ago.

ACTUAL INCREASE IN FAMILY INCOME

	Per cent reporting higher family income now than one year ago	
	1968	1969
January	36.0	36.4
April	40.9	35.9
July	40.3	
October	38.0	

Personal income. Expansion of personal income slowed in April, as employment increases were small and growth in wages and salaries in most major industry groups was reduced.

CHANGES IN PERSONAL INCOME, 1969
(Billions of dollars, at seasonally adjusted annual rates)

	February	March	April
Personal income	5.1	6.5	2.8
Wages and salaries	3.9	5.3	1.7
Private wages and salaries	3.3	4.7	1.2
Manufacturing	-.1	2.8	.1
Nonmanufacturing	3.5	1.9	1.1
Government	.6	.6	.5

In coming months, pressure on wage and salary disbursements from pay increases seems likely to continue comparatively strong. More than 2 million unionized workers will receive deferred increases ranging from 4 to 5 per cent during this quarter and new contracts covering about 300,000 construction workers are likely to provide for large first-year increases. In addition, the Federal civilian and military pay increase scheduled for early July will add approximately $2.6 billion (annual rate) to wage and salary disbursements.

Productivity and labor costs. Output per manhour in the private nonfarm economy declined in the first quarter of 1969 for the first time since the mini-recession of 1967. In part, the first quarter drop reflected erratic movements in labor input. However, when the fourth and first quarter changes are averaged, the growth rate of output per manhour was still only half as large as during early 1968.

The entire weakening in productivity growth occurred in the nonmanufacturing sector, where employment rose at an accelerated rate while output growth slowed further. In manufacturing, output per manhour continued to increase as output (based on the Board's unrevised manufacturing production index) rose more rapidly than employment.

Productivity declines are not unusual when there is a slowing of growth in the economy because work force adjustments tend to lag changes in output. This is especially likely to be true in a tight labor market when employers are reluctant to lay off workers who may find alternative jobs and not be available for recall when demand increases again.

The growth rate of hourly compensation slowed somewhat in the first quarter from the accelerated rate of late 1968. However, the rate for the nonfarm economy was only a little lower than in 1968 as a whole--

6.4 per cent compared with more than 7 per cent--and with productivity down, the annual rate of increase of unit labor costs rose sharply in the first quarter. (Over the year, unit labor costs were up 4.5 per cent, compared with an average rise of 4 per cent during 1968.) The last time unit labor costs rose sharply was during the early 1967 adjustment. At that time, unit labor costs spurted up to an 8.7 per cent annual rate, then fell back in the next quarter as labor input flows were adjusted to desired output levels.

PRODUCTIVITY CHANGES IN THE PRIVATE NONFARM SECTOR
(Seasonally adjusted, annual rate)

	1966	1967		1968	1969
	IV	I	II	IV	I
Compensation per manhour	6.3	5.6	5.6	8.3	6.4
Output per manhour	3.8	-2.8	3.4	3.9	-1.2
Unit labor costs	2.2	8.7	1.8	4.7	7.3

Labor market. The labor market showed some indications of easing in April, with employers possibly reacting to the recent imbalance between employment growth and demand for output. In the fourth and first quarters, employment gains had accelerated strongly while total output growth eased somewhat. This was reflected in a decline of productivity in the private nonfarm economy in the first quarter of 1969, and may have been a factor in the slowing in hiring in April. Thus far, the easing has not caused layoffs and insured unemployment continued low through early May. The overall unemployment rate edged up to 3.5 per cent in April, with the rise occurring mainly among nonwhites, especially nonwhite women.

Employment. Nonfarm payroll employment rose by only 34,000 in April compared with 200,000 in March and an average monthly advance of 320,000 between September 1968 and February 1969. The April rise was the smallest since January 1968 and reflected the absence of significant growth in all sectors except finance and State and local government.

Manufacturing employment showed a negligible advance as small gains in machinery and electrical equipment were offset by declines in the nondurable-goods group. Since September, virtually all the growth in manufacturing has been in the capital goods industries, while employment and hours have held steady or eased slightly in most of the consumer goods industries. In the defense group, employment has edged down in aircraft manufacturing and the workweek has dropped sharply in ordnance.

INCREASES IN NONFARM PAYROLL EMPLOYMENT
(In thousands, seasonally adjusted)

	September to February monthly average	March	April
Total	320	197	34
Manufacturing	62	61	3
Durables	49	39	14
Nondurables	13	22	-11
Nonmanufacturing	258	136	31

April also brought the second consecutive monthly decline in construction employment (down 24,000 seasonally adjusted), due partly to strikes accompanying the annual round of spring wage bargaining.

Employment levels in services and trade were little changed over the month, but such slowdowns are frequently followed by sharp increases in subsequent months. Over the year, trade and service employment had risen by nearly 1.2 million and there is no reason to think that the strong demands for workers in these industries have suddenly abated.

Hours and earnings. Hours of work in private nonfarm industries were unchanged in April at 37.8 hours, but the average workweek of production workers in manufacturing declined one-tenth of an hour. More significantly, overtime in manufacturing was reduced by three-tenths of an hour, to 3.4 hours, with the bulk of the cutback in durable goods industries. This is the smallest amount of overtime in a year and, together with the lack of significant increase in manufacturing employment, suggests that manufacturers are adjusting labor input schedules to conform to the slower growth of demand.

Average hourly earnings in manufacturing rose one cent to $3.14 in April, a rise of 5.7 per cent over a year ago. The increase from March was at about the same rate as in the first quarter, but in both periods the increase was somewhat smaller than the large gains of late 1968. The slower growth of manufacturing hourly earnings in part reflects the limited number of contract reopenings this year.

Although earnings increases have eased appreciably in manufacturing, rapid advances continued in the nonmanufacturing industries, mainly because of large increases granted in wage decisions affecting unorganized workers, and large negotiated increases for longshoremen, airline mechanics, and construction workers.

AVERAGE HOURLY EARNINGS
(Per cent change from a year earlier)

	1968		1969	
	1st half	2nd half	1st quarter	April
Private nonfarm	6.1	6.9	6.8	6.8
Manufacturing	6.0	6.8	6.0	5.7
Mining	4.4	5.2	6.6	7.6
Construction	6.8	6.5	6.2	8.0
Trade	6.7	7.4	6.7	6.3

Labor force and unemployment. The civilian labor force declined slightly in April and there has been almost no net increase since February. However, because of the huge gains between September and February, the labor force was still averaging 1.9-2.0 million above the level of twelve months ago--about half a million more than "normally" anticipated from population and participation rate increases.

The unemployment rate edged up to 3.5 per cent in April, rising a tenth of a point for the second successive month. Jobless rates were higher in April than in February for both whites and nonwhites and for most age-sex groups. Although the slight rise in total unemployment was spread widely, the largest increase occurred among nonwhite adult women, whose rate rose from 5.3 per cent in February to 7.2 per cent in April. Many such women are in service occupations and the unemployment rate for service workers also rose sharply.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1968		1969	
	III	IV	I	April
Whites	3.2	3.0	3.0	3.1
Men	2.0	1.8	1.7	1.8
Women	3.4	3.2	3.3	3.3
Teenagers	11.2	10.7	10.5	11.3
Nonwhites	6.6	6.6	5.9	6.9
Men	3.8	3.9	3.4	3.7
Women	6.3	5.9	5.4	7.2
Teenagers	24.3	25.9	22.2	23.6

The rate for blue collar workers also drifted up over the February-April period, with the bulk of the rise among laborers last employed in construction and manufacturing. These rates are quite variable, with minor changes often reflecting differences in weather conditions, or jobseeking among young men in college or just leaving the Armed Forces.

The market continued very tight for most other groups. Unemployment rates for married men and white-collar workers continued below 2 per cent, while the index of help wanted advertising moved up to a new high in March (April data not available).

<u>Collective bargaining</u>. The cost of collective bargaining settlements during the first quarter of 1969 continued at about the same high level as in 1968. Approximately three quarters of a million workers in transportation, service activities, petroleum refining, and apparel were covered under the early 1969 settlements which provided median wage and benefit increases of 5.9 per cent annually during the life of the contract. In 1968, the median annual wage and benefit increase was 6 per cent.

First quarter negotiations continued to emphasize large first-year wage boosts and the median first-year wage adjustment was only slightly less than 6.9 per cent in 1968--compared with 7.2 per cent. First-year boosts averaged near 10 per cent in several nonmanufacturing settlements including the airline and longshoremen's contracts, and several construction settlements.

Over the next several months, collective bargaining will be dominated by negotiations in the construction industry, where springtime bargaining and strikes are common. As of mid-May, about 45,000 construction workers were out on strike and their number is likely to rise in the next few months. Overall, the upcoming settlements will cover approximately 300,000 workers in a number of large cities and large wage and benefit increases are likely.

A continuing strike of approximately 35,000 GM assembly workers at 7 regional planss has resulted in the layoff of nearly 35,000 parts workers, cutting production and dealer inventories in recent weeks.

At issue are local wage scales in merged assembly operations. Because of the high level of auto inventories, the strikehas not appreciably affected sales and settlements are apparently near. The liquidation of inventories now taking place seems likely to leave the industry in a somewhat more favorable inventory position at the end of the model year than had been expected prior to the strike.

Wholesale prices. The rise in wholesale prices of industrial commodities slowed to 0.1 per cent (1.1 per cent annual rate) from mid-March to mid-April, compared to a rate of 6 per cent or more in each of the months of the first quarter. However, increases in wholesale prices remained widespread last month, though not so numerous as in January and February, and only an abrupt reversal in the earlier upward push of lumber and plywood prices prevented a much larger increase in the industrial total. Excluding lumber and plyoood, average industrial prices increased at an annual rate of 3.5 per cent in April--a high rate but down from the 4.6 per cent rate between December and March.

Nonferrous metals continued the first quarter rate of rise of over 20 per cent annually between mid-March and mid-April, with boosts in the price of lead and in brass and aluminum products. Copper, molybdenum and zinc prices have since increased. The April industrial average also reflected important, if less dramatkc, increases in prices of machinery, pulp, and paper products, gasoline, and hides. More recently, hide prices have declined.

Lumber and plywood prices have dropped sharply since late February, when they reached an all-time high, with the bulk of the decline in late March and early April. The decline brought quotations in late April back to the January level for lumber and to the level of last August for plywood. Improved production of logs and resistance from buyers, many of whom were holding heavy inventories, were instrumental in bringing the price of plywood down, but recent indications are that the market has firmed. If plywood prices stabilize or again increase, the special FR sensitive materials index, which declined in April from an 18-year high in March, is likely to rise again in May.

CHANGES IN PRICES OF INDUSTRIAL COMMODITIES
(Federal Reserve Groupings)

	Per cent changes at annual rates			
	April to Aug. 1968	August to Dec. 1968	Dec. 1968 to Mar. 1969	March to Apr. 1969
Industrial commodities	0.5	3.3	6.2	1.1
Materials	- 0.3	3.6	8.5	0.1
Sensitive	- 3.4	9.8	20.3	- 9.4
Lumber and plywood	15.0	40.8	61.2	-77.9
Nonferrous metals	-21.3	4.4	20.7	23.0
Other	0.3	2.0	5.2	3.2
Steel mill products	0.8	3.0	9.5	2.0
Products	1.4	3.0	2.9	2.0
Consumer nonfoods	1.4	2.2	2.6	2.2
Producers' equipment	1.6	4.4	3.0	1.0
Addendum:				
Industrial commodities excluding lumber and plywood	0.03	2.4	4.6	3.5

Prices of livestock and meat advanced further in April, helping to push the index for farm products and foods up by 0.2 per cent. Wholesale prices of eggs, fresh vegetables, and poultry declined.

In 1969 thus far, meat supplies, especially pork and poultry, have exceeded the same period last year by a substantial margin. Rising livestock prices seem to reflect very heavy consumer demand for beef, and some geographical maldistribution of supplies. Since mid-April, livestock prices have risen sharply, as marketings have leveled off. However, beef supplies are expected to improve modestly in the second half of the year, and further substantial gains in marketings of hogs and poultry are anticipated.

Consumer prices. The consumer price index advanced 0.6 per cent in April. (Confidential until 11 a.m., May 22) Although almost all categories of goods and services rose, two items--food, and the costs of "insurance and finance" contributed almost half the total advance in the consumer index.

Meats, poultry, and fish were responsible for much of the 0.7 per cent rise in food prices in April. Despite prospects of relatively ample supplies, prices of meat, and particularly beef, have risen strongly this year. Moreover, the rise in wholesale meat prices of 5 per cent, seasonally adjusted, since January has outstripped the retail price climb of 2.8 per cent (also adjusted), indicating that further increases for the consumer price index are likely. However, a decline in retail prices of fresh fruits and vegetables which have already dropped at wholesale, should provide some offset to climbing food costs in May. In the second half of this year, larger year-over-year gains in marketings of livestock, mainly hogs and poultry, are expected, which should moderate the advance in meat prices.

Costs of apparel and household durables increased substantially in March. New car prices declined and used car prices, which had increased 13 per cent between January and March, rose little further. Recently, discounts on new cars have been reported to be increasing.

Service prices in April continued to rise at an annual rate of almost 10 per cent reaching a level 7 per cent above a year earlier. Costs of insurance and finance, which includes mortgage interest and property taxes and insurance, rose 4 per cent between January and April, but they are expected to rise more slowly in May in response to a slower rise in mortgage rates. Other service prices--medical care, utilities, home-maintenance, etc.--are showing little tendency to slow their advance, while the cost of recreational services went up exceptionally fast in April.

The consumer price index and the GNP deflator. As a result of the very large rise in March, the increase in the consumer price index accelerated in the first quarter. The rise in the implicit GNP deflator also showed some pick-up (from an annual rate of 4.1 per cent in the fourth to 4.3 per cent in the first quarter), but the implicit deflator for personal consumption expenditures (PCE) showed substantially less rise in the first than in the fourth quarter. The pick-up in the GNP deflator reflected sharp step-ups in the rate of increase in the cost of both residential and business construction from an average annual rate of only about 3 per cent in the fourth quarter.

The marked contrast between the behavior of the CPI and the deflator for personal consumption expenditures in the first quarter stems (as was also the case in the third quarter last year) in part from inclusion of sharply rising mortgage interest charges and property taxes and insurance in the service component of the CPI. These specific homeownership costs jumped particularly sharply in March and contributed to the marked acceleration in the rise in the CPI service component for the first quarter. In the GNP accounts, housing "services" of homeowners are measured by imputed rent, and they are deflated by the slow-moving CPI rent index. Quarterly increases in the CPI service index with and without "insurance and finance," about three-fifths of which represents mortgage interest and property taxes and insurance, are compared below with the implicit deflator for consumption expenditures on services:

PER CENT CHANGES IN PRICES OF SERVICES
(at annual rates)

	1968				1969
	I	II	III	IV	I
CPI service index	5.5	5.2	7.2	5.6	7.3
CPI service index, excluding insurance & finance 1/	5.4	5.1	3.8	4.7	5.5
GNP implicit deflator for services (PCE)	4.5	5.1	3.4	4.7	4.6

1/ The published index for "insurance and finance' includes the unpublished series on mortgage interest charges as well as property taxes and insurance. Together these housing costs account for about three-fifths of "insurance and finance", which in turn accounts for almost one-third of Services in the CPI.

Another factor in the first quarter divergence of the CPI and the GNP consumption deflator was a very sharp increase in the CPI used car price index, which has shown unusual ups and downs in recent months. These movements have only minimal influence on the GNP deflator for autos, since the GNP includes only the mark-up for used cars as representing the value of current production. After excluding used car prices and also taking account of seasonal changes--which are important for both durable and nondurable commodities in the fourth and first quarters--the CPI durable goods commodity index showed the same rate of increase in the first quarter as in the fourth (about 3 per cent, at an annual rate). With used cars included, the rise in the CPI durable goods commodity index jumped sharply in the first quarter, to an annual rate of over 5 per cent.

There remain unexplained differences between the movements of the CPI and the PCE deflator in the first quarter. These may reflect a combination of certain other differences in coverage and in seasonals and the basic weighting differences between the two measures. In the third quarter 1968, there was also a large difference between the two after rough allowance for the major coverage differences mentioned above, and a significant part of this difference could be attributed to the basic differences in weighting concepts. (<u>See March 1969 Survey of Current Business</u>.)

A summary look at the two measures for the fourth and first quarters is given below:

COMPARISON OF CPI AND IMPLICIT PCE DEFLATOR
(Per cent changes at annual rates)

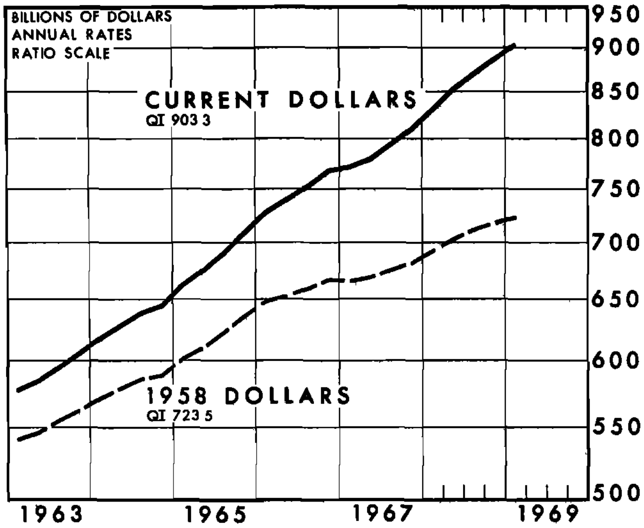
	PCE Deflator		CPI adjusted estimate 1/		CPI as reported	
	IV '68	I '69	IV '68	I '69	IV '68	I '69
Commodities and services	.4.7	3.6	4.6	4.5	4.6	4.9
Durable commodities	3.8	1.9	3.0	3.0	4.5	3.7
Nondurable commodities	4.4	3.0	5.0	4.0	4.0	3.0
Services	4.7	4.6	4.7	5.5	5.6	7.3

1/ Mortgage interest, property taxes and insurance and used cars excluded and PCE fourth quarter 1968 weights used. Both the CPI and PCE deflator are seasonally adjusted.

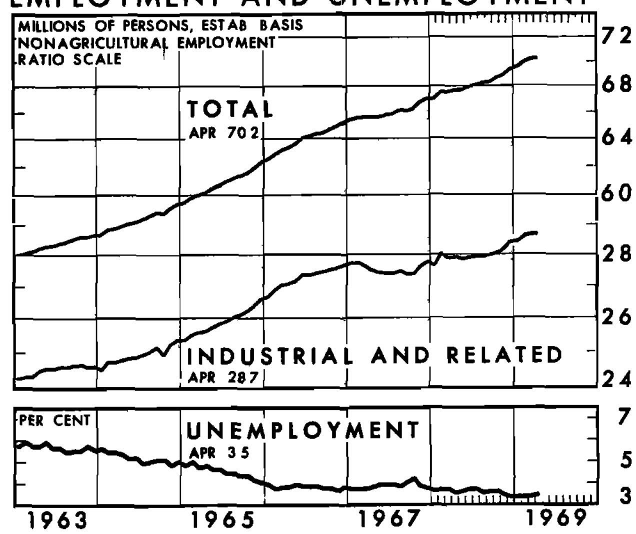
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

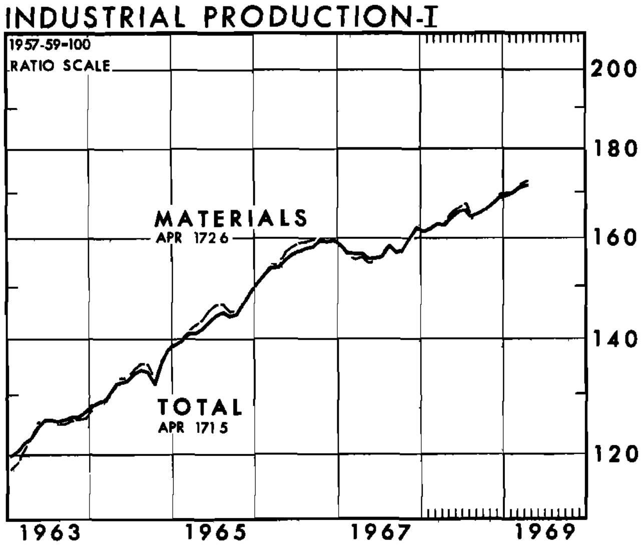
GROSS NATIONAL PRODUCT



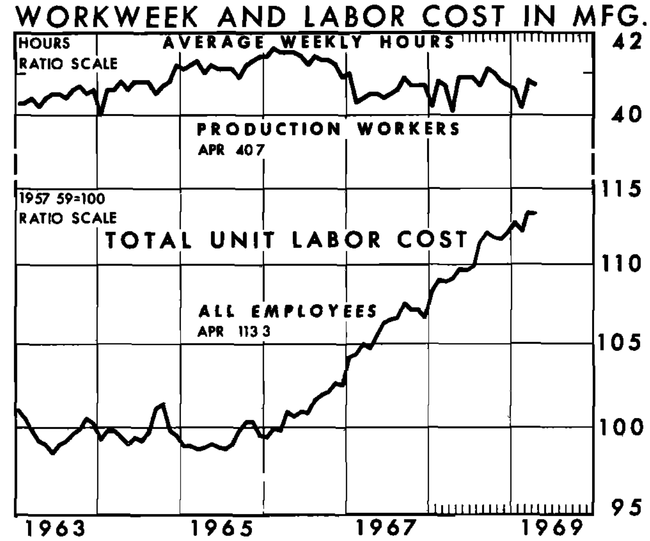
EMPLOYMENT AND UNEMPLOYMENT



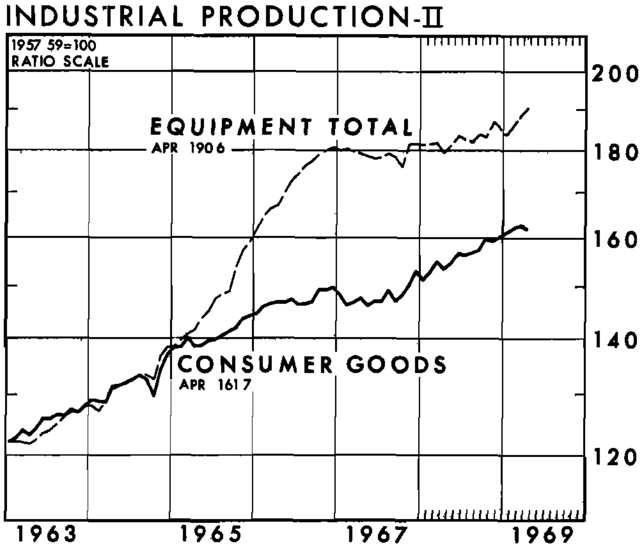
INDUSTRIAL PRODUCTION-I



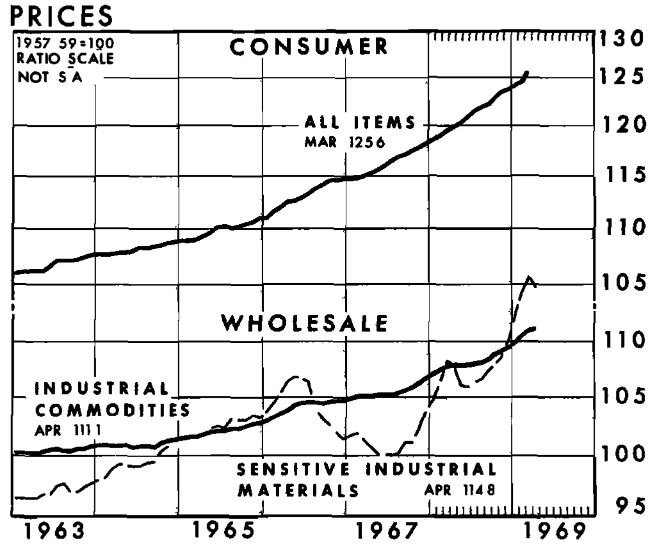
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



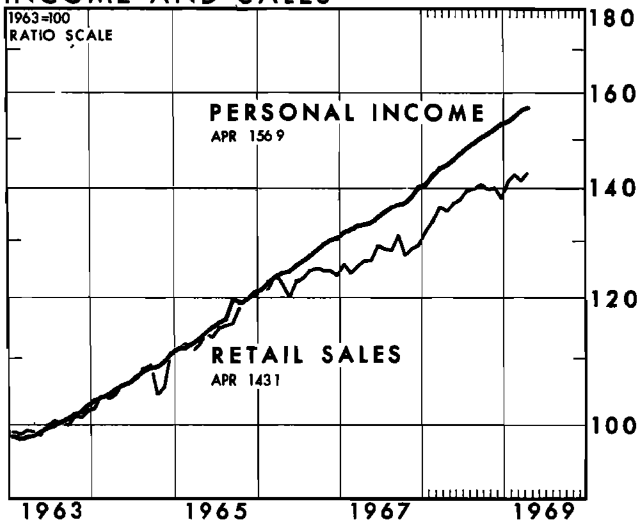
PRICES



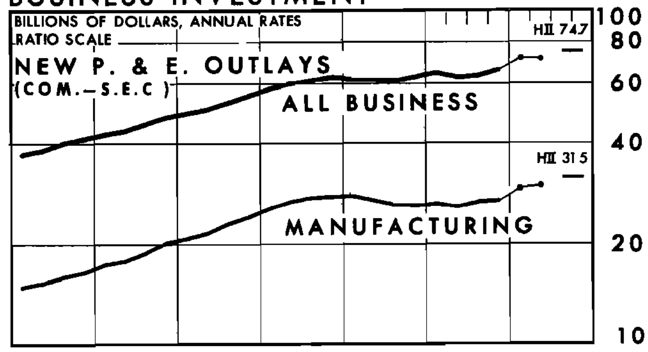
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

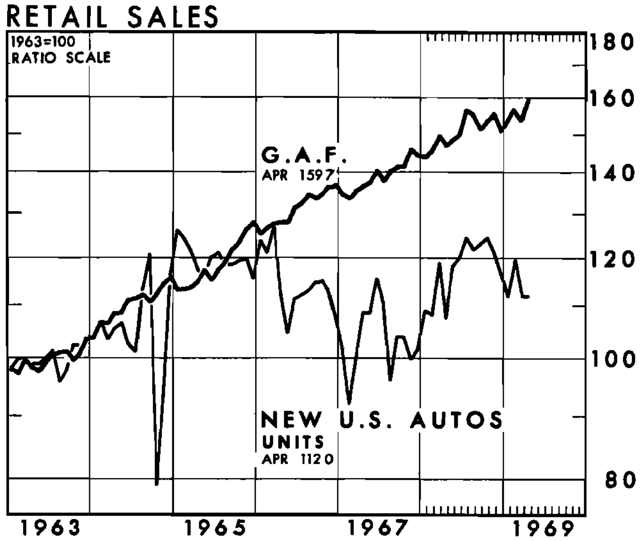
INCOME AND SALES



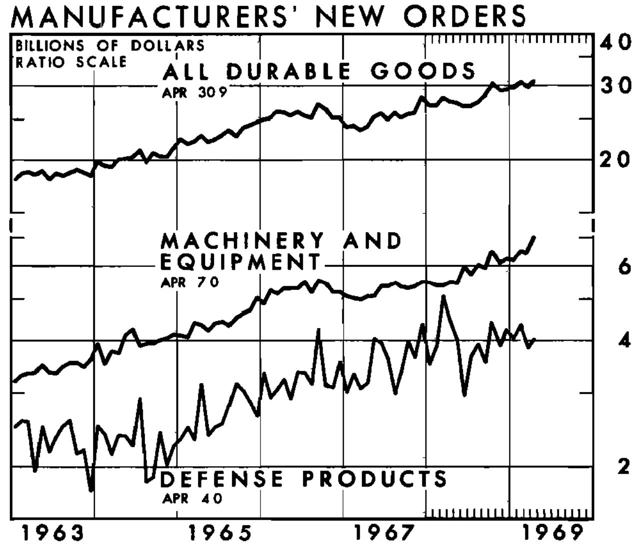
BUSINESS INVESTMENT



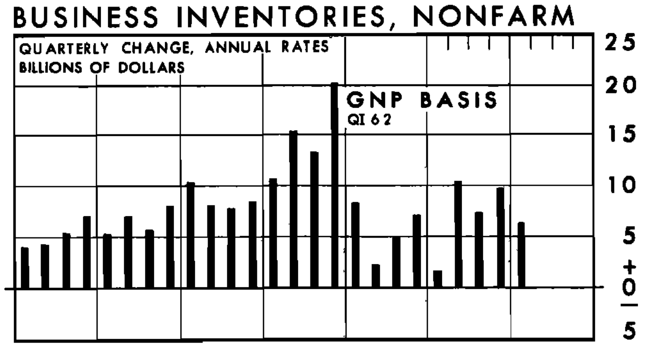
RETAIL SALES

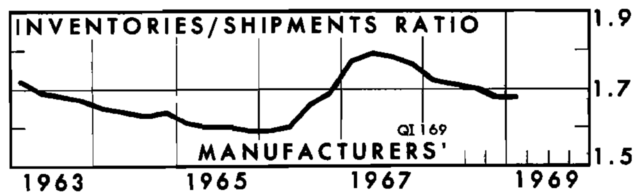


MANUFACTURERS' NEW ORDERS

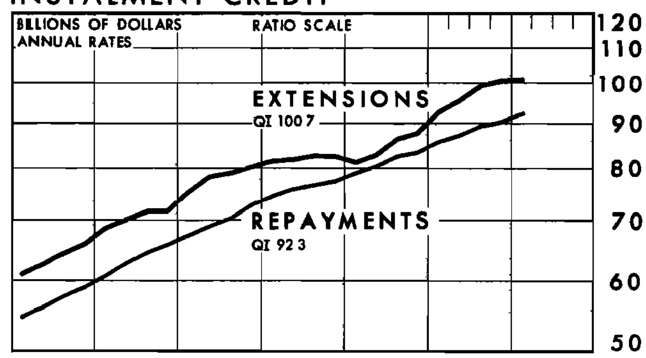


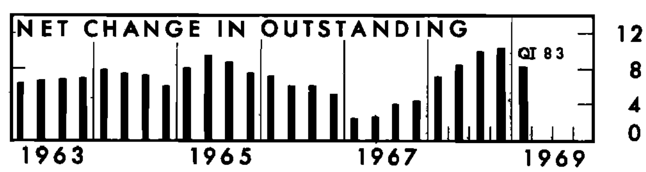
BUSINESS INVENTORIES, NONFARM





INSTALMENT CREDIT





DOMESTIC FINANCIAL SITUATION

Flow of Funds, First Quarter, 1969. Flow of funds tabulations for the first quarter show relatively modest changes in total borrowing and its composition in comparison with either the fourth quarter of 1968 or the year 1968 as a whole. On the supply side of credit markets, however, changes in sources of funds were major, reflecting mainly the cessation of demand deposit growth, the drain of CD balances from banks, and the conversion of foreign holdings of dollars from Government securities to Euro-dollar lending to U.S. banks. During the first quarter banks managed to supply a substantial part of the credit raised by private borrowers, but only through sizable runoffs in Government security holdings and security credit.

Total borrowing, at a seasonally adjusted annual rate of $91 billion (Table 1), was up $5 billion over the fourth quarter, the net effect of a $10 billion increase in Government borrowing and a $5 billion decrease in private funds raised. The drop in private credit flows appeared mainly in State and local government borrowing (line 9), which retreated somewhat from the very high rates in the second half of 1968, and in consumer credit (in line 6). Business demand for funds (line 12) continued at the high rates of the fourth quarter, but with

Table 1

SUMMARY OF BORROWING

(Net flows in billions of dollars, seasonally adjusted annual rates)

	1966	1967	1968	1968 IV	1969 I
1. By type of credit:	69.9	83.1	98.2	86.3	91.1
2. U.S. Gov't. Securities	6.3	12.7	15.7	-11.4	- .2
3. Other securities	17.9	28.8	24.9	30.7	30.7
4. Mortgages	20.6	20.9	25.7	27.5	27.0
5. Bank loans n.e.c.	9.6	8.9	12.0	21.6	14.4
6. Consumer credit and other loans	15.5	11.8	19.9	17.9	19.6
7. By sector borrowing:	69.9	83.1	98.2	86.3	91.1
8. U.S. Gov't.	6.3	12.7	15.7	-11.4	- .2
9. State & local gov't.	6.8	10.5	11.4	14.9	13.0
10. Foreign	1.5	4.0	2.9	3.1	1.8
11. Households	21.6	18.7	31.9	33.3	29.2
12. Business	33.6	37.2	36.3	46.4	47.4

sizable shifts away from direct bank loans and toward commercial paper issues, which increased by a record amount in the first quarter (in line 6). Corporate security issues also increased somewhat in the first quarter but were offset by the decline in municipal offerings (in line 3). All forms of mortgage borrowing (line 4) continued fairly stable in the first quarter at about their fourth-quarter rates.

The structure of credit supply, in Table 2, combined two contrasting developments in the first quarter. The first is the shift of direct lending entirely away from banks (in line 2) and away from foreign lenders (line 7), whose supply was dominated by conversions of dollar holdings into deposits at foreign branches of U.S. banks. This shift is reflected in the unprecedented estimate of $60 billion for direct purchases of securities by private domestic nonfinancial investors (line 8), an amount that is more than twice as high as in the earlier peak quarters in 1966. At the same time, however, and in contrast to bank developments, savings institutions and other nonbank finance (lines 3 and 4) maintained their net lending rates at just about the fourth-quarter levels, on the basis of continuing stable supply of deposit funds to them.

Table 2

FUNDS ADVANCED DIRECTLY

(Net flows in billions of dollars, seasonally adjusted annual rates)

	1966	1967	1968	1968 IV	1969 I
1. Direct investment in credit markets	69.9	83.1	98.2	86.3	91.1
By--					
2. Commercial banks	17.3	36.2	38.6	44.2	- 4.4
3. Savings institutions	8.0	16.9	14.5	15.2	15.5
4. Other financial inst.	14.5	15.5	15.1	16.1	15.2
5. Federal Reserve	3.5	4.8	3.7	- 3.2	.1
6. Federal Gov't.	7.9	4.5	8.1	5.1	8.6a/
7. Foreign	- 1.4	3.2	2.1	7.0	-3.5
8. Pvt. domestic nonfinancial (Households, business, and State and local gov'ts.)	20.1	2.0	16.1	2.0	59.7

a/ I/69 increase is mainly in FHLB lending to savings and loan associations.

The rise in private direct lending from a $2 billion rate in the fourth quarter to a $60 billion rate in the first quarter appears in Table 3 in relation to the corresponding private deposit flows, which decrease more than enough from the fourth quarter to the first quarter to finance those security purchases. The shift in time deposit flows (line 3) from fairly rapid growth into December of last year to runoff this year accounts for over half of the funds required, and the cessation of demand deposit growth provided the rest. Throughout the period onflows to savings institutions (line 4) remained stable, providing the base for savings institution lending in Table 2.

Table 3

PRIVATE DOMESTIC NONFINANCIAL INVESTORS

(Net flows in billions of dollars, seasonally adjusted annual rates)

	1966	1967	1968	1968 IV	1969 I	Change IV/68 to I/69
1. Total deposits and credit market instruments	42.8	53.0	61.4	69.6	54.4	-15.2
2. Money	2.9	12.0	12.6	28.4	-12.9 a/	-41.3
3. Time deposits at commercial banks	12.5	22.4	20.0	25.4	- 6.4	-31.8
4. Deposits at savings institutions	7.3	16.6	12.7	13.8	13.9	.1
5. Credit market instruments, directly	20.1	2.0	16.1	2.0	59.7	57.7
6. U.S. Gov't. securities	8.0	-3.0	7.7	- .9	28.1	29.0
7. Other securities b/	7.8	4.2	3.2	- .2	20.5	20.7
8. Other credit c/	4.1	3.0	6.6	5.9	8.5	2.6
9. Less: net security debt	- .2	2.2	1.4	2.8	-2.6	- 5.4

a/ IV/68 and I/69 figures for money reflect a sharp peaking at December 31.
b/ Corporate, municipal, and foreign bonds.
c/ Commercial paper, consumer credit, and mortgages.

Of the $60 billion estimate for private direct lending (line 5), about half was purchases of Governments (line 6) that offset bank and foreign sales in the Government securities market. Another $20 billion appears to have gone into municipal and corporate bonds, partly from State and local retirement funds but with the major increase appearing in household (and personal trust) buying. Individuals appear to have supplied virtually all of the funds raised in the municipal market during the first quarter, and in this respect the period was similar to the second half of 1966 and in contrast to periods of easier monetary conditions, when banks frequently buy two-thirds to four-fifths of the net amounts issued. In the 1966 period, however, the volume of net municipal issues--and household purchases--were at about a $5 billion annual rate, whereas during the first quarter of this year they were close to a $13 billion rate.

Of the total credit raised in the first quarter, banks of course supplied approximately zero, as against 51 per cent in the fourth quarter. The largest part of the drop in bank credit flow was in Government securities, municipals, and security credit, however, and bank lending to private borrowers fell off only moderately. This can be seen in Table 4, which compares total private borrowing and the bank component, omitting State and local borrowing and security credit from both totals (lines 1 and 2). The first-quarter bank share (line 4) was down from the fourth quarter, but it was only slightly below the year averages for 1967 and 1968 and was a little above 1966.

Table 4.

PRIVATE BANK CREDIT

(Net flows in billions of dollars, seasonally adjusted annual rates)

	1965	1966	1967	1968	1968 IV	1969 I
1. Net funds raised by households, nonfinancial business, and foreign	60.8	56.7	59.9	71.1	82.8	78.3
2. Bank loans except security credit a/	26.2	18.0	17.0	26.2	38.7	27.0
3. Other sources of private credit (1-2)	34.6	36.7	42.9	45.0	44.1	51.3
4. Bank loans as per cent of private credit (2-1)	43%	32%	38%	37%	47%	34%

a/ Includes mortgages and corporate bonds.

The fourth-to-first quarter pattern in Table 4 was fairly similar, although in a shorter time period, to the movements from 1965 to 1966. In both cases there was a decrease in private credit from banks together with an increase of smaller amount in private borrowing outside banks, with the two combining to produce a moderate drop in total private borrowing. The bank actions required this year to maintain their private credit flow were, however, far more extreme than in any of the quarter of 1966, with Government security liquidations and Euro-dollar borrowing both over twice as large as in any quarter of 1966. The effect can be seen in the figures below, where the ratio of bank loans to total bank credit increased 1-1/2 percentage points over the quarter (still omitting security credit), as compared with 1-percentage point increases in each of the first two quarters of 1966.

Table 5

BANK LOANS, EXCEPT SECURITY CREDIT, AS PER CENT OF TOTAL BANK CREDIT

(Seasonally adjusted outstandings at end of quarter)

1965 - IV	62.1 a/	1968 - IV	62.5
1966 - I	63.0 a/	1969 - I	64.0
II	64.2		
III	64.3		
IV	64.4		

a/ Converted to current definitions.

Sources and uses of corporate funds. The gap between capital expenditures and internal funds of nonfinancial corporations widened substantially in late 1968 and early 1969, as outlays for physical assets rose sharply while the flow of internal funds declined. In part to fill this widening gap, nonfinancial corporations greatly increased the volume of funds raised in credit and capital markets. Such external financing was also large enough to permit a substantial addition to holdings of liquid assets.

By the first quarter of 1969, capital expenditures of non-financial corporations exceeded internal funds by a record $24.3 billion, compared with $20.1 billion in the preceding quarter and around $15 billion earlier in 1968. Financing in credit and equity markets, which had increased from a seasonally adjusted annual rate of $23 billion in the first 9 months of 1968 to $36 billion in the fourth quarter, rose further to nearly $39 billion. Accumulation of liquid assets, however, was smaller than in 1968 as a whole, though well above the levels of any other recent year.

Staff projections of the national income and product accounts in the second and third quarters of 1969 imply little change from first quarter levels in either internal funds or capital expenditures. Thus the spread between the principal use and the major source of corporate funds is expected to remain at about the record rate reached in the first quarter. A projected pattern of other uses and sources of corporate funds in the second and third quarters, associated with these GNP projections, is presented in the table on the next page. Major features of this pattern are the continued heavy volume of corporate financing in credit and capital markets, at a level not much below the first quarter, and a marked drop-off in accumulation of liquid assets (net of the change in tax liabilities).

The critical element in the course of corporate financing over the next few months seems likely to be the influence of expectations about prospective credit conditions on attitudes of corporations about their liquidity positions. It is especially difficult, given the current uncertainty among market participants as to the near-term course of interest rates, to anticipate the nature of expectational factors in the third quarter. The financing pattern projected in the table arbitrarily assumes an expectation that borrowing conditions will ease reasonably soon <u>after</u> the third quarter. This assumption has two major implications for liquid asset management and hence for corporate external financing.

FLOWS OF FUNDS NONFINANCIAL CORPORATE BUSINESS
(Billions of dollars; seasonally adjusted annual rates)

	1968		1969		
	III	IV	Ip	IIe	IIIe
Sources					
Internal funds (current surplus)	66.1	65.9	64.4	65.3	65.7
Undistrib. profits + IVA	20.2	19.1	16.7	16.7	16.3
Capital consumption	46.0	46.8	47.7	48.6	49.4
Credit & equity market instruments	25.4	35.9	38.6	35.5	36.0
Net new security issues	10.2	14.0	17.0	17.5	19.5
Other borrowing	15.1	22.0	21.6	18.0	16.5
Change in profit tax liability	-1.7	.9	3.0	-8.0	1.4
Uses					
Capital expenditures	80.7	86.0	88.7	89.5	90.6
Fixed investment	74.0	77.9	83.0	83.5	84.2
Change in inventories	6.6	8.1	5.8	6.0	6.4
Net trade credit	7.6	6.6	9.0	8.0	7.0
Misc. uses, net	-3.8	-2.5	.8	1.5	1.5
Change in liquid assets	4.1	12.4	6.3	-7.2	3.0
Discrepancy	1.2	.3	1.1	1.0	1.0
Memo:					
Cap. exp. less internal funds ("gap")	14.6	20.1	24.3	24.2	24.9
Liquid assets less change in tax liab.	5.8	11.5	3.3	.8	1.6

Note: Figures shown above reflect the use of new seasonal factors, primarily to take account of the current pattern of Federal income tax payments.

First, it implies that, in the second and third quarters, corporations will not borrow significant amounts in advance of current needs, and will add little to their holdings of liquid assets. The erosion in liquidity which would result would probably not be acceptable to corporations except temporarily.

Second, it implies that corporate efforts to husband liquid assets and to restrain bank borrowing will result in a shift toward non-cash methods of financing mergers and acquisitions. Most mergers and acquisitions, of course, are accomplished through exchange of stock (which has no effect on financial flows for the corporate sector as a whole), and some have involved exchanging the bonds or convertible debentures of the acquiring company for the stock of the acquired company,(which increases the volume of net bond issues and decreases the volume of net stock issues by the same amount).

But through most of 1968, and in early 1969 as well, a number of large acquisitions involved payments in cash to the stockholders of the acquired company. In the fourth quarter of last year, cash retirements of this type were at an annual rate of more than $7 billion. This method of financing mergers and acquisitions absorbs cash assets, and reduces the reported volume of net stock issues with no net borrowing offset except to the moderate extent that funds used to retire stock are obtained from banks. The projections shown in the table assume that use of this method will be declining in the second and third quarters, but not to pre-1968 proportions.

A different assumption about expectations would greatly affect the projected levels of corporate financing. For example, once corporations become so confident of imminent easing of credit conditions that they are relatively unconcerned about a temporary substantial erosion in liquidity, cash retirements of the stock of acquired companies could become very large again and this, together with temporary additional postponements of new borrowing, could--if it occurred early in the third quarter--result in a significantly lower volume of financing in credit and capital markets in that quarter than is shown in the table (and a decline, rather than modest increase, in holdings of liquid assets). On the other hand, expectations that any substantial easing in credit market conditions would be deferred indefinitely could activate concern about liquidity positions, with the result that cash retirements of stock might dwindle to almost nothing, postponement of new borrowing appear fruitless, and the net volume of external financing thus be considerably larger than projected in the table.

Bank credit. Total loans and investments at all commercial banks rose by over $3 billion in April, following relatively little growth over the first quarter. The April increase was concentrated at weekly reporting banks and reflected bank participation in the most recent Treasury bill strip, as well as rapid loan expansion associated in part with financing of April tax payments. This credit expansion was associated largely with increases in U.S. Government deposits at banks, which rose by more than $3 billion from the end of March through the end of April.

NET CHANGE IN BANK CREDIT

All Commercial Banks
(Seasonally adjusted annual rates, in per cent)

	1968	1969		
	4th Qtr.	1st Qtr.	April	1st 4 Months
Total loans & investments 1/	10.7	2.3	9.6	4.1
U.S. Gov't. securities	-15.6	-26.7	4.2	-19.0
Other securities	26.9	2.2	-3.3	0.8
Total loans	13.1	9.4	14.4	10.7
Business loans	15.2	16.3	16.8	16.6
All other loans	11.9	5.1	12.9	7.1
MEMO:				
Credit proxy 2/	11.7	-2.4	6.0	-0.3

1/ Last Wednesday of the month series.
2/ Monthly average of daily figures, adjusted to include Euro-dollar borrowing.

Bank holdings of U.S. Government securities rose slightly in April, in contrast to large declines at both weekly reporting and nonweekly reporting banks during the first quarter. The April increase resulted in large part from an increase in bill holdings early in the month at weekly reporting banks, as they underwrote nearly all of the $1.8 billion Treasury bill strip with full tax and loan credit. These banks, however, ran off substantial amounts of bills in subsequent weeks, and by the first week in May, their holdings of U.S. Government securities were below those in late March just prior to the financing. Nonweekly reporting banks made sizable further reductions in their holdings of U.S. Government securities during April.

NET CHANGE IN BANK CREDIT

(Billions of dollars, not seasonally adjusted)

	1st Quarter			April		
	1967	1968	1969	1967	1968	1969
Weekly Reporting Banks						
Total loans and investments	1.5	-3.6	-9.0	0.6	1.4	4.3
U.S. Gov't. securities	1.6	-1.7	-4.5	-1.5	-0.9	--
Other securities	2.9	1.2	-0.9	1.4	0.3	0.3
Loans	-2.9	-3.1	-3.5	0.7	2.0	4.0
Other Banks						
Total loans and investments	0.7	0.6	1.2	1.8	1.8	0.8
U.S. Gov't. securities	--	0.4	-1.4	-0.1	-0.5	-0.6
Other securities	0.3	0.4	0.8	0.6	0.4	0.3
Loans	0.2	-0.2	1.8	1.4	1.8	1.1

Bank holdings of other securities fell somewhat in April after having risen only slightly over the first quarter. The seasonally adjusted decline reflected less than usual increases in holdings of these securities at both weekly reporting and nonweekly reporting banks--which for the smaller banks, was in sharp contrast to the sizable amounts of other securities that they took into portfolio over the first quarter.

Total loans expanded relatively more rapidly in April than in the first quarter, but much less of this increase was at nonweekly reporting banks than was the case during the first quarter. Nearly one-half of the April rise was in loans to businesses, which continued to increase at about the same rapid 16 per cent annual rate of the previous six months. Growth in real estate loans, which maintained the advanced rate of recent months, contributed significantly to the April increase. Loans to finance companies also rose substantially and may have reflected some diversion of borrowing from the commercial paper market to banks, as indicated below. Security loans rose only slightly--in contrast to large declines over the first quarter--presumably in response to the increase in dealer inventories of securities in April. Consumer loans, however, continued to expand at the reduced pace prevailing since year-end.

The continued strength in business loan demand probably reflects in part financing of inventory accumulation, although a large part of the April increase represented borrowing to meet mid-month tax payments. At weekly reporting banks, the increase in business loans in April and early May was sizable at both New York and outside banks, in contrast to increases over the previous 6 months which were mainly at banks outside New York City. The recent increase was also fairly widespread among industry categories, but loans to a few industries such as services, construction, and public utilities--which were large during the first quarter--did not account for much of the recent rise. In the week ending May 14, there was an unusually large rise in business loans at banks in New York City and a large decline at banks in Chicago. The New York rise included a broad spectrum of industries, and is reported to have included some borrowing diverted from the commercial paper market in view of the recently reduced spread between rates in that market and the prime rate. The drop in Chicago reflects in part the sales of $250 million of domestic loans, of which 85 per cent was in business loans, to London branches during the March crisis; these transactions presumably will be reversed in the coming weeks.

Bank deposits. Time and savings deposits at all commercial banks declined slightly further in April, reflecting sizable deposit losses at larger banks and less than usual inflows at smaller banks. The decline at weekly reporting banks represented not only continued CD attrition, but also substantial outflows of consumer-type time and savings deposits.

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

	1st Quarter 1/			April and 1st Week in May 2/		
	1967	1968	1969	1967	1968	1969
Total time & savings deps.	6,494	2,142	-3,695	656	-805	-1,571
Consumer-type deposits	2,719	1,825	855	490	-350	- 672
Savings deposits	- 115	339	- 494	-32	-696	- 946
Time deposits, IPC (Other than CD's, IPC)	2,834	1,486	1,394	522	346	274
Negotiable CD's	3,657	224	-4,028	-695	-806	-1,297
All other time deps. 3/	118	93	- 522	861	351	398
MEMO:						
Euro-dollar borrowings 4/	- 624	679	2,933	-622	315	275

1/ Last Wednesday in December to last Wednesday in March.
2/ Ending on May 7, 1969.
3/ Consists primarily of time deposits held by State and local governments and by foreign institutions.
4/ Liabilities of major U.S. banks to their foreign branches, Wednesday figures. These banks decreased their Euro-dollar borrowings by $390 million in the week ending May 14.

Outstanding CD's at large banks fell by nearly $1.3 billion in April and in the first week of May, with New York and Chicago banks losing another $75 million in the following week. These declines brought total CD attrition from December 11 to more than $6.8 billion, or almost 30 per cent of outstandings on that date. The CD run-off for the month of May should moderate, however, reflecting in large part the substantially reduced volume of maturing certificates. Banks with foreign branches increased their Euro-dollar borrowings only moderately from the end of March through the first week in May. And in the following week head office liabilities to foreign branches dropped by $390 million, probably reflecting the reduced availability of Euro-dollar funds associated with the recent foreign exchange crisis and the loan sales referred to above.

Consumer-type time and savings deposits at large banks fell sharply in April and early May, reflecting large withdrawals of savings deposits and less than usual inflows of time certificates and open accounts. The declines in savings deposits were particularly large just prior to and during thd mid-month tax period, but they moderated substantially in subsequent weeks. Similarly, country banks experienced sizable outflows of savings deposits around mid-April but small inflows had resumed by early May. Inflows of other time deposits at country banks, however, were maintained at about the pace of recent years.

The money stock--measured on a daily average basis--rose sharply in April at more than an 11 per cent annual rate, compared to expansion at less than a 2 per cent annual rate over the first quarter. The April increase reflected in part a large one-week increase in private demand deposits around the Easter holiday. A bulge in private cash balances just prior to the mid-April tax payment date also contributed importantly to the average increase for the month.

Nonbank depositary intermediaries. Reflecting mainly tax payments, outflows from the thrift institutions during April were substantially larger than a year earlier. Outflows tended to be concentrated at West Coast S&Ls and New York State savings banks. Masaachusetts savings banks, which either are not regulated as to rate or which were recently permitted by FDIC to meet local competition in setting rates, accounted for all of the $46 million inflow recorded outside of New York State. Indications for early May suggest some inflows--albeit smaller than the modest 1968 gains--to intermediaries in both of the sensitive areas of New York and California. In New York however, a sharp increase in passbook loans foreshadows future outflows.

SAVINGS FLOWS
($ millions, not seasonally adjusted)

	Mutual Savings Banks			Savings and Loan Associations		
	All	New York State	All Except New York	All	San Francisco District	All except San Francisco
April - 1966	-341	-301	-40	-760	-528	-232
1967	189	92	97	502	126	376
1968	- 75	- 92	17	-294	-292	- 2
1969p/	-200	-246	46	-476	-350	-126

p/ Preliminary.

The March-April seasonally adjusted savings growth average rate of 5 per cent, which is probably more indicative of underlying trends than either month alone, suggests a gain equivalent only to the rate of interest/dividends credited, or virtually no net new money. Responses to the Mortgage Market Survey suggests that the intermediaries expect second quarter savings flows roughly similar to the first quarter rate.1/

SAVINGS GROWTH: NONBANK DEPOSITARY INTERMEDIARIES2/
(Seasonally adjusted annual rates in per cent)

	MSBs	S&Ls	BOTH
1968 - I	7.1	5.6	6.1
II	6.7	5.7	6.0
III	6.5	5.9	6.1
IV	7.1	6.2	6.5
1969 - I	6.2	6.1	6.1
January	4.1	4.8	4.6
February	7.2	5.3	5.9
March	7.1	8.0	7.7
April	2.9	2.1	2.3
Memo: March - April			
1968	6.6	5.9	6.1
1969	5.0	5.1	5.0

2/ Because of seasonal adjustment difficulties, quarterly or bi-monthly rates are more meaningful than monthly.

S&L advances from the FHL Banks during April increased by about $400 million, or somewhat more than seasonally, with West Coast associations, as is typical, accounting for more than half of the total net increase.

1/ More detailed results of this Survey are presented in the special supplement distributed with the Greenbook.

The volume of borrowing was about one-third greater than a year ago, but was about half the amount in April 1966. Liquidity ratios declined somewhat as a result of larger-than-seasonal liquidations of cash and Governments.

The FHLB Board has maintained its position of leniency regarding advances to support mortgage lending. New money raised by the System in its recent financing will bring funds available for advances to more than $1.5 billion. In another action, the FHLB Board has eased slightly a technicality relating to S&L's required allocations to reserves; FHLB staff expects the real impact of this change to be negligible.

Mortgage market. The recently concluded FRB-FHLB survey of home mortgage market conditions, contained in the special supplement distributed with the Greenbook, confirms that pressures arising from the reduced pattern of savings inflows at the major thrift institutions have led to a modest tightening in the residential mortgage market during the past three months. As a result, mortgage interest rates have been forced higher and the availability of credit, for conventional loans in particular, has become somewhat more limited. In addition, the survey also suggests a further shift away from single-family mortgage loans toward apartment-house mortgages.

Yields in the secondary market for Government-underwritten mortgages declined during the most recent FNMA auctions of forward purchase commitments. Reflecting a higher volume of offerings, the decline--25 basis points since mid-April--was somewhat less than in the corporate bond market.

FNMA WEEKLY AUCTION
(Dollar Amounts in Millions)

	Amount of total Offers		Implicit private market yield 6-month commitments
	Received	Accepted	(per cent)
Highs			
1968	$232 (6/3)	$ 89 (7/1)	7.71 (6/10)
1969	320 (2/3)	102 (4/7)	8.17 (3/3)
April 14	145	101	8.10
21	128	101	8.05
28	158	84	7.94
May 5	171	84	7.90
12	210	85	7.89
17	236	83	7.88

NOTE: Average secondary market yield after allowance for commitment fee and required purchase and holding of FNMA stock, assuming prepayment period of 15 years for 30-year Government-underwritten mortgages. Yields shown are gross, before deduction of 50 basis point fee paid by investors to servicers. The first auction date was May 6, 1968.

Despite the recent decline in FNMA secondary market yields, home mortgage rates continued to rise in April, according to FHA data. In the primary market--by far the largest sector of the home mortgage market--the average contract rate for conventional first mortgages rose slightly more in April than in either of the two previous months.

Regionally, the largest increases occurred in the Northeast and the West where thrift institutions were particularly hard hit by an outflow of funds during April. In the secondary market for Government-underwritten loans, however, there was little further increase in the average yield (1 basis point) following a 3-month period of upward adjustment to the January increase in the FHA and VA ceiling rate. The yield spread favoring Government-underwritten mortgage over new issues of high-grade corporate bonds widened in April, though it remained rather unattractive by pre-1966 standards.

Mortgage lending, particularly on conventional home loans, has continued to be influenced by comparatively low usury ceilings in more than half the States. Among other effects, these ceilings have tended to inhibit inflows of out-of-state investment funds, foster the outflow of local capital, extend loan closing dates, and encourage a switch from single-family to multi-family mortgage investments. Since the end of March, usury ceilings have been adjusted upward in Arizona (10%, effective July 1), Georgia (9%), Iowa (9%), and Vermont (7-1/2%)--states which accounted for about 6 per cent of all residential building permits issued in 1968. Bills to raise usury ceilings are now pending before legislatures in a number of other States, including Michigan and Illinois.

In addition to usury ceiling problems, there is some uncertainty in the market arising from the impending Truth-in-Lending regulations, which becomes effective July 1. A number of mortgage lenders remain unclear about the mechanics of the law, while others are uncertain as to the effect of compliance on their origination costs or on the marketability of their loans.

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)
1968					
April	6.90	40	6.94	44	7.9
May	7.15	51	7.50e/	86e/	6.1e/
June	7.25	60	7.52	87	6.3
July	7.30	79	7.42	91	5.5
August	7.30	115	7.35	120	5.0
September	7.30	103	7.28	101	4.4
October	7.25	78	7.29	82	4.5
November	7.30	69	7.36	75	5.1
December	7.40	61	7.50	71	6.2
1969					
January	7.55	63	7.85e	93e/	2.8e/
February	7.60	69r/	7.99	108r/	3.9
March	7.65	30r/	8.05	70r/	4.4
April	7.75	55	8.06	86	4.5

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 1968. Data for May 1968 estimated by Federal Reserve based on 6-3/4 per cent regulatory interest rate in effect through December 1968. Data for January 1969 estimated by Federal Reserve for 7-1/2 per cent regulatory interest rate, on which a change of 1.0 points in discount is associated with a change of 12 to 14 basis points in yield. Gross yield spread is average mortgage return, before deducting service fees, minus average yield on new issues of high grade corporate bonds with 5-year call protection.

e/ Estimated.

r/ Revised.

<u>Policy loans at life insurance companies</u>. The net increase in policy loans extended by life insurance companies during April was substantially larger than the usual tax-related March-to-April pattern, and represented the largest volume for any month in the series except September, 1966. Similarly, the $200 million volume of gross loans made (not shown in the table) was exceeded only in September, 1966. In context, $200 million is equivalent to about half the amount of recent monthly gross acquisitions of mortgages or private placements for a sample of life insurance companies representing a similar share of the industry.

NET CHANGE IN POLICY LOANS
15 LIFE INSURANCE COMPANIES 1/
($ millions)

	January	February	March	April
1965	20	25	35	37
1966	36	33	57	69
1967	70	56	64	60
1968	57	57	67	73
1969	81	82	106	139

1/ These companies account for about two-thirds of industry policy loans.

The large increase in activity was reported to be uniform among companies, unlike 1966 when certain mutual companies were especially affected. Although some further policy loan increases had been anticipated, continuation of the current--generally unexpectedly large--volume of activity could represent a serious drain on the industry. Several companies reported that they were revising their cash flow projections in light of the April--and early May--drains, and would strive to remain less than fully committed.

Corporate profits in manufacturing. Overall corporate profits before taxes are currently estimated at a seasonally adjusted annual rate of $96.0 billion in the first quarter. Preliminary data for the manufacturing sector--the most volatile and by far the largest component of the total--are consistent with the present over-all estimate. They indicate that, despite a narrowing in the year-to-year increase in profits and sales, seasonally adjusted profit margins of manufacturing corporations inched up in the first quarter. (For the FTC-SEC series used here, neither sales nor profits are available on a seasonally adjusted basis.)

While a "profit squeeze" throughout 1969 has been widely predicted by the business and financial community, increases in unit prices apparently offset any tendency in this direction in the first quarter, despite slower growth in total sales volume. In fact, preliminary data indicate a seasonally adjusted profit margin for manufacturing corporations as a whole which was slightly above its level in each of the last three quarters of 1968 and higher than at any time since late 1966.

Profits before taxes of all manufacturing corporations are estimated to have been 11 per cent larger in the first quarter of this year than they were a year earlier. The year-to-year increase had amounted to 16 per cent in the fourth quarter of 1968 and 20 per cent in the third quarter. Sales volume rose only 8 per cent on a year to-year basis, however, compared with increases of 11 and 10 per cent in the two preceding quarters, and the unadjusted ratio of profits to sales was 8.7 per cent compared with 8.4 per cent a year earlier.

SALES AND PROFITS OF MANUFACTURING CORPORATIONS
(Billions of dollars)

	Sales (Not seasonally adjusted)	Profits Before Taxes (Not seasonally adjusted)	Ratio of Profits Before Taxes to Sales (Seasonally adjusted) (per cent)
1967 - I	$137.0	$11.4	8.5
II	145.1	12.6	8.2
III	141.5	11.0	8.1
IV	151.8	12.8	8.4
1968 - I	148.9	12.5	8.6
II	158.9	14.8	8.8
III	155.7	13.2	8.8
IV	168.4	14.9	8.8
1969 - Ip/	160.5	13.9	8.9

Note: Based on FTC-SEC Quarterly Financial Report for Manufacturing Corporations.

p/ Preliminary.

Corporate and municipal bond markets. Corporate bond yields in the first half of May have fluctuated around the lower levels reached in mid-April, some 50 basis points below their March high. Very recently, new issue yields have advanced significantly--although this has occurred since the pricing of issues included in the yield level for the latest week in the table--and several recent offerings at the lower yield levels have experienced lukewarm receptions. Corporate new issue inventories have been reduced by price cutting, but some dealers reportedly still have sizable inventories of unsold bonds--and large bank financing requirements--that have also recently acted to restrain aggressiveness. In the municipal market, yields have advanced more than 20 basis points since late in April and by mid-May pierced their previous peaks reached in late March.

BOND YIELDS

(Weekly averages, per cent per annum)

	New Corporate Aaa With Call Protection	State and Local Government Bond Buyers (mixed Qualities)
1968		
Low	6.13 (8/30)	4.07 (8/9)
High	6.92 (12/13)	4.85 (12/27)
1969		
Low	6.90 (1/10)	4.82 (1/24)
High	7.57 (3/21)	5.31 (5/16)
Week ending:		
April 4	7.28	5.25
11	7.30*	5.29
18	7.02	5.13
25	--	5.09
May 2	7.18	5.10
9	7.10	5.17
16	7.08	5.31

* Includes some issues with 10-year call protection.

Recent upward yield pressure in the municipal market has resulted in part from the substantial volume of bonds offered in April and committed for by dealers in the hope of later sales at higher prices. These bonds are now being delivered but dealers have not been very successful in placing recent offerings, as banks reportedly have sharply limited their new commitments. On average, commercial bank municipal holdings in April showed a significant contraseasonal decline.

In view of deliveries of earlier speculative purchases, the lackluster sales of recent offerings, and the large negative carry on municipal inventories, dealers have become very cautious. Several syndicates have been terminated with sizable upward yield adjustments and recent new issue bidding has been much less aggressive than during April. The resulting upward yield movements have generated an increased volume of postponements, as shown in the table. Tax-exempt bond volume in May is estimated at slightly less than $1 billion, little changed from earlier estimates and appreciably below the year-earlier pace as well as that in April, when volume had been buoyed by a rise of new offerings to take advantage of then available lower yields.

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

			Postponements
	1967	1968	1968
Year - Monthly average	1,230	1,381	86
	1968	1969	1969
Q I - Monthly average	1,246	913	281
QII - Monthly average	1,285	1,167e	n.a.
April	1,318	1,625e	92
May	1,143	975e	200e
June	1,395	900e	--

e/ Estimated.

1/ Data are for principal amounts of new issues.

Municipal bond volume in June is tentatively estimated to remain relatively low at $0.9 billion, somewhat below May and nearly $400 million less than the corresponding month a year ago. The estimated volume implicitly assumes continuation of yield pressure that will generate further postponements or cancellations; and it reflects also the absence of large revenue bond issues in June as well as a temporary lull in the expected issues of large, frequent borrowers.

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

	Bonds				Stocks		Total Bonds and Stocks	
	Public Offerings		Private Placements					
	1967	1968	1967	1968	1967	1968	1967	1968
YEAR-Monthly avg.	1,249	894	580	554	237	382	2,066	1,830
	1968	1969	1968	1969	1968	1969	1968	1969
Q I - Monthly avg.	821	886	574	513	300	674	1,726	2,073
Q II - Monthly avg.	1,035	1,122e	548	583e	319	567e	1,902	2,270e
April	719	1,260e	438	550e	271	600e	1,428	2,410e
May	1,046	1,000e	521	550e	300	550e	1,867	2,100e
June	1,340	1,100e	685	650e	385	550e	2,410	2,300e

MEMO: DETAIL ON PUBLIC BOND OFFERINGS
(Millions of dollars)

				Long-term NonConvertible	
	Total	Convertible	3-5 Year Notes	Public Utilities	Non-public Utilities
1968 - Monthly avg.					
Q I	821	173	--	348	300
QII	1,035	227	--	444	364
QIII	869	292	--	317	260
QIV	842	195	--	501	156
1969 - Monthly avg.					
Q I	886	365	--	408	113
March	835	314	--	449	72
April e/	1,260	485	315	325	135
May e/	1,000	470	50	420	60

e/ Estimated.
1/ Data are gross proceeds.

In the corporate bond market, public offerings during May are estimated at $1.0 billion, less than in April but significantly above the average monthly volume over the first quarter. As shown in the table, the scheduled volume of issues continues the pattern evident since late last year, with convertible and public utility issues accounting for the great bulk of public bond issues.

Corporate security issues in June are estimated at slightly above May, primarily as a result of usual seasonal factors. Public bond offerings are expected to total $1.1 billion, $100 million above May. When taking account of private placements and stock issues total corporate security offerings are estimated at $2.3 billion in June, about $200 million above the first quarter average monthly volume and the record average monthly pace set over the full year 1967. Even though public bond volume is not expected to reach the 1967 volume, this will be more than offset by the continuing large flow of stock issues.

<u>Stock market</u>. Reflecting improved expectations regarding profits and the outlook for peace, equity prices rose 4 to 5 per cent from late April until the President's speech on May 14; during this period, prices and weekly trading volume rose to new highs for the year. Since the President's proposals for peace in Vietnam--which were evidently taken by financial market participants to be less promising than originally expected--prices have declined, wiping out one-half to two-thirds of the earlier gains. At this writing (May 20), the Dow-Jones Industrial and the New York Stock Exchange Composite indicies are only marginally below their earlier highs reached in February; but prices on the American Stock Exchange are over 5 per cent below their February 1969 highs.

STOCK PRICE INDICIES

	Dow-Jones Industrials	New York Stock Exchange Index	American Stock Exchange Index
1968			
High[1/]	985.21(12/3)	61.14(12/2)	33.25(12/20)
1969			
Feb. high	952.70(2/13)	58.70(2/17)	32.69(2/4)
Low for year to date	903.03(2.27)	54.93(3/14)	29.48(3/14)
Most recent period:			
April 25	924.00	56.84	30.09
May 14 (High)	968.85	59.32	31.42
May 20	949.26	58.16	30.97
Per cent change:			
Dec. high to May 20	- 3.6	- 4.9	- 6.9
Feb. high to May 20	- 0.4	- 0.9	- 5.3
April 25 to May 14	+ 4.9	+ 4.4	+ 4.4
May 14 to May 20	- 2.1	- 2.0	- 1.4

1/ All time highs except for the Dow-Jones Industrial index which almost reached 990.0 in early 1966.

AVERAGE WEEKLY TRADING VOLUME

	New York Stock Exchange	American Stock Exchange	Memo: Fails to deliver by members of the New York Stock Exchange
	(Millions of Shares)		(Billions of Dollars)
1968			
High	67.3 (Apr.)	38.9 (May)	$ 4.1 (Dec.)
Low	43.1 (Aug.)	17.5 (Mar.)	2.7 (Apr.)
1969			
Jan.	58.4	32.8	3.3
Feb.	52.6	26.1	3.0
Mar.	49.8	22.0	2.5
Apr.	47.9	21.5	2.3
Week ending:			
April 25	56.3	24.7	--
May 2	72.7	36.7	--
9	67.6	38.4	--
16	62.0	32.6	--

With volume continuing to drift downward during April as a whole, the volume of securities not delivered by members of the New York Stock Exchange within the normal 5-day settlement period tended further downward, as indicated in the last column of the table. However, with the recent accelerated pace of trading, "fails" may rise again in May.

Preliminary data suggest that margin credit extended by brokers/dealers on the New York Stock Exchange increased somewhat in April but the volume of such credit, at $5.7 billion, remained about 15 per cent below the level reached in mid-1968, when the Board last raised margin requirements. Security credit extended by large banks to other broker/dealers declined in April, by almost $20 million.

U.S. Government securities market. Yields on most Treasury bills have risen about 15 to 20 basis points on balance since the last meeting of the Committee. Over the same period, yields on Government coupon issues also have advanced, by some 10 to 25 basis points.

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

	1969 1/		1969		
	Lows	Highs	April 29	May 13	May 20
Bills					
1-month	5.30 (3/25)	6.52 (4/20)	6.19	6.15	6.10
3-month	5.87 (4/30)	6.25 (1/7)	5.92	6.09	6.12
6-month	5.96 (4/30)	6.42 (1/7)	5.99	6.19	6.17
1-year	5.86 (1/16)	6.39 (2/27)	5.94	6.12	6.09
Coupons					
3-year	6.02 (1/20)	6.59 (5/20)	6.34	6.44	6.59
5-year	6.11 (1/20)	6.58 (5/20)	6.38	6.49	6.58
10-year	5.95 (1/20)	6.35 (3/18)	6.21	6.25	6.34
20-year	5.91 (5/5)	6.32 (3/18)	6.00	5.99	6.12

1/ Latest dates of high or low rates in parentheses.

In the early part of the period, uncertainties in the foreign exchange markets stemming in part from the resignation of President deGaulle and later from speculative flows of funds into Germany caused considerable nervousness in the Government securities market. Some of the yield back-up was attributable to these developments. More recently, the absence of any breakthrough in the Vietnam peace negotiations, together with continuing high financing costs and relatively large inventories of coupon issue acquired in the Treasury's refunding, have contributed to a substantial weakening of market psychology and further yield advances.

In the refunding the $2.2 billion of public exchanges into the new 6-1/2 per cent 7-year Treasury note were larger than many dealers had anticipated, including the overall awards to dealers themselves. As a result, while dealers' total inventories of Treasury securities have declined considerably since the last meeting of the Committee, their holdings of coupon issues are up, especially in the over 5-year category. Just after the books closed on the refinancing dealers had net positions of $222 million in the 15-month note, and $658 million in the 7-year issue. By the settlement date on May 15, the last date for which data are available, net sales had reduced these positions to $120 million and $569 million, respectively. The bulk of the sales of longer notes were made in response to orders from official accounts. Most recently as market psychology has deteriorated, some dealers have moved rather aggressively to make further reductions in their holdings of the new 6-1/2, with most of their progress again being accounted for by sizable official purchases.

DEALER POSITIONS IN GOVERNMENT SECURITIES
(Millions of dollars)

	April 28	May 12	May 19
Total	2,944	2,961	1,654
Treasury bills (total)	2,380	1,883	980
Due in 92 days or less	545	204	-106
93 days and over	1,835	1,679	1,086
Treasury notes and bonds (total)	564	1,078	674
Due within 1 year	506	70	75
1 - 5 years	- 80	225	64
Over 5 years	138	784	536

Dealers' remaining positions in all Treasury issues have had to be financed at high rates. Federal funds often have traded in an 8 to 9 per cent range or above in recent trading sessions, and the associated lending rates to Government security dealers at major money center banks have at times reached levels as high as 10-1/8 per cent.

The relatively low levels of bill rates that developed around the time of the last meeting were due in part to expectations of good-sized demand from selling of rights and from attrition in the refunding. While dealers were disappointed by the actual size of this demand, churning associated with developments in the foreign exchange markets generated a sizable foreign demand for bills. In fact, the Desk made $1.4 billion of net bill purchases for foreign accounts between April 29 and May 19 (the time period covered by the dealer position table) over half of which were for the German central bank. Over the same period, the Desk bought $568 million of bills directly for System account. These dema nds tended to keep bill rates from rising, despite the very tight money market conditions. But most recently, the persistence of money market tightness has contributed to a further back-up of yields despite the sharp drop in dealer bill positions.

Yields on most other short-term instruments also have advanced over the past month, in line with the general rise in interest rates. As the accompanying table indicates, these rate increases have averaged around 1/8 to 1/2 of a percentage point.

SHORT-TERM INTEREST RATES

	1969 1/ Lows	1969 1/ Highs	1969 April 29	1969 May 13	1969 May 20
1-month					
CD's (prime NYC)					
Highest quoted new issue	5.50	5.50	5.50	5.50	5.50
Secondary market	6.45 (3/14)	7.00 (5/14)	6.85 (4/23)	7.00 (5/7)	7.00 (5/14)
3-month					
Bankers' acceptances	6.38 (2/17)	7.50 (5/20)	7.00	7.50	7.50
Federal agencies	6.13 (4/4)	6.78 (5/14)	6.49 (4/23)	6.57 (5/7)	6.78 (5/14)
Finance paper	6.13 (1/24)	6.88 (5/20)	6.75	6.88	6.88
CD's (prime NYC)					
Highest quoted new issue	6.00	6.00	6.00	6.00	6.00
Secondary market	6.40 (1/30)	7.37 (5/14)	6.90 (4/23)	7.15 (5/7)	7.37 (5/14)
6-month					
Bankers' acceptances	6.50 (2/17)	7.63 (5/20)	7.13	7.63	7.63
Commercial paper	6.25 (1/6)	7.25 (5/20)	7.13	7.25	7.25
Federal agencies	6.32 (1/17)	6.67 (5/14)	6.58 (4/23)	6.56 (5/7)	6.67 (5/14)
CD's (prime NYC)					
Highest quoted new issue	6.25	6.25	6.25	6.25	6.25
Secondary market	6.50 (1/30)	7.50 (5/14)	7.10 (4/23)	7.25 (5/7)	7.50 (5/14)
1-year					
Prime municipals	3.90 (1/2)	4.55 (3/21)	4.05 (4/23)	4.25 (5/7)	4.25 (5/14)

1/ Latest dates on which rates occurred are indicated in parentheses.

Federal finance. Preliminary data available for April and early May suggest that both receipts and outlays for fiscal 1969 may have been running higher than staff estimates shown in the last Greenbook. On the receipts side, the upward adjustment -- which amounts to about $600 million -- stems chiefly from larger than expected corporate tax payments in April and from higher individual income tax payments in May. On the expenditure side, outlays for April appear to have been $1.3 billion larger than previously projected, with an upsurge in defense spending accounting for the bulk of the increase. It is not clear whether this overrun reflects Vietnam outlays, or other defense expenditures not exempt from the expenditures ceiling. If recent increases are of the latter type, these together with spending increases on Farmers' Home Administration and other non-exempt programs, could quickly use up the leeway remaining under the spending ceiling.

In the Administration's recent Budget Review the implied leeway for estimated non-exempt outlays remaining below the expenditure ceiling amounted to $1.3 billion. But the Board staff projection for fiscal 1969 now sets total outlays at $186.2 billion, which would bring non-exempt outlays up to the maximum allowed and eliminate the leeway. At the end of any fiscal year, budget officers typically possess considerable flexibility for adjusting expenditure data that go into the final budget accounts, resorting to such things as delayed issuance of checks particularly in defense programs. With another expenditure ceiling now likely for fiscal 1970, however, it is not clear how actively such measures will be used this year.

After some decline in May and early June, the Treasury cash balance is expected to rise to about $7.5 billion by the end of June. Recent shifts of dollar balances by foreign central banks into special Treasury notes added over $1 billion to the Treasury balance, but this windfall is expected to be short-lived, since the funds are now in the process of being withdrawn for direct investment in higher yielding marketable Treasury bills. Assuming a balance around $7.5 billion at midyear, the Treasury could probably defer cash borrowing in the new fiscal year until late July or early August.

Budgetary prospects for all of fiscal 1970 remain beset by uncertainties concerning (1) extenstion of the surtax, (2) repeal of the investment tax credit, (3) tax reform, (4) the timing of increased social security benefits and tax rates, (5) the format of a new spending ceiling, and (6) the significance of the recent upsurge in defense spending as compared to the Administration's budget review projection. The latter holds defense spending level for the first three quarters of calendar 1969 (apart from the July pay-raise), and then schedules a significant decline during the following three quarters.

In testimony at the May 20 hearings on extension of the surtax, the Budget Director presented the latest official estim ate for fiscal 1970, showing a projected surplus of $6.3 billion. No change was made in the earlier $192.9 billion estimate of outlays--which among other things assumes a 7 per cent increase in social security benefit payments and an increase in postal rates, neither of which now seems likely in the form requested. Estimated receipts are adjusted upward by $500 million, however, assuming that the surcharge will be extended as requested, and that the investment tax credit will be repealed.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	March	April[a]	May	June
Borrowing operations				
New cash raised				
Weekly and monthly bills	2.8	--	--	--
Tax bills	--	--	--	--
Coupon issues	--	--	--	--
Other (agency, debt repayment, etc.)	-2.4	-2.5	-1.0	-8.0
Total ne t borrowing from public	.4	-2.5	-1.0	-8.0
Plus: Other net financial sources[b]	1.4	.2	-.4	.5
Plus: Budget surplus or deficit (-)	-1.9	5.7	-1.1	9.4
Equals: Change in cash balance	-.1	3.4	-2.5	1.9
Memorandum: Level of cash balance end of period	4.8	8.2	5.7	7.6

a/ Actual and estimated data.
b/ Checks issued less checks paid and other accrual items.

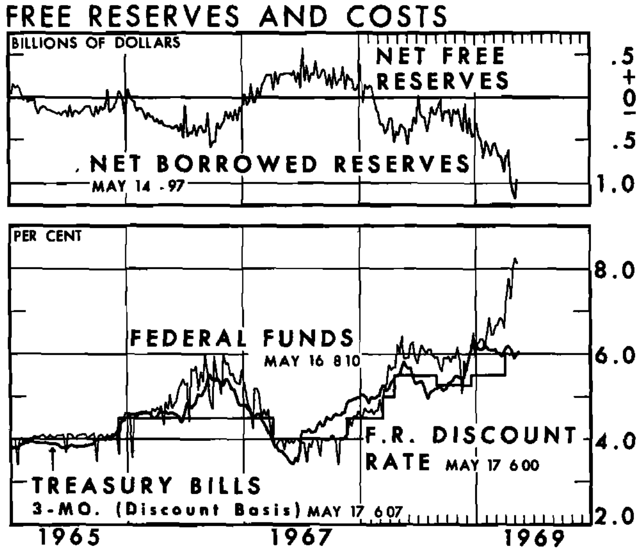
NEW BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS
(In billions of dollars)

	FY 1968	Fiscal 1969			Calendar quarter						Calendar
					1968		1969				year
	Actual	Jan. Budget	5-20-69 Revision	F.R. Bd	III	IV	I	II e/	III e/	IV e/	1969 e/
Quarterly data, unadjusted											
New budget:											
Surplus/deficit	-25.2	2.4	.9	1.7	- 3.2	- 7.1	- 2.0	14.0	- 3.2	- 4.3	4.6
Receipts	153.7	186.1	186.5	187.9	43.6	39.3	44.2	60.9	48.0	43.0	196.1
Total expenditures and net lending	178.9	183.7	185.6	186.2	46.9	46.3	46.1	46.9	51.2	47.3	191.5
Means of financing:											
Total borrowing from the public	23.1	- 3.1	n.a.	- .1	7.7	3.4	.2	-11.5			
Decrease in cash operating balance	.4			- 2.3	- 3.3	3.9	- .1	- 2.8			
Other 1/	1.7	n.a.		.9	- 1.1	- .2	1.9	.3		n.e.	
Cash operating balance, end of period	5.3			7.6	8.6	4.7	4.8	7.6			
Seasonally adjusted annual rate											
Federal surplus/deficit in national income accounts	-11.3	2.7	1.7	3.0	- 2.8	.2	7.2	7.4	3.3	5.3	5.8
Receipts 2/	161.1	190.0	190.0	191.6	182.1	187.1	196.9	200.1	199.2	201.0	199.3
Expenditures	172.4	187.3	188.3	188.6	184.9	186.9	189.7	192.7	195.9	195.7	193.5

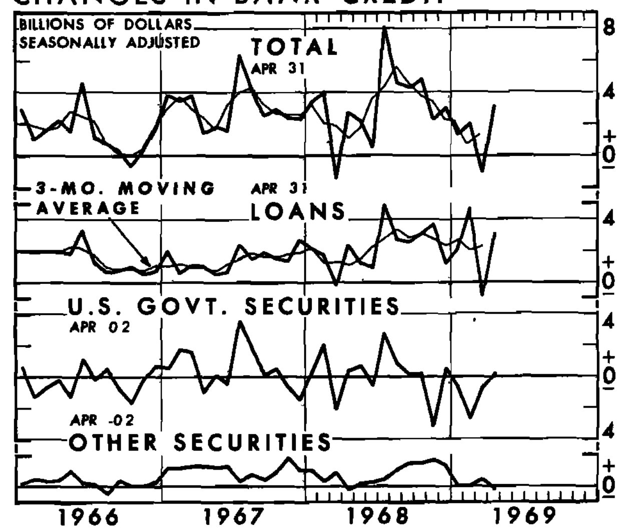
e--Projected.
p--Preliminary.
1/ Includes various accrual items, such as deposit fund accounts and clearing accounts.
2/ Corporate tax accruals in 1969 assume extension of surtax through calendar 1969.

FINANCIAL DEVELOPMENTS - UNITED STATES

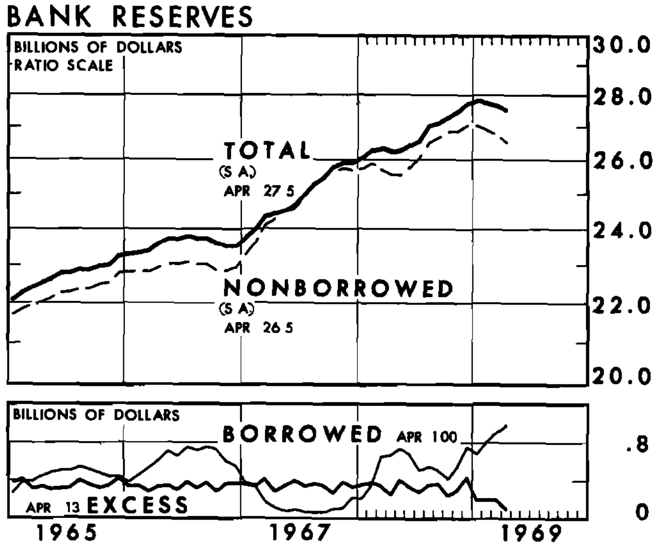
FREE RESERVES AND COSTS



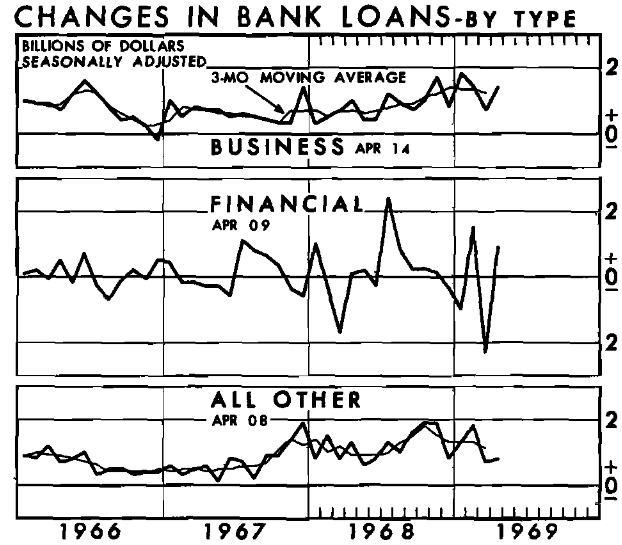
CHANGES IN BANK CREDIT



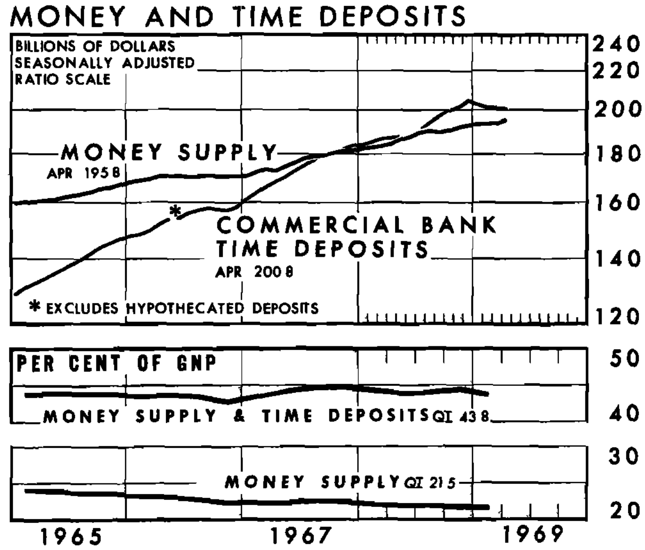
BANK RESERVES



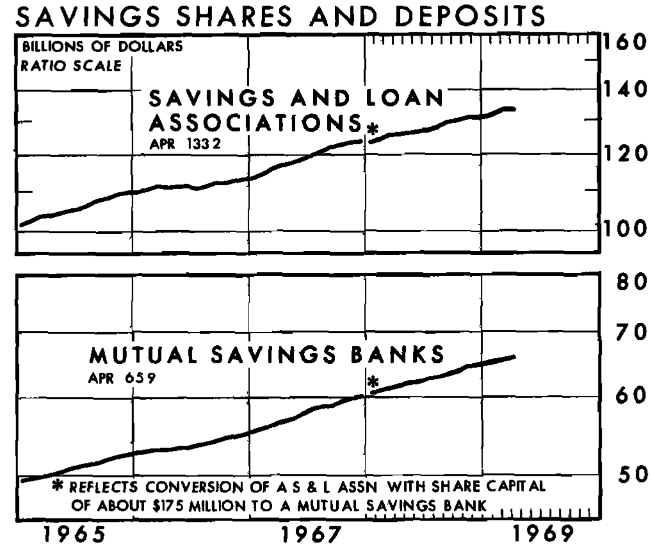
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

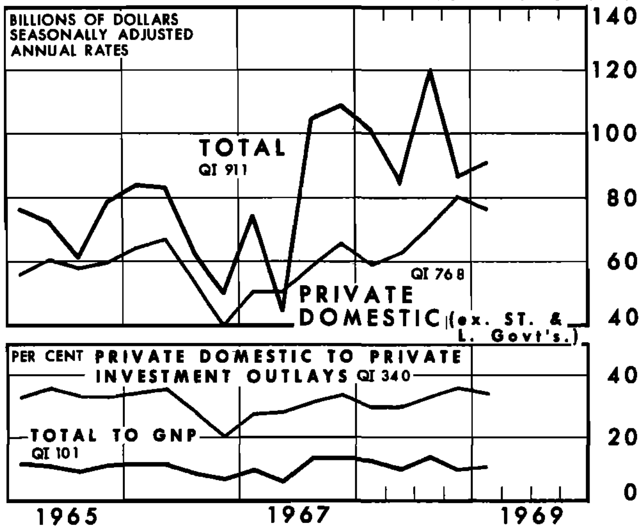


SAVINGS SHARES AND DEPOSITS

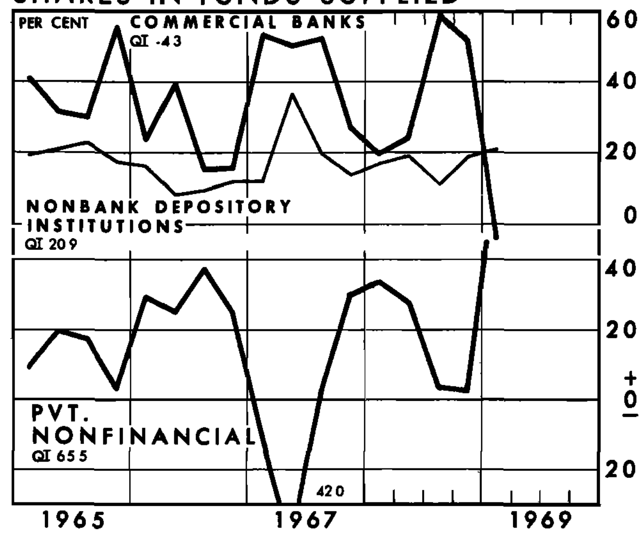


FINANCIAL DEVELOPMENTS - UNITED STATES

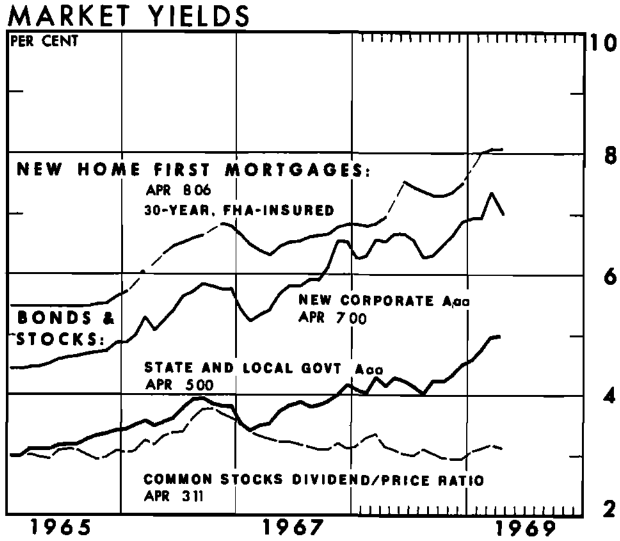
NET FUNDS RAISED - NONFINANCIAL SECTORS



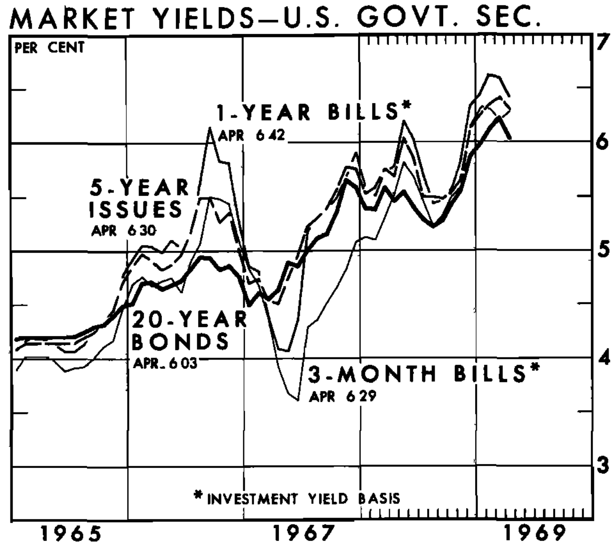
SHARES IN FUNDS SUPPLIED



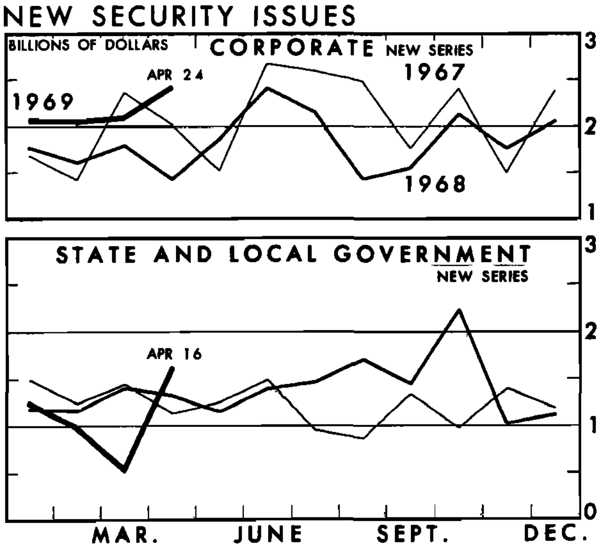
MARKET YIELDS



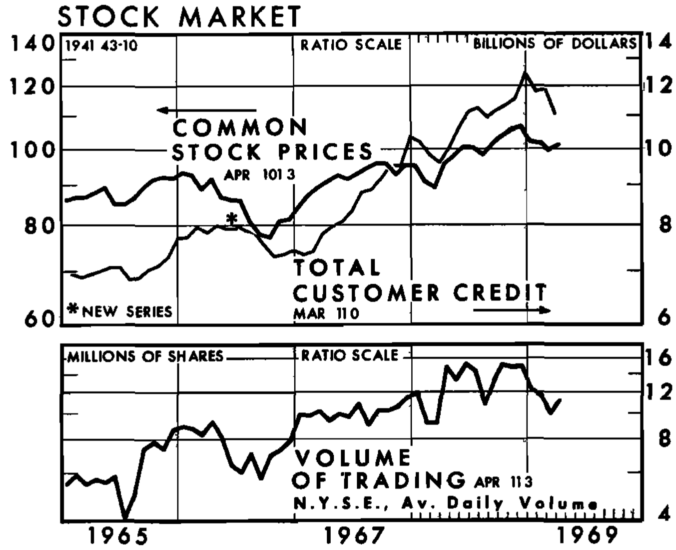
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

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U.S. balance of payments. Any expectation that the U.S. balance of payments would rebound quickly from the deep first-quarter deficit has been submerged by what seem to be very large outflows of capital related to speculation on revaluation of the German mark. In the first quarter, there was a deficit of $1.8 billion on the liquidity basis, and a somewhat larger deficit on the adjusted over-all basis (see Appendix C for a discussion of this measure which takes the place of the "liquidity balance before special transactions"). The marked worsening at the beginning of the year could be explained in terms of the effects of the strike-induced weakness in the trade balance and the resurgence of corporate capital outflows. Once these adverse elements were absorbed, it was hoped the balance for the rest of the year would be considerably better. This result was also implied by an inter-agency projection for the year discussed below. Heavy deficits in April and May, however, have cast some doubt on these expectations.

The April liquidity deficit before seasonal adjustment was about $800 million, according to the early indicators. Seasonal factors are adverse, but even after rough seasonal adjustment the April deficit would be over $1/2 billion. Inflows of foreign capital to purchase U.S. equity securities are estimated on partial tabulations to have held up at something like the $100 million per month March rate, but the trade balance was probably still very low. In the first two weeks of May, the liquidity deficit soared to about $2 billion. Since there is no evidence of a dramatic shift in the usual types of transactions, this sudden worsening seems to be the result of anticipations of a revaluation of the German mark. There may have been some withdrawal of foreign ("non-liquid") funds invested in the United States, but it seems likely that the largest element was an outflow of U.S. capital.

Reflows out of Germany after the decision against revaluation was announced have amounted to about one quarter of the inflow that occurred through May 9, and there may be some return of U.S. funds that would lower the U.S. deficit later in the quarter. In the case of U.S. corporations that placed funds abroad early in May, the OFDI regulations limiting the holding of liquid funds abroad may force some repatriation by the end of the month (though reports are not required until the end of the quarter.)

On the official settlements basis there was probably near balance in April, as liabilities to commercial banks abroad (including branches of U.S. banks) rose by over $3/4 billion, in spite of a sharp attrition of these accounts at the end of that month. In the first two weeks of May, however, there was little net change in these liabilities to commercial banks abroad, as an increase early in the month was eliminated by attrition in the second week (see page IV-10). The official settlements deficit in this half month was therefore about the same ($2 billion) as the deficit on the liquidity basis.

The adjusted over-all balance described in Appendix C gives results generally close to the liquidity balance before special transactions. This year, since special transactions have been relatively small and changes in liquid liabilities to private foreigners other than commercial banks are not known to have been large, the change in underlying transactions shown by the adjusted balance does not differ significantly from the change in the liquidity balance.

Prospects for 1969. With temporary factors bulking so large in the balance of payments in recent months, and so little known about the strength of basic economic factors at work, this is not a propitious time to make forecasts. However, a projection for the year was made by an inter-agency committee early in May, and it may be useful to survey briefly the broad outlines of the results.

With respect to merchandise trade, the outlook for the second half as well as for the entire year reflected in the projection is considerably less optimistic than in earlier estimates. It is now thought that the trade balance in 1969 will be not much different from last year with exports lower and imports higher than earlier expected.

Exports in calendar 1969 are still estimated to be substantially greater than in 1968, by about 8-1/2 per cent. Perhaps $400 million of exports may have been lost permanently as a result of the dock strike, half in agricultural products and half in other categories. Commercial aircraft exports, which increased sharply last year, are expected to fall by 20 to 25 per cent in 1969 as deliveries of current models slow down prior to the scheduled deliveries of the new larger Boeing 747's in 1970. Most of this decline is likely to occur in the second half of the year. Shipments of cars and parts to Canada should continue to rise, though not by as much as imports of cars and parts from Canada.

Nonagricultural exports other than of aircraft and of cars to Canada will be favorably affected by stronger demand pressures in Europe than earlier assumed, partly offset by the negative effect of more rapid price advances here than abroad. For this group of products, the 1967-68 increase was 8-1/2 per cent and the 1968-69 increase is now expected to be about 12 per cent. A major element in this expected large growth is an acceleration in foreign demand for U.S. machinery. Export orders for such equipment rose steeply in February and March and for the first quarter were 20 per cent higher than in the first quarter of 1968.

Imports in 1969 are now expected to be about $1 billion larger than previously thought, owing mainly to greater demand pressures and price increases in the United States.

The net export balance on services and military transactions is now expected to be slightly lower this year--about $1/4 billion--than in 1968. A principal factor holding down this balance is the high level of U.S. interest payments to foreigners. Even the present estimate of income payments, $3.6 billion, may be too low if current Euro-dollar interest rates should prevail throughout the year.

Taking both the merchandise and other current transactions into account, this projection results in a current account surplus of about $1.6 billion, compared with $2.0 billion in 1968. This is a sharp revision from the earlier estimate for 1969, which projected a $3.8 billion surplus on current account.

International capital flows are apparently even more volatile than usual this year, and an extremely wide range of possibilities exists even under the present controls. The net outflow of U.S. corporate capital in 1968 (net of the use of funds borrowed abroad) was only about $400 million. Given the liberalization of the controls, and the carry-over of unused "allowables" from 1968, the outflow of U.S. funds for direct investment abroad could be very much greater this year. Estimates provided to the Office of Foreign Direct Investments by the major direct investors would result in an increase in $1 billion over 1968. That would still be within the 1969 program ceiling but assumes that the carry-forward of allowables would not diminish. In addition, there is no regulatory limit on ordinary commercial credits, or on funds placed abroad by U.S. residents who are not direct investors. In the projection for 1969, an allowance was made for total corporate outflows to increase by about $1 billion; this now seems comparatively modest.

The other major element in long-term private capital flows has been foreign investments in U.S. corporate stocks, and the current projection, taking note of the sizable inflows in the first quarter, puts this amount close to the $1.9 billion of last year. Changes in claims on foreigners reported by U.S. banks are also projected to be close to last year's small inflow, in spite of the larger ceiling in the 1969 voluntary restraint program.

In broad outline, therefore, the inter-agency group view early in May was that U.S. international transactions, under the assumptions given, would make no net progress toward balance in 1969, though the measures being taken to slow domestic demand might be establishing the necessary basis for improvement next year. The current account balance would be slightly smaller than in 1968, U.S. private capital outflows would rise by about $1 billion (after deducting the use of funds derived from borrowing abroad), and the inflow of foreign private capital to purchase securities or make direct investments in the United States would be slightly reduced from the 1968 peak. These and other elements would result in an over-all deterioration of roughly $2 billion in terms of the adjusted over-all balance. As noted above, the deficit for 1969 through May 14 had already exceeded the 1968 figure by that amount.

The inter-agency group did not attempt to project the outcome on the official settlements basis for the year. Foreign official claims on the United States were <u>reduced</u> by $1.7 billion in the first quarter (not seasonally adjusted) and the increase in such claims of about $3.4 billion from the end of March through May 14 was more than accounted for by a gain of $4.3 billion in German official accounts. It is quite possible that for the remainder of the year there will not be significant further changes in foreign official accounts, and that despite a very large deficit on the adjusted over-all basis there will not be any serious reduction in U.S. reserve assets. Through May 14, U.S. reserve assets increased by $894 million, including $125 million in gold, $109 million in our IMF position, and some $600 million in convertible currencies. The last item reflects very largely swap drawings by several countries at the time of the speculative flow into German marks.

Foreign exchange market developments. From April 22 through May 9 foreign exchange markets were caught up in the development of an increasingly speculative atmosphere. Conditions and events in Germany lay at the bottom of this development--see Page IV - 11--and its timing was affected by uncertainty over the French referendum and then de Gaulle's defeat. Finally, in the week of May 5-9 there was a massive speculative rush into German marks. During those three weeks the Bundesbank purchased about $4.8 billion spot and swapped out about $650 million before ceasing its swap operations on May 8. At the height of the speculation--May 8 and 9--the Bundesbank purchased about $1.2 billion per day. Since the German announcement on May 9 that the current mark parity would be held, the Bundesbank has sold only about $1.1 billion. Exchange market doubts about the permanence of this decision were reinforced by the apparent inadequacy of the package of measures which German authorities announced last week to support their decision not to revalue.

The massive flow of funds into marks had its counterpart in flows out of all major currencies, including especially the dollar. Very fragmentary information available suggests that more than one-third of the Bundesbank reserve increase came from sales of dollars by other central banks, more than one-third from mark purchases by U.S. non-bank residents, and a little less than one-third out of the Euro-dollar market (as reflected in the decline in U.S. bank liabilities to their overseas branches). Selling pressure was heavy against the pound and the French franc. In the three weeks from April 22 to May 9 the Bank of England had losses of about $550 million and the Bank of France had losses of about $515 million. The reserve drains prompted by the speculation were also relatively severe in the case of the Danish and Belgian central banks although most major central banks were hit with some reserve losses.

Since May 9 the reflow of funds into sterling--the Bank of England has purchased about $325 million--has been especially encouraging despite the announcement of the poor U.K. trade figures for April. Demand for French francs has also been firm and the Bank of France has purchased about $125 million since May 9. Current conditions in exchange markets are very quiet and market participants appear to be waiting to see how soon the build-up of speculative funds in Germany runs off. Next week is an especially short trading week with a holiday throughout Europe on Monday and a holiday in the United States on Friday; so exchange markets are expected to remain relatively inactive until after the first of June, when the French election occurs.

The price of gold was unaffected by the recent exchange market turmoil and has ranged between $43.15 and $43.60 an ounce since April 21.

Euro-dollar market. The extremely large speculative movement of funds to the German mark which began in late April exerted strong pressures on the Euro-dollar market, whether through deposit attrition or through demand to borrow dollars (to buy marks). Euro-dollar rates advanced very sharply, particularly in the days just before the German authorities announced on May 9 their decision against a revaluation. On Thursday, May 8, the bid rate for call deposits reached 10 per cent per annum; three- and six-month deposit rates hit 9-13/16 per cent per annum and one-year deposits were bid at 9-5/8 per cent per annum. One-month deposits reached their peak level of 9-15/16 per cent per annum on Friday, May 9. At these peaks the call deposit rate was more than 2 percentage points above its late April level, and rates in the longer maturities had risen between 120 and 190 basis points.

Euro-dollar rates declined moderately during the first few days following the cessation of the flow of funds into German marks but have tended to firm in recent days. As of May 21 rates in most maturities are near 9-1/2 per cent per annum.

U.S. bank's liabilities to their foreign branches declined by $1.4 billion between April 23 and May 13. (More than $300 million of this decline, however, reflected sell-offs of domestic loans to London branches). Since May 13, liabilities to branches have increased somewhat.

SELECTED EURO-DOLLAR AND U.S. MONEY MARKET RATES
(weekly average of daily figures)

Average for week ending Wednesday	(1) Call Euro-$ Deposit	(2) Federal Funds	(3) =(1)-(2) Differ-ential	(4) 3-month Euro-$ Deposit	(5) 3-month Treasury bill	(6) =(4)-(5) Differ-ential
Apr. 16	7.69	7.63	0.06	8.38	6.19	2.19
23	7.94	7.48	0.46	8.38	6.18	2.20
30	8.15	7.79	0.36	8.45	5.99	2.46
May 7	8.77	8.23	0.54	8.86	5.97	2.89
14	9.78	8.30	1.48	9.38	6.02	3.36
21	9.50	8.88 p/	0.62	9.55	6.08	3.47

p/ Preliminary.

Balances of payments and reserves of other countries. Changes in the underlying payments positions of the other industrial countries have been especially difficult to discern this year, because of the effects on short-term capital movements of the very high U.S. demand for Euro-dollars and because of the renewed speculation on a revaluation of the German mark. Moreover, seasonal adjustment problems and accounting differences add to the difficulties of matching up a net total of surpluses in other industrial countries against the U.S. deficit on current and long-term capital accounts. Both Britain and France continue to suffer from serious deficits in their "basic" balance of payments (i.e., on current and long-term capital accounts). Italy's seasonal deficit in the first quarter was much larger than last year, and Canada's payments position has been close to equilibrium since the beginning of 1969. Japan, and probably also Switzerland, had surpluses on current and long-term capital account in the first quarter. For Germany, whose underlying balance of payments is potentially in surplus, outflows of long-term capital were more than enough to offset the current account surplus in the first quarter.

For the second time in six months, expectations of possible changes in currency parities have given rise to massive purchases of German marks by holders of various other currencies. Speculation that the mark might be revalued upward was revived after the German central bank's discount rate was raised on April 17, and beginning April 30 was greatly intensified by various remarks made by German officials. A major part of the purchases of marks were made by businesses and others moving out of dollars--in the United States or in the Euro-dollar market--but the central banks of the United Kingdom and France lost large amounts of reserves. The Danish central bank was also a very heavy loser of reserves. (See pages IV- to for additional information.)

After the May 9 announcement of the German Government's decision not to revalue, there was a reflow out of marks of some of the funds that had come in during the previous three weeks.

The renewed speculation on the mark rested on the belief that capital outflows from Germany could not continue at their recent high levels and that consequently a large and persistent surplus would soon re-emerge in Germany's balance of payments. For some months prior to April, outflows of long-term private capital from Germany had been sufficiently large to more than compensate for the surplus on current transactions, but it was recognized that these flows were occurring at a time when credit markets in Germany were extremely easy in relation to markets in most other industrial countries. The rise in the Bundesbank's discount rate from 3 to 4 per cent on April 17 was widely interpreted as the harbinger of a period when the relative ease in German credit markets would lessen. The conviction that reduced capital outflows would mean the reappearance of an over-all surplus was based on the assumption that Germany's large trade surplus would be little reduced by the border tax adjustments put into effect late last year after the November crisis. Although the impact of those measures is still unclear, German exporters have apparently absorbed part of the reduction in the border tax rebates, and can still promise early delivery dates. Export orders are continuing to rise strongly.

The particular susceptibility of the pound and the franc to speculative attack in recent weeks has been related, in each instance, to the persistence of serious trade deficits in those countries. After some improvement in previous months, Britain's trade performance was sorely disappointing in the months of February, March and April. In the French case, the trade deficit has remained large in 1969 notwithstanding the austerity moves in the fiscal and monetary areas decided upon last November. New credit measures to curb consumer buying were announced in France on May 8. The possibility, followed by the fact, of General de Gaulle's resignation also suggested to exchange market operators that devaluation had become a more likely solution to France's external imbalance, even though such a step is highly unlikely before a new government takes office.

Prior to the recent crisis, international payments developments in the first three and a half months of this year were highlighted by the impact of increased demand for Euro-dollars on the part of U.S. banks, and by the regulatory and monetary policy actions taken in a number of countries at least partially in response to the increased flow of Euro-dollars to the United States. Increased net lendings to the Euro-dollar market (or reduced borrowing from that market) by commercial banks and others outside the United States have the effect of decreasing the dollar holdings of central banks if the funds are relent to U.S. banks. With a large balance of payments deficit in prospect, the French authorities took action in January to isolate French banks from the pull of the Euro-currency markets, and in fact to force some repatriation of funds. In February the Bundesbank and the Bank of Italy halted or greatly reduced their swaps of dollars with commercial banks, and later the Bank of Italy required Italian banks to repatriate a large volume of funds prior to June 30. In the Italian case, domestic considerations were also importantly involved in this decision, which was accompanied by other measures aimed at reducing capital outflows. These developments on the supply side contributed to a further sharp rise of Euro-dollar interest rates in February, and since then these rates have remained very high. Belgium has also acted to require banks to repatriate Euro-dollars.

CHANGES IN COMBINED OFFICIAL AND
COMMERCIAL BANK NET FOREIGN POSITIONS
(in millions of dollars)

	1968					1969
	Year	I	II	III	IV	I
Germany	948	774	6	65	103	- 677
France	-3,208	- 194	-683	-1,221	-1,110	- 402[a/]
Italy	586	- 176	160	601	1	- 374
Belgium	- 222	- 54	54	- 132	- 90	- 30
Netherlands	- 100	- 46	- 78	72	- 48	89
Total EC	-1,996	304	-541	- 615	-1,144	-1,394
Sweden	- 43	- 5	6	29	- 73	- 132
Switzerland	1,153	291	396	164	302	n.a.
United Kingdom	-2,173	-1,133	-575	22	- 487	523
Canada	439	- 813	612	299	341	26
Japan	1,102	- 247	221	541	587	278

a/ Excludes March change in commercial banks' position.
Source: Confidential BIS data.

Germany's over-all balance of payments registered a deficit of $677 million in the first quarter, as measured by changes in official and commercial bank net foreign assets. This was in sharp contrast with the surplus of $744 million recorded in the first quarter of 1968, and it produced a 12-month deficit, through March, of $503 million. Long-term capital outflows were extremely large in the first quarter, and greatly exceeded the current account surplus, which was somewhat reduced by special factors. (The reduction in border taxes on German imports decided upon last November 20 became effective immediately, but the reduction in border tax rebates on exports did not become effective until December 23. In the interim, export shipments were sharply accelerated, at the expense of shipments subsequent to December 23; the shift amounted to $300 million in round terms.)

Imports in the first quarter were 11 per cent higher than in the fourth quarter of 1968, the marked rapidity of this rise being a result at least partly of the lower border taxes. But the cut in the border tax rebate for exports seems to be having little effect toward reducing export sales. Export shipments in March (seasonally adjusted) were 4 per cent above November. New export orders in January-February (seasonally adjusted) were about equal to the November level, but soared in March, so that export orders in February-March were up 9 per cent (preliminary) from December-January.

The net outflow of long-term private capital from Germany in the first quarter came to $1.4 billion, well above the already high levels of $0.9 billion and $0.6 billion in the two previous quarters respectively. Flotations of mark-denominated bonds by foreign borrowers--a large portion of which were acquired by German commercial banks--accounted for about one-half of the first quarter outflow, and bank loans (of over one-year maturity) for most of the remainder. Only a small percentage of the total was offered by U.S. companies.

The Bundesbank's net foreign assets declined by $2.2 billion in December-January as the combined result of the basic payments deficit, an unwinding of the November speculative inflow indicated, for example, by nearly $600 million of withdrawals by foreign residents of mark balances from German banks, and an increase of about $1.1 billion in German banks' net lendings in the Euro-dollar market. Liquid foreign currency balances of the Bundesbank were reduced to about $1.4 billion at the end of January, a level well below that prevailing prior to November. To discourage further placements of bank funds in the Euro-dollar market, in the period from late December to early March the Bundesbank gradually raised the cost to banks of preferential dollar/mark swaps. Banks' recourse to new swaps declined progressively after January and, as outstanding swaps matured, the banks' net foreign assets were reduced in February and March. In those two months German banks' net lendings in the Euro-dollar market appear to have been reduced by about $550 million.

CHANGES IN NET FOREIGN POSITIONS OF OFFICIAL INSTITUTIONS AND COMMERCIAL BANKS
(in millions of dollars)

		1968 IV	1969 I	1969 by months Jan.	Feb.	Mar.	Apr.
Germany:	Official	707	-1,814	-1,297	-138	-379	627
	Banks	-604	1,137	1,462	-221	-103	n.a.
France:	Official	-247	169	300	73	-204	-589
	Banks	-863	n.a.	- 290	-281	n.a.	n.a.
Italy:	Official	-237	- 377	- 145	- 92	-140	80
	Banks	238	3	81	- 21	- 57	-275p
Belgium:	Official	-138	- 100	- 48	- 40	- 12	60
	Banks	48	70	24	44	2	n.a.
Netherlands:	Official	- 48	- 58	- 85	- 6	33	15
	Banks	--	147	110	- 17	54	n.a.
Sweden:	Official	-128	- 68	- 2	- 48	- 18	- 6
	Banks	55	- 64	- 26	- 36	- 2	18
Switzerland:	Official	944	- 778	- 877	-105	204	- 42
	Banks	-642	n.a.	n.a.	n.a.	n.a.	n.a.
United Kingdom:	Official	-846	456	162	206	88	n.a.
	Banks	359	67	- 318	178	159	n.a.
Canada:	Official	300	- 38	33	- 37	- 34	21
	Banks	41	64	- 44	194	- 86	n.a.
Japan:	Official	519	319	47	142	130	-119
	Banks	68	- 41	- 145	44	60	279

Source: Confidential BIS data.

The German Government's decision on May 9 not to revalue was followed by several Cabinet actions in the balance of payments and fiscal areas, some of them subject to Parliamentary approval. The Bundesbank is to be given authority to impose minimum reserve requirements of up to

100 per cent against all outstanding foreign liabilities of German banks, rather than merely to increases since some base date; at present, for example, the 100 per cent requirement applies only to increases since April 15. Such authority would presumably enable the Bundesbank to force German banks to expel foreign funds. The border tax measures of last November will be extended indefinitely instead of expiring at the end of March 1970. With regard to the budget, Federal and some State tax receipts in excess of original 1969 estimates will be "blocked" at the Bundesbank, and Federal expenditures will rise less this year than was planned. The fiscal measures are alternatives to currency revaluation only as domestic anti-inflationary measures; they would tend to enlarge rather than reduce a balance of payments surplus. However, they are not expected to have a significant effect in damping down demand in Germany this year.

The external position of France has shown deficits of apparently increasing magnitude this year, and reserve losses have been very large. The decline in official net foreign assets in the first four months of the year (including drawings on central bank swap facilities) came to $420 million; further reserve losses in the first 15 days of May are estimated at $250 million; and commercial banks' net foreign liabilities increased by $571 million in January-February (figures for later months being unavailable). During February and perhaps later also, transfers of dollars were made from commercial banks to the monetary authorities under a January 31 regulation.

The trade deficit has been not only a direct cause of France's external imbalance, but an indirect one as well in that the persistence of a large trade deficit has induced speculative capital outflows. The trade deficit was already at a high level at the close of last year because of the extremely rapid rise of imports in the previous six months. From December through March, there was no further rise in imports from countries outside the franc area, which averaged almost the same (seasonally adjusted) in February-March as in November-December. But export expansion has slowed down despite last November's changes in French taxation and related changes in border tax adjustments designed to increase French competitiveness.

Aggregate demand in France continued to increase strongly during the first quarter and into April, with consumer demand especially buoyant. New credit restrictions announced on May 8 included a tightening of consumer credit terms, particularly for automobiles, and an extension through December of very tight ceilings on expansion of short-term bank credit. Maximum interest rates on most time deposits were raised one-half percentage point, and the ceiling was abolished for certificates of deposit of over 100,000 francs (about $20,000).

Reserve losses in March-May were far in excess of the trade deficit; the trade deficit with non-franc area countries (and with imports estimated on an f.o.b. basis) was about $140 million in March and $165 million in April. There may have been outflows of foreign capital, which are not subject to exchange controls. French capital has been illegally moved via banknote exports to Switzerland and via capital transfers through overseas franc area countries where enforcement of controls is reportedly lax. Accelerated remittances of foreign workers' earnings, and advance purchases of foreign currency available under the tourist allowance, may also have contributed to the enlarged deficits.

French commercial banks with net foreign assets in foreign currency on January 31 were required to place them in a special dollar account at the Bank of France prior to April 25, in accordance with a schedule. The deposits bear interest daily at the call money rate but cannot be counted for reserve requirement purposes. Reportedly, the sums deposited totaled several hundred million dollars and were earmarked for repayment by the Bank of France of swaps with French commercial banks made in 1968. Banks with net foreign liabilities in foreign currency at the end of January have been prohibited from reducing them. Both these measures contributed to the tightening of the Euro-dollar market.

Britain has seemingly made little progress this year in its continuing efforts to shift from external deficit to surplus, although reserve changes were favorable up to mid-April thanks to short-term capital inflows. The deficit in the current account has in all probability been at a rate little less than in 1968, when it amounted for that year as a whole to $1.0 billion, and the same is likely to have been true of the "basic balance" (current and long-term capital accounts), on which last year's deficit was $1.1 billion.

In the first four months of this year the seasonally adjusted trade deficit on the balance of payments basis averaged $110 million per month. While this was better than the $137 million average for 1968, the month-to-month changes have shown some deterioration since January. Imports declined late in 1968 and again in January, but from January to April they moved up again by 4 per cent. Exports, on the other hand, have been more or less stable thus far in 1969. The average monthly trade deficit in March-April was $133 million, barely below the 1968 level. The U.S. dock strike probably reduced Britain's first-quarter imports and exports in equal proportions, perhaps 2 per cent in each case.

For the first quarter, net foreign liabilities of the British monetary authorities were reduced by $456 million and those owed by commercial banks in Britain contracted an additional $67 million. The contrast between this reserve gain and the basic balance of payments deficit of several hundred million dollars is partly ascribable to inflows of short-term capital in the form of payments by foreign exporters of the import deposits required since the end of November 1968. It is presumed that a substantial part of the $1.1 billion equivalent paid in under this regulation through April 30 has come from abroad. Because these deposits are refunded after six months, after the end of May their outstanding amount will tend to rise relatively slowly and the short-term capital inflows associated with them until now will tend to disappear. In addition, seasonally favorable trade movements of outer sterling area countries with third countries contributed to Britain's reserves; the exchange value guarantee of official sterling balances granted in connection with the Basle agreement of September 1968 is a deterrent to withdrawals of these balances.

Because of a much higher level of capital outflow, Italy's over-all balance of payments deficit in the first four months was $569 million, as compared with $129 million a year earlier. The first quarter is seasonally weak for Italy, which for the full year 1968 ran a surplus of $586 million. The total net outflow of non-bank capital (nearly all of it private) in the first quarter increased from $410 million to $732 million between the two first quarters, the bulk of it continuing to be financed by illegal exports of Italian banknotes. Although tighter credit conditions outside Italy undoubtedly caused capital outflows to increase, investors' uneasiness related to student and worker disturbances is thought to have been another factor.

The Italian authorities are now seeking to hold down the exodus of Italian capital. Measures announced early in April should severely restrict sales in Italy of foreign mutual funds. The participation of Italian banks in the underwriting of bond issues outside the country--which last year may have approached $400 million--will be subject to issue-by-issue authorization, in the expectation that purchases of foreign bonds by non-bank Italian investors will thereby be reduced. It is not known how liberally the authorizations will be given, but some have been granted in recent weeks. These moves reflect a desire to facilitate the raising of risk capital and to promote the current cyclical expansion by keeping Italian capital markets easier than otherwise. There may also be some official concern over the balance of payments outlook, in view of the much higher level of capital outflow this year and the possibility that domestic expansion will reduce the current account surplus.

For reasons akin to those just set forth, in February the Bank of Italy stopped its swaps of dollars for lire with Italian commercial banks (by raising their cost), and in March instructed banks that by June 30 they must liquidate their net foreign assets, which at the end of January were about $800 million. Italian banks reduced their net foreign assets by some $350 million in the period February through April, after having increased their net lendings in the Euro-dollar market on a heavy scale in preceding months.

First-quarter data show a balance of payments surplus for the Netherlands compared with a deficit a year earlier and a deficit for the full year 1968 of $100 million. About half of the year-to-year improvement in the first quarter reflected a reduction in the trade deficit since the end of last year, despite continuing strong inflationary pressures.

Belgium continued to run a deficit in the first quarter because of capital outflows, but the imbalance was less than a year earlier and much smaller than the deficits in the latter half of 1968 that were largely responsible for Belgium's $222 million deficit for all of last year.

Outflows of non-bank capital seem to have slowed in 1969, influenced by the exceedingly sharp increases in short-term interest rates in Belgium since last fall. Belgian banks, however, increased their net foreign assets considerably in January and February in response to the pull of the Euro-dollar market, and by end-February net official reserves were down $320 million from last June 30. Although the banks' net foreign position was practically unchanged in March, early in April the National Bank of Belgium issued instructions which, it is believed, require banks to reduce their gross foreign assets by perhaps about $150 million by the end of June.

Sweden's balance of payments was rather severely in deficit in the first quarter, despite the fact that the trade balance strengthened markedly after the turn of the year. The deficit seems to be a reflection of a substantial outflow of non-bank capital. This may have slowed down, however, after the rise in the discount rate from 5 to 6 per cent at the end of February and the steps taken in March to restrain credit expansion. Much of the first-quarter deficit was financed by a rundown of the commercial banks' net foreign assets, a development contrary to that in most other Western European countries.

The large decline in Swiss official reserves since January has reflected the placement abroad of funds which Swiss commercial banks repatriated in December for liquidity reasons, together with some seasonal weakness in trade and tourism. Switzerland had an extremely large balance of payments surplus of $1.15 billion in 1968. It is estimated that the current account was in surplus by about $450 million last year, and there are no indications of worsening this year.

The Canadian balance of payments was in equilibrium on an unadjusted basis in the first quarter of the year, following large surpluses in each of the three preceding quarters. Seasonally adjusted, there was a surplus of about $175 million. The shift from a $341 million surplus in the fourth quarter of 1968 to virtual balance in this year's first quarter was the result largely of changes in flows of non-bank short-term capital under the influence of tighter U.S. credit conditions. The current account showed only a minor seasonal weakening, and seasonally adjusted imports and exports both advanced 7 per cent over the previous quarter. Net receipts of long-term capital were probably at least as great as in the fourth quarter, since deliveries to foreigners of bonds newly issued by the Federal and provincial governments and Canadian corporations in January and February alone exceeded the total for the fourth quarter by $137 million. In contrast with the marked change in flows of non-bank short-term funds, Canadian banks increased their net short-term foreign assets by a relatively small $64 million, little more than in the fourth quarter. The Canadian dollar was virtually untouched by the April-May speculation on the mark.

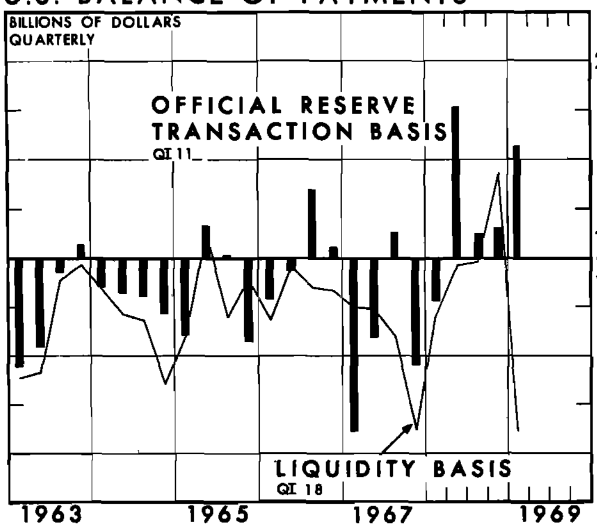
In Japan, the balance of payments remained heavily in surplus in the first four months of the year, and the surplus on merchandise trade increased. The swing from a deficit of $259 million in January-April 1968 to a surplus of $438 million this year was mainly a reflection of an increased trade surplus, although a slimming of the deficit on services also was instrumental. In the first quarter, seasonally adjusted exports rose a further 6 per cent over the fourth quarter, but imports fell back 2 per cent. Compared with a year earlier, exports were 29 per cent higher and imports 10 per cent higher.

Further increases in Japanese net official reserves in the first quarter brought the total gain for the latest 12-month period to $1.25 billion. In April, however, official net reserves declined $119 million, as Japanese commercial banks reduced their net foreign liabilities by $270 million. On April 8 the Bank of Japan gave Japanese banks permission to shift from dollar to yen import financing and to repay about $250 million of gross short-term foreign liabilities in the second quarter. This action was taken in the light of the high interest rates prevailing in both the Euro-dollar market and the United States.

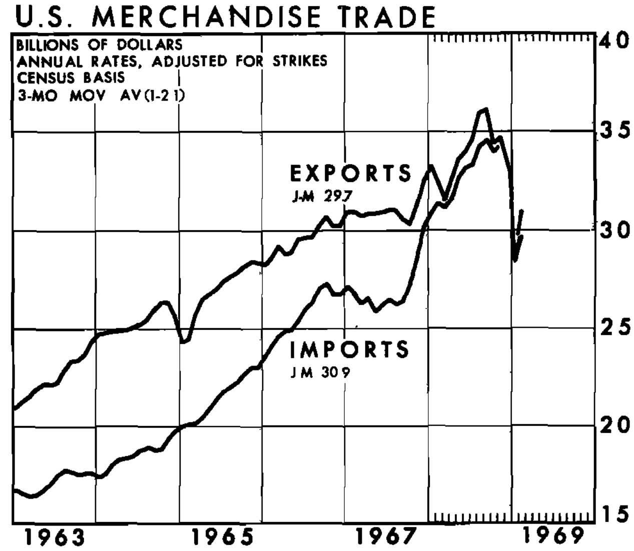
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

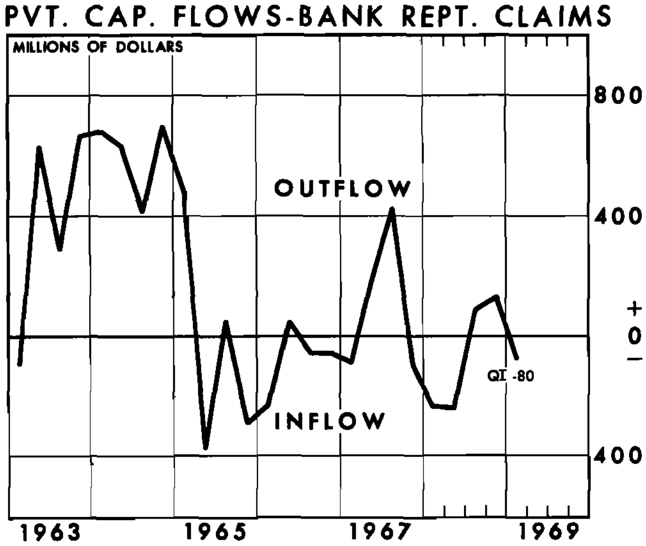
U.S. BALANCE OF PAYMENTS



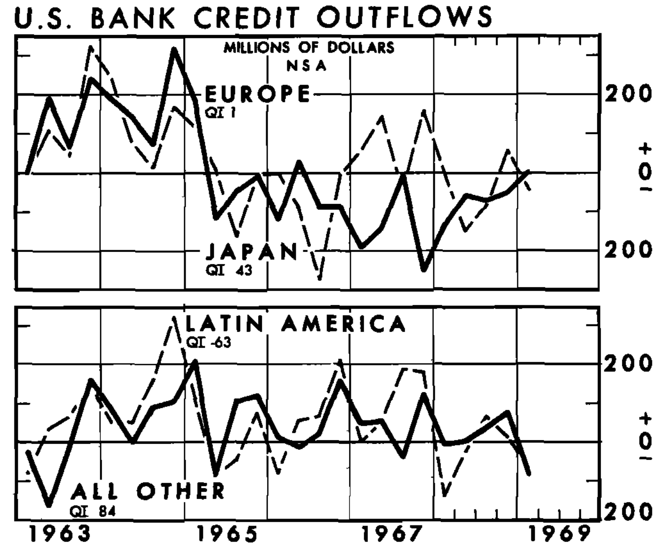
U.S. MERCHANDISE TRADE



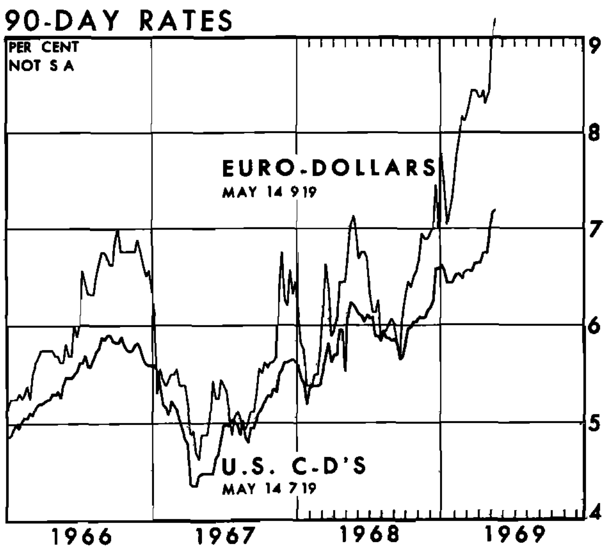
PVT. CAP. FLOWS-BANK REPT. CLAIMS



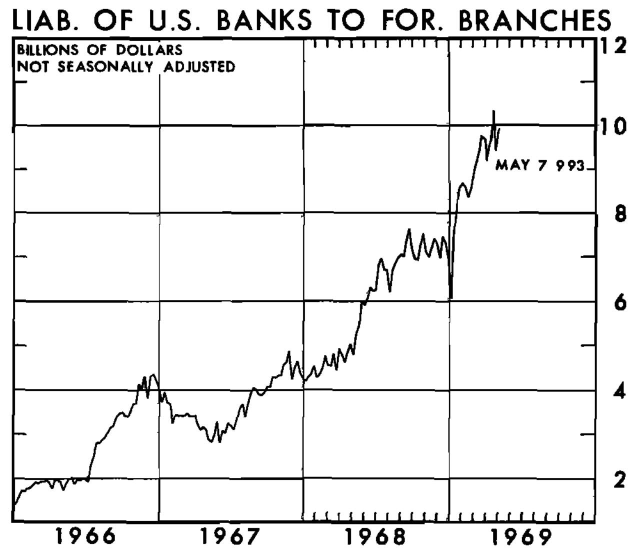
U.S. BANK CREDIT OUTFLOWS



90-DAY RATES



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



On October 31, the System launched a new quarterly survey of loan commitments at 48 of the largest respondents in the Quarterly Interest Rate Survey--that is, banks with total deposits of $1 billion or more, and a second survey was conducted on January 31. The results of the first two surveys, tabulated according to special procedures necessary to provide meaningful data comparisons, are summarized below.[1/]

Results of the Surveys.

Total unused commitments of the sample of 42 banks that reported all items on the January 31 survey were in excess of $48 billion, with nearly 80 per cent extended to commercial and industrial firms, as shown

1/ Owing to the limited advance notice, reporting on the first survey was incomplete and in some cases inaccurate due to misunderstanding of the reporting form instructions. Many of these difficulties had been resolved by the time the second survey was conducted as of January 31, although some banks were still unable by that time to provide all the detail requested. Consequently, special tabulation procedures had to be developed in order to provide meaningful interrelationships of the data. The major focus in the revised procedures was to assure internal consistency and comparability of the statistics. This imposed two principal constraints: (1) Tabulations showing interrelationships of reported items, such as components to totals and new commitments to unused commitments, were confined to those reports in which information had been supplied for all items. Thus, banks indicating that certain items were not available or that had combined items (other than term loans and revolving credit commitments to commercial and industrial firms) were excluded. (2) Tabulations showing changes in commitments from the previous survey were confined to a matched sample of banks reporting comparable data on both surveys. In the January survey, 42 of the 48 respondents submitted reports that were sufficiently complete to be included in the over-all tabulation of commitments by types, while only 34 respondents had submitted reports in both October and January that were suitable for comparisons between surveys and of new commitments to outstandings. Satisfactory responses to the qualitative questions were provided by 47 banks in October and 48 in January. In the tabulations, where the sample of responses has been cut back for matching purposes, the number of banks included is shown in parentheses. Hopefully, as banks are able to supply more complete data, the tabulations can be expended to include all 48 respondents. Until then, time series generated by these surveys will need to be viewed with caution since the number of banks included in the tabulations will vary from survey to survey.

in Table 1. For the 34 banks submitting reports in January and October suitable for comparison, unused commitments to commercial and industrial firms fell by over $1 billion during the three months ending January 31, while unused commitments to nonbank financial institutions and mortgage commitments both registered small increases.

Commitments to C&I firms. New commitments made to C&I firms during the three months covered by the January survey were almost one-third of the amount of unused commitments outstanding on October 31, 1968, but takedowns, expirations, and cancellations (hereafter referred to simply as takedowns) were even larger. The high rate of takedowns probably reflected the marked acceleration of the growth rate in business loans outstanding during these three months. Nevertheless, unused C&I commitments on January 31 remained greater than total C&I loans outstanding at the sample banks.

Confirmed lines of credit constitute the largest category of unused commitments to C&I firms, accounting for nearly two-thirds of the total and three-fifths of the new commitments made during the quarter. Percentage increases of new commitments were also high in both the term loan and other commitments categories, while takedowns in both categories were in excess of 50 per cent of all available commitments. The volume of unused commitments on term loans--which is a factor of particular concern to banks during periods of monetary restraint in view of their slow roll-over--declined by more than one-fourth between October and January, and accounted for less than 5 per cent of the total for C&I loans on January 31. Unused commitments on revolving credits, which generally run for a year or two, also declined between October and January, and account for nearly one-fourth of the unused C&I total on January 31.

Nonbank financial institution and mortgage commitments. Unused commitments to nonbank financial institutions rose slightly over the three months, bringing the ratio of these commitments to the amount of loans outstanding to those institutions to over 135 per cent. The ratio of finance company commitments to finance company loans was almost 175 per cent at the end of January. However, as a measure of relative exposure compared with other loan categories, this is not a meaningful figure, since many finance companies rotate their use of credit lines among their banks throughout the year, and generally try to schedule takedowns to the convenience of the individual bank. Unused commitments to acquire residential real estate mortgages showed the sharpest rise--nearly 22 per cent--for any category during the January survey quarter. Mortgage loan commitments, however, account for a relatively small percentage of total, and most of them were construction loans.

Policy views. About 75 per cent of the respondent banks indicated that their commitment policy was more restrictive on January 31 than it had been three months earlier, while no banks eased their commitment policies, as shown in Table 3. In the October survey, only about 20 per cent of the respondents had firmed their commitment policy from that of three months earlier. In the January survey, banks that stiffened their commitment policies tended to be those that experienced increases in unused commitments in the preceding three months--ending in January--and that anticipated takedowns to increase in the next three months (Table 4). About 45 per cent of banks firming commitment policies gave reduced availability of funds as the reason, while about 40 per cent indicated both reduced availability of funds and increased loan demand (Table 6).

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QUOTATION OR
PUBLICATION

QUARTERLY SURVEY OF BANK LOAN COMMITMENTS
AT SELECTED LARGE U.S. BANKS 1/
(AS OF JAN 31, 1969)

TABLE 1
UNUSED AND NEW COMMITMENTS 2/
PART A -- MILLIONS OF DOLLARS

	UNUSED COMMITMENTS			NEW COMMITMENTS		TAKEDOWNS, EXPIRATIONS AND CANCELLATIONS	
	AS OF JAN 31 1969	CHANGE FROM OCT 31 1968	PERCENT CHANGE FROM OCT 31 1968	DURING QUARTER ENDING JAN 31 1969	AS A PERCENT OF UNUSED COMMIT 3/	DURING QUARTER ENDING JAN 31 1969	AS A PERCENT OF AVAILABLE COMMIT 4/
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
NUMBER OF BANKS 5/	42	(34)	(34)	(34)	(34)	(34)	(34)
GRAND TOTAL COMMITMENTS	48,289	-1,170	- 2.7	12,901	29.8	14,071	25.1
TOTAL-COMMERCL + INDUS FIRMS	37,406	-1,509	- 4.4	10,389	30.5	11,898	26.8
TOTAL-NONBANK FINANCIAL INST	8,139	+ 200	+ 2.8	1,649	23.5	1,449	16.7
TOTAL-REAL ESTATE MORTGAGES	2,744	+ 139	+ 6.3	863	38.9	724	23.5
MEMO-CONSTR LOANS (INCL ABOVE)	(2,228)	+ (64)	+ 3.5	(698)	37.8	(634)	24.9
TOTAL-COMMERCL + INDUS FIRMS							
TERM LOANS	1,639	- 568	- 27.9	1,422	69.8	1,990	57.5
REVOLVING CREDITS	8,726	- 635	- 7.4	2,131	25.0	2,766	25.9
TOTAL TERM + REVOLVING 6/	11,221	-1,236	- 10.8	3,886	34.0	5,122	33.5
CONFIRMED LINES OF CREDIT	24,579	+ 15	+ .1	6,152	28.2	6,137	21.9
OTHER COMMITMENTS	1,606	- 288	- 36.6	351	44.6	639	56.2
TOTAL-NONBANK FINANCIAL INST							
FINANCE COMPANIES	5,305	+ 108	+ 2.4	886	19.5	778	14.4
FOR MORTGAGE WAREHOUSING	1,410	+ 53	+ 4.7	309	27.3	256	17.8
ALL OTHER	1,424	+ 39	+ 2.9	454	33.5	415	23.0
TOTAL-REAL ESTATE MORTGAGES							
RESIDENTIAL	848	+ 118	+ 21.6	264	48.4	146	18.0
OTHER	1,896	+ 21	+ 1.3	599	35.8	578	25.4

1/ PARTICIPANTS IN QUARTERLY INTEREST RATE SURVEY WITH TOTAL DEPOSITS OF MORE THAN $1 BILLION (48 BANKS).
2/ DETAILED DATA NOT AVAILABLE FOR ALL BANKS THEREFORE ACTUAL COMMITMENTS MAY BE MORE THAN INDICATED HERE.
3/ NEW COMMITMENTS DURING CURRENT PERIOD AS A PERCENT OF UNUSED COMMITMENTS AT END OF PREVIOUS PERIOD.
4/ AVAILABLE COMMITMENTS ARE DEFINED AS UNUSED COMMITMENTS AT END OF PREVIOUS PERIOD PLUS NEW COMMITMENTS DURING THE CURRENT PERIOD.
5/ PARENTHESES INDICATE MATCHED SAMPLE OF BANKS.
6/ MAY EXCEED SUM OF PREVIOUS TWO ITEMS BECAUSE SOME BANKS REPORT COMBINED TOTAL ONLY.

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TABLE 1
UNUSED AND NEW COMMITMENTS
PART B -- PERCENTAGES

	UNUSED COMMITMENTS	NEW COMMITMENTS	TAKEDOWNS, EXPIRATIONS AND CANCELLATIONS
	AS OF JAN 31 1969	DURING QUARTER ENDING JAN 31 1969	DURING QUARTER ENDING JAN 31 1969
	(1)	(2)	(3)
NUMBER OF BANKS	42	(34)	(34)
GRAND TOTAL COMMITMENTS	100.0	100.0	100.0
TOTAL-COMMERCL + INDUS FIRMS	77.5	80.5	84.6
TOTAL-NONBANK FINANCIAL INST	16.8	12.8	10.3
TOTAL-REAL ESTATE MORTGAGES	5.7	6.7	5.1
MEMO-CONSTR LOANS (INCL ABOVE)	4.6	5.4	4.5
TOTAL-COMMERCL + INDUS FIRMS	100.0	100.0	100.0
TERM LOANS	4.4	13.7	16.7
REVOLVING CREDITS	23.3	20.5	23.2
TOTAL TERM + REVOLVING	30.0	37.4	43.1
CONFIRMED LINES OF CREDIT	65.7	59.2	51.6
OTHER COMMITMENTS	4.3	3.4	5.3
TOTAL-NONBANK FINANCIAL INST	100.0	100.0	100.0
FINANCE COMPANIES	65.2	53.7	53.7
FOR MORTGAGE WAREHOUSING	17.3	18.8	17.7
ALL OTHER	17.5	27.5	28.6
TOTAL-REAL ESTATE MORTGAGES	100.0	100.0	100.0
RESIDENTIAL	30.9	30.6	20.2
OTHER	69.1	69.4	79.8

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TABLE 2
RATIOS OF UNUSED COMMITMENTS TO LOANS OUTSTANDING

UNUSED COMMITMENTS.......AS A	PERCENT OF.......LOANS OUTSTANDING 1/	OCT 31 1968	JAN 31 1969
		(1)	(2)
NUMBER OF BANKS		34	42
TOTAL UNUSED COMMITMENTS	GROSS LOANS	68.6	63.0
COMMERCL + INDUSTRL FIRMS	COMMERCIAL + INDUSTRIAL LOANS	109.0	100.5
NONBANK FINANCIAL INST	LOANS-NONBANK FINANCIAL INST	131.2	135.5
REAL ESTATE MORTGAGES	REAL ESTATE LOANS	23.2	25.1
COMMERCL + INDUSTRL FIRMS			
TERM LOANS	COMMERCIAL + INDUSTRIAL LOANS	5.4	4.8
REVOLVING CREDITS	COMMERCIAL + INDUSTRIAL LOANS	22.5	25.3
TOTAL TERM + REVOLVING	COMMERCIAL + INDUSTRIAL LOANS	34.4	29.8
CONFIRMED LINES OF CREDIT	COMMERCIAL + INDUSTRIAL LOANS	69.6	65.9
OTHER COMMITMENTS	COMMERCIAL + INDUSTRIAL LOANS	2.3	3.8
NONBANK FINANCIAL INST			
FINANCE COMPANIES	LOANS TO FINANCE COMPANIES	164.1	173.2
MORTGAGE WAREHOUSING	OTHER NONBANK FINANCIAL INST	53.4	53.5
ALL OTHER	OTHER NONBANK FINANCIAL INST	47.4	46.2
REAL ESTATE MORTGAGES			
RESIDENTIAL	REAL ESTATE LOANS	6.3	7.1
OTHER	REAL ESTATE LOANS	17.0	18.1

1/ AS REPORTED ON THE WEEKLY REPORT OF CONDITION (FR416) FOR THE WEDNESDAY NEAREST THE SURVEY DATE.

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TABLE 3
VIEWS ON COMMITMENT POLICY
PART A -- NUMBER OF BANKS

	OCT 31 1968	JAN 31 1969
	(1)	(2)
TOTAL NUMBER OF BANKS	47	48
UNUSED COMMITMENTS		
IN THE PAST THREE MONTHS HAVE		
RISEN RAPIDLY	1	3
RISEN MODERATELY	25	19
REMAINED UNCHANGED	18	17
DECLINED MODERATELY	3	9
DECLINED RAPIDLY	-	
TAKEDOWNS		
IN THE NEXT THREE MONTHS SHOULD		
RISE RAPIDLY	1	4
RISE MODERATELY	27	28
REMAIN UNCHANGED	19	15
DECLINE MODERATELY	-	1
DECLINE RAPIDLY	-	
COMMITMENT POLICY		
COMPARED WITH THREE MONTHS AGO IS		
MUCH MORE RESTRICTIVE	1	8
SOMEWHAT MORE RESTRICTIVE	9	28
UNCHANGED	33	12
LESS RESTRICTIVE	4	-
MUCH LESS RESTRICTIVE	-	-

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TABLE 4
COMPARISON OF SELECTED RESPONSES IN THE
OCT 31 1968 AND JAN 31 1969 SURVEYS
PART A -- NUMBER OF BANKS

	OCT 31 1968	JAN 31 1968		
		UNUSED COMMITMENTS IN THE PAST THREE MONTHS HAVE		
UNUSED COMMITMENTS IN THE PAST THREE MONTHS HAVE	NUMBER OF BANKS	RISEN	REMAINED UNCHANGED	DECLINED
RISEN	26	13	9	4
REMAINED UNCHANGED	18	8	7	3
DECLINED	3	-	1	2
TOTAL	47	21	17	9

		TAKEDOWNS IN THE NEXT THREE MONTHS SHOULD		
TAKEDOWNS IN THE NEXT THREE MONTHS SHOULD		RISE	REMAIN UNCHANGED	DECLINE
RISE	28	23	4	1
REMAIN UNCHANGED	19	8	11	
DECLINE	-			
TOTAL	47	31	15	1

		TAKEDOWNS IN THE NEXT THREE MONTHS SHOULD		
COMMITMENT POLICY COMPARED TO THREE MONTHS AGO IS		RISE	REMAIN UNCHANGED	DECLINE
MORE RESTRICTIVE	10	7	3	
UNCHANGED	33	20	12	1
LESS RESTRICTIVE	4	4	-	
TOTAL	47	31	15	1

		UNUSED COMMITMENTS IN THE PAST THREE MONTHS HAVE		
TAKEDOWNS IN THE NEXT THREE MONTHS SHOULD		RISEN	REMAINED UNCHANGED	DECLINED
RISE	28	12	8	8
REMAIN UNCHANGED	19	9	9	1
DECLINE	-			
TOTAL	47	21	17	9

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TABLE 5
CROSS CLASSIFICATION OF SELECTED
RESPONSES IN THE CURRENT SURVEY
PART A -- NUMBER OF BANKS

UNUSED COMMITMENTS IN THE PAST THREE MONTHS HAVE	NUMBER OF BANKS	COMMITMENT POLICY COMPARED TO THREE MONTHS AGO IS: MORE RESTRICTIVE	UNCHANGED	LESS RESTRICTIVE
RISEN	22	17	5	
REMAINED UNCHANGED	17	11	6	
DECLINED	9	8	1	
TOTAL	48	36	12	

****

UNUSED COMMITMENTS IN THE PAST THREE MONTHS HAVE		TAKEDOWNS IN THE NEXT THREE MONTHS SHOULD: RISE	REMAIN UNCHANGED	DECLINE
RISEN	22	18	4	
REMAINED UNCHANGED	17	9	8	
DECLINED	9	5	3	1
TOTAL	48	32	15	1

****

TAKEDOWNS IN THE NEXT THREE MONTHS SHOULD		COMMITMENT POLICY COMPARED TO THREE MONTHS AGO IS: MORE RESTRICTIVE	UNCHANGED	LESS RESTRICTIVE
RISE	32	26	6	
REMAIN UNCHANGED	15	9	6	
DECLINE	1	1	-	
TOTAL	48	36	12	

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QUOTATION OR
PUBLICATION

TABLE 6
EXPLANATION OF RECENT CHANGE IN NEW COMMITMENT POLICY AS INDICATED IN THE CURRENT SURVEY

INDICATED CHANGE	NUMBER OF BANKS INDICATING CHANGE	REASONS FOR CHANGE (NUMBER OF BANKS)		
		INCREASED LOAN DEMAND	REDUCED AVAILABILITY OF FUNDS	BOTH DEMAND AND FUNDS
MORE RESTRICTIVE	36	5	16	15
		DECREASED LOAN DEMAND	INCREASED AVAILABILITY OF FUNDS	BOTH DEMAND AND FUNDS
LESS RESTRICTIVE	NONE	-		

APPENDIX B: A COMPARISON OF THE FRB AND WHARTON CAPACITY UTILIZATION SERIES*

The following table compares recent values of the quarterly manufacturing capacity utilization series of the Federal Reserve Board with the industrial (manufacturing, mining and utilities) utilization series published by the Wharton School of Finance and Commerce.

	FRB Manufacturing Capacity Utilization	Wharton Industrial Capacity Utilization
1966 - I	90.5	95.4
II	90.8	96.3
III	90.6	96.7
IV	90.0	96.5
1967 - I	87.1	93.9
II	85.0	92.4
III	84.3	91.8
IV	84.8	92.6
1968 - I	84.9	93.4
II	84.8	93.7
III	84.0	93.1
IV	84.2	93.7
1969 - I	84.4	94.1

It is evident that the Wharton index is generally higher over this period, and that the difference is increasing. The 1967 decline was less severe in the Wharton figures and more of a recovery has taken place since then. By the end of 1968 the Wharton rate was 3 points below its 1966 high, compared to over 6 points for the FRB series.

The general level of the FRB series is controlled by the results of an annual survey taken by McGraw-Hill Co. which asks manufacturing firms to state the per cent of their capacity which they were operating at the end of the previous year. The most recent survey, which has just become available, was in line with the FRB figures. However, there are some reasons for thinking that current values of the FRB series could be too low.

* Prepared by Jared J. Enzler, Economist, Division of Research and Statistics.

(1) The FRB series depends heavily on a stable relationship between capital output ratios and capacity. Data by Kuznets has indicated that the capital output ratio in the U.S. has declined slowly but steadily since 1900. Since 1966 this relationship seems to have reversed. The underlying reasons for the change are apparently the investment tax credit and accelerated depreciation law of 1962, and the Long amendment of 1964. These changes reduced the price of capital relative to other factors of production and shifted the desired capital output ratio. Some work done for the FRB-MIT model suggests that a dollar of capital expenditure since 1966 buys at least 10 per cent less capacity than a 1958 dollar spent before that date. The FRB series is constructed in such a way that this shift, if it has really occurred, has been only partially taken into account.

(2) Another possible source of bias is the sudden rise in capital expenditures for computers. When IBM builds a computer and rents it to an insurance company, the computer is counted as part of the manufacturing industry's capital stock. The rapid growth of this practice since 1965 has inflated recent manufacturing capital stock series and biased the capacity series. It may be necessary to make an adjustment for this in the next revision.

With regard to the problem of comparing the Wharton and FRB series we first need a short description of the computation of the Wharton series. Wharton in effect plots production series for each of thrity industries included and then draws straight lines between periods of peak output. These lines are held to represent capacity for their respective industries. From these capacity lines and the production series, utilization rates for each industry are calculated. A weighted combination of these utilization rates gives the operating rate for the industrial sector.

While such a procedure might appear to furnish only a crude approximation, it has been pretty well thought out by the Wharton people. However, it is well to keep in mind the following points:

(1) Levels of the Wharton and FRB series cannot be compared directly. Since each peak production period is regarded as 100 per cent utilization by Wharton, their utilization rate is almost always well above the FRB rate.

(2) If the current quarter is not a "peak" quarter, capacity is calculated by extrapolating the line between the two previous "peaks". Eventually production will exceed this extrapolated line and the line will be tilted upward. Because of this, current values of the Wharton index are always biased upward and tend to be lowered by later data. These revisions can be serious. For example, for the first quarter of 1962 the initial Wharton estimate of the utilization rate was 94. By 1968 the estimate for the same quarter had been reduced to 82.8, a reduction of over 10 points. While this is an extreme case, it still indicates that current values of the Wharton index are suspect.

(3) The practice of drawing straight arithmetic lines between peaks causes an artifical decline in estimated capacity growth rates and biases current Wharton utilization rates upward. This is a serious matter only if the interval between peaks is long. Since for many industries the last two peaks were in 1959-60 and 1966, this has become an important source of bias. This has been most significant in the Wharton evaluation of capacity growth rates for chemicals, nonelectrical, and electrical machinery.

(4) The Wharton series is calculated in such a way that if output grows steadily at any positive growth rate the Wharton utilization rate will eventually reach 100 per cent regardless of what happens to actual capacity. For almost two years now the industrial production has grown at a remarkably steady rate.

Despite the above, we cannot assert with confidence that current Wharton utilization rates are too high, but past performance suggests they will be revised downward to show a pattern more like the present FRB series.

APPENDIX C: ADJUSTED OVER-ALL BALANCE

It has become increasingly evident that the two standard measures of over-all surplus or deficit in the international transactions of the United States--the liquidity balance and the balance settled by official reserve transactions--are often very misleading indicators of changes in the underlying trends of the international transactions of the United States. Any such measure is, of course, an analytical abstraction that can not be substituted for analyses that examine the structure of payments and receipts and that take into account a wide range of circumstances and objectives. Nevertheless, summary measures such as these make an impression on public consciousness. It is important for policymakers to understand their peculiarities, and to be familiar with alternative measures that may in some respects be superior to the standard measures.

Unlike other macro-measures, such as the Gross National Product, the "balance" of a set of international transactions involves a selection rather than a simple summation or averaging process. The difficulties and ambiguities in doing this are described in some detail in the Report of the Review Committee for Balance of Payments Statistics (Bernstein Report).

It should be emphasized that no one of the possible summations of the balance of payments can in itself measure an absolute degree of deviation from some "equilibrium" position. For instance, U.S. payments deficits in the period up to 1957 could have been quite consistent with long-run international equilibrium, had not important changes in international competitive positions begun to develop in the mid-1950's. The variety of considerations bearing on the question of equilibrium includes many factors not represented in the international transactions accounts per se, and a wide array of information needs to be taken into account in reaching judgments on that more general issue. Nevertheless, a well-chosen summary measure of the balance of payments can serve this important purpose: its changes over time ought to provide a not-too-misleading starting point for discussion of whether the underlying balance of payments position is changing in a desirable direction or not.

Both of the standard measures fall short of doing this satisfactorily. The changes in net payments or receipts which they measure from quarter to quarter are excessively influenced by large movements of certain types of funds.

In the case of the liquidity balance, as is well known, results depend on a classification of U.S. liabilities into liquid and nonliquid liabilities. Thus the measure can be affected, deliberately or otherwise, by changes in the form rather than the substance of international assets or liabilities. Most familiar is the transformation of foreign official accounts in the United States into non-liquid claims by placing them in deposit accounts with an original maturity of over one year. Other difficulties with this balance arise because of the asymmetrical treatment of privately held assets and

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Prepared by Samuel Pizer, Associate Adviser, Division of International Finance.

liabilities. For instance, by convention, deposits abroad of U.S. private residents are not counted "below the line" though deposits of private foreigners in U.S. commercial banks are so counted.

Similarly, the over-all balance settled by official reserve transactions provides a poor starting point for analysis of underlying trends because of the extreme variability introduced by large changes from quarter to quarter in the flows of liquid funds to the United States through commercial banks abroad. It should be borne in mind, too, that this measure has deficiencies in terms of its own objectives. This measure is sometimes thought to reflect the extent to which monetary authorities are gaining or losing international reserves as the result of market forces. It is also assumed to be the indicator used uniformly by monetary authorities to measure changes in their international positions, and thus to insure consistent policy responses among countries. But monetary authorities who intervene in forward markets or who use directives to regulate the net foreign position of their commercial banks commonly count changes in the net foreign position of the commercial banks of their countries as part of their over-all view of their international reserve position. It is hardly likely that a European central bank would act as if it had a deficit if it was taking steps to reduce its holdings of dollars by inducing its commercial banks to hold them.

For some time efforts have been made to derive measures of the over-all payments position that sidestep some of the difficulties of the standard measures. One approach has been to identify as "special" certain transactions involving foreign official claims on the United States, and to adjust the two conventional measures so as to eliminate the effect of such transactions. Usually, the resulting measure has been called the liquidity balance before special transactions. The thought behind this adjustment is that such "special" transactions artifically obscure the state of affairs as reflected in all other international transactions, and tend to show gains from time to time that are not supported by underlying economic developments. Such an adjusted liquidity balance can be derived from the data given in the regular quarterly articles on the balance of payments published by the Commerce Department in the Survey of Current Business and has also been used frequently--with some relatively minor differences--in the Green Book.

Though the liquidity balance before special transactions has proved to be a more stable indicator of changes in the underlying position than the standard measures, it too presents some difficulties to the user. These difficulties include the following:

(1) It is necessary to identify many transactions as "special," some of which are recurrent or could be sustained for some time, while others are one-time. Moreover, though all these transactions affect official reserves, they differ greatly in size and significance. But obviously other official

actions through more general measures also affect reserve positions. The result is that there are serious questions as to the analytical consistency involved in this particular grouping of transactions, and a continuing debate among knowledgeable users of the data as to the suitability of counting this or that item as "special."

(2) The use of such a selected measure tends to focus attention on so-called window-dressing operations, undermining unnecessarily the credibility of the statements that are issued by the U.S. Government. Moreover, it is very difficult to explain to less knowledgeable users what these adjustments are all about.

(3) Data for some of the "special" transactions are not readily available, and some are available only with a considerable lag if they are derived from the Government transactions information gathered by the Office of Business Economics. Also, the OBE accords different treatment to some items (e.g., the German military offset arrangement) than has been done in the Green Book tabulations, and in some instances the OBE does not publish precise information because of confidentiality problems (e.g., the liquidation of the U.K. portfolio).

(4) When certain items are identified as "special" the impression is given that the remaining items are "regular" or basic. There are many other temporary influences at work that ought to be allowed for in a reasonably complete analysis, but this partial selection may divert attention from the need for a further search for such "special" factors. That is, the name given to this balance gives a spurious notion of the extent of the analysis that is involved in its creation.

An attempt is being made in this Green Book (and was made in the April Federal Reserve Bulletin) to derive a measure of changes in the over-all balance that avoids some of these difficulties, though it, in turn, is not to be taken as a substitute for analysis. For want of a better name, this is called the "adjusted over-all balance." It may be considered to measure the net sum of all international transactions other than (1) changes in international reserves of the United States, and (2) changes in U.S. liabilities to foreign official reserve holdings and to foreign commercial banks (including foreign branches of U.S. banks). In other words, this is the balance measured by, and financed by, the sum of official settlements and changes in bank-reported liabilities to foreign commercial banks. (The latter includes only liabilities reported by U.S. banks; it does not include any liabilities to foreign banks appearing only in the accounts of U.S. non-banks.)

For purposes of comparison, the table that follows gives the over-all balance as measured by four different concepts quarterly for the past several years. Two variants of the adjusted over-all balance are presented, one differing from the other by counting as financing items the advance repayments of U.S. postwar loans and the liquidation of the U.K. official portfolio of U.S. securities.

The new measure, introduced here on a still experimental basis, has some advantages that are the counterparts of the difficulties of the other balances mentioned above:

(1) it is simple to construct from readily available data, and to explain to the public;

(2) it does not undergo large changes from quarter to quarter due solely to nominal changes in the degree of liquidity of officially held assets, or because of changes in the pace or the direction of switches in dollar claims on the United States between foreign central banks and foreign commercial banks;

(3) it avoids controversies over the nature of "special" transactions;

(4) it can readily be modified, if desired, to take account of specific official transactions such as debt prepayments--but the possible desirability of inserting such modifications points up the fact that this measure, like the others, is much too selective to be substituted for analysis;

(5) it places <u>all</u> transactions of international lending institutions with the United States above the line, which has the desirable effect of <u>not</u> contributing to enlarge the deficit whenever one of these institutions borrows in the United States and deposits the proceeds in a U.S. bank pending disbursement;

(6) it does <u>not</u> count as an element contributing to deficits an increase in liquid claims on the United States by private foreigners other than commercial banks, so that an increase in working balances held by such non-residents is regarded as a capital inflow rather than as a financing item.

As noted above, this adjusted measure is being introduced on an experimental basis; whether it is retained or not will depend on whether it turns out to be useful as a means of conveying succinctly the over-all course of U.S. international transactions. The other measures will also continue to be used, though perhaps with a heightened awareness of their significance.

Measures of Over-all Balance in U.S. International Transactions
(in millions of dollars; seasonally adjusted; deficit (-))

	Liquidity basis (1)	Official Settlements basis (2)	Liquidity basis before special transactions (3)	Liabilities to foreign commercial banks NSA (decrease(-)) (4)	Advance debt repayments (5)	U.K. liquidation (6)	Adjusted over-all balance 1/ (7)	Adjusted over-all balance 2/ (8)
1960	-3,901	-3,403	-3,873	140	54	-60	-3,543	-3,537
1961	-2,371	-1,347	-3,018	586	695	-25	-1,933	-2,603
1962	-2,204	-2,702	-3,069	-138	680	-75	-2,564	-3,169
1963	-2,670	-2,011	-3,116	470	326	115	-2,481	-2,922
1964	-2,800	-1,564	-3,042	1,454	123	-133	-3,018	-3,008
1965	-1,335	-1,289	-1,383	116	221	-498	-1,405	-1,128
1966, total	-1,357	266	-2,947	2,697	428	-31	-2,431	-2,828
Q 1	-646	-390	-623	404	3	-26	-609	-586
2	-22	-108	-605	316	7	-46	-558	-519
3	-325	582	-723	1,144	226	8	-348	-582
4	-364	182	-997	833	192	33	-916	-1,141
1967, total	-3,571	-3,405	-4,831	1,262	6	-439	-4,667	-4,234
Q 1	-543	-1,759	-919	-753	--	9	-831	-840
2	-366	-741	-1,139	161	*	52	-1,012	-1,064
3	-892	59	-1,196	1,265	5	52	-970	-1,027
4	-1,770	-964	-1,576	589	*	-552	-1,854	-1,302
1968, total	156	1,639	-2,643	3,392	269	--	-1,753	-2,022
Q 1	-602	-423	-857	638	42	--	-888	-930
2	-71	1,518	-886	2,248	3	--	-829	-832
3	-23	239	-673	975	55	--	-492	-547
4	852	305	-226	-469	169	--	456	287
1969								
Q 1	-1,778	1,126	-2,029	3,239	7	--	-1,941	-1,948

* = Less than $500,000.
1/ The sum of columns 2 and 4 not seasonally adjusted, and the seasonal component of column 1.
2/ The sum of columns 5,6, and 7.