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CONFIDENTIAL (FR)

CURRENT CONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

January 7, 1970

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SUMMARY AND OUTLOOK

Outlook for Economic Activity

Weakness in the economy became more pronounced in the fourth quarter. Expansion in GNP slowed appreciably and real growth was minimal--apparently less than at any time since the first quarter of 1967. Final demands moderated in most sectors and inventory accumulation may have been smaller than in the preceding quarter. In some industries, such as autos, cutbacks in production schedules slowed inventory building, while in others stocks declined because of strikes.

At year-end, a number of key indicators continued to show weakness. Industrial production apparently declined in December for the fifth successive month, mainly reflecting continued output adjustments to weakening sales, especially in consumer durable goods industries; in defense and in some materials-producing industries output was also being cut back. Employment in manufacturing industries declined further in December.

Retail sales continue lackluster, as income gains have slowed and attitudes remain pessimistic concerning rising prices and future job and income prospects. December sales apparently declined from the reduced November level, according to weekly data, and new domestic auto sales dropped sharply to an annual rate of 7.7 million units.

There is a high probability of further easing in economic activity in the first half of 1970, especially in view of recent weakening trends. Some decline in inventory investment seems likely, and we have projected a $4 billion lower rate of accumulation in the second quarter. Limited availability of mortgage funds and high interest rates continue to point to further substantial declines in housing starts. Financing difficulties can also be expected to slow State and local government capital expenditures, and by mid-1970, Federal purchases of goods and services are still projected to be $4 billion below the fourth quarter level.

Recent legislation reducing taxes and increasing social security benefits provides more stimulus than we had assumed earlier, and should serve to increase consumption somewhat. But prospective additions to disposable income should be moderated in the first half by downward pressures on output and employment and a further rise in the saving rate is likely to be associated with the reduction in the surtax and the bulge in social security benefits.

Higher outlays for business fixed investment remain the major expansive force in the first half of this year. We continue to project first half increases in capital spending close to those reported in the recent Commerce-SEC survey, though there is an increasing likelihood of short-falls as the year progresses. On balance, real GNP is likely to show no further rise and may actually decline in the first half of this year.

Outlook for resource use and prices

Pressures on available industrial capacity and manpower have been abating over recent months, and this trend should continue well into 1970. The capacity utilization rate in manufacturing is estimated to have declined to under 81 per cent in December; without the General Electric strike, the rate would have been around one-half percentage point higher. With industrial production projected to decline further while capacity continues to grow, the rate is expected to dip below 80 per cent in the current quarter and some further downdrift is likely over the remainder of the year.

Initial and continued claims for unemployment insurance rose further in December, in part reflecting reductions in output of autos and other consumer durable goods. Our projections continue to show little change in nonfarm employment in the first half of this year--with some decline in manufacturing employment--and a rise in the unemployment rate to about 4.5 per cent by mid-year.

Nonetheless, upward pressures on wages are intense and settlements this year will be substantial. The agreement with the New York City transit workers provides a very large wage increase over the next two years. In the current quarter, major contracts covering some 1.5 million workers must be renegotiated and another million workers are covered by contracts expiring in the second quarter. Difficulties ahead in settling new labor contracts are pointed up by the apparent lack of progress in the G.E. negotiations after ten weeks of strike.

Despite potentially large settlements on new contracts, we expect some moderation this year in the over-all rate of increase in nonfarm average hourly earnings. This comprehensive measure should reflect the easing in demands for labor and shorter workweeks with less overtime pay.

While we continue to expect some slowing of price inflation, we have again raised our projection of the GNP deflator for 1970. Partly this reflects the effect on materials prices of the continued boom in Western Europe and Japan, and the less favorable outlook for food prices as a result of a larger and more extended shortfall in pork supplies than had been anticipated. In addition, prospective further increases in unit labor costs and management efforts to minimize declines in profits through pricing policies will keep upward pressures on industrial commodity prices. But relatively weak over-all demands and growing manpower and industrial resources still seem likely to dampen the over-all rate of price advance.

Prospective financial developments

A major factor in the near-term financial outlook is the very large volume of security offerings now in prospect for early 1970. As this expanded supply of new issues is marketed, interest rates may come under renewed upward pressure at least temporarily. Over the somewhat longer run, the principal influence that would tend to moderate interest rate pressures would be a further slowing of economic activity. Any overt action lessening the intensity of monetary restraint would, of course, accelerate such rate declines.

Outlook for securities markets. Expansion in the prospective supply of securities is centered chiefly in markets for publicly offered corporate bonds and Federal agency obligations. Nearly $1.5 billion of corporate bonds are already scheduled for January offering. In the absence of postponements, this supply could easily become still larger by month end, and volume for succeeding months of the quarter also seems likely to be sizable.

In the market for Federal agency obligations, the Home Loan Bank System can be expected to seek as much new money as the market will bear during the first quarter, given the heavy volume of already outstanding FHLB notes that must be refinanced. Altogether this net cash need may run to $1.3 billion of new money, and near the end of January the Farmer's Home Administration will be marketing $350-400 million of 5- and 10-year loan notes through an underwriting syndicate. If this latter operation is successful and the Budget goal on asset sales is to be even approximately realized, sizable further offerings of loan notes will be needed by early spring. With respect to State and local governmental units, financial needs will also remain pressing, although interest rate ceilings and constraints on commercial bank purchases should continue to restrict the average monthly volume of new offerings to less than $1 billion.

Even if heavy savings attrition at the S&L's should force the Home Loan Bank System to draw temporarily on its direct borrowing line at the Treasury, the Treasury is not expected to enter the market for new money until late February or early March. However, the February Treasury refinancing will be an additional factor exerting pressure on securities markets during January and early February, and this pressure will be intensified if the 2-1/2 per cent bond that matures in March is refunded along with the maturing February note, as seems likely. Taken together, public holdings of these two issues total $5.6 billion. Announcement of terms on the refinancing is scheduled for the last week in January, with books open early in February.

Outlook for mortgage lending. Fragmentary evidence available for the initial days of the current reinvestment period at depositary institutions suggest that savings attrition, while not of the disastrous proportions some had feared, is nevertheless likely to be large. Since heavy attrition had been widely anticipated, nonbank thrift institutions have already been following a policy of substantially reduced mortgage lending. The supply of mortgage money should thus remain light in the period ahead and mortgage interest rates should rise further, although the recent increase in ceiling rates on FHA and VA mortgages will tend to facilitate renewed activity in these Federally underwritten instruments.

Outlook for commercial banks. The heavy volume of capital market borrowing scheduled by corporations for early 1970 may permit some loan repayment at banks, and the projected cutback in business inventory investment may also help to reduce business loan growth. Overall, however, business demands for funds seem likely to remain strong enough to maintain heavy pressures on the banking system--particularly if the interest costs of commercial paper financing continue above the prime rate on loans at banks. Also, with the volume of offerings in securities markets expanding, security loans at banks could very well rise again.

The initial evidence on January deposit experience at banks suggests that attrition in consumer-type time and savings accounts will be heavy during the post-interest crediting period, as expected. While the rate of attrition is likely to moderate substantially as the quarter progresses, there appears to be little prospect for significant renewed growth in such accounts in the absence of a change in prevailing money market conditions or Regulation Q rate ceilings. Further declines in large domestic CD's are also expected but at a reduced rate commensurate with the shrinking level of outstandings, and inflows of foreign official deposits probably will continue to provide some offset to these losses. Taking all prospective sources of bank funds together, the outlook seems to be for little change from the recent conditions of persistent restraint, with little growth on balance or even some decline in both bank credit and the money supply, barring a change in monetary policy.

Balance of payments outlook

U.S. foreign trade statistics for November again failed to demonstrate as much slowing in the trend of U.S. import demand as we have been expecting. On the export side, too, the November outcome was a little disappointing, especially as regards machinery shipments--for which new export orders have continued strong. Probably the maintenance of strong U.S. demand for business capital equipment and tight supply conditions in this market contributed to the November trade results. The same factors may continue to act as a drag on improvement of the U.S. balance of payments on current account in coming months, and may perhaps call for some revision of our net export projection.

For the over-all balance of payments, prospects for 1970 are still for a net outflow of capital--apart from U.S. banks' borrowings abroad--much exceeding the expected small surplus on goods and services. The end-of-1969 gyrations in flows of U.S. corporate and other nonbank funds and the associated over-all surpluses on both bases of computation for December were occasioned partly by year-end requirements of the OFDI controls and partly by the continuing seepage of money out of the German mark; the first of these factors was strictly temporary and the second will now be of diminishing importance.

Efforts of U.S. banks to attract funds out of other currencies into Euro-dollars may be expected to be less successful in the next few months than at the same time of year in 1969, when interest rates in some European national markets were considerably lower than now and when holders of sterling and French francs were less confident about staying in those currencies. Although U.S. money market rates, and with them Euro-dollar rates, are much higher now than a year ago, the willingness of U.S. banks to bid up Euro-dollar rates still further is now somewhat restrained by the cost of the 10 per cent marginal reserve requirement on their borrowings from branches.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1969				Per Cent Changes* From		
	Aug.	Sep.	Oct.	Nov.	1 Mo. ago	3 Mos. ago	Year ago
Civilian labor force (mil.)	81.1	81.4	81.5	81.3	-0.2	0.3	2.9
Unemployment rate (%)	3.5	4.0	3.9	3.4	-	-	[3.4] 4/
Insured unempl. rate (%)	2.2	2.2	2.2	2.3	-	-	[2.1] 4/
Nonfarm employment, payroll (mil.)	70.5	70.4	70.6	70.6	0.0	0.2	2.9
Manufacturing	20.3	20.2	20.2	20.0	-0.9	-1.7	0.4
Nonmanufacturing	50.2	50.2	50.5	50.6	0.3	0.9	3.8
Industrial production (57-59=100)	174.3	173.9	173.1	171.1	-1.2	-1.8	2.1
Final products, total	172.7	172.6	171.0	168.7	-1.3	-2.3	0.5
Consumer goods	164.2	163.3	161.3	160.2	-0.7	-2.4	0.6
Business equipment	197.0	200.3	200.6	195.7	-2.4	-0.7	2.4
Materials	175.9	175.7	175.5	173.5	-1.1	-1.4	3.5
Capacity util. rate, mfg.	84.1	83.7	82.7	81.2	-	-	[84.3] 4/
Wholesale prices (57-59=100) 1/	113.4	113.6	114.0	114.7 5/	0.6	1.1	4.7
Industrial commodities (FR)	111.8	112.2	112.8	113.1	0.3	1.2	3.8
Sensitive materials (FR)	112.5	113.5	113.5	114.2	0.6	1.5	5.4
Farm products, foods & feeds	114.6	114.3	114.3	115.7 6/	1.2	1.0	6.8
Consumer prices (57-59=100) 1/	128.7	129.3	129.8	130.5	0.5	1.4	5.8
Food	127.4	127.5	127.2	128.1	0.7	0.5	6.3
Commodities except food	118.2	118.7	119.8	120.2	0.3	1.7	4.2
Services	145.0	146.0	146.5	147.2	0.5	1.5	7.1
Hourly earnings, pvt. nonfarm ($)	3.07	3.09	3.10	3.11	0.3	1.3	6.5
Hourly earnings, mfg. ($)	3.23	3.24	3.26	3.26	0.0	0.9	5.8
Weekly earnings, mfg. ($)	131.22	131.79	131.75	131.70	0.0	0.4	5.0
Net spend. weekly earnings, mfg. (3 dependents 57-59 $)	86.59	88.17	87.50	87.07	-0.5	.6	-1.6
Personal income ($ bil.) 2/	757.5	760.7	763.7	766.9	0.4	1.2	7.8
Retail sales, total ($ bil.)	29.3	29.3	29.6	29.5	-0.2	0.7	2.6
Autos (million units) 2/	8.1	9.1	8.4	8.3	-1.4	2.4	-6.4
GAF ($ bil.) 3/	8.1	7.9	8.1	8.0	-0.9	-1.0	3.4
12 leaders, composite (1963=100)	151.7	153.6	153.4	152.5	-0.6	0.5	3.6
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/	1,384	1,542	1,372	1,287	-6.2	-7.0	-25.7
Factory workweek (hours)	40.6	40.8	40.5	40.5	0.0	-0.2	-0.7
Unempl. claims, initial (thous.)	19.6	20.1	20.2	21.4	-5.9 8/	-9.2 8/	-12.6 8/
New orders, dur. goods, ($ bil.)	30.5	32.1	31.7	31.0	-2.2	1.7	5.8
Machinery & equipment	6.2	7.4	6.5	6.5	0.1	3.4	6.0
Common stock prices (41-43=10)	94.18	94.51	95.52	96.21 7/	0.7	2.2	-8.7

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ December prel., 115.0. 6/ December prel., 116.3. 7/ December figure, 91.11.
8/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	Averages - 1969					
	QI	QII	QIII	QIV	Dec.	Week ended Dec. 31
Interest rates, per cent						
Federal funds	6.56	8.33	8.98	8.94	8.97	8.71
3-mo. Treasury bills	6.09	6.20	7.02	7.36	7.82	8.00
3-mo. Federal agencies	6.39	6.80	7.63	7.92	8.14	8.23
3-mo. Euro-dollars	7.98	9.69	10.89	10.48	11.09	10.69
3-mo. finance co. paper	6.28	6.72	7.74	7.89	7.91	7.93
4-6 mo. commercial paper	6.65	7.54	8.49	8.63	8.84	9.00
Bond buyer municipals	5.03	5.43	6.00	6.41	6.82	6.79
Aaa corporate-new issues	7.06	7.32	7.75	8.32	8.75	--
20-year Treasury bonds	6.10	6.14	6.34	6.71	6.91	7.04
FHA mortgages, 30-year	8.04	8.17	8.37	8.48p	n.a.	n.a.

	Change during period				
	QI	QII	QIII	QIV	Dec.
Change in monetary aggregates (SAAR, per cent)					
Total reserves	.1	1.2	- 9.3	.5	3.8
Nonborrowed reserves	- 2.8	- 4.7	- 4.8	- 1.0	9.6
Credit proxy	- 4.8	- 2.2	- 9.4	- .3	- 1.7
Credit proxy + nondep. funds	n.a.	n.a.	- 7.4	2.1e	- .8e
Money supply	4.1	4.5	--	- .2	- 3.6
Time and savings deposits	- 5.1	- 3.0	-13.3	.2	5.0
Deposits at S&L's and MSB's	6.0	3.9	2.1	n.a.	n.a.
Bank credit, end-of-month	2.1	6.1	- .8	.6e	- 7.8e
Treasury securities	-26.7	- 8.4	-11.4	-27.1e	-49.6e
Other securities	2.2	.6	- 7.2	2.8e	--
Total loans	9.1	10.9	3.1	5.6e	- 1.8e
Business	15.4	10.8	5.1	3.9e	9.2e
	QI	QII	QIII	Oct.	Nov.
Commercial paper (SA change, $ mil.)	1,288	3,683	3,552	1,797	847
Bank related (NSA)	n.a.	n.a.	1,254	1,146	437

	1968			1969		
	Dec.	QIV	Year	Dec.	QIV	Year
New security issues (NSA, $ mil.)						
Total corp. issues	2,055	5,950	21,965	2,940e	7,610e	27,514e
Public offerings	607	2,555	10,731	1,340e	3,360e	12,622e
State and local government bond offerings	1,115	4,366	16,574	800e	2,936e	11,797e
Fed. sponsored agency debt (change)	418	594	3,353	587e	3,009e	9,331e
Fed. gov't. debt (change)	-3,586	-1,146	5,335	-2,370e	4,673e	-2,919e

n.a. - Not available. e - Estimated. p - Preliminary.
SAAR - Seasonally adjusted annual rate. NSA - Not seasonally adjusted.

U.S. BALANCE OF PAYMENTS
(In millions of dollars)
(Seasonally adjusted, except where noted)

	1968			1969				
	Year	III	IV	I	II	III p/	Oct. p/*	Nov. p/*
A. Good and services, net 1/	2,516	909	301	363	303	736		
Trade balance 2/	626	313	-75	-103	-3	328	117	91
Exports 2/	33,598	8,879	8,383	7,469	9,588	9,560	3,319	3,285
Imports 2/	-32,972	-8,566	-8,458	-7,572	-9,591	-9,232	-3,202	-3,194
Service balance	1,890	596	376	466	306	408		
B. Remittances and pensions	-1,159	-325	-285	-271	-286	-307		
C. Govt. grants & capital, net	-3,955	-968	-835	-793	-1,155	-1,052		
D. U.S. private capital	-5,157	-1,868	-947	-1,341	-2,002	-1,333		
Direct investment	-3,025	-1,262	-283	-928	-1,057	-1,095		
Foreign securities	-1,266	-337	-455	-323	-427	-562		
Banking claims	269	-90	-120	82	-501	205	-145	54
Other	-1,134	-179	-89	-172	-17	119		
E. Foreign capital	9,277	2,515	2,902	3,351	4,525	3,532		
Official foreign, nonliquid	2,407	433	709	-42	-278	-592		
Official foreign, liquid	-3,099	-55	22	-1,133	-570	2,127		
Foreign commercial banks, liquid	3,382	702	-74	2,962	4,801	1,253	374	865
New direct investment issues 3/	2,129	586	378	401	150	216		
U.S. corporate stocks	2,084	459	786	751	127	169	347	110
Other	2,374	390	1,081	412	295	359		
F. U.S. monetary reserves (increase -)	-880	-571	-1,076	-48	-299	-686	427	316
Gold stock	1,173	-74	-137	56	-317	-11	-26	19
Convertible currencies	-1,183	-474	-575	-73	246	-442	456	476
IMF gold tranche	-870	-23	-364	-31	-228	-233	-3	-179
G. Errors and omissions	-642	309	-60	-1,260	-1,088	-891		
H. BALANCES, (deficit -)								
Official settlements balance, S.A.		97	367	1,144	1,236	-918		
" " " N.S.A. 4/	1,638	72	-75	1,711	1,202	-1,038	-476	412
Liquidity balance, S.A.		-139	862	-1,670	-3,871	-2,555		
" " , N.S.A.	168	-408	738	-1,275	-3,812	-2,923	-837	-531
Adjusted over-all balance, S.A. 5/		-613	464	-1,826	-3,572	-2,179		
" " " , N.S.A.	-1,744	-882	340	-1,431	-3,513	-2,547	-850	-453
Financed by:								
Liab. to comm. banks (decrease -)	3,382	954	-415	3,142	4,715	1,509	374	865
Official settlements 6/	-1,638	-72	75	-1,711	-1,202	1,038	476	-412

1/ Equals "net exports" in the GNP, except for latest revisions.
2/ Balance of payments basis which differs a little from Census basis.
3/ New issues sold abroad by U.S. direct investors.
4/ 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.
5/ 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.
6/ Minus sign indicates decrease in net liabilities.

* Only exports and imports are seasonally adjusted.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. The year ended with further indications of weakness in most major sectors of demand. Consumer purchases continued sluggish through December--with a sharp decline in auto sales--and further reductions were also evident in new residential construction and in defense expenditures. The weakness in these areas of final sales was apparently reflected in some unintended accumulation of stocks, further downward adjustments of output, particularly in consumer goods industries, and reduced pressure on resources. Industrial production in December is expected to show a decline for the fifth month in a row; manufacturing capacity use was reduced further; factory employment declined and personal income gains slowed appreciably. Nevertheless, cost and price pressures still remain strong, and the latest evidence of capital spending intentions--a December Commerce-SEC survey of plans for the year 1970--indicates that businessmen still intend to increase their spending, particularly in the first half of this year.

We are now estimating that GNP increased by about $11 billion in the fourth quarter, and in real terms growth of gross national product slowed almost to a halt. Sluggish retail sales figures reflected both the recent slowing in income gains and a continued disinclination on the part of consumers to spend, particularly for such items as automobiles and appliances. As a result, the saving rate probably remained close to the relatively high third quarter rate. Unit sales of new domestic cars edged down throughout the fourth quarter; in December the annual rate of sales, at 7.7 million units, was about 10 per cent below a year earlier. Although there may have been a last minute flurry of pre-Christmas buying, weekly figures indicate that sales for the month declined, following a drop in November. In real terms, retail sales have now been below year-earlier levels for over half a year.

Residential construction activity also continued weak. Housing starts declined in November and for the quarter as a whole are estimated to have dropped to 1.3 million rate. Residential construction expenditures held at about the third quarter level, but only because of an increase in expenditures for alterations and additions. More significant, however, was the sizable decline in October and November of multi-family housing starts, which previously had appeared to be less affected by tight financial markets than single family units.

State and local governments also continued to be adversely affected by the high cost and limited availability of funds. Purchases of goods and services by this sector this past quarter continued the sluggish pattern of gains in outlays evident since mid-year. Federal purchases were held in check by a further cut in defense outlays. Even business expenditures for new plant and equipment rose by somewhat less than in the third quarter. As a result, growth of final sales was down for the third quarter in a row--to about a $13 billion increase, compared with a rise of $20 billion in the first quarter. Although inventory accumulation was more rapid in some sectors, reduced production levels and the G.E. strike operated to cut the rate of accumulation late in the year; for the quarter as a whole, inventory accumulation was estimated to be $2 billion less than in the previous period.

It still appears likely that overall demand will continue to ease further in the first half of this year and that real GNP may decline somewhat. Reported plans for continued expansion of capital spending and the passage of the tax reform measure provide elements of potential strength, but these factors do not appear sufficient to offset the probable weakness in other areas. Current monetary restraint is expected to reduce construction activity further and to hold down growth of State and local expenditures. Total Federal purchases are projected to decline by $4 billion annual rate between the fourth quarter of 1969 and the second quarter of 1970.

A large part of the increase in business spending indicated by the Commerce-SEC survey is projected for nonmanufacturing sectors--mainly public utilities, communications and airlines--where expanding demand continues to press available capacity. The increase being planned by manufacturers in the first half of this year is relatively small. Moreover, some manufacturers are already planning to reduce expenditures this year, and it is probable that investment plans of others may be adjusted down in response to short-falls in anticipated sales, declining profits and the continued scarcity and high cost of external funds. We are, therefore, holding close to our former projection of an increase in capital spending of about 8 per cent for the year 1970, as compared to the rise of about 10 per cent reported by the recent Commerce-SEC annual survey.

With respect to the new tax measure, our projections had already incorporated the estimated impact on disposable income and consumption of the surcharge reduction effective January 1, and we had assumed a 10 per cent increase in Social Security benefits effective April 1. The major impact of the new law occurs in the second quarter when a 15 per cent increase in Social Security benefits, with retro-active payments to January 1, adds about $7 billion to disposable income--about $4 billion more than we had formerly estimated. A large part of this addition to income is likely to be reflected in higher consumption, given the limited income of most of the social security recipients. But with other demands generally easing, growth of employment is likely to be small at best and the workweek to be curtailed, dampening increases in wage and salary income. Consumer attitudes toward spending have seriously deteriorated in recent months and a relatively high saving rate seems likely to be maintained. As a result, the overall rise in consumer expenditures is still expected to be relatively moderate in the second quarter, and total final sales are projected to grow rather slowly. With additional cuts in production likely to slow the rate of inventory investment, we are projecting increases in current dollar GNP of only $8-9 billion in the first and second quarters.

Although cost factors are likely to continue strong in the next few quarters, easing demands should be reflected in growing reluctance of markets to accept price increases. But prices have continued to rise at a faster rate than we had earlier thought, and the 3.7 per cent annual rate of increase in the GNP deflator in the second quarter is somewhat more than we had projected in the last Greenbook.

Some rebound in the rate of growth of GNP continues to appear probable in the second half. A moderate easing of monetary restraint--which we continue to assume will commence by early spring--should halt the decline in residential construction activity and encourage appreciable recovery before year-end. In addition, consumer demand is likely to respond to the combined impact of the midyear elimination of the surcharge and increase in personal income tax exemptions, an expected July 1 Federal pay raise of about 6 per cent, and the lagged effects of the increase in Social Security benefits paid in the previous quarter. Given the better market prospects, output seems likely to recover and inventory investment to stabilize. But resumed growth in real GNP is not initially anticipated to be at a rate that will press on available resources, so that some easing of price increases seems probable in the second half of 1970, even though wage rates may continue to exceed productivity gains.

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.)

				1969*			1970*			
		1969	1970			Projected				
	1968	Proj.	Proj.	II	III	IV	I	II	III	IV
Gross National Product	865.7	932.5	980.2	924.8	942.8	953.8	961.8	970.8	986.3	1001.8
Final sales	858.4	924.2	975.2	917.9	932.0	944.7	954.4	965.7	982.8	997.8
Private	658.1	709.3	752.0	705.0	715.0	725.2	734.2	745.1	757.8	771.0
Excluding net exports	655.6	707.3	748.4	703.4	712.3	722.8	730.7	741.1	754.3	767.5
Personal consumption expenditures	536.6	575.7	613.9	572.8	579.8	588.3	596.5	607.9	620.1	630.9
Durable goods	83.3	89.9	91.5	90.6	89.8	90.6	89.5	90.7	92.2	93.7
Nondurable goods	230.6	243.5	260.3	242.1	245.1	248.0	252.4	257.6	263.4	267.7
Services	222.8	242.4	262.1	240.1	244.9	249.7	254.6	259.6	264.5	269.5
Gross private domestic investment	126.3	139.9	139.6	137.4	143.3	143.6	141.6	138.3	137.7	140.6
Residential construction	30.2	32.2	27.1	32.7	31.4	31.5	28.7	25.7	25.7	28.1
Business fixed investment	88.8	99.3	107.5	97.8	101.1	103.0	105.5	107.5	108.5	108.5
Change in business inventories	7.3	8.3	5.0	6.9	10.7	9.1	7.4	5.1	3.5	4.0
Nonfarm	7.4	8.0	4.9	6.7	10.3	8.5	7.0	5.0	3.5	4.0
Net exports of goods and services	2.5	2.1	3.6	1.6	2.7	2.4	3.5	4.0	3.5	3.5
Gov't. purchases of goods & services	200.3	214.9	223.1	212.9	217.0	219.5	220.2	220.6	225.0	226.8
Federal	99.5	102.2	100.4	100.6	103.2	103.2	101.4	99.3	101.0	100.0
Defense	78.0	79.4	75.7	78.5	80.3	79.9	77.5	75.0	75.8	74.5
Other	21.5	22.7	24.7	22.1	22.9	23.3	23.9	24.3	25.2	25.5
State & local	100.7	112.7	122.7	112.3	113.8	116.3	118.8	121.3	124.0	126.8
Gross national product in constant (1958) dollars	707.6	728.0	733.5	726.7	730.6	731.4	730.4	730.5	733.8	739.2
GNP implicit deflator (1958=100)	122.3	128.1	133.6	127.3	129.0	130.4	131.7	132.9	134.4	135.5
Personal income	687.9	747.1	795.9	740.5	756.5	766.8	775.5	792.0	801.5	814.5
Wages and salaries	465.0	509.8	541.8	504.3	516.9	524.5	530.0	536.3	545.8	555.2
Disposable income	590.0	629.5	677.3	622.0	639.0	646.9	657.5	672.0	684.8	694.9
Personal saving	38.4	37.8	46.6	33.3	43.1	42.2	44.5	47.4	47.7	46.9
Saving rate (per cent)	6.5	6.0	6.9	5.3	6.7	6.5	6.8	7.1	7.0	6.8
Corporate profits before tax	91.1	93.7	86.9	95.4	92.5	91.5	88.5	86.0	86.0	87.0
Federal government receipts and expenditures (N.I.A. basis)										
Receipts	176.3	201.5	198.9	202.9	201.4	203.0	198.8	199.9	196.8	200.1
Expenditures	181.5	191.8	204.3	189.3	193.6	195.9	197.1	205.0	206.7	208.4
Surplus or deficit (-)	-5.2	9.7	-5.4	13.6	7.9	7.1	1.7	-5.1	-9.9	-8.3
Total labor force (millions)	82.3	84.3	85.5	83.8	84.6	84.9	85.1	85.3	85.6	85.9
Armed forces "	3.5	3.5	3.3	3.5	3.5	3.5	3.4	3.3	3.3	3.2
Civilian labor force "	78.7	80.8	82.2	80.3	81.1	81.4	81.7	82.0	82.3	82.7
Unemployment rate (per cent)	3.6	3.6	4.5	3.5	3.7	3.6	4.0	4.5	4.6	4.8
Nonfarm payroll employment (millions)	67.9	70.2	70.9	70.0	70.4	70.6	70.8	70.8	70.9	71.2
Manufacturing	19.8	20.1	19.9	20.1	20.2	20.1	20.0	19.9	19.8	19.9
Industrial production (1957-59=100)	165.4	172.2	170.1	172.6	174.3	171.6	170.0	169.0	170.0	171.5
Capacity utilization, manufacturing (per cent)	84.5	83.7	78.8	84.5	84.2	81.7	79.9	78.5	78.0	77.7
Housing starts, private (millions A.R.)	1.51	1.49	1.09	1.51	1.43	1.31	1.13	1.00	1.00	1.22
Sales new domestic autos (millions, A.R.)	8.62	8.50	8.12	8.54	8.45	8.13	7.75	8.00	8.25	8.50

* Assumes Administration's proposals for repeal of investment tax credit and extension of tax surcharge at 10% through 1969 and then at 5% through June 1970.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1968	1969 Proj.	1970 Proj.	1969* II	1969* III	1969* IV	1970* Projected I	1970* Projected II	1970* Projected III	1970* Projected IV
	-----	-----	-----	-----	In Billions of Dollars	-----	-----	-----	-----	-----
Gross National Product	72.2	66.8	47.7	16.1	18.0	11.0	8.0	9.0	15.5	15.5
Inventory change	-0.1	1.0	-3.3	0.3	3.8	-1.6	-1.7	-2.3	-1.6	0.5
Final sales	72.2	65.8	51.0	15.8	14.1	12.7	9.7	11.3	17.1	15.0
Private	52.0	51.2	42.7	12.9	10.0	10.2	9.0	10.9	12.7	13.2
Excluding net exports	54.7	51.7	41.1	12.8	8.9	10.5	7.9	10.4	13.2	13.2
Net exports	-2.7	-0.4	1.5	0.1	1.1	-0.3	1.1	0.5	-0.5	0.0
Government	20.2	14.6	8.2	2.9	4.1	2.5	0.7	0.4	4.4	1.8
GNP in constant (1958) dollars	33.0	20.4	5.5	3.6	3.9	0.8	-1.0	0.1	3.3	5.4
Final sales	33.3	19.7	8.5	3.5	0.6	2.4	0.4	1.8	5.1	5.1
Private	24.9	18.2	11.5	3.9	1.4	2.4	1.5	3.6	4.8	5.4
	-----	-----	-----	-----	In Per Cent Per Year	-----	-----	-----	-----	-----
Gross National Product	9.1	7.7	5.1	7.1	7.8	4.7	3.4	3.7	6.4	6.3
Final sales	9.2	7.7	5.5	7.0	6.1	5.4	4.1	4.7	7.1	6.1
Private	8.5	7.8	6.0	7.5	5.7	5.7	5.0	5.9	6.8	7.0
Personal consumption expenditures	9.0	7.3	6.6	7.7	4.9	5.9	5.6	7.6	8.0	7.0
Durable goods	14.1	7.9	1.8	10.0	-3.5	3.6	-4.9	5.4	6.6	6.5
Nondurable goods	7.2	5.6	6.9	5.9	5.0	4.7	7.1	8.2	9.0	6.5
Services	9.1	8.8	8.1	8.7	8.0	7.8	7.8	7.9	7.5	7.6
Gross private domestic investment	8.9	10.8	-0.2	6.5	17.2	0.8	-5.6	-9.3	-1.7	8.4
Residential construction	20.8	6.6	-15.8	-7.2	-15.9	1.3	-35.6	-41.8	0.0	37.4
Business fixed investment	6.1	11.8	8.3	10.5	13.5	7.5	9.7	7.6	3.7	0.0
Gov't. purchases of goods & services	11.2	7.3	3.8	5.5	7.7	4.6	1.3	0.7	8.0	3.2
Federal	9.7	2.7	-1.8	-3.9	10.3	0.0	-7.0	-8.3	6.8	-4.0
Defense	7.7	1.8	-4.7	-2.5	9.2	-2.0	-12.0	-12.9	4.3	-6.9
Other	16.8	5.6	8.8	-8.9	14.5	7.0	10.3	6.7	14.8	4.8
State & local	12.8	11.9	8.9	14.0	5.3	8.8	8.6	8.4	8.9	9.0
GNP in constant (1958) dollars	4.9	2.9	0.8	2.0	2.1	0.5	-0.5	0.0	1.8	3.0
Final sales	5.0	2.8	1.2	2.0	0.3	1.3	0.2	1.0	2.8	2.8
Private	4.7	3.3	2.0	2.8	1.0	1.6	1.1	2.5	3.3	3.7
GNP implicit deflator	4.0	4.7	4.3	5.1	5.6 1/	4.2	3.9	3.7	4.6 2/	3.3
Personal income	9.3	8.6	6.5	8.9	8.6	5.4	4.5	8.5	4.8	6.5
Wages and salaries	9.8	9.6	6.3	8.9	10.0	5.9	4.2	4.8	7.1	6.9
Disposable income	8.0	6.7	7.6	7.7	10.9	4.9	6.6	8.8	7.6	5.9
Corporate profits before tax	13.4	2.9	-7.3	0.4	-12.2	-4.3	-13.1	-11.3	0.0	4.6
Federal government receipts and expenditures (N.I.A. basis)										
Receipts	16.7	14.3	-1.3	8.5	-3.0	3.2	-8.3	2.2	-6.2	6.7
Expenditures	10.8	5.7	6.5	1.7	9.1	4.8	2.4	16.0	3.3	3.3
Nonfarm payroll employment	3.0	3.4	1.0	2.9	2.3	1.1	1.1	0.0	0.6	1.7
Manufacturing	2.1	1.5	-1.0	0.0	2.0	-2.0	-2.0	-2.0	-2.0	2.0
Industrial production	4.6	4.1	-1.2	5.6	3.9	-6.2	-3.7	-2.4	2.4	3.5
Housing starts, private	16.7	-1.0	-27.1	-48.3	-21.5	-33.8	-56.8	-44.4	0.0	90.0
Sales new domestic autos	14.0	-1.4	-4.5	8.4	-4.2	-15.3	-18.5	12.9	12.5	12.1

* Assumes Administration's proposals for repeal of investment tax credit and extension of tax surcharge at 10% through 1969 and then at 5% through June 1970.

1/ Excluding Federal pay increase 4.3 per cent.

2/ Excluding Federal pay increase 3.5 per cent.

Industrial production. Industrial production is estimated to have declined somewhat further in December--probably by more than one-half index point to 170.5 per cent. While the decline is though to be mainly in consumer goods, cutbacks in output of some materials are also anticipated.

With retail sales sluggish and stocks high, output of television sets, radios, some appliances, and autos were reduced further in December. Auto assemblies dropped 8 per cent to an annual rate of 7.3 million units, as compared to an 8.5 million rate in the first 3 quarters of 1969. Production schedules for the first quarter of 1970 are now set at the reduced December level. Output of business equipment appears to have changed little from the strike-depressed November level. Production of trucks was maintained at record rates, but trade reports indicate cutbacks in farm machinery.

Output of raw steel changed little in December but production of materials and parts for the automotive industry--steel, metal stampings, glass, rubber and textile products, etc.--as well as construction materials are estimated to have been reduced further.

The decline in output of consumer durable goods in 1969 has been much larger than for materials, as shown in the table, and by the end of the year production curtailments of consumer goods may have about reached their low point. However, at these levels of output, materials consumption has been reduced sharply. Hence, in the first quarter of 1970 we anticipate further declines in materials production and little change in output of consumer goods and business equipment, except on settlement of the G.E. strike. If these expectations are realized, the total index would continue to decline at an annual rate of about 4 per cent, similar to that in the last five months of 1969, in both time intervals abstracting from the effects of the G.E. strike.

DECLINES IN INDUSTRIAL PRODUCTION FROM 1969 HIGHS

	Month of 1969 high	Per cent decline to November	Per cent decline excl. GE strike e/
Total index	July	- 2.0	- 1.3
Consumer goods	July	- 2.6	
Consumer durables	July	- 8.0	
Autos	July	-14.0	
Appliances	Sept.	-13.0	- 9.0
TV & radio	March	-23.2	-18.0
Apparel	July	- 5.0	
Business equipment	Oct.	- 2.5	0.0
Defense equipment	May	- 8.2	- 7.0
Materials, total	July	- 1.7	- 1.4
Textiles	June	- 4.5	
Rubber	Aug.	- 2.5	
Industrial chemicals	July	- 1.3	
Construction materials	March	- 3.0	
Metal materials & parts	Aug.	- 3.6	- 2.0

e/ Estimated.

Retail sales. Figures for the first four weeks of December suggest that sales last month declined about 1 per cent from November. In real terms, sales were below year-earlier levels for the seventh month in a row. (The "advance" estimate of November sales has been revised up and a decline of only 1/4 per cent is now shown from the October peak rather than the originally reported drop of nearly 1 per cent.)

In December, sales declines apparently occurred at food stores, eating and drinking places, general merchandise stores (including department stores), and at automotive outlets. Dealers sales of new domestic cars were down in December to an annual rate of 7.7 million units, as compared with 8.3 million in November, and were a tenth below a year earlier. Sales at apparel stores, however, were up considerably following the large November decline.

For the fourth quarter as a whole, retail sales are now estimated to have barely exceeded the second quarter level. Sales at nondurable goods stores have increased moderately in each quarter this year, but sales at durable goods stores declined in the second half and were below year-earlier levels.

CHANGES IN RETAIL SALES
(Per Cent)

	1968	1969			
	IV	I	II	III	IV*
		Change from Preceding Quarter			
All stores	.1	1.6	1.2	- .6	.8
Durable goods	.4	1.9	.6	-3.2	- .1
Nondurable goods	.0	1.4	1.4	.7	1.2
Department stores	1.7	.8	4.6	1.9	- .5
		Change from Year Earlier			
All stores	8.6	5.7	4.7	2.3	2.9
Durable goods	11.4	7.5	4.8	-[illegible].4	-[illegible].8
Nondurable goods	7.3	4.8	4.6	3.5	4.7
Department stores	15.3	10.3	12.0	9.2	6.9

* Based on estimate for December.

Consumer credit. During November consumer instalment credit outstanding increased by $7.4 billion, seasonally adjusted annual rate. Except for August, this was the smallest monthly rise in outstandings since January 1968. Growth in auto credit fell sharply after two months of sizable increases, but this drop was partly offset by a rebound in credit for other consumer goods. Personal loans continued to expand about as much as in other recent months.

The slower growth in instalment credit since the second quarter, when it was increasing at a $9.6 billion annual rate, has resulted from a moderate decline in extensions and a further rise in loan repayments. Extensions of credit for autos and other consumer goods have tended to fluctuate with changes in retail sales of durable goods; extensions of personal loans--which are more generally associated with expenditures for services but which may also be made for purchases of goods--have continued to rise but at a somewhat slower rate than earlier.

CONSUMER INSTALMENT CREDIT EXTENDED AND REPAID
(Billions of dollars, seasonally adjusted annual rates)

	Extended	Repaid	Net Increase
1969 - QI	100.7	92.3	8.3
QII	104.4	94.8	9.6
QIII	103.5	95.8	7.7
July	102.3	94.8	7.5
August	104.2	97.0	7.2
September	104.0	95.7	8.4
QIV	--	--	--
October	103.9	95.9	8.0
November	103.6	96.1	7.4

Cyclical indicators. In November, the Census composite leading indicator declined 0.6 per cent. But the October composite was revised upward and the preliminary November figure is only 0.7 per cent below September. The coincident and lagging indicators rose; the coincident composite continues less strong, however, than the lagging composite.

COMPOSITE CYCLICAL INDICATORS
1963 = 100

		12 Leading indicators	5 Coincident indicators	6 Lagging indicators
1969:	August	151.7	172.3	193.7
	September	153.6	171.4	194.9
	October	153.4	172.4	196.3
	November (prel.)	152.5	173.0	197.1

Contributing to the drop in the leaders were an increase in initial unemployment claims and declines in durable goods new orders, plant and equipment contracts and orders (almost all of which was in the construction component), housing permits, and the ratio of price to unit labor cost. The common stock price average was up in November and the workweek and the materials price index were unchanged. In December, the preliminary materials price index was up while the common stock price average was down.

Inventories. The increase in the book value of manufacturers' inventories slowed in November; durable manufacturers' stocks grew at a slower rate, while nondurable manufacturers reported a slight decline.

Wholesale book values increased much less than the upward-revised October rate. Figures for retail trade are not yet in, but some decline from the high October rate of build-up at automotive dealers is likely in November and December.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES
Seasonally adjusted annual rate, billions of dollars

	1969			
	QII avg.	QIII avg.	October	November
Manufacturing and trade, total	11.5	13.9	18.2	
Manufacturing, total	7.6	8.0	8.5	5.4
Durable	6.0	6.2	7.2	5.8
Nondurable	1.6	1.8	1.3	- .4
Trade, total	3.9	5.9	9.7	
Wholesale	2.2	.4	2.9	1.0
Retail	1.7	5.5	6.8	
Durable	- .7	2.9	5.8	
Automotive	.2	2.8	5.0	
Nondurable	2.4	2.6	1.0	

As in October, the build-up in durable goods stocks at manufacturers was mainly in finished and in-process goods. Inventory growth slowed in the electrical machinery industry, reflecting the G.E. strike, and at transportation equipment manufacturers. Accumulation at nonelectrical machinery plants continued at the October rate, and there was an increase in the rate of growth of inventories of construction materials.

Among nondurable goods manufacturers, book value inventory declines were reported at food, textile, rubber and miscellaneous industries, largely offset by increases in paper, chemical, and petroleum.

Although accumulation slowed at durable goods factories, their inventory-shipments ratio rose; it was above late 1966 levels, but no higher than in May 1969. And their inventory-backlog ratio continued to climb.

INVENTORY RATIOS

	1966			1969	
	October	November	December	October	November
Inventories to sales:					
Manufacturing, total	1.65	1.69	1.72	1.67	1.69
Durable	1.88	1.95	2.00	1.97	2.04
Nondurable	1.37	1.38	1.37	1.29	1.28
Wholesale trade	1.17	1.21	1.22	1.18	1.18
Inventories to unfilled orders:					
Durable goods manufacturing	.622	.633	.639	.726	.731

Orders and shipments. New orders for durable manufactured goods dropped 2.2 per cent in November, according to the preliminary report. It was the second decline after September's unexpected substantial increase, but was smaller than the decline indicated in the advance report. Durable goods shipments also declined and the order backlog increased slightly, so that the ratio of unfilled orders to shipments rose. Nondurable goods orders and shipments continued to rise.

VALUE OF MANUFACTURERS' NEW ORDERS
TOTALS AND SELECTED MARKET CATEGORIES
Seasonally adjusted monthly, billions of dollars

	1969		
	QIII avg.	October	November
Total manufacturing	55.8	56.8	56.4
Durable	31.2	31.7	31.0
Nondurable	24.6	25.1	25.4
Machinery, equipment and defense, total	10.4	10.5	11.0
Defense products (new series)	1.8	1.8	2.1
Equipment less defense	8.6	8.7	8.9
Automotive equipment	5.3	5.1	4.8
Home goods and apparel	4.8	4.6	4.3
Consumer durables exc. autos	2.2	2.1	1.9
Consumer staples	10.5	10.9	11.1
Construction materials	4.6	4.8	4.7

The November decline in durable goods orders was largely in consumer areas. Moreover, a half billion dollar drop in primary metals orders was probably associated, at least in part, with cuts in production anticipated for autos and other consumer durables.

Orders in the aircraft industry increased by $700 million, reflecting a $300 million increase in defense orders and, apparently, strength in civilian aircraft orders as well. The increase in defense orders was the second in a row and brought the series back to early spring levels after a midyear decline. "Equipment less defense" orders, which includes commercial aircraft and may be a better indicator of capital goods demand than the machinery and equipment series, increased in November.

<u>Construction and real estate</u>. Seasonally adjusted new construction put in place changed little in December at an annual rate of $91.8 billion. While the rate was only slightly below the record high reached in September, as in other recent months, all of the year-to-year increase was due to higher costs as measured by the Census Bureau.

Private residential construction activity dipped again in December as a 3 per cent further decline in outlays for new dwelling units more than offset increased outlays for additions and alterations and for hotel and other nonhousekeeping units, which together account for about a fourth of the private residential total. Outlays for private nonresidential structures changed little in December, at a rate substantially above a year earlier but appreciably under the last September peak.

Public construction expenditures edged higher, but this reflected entirely an advance for the relatively small Federally-owned sector, which continued below its year-earlier level.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	December 1969 ($ billions) 1/	Per cent change from November 1969	Per cent change from December 1968
Total	91.8	--	+ 4
Private	63.4	- 1	+ 8
Residential	30.8	- 1	- 1
Nonresidential	32.6	--	+ 17
Public	28.3	+ 1	- 3
Federal	3.3	+ 6	- 5
State and local	25.0	--	--

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

Private housing starts, which were revised upward in October, dropped further in November to a seasonally adjusted annual rate of 1.29 million units as multi-family units fell to a rate sharply below earlier advanced levels. Regionally, starts showed a month-to-month advance only in the South.

PRIVATE HOUSING STARTS AND PERMITS

	November 1969 (Thousands of units) 1/	Per cent change from October 1969	Per cent change from November 1968
Starts	1,287	- 6	-26
1-family	767	--	-15
2-or-more-family	520	-14	-37
Northeast	141	-19	-27
North Central	259	-16	-35
South	558	+ 6	-31
West	329	-10	- 2
Permits	1,159	- 2	-19
1-family	595	+ 4	-18
2-or-more-family	564	- 7	-19

1/ Seasonally adjusted annual rates; preliminary.

Major downward pressures in recent months have been particularly pronounced for multi-family units, which have benefited much less than single family units from the unprecendented support made available by the Federal National Mortgage Association and the Federal Home Loan Banks. Based on this support to a single family activity and other factors, indications are that total housing starts in December may have held fairly near the November rate, for a fourth quarter average somewhat above the 1.3 million unit level. Even so, this would be nearly a tenth below the already reduced average for the third quarter and would imply a total for 1969 as a whole of about 1.49 million, close to the 1.51 million total for 1968 when vacancy rates were already quite low and the trend of starts was upward.

If allowance is made for the sharp further expansion in mobile home shipments (which are not included in housing starts or reflected in residential construction expenditures), the combined total of new residential units available for purchase may have reached 1.88 million. This would still be appreciably short of actual requirements. However, in 1968, when mobile home shipments totaled 320,000, the comparable total was 1.83 million units. In 1966, it was no more than 1.4 million.

Plant and equipment spending. A special Commerce-SEC survey of business plans for plant and equipment expenditures, conducted in December, indicates a total of $78.1 billion for the year 1970, up 9.7 per cent from 1969. This annual figure along with expenditures planned for the first two quarters of this year as indicated by the October-November survey, would imply outlays in the second half of 1970 only about 1.5 per cent higher than in the first half. The outlook for some further decline in final demands appears to support the likelihood of a leveling off of business fixed investment next fall.

A much larger rise in investment spending is presently planned by nonmanufacturing industries as a group than by manufacturing. Public utilities and the communications and commercial category each report plans to spend 15 per cent more than in 1969, but nonrail transportation and mining companies are planning to cut their spending. In manufacturing, an increase of 6.4 per cent is planned for 1970--with above average increases reported by petroleum, electrical and nonelectrical machinery, and chemical companies. Spending declines are planned by rubber, textile, auto, and other transportation equipment firms.

1970 PLANT AND EQUIPMENT EXPENDITURES PLANS
COMMERCE-SEC NOVEMBER AND DECEMBER SURVEYS
(Billions of Dollars)

	1968	1969	1970	1969		1970	
	Act.	Est.	Planned	1st Half Act.	2nd Half Est.	1st Half Planned	2nd Half Planned
				----At Annual Rate----			
All Business	64.1	71.3	78.1	69.6	72.9	77.6	78.7
Manufacturing	26.4	29.7	31.6	28.8	30.5	31.5	31.6
Durable	13.5	15.3	15.7	15.2	15.5	16.0	15.4
Nondurable	12.9	14.4	15.9	13.6	15.1	15.5	16.2
Nonmanufacturing	37.6	41.6	46.6	40.8	42.4	46.0	47.1
----Changes in Billions of Dollars----							
All Business	2.4	7.2	6.9	5.0	3.3	4.7	1.2
Manufacturing	- .3	3.3	1.9	2.0	1.8	1.0	.1
Durable	- .2	1.8	.4	1.4	.3	.5	- .6
Nondurable	- .1	1.4	1.5	.6	1.5	.5	.7
Nonmanufacturing	2.7	3.9	5.0	3.0	1.6	3.6	1.1
----Per Cent Changes At Annual Rates----							
All Business	3.9	11.2	9.7	15.5	9.6	12.8	3.0
Manufacturing	- .9	12.3	6.4	15.0	12.4	6.5	.8
Durable	-1.4	13.5	2.5	20.3	4.2	6.8	-7.4
Nondurable	- .5	11.0	10.5	3.8	21.8	6.0	9.0
Nonmanufacturing	7.6	10.4	12.0	16.0	7.7	17.1	4.3

Labor market. Layoffs of factory workers have risen in recent months, and in November separations exceeded hirings by a significant margin, suggesting a further decline in manufacturing employment in December. In addition, joblessness covered under State unemployment insurance programs continued to rise sharply in December. The number of workers drawing unemployment pay in mid-December was up 16 per cent from a year earlier and equal to its highest level (seasonally adjusted) since early 1967. To some extent, the higher December levels may reflect the effects of the G.E. strike; supplier firms have been forced to layoff some workers and in New York, which permits strikers to draw unemployment pay after seven weeks on strike, some G.E. strikers are now drawing unemployment insurance checks.

STATE INSURED UNEMPLOYMENT
(Weekly average, in thousands, seasonally adjusted)

	Initial claims	Insured unemployment
June	180	1,066
August	206	1,103
October	199	1,152
December*	221	1,254

* Estimates based on data for first three weeks of December.

The recent rise of insured unemployment--which began from a very low level--has been more rapid than during the 1966-67 slowdown. If increases persist at the recent pace, the level of insured unemployment would rise early this year above 1.35 million (seasonally adjusted) the peak during the 1966-67 slowdown.

Income and employment. Personal income rose $3.2 billion in November, close to the increases of September and October but well below the average monthly rise from January through August. The slowdown of recent months has been concentrated in wages and salaries, reflecting slower growth of employment and a reduction of working hours.

In November, manufacturing payrolls declined, mainly because of the G.E. strike, but a strong pick-up was reported in nonmanufacturing payrolls. The over-all increase in wages and salaries was about the same as the relatively small October amount. Most non-wage income components recorded small advances in November and continued to add about $1 billion to the increase in personal income.

PERSONAL INCOME
(Billion of dollars, seasonally adjusted)

	1969 average monthly changes			
	March-June	June-Sept.	Sept.-Oct.	Oct.-Nov.
Personal income	5.1	4.9	3.0	3.2
Wage & salary disbursements	3.5	3.8	2.3	2.2
Government	.5	1.4	0.6	.5
Private	3.0	2.4	1.7	1.7
Manufacturing	1.0	1.0	- .1	-1.0
Nonmanufacturing	2.0	1.4	1.7	2.7
Other sources of income	1.7	.9	1.0	.9

Note: Totals may not add due to rounding.

Industrial relations. At least 5 million workers will be affected by major collective bargaining negotiations in 1970, a larger number than in any year of the 1960's and over 2 million more than in 1969. Prospects for extremely difficult collective bargaining this year have been underscored in recent weeks by workers' rejection of the proposed railroad shopcraft settlement, the absence of progress in the G.E. negotiations, and the costly settlement won by the New York City transit workers.

The New York transit workers contract provides an immediate 8 per cent wage increase, with a 10 per cent boost on July 1, 1971. Fringe benefit improvements include a provision that pension fund contributions now paid by the workers (estimated to equal about 6 per cent of the average wage) will be borne by the city beginning July 1, 1970.

The proposed railroad agreement--which rail executives had hoped would set the pattern for this year's bargaining with 450,000 workers--was voted down by the shopcraft unions and must now be re-negotiated.

Consumer prices. The consumer price index rose at an annual rate of 6 per cent in November, compared with 4.8 per cent in October, and was 5.8 per cent above a year ago. Food accounted for a third of the increase, due to a very sharp temporary rise in fresh vegetables, sharply increasing egg prices, and a less-than-seasonal drop in pork prices.

Another third of the increase was due to housing costs, particularly homeownership, including home purchase and services such as mortgage interest, property taxes, insurance, and residential gas rates. Apparel, health, and recreation contributed the final third of the rise of the CPI. This latest large rise in apparel prices continued the sharp increases begun this fall which have brought the level to more than 5 per cent above a year ago.

Prices of durable goods rose less than seasonally in November even though new car prices continued to increase. Only 1970 models were priced in November, whereas some 1969 cars were included in the October sample.

Changes in major components of the CPI from October to November and over other selected periods are shown below:

CONSUMER PRICE INDEX
Per cent change at annual rates to November 1969 from:

	One Year Ago	Six Months Ago	Three Months Ago	One Month Ago
All items	5.8	5.8	5.6	6.0
All commodities	5.0	5.6	4.8	4.8
Durable	3.8	4.0	5.6	3.6
New cars	1.3	6.4	16.4	10.8
Used cars	n.a.	- 3.0	- 1.6	- 8.4
Household durables	3.6	1.8	2.0	1.2
Nondurables	5.3	6.0	4.8	6.0
Food	6.3	6.8	2.0	8.4
Apparel and upkeep	5.4	6.4	12.8	8.4
Services	7.1	6.4	6.0	6.0
Insurance and finance	11.7	10.0	10.4	9.6
Seasonally adjusted				
Food	6.3	7.0	6.8	14.4
Apparel and upkeep	5.3	5.4	7.6	7.2
Transportation	3.6	1.6	2.8	- 2.4

Wholesale prices. (Confidential until released Thursday) Both the total wholesale price index and average prices of industrial commodities increased at an annual rate of about 4 per cent from mid-November to mid-December. Farm products and processed foods and feeds advanced at an annual rate of 7 per cent.

Few signs of slowing inflation can be observed as yet, as may be seen in the table, price increases in December and also over the quarter were larger than over the preceding quarter. Prices of metals, machinery, and many other products are showing steep increases, and the outlook for food prices has worsened since last month. Lumber and plywood prices, however--which fell in December after rising in November--appear to be stable or declining.

WHOLESALE PRICES
(Percentage changes at annual rates*)

BLS Commodity Groups	Dec. '68 to Mar. '69	March '69 to June '69	June '69 to Sept. '69	Sept '69 to Dec '69	Nov'69 to Dec'69	Dec'68 to Dec'69
All commodities	6.9	5.4	1.4	5.3	4.2	4.8
Industrial commodities	6.5	.7	3.6	4.9	4.2	4.0
Steel Mill Products	9.5	3.9	9.6	3.1	0	6.7
Non-ferrous Metals	20.7	17.2	23.6	18.4	30.3	21.5
Machinery & Equip.	3.8	2.7	4.4	6.7	8.9	4.5
Farm Products, & processed foods & feeds	8.5	17.3	- 4.2	7.3	7.3	7.4

* Calculated from published indexes.

The increase in machinery and equipment prices this fall--September to December--was twice as fast as the rise a year earlier.

Metals were the largest factor in the overall increase in industrial commodity prices in December; non-ferrous metals rose at an annual rate of 30 per cent. Since the mid-December pricing date, the rise in prices of non-ferrous metals has continued with an increase posted for lead--the seventh in 1969--and a large rise in copper announced by some producers. A large part of the explanation for continued strength in prices of metals lies in heightened foreign demands and apparently low inventories of many metals.

Since mid-December, price increases have also been announced for a number of steel products--stainless, specialty, reinforcing bars, railroad track accessories, and scrap. However, a new billing system this month will lower prices of major flat-rolled steel products. Large steel shipments are therefore expected this month especially as charges for extras will be added February 1.

Prices of foods rose further in December. Although the November bulge in fresh vegetable prices was reversed, eggs continued to rise to the highest levels since 1953. Prices of livestock and meat, which had declined in November, were higher again on the December pricing date, reflecting a substantial short-fall on pork supplies. The Department of Agriculture has recently reported that the spring pig crop will also be small and meat prices are expected to remain under pressure.

Farm real estate values. The rise in land values slowed to 4 per cent in the year ending November 1, 1969 from 6 per cent in each of the two preceding years and a rate of 8 per cent during the world-food-crisis year, 1965-66. For the first time in the decade values rose less than the GNP deflator, a disappointing performance for those holding farm real estate as a hedge against inflation. The number of sales was down about 2 per cent from 1968.

Regional trends were mixed with the most pronounced slackening occurring in the Western states and the vast livestock and grain producing central regions where market values are determined largely by demand for agricultural uses. In the Northeast, advances in values larger than the national average probably reflected improved returns from dairying and the strong current and anticipated demand for land for nonfarm uses. In the Southeast and the Delta, advancing values reflected impetus of new farming techniques and industrial expansion which affected values indirectly.

With the first hand observations of reporters in the November 1 survey yet to be collated, one can only hypothesize about the underlying causes of the slowing rise in market values in the principal agricultural areas. Apprehension about the farm programs replacing the ones expiring with the 1970 crop year may be a depressing factor since farmers are aware that large segments of the general public are extremely critical of price supports and acreage diversion payments which are the key provisions of the feed grain and wheat programs. Also,with 80 per cent of land transfers credit financed, the credit stringency cited by reporters in the March 1 survey as the major factor undoubtedly continues to be the most potent force in the farm real estate market.

INDEX NUMBERS OF PER ACRE VALUE OF FARM REAL ESTATE
BY FEDERAL RESERVE DISTRICTS
1957-59 = 100

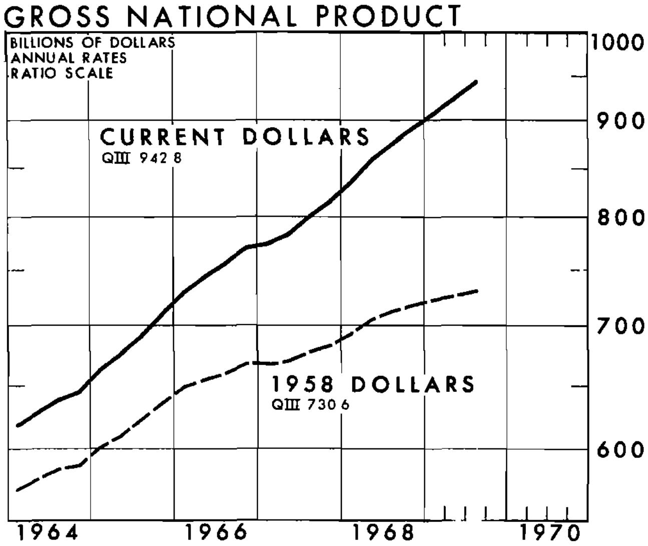
	Index Nov. 1, 1969	Per cent change, November to November				
		1965 to 1966	1966 to 1967	1967 to 1968	1968 to 1969	1959 to 1969
U.S., total	183	8.3	6.4	6.0	4.0	5.3
Boston	194	7.2	9.0	7.7	6.5	5.6
New York	178	5.1	5.6	10.6	6.6	5.1
Philadelphia	201	7.5	7.0	7.7	10.4	6.2
Cleveland	171	8.8	5.4	4.5	4.9	4.9
Richmond	184	9.7	4.4	7.8	2.8	5.6
Atlanta	221	8.1	3.9	9.7	8.9	6.8
Chicago	165	11.0	7.8	5.3	3.1	4.4
St. Louis	196	10.2	8.0	6.8	4.3	6.1
Minneapolis	170	6.6	6.2	7.1	2.4	4.6
Kansas City	181	6.8	6.4	6.6	2.3	5.2
Dallas	202	7.0	6.5	6.1	5.8	6.1
San Francisco	174	5.2	3.1	2.4	2.4	4.6

Land and buildings.

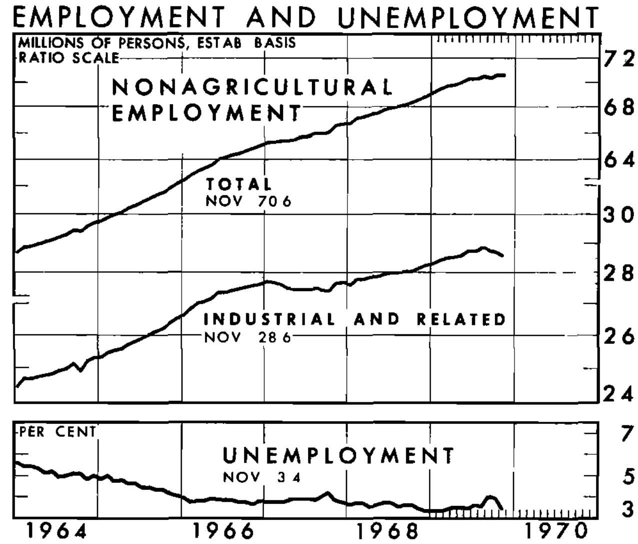
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

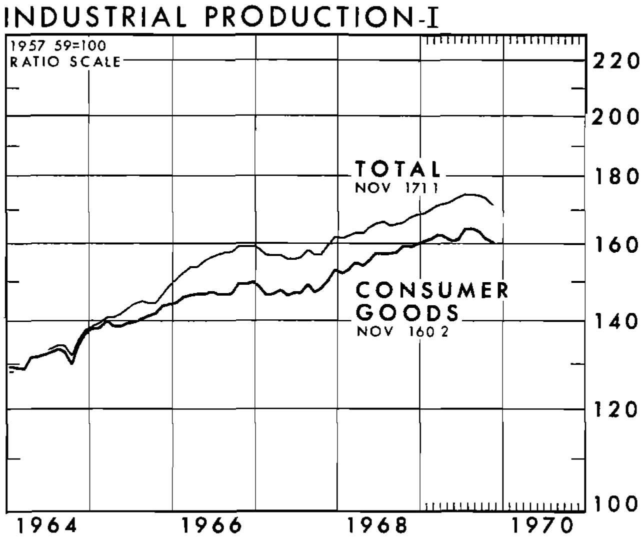
GROSS NATIONAL PRODUCT



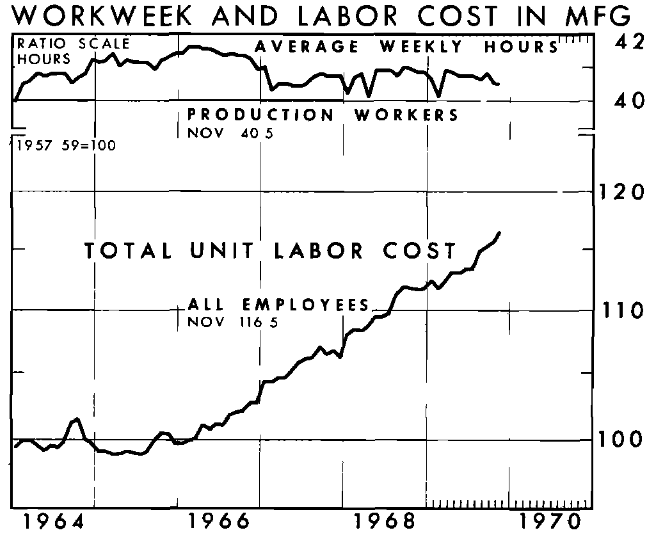
EMPLOYMENT AND UNEMPLOYMENT



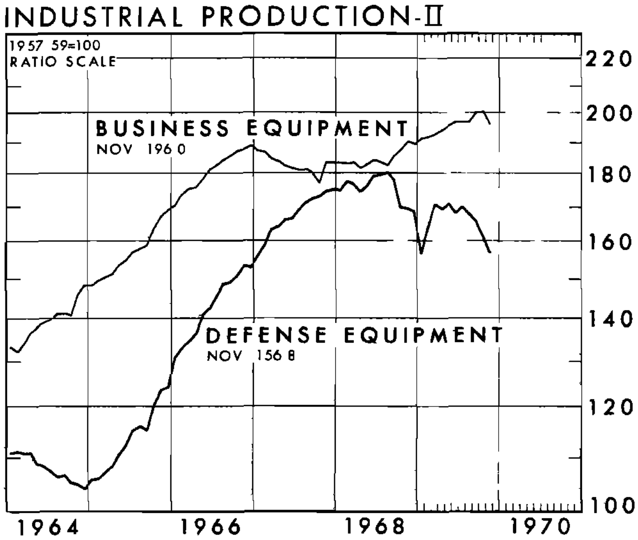
INDUSTRIAL PRODUCTION-I



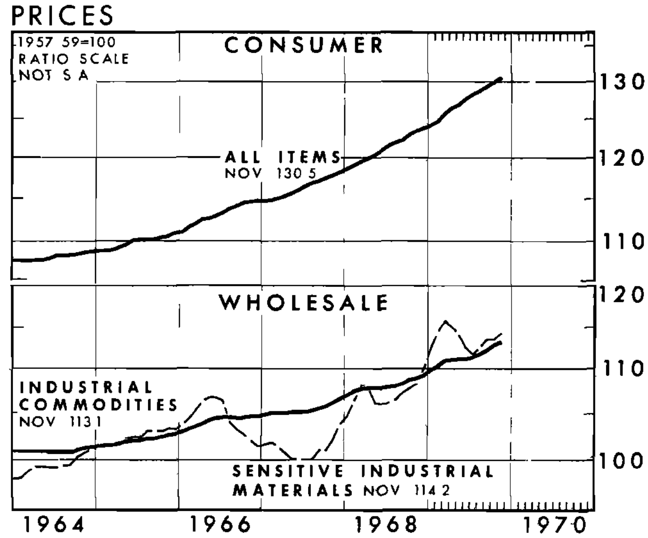
WORKWEEK AND LABOR COST IN MFG



INDUSTRIAL PRODUCTION-II



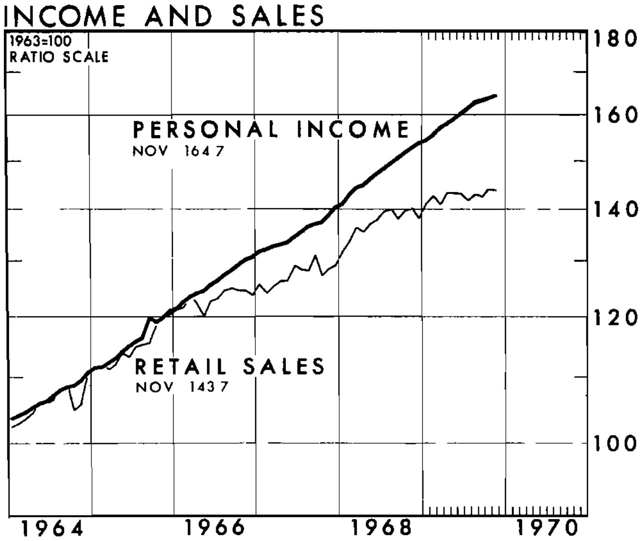
PRICES



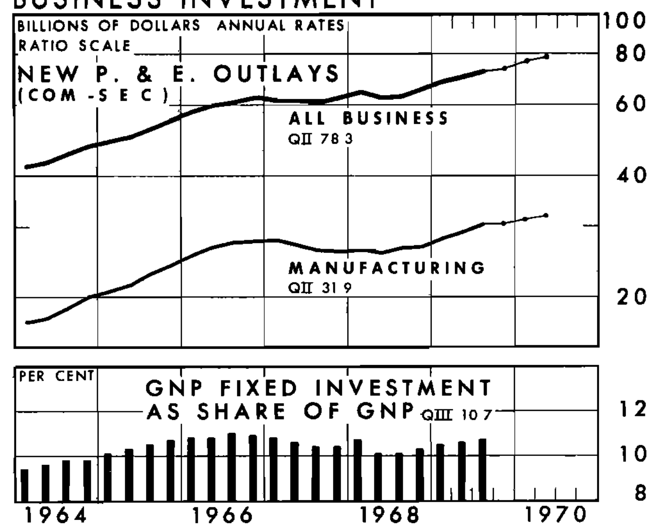
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

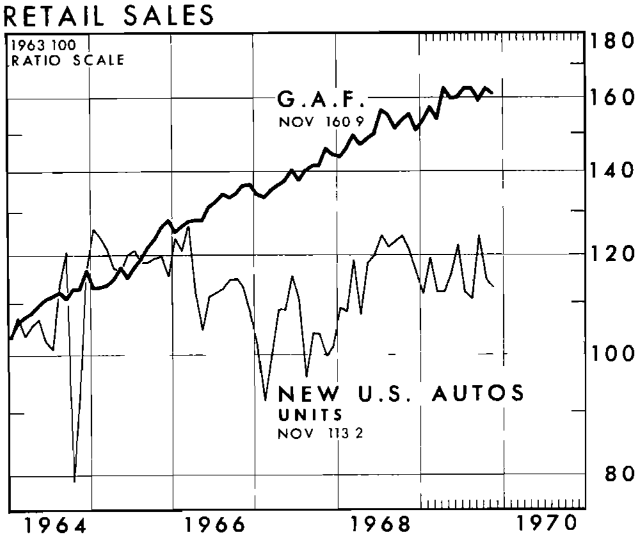
INCOME AND SALES



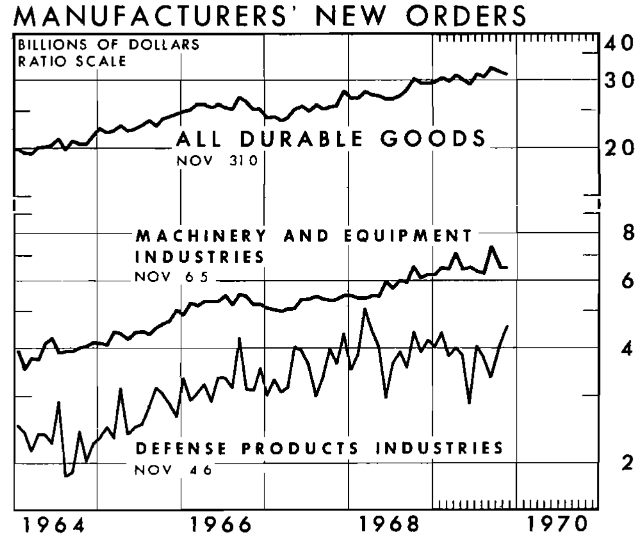
BUSINESS INVESTMENT



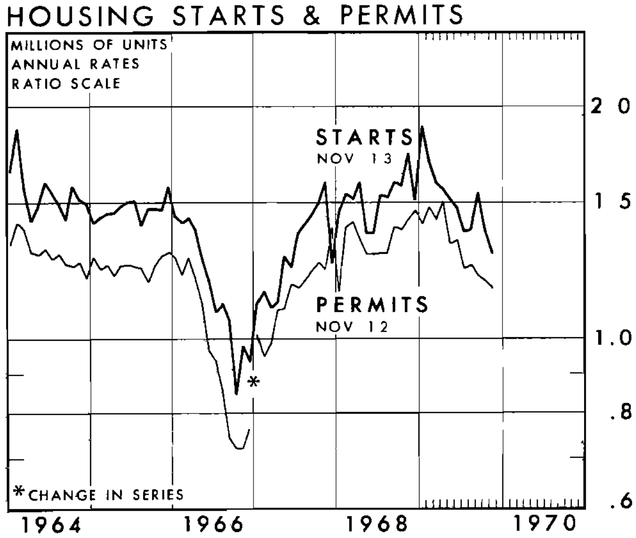
RETAIL SALES



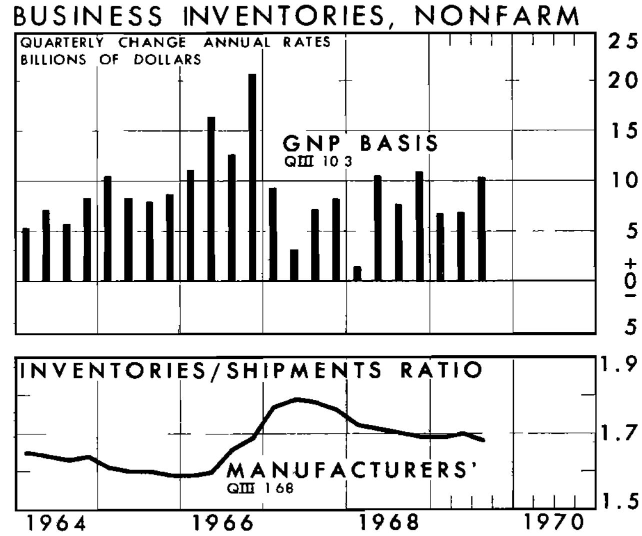
MANUFACTURERS' NEW ORDERS



HOUSING STARTS & PERMITS



BUSINESS INVENTORIES, NONFARM



THE ECONOMIC PICTURE IN DETAIL

Bank credit. Bank credit is estimated to have declined $2.6 billion, on a seasonally adjusted basis, in December. This reduction was nearly as large as the increase recorded in November. At year-end, bank credit was slightly below its midyear level and about 1.8 per cent above its year-earlier level.

More than four-fifths of the December decline was accounted for by a drop in holdings of U.S. Government securities; holdings of other securities showed little net change over the month, following their substantial increase in November. A sharp decline in security loans, which reversed most of the build-up that had taken place in the two previous months, more than accounted for the rest of the drop in total bank credit; all other loans taken together continued to rise at the moderate pace of other recent months and total bank loans showed their first monthly reduction since March of this year.

The decline in holdings of U.S. Treasury securities included decreases in all maturity categories. The sale by banks of the tax bills acquired in the Treasury's late November financing partly explains the decline in shorter-dated Treasury issues. In addition, a tax anticipation bill matured in December and a 2-1/2 per cent bond was redeemed on December 15. Some banks also are reported to have sold heavily discounted longer-term issues in order to charge capital losses against favorable current revenues, thereby reducing 1969 tax liabilities.

NET CHANGE IN BANK CREDIT 1/
All commercial banks
(Seasonally adjusted percentage change, at annual rates)

	1968 Year	1969 Year	1969 Jan.-May	1969 June-November	1969 December 2/
Total loans & investments	11.0	2.0	4.7	1.4	-7.8
U.S. Gov't. securities	3.0	-17.2	-21.1	-10.7	-49.6
Other securities	16.4	-0.4	1.7	-2.2	0.0
Total loans	11.6	7.3	11.9	4.8	-1.8
Business	11.1	9.1	16.0	2.9	9.2
MEMORANDA:					
Total loans plus loan sales 3/	11.0	8.9	13.1	7.2	-3.9
Business loans plus loan sales 4/	11.1	12.1	18.0	7.8	4.5

1/ Last Wednesday of month series.

2/ All December rates are preliminary estimates based on incomplete data and are subject to revision. Loan sales are through December 24.

3/ Includes outright bank sales of loans to their own holding companies, affiliates, subsidiaries, and foreign branches.

4/ Includes outright bank sales of business loans to their own holding companies, affiliates, subsidiaries, and foreign branches.

Business loans at banks increased at a faster pace than the average experience in the second half of the year. The step-up was mainly accounted for by buying back loans previously placed with affiliates in order to build up their year-end loan base for the calculation of bad debt reserves. Adjusting for this development, business loans rose at only a 4.5 per cent rate in the month, which is considerably less than the corresponding adjusted figures for previous months. On the other hand, there is some indication that the recent tax legislation has resulted in a change in the December seasonal pattern. The tax benefits that crude petroleum and other extractive industries previously derived from carve-out loans were eliminated and as a result the usual loan expansion at year-end from this source did not materialize. If a rough correction were made in the seasonal adjustment factors, December business loan developments, including adjustment for net loan sales to affiliates, might appear about as strong as the average of recent months.

Some pickup in seasonally adjusted business loan growth had been expected for December in view of the large corporate tax payments scheduled for the middle of the month in face of the generally diminished state of corporate liquidity. This factor does appear to have had some impact on the rate of business borrowing that did occur. The increase in business loans was concentrated in machinery and transportation equipment manufacturers, public utilities, and holdings of acceptances.

Bank sources of funds. Total commercial bank deposits declined moderately in December on a seasonally adjusted basis as a comparatively large advance in time deposits--the first monthly advance since last December--was more than counterbalanced by declines in private demand deposits and U.S. Treasury deposits. In contrast with earlier experience, nondeposit sources of funds provided no offset to these deposit outflows. Oustanding commercial paper rose moderately through December 24 but this was slightly offset by a contraction in borrowing in the Euro-dollar market. The decline in Euro-dollar borrowing is usual for December, since foreign holders withdraw funds from this market for seasonal and window-dressing reasons.

Large banks in New York and Chicago continued to be successful in attracting foreign official funds in December and as a result the large CD situation at these banks remained much improved. Large banks outside these two money centers also experienced a slight abatement in the rate of decline in their large CD's. The picture with regard to consumer-type time and savings deposits at large banks was somewhat different, however, as the rate of outflow in December, when rough allowance is made for seasonal patterns, was essentially unchanged from the comparatively strong pace set in other recent months. At country member banks, the time deposit picture appeared to be slightly improved in December as compared to recent months although continuing quite weak compared to previous years.

NET CHANGES IN MAJOR SOURCES OF FUNDS AT
WEEKLY REPORTING BANKS
(Billions of dollars, not seasonally adjusted)

	Dec. 31-June 25 1/		June 25-Nov. 26 1/		Nov. 26-Dec. 24 1/	
	1968	1969	1968	1969	1968	1969
Time and savings--total	.9	-8.1	8.1	-7.6	.2	- .1
Consumer-type	2.2	- .0	2.6	-2.4	.4	- .2
Savings	- .1	-1.6	*	-1.2	*	- .2
Other time 2/	2.3	1.6	2.6	-1.1	.5	*
Negotiable CD's	-1.1	-7.6	5.0	-4.0	-.8	- .3
All other time	- .3	- .6	.4	-1.3	.6	.3
Nondeposit funds--total	n.a.	10.8	n.a.	4.4	n.a.	- .2
Euro-dollar 3/	2.0	8.3	1.0	1.9	-.2	- .4
Commercial paper 4/	n.a.	1.2	n.a.	2.8	n.a.	.3
Loans sold under repurchase agreements 5/	n.a.	1.3	n.a.	- .4	n.a.	*

* Less than $50 million.

1/ Dates are for 1969; corresponding dates used for other years.
2/ Time deposits, IPC, other than CD's, IPC.
3/ Borrowed through foreign branches, through branches in U.S. territories and possessions, directly from foreign banks, and through domestic brokers and dealers. Includes an indeterminate amount of Federal funds purchases from U.S. Agencies of foreign banks. Prior to May 1969, data include only those funds borrowed through foreign branches.
4/ Issued by bank subsidiaries, holding companies, or other bank affiliates.
5/ To bank holding companies, affiliates, or subsidiaries and to the nonbank public. Examination of individual bank reports indicates that virtually all of the loans sold under repurchase agreement to bank affiliates were at banks having no commercial paper outstanding, so that the possibility of double counting is minimal.

Money supply. After dropping sharply over most of December, the money supply increased substantially in the final week of the month. This turnaround at month-end possibly reflected temporary repatriation of corporation funds held abroad and shifts of funds from time deposit accounts in preparation for making market investments. For the month as a whole, the money supply declined at a 3.0 per cent annual rate. This brought the figure for the fourth quarter to a slight over-all decline comparable to that for the third quarter. In contrast, over the first half of the year the money stock increased at a 4.3 per cent annual rate. For the year as a whole, the money supply grew at about a 2 per cent rate as compared to 7.2 per cent in 1968.

Nonbank depositary intermediaries. Preliminary information suggests that deposit outflows from both mutual savings banks and savings and loan associations during the three-day end of December grace period were not substantially different from those a year earlier. In fact, San Francisco District savings and loans experienced a smaller grace-period outflow this year than last year, although these associations have been experiencing steady deposit drains for the past several months.

NONBANK THRIFT INSTITUTIONS
DEPOSIT FLOWS DURING THE EARLY PART OF THE
DECEMBER-JANUARY REINVESTMENT PERIOD
(Millions of dollars, not seasonally adjusted)

	1966-67	1967-68	1968-69	1969-70
Mutual Savings Banks 1/				
December grace days	-124	-186	-198	-223
January 2	- 12	- 25	- 21	- 37
Savings and Loans 2/				
December grace days:				
U.S. Total	-558	-442	-553	-598
San Francisco District	-102	- 85	-210	-124

1/ 15 largest savings banks in New York City, which account for 29 per cent of industry deposits. Data exclude interest credited.
2/ Universe estimates based upon a FHLB sample of 480 associations. Data exclude interest credited.
Note: The December grace days consist of the last 3 business days in the month. The entire reinvestment period also includes the first 10 calendar days of January.

Contrary to the usual pattern, there were significant deposit shortfalls early in December both at New York City savings banks and at all savings and loan associations. For the entire month of December, after adjustment for the seasonally heavy crediting of dividends and interest, savings and loan associations' deposits actually declined slightly, at a seasonally adjusted annual attrition rate of nearly one per cent. For the second half of 1969, savings and loan association deposit growth slowed markedly to a one per cent seasonally adjusted annual rate, in contrast to the nearly 5 per cent growth rate experienced during the first half of the year.

DEPOSIT GROWTH
NONBANK THRIFT INSTITUTIONS
(Seasonally adjusted annual rates, in per cent)*

	Mutual Savings Banks	Savings and Loans	Both
1968 - QI	7.1	5.5	6.0
QII	6.8	5.9	6.2
QIII	6.5	5.9	6.1
QIV	7.1	6.3	6.6
1969 - QI	6.1	6.0	6.0
QII	4.3	3.7	3.9
QIII	2.0	2.1	2.1
QIV	n.a.	0	n.a.
October	.9	-1.5	-0.8
November	5.0	2.5	3.3
December	n.a.	-0.9	n.a.
Memo:			
November and December	n.a.	.8	n.a.

* Data are revised reflecting updated seasonal adjustment and FHLBB revisions of 1968 S&L data. Monthly changes may not be significant.

It is difficult to interpret this unusual deposit flow pattern. The early December pattern may reflect the widespread growth in the usage of daily interest crediting on passbook accounts, which minimizes the pressure to withdraw at end of quarters. It is quite unlikely that the recently-announced "Housing Certificate of Deposit" authorized by the FHLBB has helped stem grace period outflows.1/ Moreover, patterns during the past few reinvestment periods have suggested that the large outflows have occurred in the early part of the month following interest crediting. Thus, information on withdrawals during early January--which may be available in time for the FOMC meeting--will provide a key measure of the ability of these institutions to retain funds.

There is no indication that the intermediaries have been taken unprepared by developments so far. Savings and loan advances from the FHLB System during December were not out of line with their pattern of the past several months, being about double the year-ago increase. Consequently, the net liquidity position of the FHLB Banks as of the end of December stood at $1.2 billion, which while a decline from the $1.4 billion held a month earlier, was in line with other recent months. If there is a marked deterioration in S&L deposit flows, the FHLB System could rely on the $1 billion (of the $4 billion authorized) available from the Treasury. The FHLB System does have a

1/ S&L's may pay up to 6 per cent on a 2-to 5-year certificate with a minimum denomination of $10,000, but only to depositors who held a minimum balance of $10,000 on December 15, 1969.

$500 million refinancing due in late January at which time--in any event--there will most likely be need to raise substantial additional new money.

In response to low deposit growth since earlier in the year as well as to widespread pessimism regarding the outlook for savings flows during the year-end interest-crediting period, both savings banks and savings and loan associations had been following cautious policies with regard to their mortgage commitment positions. This trend continued during November, when new mortgage commitments made by both of these institutions declined by more than 17 per cent after seasonal adjustment, and their backlog of outstanding commitments had been worked down to 11 per cent below that of a year ago. Gross mortgage investment has already begun to abate. For example, S&L's closed a sharply reduced volume of new mortgages during November, and at the same time, their mortgage repayments reached a three-year low after having been maintained at a very stable dollar volume. The impact of these reduced mortgage repayments, which probably reflect the slowdown of mortgage closings and the ever-increasing use of mortgage assumptions, will most likely fall primarily on S&L earnings, as the rate has been slowed at which older lower-rate mortgages are removed from portfolios.

INSURED SAVINGS AND LOAN ASSOCIATIONS
GROSS MORTGAGE FLOWS
(Billions of dollars, not seasonally adjusted)

	Monthly averages			October	November
	QI	QII	QIII		
1965 - Closings	1.7	2.1	2.1	1.9	1.8
Repayments	1.1	1.3	1.4	1.3	1.2
1966 - Closings	1.7	1.7	1.2	.9	.8
Repayments	1.2	1.2	1.1	.9	.9
1967 - Closings	1.0	1.7	2.0	1.9	1.8
Repayments	.9	1.1	1.2	1.2	1.1
1968 - Closings	1.5	2.0	1.8	1.9	1.7
Repayments	1.1	1.2	1.2	1.2	1.1
1969 - Closings	1.6	2.1	1.8	1.6	1.3
Repayments	1.1	1.2	1.2	1.1	.9

Mortgage market. Faced with the fact that Government-underwritten mortgages were no longer attractive either from the borrower or the investor viewpoint, due primarily to the deep discounts, the Secretary of HUD raised the ceiling rate on FHA and VA mortgages to 8-1/2 per cent, effective January 5. The change in the ceiling was the first since January 1969 and the one per cent increase was the largest in the history of FHA. Although the new 8-1/2 per cent ceiling is higher than the usury ceilings in 21 states and the District of Columbia, all but 7 of these jurisdictions exempt Government-underwritten loans from the state usury laws.[1/]

1/ The jurisdictions in which lenders will be unable to take full advantage of the new rate are Indiana, Mississippi, Missouri, Ohio, South Dakota, Virginia, and the District of Columbia.

The change in the ceiling was dictated by the need to permit prospective borrowers to compete for available funds, and to ease the discount burden normally borne by sellers of existing homes and builders of new homes. However, the higher ceiling will also raise the effective level of monthly debt service payments, thereby forcing some households to accept a somewhat smaller loan and/or provide larger downpayments. Total out-of-pocket monthly outlays for all homeownership costs on homes purchased with Government-underwritten loans would rise by about 5 per cent.

In December, the implicit private market yield on FNMA 6-month forward purchase commitments continued to rise. The FNMA yield was bid up in anticipation of the increase in the FHA and VA rate ceiling by bidders who could no longer originate loans at the required discounts. Under the rules of the FNMA auction, bidders will be allowed to deliver the new 8-1/2 per cent mortgages against their outstanding commitments with FNMA adjusting the price upward to receive the same yield as specified by the original bid, which was based on the 7-1/2 per cent rate ceiling. This implies that successful bidders will now be able to deliver the new 8-1/2's at prices near par under the FNMA commitments received in December. In the January 5 auction, the first based on the 8-1/2 per cent ceiling, the volume of bids received increased substantially as the outlook for originations became brighter. With the auction limits set even lower than in the previous week--based on FNMA's lagged response to auction developments--yields rose quite sharply. As a result, discounts, which had reached nearly 10 points in prior auctions, still averaged 4.5 points based on the new ceiling rate. However, the action taken by HUD and its impact on FNMA auction bidding should help to assure the continued strong support by FNMA of the Government-underwritten mortgage market.

FNMA WEEKLY AUCTIONS

	Amount of total offers		Implicit private markey yield on 6-month commitments	Average discount on 6-month commitments
	Received	Accepted		
	(Millions of dollars)		(Per cent)	(Points)
Highs				
1968	$232 (6/3)	$ 89 (7/1)	7.71 (6/10)	8.1 (5/6)
1969	410 (6/13)	152 (9/8)	8.87 (12/29)	9.6 (12/29)
Dec. 1	236	121	8.58	7.6
8	243	123	8.64	8.1
15	229	122	8.70	8.6
22	307	122	8.78	9.0
29	269	128	8.87	9.6
Jan. 5	705	123	9.19	4.5

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.

During November, the average contract rate on conventional first-mortgages rose only slightly. The average yield in the private secondary market for FHA-insured home mortgages was unchanged in November as the associated discounts remained at almost 8 points, which is higher than in December 1968 just before the previous upward adjustment in ceiling limits. The size of the discount and a substantial rise in the rates on new issues of Aaa corporate bonds during the month combined to make FHA and VA mortgages extremely unattractive investments for diversified lenders. In November, before adjustment of servicing costs, residential mortgages yielded the lowest premium above Aaa corporate bonds on record.

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					
Low	6.75(Jan.Feb.)	23(Mar.)	6.78(Feb.)	26(Mar.)	4.4(Sept.)
High	7.40(Dec.)	115(Aug.)	7.52(June)	120(Aug.)	7.9(Apr.)
1969					
Low	7.55(Jan.)	3(Nov.)	7.85e(Jan.)	16(Nov.)	2.8e(Jan.)
High	8.35(Nov.)	69(Feb.)	8.48(Oct.Nov.)	108(Feb.)	7.7(Oct.Nov.)
April	7.75	58	8.06	89	4.5
May	7.75	53	8.06	84	4.5
June	8.00	42	8.35	77	6.7
July	8.10	47	8.36	73	6.8
August	8.20	55	8.36	71	6.8
September	8.25	27	8.40	42	7.1
October	8.30	41	8.48	59	7.7
November	8.35	3	8.48	16	7.7

Note: FHA series: Interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points. Data for FHA loans in 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.

<u>Corporate security and municipal bond markets</u>. With the seasonal decline in supply at yearend, in late December and early January, recent yields on corporate new issues receded slightly from the 1969 high set in the first week of the month. The first large issue of the new year--a Bell Telephone offering--sold out quickly in early January at a yield 40 basis points below a comparable offering one month earlier; underwriters report the bulk of the issue was distributed to individuals. Rates on municipals continued to advance through the first three weeks of December, declining only when the new issue supply dried up during the holidays.

STOCK PRICES AND BOND YIELDS

	Stock Prices 1/		Bond Yields	
	NYSE	AMEX	New Corporate Aaa 2/	Long-term State and local Bonds 3/
1968				
Low	48.66(3/4)	21.58(3/5)	6.13(8/30)	4.07(8/9)
High	61.27(11/29)	33.25(12/20)	6.92(12/13)	4.85(12/29)
1969				
Low	49.31(7/29)	25.02(7/29)	6.90(1/10)	4.82(1/24)
High	59.32(5/14)	32.91(1/3)	8.85(12/5)	6.90(12/19)
Week of:				
Dec. 5	51.20	26.62	8.85	6.72
12	50.66	26.34	8.70	6.88
19	51.00	26.31	8.76	6.90
26	51.29	26.34	--	6.79
Jan. 2	52.10	26.71	--	6.79

1/ Prices as of the day shown. NYSE is New York Stock Exchange. AMEX is American Stock Exchange.
2/ With call protection (includes some issues with 10-year call protection).
3/ Bond Buyer (mixed qualities).

Despite two large postponements late in the month, December public bond offerings rose more than previously estimated, to a total of $1.3 billion, a new December record and a high for 1969. Significantly, the December volume included a larger-than-usual proportion of issues by industrial transportation, and mortgage investment companies. The calendar built up rapidly as several large new filings were made and a number of convertible bonds were issued in spite of the weakness in the stock market that was evident in the first three weeks of December. The heavy volume of public bond offerings combined with a large total for new stock issues and the usual end-of-year increase in private placements brought the total corporate security offerings for December to an estimated $2.9 billion, which would be the largest monthly volume in three years.

CORPORATE SECURITY OFFERINGS 1/
Monthly or Monthly Averages
(Millions of dollars)

	Bonds				Stocks		Total	
	Public Offerings		Private Placements					
	1968	1969	1968	1969	1968	1969	1968	1969
Year	894	1,051	554	532	382	697	1,830	2,280
QI	821	886	574	513	330	674	1,726	2,073
QII	1,035	1,136	548	526	319	709	1,902	2,371
QIII	869	1,065	454	487	389	588	1,711	2,140
QIV	852	1,117e	641	600e	491	817e	1,984	2,534e
November	939	1,060e	362	500e	466	1,000e	1,767	2,560e
December	607	1,340e	964	800e	483	800e	2,055	2,940e
	1969	1970	1969	1970	1969	1970	1969	1970
January	980	1,700e	636	500e	460	800e	2,075	3,000e
February	842	1,300e	395	500e	807	700e	2,045	2,500e

1/ Data are gross proceeds. e - Estimated.
e/ - Estimated.

The corporate calendar for January is building rapidly, with $1.5 billion already scheduled. The staff now estimates that January public bond offerings will total about $1.7 billion; and, although only $400 million of bonds have been assigned February issue dates thus far, the February volume is expected to be at least $1.3 billion. Many of the firms planning to enter the market early in the year are in capital-intensive industries, such as power, communications, transportation, and petroleum, which need to modernize equipment and install new capacity in order to satisfy steadily growing demand for real output. Furthermore, underwriters report that several industrial firms, under pressure to improve liquidity ratios and restructure balance sheets, may soon be induced to enter the market, particularly if the Standard Oil and Ford financings already scheduled for January prove successful.

New long-term issues by State and local governments amounted to about $800 million in December. A $125 million Pennsylvania offering, which came to market just under the 7 per cent ceiling in that state, accounted for much of the increase of the final total over the preliminary staff estimate. As yet, the visible supply for the month of January is relatively light, but the ultimate volume is expected to total about $900 million. Potential demand for long-term funds by states and municipalities remains high and three additional states--Michigan, Florida, and Maryland--liberalized interest rate ceilings in December, bringing the total number of states that have statutory ceilings of 7 per cent or more to 30. Thus, some large issues that have been postponed in recent months may be reoffered early next year. Already a number of bond offerings by the three states that have most recently changed their ceilings have reappeared on the calendar in the last few days. In addition, it is reported that several traditionally large borrowers will be in the market again within 45 days. However, the continuing constraint on commercial bank acquisitions of municipals, the pressure of market yields against rate ceilings for many jurisdictions, and the rise in rates that market participants think would result if supply were to increase significantly will tend to limit any sharp growth in long-term municipal borrowing.

LONG-TERM STATE AND LOCAL GOVERNMENT OFFERINGS
Monthly or Monthly Averages
(Millions of dollars)

	1968	1969
Year	1,381	981e
QI	1,247	929
QII	1,285	1,215
QIII	1,537	810
QIV	1,455	979e
November	1,021	827
December	1,115	800e
	1969	1970
January	1,262	900e
February	987	900e

e - Estimated.

Government securities market. Yields on Government securities rose to new record highs in late December; and at month end, rates on Treasury bills were 20 to 50 basis points above their levels at the beginning of the month while yields on coupon issues had increased on balance by around 70 basis points over the month. In early January, however, yields moved 10 basis points or so below their late-December levels in both the bill and coupon sectors of the Treasury market.

WEEKLY AVERAGE MARKET YIELDS ON U.S. GOVERNMENT AND AGENCY SECURITIES[1/]
(Per cent)

	1969		Week ending		
	Lows	Highs	Dec. 16	Dec. 30	Jan. 6
Bills					
1-month	5.80(3/25)	7.20(9/22)	6.97	7.67	7.45
3-month	5.87(4/30)	8.08(12/29)	7.88	7.96	7.94
6-month	5.96(4/30)	8.09(12/29)	7.92	7.96	7.97
1-year	5.86(1/16)	7.86(11/24)	7.60	7.67	7.59
Coupons					
3-year	6.02(1/20)	8.51(12/29)	8.13	8.38	8.38
5-year	6.11(1/20)	8.33(12/29)	7.98	8.22	8.22
7-year	6.09(1/16)	7.77(12/29)	7.53	7.71	7.67
10-year	5.95(1/20)	8.05(12/29)	7.63	7.95	7.90
20-year	5.91(5/5)	7.14(12/29)	6.89	7.05	6.92
Agencies					
6-month	6.47(1/21)	8.70(12/29)	8.60	8.69	8.63
1-year	6.33(1/20)	8.76(12/29)	8.73	8.76	8.74
3-year	6.53(1/28)	8.55(12/31)	8.45	8.52	8.53
5-year	6.57(1/22)	8.47(12/31)	8.27	8.37	8.41

1/ Latest dates of high or low rates in parentheses and refer to single dates.

Continued high dealer financing costs, generally in a 9-1/2 to 10-1/4 per cent range in New York, and a resulting heightened dealer reluctance to build up positions have remained the dominant factors in all sectors of the Government market, with the result that yields have reacted very sensitively to shifts in market supply or demand conditions.

In the bill market, for example, reinvestment demand from the $1.25 billion of maturing December tax bills not turned in for taxes was smaller than dealers had anticipated, with the result that positions were not reduced as readily as expected and rates rose accordingly as dealers sought to move their holdings. Upward rate pressures also arose from the supply side of the market, with heavy sales of bills by the Desk for foreign accounts. More recently, bill rates have moved lower, particularly in the 6-month area, most likely in response to demands arising out of savings outflows from thrift institutions.

In the market for Treasury coupon securities, investment demand has been quite light on the whole, and prices drifted steadily lower throughout December. Just before year-end, bank selling of Governments developed for the purpose of taking capital losses before the Tax Reform Act--the provisions of which were unclear to the banks--became effective. These sales, which put additional downward pressure on note and bond prices, were especially heavy on the part of small and intermediate-sized banks and were largely concentrated in short- and intermediate-term maturities and account for a large part of the rise in dealers' positions in the under 5-year maturity categories.

DEALER POSITIONS IN GOVERNMENT AND AGENCY SECURITIES
(In millions of dollars)

	December 15	December 29	January 5
Treasury securities			
Total	3,073	3,610	3,126
Treasury bills (total)	2,585	2,821	2,498
Due in 92 days or less	170	151	116
93 days or over	2,414	2,670	2,381
Treasury notes & bonds (total)	488	789	628
Due within 1 year	163	410	344
1-5 years	190	248	178
over 5 years	135	131	106
Agency securities			
Total	449	572	572
Due within 1 year	208	382	392
over 1 year	240	190	180

Yield changes in the market for Federal Agency securities have been relatively minor in comparison to the changes in the Treasury market. In the Agency market as well, however, new highs were set for yields in most maturity categories. New issue activity in the Agency market since the last meeting of the Committee was confined to monthly short-term refinancing operations by the Banks for Cooperatives and the Federal Intermediate Credit Banks with both Agencies raising only small amounts of new money. Looking ahead slightly, however, the Farmer's Home Administration announced last week that on January 22 they will offer $350-400 million of 5- and 10-year loan notes. A large issue by the Federal Home Loan Banks is also expected in the latter part of January, although the exact size is uncertain at this time.

Other short-term credit markets. During December, short-term interest rates outside the Treasury bill market continued to move higher. Rates on 3- and 6-month commercial paper have increased by 50 basis points since early December to a record high of 9.25 per cent. One-month finance paper, where the volume of new finance paper issues has recently been concentrated, was quoted at 9.00 per cent as of January 2, an increase of about 25 basis points from early December.

Rates on bankers' acceptances increased about 37 basis points to 9.00 per cent in mid-December after having held steady for about a month. During December, several of the major dealers in acceptances announced that, as a result of increased trading activity and daily rate fluctuations, they would no longer post rates on bankers' acceptances. In consequence, rates on all bankers' acceptances should henceforth show somewhat more sensitivity to changing credit market conditions than previously.

NOTE:

The latest figures available on the supply of commercial paper outstanding report that, in November, such paper increased $848 million, seasonally adjusted, or by 3 per cent, compared to a 6 per cent rise in October. The November increase was the lowest monthly gain since March. Bank related paper (not seasonally adjusted) increased by $252 million in the first 3 weeks of December to a total of $4,331 reported on December 24.

COMMERCIAL AND FINANCE PAPER AND BANKERS' ACCEPTANCES OUTSTANDING
(In millions of dollars)

	September	October	November
Commercial and finance paper 1/	30,248	32,044	32,892
Total			
Placed through dealers	11,302	11,809	12,412
Placed directly 2/	18,946	20,236	20,480
Note: Bank related paper (unadjusted)	2,496	3,642	4,079
Bankers' acceptances	5,232	5,256	5,212

1/ Data for commercial and finance paper are seasonally adjusted, in contrast to similar data published in the Bulletin that are seasonally unadjusted.
2/ As reported by companies that place paper directly with investors. As of June 1969, these figures include for the first time directly placed commercial paper issued by bank related companies. Dealer totals have always included paper issued by bank related companies.

SELECTED SHORT-TERM INTEREST RATES
(Friday Quotation - Discount Basis)

	December 5	December 19	January 2
1-month			
Finance paper	8.38	8.63	9.00
Bankers' acceptances	8.50	8.75	9.00
Treasury bill	6.75	6.70	7.47
3-month			
Commercial paper	8.75	9.00	9.25
Finance paper	8.13	8.13	8.13
Bankers' acceptances	8.63	8.75	9.00
Treasury bill	7.65	7.82	7.92
6-month			
Commercial paper	8.75	9.00	9.25
Finance paper	8.13	8.13	8.13
Bankers' acceptances	8.63	8.75	9.00
Treasury bill	7.88	7.82	7.96
12-month			
Prime municipals 1/	5.75	6.00	5.80
Treasury bill	8.05	8.00	7.50

1/ Bond yield basis.
Source: Salomon Brothers & Hutzler's Bond Market Roundup.

Federal finance. The Board staff is now projecting a fiscal 1970 surplus of just $200 million on a unified budget basis and $2.9 billion on an NIA basis. Passage of the 15 per cent increase in social security benefits effective January 1, 1970 and a reappraisal of expected interest payments have substantially altered the expenditure outlook toward more outlays (see Appendix A). Staff estimates of receipts, already well below the Administration's figure, have been lowered $1.0 billion to take account of lower than expected corporate and withheld taxes for December and enactment of tax reform and relief provisions. The necessary adjustment for tax reform was small because earlier staff estimates had already included the investment credit repeal, extension of excise taxes, and the drop in the surtax rate.

Reflecting some of these shifts in receipts and outlays, the end of December balance at the Treasury was $5.3 billion, $600 million lower than projected in the last Greenbook. The Board staff now estimates that the Treasury cash balance will amount to $4.8 billion at the end of January and drop to a mid-month low of about $2 billion. In the event the FHLBB were forced to draw down some of its $4 billion special borrowing line at the Treasury during the January reinvestment period, the end of month balance could be lower than the $4.8 billion estimate, and the Treasury would probably have to borrow temporarily from the System around mid-month. During February, the balance would fall about $1 billion from its level on January 31, unless the Treasury chooses to raise some new money in anticipation of its needs in March. In any case, about $4.5 billion of cash borrowing will probably be needed sometime in the first quarter to keep the cash balance up to acceptable operating levels until the surge of income tax receipts in April.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	Dec.	Jan.	Feb.
Borrowing operations			
New cash raised			
Weekly and monthly bills	.4	.5	--
Tax bills	--	--	--
Coupon issues	--	--	--
Other (agency, debt repayment, etc.)	-2.8	-.7	--a/
Total net borrowing from public	-2.4	-.2	--
Plus: Other net financial sources b/	--	.8	-.9
Plus: Budget surplus or deficit (-)	1.3	-1.1	-.1
Equals: Change in cash balance	-1.1 c/	-.5	-1.0
Memoranda: Level of cash balance end of period	5.3 c/	4.8	3.8
Derivation of budget surplus or deficit			
Budget receipts	17.0	15.3	15.1
Budget outlays	15.7	16.4	15.2

a/ Does not allow for attrition in February refunding or the assumption that a cash refinancing might be undertaken.
b/ Checks issued less checks paid and other accrual items.
c/ Actual

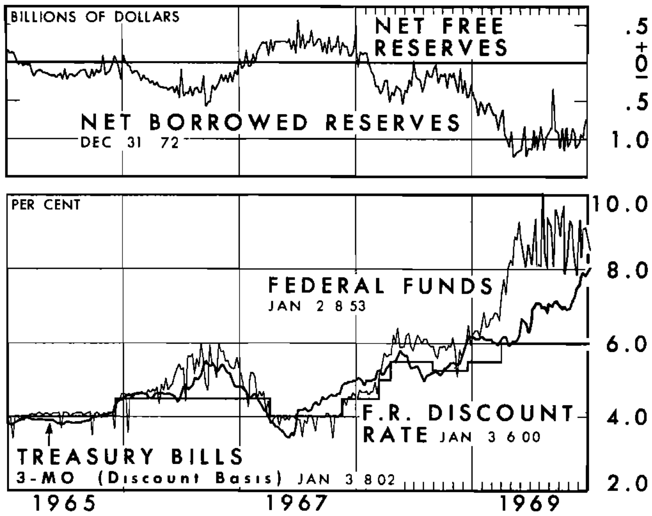
NEW BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS
(In billions of dollars)

	Fiscal 1970		Calendar Year e/		Calendar quarter					
					1969		1970 e/			
	Summer Budget Review	F.R Board e/	1969	1970	III*	IV e/	I	II	III	IV
Quarterly data, unadjusted										
New budget:										
Surplus/deficit	5.9	.2	5.0		2.5	-6.0	-3.9	12.6		
Receipts	198.8	195.2	195.8		47.9	43.1	44.1	60.1		
Total expenditures and net lending	192.9	195.0	190.9		50.4	49.1	48.0	47.5		
Means of financing:									n.e.	
Total borrowing from the public		2.8	-4.5	n.e.	3.2 1/	4.7	2.5	-7.6		
Decrease in cash operating balance	n.a.	-2.5	- .6		- .7	1.3	.7	-3.8		
Other 2/		- .6	--		--	- .1	.7	-1.2		
Cash operating balance, end of period		8.4	5.3*		6.6	5.3*	4.6	8.4		
Seasonally adjusted annual rate										
Federal surplus/deficit in national income accounts	5.1	2.9	9.7	-5.4	7.9	7.1	1.7	-5.1	-9.9	-8.3
Receipts	201.2	200.8	201.5	198.9	201.4	203.0	198.8	199.9	196.8	200.1
Expenditures	196.1	197.9	191.8	204.3	193.6	195.9	197.1	205.0	206.7	208.4
High employment budget surplus/deficit 3/	n.a.	7.0	9.5	3.3	7.9	9.6	7.3	3.3	.1	2.6

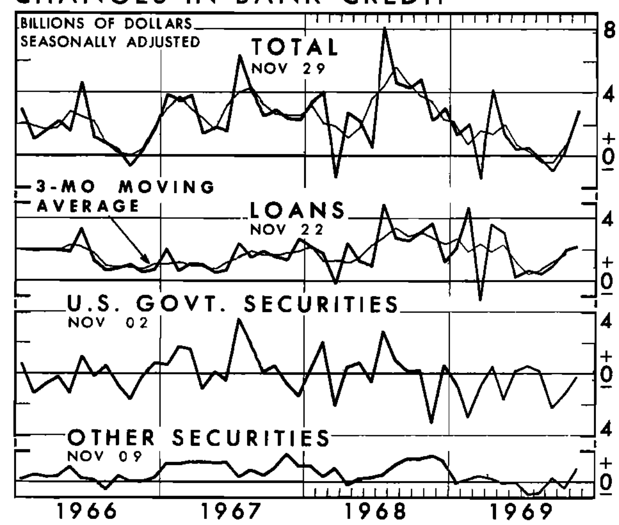
* Actual.
e--Projected. Incorporates provisions of Tax Reform Act of 1969.
n.a.--Not available. n.e.--Not estimated.
p--Preliminary.
1/ Excludes effect of reclassification of $1.6 billion of CCC certificates of interest from Budget transactions to borrowing from the public.
2/ Includes such items as deposit fund accounts and clearing accounts.
3/ National Income account translation estimated by Federal Reserve staff.

FINANCIAL DEVELOPMENTS - UNITED STATES

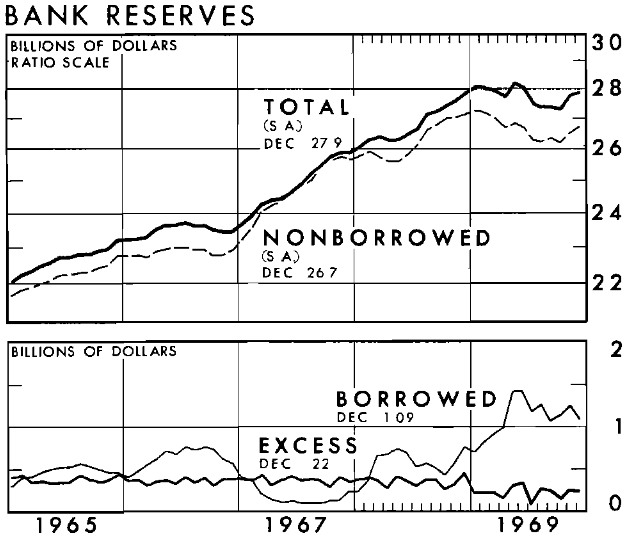
FREE RESERVES AND COSTS



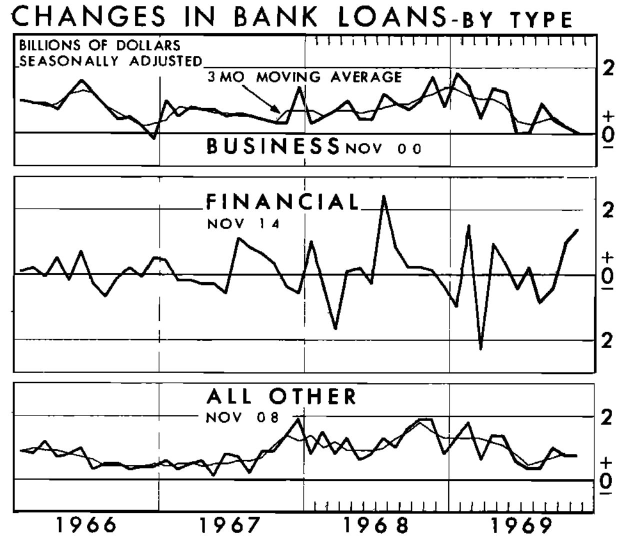
CHANGES IN BANK CREDIT



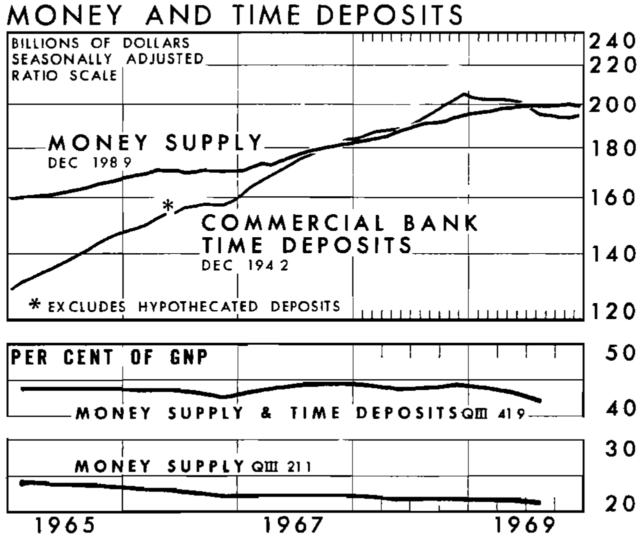
BANK RESERVES



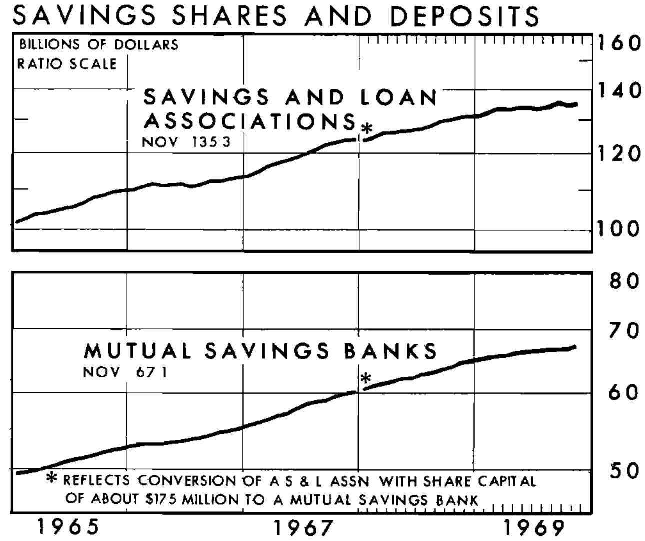
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

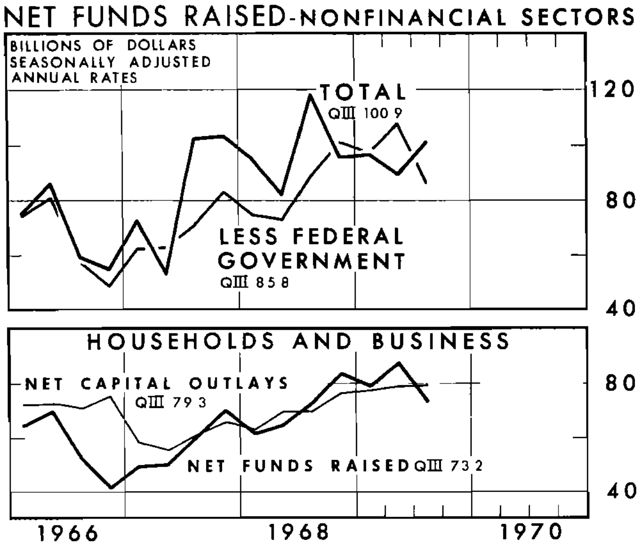


SAVINGS SHARES AND DEPOSITS

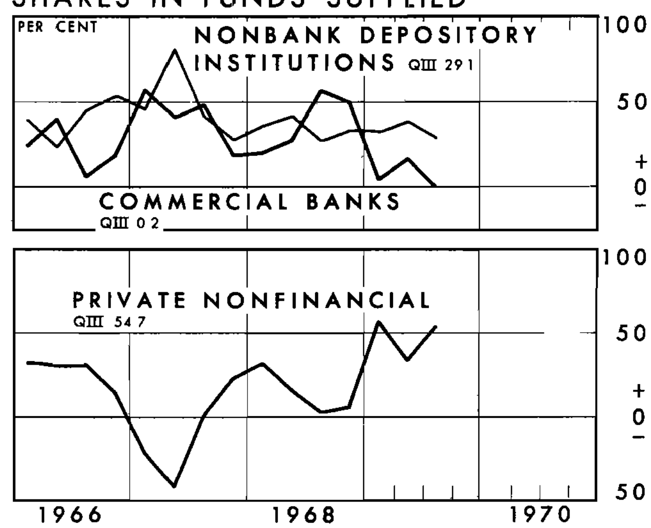


FINANCIAL DEVELOPMENTS - UNITED STATES

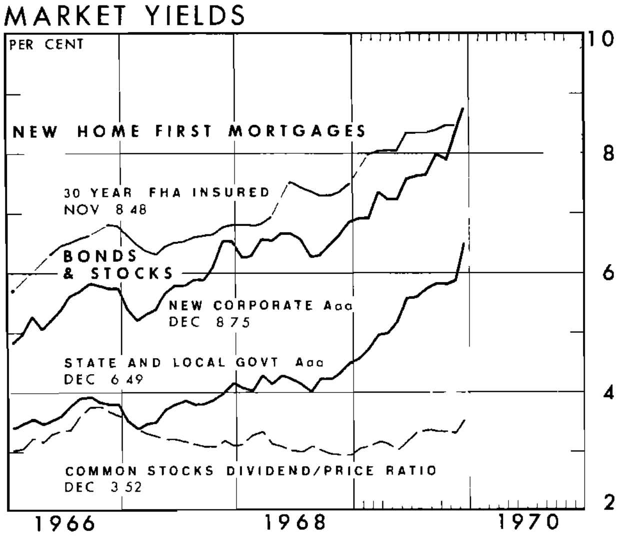
NET FUNDS RAISED-NONFINANCIAL SECTORS



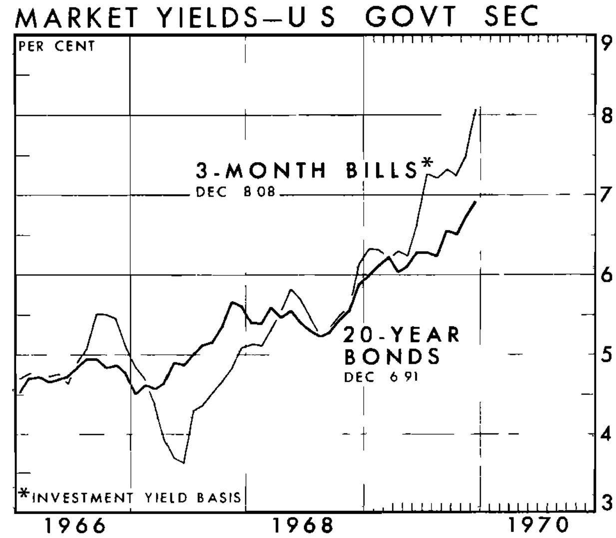
SHARES IN FUNDS SUPPLIED



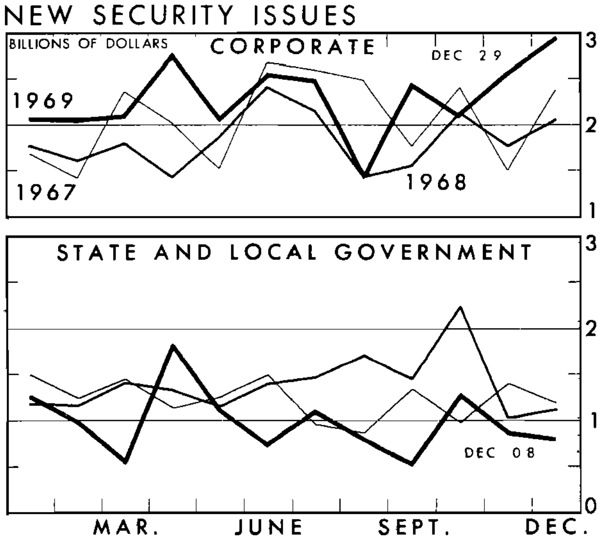
MARKET YIELDS



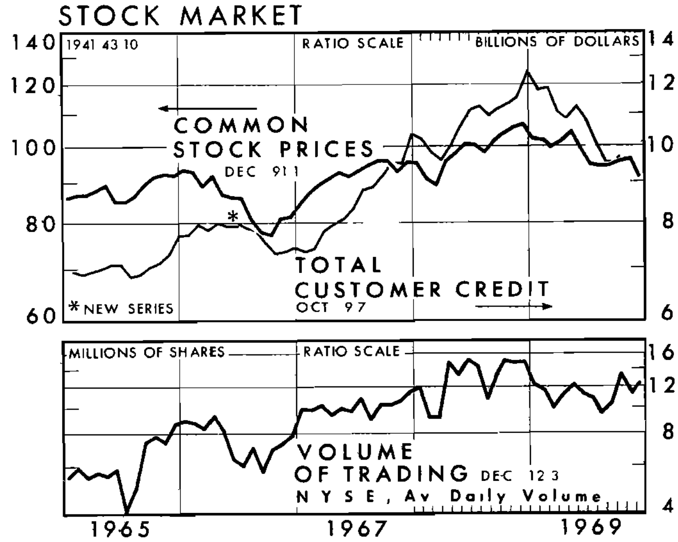
MARKET YIELDS—U S GOVT SEC



NEW SECURITY ISSUES



STOCK MARKET



THE ECONOMIC PICTURE IN DETAIL

International Developments

Balance of payments. Climaxing a year of bizarre events in the balance of payments, the liquidity balance for December, according to weekly indicators, registered a surplus on the order of $2-3/4 billion (not an annual rate). On this basis, the fourth quarter would show a surplus of about $1-1/4 billion, and the liquidity deficit for the year would be on the order of $6-3/4 billion. While large return flows to the United States at year end were expected, the potentialities were considerably underestimated. In 1968, the liquidity surplus in the last two weeks of the year was about $1.2 billion; this year it totaled $2.7 billion. Moreover, the official settlements balance also showed a sizable surplus as the year ended, amounting to perhaps $1 billion for the month of December, and a little less for the entire fourth quarter. For the year, this balance was in surplus by perhaps $2-3/4 billion.

The flood of receipts at year end is assumed to reflect in large part the return of funds that had been placed by corporations and others in the Euro-dollar market and in Deutschemark or other investments abroad. Some of the return flow was no doubt the result of the need to comply with the direct investment controls, and will be reflected in either direct investment capital flows (as it was last year), a reduction in reported corporate short-term assets abroad or an increase in liabilities to foreigners (such a return of funds borrowed abroad can be credited against earlier direct investments for purposes of compliance with the regulations), or in large dividend receipts. Another part of the inflow may relate to the large unrecorded payments of the earlier part of the year and may appear in the accounts in the fourth quarter only as unrecorded receipts. Part of the liquidity surplus is also reported to be the result of sizable shifts of claims on foreigners from head office books of banks to their foreign branches.

The surplus in the closing days of the year, unlike that of 1968, benefited only moderately from receipts from foreign governments. However, there was an improvement over 1968 through the payment of $161 million by Britain, as scheduled, of principal and interest on the postwar loan.

Apart from the flows of volatile funds, international transactions in the fourth quarter apparently involved no sharp break with the experience of earlier months. The trade balance was probably not much changed from the $1.3 billion annual rate of the third quarter, as discussed below. Outflows of U.S. private capital, other than the kinds of flows mentioned above, were probably relatively low. New issues of foreign bonds in the U.S. market were held down by high interest rates, and purchases of other foreign securities also seemed to have fallen off. U.S. banks reported a reduction in foreign claims in November, and may have made further reductions in December, including transfers of credits to foreign branches.

Inflows of private foreign capital to purchase U.S. equity securities were about $110 million in November, despite a falling stock market, following a $350 million inflow in October. Unless there were net liquidations in December, the fourth quarter rate of inflow was considerably higher than in the summer months, though not as high as the peak rates of last winter.

The year-end liquidity surplus resulted in a large reduction in liabilities of U.S. banks to their foreign branches as well as in U.S. liabilities to foreign central banks. About $1.4 billion of branch liabilities were run off in the last week of the year, compared to a reduction of about $.9 billion in the last week of 1968. Part of the difference probably reflects larger shifts of claims on foreigners to the accounts of foreign branches. It would appear that some of the very large increase in demand deposits in U.S. banks on December 31 represents the temporary lodging place of these repatriated funds, as well as of funds brought back out of other currencies. Outstanding liabilities to branches at year -- end were about $13.2 billion, somewhat below the level at mid-year, but about $7 billion above the end-of-1968 amount.

It is doubtful whether in the early days of the year U.S. banks will add anything like the $1.4 billion that they added to their liabilities to branches in the first week of 1969. Conditions in the Euro-dollar market this year are quite different from a year ago, since most European countries are operating with tight monetary policies, and there is no ready source of funds such as was provided last year by the reflows from the November 1968 speculation on a Deutschemark revaluation. There may still be a return flow of U.S. nonbank funds to the Euro-dollar market to take advantage of high yields, but it will probably be more difficult to attract private foreign funds at the expense of foreign monetary reserves.

At the year end, U.S. reserve assets were increased through the purchase of $500 million of gold from Germany ($200 million of gold was purchased earlier in December from the BIS), and by an increase in the IMF gold tranche through drawings of dollars by other countries. As 1970 began, reserves were increased further by the initial allocation of $867 million of Special Drawing Rights by the IMF.

U.S. foreign trade. The export surplus fell in November as exports dropped while imports held at the very strong October level. For October-November together the export surplus was at an annual rate of $1.3 billion (balance of payments basis), about the same as in the third quarter. For calendar 1969, it is likely that the trade balance was not appreciably different from the $.6 billion recorded in 1968. If not for the effects of the dock workers' strike in early 1969, which reduced exports more than imports, the export surplus in 1969 might have reached $1 billion.

Despite the improvement in our trade performance in the last half of 1969, the pattern of trade does not fully reflect what might be expected from cyclical conditions here and abroad, i.e., a strong economic boom in Europe and Japan and a slowing in the growth of U.S. activity. U.S. imports remained strong in October and November, while the gain in exports since mid-1969, and particularly in October and November, depended largely on exceptionally heavy shipments of agricultural products. Exports of nonagricultural commodities have also expanded but not as rapidly and perhaps less -- at least through November -- than might have been expected with production and consumption abroad pressing against capacity. But export orders for machinery are rising sharply, promising an acceleration in exports of such equipment this year. In October-November these orders were about one-third greater than in the year-earlier period.

Exports in October-November were $39.6 billion at an annual rate (balance of payments basis), nearly 4 per cent greater than in the third quarter. The increase was about evenly divided between agricultural and nonagricultural commodities. Shipments of agricultural items -- particularly corn and soybeans but also tobacco -- rose by 10 per cent above the high level of the third quarter. Agricultural exports in October-November were running at an annual rate of close to $7 billion, an amazing rebound from the strike-depressed level of $5.5 billion in the first half of 1969 and considerably greater than the $6.3 billion recorded in calendar 1968. Presently, shipments of feedgrains and soybeans are benefiting from high demands in our principal foreign markets -- Europe and Japan -- while supplies of competing products from East European and Latin American countries are relatively limited until the new harvests become available. For the crop year ending June 1970, total exports of agricultural commodities are expected to total only about $6.2 billion.

Exports of nonagricultural products in October-November were about 3 per cent greater than in the third quarter. The largest advances were in coal (principally to Japan to feed their booming steel output) and steel. Shipments of machinery, which had increased sharply in the third quarter over the average of the first half, expanded further but at a slower pace. Deliveries of commercial aircraft also were above the low number shipped in the third quarter.

By areas, the export rise in October-November was concentrated in shipments to Canada (other than in shipments of automotive equipment which declined) and Japan. Exports to Western Europe held at the third quarter level. A moderate rise in sales to Latin America was more than offset by a decline in shipments to other developing countries.

Imports in October-November were at an annual rate of $38.4 billion (balance of payments basis), 4 per cent greater than in the third quarter. Imports in each month were about the same and were the highest since May. Price increases for a number of commodities -- coffee, copper, nickel and other metals -- appear to be a factor in the continued strength in imports.

The increase in the value of coffee imports accounted for about one-fourth of the October-November rise. Other consumer goods (other than automobiles) continued to expand while imports of industrial material and automobiles, in total, were unchanged. Purchases of foreign machinery turned down despite the continued increase in domestic investment outlays.

The large expansion in coffee arrivals reflected renewed stock-building in anticipation of higher prices and more limited supplies as a result of reported frost damage to the new Brazilian crop.

The value of imports of iron ore, copper, and other metals used in the production of durable goods was up slightly and just about offset a decline in imports of textiles and other nondurable materials. Heavy arrivals of iron ore probably represent a catching up from the low levels of the third quarter, depressed because of the extended strike at Canadian mines last summer.

Arrivals of cars from Canada expanded further in October-November, but fewer cars were imported from Europe and Japan. Sales of foreign-type cars in the U.S. increased in October-November but these increased sales were drawn from stocks, and the usual seasonal stockbuilding of these cars did not occur this year.

Foreign exchange markets. Foreign exchange trading was very active during December. The Bundesbank resumed rather heavy sales of dollars at mid-month after having been out of the exchange market for nearly two weeks. Selling pressure on the German mark continued through the end of December. Demand for sterling was strong and the Bank of

England registered reserve gains during the month. The Bank of France and Belgian National Bank were also able to make moderate purchases of dollars in the market. On the other hand, the Dutch and Italian central banks suffered small market losses of dollars.

The resumption of selling pressure on the mark at mid-month was attributed to a number of factors -- including a moderate easing of German money market conditions after the December 15 German tax date, the sharp advances in Euro-dollar rates which occurred during the first three weeks of December, and sizable repatriations from Germany of U.S. corporate funds for the purpose of complying with OFDI regulations at the year-end. (See balance of payments section.) On December 19 the Bundesbank removed the prohibition against interest payments by German commercial banks on foreign-owned deposits -- put into effect in early 1964 -- to help moderate the large withdrawals of foreign funds from Germany. The mark rate moved moderately above its lower limit in rather thin trading during the last two days of the year (for value after New Year's) and the first trading day of the new year. But it then fell back close to the lower support limit.

During December the Bundesbank sold $1.9 billion in the market. This was partially offset by $750 million of receipts from maturing forward contracts -- the last of the Bundesbank's outstanding forward contracts to receive dollars. At the end of December its reserve assets had declined to an estimated $7.5 billion (including IMF position), somewhat below the

$8.2 billion level at the end of 1967 before heavy speculation on a DM revaluation began.

Sterling ended the year on a strong note. Demand for the pound was firm throughout the month and the Bank of England purchased $330 million in the market, about $200 million less than in November. The pound exchange rate pushed to slightly above par late in the month -- the first time it had been at or above par since April 1968.

The improved position of sterling enabled the British Government to lift in late December exchange restrictions in effect since 1966 on purchases of certain foreign currencies for travel abroad. Previously British citizens were limited to £50 per year for holiday travel abroad. Under the modified controls, individuals may purchase up to £300 per journey for foreign holiday travel with no questions asked.

The Swiss franc was under the influence of year-end repatriations by Swiss commercial banks for liquidity and window-dressing purposes thoughout December. The Swiss National Bank made swap facilities available to the banks to facilitate repatriation of dollar assets and did almost $800 million of swaps -- taking in dollars for Swiss francs. Most of these swaps will be reversed during January.

Demand for the French franc was firm thoughout December. The franc rate moved higher and the Bank of France was able to purchase an estimated $150 million. On January 7 the franc exchange rate moved up slightly above its new par value -- the first time it had been at or above par since the devaluation in August 1969.

The free market price of gold continued to fall sharply during December and reached a low point in the London market of $35.00 an ounce on December 19. Since then it has moved in a range between $35.20 and $35.00 and seemed to be little affected by the accord reached between the IMF and the South African Government on gold sales by the latter, announced by the IMF on December 30.

Euro-dollar rates moved higher as year-end approached, reflecting the usual seasonal pressures on the Euro-dollar market. Rate increases were particularly notable in the one-month maturity -- from around 10-7/8 per cent in early December to 12-13/16 per cent on the last two trading days for which settlement would be made before year-end. Rates generally declined after year-end, with the one-month maturity again showing the greatest change. One-month rates for the week ended January 7 averaged 10-3/8 per cent.

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
Nov. 26	8.83	8.32	0.51	10.75	7.44	3.31
Dec. 3	9.47	8.91	0.56	10.83	7.55	3.28
10	9.35	8.75	0.39	11.05	7.75	3.39
17	10.93	9.14	1.79	11.33	7.88	3.45
24	10.75	9.18	1.57	11.35	7.83	3.52
31	10.17	8.71	1.46	10.44	8.00	2.44
Jan. 7	10.28	9.44p	0.84p	10.35	7.88p	2.47p

p = Preliminary

Part of the upward pressure on Euro-dollar rates in December apparently arose from the large volume of repatriations of funds by German banks. According to partial data, German banks reduced their net external assets by about $1.1 billion in the three weeks ended December 23. Nevertheless, the Bundesbank had a net reserve loss of approximately one billion dollars in December. Repatriations by U.S. corporations to meet OFDI guidelines were probably an important factor in these foreign exchange losses.

Year-end window dressing by Swiss banks was facilitated by BNS Swiss franc-dollar swaps ($790 million in December). The BNS, in turn, placed the dollar proceeds of these swaps in the Euro-dollar market, both directly and through the BIS, thus offsetting the withdrawals by the Swiss commercial banks.

U.S. corporate year-end repatriations from the Euro-dollar market, accompanied as they were by very large declines in U.S. banks' liabilities to their foreign branches, were probably not a major factor in the rise in Euro-dollar rates.

The emerging pattern of current account balances in major industrial countries.* This year--1970--is likely to see some progress towards achieving the current account objectives of all of the major industrial countries, with the important exception of Japan, and, to a much lesser extent, Canada. The German trade surplus will be reduced, as strong domestic demand conditions reinforce the impact of the revaluation of the mark on imports and exports, particularly in the first half of the year. The rate of growth of German exports will fall, but the impact of the revaluation will be partially offset by other factors. The deficit on services and unilateral transfers is likely to increase so that the current account may be in balance, or even slight deficit, in the second half of the year.

France will experience a decline in its current account deficit, although the deficit will remain large. In spite of a slowdown in world trade, the growth of French exports is expected to accelerate. The growth rate of imports will fall. The United Kingdom's current account surplus of around $850 million in 1969 may be enlarged by, perhaps, another one-half billion dollars. There is a strong possibility that Britain will even have a small trade surplus for the year, the first since 1958.

* The term "current account" is here defined to include unilateral transfers. The "current account balance" is therefore comparable to the "balance of goods and services plus unilateral transfers" in the U.S. balance of payments presentations.

Italy's trade surplus will probably decline significantly--perhaps by about half--while Japan's already very large surplus will become considerably larger. The Dutch trade deficit, and Canada's trade surplus, will each decline slightly.

TRADE BALANCES[a/]
(seasonally adjusted, in millions of U.S. dollars)

	1969			1970[c/]		
	1st half	2nd half[b/]	Year[b/]	1st half	2nd half	Year
Germany	1,653	2,200	3,853	1,850	1,350	3,200
United Kingdom	- 399	25	- 374	70	120	190
France	-1,164	-1,415	-2,579	- 400	- 500	- 900
Italy	540	500	1,040	550	- 150	400
Netherlands	- 447	- 496	- 943	- 450	- 400	- 850
Japan	2,006	1,608	3,614	2,200	2,400	4,600
Canada	388	442	830	300	400	700
Total, excl. U.S.	2,577	2,864	5,441	4,120	3,220	7,340
U.S.	- 100	700	600	1,300	1,000	2,300

a/ Trade balances are shown on an f.o.b. basis for all countries listed except Germany and the Netherlands, where imports are on a c.i.f. basis.
b/ Estimate. c/ Forecast.

CURRENT ACCOUNT BALANCES[a/]
(seasonally adjusted, in millions of U.S. dollars)

	1969			1970[c/]		
	1st half	2nd half[b/]	Year[b/]	1st half	2nd half	Year
Germany[d/]	760	845	1,605	400	- 150	250
United Kingdom	218	631	849	600	650	1,250
France	-1,611	-1,865	-3,476	- 700	- 800	-1,500
Italy	1,517	1,450	2,967	1,550	750	2,300
Netherlands	31	39	70	50	80	130
Japan	1,214	828	2,042	1,200	1,500	2,700
Canada	- 345	- 405	- 750	- 550	- 500	-1,050
Total, excl. U.S.	1,784	1,523	3,307	2,550	1,530	4,080
U.S.	650	1,400	2,050	1,900	1,750	3,650

a/ Includes unilateral transfers. b/ Estimate.
c/ Forecast. d/ Includes official transfer payments.

The combined trade surplus of all these countries vis-à-vis the rest of the world will increase from about $5.4 billion in 1969 to about $7.3 billion in 1970. The combined current account surplus will also increase, though less markedly because of the continuing large increase expected in the German deficit on services and unilateral transfers. Meanwhile, the trade and current account position of the United States is also expected to improve. If these expectations for the major countries are realized, the result will be an improvement in their combined current account surplus of something on the order of $2-1/2 billion. Some part of this increase may be reflected in a reduced current account surplus for other industrial countries. But also implied is some increase in the combined current account deficit of less developed countries. Unless there is a corresponding movement of capital, less developed countries will experience either a smaller increase, or some depletion, of their reserves, a means of financing that cannot continue for long.

FOREIGN TRADE GROWTH RATES
(percentage changes from preceding half year at annual rates; seasonally adjusted)

	Exports				Imports			
	1969		1970[b]		1969		1970[b]	
	1st half	2nd half[a]	1st half	2nd half	1st half	2nd half[a]	1st half	2nd half
Germany	5	25	10	6	26	20	18	11
United Kingdom	7	16	8	8	3	5	7	7
France	15	4	20	12	37	10	3	4
Italy	28	10	33	0	19	13	35	22
Netherlands	20	22	4	3	16	22	3	1
Japan	24	16	21	16	8	30	9	15
Canada	12	5	3	6	20	4	7	4
U.S.	-2	14	5	2	2	10	2	4

a/ Estimate. b/ Forecast.

Our forecast of a 13 per cent growth in German exports in 1970, with a slowdown in the second half, reflects the large existing order backlog for German exports, an expectation of continued high levels of demand and significant capacity limitations in Germany's major export markets, and the prospects of price inflation in these markets--all of which could considerably offset for this year the price effects of the revaluation. We do not expect German export growth to slow down as much as the OECD Secretariat forecast of a growth rate of only 4 per cent in the second half of 1970, primarily because we expect foreign demand for German output to continue strong; and in the event of a slowdown in the German economy during this period, German exporters are likely to demonstrate their usual propensity to offset decreased domestic demand with increased exporting efforts.

German imports could grow quite rapidly, since the high level of domestic demand and rather severe pressures on productive capacity should continue until at least mid-year, with only a moderate easing expected during the second half of the year. This implies that the revaluation will have a significant dampening effect on the growth of aggregate demand only after a considerable time lag.

The overall current account balance should deteriorate somewhat more than is implied by the OECD forecast of a $400 million surplus for the year. The increase in remittances by foreign workers in Germany--related to the severe labor shortage--and the increased incentive for Germans to travel abroad should have a substantial effect on Germany's current account in 1970.

United Kingdom exports are expected to grow at a rate of about 8 per cent, or slightly below that of world trade. Capacity problems in major export industries, such as engineering, coupled with the likelihood of continued labor troubles explain why Britain's market shares are likely to fall slightly in 1970. A rapid rate of growth in output for domestic uses could also adversely affect exports, by reducing capacity available for export production and by having an inflationary impact on export prices.

Imports in value terms are expected to increase by 7 per cent in 1970 on the assumption that real national income will grow at about 3 per cent and import volume--as has been true in the past--will rise at a somewhat faster rate (5 to 5-1/2 per cent). Prices will rise by about 1-1/2 to 2 per cent.

Our balance of trade forecast may be optimistic. If the economy grows faster than 3 per cent--as it well may, if the authorities loosen restraints in what is likely to be an election year--then imports would probably grow more than 7 per cent. Moreover, imports may be stimulated by a surge in inventory accumulation, a likely development if monetary stringency is eased. Because of tight money, British businesses are currently operating at very small inventory-output ratios. Historically, there has been a strong positive correlation between imports and stock-building. Termination of the import deposit scheme before next December would of course also encourage imports. Largely as a result of the lifting of travel restrictions, a slight deterioration of the services account by perhaps as much as $100 million also seems likely this year.

No official target for calendar 1970 has been set yet, but shortly after the 1967 devaluation Chancellor Jenkins announced the goal of running surpluses on the basic balance of payments of $1.2 billion each year for several years. If the long-term capital account is in balance next year--a reasonable possibility--this target stands a good chance of being met, provided the authorities do not relax current restraints too rashly.

Trade projections for France for 1970 are difficult since price adjustments following parity changes are still far from being completed. The French Government's target is to reach equilibrium on trade account by mid-1970. However, the current account deficit according to our estimates will still be large--around $1.5 billion--and may well prove unacceptable to the authorities. If the authorities take further measures, such as extending the very restrictive terms on installment purchases beyond the present expiration date of January 31, 1970, or increasing taxes, imports may not be as large as we anticipate.

During the second half of 1969 and the first half of 1970 Italian trade trends will probably be markedly distorted by the effects of the autumn strikes. In the absence of the strikes, Italian exports would have increased at annual rates of 20 per cent in the second half of 1969 and possibly 15 per cent in the first half of 1970 (relative to the preceding half-year). However, the strikes caused a shift of exports valued as much as $300 million from the latter half of 1969 to the first half of 1970, thereby reducing the rate of expansion in the first of these periods and accentuating it in the second. The slower rate of expansion in the underlying trend of exports in the first half of this year reflects a slower growth of import demand in other countries, notably France and the U.S. But we assume that demand for Italian exports will not slow down as abruptly as might be inferred from the OECD forecast that total OECD imports will increase only half as fast in the first half of 1970 as in the second half of 1969. But the underlying trend of exports will show a further deceleration in the second half of 1970 because of decelerating demand abroad and increasing inflationary pressures in Italy.

The strikes also shifted some imports (estimated at $200 million) from the second half of 1969 to the first half of 1970. This year demand in Italy will increase rapidly because of recently granted large wage increases and official policies designed to maintain the expansion of output. As aggregate demand expands, existing unused capacity will tend to disappear and upward price pressures will intensify. Abstracting from the effect of the strikes (which the tables do not), the underlying annual rate of increase in imports probably would remain at 20 per cent in the first half of 1970, but would accelerate to 30 per cent in the second half.

Our forecast for an improvement in the overall current account balance of the Netherlands, which roughly agrees with the forecast of the Dutch Central Planning Bureau, is based upon an expectation that the volume of exports will increase by approximately 9 per cent during 1970, that of imports by about 7 per cent. The expectation of a slightly slower growth rate for Dutch exports during the second half of the year stems from the likelihood of some slowdown in the German and U.S. rates of expansion during this period.

The services account is assumed to remain essentially unchanged. While the revaluation of the German mark could cause a notable rise in Dutch tourist receipts, a significant reduction in the growth of world trade could have an adverse effect on Dutch earnings from shipping.

In making a trade forecast for Canada, we have assumed a low rate of real economic growth for both Canada and the United States (which accounts for over 2/3 of Canada's trade). Growth in Canadian real GNP for 1970 is assumed to be on the order of 1 to 2 per cent, slightly lower than the forecast of Canadian officials, and less than half the OECD forecast. This assumption is based on the expectation that the very restrictive monetary policies being pursued in both countries will result in zero or negative growth for at least two quarters this year.

A low rate of growth in aggregate expenditure in the United States, and, particularly, lagging automobile sales, will depress the rate of growth of Canadian exports. However, some resource-based exports (nickel, steel and wheat) which suffered declines last year related to special factors, should recover somewhat in 1970. Machinery and equipment imports will probably be up fairly strongly in the first part of the year, as Canadian firms undertake investment projects delayed by widespread strikes in 1969.

Canadian authorities would not be disturbed by a current account deficit of the size indicated, which would undoubtedly be financed mainly by long-term borrowing in the United States. Nor would such a deficit be incompatible with Canada's desire to lessen inflationary pressures in the domestic economy. Canada's long-range goal is for current account balance, but the timetable is vague and not inconsistent with a higher deficit in times of inflationary pressures.

In Japan, an official balance of payments forecast for 1970 is not yet available, but the private Japan Economic Research Center has estimated that exports in 1970 will increase 22.7 per cent over 1969 and imports will rise 19.7 per cent. The OECD forecast is more conservative, and places the export and import increases at 13.2 per cent and 15.6 per cent, respectively. Largely on the basis of recent economic trends in both Japan and the United States, it would appear reasonable to expect an export growth of about 20 per cent and a rise in imports of about 18 per cent, or approximately the same rate as in earlier years. On this basis, a current account surplus of about $2.7 billion is forecast for 1970.

U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

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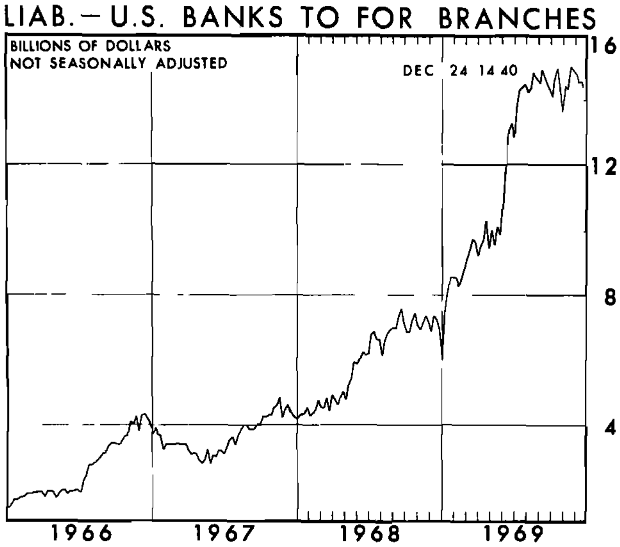
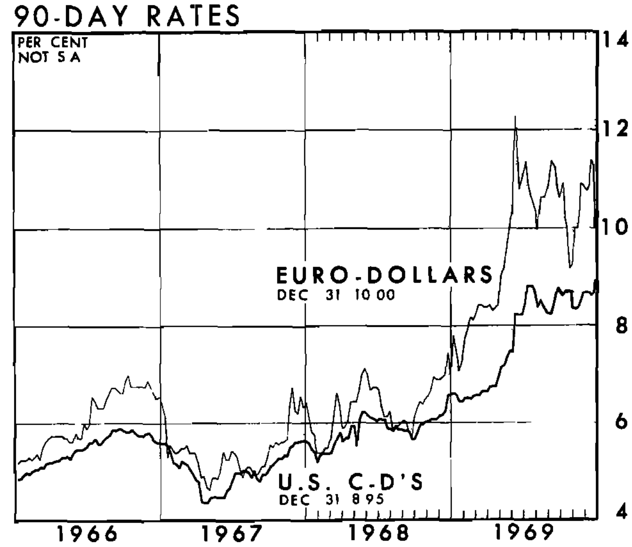
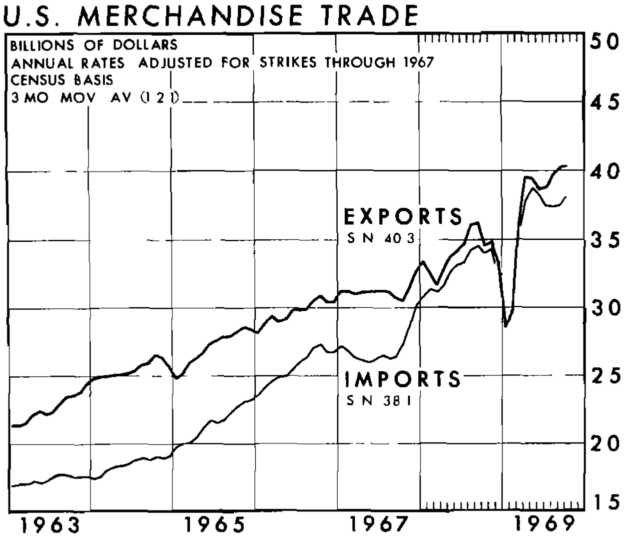


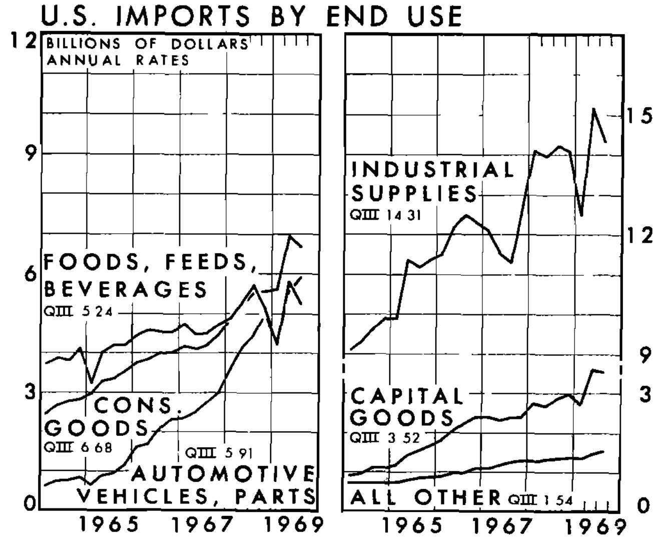
90-DAY RATES



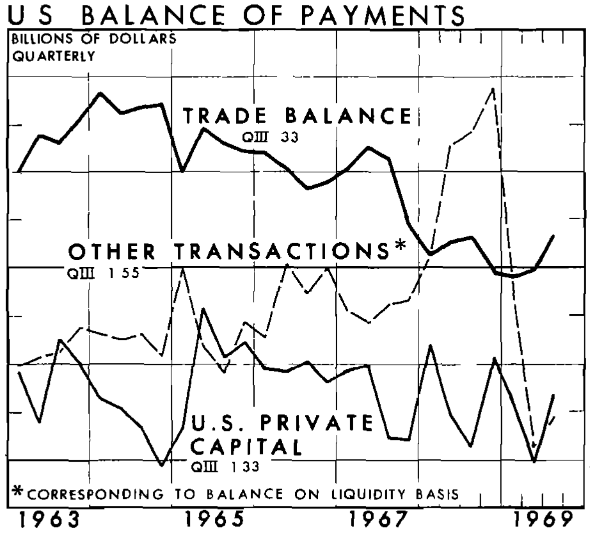
U.S. MERCHANDISE TRADE



U.S. IMPORTS BY END USE



U S BALANCE OF PAYMENTS



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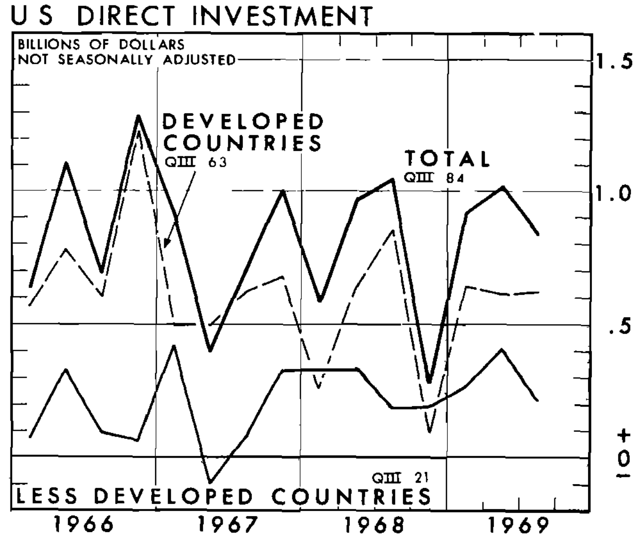

APPENDIX A: FEDERAL FISCAL POLICY IN 1970*

As a consequence of the recently enacted Tax Reform Act of 1969, Federal fiscal policy is expected to move somewhat more strongly toward stimulus in the coming year than was projected in previous Greenbooks. However, a sizable shift toward fiscal ease had already been built into earlier staff projections, since the staff had anticipated many of the provisions of the Tax Act. Table I, Part A, shows the adjustments to earlier staff estimates resulting from passage of the Tax Reform Act. In the aggregate these adjustments amount to a reduction of $2.3 billion in the calendar year 1970 budget surplus (NIA basis).

Previous staff projections of the Federal budget had included the most costly provision of the Tax Act--the reduction of the tax surcharge from 10 per cent to 5 per cent, effective January 1, 1970, and the elimination of the surcharge, effective July 1, 1970. Together these changes reduce NIA Federal receipts for calendar year 1970 by an estimated $9.4 billion as shown in Part B of Table I. A major portion of this revenue loss will be reflected in downward revisions in withholding tax rates in January and also in July of 1970.

The retroactive repeal of the investment tax credit, which adds about $1.9 billion to calendar 1970 revenues, and the extension of excise taxes were also included in earlier staff estimates. In addition to these items, the tax reform and relief provisions of the bill, as shown in Table I, provide a net additional $.6 billion reduction in Federal receipts during the year. The Tax Act also included a hike in social security benefit rates, costing about $4.0 billion in the 1970 calendar year or $1.7 billion more than previous staff estimates.

As a result of the above mentioned items and other projected changes in Federal receipts and expenditures, the staff now forecasts a shift in the Federal budget (NIA basis) from a $9.7 billion surplus in calendar year 1969 to a $5.0 to $6.0 billion deficit in calendar 1970. The components of this $15 billion adjustment are shown in Table II. In addition to the tax and social security items discussed above, the staff is tentatively forecasting a cut of nearly $4 billion in defense spending during the next year, which will be more than offset by a $12 billion net increase in nondefense expenditures.1/ These are interim staff estimates of expenditures that can serve as stand-in figures until the President's Budget becomes available; they do not reflect advance knowledge of what the Budget will show.

Due to the projected slowdown in economic growth, discussed elsewhere in the Greenbook, revenue growth from an expansion in the tax base is estimated to amount to only $5 billion during the calendar year, in contrast to the $14 billion that is frequently cited as a normal fiscal dividend at recent levels of the economy. Also, an increase in unemployment insurance benefit payments of $1 billion is anticipated. For the calendar year, these various calculations produce a measured deficit slightly exceeding $5 billion.

1/ Includes normal growth of social security payments, increased outlays for interest on the debt, agricultural price supports, new veterans benefits, increased aid to state and local governments, a federal pay increase effective July 1, 1970, and other expenditure items.

Table I

FISCAL IMPACT OF TAX REFORM ACT OF 1969[1/]

(NIA basis in billions of dollars)

	Calendar year 1970	1970 Seasonally adjusted annual rates I	II	III	IV
A. Changes from Earlier Staff Projections of Receipts and Expenditures[2/]					
Receipts					
Corporate tax reform	0.7	0.7	0.7	0.7	0.7
Individual tax reform and relief	-1.3	-0.6	-0.6	-2.0	-2.0
Total tax reform and relief	-0.6	0.1	0.1	-1.3	-1.3
Expenditures					
Additional increase in social security benefits[3/]	1.7	0	4.2	1.3	1.3
Total additional effect on budget surplus of Tax Reform Act of 1969	-2.3	+ .1	-4.1	-2.6	-2.6
B. Total Direct Impact of Act Relative to Tax and Benefit Rates In 1969					
Receipts					
Tax reform and relief	-0.6	0.1	0.1	-1.3	-1.3
Surtax reduction and repeal	-9.4	-7.2	-7.2	-11.6	-11.6
Individuals	-6.6	-4.4	-4.4	-8.8	-8.8
Corporate	-2.8	-2.8	-2.8	-2.8	-2.8
Investment Tax Credit repeal	+1.9	+1.9	+1.9	+1.9	+1.9
Total receipts	-8.1	-5.2	-5.2	-11.0	-11.0
Expenditures					
Increase of social security benefit rates	4.0	0	7.2	4.3	4.3
Total effect on budget surplus of Tax Reform Act	-12.1	-5.2	-12.4	-15.3	-15.3

1/ The dollar value of the impacts is calculated on the basis of 1969 income levels.

2/ Previous Greenbooks have anticipated the Act's provisions relating to the surtax and investment tax credit and also allowed for a more modest increase in social security benefit rates.

3/ Reflects retroactive benefits to be paid in April and a 15 per cent rather than 10 per cent benefit increase.

Table II

COMPONENTS OF THE PROJECTED SHIFT FROM SURPLUS TO DEFICIT OF THE FEDERAL SECTOR IN THE NIA ACCOUNTS

		Signs indicate effects Surplus/Deficit (-)
Estimated Budget Surplus in Calendar 1969, NIA Accounts . . .		9.7
Adjustments in Receipts Resulting from Congressional Action . . .		-7.8
Surtax Reduction and Repeal	-9.4	
Investment Tax Credit Repeal	+1.9	
Tax Reform and Relief	-0.6	
Medicare Contributions Rate Increase 1/	+0.3	
Adjustments in Expenditures Resulting from Congressional and Administrative Action		-11.5
Defense Spending	+3.7	
Social Security Benefit Rate Increase	-4.0	
Net Growth of Other Expenditure Categories 2/	-11.2	
Adjustments for Current Greenbook Projection of Economic Growth		+4.2
Revenue Growth 3/	+5.2	
Increased Unemployment Insurance Payments	-1.0	
Estimated Surplus in Calendar 1970 (NIA Accounts)		-5.4

1/ Medicare contribution rate has been increased by Administrative action effective July 1, 1970.

2/ Includes also growth in social security transfer payments other than the effect of the 15 per cent rate increase.

3/ Due to the projected slowdown in the economy, the $14 billion fiscal dividend that would be consistent with long-term growth trends in the economy is expected to be only $5.2 billion in calendar year 1970.

For fiscal year 1970, current staff estimates suggest a NIA surplus of $2.9 billion in fiscal 1970, compared to a surplus of about $5.1 billion that was implied in the September budget review by the Administration. Projected quarterly totals for the Federal sector in the national income accounts are given in the budget table at the end of Section III of the body of Greenbook. The shift toward fiscal ease during 1970 is expected to result in a deficit beginning in the second quarter, 1970, with the deficit reaching its highest level (at nearly a $10 billion annual rate) in the third quarter. As already indicated a substantial portion of this deficit is a reaction to the projected slowdown in economic growth and in the rate of price increases.

Comparisons with previous periods of Economic Slowdown

The combination of restrictive monetary and fiscal policies in 1969 seems to be setting the stage for an economic slowdown in 1970. The question arises whether the substantial shift in fiscal policy during 1970 will again provide excessive stimulus.

Table III shows some data on the budgetary position in three previous periods when expansion in economic activity was followed by a slowdown or a recession. In each case the budgetary position in the last four quarters of expansion is compared to the immediately following four quarters during which the slowdown occurred and a recovery ensued.

Thus in the four quarters preceding and including the cyclical peak in 1957, the Federal NIA surplus averaged $3.9 billion, while in the immediately following four quarters the Federal sector showed a deficit of $8.2 billion. Hence in the 1957-58 cycylical transition, the shift in toward deficit amounted to $12.1 billion. But most this shift was due to the automatic stabilizers, as can be seem in a rough fashion from the second data line in Table III, which indicates that the high employment surplus was practically the same during the period of economic expansion as during the subsequent four quarters of contraction and recovery. In calculating the high employment budget surplus, the economy is assumed to grow at according to longer-run trends, and hence the effect on actual budget receipts and unemployment insurance benefits of short-run variations in economic growth is removed.

Table III shows that the Federal sector in most instances had a surplus in the four quarter time span preceding a cyclical peak and in all of the instances cited here a deficit occurred in the following four quarters. The 1966 period, however, is an exception, because during that year the Federal budget showed a small deficit, even before the slowdown. Moreover, orders for military purchases which precede outlays were increasing rapidly in 1966. The lagged effects of the stimulative fiscal policy in 1966, coupled with substantial further stimulation in 1967, probably contributed to the continuance of inflation at that time.

Table III

PERSPECTIVES ON THE FEDERAL BUDGET
IN PERIODS OF CYCLICAL TRANSITION
Surplus/Deficit (-), Selected Four Quarter Averages
(In billions of dollars)

	Economic Expansion	Contraction and Recovery	Shift
1957-58 Recession	QIV 1956 to QIII 1957	QIV 1957 to QIII 1958	
NIA Surplus/Deficit (-)	3.9	-8.2	-12.1
High Employment Budget 2/	6.3	5.8	-0.5
1960-61 Recession	QIII 1959 to QII 1960	QIII 1960 to QII 1961	
NIA Surplus/Deficit (-)	2.8	-2.1	-4.9
High Employment Budget 2/	12.2	13.9	1.7
1967 Slowdown	QI to QIV 1966	QI to QIV 1967	
NIA Surplus/Deficit (-)	-.2	-12.7	-12.5
High Employment Budget 2/	-2.4	-11.8	-9.4
1970 Projected Slowdown 1/	QI to QIV 1969	QI to QIV 1970	
NIA Surplus/Deficit (-)	9.7	-5.4	-15.1
High Employment Budget 2/	9.5	3.3	-6.2

1/ Tentative projections for calendar year 1970 by Board Staff.
2/ Data for all quarters prior to 1969 are based upon the high employment budget figures calculated by the Federal Reserve Bank of St. Louis. The estimates for 1969 and 1970 are based upon calculations made by the Board Staff.

The situation appears different for calendar 1970. While the shift toward fiscal stimulas during 1970 is now anticipated to be sizable, the economy in 1970 should still be reacting to considerable extent to the momentum of the lagged effects of the fiscal restraint during 1969. The anticipated large shift toward fiscal stimulus in 1970 partly reflects the release of the automatic stabilizers that will come into play if the economy actually experiences a slowdown in economic growth. Another part of the shift toward fiscal stimulus is caused by the decline in tax rates in 1970, chiefly the reduction and expiration of the surtax. In the previous periods of economic slowdown or recession, tax rates were not reduced; on the other hand, however, Administration efforts to cut or limit Federal spending are more intense at present than in previous periods of economic slowdown.

The Unified Budget in Fiscal 1970

The $5.9 billion surplus for fiscal 1970 forecast by the Administration in the September budget review could virtually vanish unless the Administration finds a way to delay outlays or undertake additional budget cuts as yet unannounced. The staff currently projects outlays of $195.0 billion (unified budget basis) in fiscal 1970, about $2.1 billion above the self-imposed ceiling of $192.9 billion set by the Administration in the September budget review.

Budget receipts, as usual, are difficult to forecast for the fiscal year, and perhaps the current staff estimate of total receipts which is a full $3.6 billion below the Administration's September review is too pessimistic. Differences between these alternative estimates of receipts hinge not only on different income assumptions, but also on the appraisal of current collection data. Preliminary data for December showed lower than expected corporate and withheld taxes. The Tax Reform Act of 1969, relative to our earlier projections, is expected to account for only a $.1 billion reduction in actual tax collections during the fiscal year.

Individual items accounting for the anticipated increase in outlays are shown in Table IV.

Table IV

ANTICIPATED INCREASES IN BUDGET OUTLAYS ABOVE SEPTEMBER BUDGET REVIEW LEVELS FISCAL 1970

	Billions of dollars	
September budget review		192.9
Increases for Congressional action 1/		1.7
Social security benefit increase	1.1	
Veterans benefit increase	.3	
No postal rate increase (Negative expenditure)	.3	
Increases for items not subject to tight control 2/		1.0
Interest on debt	.5	
CCC	.5	
Reductions arising from Congressional and executive economies 3/		-.6
Current staff estimates of total budget outlays, fiscal 1970		195.0

1/ Assumes that a Federal pay increase will be postponed until July 1970, and that the President will veto a bill providing an additional $.5 billion for education in fiscal 1970. Certain loan funds appropriated for FHA and VA because of Congressional inaction are assumed to be impounded by the administration.
2/ Excludes possible increases in outlays resulting from a failure to complete certain asset sales (a negative outlay) included in the budget.
3/ Assumes reductions in defense and in other programs.

The largest increase in spending above the level projected in the September budget review is expected in social security benefit payments. The tax bill included a 15 per cent rate hike in social security benefits effective January 1, 1970, costing $1.1 billion more in fiscal 1970 than the 10 per cent rate increase, effective April 1, 1970, requested by the Administration. A postal rate increase (a negative expenditure) was included in the Administration estimate for the fiscal year, but prospects for implementation of this proposal before July 1, 1970 are now remote. Failure to increase the postal rate is expected to cost $.3 billion in the current fiscal year. The Board staff expenditure estimate also includes $.3 billion for Vietnam veterans assistance above the amount included in the September budget review. The staff estimate excludes $.5 billion appropriated by Congress for education in the Labor, Health, Education and Welfare bill, which the President may veto. Also excluded from the staff expenditure projections is a possible pay increase beginning in the Spring for Federal employees that could cost $.7 billion in fiscal 1970.

There are two categories of expenditures that are not subject to tight administrative control which seem to be running well ahead of budget estimates. The largest is interest on the debt, which the Administration now estimates will be more than \$.9 billion, gross, above the amount included in the September budget review. The staff has included \$.5 billion net increase over earlier estimates of interest costs. Outlays by the Commodity Credit Corporation are also expected to be above earlier Administration estimates by at least \$.5 billion. In addition to the hard to control categories of expenditures mentioned above, there is a possibility that the Administration will have difficulty completing nearly \$4.0 billion of asset sales that appear as negative outlays in the fiscal 1970 budget. As of Dec. 1, 1969 asset sales were lagging behind schedule because of tight credit conditions.

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* Prepared by William Beeman and Helmut Wendel, Government Finance Section, Division of Research and Statistics.

APPENDIX B: THE TAX REFORM ACT OF 1969: A SUMMARY*

The Tax Reform Act of 1969 became law on December 30. While it contained fewer substantial reforms of the income and profits tax laws than had been proposed, it will provide considerable general relief for individuals in the years to come. A summary of the bill's major provisions follows.

¶The personal exemption will be increased to $625 for calendar 1970 (effective July 1 at $650 for withholding purposes), to $650 in 1971, $700 in 1972, and finally to $750 in 1973.

¶In 1971, the maximum standard deduction will be $1,500 or 13 per cent of adjusted gross income, whichever is less. The 1972 ceiling will be 14 per cent or $2,000, and the levels for 1973 and beyond will be 15 per cent or $2,000.

¶The minimum standard deduction will be $1,100 in 1970, $1,050 in 1971, and finally $1,000 in 1972. In order to restrict the benefits of the minimum standard deduction to low income taxpayers, there is a trade-off during 1970 whereby the deduction allowable is reduced $1 for every $2 of taxable income reported. In 1971, the phaseout is $1 of deduction lost for ever $15 of taxable income; but after 1971, the $1,000 minimum deduction will be available to all taxpayers regardless of their income level. ["This minimum standard deduction plan is often called the low income allowance.]

¶Rates for single taxpayers will be reduced to a level just 20 per cent above rates on joint returns.

¶In 1971, the maximum tax rate on wages, salaries, and professional fees ("earned income") will be 60 per cent, except for those individuals who have tax-preferred income in excess of $30,000 per year. The maximum rate in 1972 and beyond will be 50 per cent.

¶"Tax-preferred income" of individuals and corporations in excess of $30,000 plus the amount of regular income taxes paid will be taxed at a 10 per cent rate. "Tax preferred income" includes half of capital gains, the excess of accelerated over straight line depreciation, the excess of depletion allowances over the cost of the property involved, the excess of bad debt deductions over actual losses, and four other minor categories of "income".

¶Individuals will have to pay half of their marginal tax rates on capital gains realized in excess of $140,000 per year. This provision could mean effective tax rates of up to 35 per cent on large capital gains, instead of the current maximum of 25 per cent.

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* Prepared by M. E. Byrn, Economist, Government Finance Section, Division of Research and Statistics.

¶Corporations will pay a flat 30 per cent on net long term capital gains, instead of the current 25 per cent rate.

¶Financial institutions will pay ordinary income tax rates on capital gains realized on corporate and government bonds and other evidences of indebtedness.

¶Commercial banks will be allowed deductions for only those additions to bad debt reserves that reflect actual bad-debt loss experience. The full impact of this provision would come in 1988, after gradual reductions from the present reserve allowance of 2.4 per cent of eligible loans to 1.8 per cent in 1970, 1.2 per cent in 1976, and .6 per cent in 1982.

¶In 1970, mutual savings banks and S&L's will no longer have the option of using the "3 per cent method" 1/ of computing deductions for bad debt reserves; and the alternative method of deducting 60 per cent of taxable income for bad debt reserves will become less attractive over a 10-year period as the deductible percentage falls to 40 per cent of taxable income.

¶Effective July, 1969, 200 per cent declining balance depreciation will be limited to new residential buildings, while used housing may be depreciated on a 125 per cent base if it has at least 20 years of useful life remaining. New commercial and industrial buildings will be depreciable by the 150 per cent declining balance method, but only straight line depreciation will be allowed on used non-residential buildings. Present law allows 200 per cent depreciation of all new buildings and 150 per cent for buildings that have changed owners.

¶The percentage depletion allowance for oil and gas will be reduced from 27-1/2 per cent to 22 per cent. Other mineral depletion allowances will also be reduced by 1-2 per cent.

¶After 1975, groups of controlled corporations will be allowed only one $25,000 exemption from the corporate surtax.

¶Formerly tax-exempt, foundations will have to pay an annual supervisory tax equal to 4 per cent of net investment income.

There are, of course, many other provisions in the Act besides these tax reform and relief actions described above; but the only other provisions with major revenue impact are: extension of the surcharge at a 5 per cent rate through June 30, 1970; repeal of the investment tax

1/ Whereby 3 per cent of the net increase in mortgage loans outstanding may be deducted from taxable income credit; extension of the present excise taxes for one more year; and a 15 per cent increase in Social Security benefits effective January, 1970.